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## A practical insight to cross-border Securitisation Law


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# Latvia


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## 1 Choice of Law

**1.1 If the seller and the debtors are resident in your country, and the transactions giving rise to the receivables and the payment of the receivables take place in your country, can the seller and the debtor choose a different country's law to govern the receivable contract and the receivables?**

Latvia is a party to the 1980 Rome Convention on the law applicable to contractual obligations. In line with the Convention, the choice by a domestic seller and a domestic debtor of a foreign law to govern the receivable contract and the receivables would be generally upheld by Latvian courts even if the transaction giving rise to the receivables and the payment of the receivables take place in Latvia. However, according to the Convention, the fact that the parties have chosen a foreign law does not, where all other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of the mandatory rules of that country. Accordingly, the choice of a foreign law in the given situation would not prejudice the application of the mandatory rules of Latvian law. In addition, as regards receivable contracts relating to the sale of goods or services to consumers, a choice of law clause, although generally allowed, cannot set aside to the detriment of the consumer any mandatory rules of the country in which the consumer has his habitual residence.

**1.2 If your country's law governs the receivables, and the seller sells the receivables to a purchaser in another country, can the seller and the purchaser choose the law of the purchaser's country or a third country to govern their sale agreement? Conversely, if another country's law governs the receivables, and the seller is resident in your country, are there circumstances where it would be beneficial to choose the law of your country to govern the sale agreement?**

Subject to the qualifications set forth in the answer to question 1.1, the choice by a domestic seller and a foreign purchaser of the law of the purchaser's country or a third country to govern their sale agreement would be generally upheld by Latvian courts. Where a debtor under a receivable is domiciled in Latvia, the effectiveness of the sale of such receivable vis-à-vis third parties may be determined by Latvian law as the *lex situs* (please see the answer to question 1.3). Although it is not mandatory, it may be recommendable that the sale agreement be governed in such case by Latvian law in order to ensure that the sale is duly perfected as required by Latvian law.

**1.3 In either of the cases described in question 1.2 above, will your country's laws apply to determine (i) whether the sale of receivables is effective as between the seller and the purchaser; (ii) whether the sale is perfected; (iii) whether the sale is a true sale; and/or (iv) whether the sale is effective and enforceable against the debtors?**

The effectiveness of the sale of receivables as between the seller and the purchaser would generally be determined in accordance with the law which applies to the sale contract. Accordingly, Latvian law would apply to determine the effectiveness of the sale of receivables as between the seller and the purchaser where the parties have chosen Latvian law to govern the sale agreement.

Since the perfection of the sale of receivables and effectiveness thereof against third parties is a proprietary rather than a contractual issue, Latvian courts would likely apply the law of the debtor's domicile as the *lex situs* to determine whether the sale is perfected and whether the sale is a true sale. Accordingly, Latvian law would apply to determine whether the sale is perfected and whether the sale is a true sale where the debtor is domiciled in Latvia. Please note that the applicability of the law of the debtor's domicile as the *lex situs* in determining the law governing the perfection and effectiveness of the sale of receivables against third parties has not yet been tested in practice, and Latvian courts may take another route to select the applicable law to determine these issues.

The effectiveness and enforceability of the sale of a receivable against the debtor would generally be determined in accordance with the law governing the receivable. Accordingly, Latvian law would apply to determine the effectiveness and enforceability of the sale of a receivable against the debtor where the receivable is governed by Latvian law.

## 2 Receivable Contracts

**2.1 In order to create an enforceable debt obligation of the debtor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivable contract; (b) are invoices alone sufficient; and (c) can a receivable "contract" be deemed to exist as a result of historic relationships?**

Generally, it is not necessary for the creation of an enforceable debt obligation that the sale of goods or services be evidenced by a formal receivable contract, as it is permissible to form a contract by one party making an offer and the other party accepting such offer. An invoice would create an enforceable debt obligation only where the receivable contract has already been made between the debtor and the seller or where the invoice serves as acceptance of the debtor's offer. Since the practice which the parties have established between themselves may serve to determine the intent of the parties to the contract, a receivable contract may, in certain situations, be deemed to exist as a result of historic relationships.

