Article Title: ARCHIVE | Legal Criteria: European Legal Criteria For Structured Finance Transactions Data: (Editor's Note: This article has been republished to withdraw certain outdated criteria articles. See "Criteria | Structured Finance | Legal: European Legal Criteria For Structured Finance Transactions," published Aug. 28, 2008.) In recognition of the development of the European structured finance market, Standard & Poor's is pleased to provide this first edition of its reference guide to its legal criteria for European structured finance. Since the first publication of Standard & Poor's U.S. legal criteria guide six years ago, the structured finance market has undergone significant transformation. Internationally the market has enjoyed unprecedented growth, as well as unprecedented uncertainty. What was once an esoteric discipline known to a handful of finance professionals has now garnered the attention of the financial markets, regulators, and politicians across the globe. Throughout this time, Standard & Poor's sought to provide value to issuers and investors, as well as other structured finance market participants. In this regard, over the past few years Standard & Poor's has published many legal criteria articles applicable to the international structured finance market. In this guide, Standard & Poor's has aimed to convey the legal analysis and thought process behind the criteria, as well as the specific components of the criteria. As with any publication that tries to comment on a market as dynamic as securitization, market and structural changes in the transactions may make portions of this guide obsolete. Accordingly, we regularly publish developments in our criteria. Interim changes to the criteria set forth in this guide may be found on Standard & Poor's Web site at www.standardandpoors.com, or on RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. We encourage you to discuss these criteria with the members of Standard & Poor's Legal Department who practice securitization and look forward to meeting the continued legal and analytical challenges in structures to come. OVERVIEW OF LEGAL CRITERIA FOR EUROPEAN STRUCTURED FINANCE TRANSACTIONS Standard & Poor's has published numerous guides setting forth its criteria for structured finance transactions, including credit, legal, and structure-related criteria. In 1998, the initial issue of Standard & Poor's U.S. legal criteria guide for structured finance was the first of its kind to compile and update structured finance legal criteria for different asset types to assist market participants when considering the rating of structured finance transactions. The U.S. guide was revised in April 2000, April 2002, and April 2004. A separate Canadian legal criteria guide was published in April 2000. This European guide is intended as a complement to the U.S. and Canadian guides. In particular, for a more extended discussion of some of the issues addressed by this paper, market participants are invited to examine "Legal Criteria For U.S. Structured Finance Transactions," published in April 2004. The full text of these articles is available on Standard & Poor's Web site at www.standardandpoors.com, or on RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. 1. How To Use This Guide The purpose of this guide, like all our criteria guides, is to further Standard & Poor's continuing effort to serve its customers by providing insight into its rating methodology and processes. Understanding the implications of Standard & Poor's assumptions and its criteria enables a prospective issuer to anticipate and resolve most legal concerns early in the rating process. The first part of this guide describes the general methodology used by Standard & Poor's when reviewing the legal aspects of European structured finance transactions. Owing to the almost limitless combination of jurisdictions, structures, asset types, laws, and transaction parties that one might encounter in the European structured finance market, it is not possible to have detailed criteria that cover every issue in every jurisdiction. In this regard, the general criteria methodology set out in this guide should be viewed as providing a set of principles that guide market participants through the legal criteria issues likely to be raised in the context of Standard & Poor's rating process. The appendices that follow contain a compilation of Standard & Poor's commentary on certain discrete asset-specific and jurisdiction-specific criteria issues for the European structured finance market. To the extent users of this guide are unable to identify any specific criteria applicable to a particular type of transaction, they are invited to contact a member of Standard & Poor's legal department to determine whether any specific legal criteria issues or concerns may apply in the ratings process. 2. General Overview An issue credit rating is assigned by Standard & Poor's to a particular financial instrument. At one end of the spectrum, the unsecured debt of an issuer is generally rated based on the general creditworthiness of the issuer and the probability of the issuer's default. Further along the continuum is the issuer's secured debt. If, in addition to its promise to pay, the issuer identifies and pledges collateral available for repayment of the rated securities, then a given issue may be enhanced, that is, rated above, the credit rating of the issuer (issuer credit rating). The degree of rating enhancement generally depends on several factors, including, for example, Standard & Poor's assessment of the probability of default by the issuer and the recovery prospects on the assets pledged as collateral. At the other end of the spectrum are structured financings. In general, structured financings seek to legally isolate assets from a transferor's insolvency so that a purchaser of securities backed by assets may disregard the creditworthiness of the transferor of the assets. Thus, the structure seeks to isolate the risk of nonpayment on the issued securities from the credit risk of entities (such as sellers or pledgors of such assets) that are either unrated or have issuer credit ratings lower than the desired issue credit rating. Relying on such isolation of assets in structured financings, Standard & Poor's is able to base its ratings on debt issued in such transactions on the creditworthiness of the isolated assets (and any enhancements such as swaps or liquidity facilities), without regard to the creditworthiness of the original owner of the assets. In performing an analysis of a structured finance transaction, Standard & Poor's applies criteria that it has developed for these transactions, and, where appropriate, may request opinions of counsel that address insolvency, security interest, and other legal issues. As noted above, however, the criteria discussed in this guide are subject to revision. Also, this guide is not exhaustive and does not seek to set out every legal issue that may be involved in or relevant to a European transaction, nor does it purport to set out a full analysis of the complex legal principles that are discussed. Lastly, this guide should not be considered to constitute legal advice. Market participants seeking a rating from Standard & Poor's are invited to familiarize themselves with all the published criteria that may be relevant to their transaction. LEGAL CRITERIA APPLICABLE TO EUROPEAN TRANSACTIONS 1. General Principles As the securitization market has expanded into numerous jurisdictions, Standard & Poor's has continued to develop criteria to fit the particular legal system or systems involved. This is an ongoing process as new jurisdictions and new asset classes are brought into the global securitization market. Transactions may also involve multiple jurisdictions and multiple legal systems (common law and civil law), and, in those cases, several sets of country-specific criteria play into the overall rating of the transaction. The approach to securitizations in civil law jurisdictions differs from that in common law jurisdictions. Civil law jurisdictions, with the formality of their civil codes, the inability to rely on equitable principles, and the scarcity or uncertainty of case law applicable to the financial sector, pose special challenges to securitization. In many cases, these challenges are addressed by enacting securitization laws. In general, the wholesale export of U.S. criteria and methodology is generally not helpful in non-U.S. transactions. Experience has shown, however, that many of the elements of securitization, such as special-purpose entities (SPEs) and "true sales," become important building blocks of transactions throughout the world. Standard & Poor's criteria for securitization transactions, wherever effected, are developed by applying the principles of securitization set forth throughout this guide. Generally, Standard & Poor's asks the question whether the securitized assets can be sufficiently isolated from the transferor so that an insolvency of the transferor does not affect the creditworthiness of the assets. Once assets are considered to be sufficiently isolated, the creditworthiness of the asset pool is subject to review, taking into consideration any legal issues that may affect the cash flow of the transaction. This part of the guide describes the general methodology used by Standard & Poor's in reviewing the legal aspects of securitization structures when transaction parties, assets, and/or structural elements are located in Europe. 2. Existence Of The Assets Most structured financings consist of asset securitization where the investors' central credit risk lies in the assets that have been securitized. Credit risk embedded in assets (usually financial assets such as mortgages, credit card debt, and car and aircraft leases) can take many forms, including some related to legal risk. A key risk in the vast majority of asset securitizations is the core credit risk associated with the asset, namely, the risk that the underlying obligor defaults: the homeowner fails to make his mortgage payments, the cardholder defaults on his card payment, or the airline goes insolvent and ceases to pay its lease payments. Standard & Poor's seeks to model the likelihood of such events to determine the appropriate rating. In addition, Standard & Poor's also seeks to understand whether there are legal issues that could result in the holders of the rated notes suffering a loss. Assuming any legal issues are identified, Standard & Poor's seeks to understand how likely they are to be a problem and, if their existence is not compatible with the rating sought, how they have been resolved or mitigated. This chapter sets out some of the legal issues that can arise in relation to securitized assets. 2.1 ASSETS DO NOT EXIST 2.1.1 Fraud This is the risk that the assets never existed and that the sale of the assets by the originator proceeds from a criminal fraud. A Standard & Poor's rating cannot address fraud risk. Ratings are based on information supplied to Standard & Poor's by the issuer and the originator or its agents, as well as information obtained by Standard & Poor's from other sources it considers reliable. Standard & Poor's relies on the issuer, the originator, their accountants, counsel, advisers, and other experts for the accuracy, completeness, and timeliness of the information submitted in connection with the rating and surveillance process. 