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Sliding doors in the Italian securitisation market

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Beginning in Summer 2007, there has been a substantial reduction in the completion of public securitisation deals in the Italian market. This reduction is mainly due to two factors:

- in relation to corporate securitisations, the global crisis in the financial markets; and
- in relation to healthcare securitisations, the new limits imposed by the European and Italian legal framework.

In the past few years the Italian securitisation market has been one of the most active in Europe and originators have frequently carried out securitisation transactions in order to obtain liquidity, off-balance-sheet treatment of the securitised receivables and/or better capital adequacy treatment.

The limited demand for asset-backed securities (ABS) from investors and the limits imposed by the legal framework have obliged arrangers and originators to consider new alternatives in order to achieve the benefits usually deriving from standard securitisation transactions. Therefore, in the last year market players have:

- implemented new structures for securitisation transactions (eg, healthcare receivables securitisations and warehouse securitisation programmes);
- used short-term financing transactions currently available to market players (eg, the Eurosystem monetary policy transactions with the European Central Bank (ECB)); and
- begun to focus on new financial products available (eg, Italian covered bonds).

This chapter describes and analyses these alternative structures, opportunities and products available in the Italian securitisation market.

Healthcare receivables securitisations

In the last four years the Italian ABS market has been dominated by healthcare receivables deals. These deals mainly consist of the issue by a special purpose vehicle (SPV) of ABS which are backed by receivables deriving from the supply of goods and services to the regional healthcare system.

Limits imposed by the European and Italian legal framework

Italian healthcare receivables securitisations have been particularly affected by the new limits imposed by the European and Italian legal framework.

In particular, pursuant to a letter dated September 4 2006 to the *Istituto Nazionale di Statistica*, Eurostat expressed its guidelines and opinions in relation to Italian healthcare receivables securitisations. In addition, pursuant to Article 1, Paragraph 739 of Law 296 of December 27 2006 (the 2007 Budget Law), the assignment or securitisation of receivables arising from supply agreements entered into with suppliers to the regional healthcare system, in respect of which the relevant public entities have assumed, even if indirectly, new obligations to pay (also in the form of a restructuring of the amortisation schedules), qualifies as financial debt and is therefore prohibited. This prohibition does not apply to transactions approved by the relevant regional authorities before September 4 2006 and completed by March 31 2007.

Finally, a feature of healthcare receivables securitisation was a settlement agreement under which payments in respect of the relevant healthcare receivables were deferred according to an agreed amortisation schedule. The resolution of the Ministry of Economy and Finance of January 31 2007 specified that any deferral of payments in respect of receivables provided for by a settlement agreement exceeding a 12-month period must be qualified as financial debt and therefore is also no longer permitted.

Alternative structures

In light of this, the two main alternative structures currently available for securitising healthcare receivables are the transfer or securitisation of healthcare receivables:

- without entering into any settlement agreement in respect thereof; or
- in which the restructuring of the healthcare authorities' debt and any deferral in the payment of the outstanding receivables do not exceed the 12-month period.

In both cases the delegation of payment by the Italian regional authorities is no longer permitted. Therefore, transactions relating to healthcare receivables are now carried out exclusively on the basis of the healthcare authorities' risk.

Warehouse securitisation programmes

In order to satisfy the increasing demand for funding from Italian originators, arrangers have structured warehouse securitisation programmes.

Legal structure

Warehouse securitisations programmes comprise two phases:

- a private phase, where the originator transfers to the SPV various portfolios of receivables under the terms of a master receivables agreement. The purchase of each portfolio is financed through the issue by the SPV of the respective series of unlisted and unrated notes (the initial notes) and the subscription of the senior initial notes by the financing bank (or, alternatively, through the granting of a bridge loan); and
- a public phase, where all the initial notes issued (or alternatively the bridge loans granted) during the private phase are repaid and reimbursed in full by the SPV using the proceeds deriving from the issue of listed and rated notes (the final notes).

Main legal issues

The main legal issues to be taken into consideration in carrying out warehouse securitisation programmes are briefly summarised below.

Segregation of the portfolio

Article 3 of Law 130/99 provides that the securitised portfolio is segregated in favour of the holders of the notes issued by the SPV in order to finance the purchase of the portfolio. The final notes are not issued by the SPV in order directly to finance the purchase of the aggregate portfolio. Therefore, the extent to which the aggregate portfolio purchased by the SPV during the private phase is segregated in favour of the holders of the final notes needs to be analysed carefully.

