The Ministry of Economy and Finance

DEPARTMENT OF THE TREASURY – DIRECTORATE II

Circular dated 31 January 2007 (O.G. of 5 February 2007 N.29)

Law No. 296 of 27 December 2006 containing "Provisions for the drafting of the annual and pluriennial budget of the State" (the 2007 Financial Law), Article 1, paragraphs from 736 to 739. Explanatory circular.

To
The Regions
The Autonomous Province of Trento and Bolzano
The Autonomous Province of Aosta
The Provinces
The Municipalities
The Mountain communities
The Island communities
The Union of the Presidents of Regions
UPI
ANCI
UNCEM
The Unified Conference State-Regions
The General Accounting Office of the State - IGEPA
The Court of Accounts
The Regional Departments of the Court of Accounts
The General State Attorney's Office
The Regional Departments of
the General State Attorney's Office
The Bank of Italy
The Italian Banking Association

Law No. 296 of 27 December 2006 containing "Provisions for the drafting of the annual and pluriennial budget of the State" (the 2007 Financial Law) has enacted further provisions in connection with the entering into of derivative transactions by regions and local authorities referred to in Legislative Decree No. 267 of 18 August 2000 and has expanded the definition of debt contained in Article 3, paragraph 17 of Law No. 350 of 14 December 2003 in the light of the position recently taken by Eurostat.

In this respect it seems appropriate to clarify certain details for the correct interpretation of the above-mentioned provisions, without prejudice to the rules relating to the monitoring activity and particularly to the procedures set forth by Ministerial Decree No. 389 of 1 December 2003

containing “Regulation on the access to the capital markets by provinces, municipalities, metropolitan cities, mountain and island communities as well as for consortia between local authorities and regions pursuant to Article 41, paragraph 1 of Law No. 448 of 28 December 2001”.

1) Article 1, paragraph 736 (Basic principles for the coordination of public finance)

The paragraph introduces certain principles to be complied with by local authorities and regions in their legislative/administrative functions relating to the management of their debt through derivative transactions. The use of the circular clearly aims at combining the independence of local finance with the necessary consideration of the overall reduction of the cost of transactions entered into by local authorities and regions to manage their debt. The provisions contained in the paragraph must therefore be interpreted in this light.

The guidelines contained in the norm can be detailed as follows:

1. The objective of activities in derivative transactions must be that of strengthening the accounts of regions and local authorities through the reduction of the final cost of the transactions to be evaluated taking into account the exposure to market risks undertaken through the specific transactions. In other words, the terms and conditions of the transactions will have to be the result of a balancing between two elements: the aggregate cost and the market risk.
2. There must be the correspondence between the nominal amount of the underlying debt and that of the derivative transaction entered into for the hedging of such debt. It is possible to enter into derivative transactions having as underlying liabilities another derivative transaction exclusively in the case where the local authority has the need to restructure a transaction as a consequence of the change in the corresponding underlying debt, event already contemplated in the Circular dated 27 June 2004 (explanatory of the Ministerial Decree No. 389 of 1 December 2003), to which express reference is made.
3. Reduction of the credit risks undertaken. Also in this case the general requirement is that of adoption of a prudent behaviour in line with the provisions contained in the regulation for the enactment of Article 41 of Law No. 448/2001 (Ministerial Decree No. 389 of 1 December 2003). Such principle, similarly to what provided in the above mentioned regulation must be complied with by regions and local authorities through their evaluation of the creditworthiness of the counterparties of derivative transactions. Such counterparties shall have indeed to be adequately rated by at least one of the primary international rating agencies (which currently are S&P, Moody’s and Fitch Ratings). In addition, also the management of the credit risk undertaken through a sinking fund or an amortisation swap required for transactions with bullet redemption at maturity shall have to be based on the same creditworthiness criteria.

2) Article 1, paragraph 737 (Article 41 paragraph 2-bis of Law No. 448 of 28 December 2001)

Regions and local authorities at the time of closing of single transactions must have in place all final contractual documentation related to each single transaction. Whenever additional structures are associated to a single transaction, including those of guarantees (including but not limited to delegations of payment, credit support annexes, credit support deeds etc..), the relevant final and complete documentation will also have to be in the possession of regions and local authorities at the time of the closing of each single transaction to which they are connected.

This paragraph has been introduced to further strengthen the provisions of Article 41, where it provides for the monitoring of indebtedness as it is believed that a prior communication to the

Ministry of Economy and Finance of transactions will permit their more accurate identification. In this way, the monitoring activity is supported by the consequent non-effectiveness of a contract should such contract not be transmitted to the Ministry prior to its signing, permitting also in this way, to cross examining the data included in the quarterly communications to be sent by regions and local authorities as provided by decree of the Ministry of Economy and Finance of 3 June 2004 (i.e. to be made on the 15 of February, May, August, November).
The burden of prior transmission, which must be made prior to the execution of a contract, applies to contracts and to any other contractual documentation to which reference may be contained therein (if any) with the requirement to specify also the underlying transactions. Such filing must be made with the Treasury Department at the fax number 06-47613197 or, alternatively, at the e-mail address dt.direzione2.ufficio4@tesoro.it.

