GLOBAL FINANCIAL MARKETS INSIGHT

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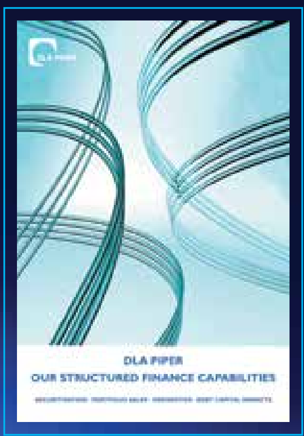
For more information on our structured finance practice see our brochure or click on the link below.



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'Global financial Markets Insight' is DLA Piper's Financial Markets newsletter designed to keep you informed of products, techniques and developments in the financial market. Find all current and past editions here:

For changes in regulatory aspects of financial markets, see also our regulatory publication.

Welcome

With recovery in financial markets starting to take hold it is an exciting time to launch our Global Financial Markets Insight. The purpose of our new quarterly is to help guide new and experienced users of finance through the vast array of financial products and financing techniques that are now available in the market place.

Whilst traditional bank lending remains an essential source of core funding, many finance directors and treasurers are now contemplating the significant range of alternative financing products that are available to supplement, enhance or replace traditional financing services.

The financial crisis and post crisis regulatory reforms have left most banks more capital constrained and with less appetite for higher risk or more complex products because of higher regulatory capital requirements. In a number of instances this has limited the efficiency of markets to move capital flows between those in need of capital and those best placed to provide and manage capital markets risk. As the global economic recovery takes hold this inevitably opens the door to a wide range of alternative products and non-bank funding sources that are in a better position to provide much needed capital resources. Areas that are critical to the wider economy such as commercial and residential property finance and business investment and development funding will need significant capital availability over the next few years and are increasingly likely to turn to alternative funding services. Already we have noted a significant increase in funding from alternative credit providers such as insurance companies and credit funds. The return of CLOs to the financial markets in 2013/2014 will further provide additional liquidity and open access to alternative funds products.

Our aim is to help guide corporates, funders and banks through some of the practical issues they face. In the more heavily regulated and complex financial world in which we operate our hope is that a guide based on a practical and deep understanding of financial products across the 78 offices from which we operate will help users in the further development of more liquid, safer and efficient global financial markets.

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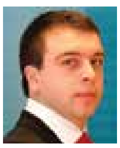

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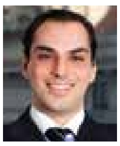

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IMPLEMENTING THE NEW EMIR REGIME FOR DERIVATIVE TRADING

"EMIR" refers to the European Market Infrastructure Regulation, which came into force in August 2012. Banks and derivatives traders have been busy throughout the summer in preparation for the new regime. EMIR creates new obligations for certain traders of over-the-counter derivatives to clear derivative trades through a central counterparty clearing house, and to report trades to a registered trade repository. The extent of these obligations depend on the nature of the trading institution and the value of its over-the-counter derivatives portfolio. For some this may involve a major shift in the cost and risk assessment of dealing in derivatives. Many corporates that don't have the large in house legal teams to deal with the changes are struggling to follow the implementation protocols and how exactly they will be effected by these changes.

Certain initial measures under EMIR became effective in March this year. On the 15th of September, further measures became effective, including the following new requirements that trading counterparties:

- reconcile their derivatives trades on a periodic basis, provided there is a sufficiently large portfolio of trades between them;
- reduce the number of trades between them by portfolio compression (but maintaining the same risk position);
- agree procedures for dispute resolution, including procedures for identifying, recording and monitoring disputes and posting collateral in connection with the dispute.

These measures are effectively steps intended to facilitate the eventual move to central clearing and the reporting of trades. In each case, the extent of the obligations will depend on the classification of the trading institutions.

In order to assist with the implementation of these latest measures, the International Swaps and Derivatives Association ("ISDA") published the 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol (the "July 2013 Protocol"). ISDA protocols like the July 2013 Protocol enable dealers of derivatives to incorporate detailed, standardised provisions into their derivatives documentation (i.e. the "ISDA Master Agreement") without expending the time and cost that would otherwise be involved in negotiating such provisions. Dealers may simply adhere to protocols by notifying ISDA of their adherence, and a list of adhering parties is publically available on the ISDA website.

By adhering to the July 2013 Protocol, parties agree to standardised procedures for the reconciliation of trades, as required under EMIR. Under the protocol it is possible to adhere as a "Portfolio Data Receiving Entity" or a "Portfolio Data Sending Entity" (this can also be ascertained from the ISDA website). It is the obligation of the former to perform the reconciliation on behalf of both counterparties, although if both counterparties have adhered as "Portfolio Data Sending Entities", they may both be required to send data to the other and perform a reconciliation, in which case the counterparties may choose to amend their derivatives documents in order to agree a more efficient process.

The July 2013 Protocol also includes a confidentiality waiver, which enables parties to comply with EMIR reporting requirements without breaching existing confidentiality provisions, and an EMIR-compliant, mutual dispute resolution procedure. EMIR itself contains provisions that ostensibly override contractually agreed confidentiality agreements but the effectiveness of such provisions in cross border transactions may still leave some scope for dispute.

The next steps for the implementation of EMIR include the commencement of reporting to recognised trade repositories, and the commencement of central clearing requirements, which are expected to begin (according to official estimates) early next year and late next year respectively. The timetable continues to be flexible, particularly as these next steps are contingent on the registration of trade repositories and the authorisation of the central counterparty clearing houses, both of which are still on-going.

For more information refer to our EMIR booklet published by the Finance & Regulatory group.

EMIR applies on a market wide basis but the context of the obligations it imposes will depend on the classification of the trading entity. Adopting the correct protocol or bilateral agreement will need to be addressed by each applicable entity.

Christopher Godwin

CAPTIVE INSURANCE

As banks have cut back on lending and sold assets to meet tough rules on capital imposed by regulators, borrowers are turning to non-bank financial intermediaries, the so called "alternative funding" or "shadow banking" sector, for their borrowing needs.

The property market both in respect of commerical and residential housing development is one area that has looked to the alternative finance sector to provide funding to develop sites and to build new homes. The use of a captive insurer ("**Captive Insurer**") is one approach considered in funding structures for development finance in the UK. Bonds issued by a special purpose entity to the capital markets are made more appealing to a wider range of investors by incorporating an insurance wrap written by the Captive Insurer within the structure.

The most high profile scheme using a Captive Insurer in relation to housing development is the NewBuy Guarantee scheme. The insurance scheme enables UK lenders to offer mortgages underwritten by house builders and the UK government in an initiative intended to support new-build domestic property development and encourage growth. The structure utilises a Captive Insurer to provide insurance to bank lenders as well as being a conduit for a guarantee from the UK government.

A Captive Insurer is an insurance vehicle that is owned by the policyholder and insures only those risks of the policyholder or its subsidiaries. Captive insurance offers many advantages when compared to obtaining insurance directly from commercial providers without paying for an insurance company's overheads and profit costs. The Captive Insurer will also have direct access to wholesale re-insurance markets (should it wish to re-insure), bespoke risk management and the ability to retain both the underwriting profit and any investment profit.

A number of jurisdictions provide a regulatory regime suited to captive insurers. Some provide additional advantages and we look at Guernsey as an example.

Guernsey, as the jurisdiction of choice for the establishment of Captive Insurers, was the pioneer of the now globally recognised and replicated segregated cell structure companies such as protected cell companies and incorporated cell companies. These structures are particularly well suited to the captive insurance market. Each policy holder can own a cell of the company and the assets and liabilities of each cell are ring-fenced from others. In effect a particular cell can transact with a third party and its liability is limited to the assets attributable to that cell.

In order to carry on insurance business in or from within Guernsey an entity needs to be licensed by the Guernsey Financial Services Commission (the "**GFSC**") under the Insurance Business (Bailiwick of Guernsey) Law 2002 (the "**Law**").