2.1.2 Assets Unenforceable Due to Documentary Defect This is the risk that the assets are not enforceable as a matter of law as a result of a documentary or similar defect. For example, local law may require certain types of loans to be notarized as a condition to their validity. In the absence of such notarization, the local courts would hold the original loan to be void. This would result in the securitization vehicle not owning any assets since they had never existed as a matter of law. 2.1.3 Assets Unenforceable Through Legislation This is the risk that the assets, although created pursuant to an otherwise valid set of documents, fall foul of some mandatory legislative requirement and that the penalty for such failure is that the underlying obligor is freed from its obligations. In certain cases, the obligor may be freed from all its obligations under the asset. In other cases, the obligor may be freed from a part only — for example, the obligation to pay early prepayment penalties. In some cases, the freeing of the underlying obligor is automatic, while in others it falls within the discretion of a court. The following are examples of such legislation: Consumer Protection Legislation.Many countries have legislation requiring consumer credit agreements to meet certain formal conditions, for example, providing for a "cool down" period during which a consumer may cancel a consumer credit agreement. Failure to inform the consumer of the existence of such a period could result in the credit agreement becoming void. Unlicensed Trading Legislation.Certain types of activity require the party engaging in them to be regulated. Insurance is a classic example. An insurance contract for the payment of regular premiums written by an unregulated insurance company is usually void. Similarly, in a number of European jurisdictions, lending activities require the lender to be regulated as a financial institution. Predatory Lending/Usury Legislation.Many countries have rules against predatory lending or usurious rates of interest. A loan made at a rate of interest above the ceiling set for usury may be void or, alternatively, interest may only be charged at the maximum non-usurious rate. Setting aside the issue of fraud, the proper party to ensure that no such defect taints the assets being securitized is the originator, who had control over their creation, and the local legal experts. Accordingly, Standard & Poor's expects the transaction documentation to contain a representation by the originator to the effect that the assets are valid and in existence. To the extent that transaction counsel is aware of specific legislation that may be applicable to the assets being securitized, Standard & Poor's expects counsel to draw attention to such legislation in the legal opinion and the originator to make specific representations covering those legislative provisions, in addition to the general representation. Although some originators may be uncomfortable with such representations in circumstances where they are primarily of a legal nature, it is the responsibility of the originator to ensure that valid assets are securitized since the originator is being paid a price consistent with assets that are enforceable. In certain rare circumstances, Standard & Poor's may accept a representation by the originator that it has sought and received legal advice to the effect that the assets are not tainted by the type of defect referred to in this section. Standard & Poor's assumes that any representations as to factual matters are made by the originator in good faith, in the belief that they are accurate and not merely as a risk allocation method. Therefore, if the originator cannot determine the substantial truth or falsity of such representations, Standard & Poor's expects to be informed of this fact. Where a risk to the existence of the assets is covered by a representation of the originator, Standard & Poor's would not usually expect to be provided with a legal opinion as to those risks. Where the originator is not willing or not able to provide such representations and Standard & Poor's is of the view that the relevant issue is material enough to affect the rating, then Standard & Poor's may request that the issue be addressed in an alternative manner. In certain cases, including that of many European asset-backed CP conduits, risks as to the existence of the assets (including sometimes fraud risk) are covered by other means, such as a liquidity facility or additional credit enhancement. In circumstances where such risks have been removed by such other means, Standard & Poor's relies on those means and does not expect any representations to be made by the originator. Equally, Standard & Poor's does not request legal comfort in such circumstances. 2.2 ASSETS EXISTED BUT CEASE TO DO SO: "DILUTION RISK" 2.2.1 Defective Goods or Services Risk This is the risk that, sometime after the creation of the receivable, the underlying obligor determines that the goods sold to it or the services performed by the seller who created the receivable were defective in some way that entitles the obligor to withhold payment of that receivable. In such cases, the documentation will usually provide that the seller must indemnify the issuer for such receivables. However, since Standard & Poor's analysis usually assumes that the seller is insolvent at the time the noteholders are to be paid, no credit can be given in the rating analysis to such indemnity. Accordingly, unless the risk is covered by other means, the risk of defective goods or services is usually accounted for in the modeling assumptions that drive the credit enhancement numbers. When sizing the credit enhancement, Standard & Poor's may add enhancement above that necessary to cover the credit default of the obligors to cover this risk. The size of such additional enhancement is typically based on an analysis of the quantum of such risk in the past, but may also take into account other facts relevant to any given transaction. 2.2.2 Credit Notes Many traders or financial institutions will seek to encourage customer loyalty through schemes such as rebates, bulk discounts, loyalty bonuses, etc. When a discount or rebate takes the form of a forgiveness of all or part of a securitized receivable, it is referred to as a "credit note". Since this credit note allows the obligor to withhold all or part of a receivable owned by the SPE, it could result in a loss to the holders of the rated notes. As a general rule, to avoid such a loss, Standard & Poor's expects that appropriate restrictions are placed by the transaction documentation on the seller's rights to issue such credit notes. Basically, the seller should not issue any credit notes unless it is within a pre-agreed limit which is reflected in the credit enhancement for the transaction and/or it has indemnified the securitization vehicle, prior to issuing the credit note, for the amount of that note. 2.2.3 Set-Off Risk This is the risk that, although the assets were validly created, when the SPE seeks to recover the proceeds of those assets, the underlying obligors are entitled to decline to pay because they have set-off rights against the seller. This could happen, for example, if the seller is a financial institution and the underlying obligor not only owes money to the institution under the receivable sold to the securitization vehicle but is also owed money by the financial institution with which it has various current and deposit accounts. In the same way, a trade creditor of the seller whose trade credit was sold to an SPE may have a claim against the seller for undelivered or defective goods. Depending on the circumstances, the trade creditor may be entitled at law to subtract from or "set off" against the amount owed under the sold receivable the amounts owed to it by the seller. When examining the issue of set-off, the first step of the analysis is practical. Factually, can the underlying obligors have any claims against the seller from unrelated dealings? (For a discussion of the claims arising from the goods and services that generated the receivable, see Part I, section 2.2.1). For example, a special-purpose auto-lending finance house that takes no retail deposits may simply not have any unrelated debts toward its customers. In such case, Standard & Poor's does not usually request any legal analysis of set-off risks. If, however, it is possible for the seller and the underlying obligors to have mutual debts, then Standard & Poor's generally expects to see an analysis of the nature of such risks in the legal opinions provided for the transaction. The issue of set-off only becomes a concern in the context of a securitization transaction once the relevant seller is insolvent. The transaction documents typically provide that, while the seller remains solvent, it will compensate the SPE for any loss resulting from a set-off. Once the seller becomes insolvent, however, such compensation right is normally just an unsecured claim against the seller's insolvency estate. Therefore, consistent with Standard & Poor's rating assumption that the seller is insolvent at the time noteholders are to be paid, Standard & Poor's cannot give any credit to such claim. The legal analysis of set-off risk in the context of securitization will usually involve two steps. The first step is to determine whether a right of set-off exists, notwithstanding the sale of the receivable. This will depend on the extent to which the local law allows set-off of unrelated claims in bankruptcy. In this context it may be that the documentation that created the securitized receivable contains contractual prohibitions on set-off. The question then becomes whether those prohibitions were lawful when entered into — for example, they may be disallowed by consumer legislation — and, if they were lawful at their creation, whether they remain enforceable in the insolvency of one of the parties. The second step is to determine whether the answer to the first question is modified by the fact that the receivable was sold to an SPE. This will depend on the position of local laws on the effect of such sale. Sometimes the sale will, by itself, end rights of set-off so that they are not a concern to a securitization. More frequently, however, rights of set-off will not cease until the obligor has been notified of the sale. Even then, the notification often merely "crystallizes" the rights of set-off. In other words, when notified of the sale, the obligor retains all the rights it had on the date of the notification but can gain no others. In some circumstances, even notification does not stop set-off rights, including rights acquired following the sale. To the extent that set-off is identified as a risk, following both the practical and the legal analysis, Standard & Poor's may be able to estimate the quantum of loss that could be suffered following a seller insolvency as a result of the exercise by obligors of lawful set-off rights. Standard & Poor's generally expects some form of credit enhancement to be put in place to cover such risks. 