Think global, act local

Austrian finance structures are usually part of a wider global structure, but the intricacies of Austrian finance law can't be ignored. By Volker Glas of Cerha Hempel Spiegelfeld Hlawati

Structured finance is understood by many writers to encompass all advanced private and public financial arrangements that serve to efficiently refinance and hedge any profitable economic activity beyond the scope of conventional forms of on-balance-sheet securities (debt and equity capital markets, loans) with an aim to lower the cost of capital. Structured investments either combine traditional asset classes with contingent claims such as risk transfer derivatives and/or derivative claims on commodities, currencies or receivables from other reference assets or fully replicate traditional assets synthetically. Often the motivation to enter into a structured finance transaction or to include structured elements in traditional financings is that established forms of external finance are either unavailable for a particular financing need or traditional sources of funds are too expensive.

Structured finance designs are usually developed in the London market by big players such as JPMorgan, Goldman Sachs, Deutsche Bank, HSBC or Bear Sterns and then forwarded to public or private clients in Austria that are endowed with the necessary asset classes and needs. Often local counsel then is confronted with a series of conflicts of law, questions in connection with the Collateral Directive 2002/47/EC, the EU Insolvency Regulation 1346/2000, and a typical Austrian patchwork type of advice in connection with stamp tax structuring.

When HSBC entered into a €100 million monetization involving an Austrian counterpart by way of an equity swap and equity collateral in the form of shares in an Hungarian company registered with a Hungarian custodian, local law issues concentrated on how the security interest was to be perfected initially and, upon relocation of the securities to another jurisdiction, how to avoid a factual place of management in the jurisdiction where the collateral is located (so that an Austrian receiver in accordance with Regulation 1346/2000 is unable to include the collateral in its domestic proceedings), how the Insolvency Regulation relates to pre-existing Austrian insolvency law, and how to avoid the imposition of Austrian stamp tax by amending the ISDA share forward confirmation and the share swap confirmation.

When JPMorgan arranged a pan-European $1.5 billion multi-currency revolving securities facility with repeating transactions expanding the class of permissible assets to LME warrants and precious metals in subsequent seasons, local law issues focused on the treatment of such repos under the Austrian implementation law of the Collateral Directive with respect to formalities, creation and perfection of security interests, on the question whether the involvement of an Austrian securities depositary (with respect to securities in Austria) leads to the applicability of the bank's general terms and conditions and, in this connection, whether the Austrian bank has a lien on securities booked on its accounts, to what extent netting of claims across different locations and/or classes of assets is permissible, and again, how to minimize the risk that the overall transaction or parts of it trigger Austrian stamp tax.

When Austrian provinces (*Bundesländer*) and municipalities (*Gemeinden*) to a growing extent negotiate ISDA framework agreements with German or London market players, preferably to enter into interest rate and more exotic forms of swaps, but also into other derivative transactions, local issues involve the representation power of these political subdivisions, consequences of the lack of representation power (while Austrian law has no direct *ultra vires* concepts, lack of representation power might lead to similar validity defects in the documentation), limits in connection with a subdivision's ability to go bankrupt and limitations in connection with enforcement against the assets of political subdivisions.

After the US tax authorities ended cross-border leasing structures in 2004, many Austrian entities were left with long-term cross border structures and assets classes eligible for further optimization. In particular Austrian counterparts with a nexus to a political subdivision (so with an excellent credit rating) such as utilities or Austrian municipalities which themselves have entered into such cross-border transactions have recently been addressed to revalorize assets tied up in security arrangements such as long-term payment undertaking agreements, to reorganize CDOs entered into in connection with such cross-border transactions, or to synthetically back up existing structures by entering into CDO (squared) transactions mirroring the scheduled payments of the payment undertaking agreement or the master CDO. Local law issues in this connection usually include (cluster) risk assessments, and again, including Austrian public law peculiarities by amending the ISDA or Deutscher Rahmenvertrag documentation.