Whilst the minimum capital requirement for general insurers is £100,000, the GFSC can require insurers to have a higher level of capital dependent on the nature of the business. The Captive Insurer must also maintain shareholder funds which are a minimum of 75% of the minimum capital requirement and a margin of solvency and approved assets. The minimum solvency requirement is (for general business) the greater of 18% of the first £5m of net premium income and 16% of the net premium income that exceeds £5m; or 5% of the value of the loss reserves. Again the Law provides that the GFSC may require a higher margin of solvency depending on the insurer's business.

Recently, the GFSC issued a consultation paper which proposed some significant updates to the insurance regulation regime. In brief, the consultation discusses a risk based solvency regime. Insurers would be split into five categories for which the GFSC would have varying tolerance to insolvency and failure. For example the GFSC would have a low risk tolerance for the failure of a commercial life insurer. Conversely given the reduced risk to the public posed by Captive Insurers or re-insurers, a more proportionate approach should be taken.

Time will tell whether or not Captive Insurers will provide the requisite enhancement that will attract investors back to investing in property development but this is one of a number of innovative approaches we have seen in the property development alternative funding and shadow banking space.

Ronan Mellon and Martin Bartlam

A GUIDE TO MANAGING COLLATERAL IN DERIVATIVES TRANSACTIONS

WHY PROVIDE COLLATERAL?

Parties to derivatives transactions will often collateralise their exposures under, and the implied volatility of, the transactions on a net basis. This enables the collateral receiver to reduce its credit risk exposure as it would have recourse to the collateral on a default of the collateral giver; consequently, collateral can help achieve better pricing structures for less creditworthy counterparties. Low volatility assets and instruments (such as cash and G7 government bonds) are typically used as collateral.

For banking and financial counterparties, collateralisation may also have benefits from reduced regulatory capital charges, the potential for positive carry and the ability to carry out more transactions bringing added liquidity to the market.

The collateral would be in respect of both initial margin (which is linked to the counterparty's credit and the implied trade volatility) and variation margin (which is linked to the mark-to-market value of the underlying trades).

The effect of collateral will be to convert credit risk into legal and operational risk which is why it is important to address the effectiveness of the collateral structure which has been adopted.

Overall, well structured collateral will improve recovery rates and reduce expected loss.

OUTRIGHT TRANSFER -VS- SECURITY INTEREST

The ISDA credit support documentation provides for collateral to be granted either by way of an outright legal transfer (under the English law Credit Support Annex) or by way of a security interest only (under the English law Credit Support Deed). The security interest approach is effectively a first priority charge over the collateral; whereas the outright transfer approach enables the collateral receiver to deal freely with the collateral as the owner thereof (subject to a requirement to retransfer equivalent assets on satisfaction of the underlying trade obligations).

TRIPARTY CONTROL AGREEMENT

The English law Credit Support Annex has long been established as the primary model for collateralising transactions in the UK market (and beyond). However, in recent years, there has been a move by market participants to resist providing collateral by way of outright transfer to bank counterparties, particularly with respect to initial margin. The concern is that on a default or insolvency of the bank, the counterparty will not be able to credit or offset the initial margin in any way and therefore it would be treated as an unsecured creditor to the bank in any ensuing insolvency proceedings.

Partly to address this risk, a new structure is starting to be seen in the UK and the US markets whereby any credit support would be split between variation margin (which would be documented under an English law Credit Support Annex as before) and initial margin (which would be documented under a security document, such as the English law Credit Support Deed). To give market participants greater comfort, the initial margin would then be held by a third party, typically being the collateral giver's custodian. This structure would be supported by a triparty control or blocked account agreement (between the collateral giver, the collateral receiver and the third party custodian) which regulates the degree of control which both the collateral giver and the collateral receiver can enjoy over the collateral.

When structuring a segregated collateral arrangement, parties need to be mindful of various legal and commercial issues underpinning these structures, such as:

- ***Fixed or Floating Charge?***

  Consideration should be had as to whether the triparty control agreement could impact on the nature of the security interest being created. A fixed charge creates a first ranking charge in favour of the collateral receiver over the collateral. If the security created is recharacterised as a floating charge, (i) in the event of an insolvency of the collateral giver, the collateral receiver would rank behind preferential creditors and the administrator's and/or liquidator's costs and expenses and (ii) there is the risk of the security being held to be void against third parties for lack of perfection.

- ***Financial Collateral Regulations***

  The Financial Collateral Arrangements (No.2) Regulations 2003 can be of benefit to collateral receivers in terms of (i) removing certain of the perfection requirements and (ii) expediting an enforcement of the security following a default. The Regulations apply to both title transfer and security interest collateral arrangements. In order to fall within the ambit of the Regulations, it is important that the collateral receiver has sufficient "possession or control" of the collateral.

  If the collateral giver has the unfettered right to deal with the collateral under the triparty control agreement, this could undermine both the fixed/floating security analysis and the collateral receiver's protection under the Regulations.

- ***Certain Commercial Considerations***

  Under the triparty control agreement, the custodian will want absolute certainty and clarity as to how instructions are given and rights are exercised, particularly with respect to collateral transfers or substitutions (eg. whether or not it should be subject to joint instructions prior to a default) so that the custodian is not required to exercise any discretion. A particular tension of the triparty control agreement relates to the consequences of (i) a default by the collateral giver and (ii) a default by the collateral receiver, and often will entail parties agreeing to a short standstill period so that disputes can be raised (and, if necessary, allowing an affected party to seek injunctive relief).

John Delamere and Claire Deasey

OPENING UP

THE POLISH SECURITISATION MARKET

The economic crisis has forced banks everywhere to review their asset book and look to new products as a means of working with their clients and investors. Securitisation is one such product that has been present on financial markets more developed than the Polish one for a long time and is beginning to generate significant interest. A number of banks have been considering the asset-backed securitisation of receivables for some time. Market developments are making this a realistic opportunity. Securitisation has the potential to improve liquidity, diversify risk and provide additional funds whilst maintaining banks' capital levels required by law.

There were a few securitisation transactions conducted in Poland in the past, but as private placement transactions and volumes were not very high. Now the securitisation market has been re-opened by an asset-backed transaction in 2012, when Getin Noble Bank successfully completed the securitisation of auto loans worth PLN 1 billion. The portfolio of securitised receivables consisted of more than 32 thousand car loans originated by the bank through a network of car dealers to private individuals and small and medium enterprises. The portfolio consisted of collateralised loans in respect of new and used cars up to five years old in relation to German, French, Japanese and Korean brands.

The securitisation developed by Getin Noble Bank is one of the first structured finance transactions of this type in Poland and the fact that a prime ranking (Aa3) has been assigned to it by an independent, international rating agency, is an achievement which has had a stimulating effect on the Polish market. The bonds were secured by way of a registered pledge over all assets and specified collateral rights. Investors included the European Bank for Reconstruction and Development and domestic financial institutions.

The securitisation will allow Getin Noble Bank to convert illiquid assets into liquid ones. It is expected that the transaction will be beneficial to the Polish market by showing how it creates increased transparency of assets, monitoring of the quality of the portfolio and bringing access to additional sources of financing. This securitisation, as well as other similar transactions which are now taking place in Poland, will have a positive effect on the capital adequacy ratios and the funding balance of entities whose receivables are subject to securitisation. An active securitisation market should provide an additional risk management tool and an increase in the liquidity of bank financial assets.

Polish banks have recognised that ABS can provide an alternative source of domestic and international funding. This should also help diversify the portfolios held by banks and enable them to develop a range of new products. The issuance of ABS should help banks to meet the capital maintenance levels required by law.

The growing importance of rated debt financing in Poland was also evidenced by the opening of the Polish office of the Moody's rating agency in September 2013.

The process of securitisation in Poland is complex and requires a deep understanding of the tax, financing and related issues. It is essential to understand the solutions which currently are being applied.