**2.2 Can the seller sell a receivable (a) without the debtor's consent if the receivable contract does not prohibit assignment and does not expressly permit assignment; (b) without the debtor's consent even if the receivable contract expressly prohibits assignment; or (c) without being liable to the debtor for breach of contract even if the receivable contract expressly prohibits assignment?**

The seller can sell a receivable without the debtor's consent even if the receivable contract does not expressly permit assignment, provided, however, that the receivable contract does not prohibit assignment. Accordingly, the seller cannot sell a receivable without the debtor's consent if the receivable contract prohibits assignment. Where the receivable contract prohibits assignment, the sale of the receivable without the debtor's consent would be ineffective against the debtor and the seller would be liable to the debtor for breach of the receivable contract.

**2.3 Do your country's laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; or (b) provide a statutory right to interest on late payments?**

The interest rate applicable to consumer credit must be calculated in accordance with the mathematical formula set out in the applicable regulations relating to consumer credit. Unless otherwise agreed, any late payments are subject to statutory interest at a rate equal to the sum of a reference rate and 7% or, where the debtor is a consumer, at a rate equal to 6%. The reference rate currently is 4%; however it is subject semi-annually to changes by the Central Bank of Latvia to reflect the fluctuations in the refinancing rate.

**2.4 Where the receivables contract has been entered into with the government or a government agency are there different requirements and laws that apply to the sale of receivables?**

No, there are no different requirements or laws that would apply to the sale of receivables where the debtor is the government or a government agency.

## 3 Asset Sales

**3.1 In your country what is necessary generally in order for a seller to sell accounts receivable to a purchaser?**

For the seller to sell accounts receivable to a purchaser, the seller would need to enter into a binding sale agreement with the purchaser. Although the sale agreement does not necessarily have to be in written form, such form is generally required for the agreement to become enforceable and is recommended for evidence purposes.

**3.2 What is required for the sale of accounts receivable to be perfected against any later purchasers of the same accounts receivable from the seller?**

The issue of perfection of the sale of accounts receivable against any later purchases is somewhat ambiguous under Latvian law. Generally, an assignment of a receivable takes effect vis-à-vis any third party (except the debtor) as from the time of assignment, therefore the priority of assignees is determined in accordance with the principle of prior tempore, potior in iure. However, where one and the same receivable has been sold to two or more purchasers, the purchaser which has notified the debtor of the sale has priority over any other purchasers even if they entered into the sale agreement earlier. Accordingly, it is recommended to perfect the sale of an account receivable by the purchaser notifying the sale to the debtor.

**3.3 What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?**

Where the receivable is documented by a negotiable promissory note, the perfection of the sale thereof requires the physical delivery of the note to the purchaser. The perfection of the sale of mortgage loans and consumer loans is generally the same as described in the answer to question 3.2. However, in order for the purchaser of a mortgage loan to benefit from the mortgage, the change of the creditor additionally needs to be registered with the Land Registry. Marketable debt securities are typically dematerialised, and the perfection of sale thereof requires them to be transferred to the purchaser's book-entry account.

**3.4 Must the seller or the purchaser notify debtors of the sale of receivables and/or obtain the consent of debtors to the sale in order for the sale to be effective against the debtors, that is (i) to allow the purchaser to enforce the debts directly against the debtors; (ii) to prevent the debtor and the seller from amending the receivable contract without the purchaser's consent; (iii) to prevent the debtor from setting off receivables against any obligations of the seller to the debtor; or (iv) to require the debtors to pay the purchaser rather than the seller?**

