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FLASH

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TRANSFER OF NON-PERFORMING LOANS IN PORTUGAL

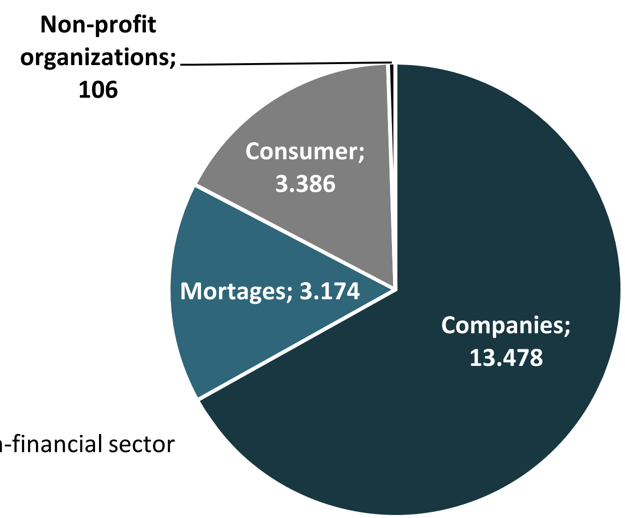
1. NPL Transfer Deals in Portugal – A New Trend

According to official sources*, there is currently an average of 8.71% of non-performing loans (“**NPLs**”) in Portugal, and the five largest banks hold NPLs in the value of circa € 20,144mn as of June 2016.

By segment, it is worth highlighting that companies NPL ratio represent on average 16.22%, whereas consumer and mortgage NPLs represent only 7.61% and 2.73%, respectively.

Given these values, pundits foresee that there will be an increasing appetite for NPL portfolio transfer deals connected with Portugal, in particular in the corporate sector, a trend that Portuguese banking lawyers are already noticing.

NPLs by segment - € mn

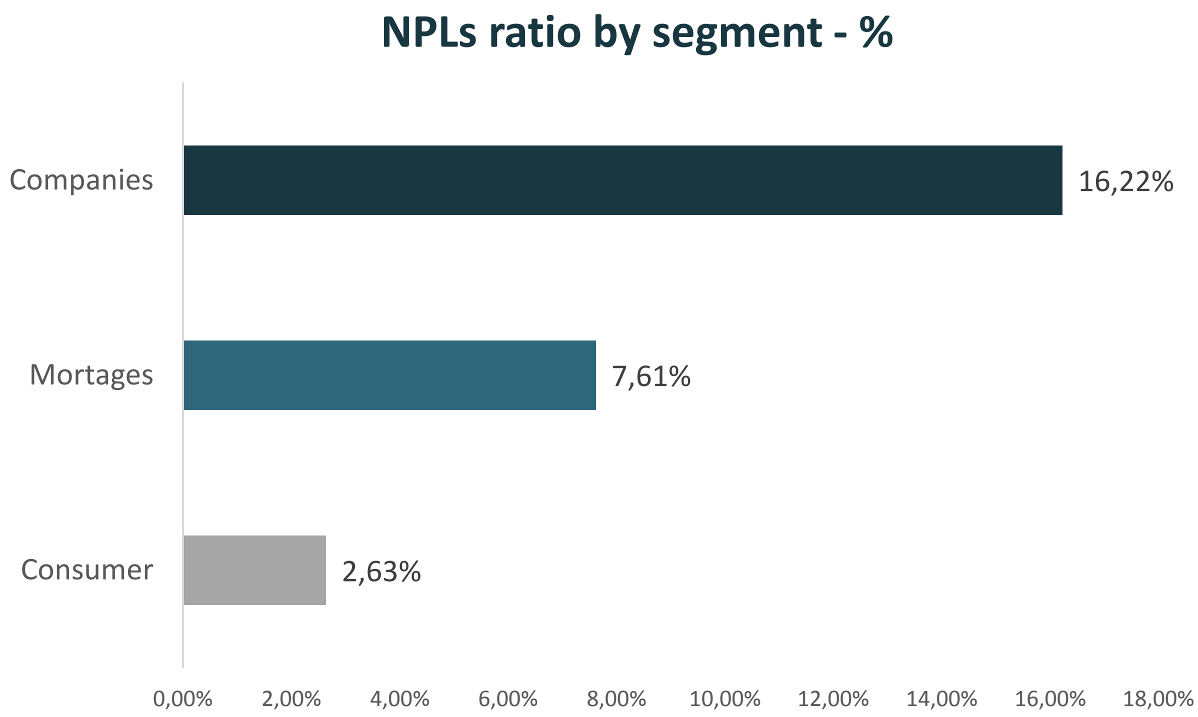


* Bank of Portugal June 2016 Statistical Bulletin 8, and Note 88/2016 dated of June 2016 on the indebtedness of the non-financial sector