Krzysztof Wiater and Pawel Turek

CHANGES IN RATING AGENCY COUNTERPARTY CRITERIA – **RECOGNISING THE NEED FOR FLEXIBILITY**

Whilst the role of the credit rating agencies ("**CRAs**") has been heavily criticised by regulators in relation to the role they played in the lead up and during the recent financial crisis, they remain central in structuring the current waive of securitisation products as well as reviewing the continued viability of existing structured products.

Nowhere is this more evident than in the approach the CRAs have taken to counterparty risk in structured finance transactions. The rating methodology largely follows a weakest link approach whereby the weakest element of the structure may set the rating cap available to rated notes (unless such weak link is mitigated to the satisfaction of the applicable rating agency). The financial crisis highlighted that in a number of cases an expectation that a counterparty to a structured transaction could or would carry out specified acts was not realised. This may have arisen because the documentation did not express a clear unambiguous obligation, the counter party was not in a position to act or the creditworthiness of the counterparty itself was subject to downgrade such that the transaction as a whole was under stress. As a result, each of the major CRAs published and have amended policy positions on counterparty risk in structured transactions.

Published criteria is set out in a number of papers:

"Counterparty Criteria for Structured Finance and Covered Bonds" and the "Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum" published by Fitch on 13 May 2013; a request for comment entitled "Approach to Assessing Swap Counterparties in Structured Finance Cashflow Transactions" published by Moody's on 12 November 2013; and "Counterparty Risk Framework Methodology and Assumptions" published by S&P on 25 June 2013, and "Methodology and Assumptions for Market Value Securities" published by S&P on 17 September 2013 (together the "Updated Criteria".)

Although each of the CRAs takes a difficult technical perspective, the basic premise is that each material counterparty to a structured transaction is required to maintain a specified minimum rating in order to support the applicable rating of the Notes. If the counterparty is downgraded below that rating it must within a specified timeframe take remedial action to mitigate such downgrade and ultimately replace itself with an adequately rated counterparty (at its own cost) in the event that the downgrade is severe or the mitigating action is insufficient.

One issue with this approach is that whilst arrangers have worked to structure transactions in line with the CRA criteria that was applicable when the transaction was entered into, many deals have been and are now required to be rated by at least two CRAs which carry out a continuous assessment of counterparty risk pursuant to their own most recently updated criteria. Changes in rating and/or changes in criteria leave counterparties being required to take potentially difficult and/or expensive remedial action. The fact that much of the early draft guidance provided by CRAs was poorly worded has further compounded the problems.

The basic CRA approach has been to set an initial downgrade trigger at which the counterparty is required to post collateral the amount of which is calculated according to the credit risk and volatility risk related to the underlying transaction and proposed collateral. If the counterparty continues to deteriorate and its credit rating drops below a further trigger level, the counterparty will be required to find an eligible guarantor or replace itself with an eligible replacement counterparty or take any other action agreed with the relevant CRA.

Ultimately, the CRAs are seeking to achieve structural isolation of a transaction's performance from the credit or operational exposure of a counterparty, so that any credit deterioration of the counterparty will not have a negative impact on the performance of the transaction itself. This enables the CRA to focus particularly on the underlying collateral, ignoring the specific risks that impact each applicable counterparty. If sufficient isolation is not achieved, the rating of the notes may not be capable of exceeding that of the lowest rated counterparty.

Too rigid an application or an over-simplistic approach would clearly have adverse consequences for transactions and the market as a whole if replacement counterparties or eligible guarantors could not be found when collateral would be an adequate remedy. As a result CRAs have adopted a more pragmatic approach in recent policy criteria, often allowing a broader approach to remedial action.

With collateral being particularly in focus the CRAs are reviewing their approach to collateral requirements, an example is the recent change to the way S&P determine the discount ("haircut") applicable to financial assets (e.g. municipal or corporate securities) backing rated notes, (paper published by S&P on 17 September 2013). This haircut will vary based on the rating assigned to the notes, asset and programme specific considerations and the estimated worst historical price declines (peak-to-trough, with measurements taken over 33 years) associated with each financial asset backing the rated market value notes. Generally, haircuts will increase for speculative-grade assets whereas haircuts will decrease for investment-grade corporate and municipal assets.

In spite of the costs of posting collateral, the options to replace a counterparty or to procure a guarantee are often the least feasible options. This is due to the difficulties in finding a replacement counterparty or an eligible guarantor within the designated time frame imposed by the CRAs, as in part due to the financial crisis many potential institutions do not have (or will likely not continue to have) the necessary credit ratings to be an eligible counterparty or guarantor. In addition, replacement costs which would likely be incurred, which can arise from mark-to-market movements between the last collateralisation date and the actual replacement date, and from pricing differences that may exist between the counterparty and its replacement, would be significant.

In order for transaction documentation to now catch up with revised rating policy, arrangers and participants should be looking at a number of features:

- is it possible to apply a lower swap counterparty rating trigger, which, once breached, will require the counterparty to take remedial action;
- is it possible to apply a lower required credit rating for a transferee which may replace the counterparty;
- is it possible to apply a lower required credit rating of a guarantor providing a guarantee in respect of obligations under a transaction;
- update the ISDA documentation so that it reflects the CRAs' methodologies and criteria in the Updated Criteria, as a failure to adhere to new criteria could result in a downgrade of the credit rating of the securities issued in the transactions;
- review and adjust the collateral-posting levels and collateral eligibility requirements;
- build in volatility cushions and liquidity adjustments, which are intended to cover potentially increased replacement costs of the counterparty;
- permit the counterparty flexibility to take any other action which will allow the rating of the notes to be maintained, notwithstanding a downgrade.

Reflecting these changes in documentation now may save significant difficulties, ambiguities and costs in the future as ratings and the potential number of guarantors or replacement counterparties may further reduce in the current market climate. Subsequent articles will analyse the specific requirements and some points of similarity and difference between CRAs in how they approach counterparty rating and the linkage criteria.

Martin Bartlam and Camilla Coates

HOW WILL NEW CLO 2.0 STRUCTURES FARE IN THE CURRENT MARKETS

As of 3 October 2013, the aggregate CLO issuance in 2013 in Europe stood at approximately €4.5 billion from 14 deals. It is safe to say that at the beginning of this year not many (if any) participants in the CLO market would have predicted such volume. Early discussions with arranging banks predicted a figure closer to 6 or 7 deals for the year.

Completing so many successful deals is even more impressive when one considers the changing regulatory environment within which CLOs have had to be structured. The key regulatory changes include the application of Article 122a of the Capital Requirements Directive and the introduction of Article 404-410 of the Capital Requirements Regulation, the Credit Rating Agencies Regulation 3, the Alternative Investment Fund Managers Directive, the European Markets and Infrastructure Regulation, the Foreign Account Tax Compliance Act, risk retention under the Dodd-Frank Act and the Commodity Pool Regulations, to name the main offenders. This has created an obstacle course for lawyers, arrangers, managers and investors to navigate. The change to Article 122a of the Capital Requirements Directive and the introduction of regulatory technical standards in May slammed the brakes on just as CLO issuance was beginning to ramp up, requiring the market to rethink its approach to retention requirements and capital applied to CLO structuring.

Despite the numerous regulations and U-turns from the EBA/European Commission, there were a number of European issuances post May 2013, Ares CLO VI was successfully closed by Martin Bartlam, Rich Reilly and Steven Krivinskas in September and Ronan Mellon closed St. Paul's CLO II in July (prior to joing DLA Piper in London).

So what does 2014 hold for the CLO market? The DLA Piper CLO team, led by partners Martin Bartlam, Rich Reilly and Ronan Mellon spent the first two weeks in October speaking to their close contacts at the major arranging banks and a number of investment managers to discuss the outlook for the European CLO market.

Not surprisingly, the market is still in a "wait- and -see" mode vis-à-vis the consultation on the regulatory technical standards. Given the surprises in May, which left a number of investors holding CLO paper which may or may not be compliant come 1 January 2014, many investors are now waiting to see how the revised regulatory technical standards will look. Given the sweeping changes previously made, no one wants to assume anything in this regard.

