

ISR

INTERNATIONAL SECURITISATION REPORT

MARCH 1993 ISSUE 1

**Country reports
and special features**

**ISR database — the public
issues for 1992**

**International directory
— the market participants**

IFR

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Publisher's letter

This is the first of four issues you will receive as part of your annual subscription to *International Securitisation Report*, the most comprehensive information product available to date on the market for securitised products worldwide.

There is, without a doubt, a gap in the existing information required by those banks, securities houses, corporates and other financial institutions wishing to participate in, or at least know more about, this relatively new financial technology. ISR can help fill this gap.

This first issue examines what happened in the MBS and ABS markets in 1992. The essence of the product comprises a comprehensive report on issuance, regulatory, and structural activity for MBS and ABS markets in 16 different countries. There is also a printed database of new issue data for all public asset and mortgage-backed deals as well as a directory of key market players worldwide. A fully revised database and directory will be published in the first issue of each year.

The second issue of ISR will be published in July. In addition to providing information on ABS and MBS deals for the quarter, there will be a regional focus on LDCs and emerging markets; an instrument focus on commercial real estate; an examination of the legal implications of cross-border transactions; and a survey of institutional investor interest in the MBS and ABS markets. An interview with a senior market participant will be featured also.

Our policy is to involve our readership in the development of this product and we would very much welcome your comments on this, the first issue. We are also open to contributions and ideas for forthcoming issues.

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Italy

Report

Securitisation is a relatively new concept for Italian financial markets but one which has already aroused considerable interest. A widespread desire to understand the fundamental nature of the technology and its various structuring possibilities has helped to break down certain psychological barriers. These barriers are more pronounced in Italy than in other countries because Italian secondary market trading is limited to standard securities (so, for example, loans are not sold or assigned, subparticipations are unheard of, etc). The main exception to this is the forfaiting market which, for securitisation, remains closed to most operators due to the costs involved. The lack of even simple precedents means that specific regulations for a more sophisticated type of asset sale or repackaging have not, to date, been deemed necessary. Any issuer wishing to structure a securitisation transaction in Italy must therefore rely on the basic legislation currently in place and navigate around the many legal and fiscal pitfalls. In practice, this typically requires breaking down the securitisation process into its individual parts and dealing with each stage separately.

Even though the current financial environment in Italy appears to be almost ideal for the development of securitisation, the market probably requires a major transaction from a prominent issuer to give it impetus and to remove the negative image the product appears to convey (since securitisation generally costs more than ordinary funding, it is thought that a company will only resort to using the technology if it is unable to obtain sufficient conventional credit). Securitisation is not yet seen as a method by which a company can lock in the possibility of unlimited growth (and by definition unlimited profits) without having to recapitalise.

The financial and economic environment in Italy

The financial and economic environment in Italy has presented an increasing number of difficulties and obstacles to the banks and financial institutions that have to survive and operate within its boundaries. Certain factors are external and affect all financial institutions

internationally, such as the need to adhere to the capital ratios established by the Bank for International Settlements. However, the nature of the Italian banking system makes the position of the Italian banks more difficult in some respects than that of banks in other countries. The majority of the Italian banking sector is state-owned and is therefore unable to obtain capital unless the State has budgeted for this as part of its public sector expenditure. Furthermore, the commercial banks in Italy are traditionally short-term lending institutions and are subject to the imposition of ceilings on their medium-term lending set according to their total assets. Broadly speaking, the volume of these institutions' medium-term loans in lire cannot exceed 30% of their total lire lending. The majority of large state-owned commercial banks have reached this 30% limit and, therefore, need to create space on their balance sheets to generate more medium to long-term assets such as mortgages and consumer loans (or they need to increase total assets in order to increase the absolute level of the 30% ceiling. However this would require additional capital which, as mentioned above, is rather difficult). The securitisation of assets would appear to be an ideal solution to this particular problem. Even without the ceiling, those financial institutions whose main activity is medium-term lending face the ongoing problem of finding new sources of matching funds. Domestic bond issues and certificates of deposit are extremely expensive options, because the market has insufficient depth to cope with growing issuance needs, and the Italian State competes aggressively for domestic savings to finance its enormous public sector borrowing requirement by affording preferential fiscal treatment to its securities. Meanwhile, the flood of Italian banking institutions in 1989, 1990 and 1991 tapping the Euroloan and Eurobond markets resulted in over-supply of this type of paper, and since then the Euromarkets have been virtually closed to all except the most prominent names. The general deterioration of Italian credit risk due to the huge government debt, its downgrading, and the recent EFIM defaults have now made it even more difficult for Italian borrowers to tap the Euromarkets. It is hoped, therefore, that the securitisation process will make it possible to access new categories of investors and markets. Moreover, now that cheap sources of funding are

less freely available, it is possible that despite the high start-up costs associated with a securitisation programme, it may be cheaper for an Italian corporate to securitise its assets than to raise funds directly.