In fact, the liquidity issues that banks are facing, coupled with the ever increasing regulatory capital pressures and difficulties in raising equity, are pressing them to transfer their NPL portfolios, despite the undesired recognition of imparities in their balance sheets.

There has also been an ongoing discussion on the upsides/downsides in creating a special governmental vehicle with a view to purchase the NPLs (a solution similar to the one adopted in Italy), without any decision being taken so far.

In this context and due to the predictable increasing relevance of NPL transfer deals connected to Portugal, we provide below a description of the main stages involved in the structuring of NPL transfer deals, and a summary of the most relevant legal issues surrounding such deals.



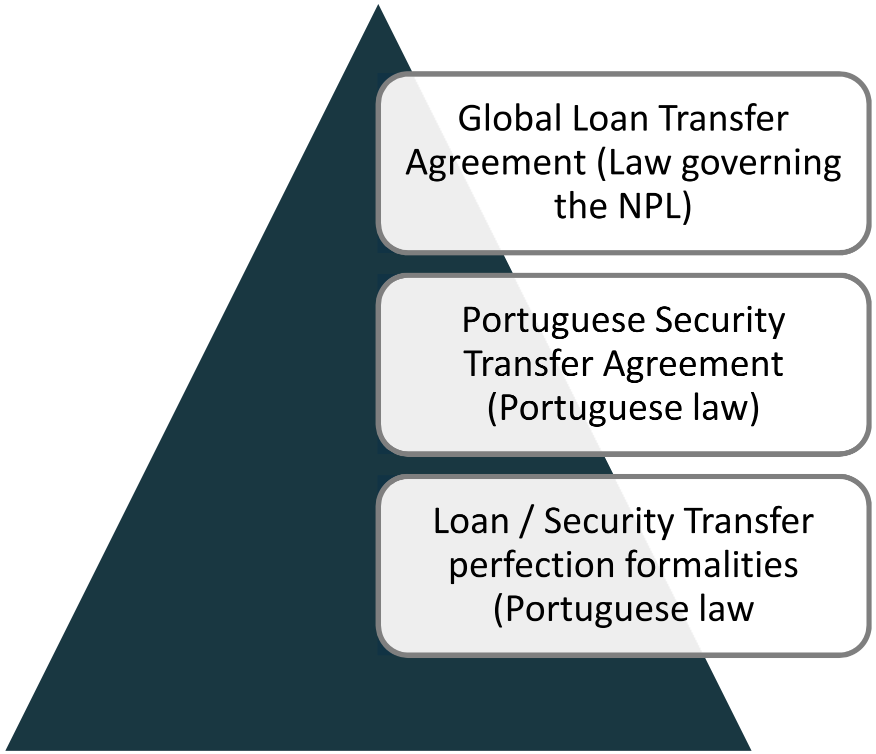
2. Structuring NPL Transfer Deals in Portugal

Acquisition Structure	Legal Due Diligence	Negotiation	Closing
In particular when the loans are acquired by a foreign institution, the tax implications of the transfer should be assessed, in view of the withholding tax applicable in its jurisdiction and the clauses on gross-up / increased costs set forth in the credit facility agreement. The purchaser may end up deciding to incorporate an SPV in other country in order to acquire the NPLs, in order to achieve tax efficiency.	The purchaser's lawyers are expected to analyse the relevant documentation in order to confirm the validity, enforceability and transferability of the NPL and attached security and guarantees, as well as any matters that may impair or limit the interests of the creditor, such as other creditors' higher ranking claims, or the existence of issues that may negatively affect the value of the credit and the secured assets.	During the negotiation stage, the usual matters concerning the transfer are dealt with, such as representations and warranties in respect of the NPLs and attached security and covenants assumed by the parties. The level of complexity of the transfer agreement will depend on the value of the NPLs, whether there are connections with other jurisdictions, and the type of secured assets.	The closing entails the execution of a transfer agreement between the seller and the purchaser. The legal form requirements will depend on the legal form adopted for the loan agreement and the type of attached security. Following execution, a number of perfection formalities must be settled, such as notification of the transfer to the obligors and registration of transfer of securities.