The effectiveness of the sale of an account receivable vis-à-

vis the debtor is generally subject to a notification of the sale being served to the debtor. The notification needs to be served by the purchaser, and a notice served by the seller would not suffice to give effect to the sale vis-à-vis the debtor unless the seller is acting as the purchaser's agent. It is only upon the notification of the sale of the accounts receivable to the debtor that the purchaser becomes entitled to enforce the debt directly against the debtor, and the debtor is prevented from setting off the receivable against any obligations of the seller to the debtor. While the sale of the accounts receivable would not generally deprive the seller and the purchaser of the right to amend the receivable contract even after the sale is notified to the debtor, no amendments that could affect the receivable would be permissible upon service of the notification to the debtor. The debtor's consent is not required for the sale of the receivable to take effect, and the sale is effective as between the seller and the purchaser even if the debtor is not aware of the sale.

**3.5 Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., debtor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics?**

No, the sale document does not need to specifically identify each of the receivables to be sold and it may therefore refer to, for example, "all existing and future receivables". The description of the receivables must, however, sufficiently identify them. In the case of sale of separate receivables, they need to be identified by at least the debtor name and the details of the underlying receivable contract. The receivables being sold do not have to share objective characteristics.

## 4 True Sale

**4.1 In general, what is necessary for a sale of receivables to be a true sale? Among other things, to what extent may the seller retain credit risk, interest rate risk, or control of collections on receivables?**

Generally, an assignment of a receivable takes effect as against any third party (except the debtor) as from the time of assignment. Accordingly, the receivable is isolated from the seller as from the time of execution of the sale agreement (in the case of an existing receivable) or the coming into existence of the receivable (in the case of a future receivable). Nevertheless, the reliance on such automatic effectiveness of the assignment would entail several risks. First, until the purchaser has notified the sale to the debtor, the debtor is entitled to pay the debt to the seller and the latter is under no obligation to transfer that amount to the purchaser. Second, the failure of the purchaser to notify the sale to the debtor may result in considerable difficulties in ensuring the priority of the sale against any subsequent sales by the seller (please see the answer to question 3.2). Third, where no notification of the sale has been served on the debtor, the receivables may be attached by the seller's creditors unless the purchaser has timely prevented such attachment by notifying the creditors. In the light of the foregoing, it is recommended that the sale of receivables is perfected by the purchaser notifying the sale to the debtor.

Since the purchaser's notification on sale of the receivable deprives the debtor of the right to discharge the debt by payment to the seller, the seller may not retain the right to collect the receivable, except in the capacity of the purchaser's agent. Therefore, any arrangements as to retention by the seller of credit risk, interest rate risk or control of collections on receivables may cause or at least contribute to the risk that the transaction may be challenged on the grounds that the legal form of the transaction does not correspond to the intent of the parties thereto. Also, the collection of the receivables by the seller by virtue of an agency arrangement may cause difficulties if the seller becomes insolvent. For example, should the collections be co-mingled with the seller's own funds, the collections may fall in the seller's insolvency estate.

**4.2 Can there be a true sale of receivables that do not yet exist (as in a "future flow" securitisation), so that a single sale on a certain date results in the purchaser automatically being the owner of the "sold" receivables immediately when they come into existence?**

While the sale of future receivables is generally permissible, it is recommended that the sale be perfected by the purchaser notifying the sale to the debtor (please see the answer to question 4.1). Accordingly, although a single sale on a certain date may result in the purchaser automatically becoming the owner of the "sold" receivables immediately when they come into existence, it is recommended that the sale be notified to the debtors in order to avoid the risks relating to determination of priority and creditor attachment.

## 5 Security Interests

**5.1 What is necessary for the purchaser to grant a security interest in accounts receivable under the laws of your country and for the security interest to be perfected?**

Depending on the status of the parties involved and the type of accounts receivable, the granting of a security interest in the accounts receivable is possible by way of creation of commercial pledge, financial collateral or possessory pledge.

Where the purchaser is a commercial undertaking or where the accounts receivable are documented as bonds of closed issues, the security interest in accounts receivable can be granted only by way of commercial pledge. The creation and perfection of a commercial pledge generally requires execution of a commercial pledge agreement between the purchaser and the grantee of the security interest and registration of the pledge with the Commercial Pledge Registry.