There does appear to be consensus that investment managers will hold the key to the CLO market as Article 404-410 of the Capital Requirements Regulation and the related regulatory technical standards will most likely require investment managers to make the required retention. There has been talk of creating an "originator" structure which would allow a non-investment manager entity to make the retention but there has not been an agreed structure in the market and many view this as an artificial construct that may not stand up to regulatory scrutiny. The jury is very much out on this approach. A number of arranging banks have shown little interest in any structures that could be perceived as not "straight down the fairway".

Given the increased importance of investment managers and the fact that they may well be the only entities eligible to retain, the race is now on amongst arranging banks to come up with an attractive way to fund investment managers to enable them to retain on a regular basis. This without doubt is topic of the day, it is also essential if the European CLO market is to really take off in 2014. The good news is that a number of arrangers appear to be offering structures on terms that investment managers are apparently happy with. We understand this can be offered on the vertical retention strip and may also be possible on a horizontal retention strip.

With a number of banks forecasting a bumper 2014 for M&A activity and leveraged loans in Europe and investment managers potentially being funded in respect of their 5% retention requirements, it looks like CLO issuance in 2014 could well go up a notch.

Ronan Mellon

STRUCTURED FINANCE IN THE MIDDLE EAST
INTRODUCTION TO SUKUK

INTRODUCTION

As global economic uncertainty persists, it has created a unique opportunity for Islamic finance to continue to flourish and expand into new economies. At this year's World Islamic Economic Forum (WIEF), held in London in October 2013, UK Prime Minister David Cameron announced the UK's intention to become the first non-Muslim state to issue a sukuk (or Islamic bond), expected to be GBP200 million. This article explores the characteristics of sukuk and the underlying Islamic (or Shari'a) principles on which they are based.

WHAT ARE *SUKUK*?

A number of contemporary financing techniques have been developed to comply with Islamic principles. These techniques tend to have a common reliance upon a trade or transaction involving underlying assets as a fundamental part of an Islamic contract. This avoids some of the fundamental prohibitions that would otherwise be associated with these kind of financing products (and which are described in more detail below).

Sukuk are a type of certificate or note which represent a proportionate interest (sometimes also described as a participatory interest) in an underlying asset or investment. They are generally considered to be securities (akin to bonds) which, depending on the underlying asset or transaction, can be traded in the secondary market. The *sukuk* certificates are often 'layered' on top of other underlying Islamic financing techniques which themselves are intended to derive a return from an underlying asset or investment: for example, *ijara* (or leasing), *mudaraba* (or investment partnership) or *wakala* (or investment agency).

However, for modern day purposes, the vast majority of *sukuk* structures are best described as being 'asset-based' because the primary credit risk remains that of the issuer/obligor who is obliged to pay the *sukuk* holder irrespective of the performance of the underlying asset or investment. This is to be distinguished from less prevalent 'asset-backed' *sukuk* (i.e. securitisation) where recourse to, and revenues from, the underlying asset or investment play a more critical role.

CORE PRINCIPLES

The Islamic finance industry has developed on the basis of the following strict principles:

- ***No interest*** – Under *Shari'a*, money is regarded as having no intrinsic value and also no time value. It is viewed simply as a means of exchange in order to facilitate trade. As such, *Shari'a* principles require that any return on funds provided by a financier should be earned by way of profit derived from a commercial risk taken by that financier. The payment and receipt of interest (*riba*) is prohibited under Islamic law and any obligation to pay interest is considered to be void. This rule also prevents a financier from charging penalties and/or default interest.
- ***No uncertainty*** – uncertainty (or *gharrar*), particularly any uncertainty as to one of the fundamental terms of an Islamic contract (such as subject matter, price or delivery), is considered to be void under *Shari'a*. This principle is fairly broad as it requires certainty on all fundamental terms of a contractual arrangement.
- ***No speculation*** – contracts which involve any speculation are not permissible (*haram*) and are considered to be void. This does not, however, prevent a degree of commercial speculation which is evident in a lot of commercial transactions. The prohibition applies to forms of speculation which are regarded as gambling. The general test is whether something has been gained by chance.
- ***Unjust enrichment/exploitation*** – a contract where one party is regarded as having unjustly gained (at the expense of another) is also void. The principle also extends to the enrichment of one party who exercises undue influence or duress over the other party.
- ***Investments*** – the proceeds in Islamic finance should not be used for the purposes of purchasing or investing in products or activities that are prohibited. These prohibited items and activities include the manufacture and/or the sale or distribution of alcohol, tobacco, pork products, music or pornographic productions, the operation of gambling casinos or manufacturers of gambling machines – but also extend to conventional banking and insurance activities, as well as defense and weaponry.

OUTLOOK

Globally, Islamic financial assets are said to be growing twice as fast as conventional banking assets and are expected to reach US$1.4 trillion by the end of 2013. Growing demand across a number of sectors, rational pricing and innovative products are trends that are shaping the future of Islamic finance. In addition, a well-publicised shortage of liquidity in the US and European markets has resulted in organisations looking more towards funding from sources in the Middle East and South East Asia, as well as a move towards more deals being funded from Islamic investors through the debt capital markets in the form of *sukuk*.

However, the strategic importance of becoming an Islamic finance hub should not be overlooked. Not only does Islamic finance provide an important source of liquidity, but it also is likely to play a significant role in the re-shaping of global financial centres in the post-financial crisis era, alongside more stringent financial services regulation. On this basis, the theme of the 9th WIEF seems very appropriate: "*Changing world, new relationships*".

Paul McViety

PURCHASING ITALIAN RECEIVABLES

Much of recent regulatory focus in the EU has been to force Europe's banks to hold more capital against assets and particularly against more risky or complex assets. As a result, banks across Europe have been selling assets at a significant rate. With regulators looking at asset quality and stepping up pressure on local banks to recognise problem or non-performing assets, the sale of portfolios is likely to continue. We look at the issues in acquiring portfolios across Europe, focussing in this article on Italy.

Acquiring loan assets in any jurisdiction requires a significant amount of care and attention. It is important to ensure that the sale is effective in accordance with applicable laws and the change of ownership of the financial assets does not adversely affect the ability to recover amounts from the underlying debtor or cause the transaction to be subject to unsustainable tax or other administrative costs. In a number of jurisdictions such as Italy, strict requirements are applied as to who can carry on a banking business and it is important that the buyer structures the deal such that it does not breach licencing or other local regulatory requirements. In order to properly value portfolios it is necessary for buyers to have a good understanding of the local insolvency and tax regimes that will impact recoveries. This article considers some of the potential issues to consider.

1. GENERAL LICENSING REQUIREMENT

Under Italian law the granting of loans carried out in whatever form towards the public (i.e. on a public basis) can only be performed either by banks or financial intermediaries duly enrolled in a register held by the Bank of Italy.

The purchase of receivables falls within the notion of granting of loans carried out towards the public. This would mean that in cases where the purchasing entity is not a bank it must be entered on a register and comply with certain requirements as stipulated in *The Legislative Decree 385, 1 September 1993*. Requirements include having a paid-up share capital of not less than five times the minimum capital required for the formation of a *società per azioni* (currently € 600,000) amongst other statutory requirements. It should also be noted that the current regulatory framework applicable to financial intermediaries is changing significantly and once the new regulations enter into force this will result in more burdensome requirements for financial intermediaries (for example the minimum capital required for the establishment of a financial intermediary may be increased to as much as € 2 million). The new regulation which is under public consultation is due to be approved by the first quarter of 2014.