2.1. A Multijurisdictional Approach

Portuguese NPL transfer deals often involve a multijurisdictional approach, with the NPLs being subject to a foreign law, but the borrower being incorporated/resident in Portugal and/or security being created over assets located in Portugal and governed by Portuguese law.

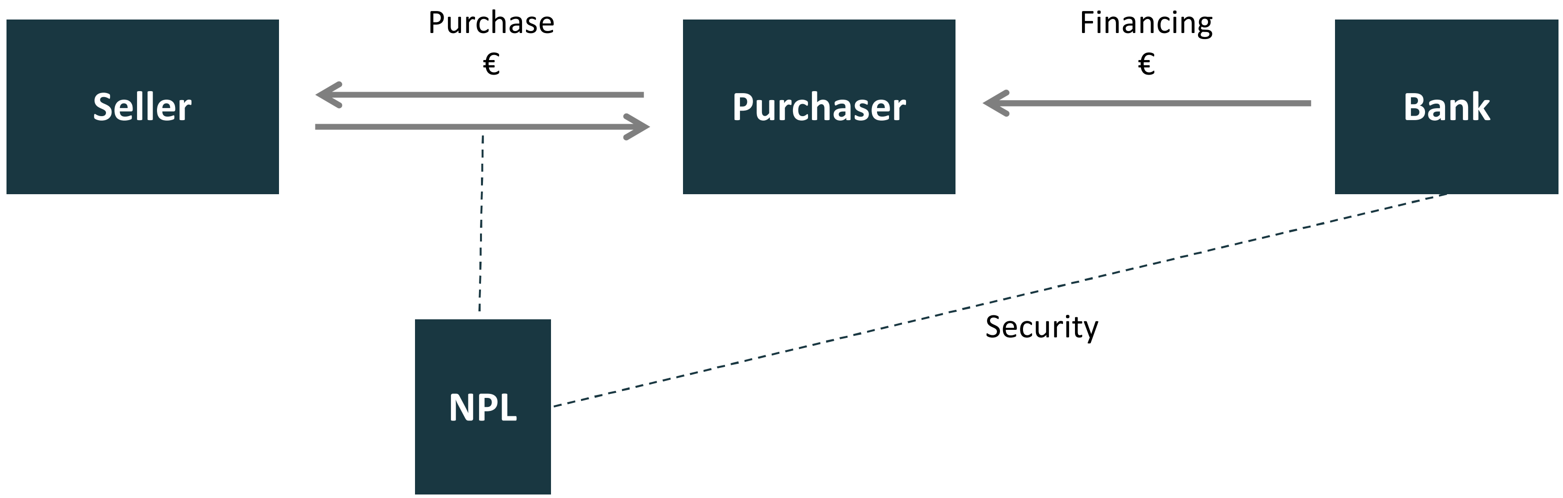
In this type of deals, the due diligence must be conducted by different law firms, and the closing usually involves the execution of a security transfer agreement governed by Portuguese law, with the purpose of ensuring a valid transfer of the security, which is tied to a NPL transfer agreement governed by the law of the NPL.



2.2. Financing of the NPL Transfer Deal

The purchaser of the NPL may wish to obtain financing for the deal, which will normally involve the creation of security over the NPL itself. It is possible to create security over a Portuguese law governed NPL, which is subject to the same contractual and legal form requirements as applicable to the NPL transfer.

However, when the NPL is connected with Portuguese territory, depending on how the security is structured, there is a risk of stamp tax being attracted.