Where the purchaser or the grantee of the security interest falls under any of the categories of parties eligible to a financial collateral agreement listed by the Financial Collateral Law (in particular, if any of them is a financial institution subject to prudential supervision by the competent authorities of a Member State of the European Union) and the accounts receivable fall under the category of

financial instruments, the security interest in the accounts receivable can be granted by way of financial collateral. The creation and perfection of a financial collateral generally requires execution of a financial collateral agreement between the purchaser and the grantee of the security interest, and making a record of such financial collateral in the book-entry account of the financial institution holding that account.

In all other cases, a security interest in the accounts receivable can be granted by way of possessory pledge. The creation and perfection of a possessory pledge generally requires execution of a possessory pledge agreement between the purchaser and the grantee of the security interest and transfer of the accounts receivable under the possession of the grantee of the security interest.

**5.2 What additional or different requirements apply to security interests in or connected to promissory notes, mortgage loans, consumer loans or marketable debt securities?**

As noted in the answer to question 5.1, the granting and perfection of security interests in promissory notes would depend on whether the promissory notes fall under the category of bonds of closed issue or financial instruments. While in the former case the security interests would need to be granted by way of commercial pledge, in the latter case the security interest would need to be granted either by way of financial collateral (provided that either the purchaser or the grantee of the security interest falls under any of the categories of eligible parties to a financial collateral agreement listed by the Financial Collateral Law) or possessory pledge.

Marketable debt securities would likely fall under the category of financial instruments; therefore, the security interests in or in connection with such securities would need to be granted either by way of financial collateral (provided that either the purchaser or the grantee of the security interest falls under any of the categories of eligible parties to a financial collateral agreement listed by the Financial Collateral Law) or possessory pledge.

No specific requirements would apply to the creation and perfection of security interests in or in connection with mortgage loans or consumer loans.

**5.3 If the purchaser grants a security interest in the receivables under the laws of the purchaser's country or a third country, and that security interest is valid and perfected under the laws of that other country, will it be treated as valid and perfected in your country?**

Yes, a security interest in the receivables granted by the purchaser under the laws of the purchaser's country or a third country would generally be treated as valid in Latvia provided that such security interest has been granted and perfected in accordance with the *lex situs* of the receivables. No parallel perfection of security interests in Latvia would be required.

## 6 Insolvency Laws

**6.1 If after the sale of receivables the seller becomes subject to an insolvency proceeding, will your country's insolvency laws prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the receivables ("automatic stay")? Does the answer to this question (or the questions below) depend on whether the sale is a true sale?**

Provided that the receivables have been duly assigned to the purchaser, such receivables would not form part of the seller's insolvency estate and generally the purchaser would not be prevented the purchaser from collecting, transferring or otherwise exercising ownership rights over the receivables. Please see however the answer to question 6.5.

**6.2 If there is no automatic stay, could the insolvency official prohibit exercise of rights by the purchaser by means of injunction, stay order or other action?**

No, Latvian insolvency laws would not generally allow the insolvency administrator to prohibit the exercise of rights by the purchaser by means of injunction, stay order or other action.

**6.3 Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

Should the seller have collected any receivables as the purchaser's agent, any amounts which have been co-mingled with the seller's own funds would be considered part of the seller's insolvency estate.

**6.4 Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding?**

In the case of the seller's insolvency, the following transactions could be declared void by the court at the request of the insolvency administrator:

1) any transaction entered into by the seller after the date of submission of the insolvency petition where the seller has intentionally caused loss to the creditors, irrespective of whether or not the counterparty to the transaction was aware of such causing of loss to the creditors;
2) any transaction entered into by the seller within five years before the date of insolvency where the seller has intentionally caused loss to the creditors and the counterparty to the transaction was aware of such causing of loss to the creditors; or
3) any transaction entered into by the seller within five years before the date of insolvency where it has been established by the court that the insolvency of the seller has been caused by criminal action and the counterparty to the transaction was aware of such criminal action.