Securitisation programme agreement

The parties involved in a warehouse securitisation programme should agree on the action to be taken in respect of the various events that may occur during the private phase of the transaction. In particular, in the event that it is not possible, for whatever reason, to issue the final notes, upon the instructions of the holder of the initial notes the SPV shall dispose of the securitised portfolio or issue other rated and listed notes to be purchased by the financing bank and placed on the market.

No negative impact on the public phase of the transaction

The transaction must be structured in such a way as to prevent, to the extent possible, the liabilities connected with the private phase of the transaction from having a negative impact on the public phase of such transaction. For this purpose, it is appropriate that all parties to the private phase of the deal accept (subject to the issue of the final notes and the repayment in full of the initial notes and other outstanding liabilities deriving from such private phase):

- the termination by mutual agreement of the transaction documents related to the private phase;
- the release and discharge of the SPV from any obligation and liability deriving from the private phase; and
- in any event, the subordination of any claims and liabilities relating to the private phase to the claims and liabilities relating to the public phase and the final notes.

Redemption of the ABS before the 18-month period

In the event that the original legal maturity of the ABS exceeds the 18-month period from the relevant issue date and such ABS (including, in particular, the initial notes) are redeemed prior to the expiry of such 18-month period, the SPV will be required to pay tax at a rate of 20 per cent of the interest accrued on the principal amount of such ABS redeemed up to and including the date of such early redemption.

Due to the global financial markets crisis, in the last few months originators and financing banks have usually preferred not to place the final notes on the market. As a consequence, the SPVs have issued rated and listed notes which have been entirely subscribed by the originators and used by them as collateral for repo transactions with the ECB.

ABS as collateral eligible for repo with the ECB

In the last year, one of the main alternatives to the issue of ABS placed on the public market has been the issue of ABS to be used as collateral eligible for Eurosystem monetary policy transactions (ie, repo) with the ECB.

Structure

In order to render the ABS eligible as collateral with the ECB, arrangers have structured plain vanilla securitisations in the context of which two tranches of ABS are issued.

Both tranches of ABS are underwritten or purchased by the relevant originator (or by companies belong to the originator's group) and the senior tranche is used by the relevant holder as collateral eligible for repo transactions with the ECB.

Main eligibility requirements

In order to be eligible as collateral with the ECB, the ABS must satisfy all eligibility criteria set forth in the ECB manual on "The Implementation of Monetary Policy in the Euro Area". The main eligibility criteria that the ABS must meet are as follows:

- The ABS must be admitted to trading on a regulated market;
- The ABS must be rated at least A- by Fitch or Standard & Poor's or A3 by Moody's;
- The ABS may not be subordinated to other tranches of the same issue. In particular, in accordance with the priority of payment applicable after the delivery of an enforcement notice, the tranche is given priority over other tranches in respect of receiving payment in respect of principal and interest, or is last in incurring losses in relation to underlying assets;
- The cash-flow generating assets backing the ABS must not consist, in whole or in part, actually or potentially, of credit-linked notes or similar claims resulting from the transfer of credit risk by means of credit derivatives; and
- No 'close links' (as defined in the ECB manual) must arise.

The ECB provides no assessment of assets before the issue of the ABS. Therefore, it is advisable to provide a simple and timely procedure to amend the transaction documents and the terms and conditions of the ABS in the event that, following the issue of the ABS, they are deemed ineligible as collateral by the ECB.

Covered bonds

Covered bonds are senior debt securities issued by banking institutions whose key feature is that they benefit from a double guarantee: the general guarantee from the issuing bank on its assets and also a specific guarantee on a segregated cover pool of high credit quality assets (typically, claims arising from mortgage loans and claims due or guaranteed by public administrations).

Therefore, in the event that the issuing bank fails to meet its payment obligations under the covered bonds (including as a result of bankruptcy proceedings or a moratorium on payments), the holders of the covered bonds will benefit from this double guarantee and will continue to be paid through the proceeds of the cover pool without interruption or acceleration of the covered bonds (ie, on the same terms as provided by the covered bonds' terms and conditions).

Covered bonds are generally low-risk investments, highly rated, safer and more guaranteed than the ordinary bank debt securities.

Legal framework

The long-awaited legal and regulatory framework which allows Italian banks to issue covered bonds was completed in May 2007.

The main legal and regulatory framework which governs the issue of covered bonds in Italy is now as follows:

- Articles 7*bis* and 7*ter* of Law 130/99, introduced by Law 80 of May 14 2005;
- Decree 310 issued by the Ministry of Economy and Finance on December 14 2006;
- CICR Decree 213 of April 12 2007; and
- Supervisory Regulation 501981 issued by the Bank of Italy on May 17 2007.