Although a wide category of assets may be considered for securitisation, in practice the most suitable are residential mortgages, car loans, lease rentals, trade receivables, credit card receivables and consumer loans. Typically, however, the first three categories are the most likely candidates for securitisation in Italy.

The residential mortgage market

There are three main categories of financial institutions offering residential mortgage finance in Italy:

- mortgage institutions and specially-designated subsidiaries of banks;
- commercial banks;
- other non-bank finance houses.

The mortgage institutions are virtually all bank-owned and together with the specialist subsidiaries of banks dominate the Italian mortgage market. Indeed, the top three institutions, which are empowered to operate nationwide, have a market share of over 50%. This first category is composed of a total of 21 institutions and, other than the three mentioned previously, six are regional public institutions and the rest are specialist subsidiaries of either public law credit institutions or savings banks. Their activities were until recently subject to certain lending restrictions contained within a specific law (DPR 7 dated 21 January 1976) stipulating, for example, the tenure of the mortgages (10 years minimum) and the loan-to-value (LTV) ratio (50% maximum). This law has recently been reformed (Law 175 dated 6 June 1991) and the mortgage institutions can now operate within a more liberal regime. In addition, the new law has opened the market to other financial institutions which were previously barred from operating. The third category of established lenders — other non-bank finance houses — are either subsidiaries of foreign banks (eg, Citifin and Abbey National) or privately owned.

At present only the first two groups report to the Bank of Italy (however, certain regulations have been recently introduced which result in the finance houses also being subject to some central bank regulation) and only statistics relating to the first group are published. These statistics reveal that at the end of 1991 mortgage loans

outstanding on the balance sheets of mortgage institutions and specialist subsidiaries of banks totalled approximately ItL95,260bn, an increase of 18% over the previous year. Turnover in the residential real estate market in Italy is judged to be in excess of ItL60,000bn per annum, a relatively large percentage of which is financed through the mortgage market. At the end of 1991, a survey of the EC Mortgage Federation placed the Italian mortgage market as the fifth largest in Europe (after Germany, the UK, France and Denmark), with a volume of Ecu64bn (ItL96,000bn).

Even before the legal reforms affecting the mortgage institutions, the commercial banks and finance houses were able to exceed both the 50% LTV ratio and the 10-year tenure limits, offering up to 70–75% and maturities ranging from five to 25 years respectively. However, this was, and still is, very much the exception to normal practice with, for example, very few mortgages being granted in excess of 15 years and the most common maturity still 10 years. The low LTV ratio of the mortgages has meant that the proportion of arrears and losses has been extremely low and well below the international average.

Although many new loans are being granted in Ecu, mortgages are mainly Italian lire-denominated and may be either fixed or floating rate, the latter currently being more likely. The floating-rate lire mortgages are mainly either linked to the Italian Prime Rate (used primarily by the commercial banks) or to 'Rolint' (an average of the domestic interbank rate and the medium-term Treasury yield, used primarily by the mortgage institutions). The most common type is the repayment mortgage, although endowment mortgages are also becoming popular. Prepayment rates are extremely low (approximately 3.5% per annum) due mainly to the breakage costs involved and to the payment of a mortgage tax (*imposta sostitutiva*) every time a loan in excess of 18 months is granted by an Italian lender to an Italian resident. As a result, it is common practice upon sale of a property to transfer the mortgage loan to the buyer who then takes on the debt repayment obligations (*accollo di debito*), the sale price being the value of the property less the outstanding mortgage loan.

The characteristics of the Italian mortgage market suggest that once all the legal obstacles detailed below are overcome, a fully pledged mortgage-backed security market is likely to develop rapidly. In fact, the Italian mortgage market is particularly suitable for securitisation, owing chiefly to the traditionally low LTV ratios. The creditworthiness of the loans is typically much better than, for example, UK mortgage loans where LTV ratios of 90% and 95% are not unusual. This in turn means that the level of credit enhancement required to achieve top ratings on mortgage-backed securities will be generally much lower and, accordingly, less expensive than for UK deals.

The car finance market

More than two million new vehicles are sold in Italy every year (2.4m in 1989) for an aggregate value of around ItL60,000bn. Approximately 60% of new car sales and 20% of used car sales are financed through loans. A further 9% of all cars sold are subsequently leased.

The most active participants in the car loan market are:

- Banks (with a market share of around 50%), the most active being Monte dei Paschi di Siena, Banca Commerciale Italiana and Banca Nazionale del Lavoro.
- Industrial captive finance companies (approx. 28% market share), such as Fiatsava (owned by Fiat), PSA Fin (owned by Peugeot), Finrenault, Ford Credit, GMAC and Merfina (owned by Mercedes).
- Finance subsidiaries of both foreign and domestic banks (approx. 16% market share), some of the most important being Citifin, Chasefin and Compass (owned by Mediobanca).

Auto loans typically have an average term of approximately three years, with monthly repayments. It is not standard practice to take a lien on the vehicle as security, due to the problems involved (the process is both time-consuming and costly) and a reasonably low probability of default, especially in northern Italy.