3. Some of the legal matters to be assessed when purchasing NPLs connected with Portugal

Licensing requirements	No licensing requirements apply in order for an SPV to conduct the business of NPLs purchase in Portugal. There is also no regulation applicable to loan transfer brokering services; a new legal regime is expected, but according to its preliminary project, only the brokerage of credit origination business will become a regulated activity.
Legal nature of the NPL Transfer	The transfer of NPLs governed by Portuguese law does not require the novation of the receivable. The novation route should also not be followed, in order to avoid renewal of insolvency hardening periods or duplication of stamp tax risks (stamp tax is owed on origination of the credit). For this reason, lawyers of both seller and purchaser are willing to structure the deal as an assignment of the credit (cessão de crédito).
Transferability	Financing agreements governed by Portuguese law usually expressly foresee that the creditor has the right to assign the loan to any third parties, or at least to other credit institutions; if the transferee does not fall within the scope of this clause, the consent of the obligors for the transfer is required. However, in the absence of the clause itself, receivables are freely transferable.

Transfer perfection requirements	In order for the transfer of the NPL to be effective vis-a-vis the debtor, a notice of transfer must be sent to it, or it must have acknowledged it. In order for the transfer of a loan secured with a mortgage (crédito hipotecário) to be effective vis-a-vis third parties, it must be executed in the form of a notarial deed (or document authenticated by a notary) and registered with the Real Estate Registry Office where the property is recorded. Other perfection requirements may apply if there is security over other assets (e.g. receivables, IP rights).
Banking secrecy and data protection	There are often doubts raised on whether the sharing of data with the transferee may involve the breach of banking secrecy or personal data protection legislation. Until now, according to reputed scholars opinion and a known higher court decision, the sharing of contractual information in respect of a NPL would not imply the breach of such duties, but the law is not clear and often the contracts do not regulate in detail this matter.
Overriding security interests	There may exist third parties benefiting of security or legal privileges attaching to credits held vis-à-vis the borrower, which enable them to rank above the NPL's creditor in an enforcement/insolvency proceeding, even when the latter benefits of security. Such may be, for example, the case of credits held by the Portuguese State in relation to tax or social security debts, or by employees in relation to a borrower which was their employer.

Subordination risks	Subordination risks do not arise, provided that the credit has been originated on an arms length basis, which is almost always the case if granted by a credit institution. The fact that control enhancement measures are in place (e.g. effectiveness of shares pledge in relation to voting rights) does not raise subordination risks, provided that they have not been adopted originally, but as a reaction to an event of default.
Transfer at the enforcement stage	The transfer of NPLs at the enforcement stage does not raise special difficulties; the transferee may easily adhere to the pending procedures by means of evidencing that it has become the new creditor. Still, it is crucial to understand what is the current position of the transferor in the proceedings, in particular if it has timely lodged its claim, what are the competing creditors and the security they benefit, and whether or not the assets judicial sale stage has already been reached; these matters should be assessed in the due diligence stage.
Enforcement of the NPL	The swiftness of enforcement shall mainly depend on the security attached to the loan; financial pledges over shares or bank accounts, to the extent as duly perfected, enable the creditor to immediately appropriate the shares or the cash standing to the credit of the bank account with virtually no costs involved. However, credits secured with mortgage over Portuguese real estate require the creditor to bring legal proceedings before Portuguese courts, which may last between 1 and 2 years on average depending on a variety of factors, and imply relevant legal fees/costs owed to lawyers, enforcement agent and court.

Transfer of housing / consumer credit NPL	The transfer of housing and consumer credit loans is subject to specific legislation and regulation aimed at safeguarding the borrower's interests, which essentially requires the creditor to conduct a credit risk assessment and negotiation process with the client; the process is completed if no agreement is reached within a period of 90 days since occurrence of the default, following which the NPL may be transferred to any third party. Notwithstanding, the NPL may be transferred before the expiration of this 90 days period, provided that the transferee is another credit institution or a securitization vehicle.
Conduct of business rules	While transferees of loans granted to professional clients are only subject to the general fiduciary duties arising of civil and banking law principles, when the NPL is qualified as consumer or housing loan, more stringent requirements apply pursuant to various legislation implemented in the wake of the financial crisis, in particular limiting the enforcement measures that may be taken in case of default by the borrower.
Taxes upon transfer	To the extent that the loan is 100% connected with Portugal and the transfer is not qualified as a financing deal (e.g. factoring with recourse), no stamp or other taxes shall be triggered by a sale of the NPL.