This chapter highlights some recent legal developments that have affected the Austrian securitisation and structured finance markets, and considers what market participants in Austria and the neighbouring Central and Eastern European jurisdictions may face in the year ahead.

The key legal developments are driven not only by amendments to statutory law, which have created some undesired side-effects of Basel II implementation, but also by case law and the development of standardised documentation, in particular as concerns hedging documentation for covered bond transactions.

Side-effects of Basel II implementation
Regulatory developments regarding licensing
The Banking Act was amended (effective as of June 2005) to exclude expressly the activities of special securitisation companies (SSCs) from any licensing requirements. Before June 2005, some uncertainty existed as to whether a true-sale transaction would, from a regulatory perspective, have to be treated as a factoring transaction so that the purchasing special purpose vehicle would have to obtain a banking licence if it offered its services in Austria on a commercial basis.

Until December 31 2006 ‘SSCs' were defined as entities whose sole business activity consists of issuing notes, raising loans, entering into security agreements and activities ancillary to this business activity, all for the purpose of acquiring assets, in particular receivables, or assuming the risks deriving from such assets.
The definition of an SSC was amended on January 1, 2007. Since then, ‘SSCs’ are defined as entities whose sole business purpose is undertaking securitisation transactions whose structure is designed to separate its own liabilities from the liabilities of the originator, and the legal and beneficial owners of which may freely pledge or dispose of the rights connected therewith. The Banking Act further provides that the licensing exemption applies to the extent the sole business activity of the SSC consists of issuing notes, raising loans, entering into security agreements and activities ancillary to this business activity, all for the purpose of acquiring assets, in particular receivables, or assuming the risks deriving from such assets. The amended definition of ‘SSC’ is a result of implementing EU Directive 2006/48/EC. In line with the directive, the term ‘securitisation’ is defined as a transaction or scheme, where:

- the credit risk associated with a receivable or a pool of receivables is transferred to investors;
- payments in the transaction or scheme are dependent upon the performance of the receivable or the pool of receivables; and
- the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

Although the author disagrees with those market participants that view the issuance of securities or notes as a prerequisite to qualify as an SSC under the new legal regime (a view that is based neither on the text of the Banking Act nor on the directive), the new legal regime has introduced some uncertainty in respect of structures that do not provide for a subordination of tranches (e.g., some conduit structures). Since the subordination of tranches is one of the key criteria to the definition of ‘securitisation’, it is not certain whether special purpose vehicles under such single-tranche structures continue to qualify for the licensing exemption or whether, in relation to such transactions, alternative ways to avoiding licensing requirements need to be applied. No official statement of the Financial Market Authority is yet available in this respect; thus, are careful analysis and structuring required to avoid as far as possible the banking licence requirements for the purchasing special purpose vehicle in single tranche (conduit) transactions.

**Tax impact of regulatory developments**

The regulatory changes have also affected the stamp duty analysis to be carried out in relation to any purchase of receivables with an Austrian aspect. In principle, assignments of receivables are subject to *ad valorem* stamp duty. Until the introduction of an express exemption for assignments to securitisation companies in January 2005, a number of structural and documentation features had to be applied to mitigate stamp duty exposure on the receivables purchase. No statutory definition of the term ‘securitisation company’, as used in the Stamp Duty Act, is available. However, because the March 2007 explanatory guidelines of the Ministry of Finance expressly refer to the regulatory concepts of the Banking Act when defining the scope of the stamp duty exemption for assignments to securitisation companies, it is likely that in future the relevant exemption will be interpreted so as to apply to entities that qualify as SSCs only. However, both Austrian and non-Austrian SSCs should qualify for the exemption. In the absence of reliance on an express exemption, more traditional stamp duty mitigants will have to be employed.