The most active participants in the car lease market are:

- Leasing companies which are subsidiaries of banks;
- The captive leasing companies which form part of industrial groups;
- Privately-owned leasing companies.

Approximately 1,000 leasing companies are currently operating in Italy, 240 of which operate in the car leasing market. In 1989, approximately 205,000 vehicles with a total value of ItL5,200bn were leased out, a 13% increase on the previous year.

Until recently, the leasing sector in Italy was largely unregulated although approximately 60 of the largest leasing companies belong to, and supply statistical data and information to, Assile, a national association for the industry. A new bill (Law no 197 dated 5 July 1991) sets

the first form of supervision in the leasing sector as a whole, establishing minimum capital requirements along with a national register and reporting system.

Car lease contracts typically have a tenure of between two and five years and can be either fixed or floating rate and denominated in Italian lire (linked to the Italian Prime Rate and the domestic interbank rate) or indexed to Ecu interest and exchange rates. The gross margin (leasing rate less cost of funds) earned by the leasing companies typically varies between 8% and 10%.

As described above, the reduced availability of cheap funding sources makes securitisation an attractive option for Italian corporates. Although a specific legal framework for securitisation does not yet exist in Italy, regulators, such as the central bank, are keen to promote the development of a market in securitised debt. In this regard, the Bank of Italy has, in particular, shown a willingness to consider proposed structures and to give its views on the capital adequacy treatment of assets sold through a securitisation programme.

Legal and fiscal issues

There are many legal and fiscal factors to consider when structuring a securitisation transaction in Italy. Some of the more important of these are described below.

Legal considerations

One of the first problems to be resolved is the method of transfer of the portfolio from the originator to the acquiring vehicle. The three options are (i) novation; (ii) subparticipation; or (iii) assignment.

Novation

Italian law uses the term novation not, as defined under English law, for the 'transfer' of obligations from one party to another, but for when the original parties agree to cancel existing obligations, substituting them with obligations that have a different object or a different legal title.

The main drawbacks to using novation (according to the English definition) in a securitisation transaction are:

- The agreement of each debtor within the portfolio has to be obtained for the novation to be effective.
- If the special purpose vehicle used within the process is domiciled in Italy, a tax would be levied (currently

at a flat rate of 0.25%) on any loan transferred that had a remaining maturity in excess of 18 months.

- Any security that had been taken originally would lapse and would have to be perfected afresh (this alone would render the transaction entirely uneconomical).

Subparticipation

The very nature of subparticipation means that it transfers the risk to the subparticipant, but does not transfer the asset itself.

The main problems arising as a result are:

- The originator remains the lender of record and, apart from a few exceptions, must keep the asset portfolio on its balance sheet.
- The investor is exposed not only to risks regarding the portfolio but also to the risk of insolvency of the originator. In order to obtain a suitable credit rating and depending on the status of the originator it may be necessary to obtain a performance guarantee to eliminate this risk.
- The original debtor is legally entitled to offset his debt with unpaid claims he may have against the originator instead of paying the 'beneficiary' of the portfolio.

Assignment

Assignment in this context must be read to mean assignment of credit/rights (*cessione di credito*) as opposed to assignment of contract (*cessione di contratto*), as the latter can only be used when reciprocal outstanding obligations exist between the parties at the moment of assignment and therefore could not be used to transfer any form of loan (once it has been drawn), such as a car or mortgage loan. In addition, the second kind of assignment would also have certain fiscal implications.

The main problem with using assignment in Italy is that the debtor must be notified in order to render it legally binding on him and third parties. The traditional methods of notification are administratively very complex; however, non-notification would leave the special purpose vehicle exposed to the risk of the originator's insolvency.

The assignment of mortgages is one of the subjects addressed within the new Law 175 dated 6 June 1991 which, as discussed above, generally aims to strengthen the domestic mortgage institutions' competitive position. This aim was clearly stated in the preparatory works to the Law and in its official presentation to Parliament.

Article 21 of the Law appears, however, to require five days' notice to debtors before mortgages can be assigned. This interpretation would effectively block mortgage securitisation at the outset. Although the complexities of the issue make it unsuitable for lengthy discussion here, it is possible to outline a plausible alternative reading which leaves the securitisation option open.

Prior to the introduction of Law 175, the assignment of mortgages was regulated by Article 56 of the banking law (also referred to within Article 20 of DPR 7/76). This Article only covered mortgage loans originated by mortgage institutions and required that debtors be notified prior to assignment. Since other types of assignment were not specifically regulated, the Civil Code applied elsewhere, leading to an 'uneven playing field' for the various types of institution. Under the Italian Civil Code an assignment is valid when the assignor and assignee agree terms, at which point the legal title to the loan may be transferred regardless of whether the debtor is aware of the change to a new creditor. Of course, in the case of 'silent' assignment — comparable to non-notified equitable assignment under English law — the enforceability on the debtor is limited (for example, if the debtor pays the assignor in good faith he is not required to make a second payment), but this does not affect the transfer of the title. The clear distinction between the validity of a contract and the enforceability of its effects should be appreciated when structuring a securitised transaction.