3. Special-Purpose Entities (SPEs) The initial structuring considerations for all securitization transactions generally focus on how assets can be isolated under local law so that a bankruptcy or corporate reorganization of the owner does not adversely affect the payment of principal and interest on the rated securities. Generally, to achieve this goal, the assets are transferred by means of a "true sale" to a "bankruptcy-remote" SPE, that is, an entity unlikely to be subject to voluntary or involuntary insolvency proceedings. In determining whether an SPE is bankruptcy remote, Standard & Poor's examines the incentives of the directors or the equity holders of the SPE to institute voluntary insolvency proceedings and the incentives of creditors of the SPE to institute involuntary insolvency proceedings. The bankruptcy-remoteness analysis also focuses on whether third-party creditors of the SPE's parent would have an incentive to make a claim against the assets of the SPE to satisfy the parent's obligations. Accordingly, the bankruptcy-remoteness analysis involves consideration of the insolvency regime (or regimes) that could govern a bankruptcy of the SPE. 3.1 CHARACTERISTICS OF BANKRUPTCY REMOTENESS Standard & Poor's has compiled the following "SPE criteria," which an entity should satisfy to be deemed a bankruptcy-remote SPE. An entity that satisfies these criteria is generally regarded by Standard & Poor's as being sufficiently protected against both voluntary and involuntary insolvency risks. These criteria can be divided into the following categories: Restrictions on objects and powers; Debt limitations; Independent director; No merger or reorganization, etc.; Separateness covenants; and Security interests over assets. Each of the above elements is important to the overall concept of bankruptcy remoteness. Regardless of the specific organizational structure of the SPE, these elements should, generally, be addressed in the relevant organizational and/or transaction documents. Their rationale, briefly explained below, is followed by a full description of the SPE criteria. 3.1.1 Restriction on Objects and Powers The fundamental SPE characteristic is that the entity's objects and powers be restricted as closely as possible to the bare activities necessary to effect the transaction. The purpose of this restriction is to reduce the SPE's risk of insolvency due to claims created by activities unrelated to the securitized assets and the issuance of the rated securities. To the extent that Standard & Poor's analysis relies upon the bankruptcy remoteness of an entity, Standard & Poor's requests that the SPE include in the transaction documents (to which the noteholders or their representative are party) or in its constituting document of establishment (for example, articles/certificate of incorporation for corporations, deed of partnership/partnership agreement for limited partnerships, articles of organization, or deed of trust/trust agreement for trusts) objects and power clauses that constrain the SPE to those activities needed to carry out the transaction. In certain jurisdictions with strong ultra vires rules, the insertion of restrictions on objects and powers in the constituting documents may create a risk that certain parts of the structured finance transaction being rated could be accidentally struck down. In jurisdictions where the risk of voiding part of the transactional structure due to ultra vires rules outweighs the benefits set out above, then the constraints may be inserted in the transaction documents. When the limitation on activities and other limitations discussed below are inserted in contractual documents, these should be inserted in one or more documents to which the noteholders or their representative are party. This serves to minimize the likelihood that the limitations could be amended without the consent of the noteholders (or their representative) and avoids reliance on often complex third-party contractual rights doctrines. SPEs generally do not have any employees, nor do they own or lease any premises. Nevertheless, there are some circumstances where premises are leased or held by SPEs. The first is CMBS transactions, in which the securitized assets consist of one or more commercial properties owned by limited-purpose entities at the loan level. These transactions and the property owner's status are covered by specific criteria (see the limited-purpose entity criteria discussed in "The European CMBS Loan-Level Guidelines", published in September 2004 on www.standardandpoors.com). The second is in those circumstances where, usually for reasons relating to tax residency, it can be demonstrated that the SPE is at greater risk from not owning premises than from owning premises. In these cases, the SPE may own or lease some form of premises. Among the risks that Standard & Poor's generally expects to see addressed are the risk of nonpayment of rent, local property taxes, occupier or owner liability, and the consequences of any damage or destruction to the premises. In brief, the SPE should not engage in unrelated business activities unless the parties to a transaction are willing to allow the rating to reflect the effect of these activities on the entity's resources, cash flows, and the ability to pay interest and principal on the rated securities. 3.1.2 Debt Limitations The purpose of the SPE additional debt limitation is to minimize the likelihood that the SPE will be filed or petitioned into bankruptcy by its creditors. The concern is that, to the extent that additional debt obligations of the SPE are rated lower than its outstanding debt, the additional debtholders may have an incentive to file a bankruptcy petition against the SPE and seek repayment on such additional debt from other assets of the SPE, such as overcollateralization supporting the higher rated debt. Once a bankruptcy petition is filed against an SPE, most jurisdictions' insolvency moratoria provisions make the timely payment of principal and interest on any of its outstanding debt obligations (regardless of the rating) highly unlikely. Therefore, Standard & Poor's rating on the initial debt issuance may be adversely affected if the SPE issues additional debt that is either not subordinated to the existing debt or is not rated the same as the existing debt. In other words, a default on lower-rated debt could bring about a default on higher-rated existing debt. Consequently, an SPE should be restricted from issuing additional debt unless that debt is either (i) fully subordinated to the outstanding debt, or (ii) rated by Standard & Poor's at the same level as the outstanding debt (at the time of issuance and at all times thereafter). 3.1.3 Exception to SPE Limitation on Additional Debt: Segregated SPE Issuers If an entity is established to serve as the issuer for multiple issuances of debt that are not rated the same or are not expressly subordinated, under certain circumstances this entity may nonetheless be viewed as an SPE by Standard & Poor's (see Part I, section 8). 3.1.4 Limitation of Recourse Any agreement between the SPE and its creditors should include limitation of recourse language pursuant to which the creditors agree that their recourse is limited to the assets backing the rated debt. "Creditors" in this context includes all transaction parties and noteholders. 3.1.5 Nonpetition Standard & Poor's also generally requests nonpetition language in any agreement between the SPE and its creditors, including all the transaction parties and noteholders, whereby the creditors agree not to file the SPE into bankruptcy and not to join in any bankruptcy filing for the SPE prior to the end of a specified period after all of the rated debt is paid in full. 3.1.6 The Independent Director An SPE acts through its board of directors, general partner, trustee, management committee, or managing member, as applicable. In the case of a corporation, for example, business is conducted at the direction and under the supervision of the board, although day-to-day management of the corporation is generally delegated by the board to the corporation's officers. The directors are elected by the shareholders, the corporation's owners. In certain European countries, among the major decisions requiring a resolution of the board of directors is the decision to initiate insolvency proceedings. It is this concern that prompts Standard & Poor's to request an "independent director" in respect of corporate SPEs, or the equivalent in the case of other forms of SPE. In many structured transactions, the SPE is sought to be established by a non-SPE operating entity parent. This parent may, at times, be either unrated or have an issuer credit rating below the issue credit rating of its subsidiary's debt. Moreover, the directors of the parent may serve on the board of directors for the subsidiary. Overlapping directorates present a potential conflict of interest. If the parent becomes insolvent there may be an incentive for the parent to cause the subsidiary to "voluntarily" commence insolvency proceedings, even though the subsidiary is nevertheless meeting its debts as they become due and is otherwise in a satisfactory financial state. From the parent's perspective, the SPE's insolvency proceedings paves the way for a consolidation of the SPE's assets with those of the parent and may be viewed as a way of forcing the holders of the SPE's debt to the negotiating table with a view to compelling them to compromise their claims. If the subsidiary has at least one director who is independent from the parent, the subsidiary may be less likely to initiate insolvency proceedings.

Standard & Poor's generally requests that the constituting documents of an entity seeking to be treated as a bankruptcy-remote SPE provide that an independent director be required to vote on bankruptcy matters and, in doing so, take into account the interests of the holders of the rated debt. Under the laws of some jurisdictions, the courts may view a director's taking creditors' interests into account to be a breach of the director's fiduciary duty to the corporation. Where this is the case, the constituting documents of the SPE should provide that the favorable vote of the independent director be required in order to pass all resolutions of the board of directors. The independent director should play a key role in the corporate governance of the SPE. In performing such a role, Standard & Poor's expects the independent director, within the boundaries of his or her legal duties to the company, to review the operation of the SPE and to provide information to the representative of the noteholders or the trustee if he or she becomes concerned as to the governance of the SPE. For this reason, even in jurisdictions where the directors have no latitude in initiating insolvency proceedings, for example, because the law only allows filing if an objective insolvency test is met, the presence of an independent director on the board is an important component of the bankruptcy remoteness analysis. In cases where an SPE is a limited partnership, Standard & Poor's generally requests that at least one general partner be constituted as an SPE, with such general partner itself satisfying Standard & Poor's bankruptcy remoteness criteria. If the SPE is a trust, Standard & Poor's requests that the related declaration of trust restrict the ability of the issuer trustee to voluntarily terminate the SPE while there is any rated debt outstanding. 