Should the transaction be entered into with an "insider" or in favour of an "insider", a rebuttable presumption would apply that such "insider" was aware of causing loss to the creditors. Similarly, should the transaction be entered into after the date of insolvency or within one month before the date of insolvency, a rebuttable presumption would apply that the seller has intentionally caused loss to the creditors.

In addition, any amounts paid by the seller in discharge of his obligations within the last six months before the insolvency date or after the insolvency date could be subjected to repayment by the order of the court if:

1) the amount was paid before the due date;
2) the payment of the amount resulted in the seller's actual insolvency; or
3) the debt was discharged to an "insider" unless the seller or the "insider" proves that the seller was not insolvent at the time of the payment and the payment did not result in the seller's actual insolvency.

**6.5 What is the effect of the initiation of insolvency proceedings on any future sales of receivables or on receivables that have been assigned but have not yet come into existence?**

Latvian insolvency laws do not currently provide any straightforward answer as to the effect of the initiation of insolvency proceedings on receivables that have been assigned but have not yet come into existence. At least a theoretical risk is present that the sale of receivables coming into existence after the initiation of insolvency proceedings may be challenged by the seller's insolvency administrator as described in the answer to question 6.4. Any assignment of receivables could take effect during the insolvency proceedings only where the seller is declared bankrupt and the due date of the receivables has not fallen due before the end of the bankruptcy proceedings, or the recovery of such receivables is impossible.

## 7 Special Purpose Entities

**7.1 Does your country have laws specifically providing for establishment of special purpose entities for securitisation? If so, then what does the law provide as to (a) requirements for establishment of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

No, there are no laws specifically providing for establishment of special purpose entities for securitisation. Accordingly, the establishment of such entities is subject to the general provisions relating to establishment of companies.

**7.2 If an agreement with a special purpose entity provides that the other parties will not take legal action against it or that they will not commence an insolvency proceeding against it, is that provision valid and enforceable?**

No, it is a general understanding under Latvian law that a waiver to take legal action or to commence an insolvency proceeding is not valid and enforceable.

**7.3 To what extent will a limitation on the liabilities of the special purpose entity (limited, for example, to available funds) be valid and enforceable?**

The most suitable form of establishment of the special purpose entity would be a limited liability company. The liability of such company is limited to the company's assets and the shareholders are not liable for the company's obligations with their personal property. While contractual limitations of liability for breach of agreement are in principle possible, a limitation of the liability to perform the agreement would not be generally upheld by Latvian courts.

**7.4 If the organisational documents or agreements of a special purpose entity provide that the directors or managers will not commence an insolvency proceeding involving the entity unless required under applicable law, is that provision valid and enforceable?**

In principle, an obligation to abstain from the commencement of insolvency proceedings would likely be considered as reasonable towards the directors and managers and may be included in agreements with them. However, due to the limited scope of the organisational documents of the special purpose entity, it would not be possible to include such obligation in those documents.

## 8 Regulatory Issues

**8.1 Does your country have laws restricting the use or dissemination of data about or provided by debtors? If so, do these laws apply only to consumer debtors or also to enterprises?**

Where the debtors are natural persons, the processing of personal data (for example, the collection, storage or transfer of data) is subject to the requirements of the Natural Persons Data Protection Law. In particular, some types of processing of such data may require the consent of the data subjects and, where a personal data filing system is organised, such organisation may require the system to be registered with the Data State Inspection. In addition, unless the consent of the data subject is obtained, the transfer of personal data abroad is only permissible as long as the country to which the data is transferred ensures at least the same level of protection of personal data as provided in Latvia, and is subject to an approval of the Data State Inspection.