If Article 21 did introduce a compulsory notification to the debtor, this would be contrary to the spirit of Law 175, with its general aims of liberalising mortgage lending and improving the competitive position of the mortgage institutions. The restrictive interpretation of Article 21 would of course continue to discriminate against the specialist institutions as far as rules on loan assignment are concerned. Furthermore, the lengthy introductory notes to the Law contain no express intention to create such an exception to the Civil Code. These reasons — together with several technical arguments — support a different interpretation of Article 21 such that a mortgage institution may in fact assign a mortgage credit to a non-mortgage institution without informing the debtor. The Italian bankers' association, ABI, has recently lent its official support to this reading in its Circular letter dated 10 July 1992. Having formerly noted in its Circular letter 'Serie Tecnica no 99' dated 11 June 1991 (five days after the passage of Law 175) that Article 21 was not consistent with the existing legal framework, the ABI now agrees with the more relaxed interpretation. The reasoning offered by the association is based in part on the above comments.

As far as the assignment of any credit is concerned, the provisions of another recent law, number 52 dated 21

February 1991, are relevant. This law imposes significant changes on the ordinary discipline of assignment as stipulated within the Civil Code, but is applicable only if the following conditions are met:

- the assignor is a business concern (private individuals, for example, are excluded);
- the credit to be assigned arises from the business activity of the assignor;
- the assignee is a '*persona giuridica*' or juridical person (any entity that is not a physical person but is capable of holding rights and obligations) with at least ItL2bn share capital and a statutory objective to purchase such credits.

The major advantage of Law 52 is that it clearly eliminates any notification requirement for the perfection of a valid assignment enforceable against third parties. It, therefore, provides an ideal mechanism for transferring credits. Such a transfer will be bankruptcy-proof (Articles 5, 6 and 7) and the assigned assets removed from the assignor's balance sheet. This treatment also applies to future credits created within two years of the assignment date.

In theory, therefore, Law 52 provides the best legal framework for the securitisation of receivables (except mortgage loans), offering a simple means of transferring assets without large expense. However, on closer examination, the law confers disadvantages which seriously jeopardise its usefulness for securitisation:

- the size of the minimum capital requirement could cause an unacceptable immobilisation of resources, particularly for small and medium-sized transactions. For larger deals, instead of the originator paying expenses directly, it may be cost-effective to capitalise the special purpose vehicle and to use its capital — subject to Civil Code constraints regarding the statutory minimum — to meet transaction costs.
- onerous bureaucratic and administrative controls imposed on the special purpose vehicle (including registration on a specific register, supervision by the Bank of Italy, a mandatory certified balance sheet, regular reporting requirements and cumbersome specified capital ratios), suggest the need to establish an 'operating' SPV.

The advantages of Law 52 from a legal perspective are at least partially offset by these complexities. The trade-off must be carefully evaluated when structuring a securitised deal, and it should be remembered that Law 52 was created to cover ordinary factoring activity and not principally for the securitisation of assets transferred by assignment.

Fiscal considerations

The fiscal aspects of any Italian securitisation structure are a major consideration and carry implications for:

- the perfection of the transfer of the receivables (eg, there may be liability to registration tax on transfer of security, loan tax etc);
- the subsequent payment of portfolio receivables to the special purpose vehicle (withholding tax on the interest element of the receivable payments);
- the servicing payments made by the special purpose vehicle itself on its funding obligations (withholding tax on bond or loan interest).

The following tables show examples of taxation currently levied at specific stages of a securitisation structure for mortgage or car loans:

Table 1: Taxation relating to the portfolio payments to the SPV

Form of transfer	Beneficiary	Withholding tax ¹
Assignment	Offshore SPV	Yes
	Domestic SPV	No
Subparticipation	Offshore SPV	Yes
	Domestic SPV	No

1. As may be reduced by any double taxation agreements from time to time.

Table 2: Taxation on servicing payments by the SPV

Issuer	Type of funding	Withholding tax rate
Offshore SPV	Eurobond	30% ¹
Domestic SPV	Domestic bond	30% ²
Republic of Italy	Domestic Treasuries	12.5% ³

1. The tax rate relates to an Italian resident investor (the non-resident investor is subject to zero withholding tax and, subsequently, to his own domestic fiscal regime) and would be deducted by the Italian intermediary acting as depositary on behalf of the investor upon repatriation of the foreign income (Article 26 of the DPR 601, dated 29 September 1973). If the investor is a private individual, no further taxation is levied. In all other cases the income obtained would be taxed at the investor's applicable income tax rate and a tax credit would be given for any taxation deducted at source.