3.1.7 No Merger or Reorganization This criterion seeks to address the concern that, while the rated debt is outstanding, the insolvency-remote status of the SPE is not undermined by any merger or consolidation with a non-SPE by any reorganization, dissolution, liquidation, or asset sale, or by the purchase by another company of the SPE's shares. This criterion is generally met by including relevant covenants and restrictions in the appropriate transaction documents. Standard & Poor's generally also requests that the SPE not amend its organizational documents so long as the rated debt is outstanding. 3.1.8 Separateness Covenants Separateness covenants are designed to provide comfort that the SPE holds itself out to the world as an independent entity. If the entity does not act as if it has an independent existence, a court may apply the principles of "piercing the corporate veil," "alter ego," or "substantive consolidation" ("consolidation") to bring the SPE and its assets into the parent's bankruptcy proceeding. The involvement of an overreaching parent is a threat to the independent existence of the SPE. Consolidation is the remedy exercised by a court when a controlling entity, such as the parent of an SPE, disregards the separate identity of the SPE such that their enterprises are seen as effectively commingled. This remedy can be sought by creditors with claims against an insolvent parent in the belief that funds can be properly traced into the subsidiary. Comfort that the SPE entity would not be consolidated with its parent in the event of the parent's bankruptcy is an important element of Standard & Poor's bankruptcy-remote analysis, and therefore the entity should observe certain separateness covenants, as more fully described below (see Part I, section 3.2.5). In addition, Standard & Poor's may request legal opinions to the effect that, in an insolvency of the SPE's parent, neither the SPE nor its assets and liabilities would be included in the insolvency estate of its parent. Such opinions are not normally sought where the SPE's parent is itself an SPE or where the shares of the SPE are held in trust for charitable purposes. 3.1.9 Security Interests Over Assets As a general matter, Standard & Poor's requests that an SPE grant a security interest over its assets to the holders of the rated debt. In connection with this criterion, Standard & Poor's generally also requests a security interest opinion, confirming that the holders of the rated debt have a perfected security interest (in the assets) that will survive the SPE's insolvency. The granting of security by the SPE provides comfort that the SPE is bankruptcy remote. This criterion assists Standard & Poor's in reaching the analytic conclusion that an issuer is a bankruptcy remote SPE by reducing the incentives of the parent, the creditors of the parent, and any other creditors of the SPE, to file the issuer into bankruptcy and thus gain access to the SPE's cash flows and assets. Reducing the incentive of the parties may reduce the risk of an involuntary bankruptcy filing. Compliance with the object and debt limitations discussed above is, as a general matter, not viewed by Standard & Poor's as an alternative to the granting of security. In multijurisdictional transactions, where the assets may be located in a variety of jurisdictions that are different from the jurisdiction of incorporation of the SPE and often different from the jurisdiction whose law governs the security document entered into by the SPE, the question arises whether the security granted by the SPE is perfected in such a way as to be enforceable in the jurisdiction where the assets are located. An example would be that of an SPE incorporated in the Cayman Islands granting security governed by English law over trade receivables due from German, Italian, and Dutch companies. Standard & Poor's is of the general view that the existence of security that is valid under its governing law and in the jurisdiction of incorporation of the SPE (or would be valid, but for conflicts of law issues relating to the jurisdictions in which the assets are situated) creates an adequate disincentive. Accordingly, in these circumstances, no opinion as to the enforceability in the jurisdictions of the obligors of the security provided by the SPE is generally requested. In addition, security interests may not be requested if incompatible with the rules set forth in any relevant securitization statute. These would include, for example, the law on French securitization funds or the law on Spanish securitization funds, so long as such rules provide alternative equivalent comfort, for example that the entity cannot be subject to bankruptcy proceedings. 3.2 GENERAL SPE CRITERIA Based on the principles discussed above, Standard & Poor's has developed the following criteria to help it assess whether an entity is a bankruptcy-remote SPE. 3.2.1 Restrictions on Objects and Powers The organizational documents or, where appropriate, the contractual documents, should provide that the entity not engage in any business or activity other than those necessary for, or incidental to, its role in the transaction. In addition, the organizational or contractual documents should provide that they cannot be amended without prior written notice to Standard & Poor's for so long as the rated debt is outstanding. 3.2.2 Debt Limitations Additional Debt.Except in the case of certain segregated SPE vehicles (see Part I, section 8) the SPE should not incur any debt unless (i) the additional debt is assigned the same rating by Standard & Poor's as the issue credit rating requested for the rated debt in a given transaction, or (ii) the additional debt is fully subordinated to the rated debt and, in either case, (a) is nonrecourse to the SPE or any of its assets, other than cash flow in excess of amounts necessary to pay holders of the rated debt, and (b) does not constitute a claim against the entity to the extent that funds are insufficient to pay such additional debt. (In addition to securities, "additional debt" includes any monetary obligation or other obligation that may involve the payment of money, such as guarantees, indemnities, and covenants by the SPE to release security.) Nonpetition.Any agreement between the SPE and its creditors should include nonpetition provisions in which the creditors agree not to initiate or join in any insolvency proceedings in respect of the SPE prior to the end of a specified period after all of the rated debt is paid in full. Limitation of Recourse.Any agreement between the SPE and its creditors should also include limitation of recourse language, pursuant to which the creditors agree that their recourse to the SPE is limited to the assets backing the rated debt. 3.2.3 Independent Director The SPE should have and maintain an independent director or its functional equivalent. "Independent Director" means a duly appointed member of the board of directors of the relevant entity who should not have been, at the time of such appointment, or at any time in the preceding five years, (i) a direct or indirect legal or beneficial owner in such entity or any of its affiliates (excluding de minimus ownership interests), (ii) a creditor, supplier, employee, officer, director, family member, manager, or contractor of such entity or its affiliates, or (iii) a person who controls (whether directly, indirectly, or otherwise) such entity or its affiliates or any creditor, supplier, employee, officer, director, manager, or contractor of such entity or its affiliates. 3.2.4 No Merger or Reorganization The SPE should not engage in any dissolution, liquidation, consolidation, merger, or asset sale (other than as provided in the relevant transaction documents) so long as the rated debt is outstanding without prior written notice to Standard & Poor's. 3.2.5 Separateness Covenants The entity should agree to abide by the following separateness covenants: To maintain books and records separate from any other person or entity; To maintain its accounts separate from those of any other person or entity; Not to commingle assets with those of any other entity (other than cash collections from the securitized assets, which may be placed in an account in the name of the servicer); To conduct its own business in its own name; To maintain separate financial statements; To pay its own liabilities out of its own funds; To observe all corporate, partnership, or other formalities required by the constituting documents; To maintain an arm's-length relationship with its affiliates (if any); Not to guarantee or become obligated for the debts of any other entity or hold out its credit as being available to satisfy the obligations of others; Not to acquire obligations or securities of its partners or shareholders; To use separate stationery, invoices, and checks; Not to pledge its assets for the benefit of any other entity or make any loans or advances to any entity (except as provided in the transaction documents); To hold itself out as a separate entity; To correct any known misunderstanding regarding its separate identity; and To maintain adequate capital in light of its contemplated business operations. 3.2.6 Security Interests in Assets Generally all of the SPE's assets should be pledged or charged to secure its rated debt. 3.3 ENTITY-SPECIFIC SPE CRITERIA Standard & Poor's recognizes that, depending on the jurisdiction of organization of an SPE and the nature of the entity to be used as an SPE (for example, corporation, trust, fiducie, partnership, fondo, etc.), there may be different or additional considerations that are relevant in reaching a conclusion that an entity is bankruptcy remote. Market participants should have regard to the principles discussed in the general SPE criteria when examining whether or not an entity and the laws of any particular jurisdiction support the conclusion of bankruptcy remoteness. In addition, market participants, when considering the use of SPEs in jurisdictions that are novel, are urged to contact Standard & Poor's as early in the transaction process as possible to allow for a timely consideration of any issues. 3.3.1 Structured Transactions Under Securitization Statutes A number of European countries have enacted statutes designed to facilitate securitization by establishing a specific framework addressing bankruptcy and security interest concerns. Most of these securitization laws set forth procedures that, if followed, lead to the conclusion that, in an insolvency of the transferor, the assets would not be available to the liquidator or any third-party creditor of the transferor. As a general matter, Standard & Poor's considers each statute and assesses whether it adequately addresses the insolvency concerns described earlier in this guide. Some of these statutes require the use of an SPE. The statute may also specify the corporate formalities necessary to create an issuing SPE, including its form (for example, trust, fund, or corporation), its powers, and its ownership structure. If the statute adequately addresses Standard & Poor's concerns, Standard & Poor's may rate the debt issued in transactions that are based on such statutory frameworks higher than the transferor's rating. Spain, France, Portugal, Italy, Greece, and Belgium, to name a few, have enacted securitization statutes. 