"Documentation related to the transactions" means the Confirmation or other contracts fixing the economic terms and all other conditions of the transactions – including the denomination of the counterparty of the region and local authority – and, whenever a reference is made to it, the Schedule or equivalent document used on the markets, the structures to provide guarantees (if any), as referred to above and any other contract or document prepared to create sinking funds, charges, pledges, credit support annexes, credit support deeds or other transactions related to the transactions referred to in paragraph 737 used on the markets.

The above-mentioned provisions are applicable also to transactions with a trade date preceding the date of enactment of Law No. 296 of 27 December 2006 whose contracts were not signed at such date as well as to amendments, restructurings, novations or renegotiations of outstanding transactions. In the case of incomplete communications sent after the date of enactment of the law and prior to the date of publication of this circular, additional communications shall need to be sent with the missing data. Starting from the date of publication of this circular, the communications shall be made on the basis of the above-mentioned provisions, with the exception of any data which may not be obtained on the market at the time of their signing, which shall then need to be communicated as soon as available. By way of example, if a final rate which is obtained on a date subsequent to the closing of the transaction for which the communication has already been sent, the final rate may be communicated on a later date.

As to the provisions of paragraph 2-ter of Article 41 of Law No. 448/2001, such paragraph transforms into an obligation the power already attributed to this Ministry to inform the Court of Accounts (*Corte dei Conti*) of transactions which prove not to be compliant with the relevant legislation so to allow the Court of Accounts to intervene as appropriate within its competence. The Treasury Department retains in any case the power to concurrently inform also the General Accounting Office of the State.

3) Article 1, paragraph 738 (List of the financial debt transactions)

The registers referred to in paragraph 738 will have to contain details at least equal to those indicated in the decree of the Ministry of Economy and Finance dated 3 June 2004, published on *Gazzetta Ufficiale* No. 168 of 20 July 2004, and such details shall need to be periodically updated during the life of each single transaction. The five year period for the keeping of such registers shall start from the final maturity date of each relevant transaction and, transactions executed prior to 31 December 2006, but still outstanding, shall also have to be included in the registers.

The above-mentioned provisions shall be applied also in the event of amendments, restructurings, novations or renegotiations of transactions already executed and entered into in the registers.

4) Article 1, paragraph 739 (Definition of debt))

The provision set forth in this paragraph is divided into two parts: the first one defines as debt certain kind of financial transactions, thus classifying these transactions as debt within the Italian legal framework, in the light of the criteria set forth by Eurostat in its communication of 4 September 2006; the second part indicates that such new classification does not apply to those transactions which have been authorised and completed within 31 March 2007.

The above-mentioned communication has clarified the accounting treatment, pursuant to ESA 95, of the assignment of claims and securitisation transactions having as object receivables of suppliers of goods and services towards the ASLs, pursuant to which regions undertake to make payments through the issue of a new delegation of payment deriving from the restructuring of the original commercial debts.

Eurostat, in the above-mentioned communication, clarifies that the issue of a new delegation of payment, associated with the rescheduling of the payment terms, represents *de facto* a novation of the original debt, which transforms the debt from a commercial debt into a financial debt, increasing the aggregate level of debt of the entity and, as a consequence, of the public administration, pursuant to the criteria set forth by the EU regulation for compliance with the parameters fixed by the Treaty of Maastricht.

For the purposes of this paragraph all receivables, even if title thereof has been transferred to financial intermediaries or special purpose vehicles, originating from contracts for the supplies of goods and services are relevant – also if originated within framework agreements – to the entities referred to in paragraph 17 of Article 3 of Law No. 350 of 14 December 2003.

Payment extensions beyond 12 months not contemplated in the original terms of the relevant supply and becoming the subject of subsequent agreements, as well as the renegotiations of new obligations assumed also indirectly by the relevant entity (such as, by way of example, the delegation of payment) associated with the rescheduling of payment terms, are considered restructuring of the amortisation schedules.

On the basis of the above, it clearly appears that when a securitisation transaction is entered into based on the above-mentioned agreements for the rescheduling of payment terms, the financial nature of the debt, so novated, is strengthened. For the purposes of the relevant legislation, any other transaction pursuant to which the relevant receivable is given as a guarantee / collateral of the notes issued, even if perfected through a private placement, is assimilated to a securitisation transaction.

Transactions for which the relevant resolution fixing the main terms and conditions has been adopted by the competent authorities within 4 September 2006 are excluded from the classification of debt transactions referred to in paragraph 17 of Article 3 of Law No. 350 of 24 December 2003, provided that such transactions are completed within and not later than 31 March 2007 and provided that such transactions do not contemplate assignments of receivables on a revolving basis.

“Main terms and conditions” means:

a) the maximum amount of receivables which are the subject of the transaction;
b) the nature of such receivables;
c) the years of origin of such receivables.

"Completion" of the transactions means, for the purposes hereof, the completion and execution of all the agreements related to the relevant transaction, including but not limited to, as the case may be, the agreements for the restructuring of the payment terms and the assignment agreements, if any, related to current and certified receivables at the date of the assignment, including the receipt of the relevant notices by the assigned debtors.

Starting from 1 January 2007 no new receivables can be injected in transactions of assignment of receivables and/or securitisation transactions on a revolving basis outstanding at 31 December 2006, even if authorised through resolutions adopted prior to 4 September 2006, and such transactions will have to be terminated within and not later than 31 March 2007. Starting from 1 January 2007, receivables being the object of assignments entered into pursuant to transactions authorised and completed prior to 4 September 2006 cannot be the further assigned.

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(Maria Cannata)