2. The same rules relating to Eurobonds also apply generally to domestic securities with the exception of certain securities which, due to their nature, are classified as *titoli atipici*, or atypical securities. In these cases, all classes of investor are treated equally and, therefore, once the withholding tax of 30% is deducted, no further tax payment of the income from these securities is due (Law 649, dated 23 November 1983). If pass-through asset-backed securities were to fall into this category, institutional investors with taxation rates in excess of 30% might have an interest in investing in such securities as a valid alternative to Treasuries.

3. These forms of investment will continue to be preferred by private individuals, who benefit from the reduced and, more importantly, definitive tax rate payable on income from domestic Treasuries, compared with alternative forms of investment.

Public Italian securitisations launched to date

The first attempt at securitisation in Italy was Chariots No.1 Ltd, signed in February 1990. The assets securitised were a portfolio of car loans originated by Citicorp Finanziaria SpA (Citifin). The legal structure used was a form of limited recourse financing with the underlying assets remaining on the originator's books and therefore on its balance sheet. In practice, Banca Commerciale Italiana (BCI) purchased a subparticipation in the car loans granted by Citifin, which were designated as part of the programme. BCI obtained funding by, in turn, granting a subparticipation to the offshore special purpose vehicle 'Chariots', the reimbursement of which was subject to BCI obtaining from Citifin debtors a corresponding amount, hence the 'limited recourse' nature. Chariots funded itself by means of a syndicated loan. The performance obligations of Citifin were backed by a performance guarantee of Citibank NA. On launch, the transaction was rated A1 but, in line with the downgrading of Citibank, was subsequently downgraded to A2.

The feasibility of this structure depends principally on the nature of the parties involved. Certain points, however, should be kept under consideration:

- the requirement on Citibank NA to issue a performance guarantee that technically could be equal to the amount securitised (and the resulting costs in terms of capital this contingent liability may incur);
- although no balance sheet advantages were achieved by Citifin, Citibank as a group benefited from the Chariots transaction, because of the generally accepted accounting principles in the US for the consolidation of balance sheets;
- no form of security was created, because the securitisation was funded by means of a syndicated loan.

The second transaction was brought to the market by BCI. The main objectives behind the legal structure it adopted for this securitisation were:

- the creation of a type of security which entitled the registered holder to receive the cash flow relating to the repayment of principal and interest due on the investment (ie, a 'pass-through' structure);

- the complete removal of the assets from the originator's balance sheet.

Both these objectives were achieved. The transaction took the form of an assignment of car lease receivables originated by Finleasing Italia SpA to a special purpose vehicle, 'Auriga'. In accordance with Italian law, the car lessees were notified that Finleasing had transferred their debts, but would continue to act as servicer. Auriga funded its purchase through a loan made by BCI, which in turn funded the loan through the issuance of transfer certificates to investors.

The deal achieved a Aaa rating from Moody's on the basis of various layers of credit risk protection:

- the excess cash flow on the receivables in any particular quarter forms the first layer of protection from subsequent shortfalls and credit losses;
- if the relevant quarter's excess cash flow has been exhausted, a 'cushion account' of a deposit of ItL5bn (or around 3.5% of the original issue), will be drawn upon next;
- a 10% letter of credit provided by Bayerische Vereinsbank, Milan (rated Aaa by Moody's) is to be drawn upon to cover shortfalls after the cushion account has been exhausted;
- BCI is the servicer of last resort;
- Auriga is a single-purpose company. It cannot have any debt besides the original loan, and no creditors besides those involved in that loan, and is accordingly considered to be bankruptcy-remote.

The Auriga transaction represented one of the first securitisations in Europe of a portfolio of car lease receivables.

The third securitisation was launched by Paribas in March 1992. In this issue, an offshore special purpose vehicle, Osiris (no. 1) Ltd Cayman Island, issued FF584.1m floating rate notes, the proceeds of which were swapped with Paribas into lire and deposited with a conduit bank. In turn the conduit bank on-lent the funds to 'Dover Srl' — a domestic special purpose vehicle — which used the proceeds to purchase about FF767m worth of lease receivables (originated by various companies of the Sipi Spa group) which were

used to collateralise the bond payments. This transaction was the first Italian securitisation with a proper Eurobond issue and also the first with multiple originators.

The fourth securitisation was arranged by Manufacturers Hannover Trust — now Chemical Investment Bank — and closed in June 1992. The special purpose vehicle, 'Car P Ifim Srl', bought ItL150bn of vehicle lease receivables originated by Ifim Leasing International SpA. The funds for this purchase were raised on the Euromarket *via* conduit structure. This transaction was the first in which the transfer of receivables by way of assignment was executed in accordance with the new Law 52 (see above). It was also innovative in being the first to incorporate the replenishment of receivables, over-collateralisation, and the release of surplus collateral back to the originator prior to the final maturity of the transaction.

The details of the public securitisations launched to date are summarised below.