3.3.2 Structured Transactions Under Corporate Law In most cases, however, the use of securitization statutes is not mandatory and/or such statutes may only facilitate the securitization of a limited number or type of assets. In other cases, the statute may not define the SPE requirements. Transaction participants may have the option of structuring securitizations under general law rather than a securitization statute. In that case, as in the case where there is no securitization statute, Standard & Poor's generally considers local corporate and contract law to assess whether an SPE organized in the particular jurisdiction or purchasing assets in that jurisdiction (in the case of offshore SPEs) can be viewed as bankruptcy remote, as understood under Standard & Poor's criteria. Standard & Poor's may also consider certain aspects of the general local law, even when a transaction is carried out under the local securitization law. This would be the case where the securitization law only partially addresses Standard & Poor's bankruptcy-remoteness criteria but where the gaps can be adequately dealt with using more-traditional legal devices. For example, in Italy, the securitization law adequately addresses the issue of true sale but only partially addresses the issue of security provided by the SPE for the noteholders. Here, to satisfy Standard & Poor's general SPE criteria, security under corporate law is typically granted by the SPE over some of its assets, in addition to the security provided for in the statute. Standard & Poor's may also consider the validity and enforceability of any covenants against the entity's incurring indebtedness and voluntary bankruptcy or reorganization. For instance, in a number of jurisdictions, voluntary bankruptcy filing or dissolution of a company is a shareholder decision by statute, and any restriction of that shareholder power, or transfer of that power to another corporate body such as the board of directors, may be unenforceable. In those jurisdictions, Standard & Poor's generally may not be comfortable that a wholly owned subsidiary of a transferor can be viewed as bankruptcy remote. 4. Asset Isolation 4.1 OVERVIEW Securitization is, in its most traditional form, a financing technique whereby the investors primarily take the credit risk embedded in a pool of assets. As a corollary, in a traditional securitization the insolvency risk of the originator is usually removed from the structure. Absent such removal, the financing becomes no more that a secured financing rather than a securitization. Key to mitigating the originator's insolvency risk is the use of appropriate legal structures. These structures ensure that if the originator becomes insolvent, such insolvency does not result in an interruption to the cash flow generated from the assets that are the subject matter of the securitization, or, if any interruption is expected, that such interruption can be sized and covered in some way to reduce the risk that payment of either principal or interest on the rated debt is adversely affected. In the U.S., where securitization began, the extensive powers granted to the bankruptcy courts over companies in Chapter 11 of the U.S. Federal Bankruptcy Code means that the most practicable way of isolating the assets from the insolvency risk of the originator is to effect a "true sale" of the securitized assets. (Note: Insolvent companies in the U.S. may ask the courts to place them in Chapter 7 of the U.S. Bankruptcy Code, which envisages the prompt liquidation of the company's assets, or Chapter 11, which is aimed at a rehabilitation of the company. Under the rules governing Chapter 11, the insolvent company receives extensive protection against creditors, including secured creditors, and the courts have broad powers to rearrange pre-insolvency rights, including those related to security.) In the U.S. context, a true sale involves the perfected transfer of title to the securitized assets from the originator to an SPE. Following a true sale, as a general matter, the assets cease to be part of the corporate estate of the originator, and therefore do not form part of bankruptcy estate of the originator. Since the modern era of securitized financing began in the U.S., true sale was seen as the hallmark of any securitization. Nevertheless, this historical perspective should not obscure the fact that the essence of a securitization is the isolation of an asset or set of assets so that the holders of the securitized debt may continue to benefit from the cash generated by such assets, notwithstanding the insolvency of the originator. This result may be obtained in many different ways in the different jurisdictions in which Standard & Poor's rates structured finance transactions (see "Securitization Without True Sales: They Do Things Differently in Europe," published Oct. 6, 2003, on www.ratingsdirect.com). It is therefore not the case that a true sale is the only way in which one may achieve a securitization. The legal analysis that Standard & Poor's applies when rating securitizations does not necessarily focus, therefore, on formalistic requirements, for example, whether there has been a sale of the asset to the SPE. Instead, the focus is on the actual legal consequences of the structure chosen by market participants, for example, if the originator becomes insolvent, whether a court can order an interruption in the payments due to the SPE. It nevertheless remains the case that many jurisdictions have insolvency regimes that contain provisions broadly similar to those in Chapter 11 of the U.S. Bankruptcy Code and that, in many places, a transfer of title to the securitized assets remains the simplest and most effective way to achieve isolation from the credit risk of the originator. In addition, transactions referred to in the market as "whole business securitizations" or "corporate securitizations" may be rated on a different basis than a traditional securitization. These securitizations may not require the isolation of a pool of assets from the insolvency risk of an originator or may be based on a form of isolation that is weaker than that anticipated by a true sale but is nevertheless appropriate for the rating because the rating is linked, to some extent, to the rating on the originator. Similarly, CMBS may be rated on a different set of criteria (see Appendix III). Finally, a large part of the present European securitization market is made up of what are commonly referred to as "synthetic" transactions. These are transactions that, by definition, do not involve any transfer of the securitized assets. Although these transactions are rated on the same general criteria as apply to all securitizations, these criteria are adapted to reflect the different legal structures used for synthetic transactions. 4.2 TRANSFERS OF ASSETS AND PERFECTION 4.2.1 General In a securitization where a transfer of assets is involved, the transfer is generally intended to be effected in a manner that shields the assets from the insolvency risk of the transferor. As a general matter, the insolvency and reorganization laws of the particular jurisdiction determine the effect of an insolvency proceeding on the assets of the bankrupt entity (insolvency moratorium, repudiation or rejection of contracts, preference rules, treatment of secured creditors, etc.). Certain countries, such as France and Italy, have enacted securitization statutes that clearly delineate the conditions and formalities under which the transfer must take place in order to achieve this objective. However, securitization laws are not always successful in eliminating obstacles to transfers. Countries where no special statute exists must rely on general laws, and, in many jurisdictions, there are significant legal and practical obstacles to structuring a true sale. One of the more common issues is that a perfected transfer of assets is cumbersome, time-consuming, and costly. Depending on the asset, the transfer may require either the consent or notification of the obligors on the underlying assets. In some cases, a transfer may require preparation and registration of notarial deeds and payment of stamp or transfer taxes. These perfection requirements generally inhibit the use of structured finance as a financing technique. In addition to the above factors, there may be circumstances in which a bankruptcy court in the particular jurisdiction may set aside a transfer of assets effected by the transferor before the bankruptcy filing (preferential transfer, fraudulent transfer, etc.). Standard & Poor's may request comfort that steps have been taken to lessen this risk. The word "transfer" is often used without regard for its scope. As a legal matter, a transfer may fulfill one or more of the following objectives: It can be valid and enforceable against a solvent transferor, and result in the transferee having priority against third-party creditors while the transferor is solvent. It can be valid and enforceable against the regulator (if any), obligor in possession, or an insolvency officer of the transferor (liquidator, administrator, examiner, administrateur judiciaire, Insolvenzverwalter, syndicos, etc.), in an insolvency or reorganization proceeding and against other creditors of an insolvent transferor. It can be valid and enforceable against the obligor, enabling the transferee to enforce its rights on the assets directly without relying on the transferor (for example, by giving the transferee the ability to foreclose on a mortgage or repossess an automobile after default on the loan). 4.2.2 True Sale of Legal Interest A perfected transfer of an asset to an SPE is a securitization technique that, although sometimes complicated or costly, is achievable in most jurisdictions. A perfected transfer of an asset is one that meets all three of the objectives noted above (i.e., it is a transfer that is immediately effective against the transferor, its creditors, its regulator, and its insolvency officer, and can be enforced against the obligor.) This transfer legally isolates the assets from the insolvency risk of the transferor. It is the fully perfected transfer of ownership interests, vesting legal title in the SPE on the closing day. Unlike a transfer of equitable interest or unperfected transfer (see Part I, section 4.2.3), such a transaction does not generally involve transfer-related triggers, i.e., events that trigger the perfection of the legal transfer, because the SPE, as owner of the assets, is able to collect scheduled payments and enforce security against the obligor. This type of transfer also usually limits the obligor's ability to set off against the transferor or, at least, crystallizes the obligor's set-off rights as of the moment the sale is in effect. It also terminates the obligor's right to receive good discharge of the debt by paying the transferor. Generally, the effect of a perfected transfer is that the assets can be realized at all times, notwithstanding the insolvency of the transferor. 