2. IS A PURCHASER SUBJECT TO THE GENERAL LICENCING REQUIREMENT

It is necessary to look at how Italian law is applicable to the purchase of receivables;

- A simple investment by a purchaser in Italy in loan assets is likely to be characterised as an act of 'granting of financing' under Italian law and as such is a restricted activity unless the purchasing activity falls within a specific exemption or is an activity carried on outside of the jurisdiction.
- In the past it was common practice to argue that if the transaction was solely a single financing transaction (i.e. the so-called "one off" transaction) it would not fall within the notion of granting of loans and thus would not be regarded as a "reserved activity". However on this point a recent decision of the Italian Supreme Court has cast some doubts on this view.
- Limited exemptions apply when the transaction is carried on outside the Italian territory. There is little guidance from the Italian courts on exactly when the transaction will fall outside of Italian restrictions and the prudent view is that care is needed even in 'cross-border' transactions.
- Some guidance may be extrapolated on when an activity falls outside of the scope of the Italian restrictions from positions expressed by the main regulatory bodies such as the Bank of Italy and the CONSOB on what is intended to be covered.
- The Bank of Italy's view is that business carried on outside of Italy will still be caught as 'cross-border' requiring authorisations if it is conducted further to a marketing activity within Italy, even where the activity consists of a pure promotional activity and does not entail the submission of an actual contractual proposal to the potential counter party.
- Under the Bank of Italy test therefore any marketing activity carried out vis-à-vis the Italian lender at any address in Italy would be caught. By contrast however if the proposal and contract negotiations are carried on outside Italy and any contractual proposal is executed outside of Italy by the lender physically signing outside of Italy this would fall outside the orbit of the expressed requirement for authorisation.
- The UIC (now merged into the Bank of Italy) took the view that a financial activity is conducted in Italy if at any time "*Italy is the centre of the interests underlying the bundle of financial relationships between the parties to the transaction*". It may be difficult to define the centre when a number of overseas jurisdictions are involved, however the UIC have stated that any entity investing in Italian lending through a IBLOR/GILD (as is often the case) structure would not be characterised as having Italy at the centre of its interests.

- The CONSOB's view is that a service is viewed as being provided into Italy if the entity providing the service "seeks" its customer in Italy (by marketing or advertising for example). Therefore, if a sale arises where there is no solicitation in Italy of the Italian lender or the Italian borrower the sale should be outside the CONSOB test.
- The general proposition appears to be that external buyers should not actively market the business of purchasing Italian loan receivables in Italy but if (as the regulators appear to wish to see happen) Italian lenders are to enter into negotiations and sell such assets outside of Italy this should not of itself be viewed as carrying on a banking business in Italy requiring authorisation.

3. CHOICE OF LAW

Under Article 14 of the Rome I Regulation ("Rome I"), it is permitted that a sale of receivables be governed by a law other than the law governing the receivables themselves. Whilst this applies to the contract between the buyer and the seller in this case, the law governing the assigned claim continues to determine whether the receivables are capable of being assigned, the relationship between the assignee and the debtor, the conditions under which the assignment can be opposed and whether the debtor's obligations have been discharged.

Under Article 9 of Rome I, overriding mandatory provisions must be applied whatever the law applicable to the contract might be. In order to provide consistency with the perfection requirements relating to the receivables themselves and to comply with mandatory laws the parties will often have the sale contract governed by the same law as that of the underlying receivables.

4. FORMALITIES UNDER ITALIAN LAW

Italian law provides that:

- Pursuant to Article 1260 of the Italian Civil Code, a creditor may assign its receivables, also without the debtor's consent, subject to certain limitations deriving from the specific characteristics of the receivables. In particular, article 1260 of the Italian Civil Code sets forth that receivables can be assigned unless: (i) the receivables are of a "strictly personal nature" (e.g. alimony receivables; receivables relating to child support; etc.); (ii) the assignment is not permitted pursuant to provisions of law; (iii) the assignment is not permitted pursuant to an agreement between the parties.
- According to Article 1264 of the Italian Civil Code, the assignment is valid and binding as against the assigned debtor if the debtor has accepted the assignment or has received notice thereof.
- In respect of subsequent good faith purchasers, Article 1265 of the Italian Civil Code provides that if the same receivable has been the object of more than one assignment, the first assignment in respect of which the debtor has been notified or which the debtor has accepted at a certain date under law (*data certa*) shall prevail.
- Different perfection requirements apply to certain kind of receivables, such as promissory notes, mortgage loans, consumer loans, receivables vis-à-vis public entities or marketable debt securities.
- There are different (less onerous) requirements for assignment of receivables under Italian law for a securitisation.

5. INSOLVENCY LAW

Some key points relating to the impact of Italian insolvency law on a sale of receivables are as follows:

- Italian Bankruptcy Law does not provide for an automatic stay on the purchaser.
- A receiver is empowered, among other powers, to manage and liquidate the assets and, for such purpose, he is entitled to institute any action to set aside and revoke transactions carried out during the so-called "suspect period". Until the sale is revoked, the receiver has no power to stay collections.
- According to Articles 64 and 65 of the Italian Bankruptcy Law, the following transactions are void vis-à-vis creditors: (a) transactions without consideration which were carried out in the two years prior to the declaration of bankruptcy; and (b) payments of debts which expire on the date of the declaration of bankruptcy or thereafter, if said payments have been made in the two years prior to the declaration of bankruptcy.
- Pursuant to Article 67 of Italian Bankruptcy Law, claw-back action may be successfully pursued by a receiver in connection with the following transactions, unless the counterparty proves that it had no knowledge of the state of insolvency of the bankrupt entity:
  - (a) transactions concluded in the one year prior to the declaration of insolvency in which the obligations performed or assumed by the debtor exceed by more than one quarter the value of what the debtor received;

(b) payment of overdue monetary debt obligations where payment was not made with money or other normal means of payment, if made in the one year prior to the declaration of insolvency;

(c) pledges, securities and mortgages judicially imposed or voluntary created in the one year prior to the declaration of insolvency in respect of pre-existing unexpired obligations; and

(d) pledges, securities and mortgages judicially imposed or voluntary created in the six months prior to the declaration of insolvency in respect of overdue obligations.

6. TAXATION

In general terms the purchase of the receivables and the subsequent activities would not alone be sufficient for the purchaser to be deemed as having a permanent establishment in Italy. However, the recent practice of the Italian Tax Authorities is more aggressive than in the past with regard to the permanent establishment of foreign entities and care is required. Other issues to consider are:

- **Withholding tax:** In general, no withholding tax is levied on payments of commercial receivables, unless the purchase could be characterised as a form of financing. In this latter case, the difference between the nominal value of the transferred receivables and the lower consideration paid by the purchaser for the acquisition of the receivables (the "Discount") could be considered as interest on a financing and thus subject to 20% withholding tax, potentially reduced under an applicable double tax treaty.
- **VAT:** VAT treatment of factoring transactions has been discussed at EU Court of Justice level (see ECJ n. C-305/01 June 26, 2003). Nonetheless the Italian Ministry of Finance only partially accepted the position of the ECJ, therefore any Italian VAT assessment must be carried out on the basis of an analysis of the actual transaction. In general terms, should the transfer of receivables be structured with the purpose of financing the supplier, VAT would be applicable to the Discount but it would be fully exempt (zero rated) pursuant to *Article 10 paragraph 1 of the Presidential Decree No. 633 of 26 October 1973*. However, where the transfer is not structured with the purpose of financing the supplier, the Discount may be treated as an administrative fee which would fall into the scope of VAT at 21%, provided that the transaction is not subject to registration tax.
- **Other taxes:** Sales of receivables made in the context of a securitisation transaction are subject to registration tax (imposta di registro) at a fixed amount (currently Euro 168, Euro 200 starting from January 1, 2014), in case (i) the transaction is characterised as a financing transaction or (ii) as an activity aimed at the management and collection of the receivables. Otherwise, 0.5% registration tax would be applied on the value of the transfer. In addition, stamp duty (imposta di bollo) shall apply at a fixed amount (currently Euro 16) for each four pages or 100 lines of the relevant document.

Please note that the tax summary above is for background illustrative purposes only, and a formal tax analysis/review of any potential transaction must be carried out.

Martin Bartlam, Marco Zechini and Carlotta Benigni

THE UK AUTO SECURITISATION MARKET

Five years on from the Lehman bankruptcy, overall primary issuance in the European securitisation market remains significantly below pre-crisis levels. Low-cost funding from the UK and European central banks has led to a markedly reduced issuance, despite robust investor demand. One asset class has however bucked this trend.