Securitisation by subparticipation of car loans originated by Citicorp Finanziaria SpA

February 1990

SPV:	Chariots No. 1 Limited, Cayman Islands
Amount	ItL210bn
Funding type:	Euroloan
Tranche A:	ItL100bn
Term:	364 days
Spread:	17.5bp over 3-month Eurolira Libor
Tranche B:	ItL110bn
Term:	Four years
Spread:	25bp for the first three years three months and 50bp thereafter
Structure:	The loan obtained by Chariots was used to fund a limited recourse loan to the London branch of BCI taliana who used the same to fund a limited recourse loan to Citifin.
Swap counterparty:	Bayerische Vereinsbank AG
Credit enhancement:	— reserve account — 12% letter of credit issued by Bayerische Vereinsbank AG — performance guarantee (of Citifin's obligations) of Citibank NA
Rating:	A2 by Moody's (originally A1)

Securitisation by assignment of car lease receivables originated by Finleasing SpA

March 1991

SPV:	Auriga Srl, Conegliano, Italy
Amount:	ItL140bn
Funding type:	Transfer Certificates
Term:	Four years
Spread:	40bp
Structure:	BCI (London branch) granted a loan to Auriga and received deposits evidenced by transferable certificates from a pool of international banks.
Swap counterparty:	BCI (London branch)
Credit enhancement:	— pledged deposit account — 10% letter of credit issued by Bayerische Vereinsbank AG
Rating:	Aaa by Moody's

Securitisation by assignment of car lease receivables originated by various companies of the SIPI SpA group

March 1992

SPVs:	Osiris (no.1) Ltd, Cayman Island Dover Srl, Italy
Amount:	FFr584.1m
Funding type:	Floating rate notes
Term:	Five years two months from initial drawdown
Spread:	25bp per annum over three month Pibor
Structure:	Osiris issued a FFr FRN, the proceeds of which were deposited with Istituto Bancario San Paolo di Torino (London branch). These funds were then lent to Dover for the purpose of purchasing about FFr767m worth of receivables used to collateralise the bond payments
Swap counterparty:	Paribas
Credit enhancement:	Approximately 31% over-collateralisation
Ratings:	Aaa by Moody's

Securitisation by assignment of vehicle lease receivables originated by Ifim Leasing International SpA

June 1992

SPV:	Car P Ifim Srl, Italy
Amount:	ItL150bn
Funding type:	Euroloan
Term:	Three years six months from initial drawdown
Availability:	Three tranches of ItL50bn within nine months of signing
Replenishment:	for the first two years
Spread:	57.5bp per annum over one month Euroaira Libor
Structure:	Credito Italiano (London branch) granted a loan to the special purpose vehicle and funded this by deposits taken from a pool of international banks
Interest rate cap provider:	Credito Italiano (back up: Societe Generale)
Credit enhancement:	22% over-collateralisation; 3% cash deposit
Rating:	Aa1 by Moody's

Conclusion

We have so far examined the motives for potential issuers, the various primary lending markets, legal and fiscal problems and the first securitised transactions. Finally, we turn to the potential investors.

The natural investor base for Italian lire securities is obviously in Italy, but any issue has to compete not only with the enormity of the Italian Treasury market (Italy has one of the largest public sector deficits in the world) but also with the preferential fiscal treatment afforded to Treasury bonds. Investment by an Italian resident in a Eurobond will generally be subject to a rate of taxation of 30% on income receivable, while investment in Treasuries currently results in deduction at a rate of only 12.5%.

It is obvious that any security which is neither state-issued nor exempt from withholding tax — such as paper issued by supranationals before 9 September 1992 (when the exemption was cancelled) — is not particularly easy to place. Notwithstanding this, it may still be possible to develop a domestic investor base — at least

theoretically — for a certain type of security known as *titoli atipici* (atypical bonds), because of the fiscal treatment afforded to them. Although no precedents as yet exist in Italy, the particular nature of a 'pass-through' security would probably put it in this category. As an exception to the general rule, the withholding tax deduction on these securities (currently 30%) is classified as definitive not only for private individuals but also for corporations and the interest earned on such investments would therefore be exempt from inclusion in the latter's overall taxable income even if their applicable tax rate were to be in excess of 30% (re Law no 649 dated 23 November 1983). It is clear that institutional investors with a corporate tax rate in excess of 30% may have an interest in investing in such securities as a valid alternative to Treasuries. However, the simplest solution may lie in using an offshore vehicle, as used in most securitisation structures elsewhere and issuing a Eurobond, thereby tapping the international investor base, which may prove more reliable.

The ability to securitise transactions *via* the issue of domestic securities with a favourable fiscal treatment would have an important secondary effect on the development of the mortgage market. Funds would be attracted to finance home ownership, which is in keeping with the directives of Article 47, Paragraph (iii), of the Italian Constitution, which specifically states that the Republic should encourage investment of private savings in home ownership.

As far as the banks are concerned, the risk asset weighting attributable to investments in securitised assets, which has yet to be determined by the Bank of Italy, will be an important factor in deciding whether or not to participate in such transactions.