4.2.3 True Sale of Equitable Interest or Unperfected Sale A transfer of an equitable interest (more likely to be available in common law jurisdictions) or an unperfected sale is a transfer that may meet only the first two objectives above. It is a transfer of full beneficial interest that is generally enforceable against the transferor, its regulator, its creditors, and also against its liquidator or receiver, but not against the underlying obligor. In structured finance transactions that involve the transfer of an equitable interest or unperfected sale, an interest recognized at law passes to the transferee, although the legal title may remain with the transferor. The effect is that the economic benefits of the assets would not be viewed as property of the insolvency estate of the transferor. However, the obligors would still be entitled to treat the transferor as their creditor. As a consequence, (i) the obligors would get good discharge by paying the transferor, (ii) the obligors would be able to set off against amounts owed by the transferor to the obligors, and (iii) in some cases, the SPE would need the co-operation of the transferor, or its receiver or liquidator (as legal owner) to enforce or realize on the assets against the obligors. To mitigate these risks, these transactions generally rely on pre-insolvency trigger events to perfect the legal transfer against the obligors by, for example, the giving of notice of the transfer to the obligors or the making of appropriate filings or registrations. In some transactions, the trigger event could be the actual insolvency of the transferor. For example, in England, a durable power of attorney may be enforceable notwithstanding the insolvency, and may enable the SPE to accomplish the legal transfer of the assets, without the co-operation of the transferor, even after insolvency proceedings begin. Often, equitable transfers or unperfected sales create liquidity stresses for the transaction. Following the insolvency of the transferor, a period of time may elapse before the SPE is able to give the notices or make registrations or filings necessary to redirect the cash flows generated by the assets. In these circumstances, Standard & Poor's may consider how the transaction is structured so as to minimize the likelihood of interruptions in the payment of interest and principal on the rated debt. This may involve an analysis of the means necessary for the SPE to proceed with perfection formalities. The liquidity stress may be mitigated by the provision of a liquidity facility by an appropriately rated third party. In other cases, the transfer may not be legally capable of being perfected as against the obligors after the initiation of bankruptcy proceedings against the transferor. In these circumstances, as stated above, the SPE may require the co-operation of the insolvent transferor to enforce or realize its rights against the obligors. In these cases, Standard & Poor's may consider the incentives for the transferor to co-operate. Such incentives may include, by way of example, a market-value servicing fee or the fact that the transferor retains an economically meaningful subordinated position in the transferred assets. This may often be the case, for example, in transfers to CP conduits, where the credit enhancement is provided through a deferred purchase price which is only payable to the transferor (or its insolvency estate) following collection. 4.2.4 True Sale Opinion Sometimes, assets may pass through multiple owners before coming to rest in an SPE. To obtain legal comfort that each transfer of assets through the chain of transfers from any transferor to an SPE constitutes a true sale, Standard & Poor's generally requests a "true sale opinion" on each transfer. The true sale opinion should state that the assets being transferred and the proceeds thereof will not be property of the transferor's bankruptcy estate. Nevertheless, Standard & Poor's may waive its request for true sale opinions on each transfer in the chain if, in its view, such opinions would be burdensome and add little real value in the particular circumstances. For example, Standard & Poor's does not request true sale opinions in the case of "open-market transfers," as it considers these transfers to be true sales for bankruptcy purposes. Standard & Poor's will consider transfers on a case-by-case basis to determine whether they are open-market transfers. As a general matter, if the transfer satisfies the following criteria, Standard & Poor's will deem the transfer to be open market: (i) the transfer is an arm's-length, nonrecourse transfer between unaffiliated entities; (ii) the transferor received payment in full at the time of the transfer; and (iii) the transferor does not receive, as payment, any notes issued in the transaction. Depending on the type of transaction, Standard & Poor's may also consider additional factors in determining whether a transfer is open market. In the context of CDO transactions, for a transfer to be deemed open market, Standard & Poor's generally considers whether the transfer was for the purpose of securitization (on the theory that the transferor of bonds or loans to the issuing SPE functioned as a broker/dealer intermediary and the bonds or loans never came to rest with the transferor) and that the transfer occurred within a reasonable period of time before the securitization. In some cases, it may not be clear whether a transfer is indeed an open market transfer, in which case Standard & Poor's may request a true sale opinion. 4.2.5 Recharacterization Risk The courts in many jurisdictions may be entitled to recharacterize transactions that purport to be sales or transfers as some other type of transaction, usually a secured loan. In other words, the court could look at the substance of the commercial relationship between the originator (i.e., the seller) of the assets and the SPE (i.e., the purchaser) and determine that, although the documents present the transaction as a sale of assets, it bears the hallmarks of a pledge or security transfer, where the cash described as the "purchase price" is actually the loan, and the "sale" of the assets is actually a pledge/security transfer of the assets to secure the repayment of that "loan". To understand how this risk could affect the rated notes, Standard & Poor's generally requests legal comfort that the sale cannot be recharacterized as some other type of legal relationship. If it is not possible for such an opinion to be given, then Standard & Poor's seeks to understand, through the legal opinion, what the consequences of such recharacterization would be. In some cases — for example, in the U.K. — such recharacterization results in a total credit loss since security interests, in order to be valid, must be inscribed in a public register. Failure to register a "sale" that has been recharacterized as a security interest therefore results in the "security" being void and the seller being entitled to the return of the receivables. In exchange, the SPE is left with an unsecured claim against the originator. In these circumstances a structure would remain exposed to the credit risk of the originator. In other cases — for example, The Netherlands—such recharacterization would result in a timing problem since, although the security would be valid, in the insolvency of the originator and under the local insolvency regime, it may not be enforceable for a period of time. The length of such period, traditionally known as an insolvency or bankruptcy moratorium, depends on the local rules and often involves the discretion of the court. In such circumstances, reliance may be placed on other structural enhancement, such as a liquidity facility or cash reserve. Absent such enhancements, however, the imposition of an insolvency moratorium is likely to lead to an interruption in payments of interest and/or principal on the rated notes. Again, in these circumstances a structure would remain exposed to the credit risk of the originator. Finally, in some jurisdictions a recharacterization may have no negative impact since the SPE, as holder of security, retains substantially the same economic rights to keep the cash collections from the assets and use them, as they would if they had owned the assets outright. The only change is that these cash collections will be received by the SPE, not as full owner of the assets, but as security beneficiary of such assets. (For an analysis of the criteria and approach Standard & Poor's would bring to bear on such security, see Part I, section 4.4). 4.3 PREFERENCE AND AVOIDANCE OF TRANSFER Almost all jurisdictions have rules whereby transfers that would otherwise have been valid can be set aside in the insolvency of the transferor. In most European jurisdictions, these "preference" rules apply where the transferor was already insolvent at the time the transfer took place or became insolvent as a result of the transfer. The preference rules then split into two categories: those jurisdictions (such as Germany and Italy) where the preference rules will not be triggered unless the SPE knew of the insolvency, and those jurisdictions (such as the U.K. and France) where the rules can be triggered even if the SPE was unaware that it was dealing with an insolvent transferor. Furthermore, the insolvency law of a particular jurisdiction may set out other circumstances that must be present before the preference rules are triggered and the transfer is voided. For example, in the U.K., the court must be satisfied that the transfer was made at an undervalue or was a "preference" as defined in the U.K. Insolvency Act; in Germany, the transfer must have been to the prejudice of other creditors. Therefore, the first line of defense against preference risk generally is comfort that the transferor was not insolvent at the time of the transfer or as a result of that transfer. In the case of transferors that have a current Standard & Poor's rating in the investment-grade category, reliance is generally placed on the transferor's rating as an indication of its solvency. For transferors that do not have a current Standard & Poor's rating or whose rating is in the speculative category (i.e., non-investment-grade), Standard & Poor's expects counsel to the transaction to perform such checks as would normally be performed to ascertain to the extent possible the solvency of a corporate entity. This may, for example, consist of a search in the Companies Register in the U.K., a check in the Registre du Commerce in France, or the obtaining of a certificato di vigenza in Italy. In addition, Standard & Poor's may request solvency certificates signed by senior officers of the transferor and dated the date of the transfer of the assets. Where requested, these certificates should state that the transferor was solvent as at that date. To the extent that transactions anticipate further asset sales after closing, Standard & Poor's generally expects transferors to issue additional solvency certificates as of the date of each sale or on a periodic basis. In cases where the transferor has an investment-grade rating on the closing date of the transaction and further sales of assets are expected (for example, by way of substitution of maturing assets), if requested, the transaction documentation should generally provide that, if the transferor ever loses its investment-grade rating, it will then comply with the requirements for a non-investment-grade transferor by providing a solvency certificate on each sale date or on a periodic basis. Clearly, solvency certificates are not legally dispositive. Even in jurisdictions where knowledge of the insolvency by the SPE is necessary, a court could choose to ignore solvency certificates in determining whether the SPE did indeed possess such knowledge. In the absence of genuine fraud, however, such certificates should provide favorable evidence to strengthen the SPE's plea of ignorance, where such