I. AUTO SECURITISATIONS IN THE WIDER EUROPEAN CONTEXT

'Auto loan ABS': involves the issue of asset-backed securities by a special purpose entity the payment of interest and principal in respect of which is collateralised by a pool of loans originated to finance the purchase of motor vehicles. Qualifying vehicle financing contracts, financing structures and regulatory issues affecting those structures are described further below.

In 2008, auto loan ABS represented 1.54 per cent of all primary securitisation issuance in Europe. By the end of 2012, this figure had risen to 10.71 per cent. Whilst this proportionate increase must in part be attributed to the drop-off in global RMBS activity, the value of new auto loan deals has increased from $18.6 billion in 2008 to $32.4 and $34.5 billion in 2011 and 2012 respectively.

Statistics for the first half of 2013 show this trend continuing:

Year	Q	Auto	Total	Auto as % of Total
2007		19,259.22	845,361.20	2.28%
2008		**18,630.48**	1,206,567.49	**1.54%**
2009		21,766.37	589,256.83	3.69%
2010		18,847.18	508,065.68	3.71%
2011		**32,412.33**	514,016.71	6.31%
2012		**34,513.36**	322,393.53	**10.71%**
2013	Q1	5,863.59	42,446.84	13.81%
	Q2	9,735.98	66,389.10	14.67%
Source: SIFMA				
(amounts in USD millions unless otherwise stated)				

The UK auto securitisation market has seen a steady deal flow in 2013 with both bank and non-bank originators closing deals, many of which have attracted strong investor demand. For example, the senior notes issued by A-BEST 8 were more than 2.5 times oversubscribed. From an investor's perspective, auto loan securitisations are attractive as they offer well-established deal structures and an ever-increasing amount of historic data from many successful transactions, allowing for more effective pricing.

Below is a list of recent UK deals that we are aware have closed in the past 12 months:

Originator	Issuer	Date of Issue	Senior Notes
GMAC U.K. Finance Plc	E-Carat Plc	December 2012	£500,000,000
FirstRand Bank	Turbo Finance 3 Plc	December 2012	£273,400,000
FGA Capital UK Limited	Asset-Backed European Securitisation Transaction 8 Plc **("A-BEST 8")**	April 2013	£218,800,000
Santander Consumer (U.K.) plc	Motor 2013-1 Plc	June 2013	A1 $450,000,000
			A2 £400,000,000
GMAC U.K. Finance Plc	E-Carat 2 Plc	September 2013	£350,000,000

2. THE BOOMING UK AUTO FINANCE MARKET

The UK auto finance market continues to grow at a pace. UK auto finance continues to be provided from a range of sources, including manufacturer-tied finance arms (such as FGA Capital), banks (such as Santander Consumer UK) and specialist finance houses (such as Alphera Financial Services).

According to the UK Finance and Lease Association, the percentage of private new car sales financed by loans taken out at point of sale (at car dealerships) reached a record high of over 70% in 2012, amounting to around £20 billion of financing. Furthermore, May 2013 marked the 17th consecutive month of double-digit growth in the consumer new car finance market. The continued growth in auto finance gives the securitisation market fuel for future deals.

3. PRODUCTS BEING SECURITISED

The main financial products available in the UK market, all of which are frequently securitised, are:

Hire Purchase Agreements: these are secured loans, typically returning a fixed interest rate and amortising in equal monthly instalments over a repayment period of between 12 and 84 months.

After all payments have been made, ownership of the vehicle transfers from the financier to the customer upon the customer exercising its option and (often) after paying a fee.

Personal Loans: these are unsecured loans, typically returning a fixed rate of interest and amortising in equal monthly instalments over a repayment period of between 12 and 84 months.

Unless otherwise agreed, the financier will neither take title to any vehicle financed by the loan nor any other security for the customer's repayment obligations.

Personal loans tend to account for a small proportion of a portfolio backing triple-A rated securities (e.g. 5.05 per cent of the A-BEST 8 securitised portfolio).

Personal Contract Purchase ("PCP") Agreements: PCP is the most popular way to buy new and used vehicles in the retail market. Customers typically pay equal monthly instalments with a fixed interest rate (albeit that some PCP Agreements may comprise a large advance payment instead of equal monthly instalments over the contract term).

At the end of the contract period, customers have the option to either:

1. settle the contract by paying a large final instalment ("**Optional Balloon Payment**"), following which ownership of the vehicle passes from the financier to the Customer ("**Option 1**"); or
2. hand back the vehicle in full and final settlement of the contract ("**Option 2**").

The Optional Balloon Payment is intended to reflect the estimated market value of the vehicle at the end of the contract (the "**Estimated Residual Value**").

There is a risk that the Estimated Residual Value of the vehicle is less than the amount of the Optional Balloon Payment (the '**residual value risk**').

In a securitisation, under Option 1, this risk is borne by the Customer and does not affect investors.

In the case of Option 2, a servicing entity (acting on the Issuer's behalf) will sell the returned vehicle at the best price it can achieve and transfer such proceeds to the Issuer. Any shortfall between the Estimated Residual Value and the sale proceeds (the residual value loss) will be borne by the Issuer, and may affect investors. Some UK deals have been structured so that the Issuer has the option to put back such receivables (in respect of which the customer has handed back the vehicle) to the financier.

PCP Agreements have accounted for the majority of the portfolios securitised in 2013 (e.g. 77.5% of the A-BEST 8 securitised portfolio).

Contract Hire: similar to an operating lease, contract hire agreements allow businesses to fund the use (but not ownership) of a vehicle. Financiers customarily include a vehicle maintenance service as part of the "package". The customer normally has no right to acquire title to the vehicle unless a separate option has been negotiated. At the end of an agreement the vehicle is handed back to the financier.

4. STRUCTURES BEING APPLIED

UK securitisation transactions have followed either a public issuance route or are structured as private transactions whereby a bank or small group of banks will provide a loan note facility to enable the SPV to acquire auto loan receivables from the relevant originator. The SPV will issue loan notes which may be held or funded through bank conduit programmes. Eligibility and other criteria follow structured public issuance criteria and the notes must meet requirements applied to assets purchased by the underlying conduit. These structures offer a programme based alternatives allowing a revolving period followed by an amortisation of the programme at the end of the revolving period.

5. THE REGULATORY LANDSCAPE

The global financial markets remain subject to a wide range of changes. Just a sample of the regulatory changes affecting structured finance products are set out below.

Article 122a Capital Requirements Directive/Article 404-410 Capital Requirements Regulation ("CRR"): rules requiring risk retention and due diligence for securitisation transactions.

From 1 January 2014, Articles 404-410 of the CRR will replace Article 122a and will apply to "securitisation" transactions, a term capturing transactions in which the credit risk on the exposure is tranched and losses are allocated according to the tranching.

The effect is that for securitisations introduced to be sold to credit institutions subject to European regulation in order for such securitisation to hold the securities with reduced regulatory capital weightings the "Originator", "Sponsor" or "Original Lender" of a securitisation transaction must hold 5% of the economic risk. This reflects a requirement to ensure such entities retain some "skin in the game". Notably under the CRR, the European Banking Authority has removed the possibility of third party investors from acting as retention-holder, which does not necessarily affect auto securitisations but has had a significant impact on the structuring of CLOs with the CLO manager being expected to be the retention-holder (See article – "*How will new CLO 2.0 structures fare in the current markets*").

Originators of assets backing auto securitisations have tended to comply with Article 122a and are expected to comply with the CRR by subscribing for the most junior notes or granting a subordinated loan to the Issuer so as to take the "first loss position".

Credit Rating Agencies Regulation 3 ("CRA 3"): new rules on the rating of and information to be published in respect of structured finance instruments ("**SFIs**").

The application of CRA 3 remains unclear in many respects pending the disclosure of detailed technical standards.

