Intelligence Search: Details

21-Jan-15 10:33 **Italian government set to unveil a bill to guarantee ABS mezzanine tranches**

EU ABS Proprietary

Intel. Type	ABS Other
Countries	Italy
Intel. Grade	Strong evidence
Intel. ID	1951730
Topics	Auto Legal/Regulatory RMBS SME ABS EUR ABS

Story

The Italian cabinet is set to unveil a bill that aims to provide public guarantees on mezzanine tranches of ABS, according to two sources close to the situation.

Italy would be the first euro-area country to provide guarantees for the tranches after the European Central Bank launched its ABS Purchase Programme in November. Under the programme, the ECB is only able to purchase the riskier tranches if they are guaranteed. France and Germany have rejected the ECB's call for governments to guarantee deals, while governments from peripheral jurisdictions have been more open to the idea.

The new legislation was originally part of so-called "investment compact", a package of measures designed to attract foreign investments approved yesterday (20 January) by the Italian Council of Ministers. However, Minister of Economic Development Federica Guidi said it will be issued through a new law decree, without mentioning any time schedule.

The guidelines of the Italian government proposal follow a policy paper authored by Alberto Gallo, head of macro credit research at Royal bank of Scotland, which was published on 19 January by Action Institute, an independent think tank chaired by Carlotta de Franceschi, a former Credit Suisse banker and one of Prime Minister Matteo Renzi's economic advisers.

According to the paper, guarantees from national governments or the European Investment Bank (EIB) should cover standard mezzanine tranches (10%-30% of the capital structure) on a first loss basis, with a 60%-80% coverage rate to limit moral hazard by leaving the investors exposed to some risk. The goal is to lower the interest rates charged on SME loans by helping banks to achieve significant risk transfer and free up capital.

For example, according to the paper, if an unguaranteed mezzanine tranche pays a 4% yield, a partially EIB-guaranteed tranche might pay just 1.2%, a figure equal to the EIB's funding cost of 70bp plus a potential 50bp liquidity premium demanded by investors, the paper noted, reducing the funding cost for the tranche by 280bps.

Adding in a 70bp premium paid to the EIB for the guarantee, the savings would still be over 2%, which the Action Institute estimates would allow lenders to reduce loan margins by 40bps, or roughly 10% of SMEs' current funding costs. A 10% saving in terms of interest cost for a 5x levered SME would result in a 10% increase of its free cash flow, the paper argued.

The EIB provides guarantees through its subsidiary, the European Investment Fund. EIF guarantees on ABS are provided usually in the form of wraps and bilateral guarantees to the noteholders on senior and/or mezzanine tranches, with a minimum double-B rating.

If the Italian government were to provide the guarantee, the savings would be less – the paper estimates a mezzanine yield of 200bps plus a liquidity premium, and the government may seek recompense for credit risk as well as its funding costs.

To be able to get a full capital relief from risk weighted asset reduction, banks have to sell the entire capital structure, a feat made more difficult by risk retention rules. Nonetheless, yield compression higher up the capital structure via public guarantees on the mezzanine tranches and ECB purchases should allow banks to increase the yield on the equity tranche and therefore make them more attractive to third parties, the paper concluded.

Key questions remain, however, as the eligibility of partially guaranteed tranches for the ECB purchase programme or even as repo collateral is unclear. The ECB has yet to publish the legal acts or other criteria governing guaranteed mezzanine tranches, despite launching the programme over two months ago and buying EUR 2.119bn of senior paper.

by Antonio Vanuzzo

Source **Debtwire EU ABS**