**8.2 If the debtors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of your country? Briefly, what is required?**

In the case of consumer credit, the purchaser would generally be bound by the provisions of the Consumer Protection Law and the applicable regulations relating to consumer credit. In particular, the purchaser is bound by the obligation to accept repayment of credit before maturity without imposing any penalties for such early repayment and to apply an interest rate which has been calculated in accordance with the mathematical formula set out in the applicable regulations relating to consumer credit. Should the consumer credit contract provide misleading information

as to the applicable interest rate or other costs, or should the applicable interest rate not be calculated in accordance with the mathematical formula set out in the regulations relating to consumer credit, the purchaser would be bound to accept the consumer paying interest at the statutory rate of 6% per annum.

**8.3 Assuming that the purchaser does no other business in your country, will its purchase and ownership or its collection and enforcement of receivables result in it being required to qualify to do business or to obtain any licence or it being subject to regulation as a financial institution in your country?**

Although the purchase and collection of receivables may, if these form part of a securitisation scheme, fall under the category of financial services as defined by the Credit Instititions Law, such activities are not reserved exclusively to entities permitted to provide banking services in Latvia. Accordingly, the purchaser would not be required to obtain a licence to carry out any of such activites and would not be subject to regulation as a financial institution in Latvia. Where the purchaser is a foreign entity, the purchase and collection of receivables may, in certain circumstances, create a risk of permanent establishment which will further be discussed under question 9.6.

**8.4 Does your country have laws restricting the exchange of your country's currency for other currencies or the making of payments in your country's currency to persons outside the country?**

No, there are no laws that would restrict the exchange of Latvian Lats for other currencies or the making of payments in Latvian Lats to persons outside Latvia.

## 9 Taxation

**9.1 Will any part of payments on receivables by the debtors to the seller or the purchaser be subject to withholding taxes in your country? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?**

Latvian withholding tax may apply to certain categories of receivable payable by Latvian resident companies or permanent establishments of non-resident companies to non-residents of Latvia, such as dividends, income from participation in partnerships, remuneration for management or consultancy services, interest to related persons or entities, payments for intellectual property, remuneration for use of property situated in Latvia, remuneration for sale of real property situated in Latvia. In addition, with some exceptions, withholding tax also applies to all payments by Latvian resident companies or permanent establishments of non-resident companies to legal, natural or other persons located or established in low-tax and tax-free countries or territories listed in the applicable regulations.

**9.2 Does your country require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

No specific accounting policy has to be adopted with regard to securitisation.

**9.3 Does your country impose stamp duty or other documentary taxes on sales of receivables?**

No stamp duties or other documentary taxes are imposed on sales of receivables.

**9.4 Does your country impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

Sales of goods or services will in most cases be subject to value added tax (VAT) at the rate of 18%. By way of exception, sales of receivables are VAT-exempt. The fees for collection agent services will likely be subject to VAT at the rate of 18%. If the services are rendered for an EU-resident taxable person (registered as a VAT-payer) the reverse charge mechanism is applied whereby the fees are not subject to Latvian VAT, but are subject to VAT at the rate applied in the country of the recipient of the service.

**9.5 If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims against the purchaser or on the receivables or collections for the unpaid tax?**

The purchaser can be liable to pay VAT in certain cases when the reverse charge mechanism is applicable.

**9.6 Assuming that the purchaser conducts no other business in your country, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the debtors, make it liable to tax in your country?**

Non-residents are liable for taxes in Latvia only for the part of their income derived from Latvia. The tax on income deriving from Latvia is, however, subject to mitigation based on double tax treaties. Generally, Latvian double tax treaties follow the OECD Model Convention.

As a general rule, the mere purchase and enforcement of the receivables should not create a permanent establishment and liability to tax for the purchaser in Latvia. However, should a domestic seller be appointed as a service and collection agent of the purchaser, a permanent establishment could be held to exist for Latvian tax purposes provided that such an agent is also authorised to conclude contracts in the name of the purchaser, and that it habitually exercises this authority. If the seller were construed as the independent agent of the purchaser, a permanent establishment would generally exist for Latvian tax purposes if the service and collection services carried out by the seller are held to go beyond the ordinary course of its business.

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