If applying to an SFI, the CRA 3 requires issuers and "related third parties" soliciting a rating to obtain ratings from at least two rating agencies. The issuer, sponsor or originator will also be required jointly to publish information on the performance of the underlying assets, the structure, cash flows and collateral on a website established by the European Securities and Markets Association.

Such changes will inevitably add cost to auto loan and other securitisation transactions.

Proposed new FCA consumer credit regime

From April 2014, all firms that carry on regulated consumer credit activities will be regulated by the Financial Conduct Authority ("FCA") rather than the Office of Fair Trading, which will cease to exist on that date (See Article – "*The changing face of consumer credit law*".

The government proposes to keep the scope of consumer credit regulation broadly the same under the new FSMA regime, including by replicating existing exemptions under the CCA. However, further changes to the scope of the regime are expected to follow. It is hoped that these will have a limited impact on the structure of auto securitisation transactions.

6. PRIME COLLATERALISED SECURITIES ("PCS")

PCS is an industry-led initiative aimed at reinforcing asset backed securities as sustainable investment and funding tools for both investors and originators.

PCS awards a label to securitisation issuance meets strict criteria set by PCS, which focus on issues of quality, transparency, simplicity and liquidity.

Seven auto securitisations have so far been awarded the PCS label, with only two such awards in the UK market: A-BEST 8 was the first in April 2013 followed by Motor 2013-1 in June 2013. DLA Piper advised FGA Capital as originator on the A-BEST 8, securitisation. The transaction, which closed in April 2013 and was more than 2.5 times oversubscribed, was also structured to allow the senior Notes to be recognised as eligible collateral for credit operations with the European Central Bank and for the purposes of the Bank of England's Discount Window Facility.

Marcus Lovatt

THE ROLE OF IUK IN PROJECT BONDS

The British Government has passed the Infrastructure (Financial Assistance) Act 2012, under which Her Majesty's Treasury ("**HMT**", the department responsible for the British Government's finance policy) has been authorised to invest in a wide range of infrastructure projects within the UK by issuing up to £40bn of financial guarantees in support of those projects. The implementation of the scheme will be managed by Infrastructure UK ("**IUK**", a division within HMT).

The financial guarantee is expected to cover the whole or part of the scheduled payments and interest payable by the relevant project company to senior lenders or investors in the project. By effectively substituting the (higher) credit worthiness of the British Government for that of the project company, the overall financing costs of the project can potentially be reduced. In return, the project company will pay HMT a guarantee fee at applicable market rates. HMT has confirmed that the guarantee scheme can be used for both loan and bond financing structures.

At the time of writing there are no completed deals involving an HMT guarantee, however from our recent experience on developing transactions which are being structured to include HMT as guarantor, we are able to form a picture of what HMT's typical requirements are likely to be going forward.

Requirements of HMT are likely to include:

- HMT will make pay-outs of principal and interest under the guarantee in accordance with the original debt service schedule;
- The term of the guarantee is to be aligned with the term of the senior debt;
- All amounts paid out by HMT under the guarantee are to be reimbursed by the project company;
- The liabilities of the project company to HMT would receive the same credit enhancement package and recourse to the project assets (usually through a combination of guarantees, security and structural subordination) as that granted in favour of the other senior creditors;
- HMT's claims would receive the same ranking as the senior creditors *vis-à-vis* the junior creditors and equity investors, so that the liabilities of the junior creditors and equity investors are subordinated;

As a general comment, HMT appears to be offering a promising degree of flexibility with regard to how the underlying financing and investment in the project is to be structured. For example, HMT is likely to permit the deferral of part of the equity or junior debt commitments of other financiers and investors, provided that such commitments are appropriately secured.

HMT has also expressed a willingness to invest alongside the European Investment Bank which, under the EU-EIB Project Bond Initiative, is able to provide financial backing to infrastructure projects across Europe in a manner similar to the British Government scheme, with the aim of encouraging new investment from the capital markets. The first successful project under the EIB initiative was the Castor energy storage project in Spain, where the EIB was able to provide a €200m liquidity line to enable the project to achieve a more attractive credit rating.

One area worth monitoring going forward is likely to be the expectation that HMT would act as "controlling creditor" in relation to the operation of the guaranteed financing arrangements and underlying security. This potentially means that, while the HMT Guarantee is in operation, HMT would be the primary decision maker in respect of matters such as consents, waivers and amendments under the finance and project documents. Potential concerns for other financiers and investors in the project are likely to include (i) protection against prejudicial action by HMT in respect of key rights of those financiers and investors, including the payment of principal and interest, or dividends in the case of equity investors, and (ii) the possibility of a conflict of interest arising from the dual roles of the British Government as controlling creditor and the procurer to the project company.

Natural comparisons for the HMT guarantee can be drawn to guarantees provided by monoline insurers to project finance transactions, under which the guaranteeing monoline would typically provide a guarantee of the senior financing to the project in order to reduce the costs of financing in a manner similar to the HMT guarantee. The expected requirements of HMT listed above are equally applicable to the terms one would expect on a typical monoline backed-project financing.

The HMT guarantee provides an attractive additional financing instrument to get UK infrastructure funded but its application is fraught with difficulties. Negotiations remain difficult and intercreditor issues have yet to be resolved. The breadth of financial support which is not limited to investment grade senior debt (a limit applicable to the monolines) should enable more infrastructure to be financed with a more flexible instrument that can be applied wherever there is demand in the capital stack. In practice however, issues remain over the exact nature of the credit support, pricing, control rights and of course the danger of crowding out private sector specialist debt providers. The sooner IUK clarifies exactly where it stands on these issues, the easier it will be to finalise financing structures for UK infrastructure assets.

Martin Bartlam and Christopher Godwin.

THE COMI ARGUMENT

FOR DOUBLE LUXCO STRUCTURES

As most structured finance practitioners will be aware, Luxembourg has emerged as one of the most popular onshore jurisdictions for the establishment of special purpose vehicles (SPVs) for structured finance transactions. The choice of Luxembourg as the jurisdiction for these SPVs is often driven primarily by tax and regulatory concerns, often because Luxembourg's tax regime allows for a relatively efficient repatriation of profits from the SPVs. In real estate structured finance transactions in particular, where both senior financing (secured directly by charges or other security interests over the underlying real property) and structural mezzanine financing (separately secured by pledges or share charges over the shares in the property-owning entities) are contemplated, the borrower structures often involve multiple Luxembourg SPVs or "LuxCos".

In addition to the relevant tax considerations, there is another compelling reason for adopting a "double" LuxCo structure -- it can be used as an effective tool to lessen the risk that a distressed borrower group will be able to successfully migrate their centre of main interest or "COMI" to another EU member state in order to access a more debtor-friendly insolvency regime.

The concept of COMI is central to the EU Insolvency Regulation (Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings) as it determines the national insolvency law applicable to a company entering insolvency. The various EU member states have substantially different insolvency regimes, with some regimes more favourable to debtors and others more favourable to lenders. If a borrower is successful in shifting its COMI to a debtor-friendly jurisdiction, this can have very serious negative consequences for the lender group.

Several mechanisms have been developed to ensure that the COMI of a LuxCo remains in Luxembourg. These mechanisms have been created largely in response to a 2011 French case involving the COMI migration of a single LuxCo to France, where the LuxCo became subject to the more debtor-friendly French restructuring procedures (see Heart of La Defense (Coeur Defense) case by the French Cour de cassation, 8 March 2011). In that case, the French court was of the opinion that the COMI of the LuxCo was located in France based (among other things) on the fact that the sole asset of the LuxCo was its participation in a French entity whose sole asset was, in turn, a real estate asset located in Paris.

Adopting a double LuxCo structure helps reduce the risk that a foreign tribunal would view the LuxCo as having its COMI in another jurisdiction because the top LuxCo in the structure would own, as its sole asset, an equity interest in another LuxCo rather than an equity interest in an entity organised in a less lender-friendly jurisdiction.