In one of structured finance's main fields of activity, the securitization market, the transaction work stream in Austria developed not as actively as it could or probably should. After the 1998 Amadeus $1.3 billion funding of a corporate debt obligation portfolio originated by Bank Austria Creditanstalt, structured partially synthetically and partially as a true sale, the 2000 Mozart Funding where Bank Austria Creditanstalt used a PSA/ISMA repurchase agreement to sell securities with a value of $650 million, which then were repackaged and securitized in two tranches, the 2001 FACT Porsche Bank AG's programme initially involving €400 million worth of auto leasing and auto loan receivables, the 2001 €2.6 billion Blue Danube benchmark transaction involving claims from state-subsidized and mortgaged housing loans originated by Niederösterreichische Landesbank-Hypothekenbank, the 2002 Promise transaction, where Bank Austria Creditanstalt synthetically transferred credit risks from loans to medium-sized entities in a volume of about €1.1 billion to Kreditanstalt für Wiederaufbau, and the 2003 €220 million auto leasing receivables originated by the Erste Bank leasing subsidiary EBV-Leasing, large bank originated transactions failed to be published until May 2007, when the Niederösterreichische Landesbank-Hypothekenbank closed another €2 billion transaction; this time, it purchased a portfolio of mortgage-backed securities from the province of Lower Austria which will continue to be guaranteed by the province and will be refinanced by the issue of mortgage bonds. This transaction again involved assessments of true sale versus synthetic securitization with the Austrian 1.2% court registration fee for the registration or transfer of mortgages being one structural issue.

In connection with corporate originators, only few transactions are published. While we are aware of a 2003 €290 million single corporate transaction where an Austrian telecommunications operator originated €350 million telecommunication receivables sold to an Irish conduit structured as a trust, the Austrian market afterwards lacked corporate originators endowed with large asset classes that were capable of making up the considerable transaction costs. Pan-European transactions, for example, of car leasing finance affiliates of European-wide operating car producers and dealers are seen in the market and make an increasing use of

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Volker Glas works in the banking and corporate finance department and has been a partner at CHSH since 1999. Glas graduated from the University of Vienna (Dr iur) in 1993 and New York University (LLM) in 1994, and joined CHSH as an associate in 1994. He was admitted both to the Austrian Bar and to the New York Bar in 1998.

Volker Glas specializes in banking, finance and capital markets. He regularly represents Austrian corporate borrowers in syndicated (LMA) loans and advises lenders or borrowers in senior and mezzanine financings, most recently Deutsche Bank AG, Amsterdam branch, in a €100 million financing of an Austrian copper refiner with the borrowing base secured by its copper warehouse, Telekom Austria in a €750 million syndicated facility involving 15 syndicate banks, JPMorgan in a multicurrency revolving LMA warrant and securities repo facility for the Bear Stearns group with respect to assets in Austria, Barclays Bank in an asset financing involving an Austrian direct marketing services provider, and in 2006 a series of other successful financings involving Check Online, Oesterreichische Kontrollbank and Bayerische Landesbank. In 2006, he advised the EIB/EIF in connection with their role as credit enhancer in a securitization involving RZB group and Polish leasing receivables. He also advises Austrian bond issuers in structuring and offering straight bonds, exchangeable bonds or EMTN or similar programmes.

Recent equity offerings included the Austrian Airlines rights offering in 2006 and the Immofinanz and A-Tec Industries convertible bond offer in January and May 2007, and on the debt side Telekom Austria's most recent €1 billion bond issue under its €5 billion EMTN programme.

Founded in 1921, CHSH Cerha Hempel Spiegelfeld Hlawati is a leading Austrian law firm, with offices in Bratislava, Brussels, Budapest, Bucharest, Gdansk, Katowice, Poznan, Warszawa and Wroclaw. The firm represents Austrian and international companies in the fields of telecommunications, energy, transport, new media and financial services. Cerha Hempel Spiegelfeld Hlawati is regarded as one of Austria's leading law firms in mergers and acquisitions, banking and capital markets, real estate, litigation and arbitration. The firm is a member of Lex Mundi.

The firm was awarded Austrian law firm of the year in 2004 as well as 2005 by the *International Financial Law Review*.

standardized documentation structures. However, pooled securitizations of comparable asset classes of unrelated originators (such as utilities with comparable electricity and gas supply receivables) have rarely seen the light of day, maybe because one could not agree on how to allocate transaction costs and the termination risk of busted deals. The implementation of even commodity documentations to local law might also lead to numerous issues to be tackled: When for example, the European Investment Bank and the European Investment Fund acted as credit enhancer in a securitization involving an Austrian bank's Polish leasing receivables, adaptations were necessary to fit into EIF's existing funding approvals. The funding had to be effected through the issue of proceeds from registered notes created under Austrian law, which had to be assignable and should at the same time not trigger Austrian stamp taxes.