ignorance is a defense, and should provide some comfort that the transferor is solvent even in those jurisdictions where ignorance is no defense. Finally, in those jurisdictions where the SPE's knowledge is not relevant to the application of the preference rules or where the burden of proof in demonstrating lack of knowledge lies not with the transferor's insolvency officer but with the SPE, Standard & Poor's may inquire as to whether the transaction exhibits any features that could lead a court to find that the transfer does indeed fall within the local preference rules. For example, in the U.K., if the sale price of receivables is substantially lower than their face (book) value, this could lead to an enquiry as to whether the transaction is at an undervalue. In these circumstances, further evidence may need to be produced to buttress the claim that the SPE, as SPE, was not aware of the transferor's insolvency (where knowledge is relevant) or to provide the noteholders with added comfort that the transferor was indeed solvent (where knowledge is not relevant). In general, Standard & Poor's requests a legal opinion from counsel in the jurisdiction of incorporation of the transferor, setting out the circumstances in which the transfer could be voided or set aside. As a general matter, such opinion should set out why such circumstances are not relevant to the transaction at hand. 4.4 SECURED LOAN TRANSACTIONS RATABLE AS STRUCTURED FINANCE: "TRUE SALE EQUIVALENCE" In some jurisdictions it may be possible to achieve the goal of isolating the assets from the insolvency risk of an originator by structuring transactions using secured loans (first-priority perfected security interest) as opposed to a true sale of assets. Market participants seeking to employ secured loan structures need to demonstrate that (i) an insolvency or a reorganization proceeding of the originator would not interfere with the payment of principal and interest on the rated debt, or (ii) if there is interference with the cash flows needed to pay the rated debt, it is limited and quantifiable and a liquidity source is available to cover timing delays that may occur in an insolvency proceeding. In the transactions analyzed in this section of the guide, the security interest plays the same functional role as a true sale in a traditional securitization: it is a legal device that isolates the assets from the insolvency risk of the originator in such a way as to allow investors to invest solely against the credit risk of the assets and any additional structural enhancements such as swaps and liquidity facilities. It is to be contrasted with transactions where the security package is provided as an enhancement to a structure, but without the intention of fully isolating the noteholders from the insolvency of the originator (see Part I, section 4.5). Because the security that is the subject matter of this section performs the functional equivalent of a true sale, most of the legal criteria and analysis relating to true sales remains relevant when analyzing such security. Equally, legal counsel should expect to have to provide appropriate opinions on most of the same issues that arise in a true sale transaction. For Standard & Poor's to assign a rating independent of the credit rating on the originator, Standard & Poor's must be satisfied that, in its estimation, there is a probability commensurate with the rating sought that, in the insolvency of the originator, the noteholders or their representative will be able to have sufficient control over the assets provided as security to allow for timely payment of principal and interest on the notes. In considering a true sale equivalent security package, Standard & Poor's analysis can be broken down into four key categories: Asset analysis; Enforceability; True control; and Liquidity issues. 4.4.1 True Sale Equivalence: Asset Analysis A quantitative analysis of the value of the assets and/or their cash flow needs to be conducted to ensure that they can provide sufficient cash (together with any credit enhancement) to meet the obligations of the SPE on the rated notes. In addition, though, some legal analysis may be appropriate to determine whether legal issues exist that could negatively affect the value of the security assets. In transactions that are structured with a security interest over a pool of assets as a means of issuing true asset-backed securities, the legal analysis relating to the assets will be the same as in a true sale transaction (see Part I, section 2). 4.4.2 True Sale Equivalence: Enforceability The second level of review is to determine whether, as a matter of law, the security is enforceable and not subject to legal challenge. In a proposed secured loan structured financing, any significant risk of challenge to the enforcement of security has obvious and serious implications for the desired rating. Where security is unenforceable and the originator is insolvent, investors will not be paid in full. As collective insolvency proceedings begin there is also the risk of delay in payment. The enforcement of security over the transferor's assets may be challenged under general law or insolvency law. General Law Challenges.A complete list of general law challenges cannot be compiled, since such challenges are crucially dependant on the jurisdiction whose laws govern the interpretation of the security. Nevertheless, these challenges to security will usually include the following: The corporate transferor did not have capacity to grant the security. The SPE was aware that the grant of the security was not made for the benefit of the transferor (the issue known as "corporate benefit"). Factors such as misrepresentations and fraud vitiate the creation of the security. In addition, in certain jurisdictions a company cannot create security unless it has a financial obligation toward the beneficiary of the security. In other words, it may not be possible to provide what is referred to in English law as "third-party security". In these circumstances, it is necessary to ensure that an appropriate obligation does flow from the provider of the security. Insolvency Law Challenges.The challenges open to an insolvency officer of a transferor in respect of a previously granted security package are usually the same as those available to it in the context of true sales. They will include claims regarding: Preference; Gratuitous transactions, that is, transactions for which the provider of security received no benefit; Transactions at an undervalue, that is, transactions for which the benefit received by the provider of the security was found to be inadequate; and Transactions defrauding creditors. For a general discussion of these issues, see Part I, section 4.3. In addition, some jurisdictions also have "excessive security" provisions. For example, in Germany, secured loan transactions can be complicated by the legal rule that allows a liquidator to petition the court for the return of "excess security". In other words, if a creditor or insolvency officer of the transferor can convince a court that the value of property provided as security for the loan was substantially in excess of the amount due, the excess can be released from the security package. Although, when assessing the value of the security, the court may consider possible defaults (i.e., not just the face value of receivables in a pool) there is nevertheless an incentive for a creditor or an insolvency administrator to challenge the amount of any overcollateralization provided as a means of credit enhancement to the transaction. The court is not necessarily required to evaluate collateral performance to ensure it survives the stress scenario contemplated by the rating on the debt and may release collateral based on ordinary expected loss scenarios. 4.4.3 True Sale Equivalence: True Control The third level of review is to ensure that the SPE has true control over its security, in other words, the assets that make up its collateral. The factors that determine whether the SPE has true control are: Whether the security confers priority in favor of the issuing SPE against all other creditors; and Whether the issuing SPE, as a secured creditor, has the conduct of (has control over) the enforcement of its security. Standard & Poor's focuses on whether the transaction structure of a proposed secured loan structured financing meets the tests of entitlement and control. Where these tests are met, Standard & Poor's may conclude that the SPE has true control over its security and that, as a result, full and timely payment objectives are capable of being met. EntitlementThe issue of "entitlement" is whether the SPE is solely entitled to the value of the security or has to share in that value with other creditors. This issue usually arises in three forms: (i) that of priority ranking as between holders of security, (ii) that of statutory preferential creditors, and (iii) that of enforcement costs. The issue of priority ranking as between holders of security will arise if another party was given security over the same assets as the SPE at a prior moment in time. Usually this will result in the SPE holding a subordinate position to that of the first beneficiary. In effect, the SPE would only be entitled to take the value of the security assets after the other party had been paid in full. Sharing of security can also occur in a variety of other ways: The SPE may contractually agree to share the security as part of the transaction. If the security is a chattel (for example, cars, bottles of wine, or gold) then a person who has actual possession of that chattel and is owed money by the transferor may have a prior-ranking security by virtue of that possession. For example, warehouse owners usually have a warehouse lien over chattels stored in their warehouses for the storage fees. Warehouse liens often outrank all other security. If the security was in place before the transaction took effect, then arguably the security was not created for the SPE but was security for an obligation transferred to the SPE. If the SPE only obtained part of the secured obligations, it may find itself a co-mortgagee with the transferor. The second form of "entitlement" issue, i.e., that of preferential creditors, arises by operation of law. In many jurisdictions, the law provides that, notwithstanding security interests, certain classes of creditors of the provider of the security have a priority claim over all of the provider's assets. Often, these classes of creditors include employees, pension and social security funds, and/or the tax authorities. The classes and their entitlements are set out in law. In some jurisdictions, only certain types of security interests are exempt from the claims of preferential creditors. It therefore becomes important in those situations that the security provided to the SPE is of the correct legal type. The third way in which the issuer's entitlement to the security may be questioned is in relation to the cost of enforcement of the security. In most jurisdictions, the person enforcing the security on behalf of the beneficiary of such security is entitled as a matter of law to defray its costs and expenses from the value of the security. This can be particularly problematic when the person enforcing the security is neither appointed by nor under the control of the SPE as beneficiary of the security and may have a fairly low incentive to minimize such costs. In Germany, for example, the general insolvency officer (Insolvenzverwalter) may dispose of assets secured under certain types of security and in certain circumstances is entitled to 9% of the value of such security in compensation for his costs and expenses. In theory, it may be possible for Standard & Poor's to rate transactions where the SPE shares the security, provided the amount that is required to be shared with other creditors is quantifiable and the legal provisions requiring such sharing still provide the SPE with adequate control over the enforcement of the security. If, however, no reasonable quantification of competing claims can be achieved, or if such quantification produces amounts that are too great and/or the SPE loses effective control of the enforcement of the security through the nature of the sharing rules, then it is unlikely that the debt issued in the transaction can be rated on a basis isolated from the rating on the provider of the security (i.e., the originator). Control of