Of course, it has also become market-standard to include contractual restrictions and covenants in the applicable finance documents (including the relevant Luxembourg share pledge agreement), obligating the borrower group to maintain the COMI of the SPVs in Luxembourg. It is also possible to provide, in the Luxembourg share pledge agreement, that the voting rights attached to the LuxCo's shares would vest in the secured lender upon the opening of insolvency proceedings or any attempt to migrate the COMI to another jurisdiction. The occurrence of these events, even where the lenders have not yet taken any enforcement actions, would enable the lender group to replace hostile directors, withdraw any relevant insolvency proceedings and prevent the relocation of COMI.

Robert Mower and Pierre-Yves Genot

THE CHANGING FACE OF **CONSUMER CREDIT LAW**

BACKGROUND

Although the Government has been engaged in a process of reforming the regulation of consumer credit for some years now it does not believe that its aims have been fully achieved. The sector continues to suffer from bad press and the actions of some in the payday loans sector have caused particular concern. The Government therefore proposes a robust regulatory regime to ensure customers are adequately protected. Practitioners in the Consumer ABS sector need to stay on top of the changing proposals.

THE FINANCIAL CONDUCT AUTHORITY ("FCA")

Historically the consumer credit sector has been regulated by the Office of Fair Trading ("OFT") but, with effect from 1 April 2014, regulation will transfer to the FCA. In legal terms, the authorisation of firms engaged in consumer credit will in future be subject to controls based on the Financial Services and Markets Act 2000 ("FSMA"), rather than on the Consumer Credit Act 1974 ("CCA"). However, at least for the foreseeable future, much of the CCA will remain in place. For example, the rules regarding the form and content of consumer credit agreements will continue to be based on the CCA.

The key changes that ABS practitioners, lenders and others engaged in the provision of consumer credit might expect to see are as follows:

- Documentation needs to reflect the change to the new FCA regime.
- The FCA have announced their intention to put the consumer at the heart of everything they do, with the aim being to reduce the perceived consumer detriment. This reflects a quite different approach to that historically adopted by the OFT with the FCA being far more concerned about the conduct of lenders rather than their compliance with black letter law.
- The FCA will have product intervention powers which may mean certain new products will have to be approved by them before they are launched.
- Much of the former OFT guidance has been "codified" into the new FCA source book (known as "CONC").
- Under the new FCA regime, each authorised party will have to have at least one "approved person" who could, ultimately, be personally responsible if there are any failures.
- There will be new rules which will apply to peer to peer lenders.
- New rules are to be included for payday lenders including limiting the number of rollovers allowed to two, limiting the number of unsuccessful attempts to take payment under a continuous payment authority to two and requiring a risk warning on all payday loan advertising.
- Lenders who accept business from third party introducers such as retailers and motor dealers will have the choice of having "authorised representatives" (e.g. dealers or brokers) for whom the lender will hold regulatory responsibility, or alternatively require all such intermediaries to obtain their own authorisation.
- The Consultation Papers also reiterate that the high-level rules from the FSMA regime as set out in PRIN, SYSC and GEN will apply to consumer credit firms.

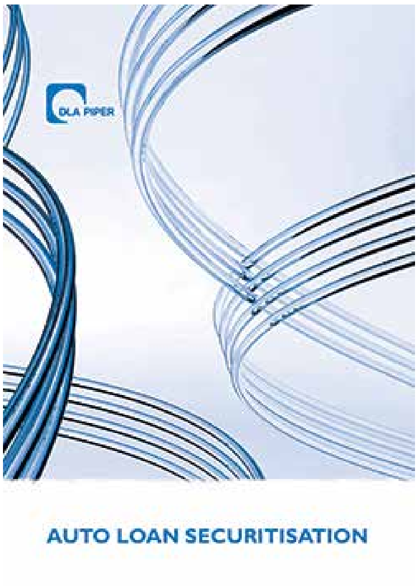
ACTION NEEDED NOW

- If you have a consumer credit licence at present, you should consider whether you will still need this after 1 April 2014, and also whether the categories of activity your current licence allows are correct. If you will still be engaged in licensable activities after this date you should apply for interim permission. The fees for doing so will be reduced if you apply before 30 November 2013.
- Parties affected by the changes have the opportunity to reply to the recent Consultation Paper 13/10 up until 3 December 2013.
- Further public ABS Transactions risk factors need to be reviewed and regulatory discrepancies updated for the new regime.

OTHER CHANGES

This is not the only forthcoming change to consumer law as the Consumer Rights Directive is due to be implemented in 2014. The majority of the Directive will be implemented in the UK by what is currently the Consumer Rights Bill but some additional regulations will be required to enact all of the Directive. The Consumer Rights Bill is ambitious in scope and seeks to consolidate and clarify numerous pieces of existing consumer legislation including sale of goods legislation, parts of the Unfair Contract Terms Act and parts of the Unfair Terms in Consumer Contracts Regulations. This change is likely to have a significant impact on terms of trading and processes for all businesses who sell to consumers.

Jeff Vernon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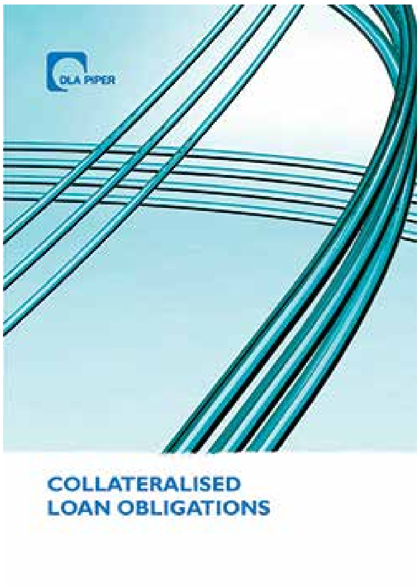
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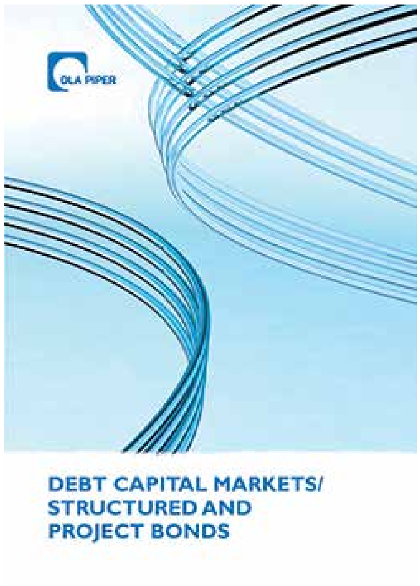
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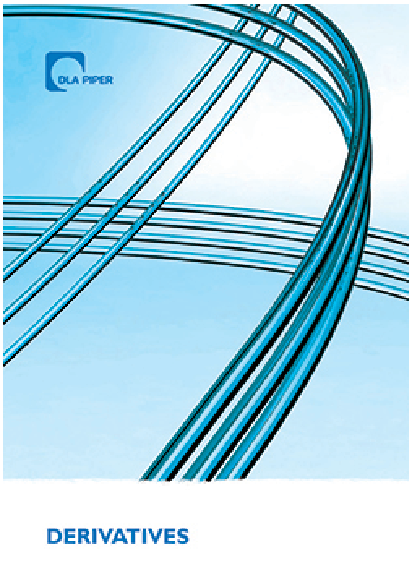
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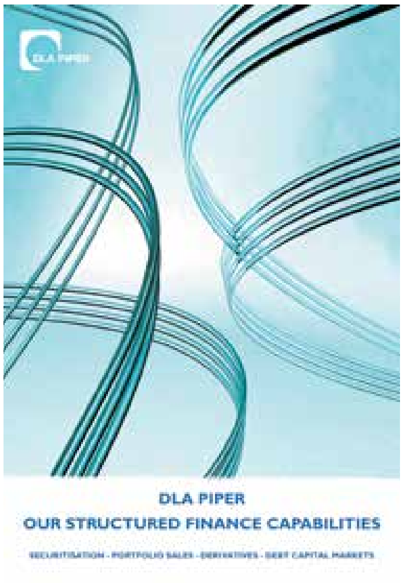
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