In the last four years in Germany, trading in non-performing loan portfolios has become established, buying and selling NPL portfolios has become a normal instrument for banks' balance-sheet and risk management, and all market participants (purchasers, vendors and service providers) have begun to adapt to a routine with procedures being increasingly standardized, but the Austrian market is still rather silent in this field. Bank Austria Creditanstalt, quite likely motivated by the good experience its shareholders have made in this connection, announced a €500 million securitization of its NPL portfolio; yet in its 2006 annual report, Bank Austria indicated that that non-performing loans were reduced by 13% in 2006; as a result, the coverage ratio (that is, the extent to which unsecured NPLs are covered by provisions) in the group as a whole improved to 81 %.

In Austria, no special statute governing activities of special purpose vehicles (SPV) registered or incorporated in Austria exists and no special statute facilitates true sales or servicing activities in Austria. General civil law, commercial law, banking supervision law, data protection law, accounting rules, and tax and stamp duty law, including pertaining case law, apply. In addition, the Austrian Securitization Forum and the Committee for the Austrian Capital Market since 2003 have made considerable lobbying achievements to get legislative relief in certain limited problem areas such as licensing requirements, contractual prohibitions of assignments and stamp tax for transfers of receivables and other rights to SPVs.

SPVs registered or incorporated in Austria, under a special statutory provision on securitization companies (*Verbriefungsspezialgesellschaften*), from June 1 2005 do not require a banking licence provided their business activities are confined to issuing notes, raising loans, concluding collateral transactions and concluding ancillary transactions relating to the mentioned business activities, all targeting at purchasing receivables resulting from the business of other companies or targeting at assuming risks derived from assets (Section 2/60 of the Austrian Banking Act). The securitization company is obliged to keep banking secrecy like a credit institution (prohibiting the credit institutions, their shareholders, board members, employees and other persons acting on behalf of credit institutions from disclosing or using secret facts entrusted or made available exclusively due to business relations with customers). With the implementation of the Banking Law Directive 2006/48/EC the Austrian Banking also harmonized the securitization terminology in line with the Directives definitions and newly implemented rules on minimum own funds requirements for credit risks arising from securitization. The definition of securitization company was expanded to explicitly state that the business purpose of the company needs to be confined to the execution of securitization transactions, that the company needs to be structured to separate own obligations from those of the originator and that the holders of the interests or beneficial interests have the right to pledge or exchange those interests without limitation (in line with Article 4/44 of the Directive). In line with Article 4/36 of the Directive, *securitization* was defined (Section 2/61 of the Banking Act) to be any documented connected transaction or scheme whereby the credit risk associated with a receivable or a class of receivables is transferred to the investors of the securitization, and where payments in the transaction or scheme are dependent upon the performance of the receivables or pool of receivables and where the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

One main part of a typical ABS transaction due diligence related to the assignability and identification of other restrictions on assignments of originators' receivables. Apart from statutory restrictions on the assignability of receivables, Austrian law has suffered a long-standing and restrictive Supreme Court case law under which contractual prohibitions or restrictions on assignments developed legal impact on third parties so that, without having obtained the counterparties' waiver, such assignments were qualified void. However, with legal effect from June 1 2005, an amendment to the Austrian General Civil Code enabled to validly assign money-claim receivables derived from agreements between non-consumers (*Unternehmer*) despite contractual restrictions on the assignment. Under the new law, a prohibition to assign money claims from business receivables between non-consumers is only valid and effective if such a clause: "(i) has individually been negotiated and (ii) does not grossly discriminate against the creditor in line with the fact pattern of the case." While the first requirement excludes clauses embedded in general terms and conditions or in forms used for entering into agreements, the second criterion of a creditor's gross discrimination will regularly be assumed by Austrian courts unless the prohibition on assignment has, economically speaking, almost no effect on the creditor's financing options. In other words, prohibitions of assignments relating to money claims stemming from business transactions between non-consumers will in the future regularly be qualified void and, even if qualified legally effective, have only legal impact among the contractual parties and not regarding third parties. This results in the debtor's being allowed to pay either to the old or (after having been notified, however, only to) the new creditor, (rather theoretical) damage claims raised by the debtor against the old creditor (but not against the new creditor), a potential reduction of contractual penalties to be paid by the creditor to the debtor and a prohibition of relying on damage claims against the old creditor for the debtor when refusing to pay to the new creditor. Detailed transitory provisions exist for receivables created before the effective date of the amendment.