**Credit derivatives**

Another undesired side-effect of Basel II implementation that came as a surprise to the Austrian structured finance market participants was its impact on close-out netting of claims deriving from credit derivatives transactions. Due to the close link between Austrian netting legislation and the regulatory treatment of derivatives transactions, the Basel II implementing legislation created some uncertainty as to what extent claims under credit derivatives transactions would continue to benefit...
from the netting privilege if Austrian substantive insolvency laws were to apply. Following lobbying by the Austrian credit institutions, remedial action has been taken on a legislative level by expressly including credit derivatives transactions in the catalogue of the transactions that qualify for purposes of Austrian netting legislation.

**Supreme Court ruling impacting hybrid bond issuance**

In a late 2005 ruling in relation to *jouissance* rights, the Supreme Court set out certain limitations to the perpetual nature of *jouissance* rights that also affect other forms of hybrid capital instrument. These limitations are particularly relevant in relation to issuances by unregulated corporate entities, where, contrary to, for example, participation capital (an Austrian specific form of Tier 1 capital) of credit institutions, no legal provisions are available to support the perpetual nature of the instruments.

As a result of this ruling, it appears to be critical that investors are granted an exit possibility by listing the instruments on an exchange (in the past, some issuers have placed unlisted Tier 1 instruments, which no longer seems feasible for corporate hybrid bonds). Even if such an exit possibility exists, this ruling has increased the risk that investors may be granted the right to request redemption of the instruments for good cause (despite contractual stipulations to the contrary).

**ISDA covered bonds documentation**

Austria introduced substantial amendments to the legal frameworks applicable to mortgage bonds and covered bonds, which took effect as of June 2005. Under the new frameworks Austrian issuers of mortgage bonds and covered bonds may include certain hedges in the cover pool, provided that the hedge transactions comply with the criteria set out by law (including non-termination upon issuer bankruptcy). In principle, derivatives transactions that serve to hedge interest, currency and counterparty risks in the cover pool in relation to the outstanding bonds are eligible for inclusion in the cover pool. Upon bankruptcy of the issuing credit institution, the hedge counterparty under such hedges enjoys protection broadly equivalent to the holders of the mortgage bonds or covered bonds.

Driven by the requests of its members, in early 2006 the International Swaps and Derivatives Association (ISDA) established a working group to develop standardised hedging documentation to reflect legislative and transactional developments in the European covered bonds markets.

In October 2006 the working group’s consultative process resulted in the publication of the Austrian covered bonds rider, which was the first piece of standard covered bonds documentation published by ISDA (with the German rider following in April 2007). The Austrian covered bonds rider, which is to be included in a schedule to the 1992 or 2002 ISDA master agreements, introduces several changes to the 1992 and 2002 ISDA master agreements and is intended to be used for hedges included in the cover pool held by Austrian issuers of mortgage bonds or covered bonds. It is designed to serve as a starting point for negotiations between the various transaction parties (including issuers, arrangers and rating agencies).

**The year ahead**

Austrian banks appear to focus on synthetic structures in order to obtain regulatory capital relief and some further transactions using credit default swap and credit linked note technology being originated out of Austria are to be expected.

To the contrary, it appears that for credit institutions in Central and Eastern Europe, including the subsidiaries of Austrian credit institutions, true-sale transactions (combining regulatory capital relief and foreign currency funding) are more appealing. Driven by an increasing demand for consumer and mortgage finance on the one hand and regulatory constraints to asset growth on the other, Austrian bankers and advisers are seeing an
increasing desire of Central and Eastern European financial services originators to structuring true-sale transactions. Local initiatives have been set up at a legislative level to foster these developments. For example, Romania has implemented securitisation legislation and an initiative to do so is well underway in Croatia.

As concerns corporate originators, an increasing number of conduit transactions involving various asset classes (including trade receivables and leasing receivables) is to be expected. This is driven by an increasing number of pan-European transactions that also involve receivables originated out of Austria, but also by an increased standardisation/commoditisation of (conduit) structures that allows originators with relatively small asset pools to tap the structured finance markets.