In conclusion, while certain questions remain to be answered before the outlook can be clearly ascertained, it is fair to say that all the basic prerequisites for the development of a securitisation market are present in Italy.

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Securitisation to date

	MORTGAGE-BACKED MARKET	ASSET-BACKED MARKET
SIZE	<p>There have been no off-balance sheet mortgage-backed securities issued to date.</p> <p>The following data relates to the total volume of bonds issued by mortgage institutions at year-ends and can give a rough estimate of the potential growth for MBS:</p> <p>1989: ItL63,798bn 1990: ItL68,552bn 1991: ItL77,696bn</p> <p>(compiled by members of the EC Mortgage Federation).</p>	<p>There have been four public deals to date:</p> <p>(i) Charlots No 1 Ltd (February 1990) — the securitisation of a portfolio of auto loans originated by Citicorp Finanziaria SpA (Citifin);</p> <p>(ii) Auriga Srl (March 1991) — the securitisation of car lease receivables originated by Finleasing SpA;</p> <p>(iii) Osiris (No 1) Ltd (March 1992) — the securitisation of lease receivables originated by various companies of the Sipi SpA group;</p> <p>(iv) CAR P. IFIM Srl (June 1992) — the securitisation of vehicle lease receivables originated by Ifim Leasing International SpA.</p> <p>There has also been at least one private issue, a deal brought by Swiss Bank Corporation based on a portfolio of receivables originated by Parmalat SpA, a Northern Italian dairy company.</p>
MAIN FEATURES	No market in MBS.	<p>The public deals to date are detailed in the Report.</p> <p>Few details were disclosed concerning the private deal brought by Swiss Bank Corporation, but it is thought that the receivables were sold to an offshore SPV which subsequently achieved funding through the Euromarkets.</p>
INVESTOR BASE	<p>Traditional bonds issued by mortgage institutions are bought by domestic institutional investors and by domestic private individuals. The MBS should suit domestic and international institutional investors. Italian private individuals are not likely to represent a significant investor base for fiscal reasons (see Report).</p>	<p>So far, banks and institutional investors (both mainly foreigners) have represented the investor base.</p>
OUTLOOK	<p>Traditionally high creditworthiness of Italian mortgage loans (owing to low loan-to-value ratios) suggest that the market is particularly suitable for securitisation. Once the remaining legal obstacles (detailed in the Report) are overcome, a fully-fledged mortgage-backed securities market is expected to develop.</p>	<p>As outlined in the Report, capital pressures and the reduced availability of cheap funding sources makes securitisation an attractive option for Italian banks and corporates. However, the market appears to require a major transaction from a prominent issuer to provide impetus and to improve its somewhat negative image (since high costs are involved at least for initial securitisation deals, it is thought that a company will only resort to the technology if it cannot obtain sufficient conventional funding).</p>

Background to securitisation

	SUPERVISORY BODIES	SECURITISATION FRAMEWORK
REGULATORY	Bank of Italy (for mortgage and banks). There is currently no specific regulatory framework for securitisation in Italy.	The Bank of Italy has not yet made any official public announcement on the treatment of asset transfers, and it appears that individual institutions have been liaising with the authorities on a case-by-case basis.

	SECURITISATION FRAMEWORK — ISSUANCE	SECURITISATION FRAMEWORK — INVESTMENT
LEGAL	The major legal problems lie in drawbacks to each of the possible methods of asset transfer (detailed in the Report) although recent laws (numbers 52, dated 21 February 1991, on factoring; 175, dated 6 June 1991 on mortgage loans; and 142, dated 19 February 1992, on consumer loans) have addressed the issue of assignment. The elimination — from the legal point of view — of the insolvency risk of the originator also presents problems. Fiscal impediments are outlined below.	No specific framework for asset-backed securities. Some general restrictions on foreign bonds are provided for mutual funds (<i>fonds commun</i>).

	ACCOUNTING BODIES	SECURITISATION FRAMEWORK
ACCOUNTING	Law no 87, dated 27 January 1992, the EEC directive 86/635 has been implemented. Therefore, as from 1 January 1993, the new accounting body for Italian banks is the Bank of Italy which has issued standard official accounting rules.	There is no such thing as a set of generally accepted accounting principles or statements of standard accounting practice relating to securitised assets in Italy. The accepted practice tends to become the rule.

	NOTES	CURRENT ISSUES
OTHERS (eg tax)	The major problems for securitisation are of a fiscal nature: including withholding tax (investment by an Italian resident in Eurobonds will generally incur a 30% withholding tax, compared with a 12.5% tax on Italian Treasuries), VAT (applicable to the servicing fee).	The government has recently implemented the EEC directive 89/646 on market access of credit. The Bank of Italy is due to issue the relevant administrative regulations, which may have some positive effects on securitisation.