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Several partly, contradictory Supreme Court decisions were passed relating to (differing) factoring agreements in connection with the characterization of a receivables purchase as a true sale. The first decision in 1994 confirmed that, absent compelling reasons for a re-characterization of a receivables purchase agreement as a secured loan, the parties' intention to sell receivables will also be recognized during insolvency proceedings initiated against the originator. This decision was later affirmed by a Supreme Court decision in 1998 for standard factoring agreements. In another, somewhat criticized decision in 1994, the Supreme Court re-characterized the factoring agreement as a loan, linked to an assignment for security purposes on the grounds and the facts that the receivables served cross-collateralization purposes, prepayment was contractually capped with a specified amount and, upon termination of the agreement, repayment of outstanding prepaid amounts was agreed in the case at hand. Relating to the avoidance by an insolvency receiver upon knowledge or negligently lacking knowledge of a debtor's insolvency in disadvantageous transactions, further case law assumed the existence of single contestable "legal transactions" upon each creation of receivables under an existing master receivables purchase agreement. Moreover, there is longstanding case law re-qualifying any agreement on global assignments of receivables as an assignment with a security purpose element so that all publicity acts required for the perfection of assignments for security purposes must be complied with if a global assignment will be used for the receivables purchase transaction. In cases of global assignments of existing and future receivables, a creditor will only be secured in the originator's insolvency proceedings to such extent that receivables have already been created (*entstanden*) before insolvency. Even a re-qualification of the receivable purchase agreement as a loan and an assignment for security purposes will usually not affect the effectiveness of the receivables assignment in the seller's insolvency proceedings (receiver's right of avoidance) provided that the pertaining book-entry has been effected before the preference period and payment of the pertaining receivable is neither effected in the preference period nor after the seller has factually become insolvent (illiquid or over-indebted).

In connection with the perfection of global assignments of receivables, Austrian case law has recently experienced a change: The Supreme Court appears to take the view that assignments for security purposes (or receivables purchase agreements that include an element of security) may only be perfected by book-entry. Concerning future receivables, perfection by setting a general (global) book entry in the creditor's books (open items list) is assumed to be enough in terms of publicity. However, the book-entry must clearly indicate that the general assignment is meant to cover future receivables as well.

Since 2005, assignments of receivables to securitization companies (*Verbriefungsgesellschaften*, see above) are exempt from Austrian stamp tax. This stamp tax exemption does not apply only to SPVs incorporated in Austria, but also to SPVs registered abroad provided the SPV was set up for the purpose of purchasing a company's receivables. However, the stamp tax exemption is not an exhaustive one and relates only to assignments to securitization companies. It leaves the general provisions of the Austrian Stamp Tax Act unaffected which, provide for 0.8% or 1.5% stamp tax on loan agreements, credit agreements and 1% on surety agreements provided: (i) the agreement is entered into in Austria; or (ii) signed outside Austria and brought into Austria and used there for legal purposes; or (iii) signed outside Austria and, in the case of loan and credit agreements, one party has its registered seat or domicile or place of business in Austria and one of the parties with its seat in Austria has a right or obligation in Austria due to the transaction. Stamp tax may also be triggered by indirect evidences of agreement, substitute documentation and even by letters signed by one party and handed out to the other party. Because, in practice, ABS transactions often include credit agreements or collateral arrangements, there is still a requirement to structure transactions to decrease Austrian stamp tax risks.

Under Austrian insolvency law, the receivables purchaser has no segregation claim relating to the assigned receivable if the monies received were commingled with other monies held by the bankrupt originator. In particular if the commingling occurred before the initiation of bankruptcy proceedings, a pertaining claim for compensation will only constitute a claim against the bankrupt's estate. In practice, the pertaining problems are tackled by structuring the payment flows over accounts held by the originator as trustee for the receivables purchaser. Claims derived from trust accounts qualify as segregation claims in insolvency proceedings. Issues relating to the processing and transfer of non-sensitive data and to the protection of banking and other professional confidentialities are usually overcome by appointing a data protection trustee or by appointing the originator as such for extraordinary events and by relying on the originator as servicer in the normal course of business. Under Section 2/60 of the Austrian Banking Act as amended, the position that the Austrian banking secrecy prohibits any transfer of claims derived from a bank's business may no longer be upheld, provided that adequate protection measures are implemented relating to the receivables purchase and their servicing, if required; this should also simplify the implementation of a first Austrian NPL securitization.