Main improvements in respect of Law 130/99

The covered bonds regime derives directly from Law 130/99. This legislation benefits from the preferential regime provided by Law 130/99 regarding bankruptcy procedures, the transfer of eligible assets to the SPV and the statutory segregation of such assets.

In addition, certain provisions of the covered bond legislation which were reproduced from Law 130/99 have substantially benefited from the experience of securitisation deals over the past nine years. Several legal issues arising under securitisation transactions, as well as under Italian structured finance transactions more generally, have been addressed with positive solutions in the covered bonds Italian legislation.

The main examples are briefly summarised below.

Extension of segregation principle to swaps and other contractual rights

The segregation principle provided for by Article 3, Paragraph 2 of Law 130/99 in relation to securitisation transactions applies to securitised receivables only. Under the Italian legislation relating to covered bonds, segregated assets will comprise the assets sold to the SPV and the sums paid by the relevant debtors or by the parties to the swap agreements and the other ancillary agreements entered into in the context of the covered bonds transaction.

Right to attach segregated assets granted to all transaction creditors

Under Article 3, Paragraph 2 and Article 4, Paragraph 2 of Law 130/99 applicable to securitisation transactions, in respect of securitised receivables, no actions by creditors other than the holders of the ABS are permitted. Under Article *7bis*, Paragraph 3 of Law 130/99 applicable to covered bonds transactions, such actions are expressly granted not only to the holders of covered bonds, but also to all other transaction creditors, including the swap counterparties.

No need to comply with special perfection formalities required for transfer of public assets

The Italian legal framework on covered bonds has expressly provided for the non-application of certain complex and expensive perfection formalities which are normally required for the transfer of public assets. This will, of course, save costs and time on covered bonds deals involving these types of asset.

No claw-back of SPV guarantee and subordinated loan

In Italian securitisation transactions the risk of a claw-back of security interest and funding arrangements is not avoided. However, such risk is avoided in relation to the SPV's guarantee and the subordinated loan entered into in the context of a covered bond transaction. In particular, Article *7bis*, Paragraph 4 of Law 130/99 provides that the SPV's guarantee and the subordinated loan entered into in the context of a covered bond transaction will not be subject to claw-back by operation of law.

Other aspects to be clarified

Even though the covered bond legislation has positively resolved several legal issues previously raised in connection with securitisation transactions, certain aspects related to covered bonds transactions still need to be clarified. In particular, the following two aspects require clarification.

Enrolment of the SPV in the special register held by the Bank of Italy

The covered bonds legislation does not specify whether SPVs carrying out covered bonds transactions are exempt from enrolment on the special register held by the Bank of Italy pursuant to Article 107 of the Banking Act. This regulatory requirement has on occasion created problems in completing securitisation transactions since the enrolment process with the register can take up to 120 days. In a draft of a consolidated decree regarding financial intermediaries circulated by the Treasury Ministry for consultation in February 2008, it was proposed that SPVs incorporated under Law 130/99 be exempted from enrolment in the register. In addition, it was proposed that SPVs incorporated under Law 130/99 which carry out covered bonds transactions must be enrolled on the special register if they do not belong to a banking group. The rationale behind such a proposal is that if the SPVs belonged to a banking group, they would be subject to the supervision of the Bank of Italy on a consolidated basis. It is hoped that this point will be clarified in the next few months and the above-mentioned draft decree will be approved.

Role and responsibilities of the asset monitor

Under the Bank of Italy regulations, certain monitoring procedures are imposed on the issuing banks and the asset monitor. The asset monitor must be an independent accounting firm appointed by the relevant issuing bank. In particular, the asset monitor must survey the validity of the transaction and the adequacy of the guarantee issued in favour of the covered bonds holders, delivering an annual report on its monitoring activities. Since the asset monitor must not be related to the issuing bank, it would be appropriate to clarify in more detail the activities to be carried out and the responsibilities it shall take in the context of the Italian covered bonds transaction.

Conclusion

The credit crunch is not having the same impact in all European countries: some financial markets have become quieter but others remain busy. In times of economic turmoil, the more active market players have the opportunity to use their experience to explore innovative and alternative solutions or to render more efficient the opportunities that are currently available.

In the last year, arrangers, originators and other market players in Italy have explored the options available and have discovered and implemented alternative structures and opportunities, and focused on new products in order to satisfy the liquidity and credit needs of Italian financial market players. Looking ahead, there is clearly uncertainty; however, Italian market players should continue to respond quickly and effectively to changes in market conditions and in originators' needs in order to be well positioned to build future successes.