BIS INTERPRETATION	CURRENT ISSUES
<p>Loans guaranteed by residential mortgages are currently weighted 50% for risk capital purposes, in keeping with the international standard. The Bank of Italy has not issued any particular provision for mortgage-backed securities, which have to be regarded as carrying a risk weight of 100%. In addition, the Bank of Italy imposes restrictions on the capacity of commercial banks to make unmatched loans for terms in excess of 18 months. While banks can individually negotiate ceilings, the restrictions give an incentive to securitise.</p>	<p>Although there is no indication of an imminent formal framework for securitisation, the regulators appear keen to promote the concept. In particular, the Bank of Italy has shown a willingness to consider proposed structures and advise on the capital adequacy treatment of assets sold through a securitisation programme.</p>

CURRENT ISSUES
<p>The assignment of mortgage loans is one of the subjects addressed within the recent Law no 175, dated 6 June 1991. However, Article 21 of the Law appears to require five days' notice to debtors before mortgages can be assigned. Certain factors would support a more relaxed interpretation, and the Italian bankers' association has recently declared its support for the view that such notice is not in fact required (Circular letter CFE 005764 dated 10 July 1992).</p>

Primary asset markets

	MORTGAGE LOANS	AUTO LOANS
SIZE	ItL92,000bn (estimated end Q1 1991). This data only covers loans made by specialist mortgage institutions.	Although a precise estimate does not exist, it can be considered that the annual volume of new auto loans approximates ItL35,000bn.
ORIGINATORS	21 mortgage institutions or <i>istituti di credito fondiario</i> (90% owned by banks) and specially-designated subsidiaries of banks; Commercial banks; <i>Finanziarie</i> , which are typically either privately owned or owned by foreign banks.	Banks (50% market share) (Monte dei Paschi, Banca Commerciale Italiana and Banca Nazionale del Lavoro are most active); auto-manufacturers' captive finance subsidiaries (28%) including Fiatsava (owned by Fiat), PSA Fin (owned by Peugeot), Finrenault, Ford Credit, GMAC and Merfina (owned by Mercedes); finance subsidiaries of domestic and overseas banks (16%), eg Citifin, Chasefin and Compass (the latter is owned by Mediobanca).
FUNDING SOURCES	Domestic bond issues, certificates of deposit, Eurobonds and Euroloans. As of end 1991, there were ItL77,696bn of domestic bonds outstanding. (Source: EC Mortgage Federation) Commercial banks also achieve funding through their retail deposit base.	Retail deposits for commercial banks' borrowing (from banks or parent companies) for the non-bank lenders. Interest rates on auto loans are generally much higher at captive finance companies and bank financing subsidiaries than at commercial banks, because of the difference in their funding costs (and because regulations prohibit banks from marketing through auto dealerships).
SUITABILITY FOR SECURITISATION		
Margin	Healthy, the margin earned above cost of funds averages around 3%, and commercial banks can achieve a higher margin owing to their retail deposit base.	Healthy and generally higher than mortgage loans.
Structure	Most common maturity is 10 years. Traditionally low loan-to-value ratios and accordingly high creditworthiness of Italian mortgage loans make the market particularly suitable for securitisation. A wide variety of mortgage types, including Ecu-denominated loans have recently been introduced. Fees are generally incurred when loans are pre-paid.	Maturity's range is 2-4 years. Generally standard medium-term monthly repayment loans, carrying high prepayment penalties. Most Italian auto lenders do not take liens against autos, since this is both expensive and time-consuming and the risk of default is low, especially in Northern Italy.
INCENTIVES FOR SECURITISATION		
Funding needs	Reduced access to alternative funding sources, owing to over-supply and fears over Italian credit risk in international markets and preferential fiscal treatment for Italian state debt within the domestic market, make securitisation an attractive option for banks and corporates.	
Capital pressures	There is a wide range of positions within the banking sector regarding the BIS requirements. Furthermore, domestic constraints on medium-term lending by institutions described within their articles of association as short-term lending institutions (which covers most large banks) mean that banks have an additional incentive to create space on their balance sheets to generate more medium to long-term assets.	As for mortgages.

CREDIT CARD RECEIVABLES	LEASING RECEIVABLES
ItL11,000bn as of 1989, with only 10% of families owning a card.	Not available
The main cards are Cartasi (issued by Servizi Interbancari SpA, owned by a consortium of banks), Diners, American Express, Bankamericard (issued by Banca d'America e di Italia, owned by Deutsche Bank).	Bank leasing companies; captive leasing companies; privately-owned leasing companies. A total of 1,000 companies operate in the leasing market, as until recently a lack of formalities encouraged new entrants.
Bank borrowings are the main, if not the only, funding sources.	Mainly bank borrowings and/or parent borrowings. Also Euroloans and securities.
Healthy.	Typically 8-10% (lease rate less cost of funds).
Part of the monthly balances are paid without delay, part in instalments.	Traditional lease terms.
The use of credit cards is still very low in Italy compared to other Western countries. As a consequence credit card companies are not under pressure to look for securities.	As for mortgages.
There is no particular pressure.	For bank-controlled leasing companies, as for mortgages.