Timing and Realization.Another key to determining true control is whether the SPE has conduct of the enforcement of security. Under English law, for example, a secured creditor is not always fully able to have the conduct of, and thus, control over, the enforcement of its security. In a secured loan structured financing, if the secured creditor (the SPE) does lose control, there is a risk that full receipt of interest and principal due on an asset-backed security will only be possible after a delay caused by an insolvency (see Part I, section 4.4.4). There is an additional risk that full recovery of interest and principal will not be possible at all. Where a secured creditor is able to maintain control over the enforcement of its security, these risks will be avoided. In any given jurisdiction, the balance between such control and lack of it will have an impact on the viability, from a rating perspective, of a secured loan structured financing. In France, the secured creditor will not usually have control of the secured property. As a general rule, control of all the insolvent company's assets pass to the administrateur judiciaire, irrespective of whether they are subject to security rights. A few specific types of security are exceptions to that rule, however. These are either security rights where the secured creditor has possession of the relevant property (for example, gage avec depossession) or security over receivables pursuant to a transfer under the Loi Dailly. These exceptions aside, the administrateur judiciaire generally has effective control of the security, and is entitled to present to the court for approval a restructuring plan that disposes of creditors' security without their consent. The creditors do retain some interest in the proceeds of the disposal. As a matter of practice, however, it is not uncommon for courts to consent to disposal plans that may substantially reduce the value of any security. This may be done, for example, to further social goals, such as preserving employment. In other jurisdictions, problems arise from the fact that the only avenue for enforcement of security allowed by the law is the disposal of the property provided as security at an official auction. This is the case for most security rights granted, for example, in Luxembourg or Belgium. In a traditional structured transaction, upon the insolvency of the originator, the noteholders would expect to continue to receive principal and interest generated out of the cash flow produced by the securitized assets. Payments continue until the noteholders are paid in full and/or the assets in the securitized pool have matured. In contrast, in jurisdictions where enforcement of security is by way of auction, the noteholders may need to rely on the current market value of the assets at the time the transferor became insolvent. In these circumstances, comfort should be provided that on a market-value basis at any time in the life of the transaction, the assets are worth an amount sufficient to fully repay the principal and interest on the rated notes. An alternative may exist in those jurisdictions where it is possible for secured creditors to "bid their debt" at the auction where the assets are disposed of. This involves the SPE paying the auction price, not with cash, but by setting off the value of the debt owed to it by the provider of the security against the purchase price. In these situations, either the SPE wins the auction, at which time the debt of the transferor is extinguished and the SPE enters in possession of the assets and their future cash flow, or a third party wins the auction. For a third party to win the auction, though, it must, by definition, have placed a bid greater than the debt owed to the SPE. This, in turn, means that the SPE will be paid in full out of the cash auction price paid by the winning third party. The SPE can then use that cash to redeem the rated notes. Where Standard & Poor's is asked to rely on the auctioning off of the secured property, Standard & Poor's generally requests an assessment of both the costs of such auction, which are usually deducted from the sale price, and the timing of the payment of the auction price to the SPE, to obtain comfort that these two factors cannot be expected to affect the likelihood of full and timely payment of the rated debt. 4.4.4 True Sale Equivalence: Liquidity Issues In addition to the asset analysis, enforceability, and true control considerations outlined above, Standard & Poor's analysis of a true sale equivalent security package may consider delays in the issuer receiving the cash flow from the security assets in an enforcement situation. Such delays can either be legal delays or practical delays. Legal Delays.Legal delays may be caused by the imposition of an insolvency moratorium such as that which exists in the English administration regime or the French periode d'observation. Under such moratoria, secured creditors are either prohibited from enforcing their security or require leave of the court to do so. In some jurisdictions, the maximum period for an insolvency moratorium is set out in the law. This is the case, for example, in The Netherlands, where it is limited to two months. In other cases, such as the administration regime in the U.K., there is no limit and, in theory, the moratorium may last forever. When determining the length of a possible insolvency moratorium, regard may be given to the nature of the company concerned and its assets. Complex companies with extensive and varied types of assets are more likely to suffer from longer periods of moratorium than special-purpose companies with one asset or one type of asset. This reflects the fact that most moratoria provisions are concerned with the rehabilitation of the company. Therefore, the larger the company, the more likely that such rehabilitation will be attempted, and the more complex the company, the more likely that such rehabilitation will be time-consuming. Conversely, there may be little incentive to attempt the rehabilitation of a holding company or an SPE without employees. In addition, once a base case for the possible length of an insolvency moratorium is ascertained, Standard & Poor's may stress such base case by reference to the rating sought. In other words, the higher the rating, the more severe the assumptions as to the length of the possible moratorium, reflecting the smaller probability of default associated with higher ratings. Another aspect of the determination of the length of any legal delays is an analysis of the incentive of the insolvency officer or the courts in enforcing the moratorium provided by law. If notwithstanding a theoretical delay in the enforcement of the security, the person who can enforce that delay will have absolutely no incentive to do so, or even an incentive in allowing the enforcement, then it may be possible to assume either no legal delay at all or a substantially reduced delay. This is the case, for example, with security in cash and securities provided in a number of German bank synthetic transactions. In these transactions, the issuer has the benefit of security provided by a German financial institution over highly rated securities. Upon the insolvency of the German financial institution, under paragraph 46 of the German Banking Act ("Kreditwesengesetz"), the German Federal Financial Supervisory Authority ("Bundesanstalt für Finanzdienstleistungsaufsicht" or "BAFin") is entitled to suspend the enforcement of any security provided by the insolvent bank. As mentioned above, this provision is designed to facilitate the rehabilitation or orderly disposal of bankrupt financial institutions. However, the BAFin has no power to remove secured assets or void valid security arrangements. Therefore, should the BAFin seek to exercise its rights under paragraph 46 in respect of the securities provided to the SPE as security, those securities would simply remain frozen. They could not be used for any other purpose. Interest accruing on those securities would belong to the SPE and therefore would not help the insolvent bank. Other than harming the SPE — and therefore the investors who purchased the rated notes — there would be no purpose whatsoever in enforcing such a suspension of the SPE's security rights. In circumstances such as these, Standard & Poor's may consider making an assumption that no legal moratorium would be imposed in determining the appropriate rating. There may be other types of delay set out in the relevant laws that would prevent a secured creditor from immediately enforcing its security. Any issues of this nature need to be examined on a case-by-case basis. Practical Delays.In addition to legally imposed or sanctioned delays in the enforcement of security, Standard & Poor's may seek to understand the practical aspects of the transaction that could result in the SPE not being able to realize the secured assets or benefit from the cash flow of those assets in an uninterrupted fashion. These possible delays are so rooted in the factual situation that surrounds any given transaction that it is difficult to do more than give examples by way of illustration. Nevertheless, they tend to fall into two broad categories: administrative delays in the insolvency proceedings and practical delays in disposing of the assets. With respect to administrative delays, the law may state that, upon the initiation of formal insolvency proceedings against the company providing the security, the beneficiary of such security is immediately entitled to enforce it. However, the reality of most insolvency proceedings is that the newly appointed insolvency officer will issue instructions effectively "freezing" all the assets of the company until he is able to take stock of the situation. Instructions from the beneficiary of the security to remove the security assets, for example, to transfer cash held in a bank account, however lawful, are therefore likely to be met by a refusal. In the example given, the account bank faced with a "freeze" instruction from the insolvency officer and a "transfer" instruction from the beneficiary of the security may refuse to act until the conflicting instructions have been worked out. In time, if the security is valid, this will be done, but not before the insolvency officer has satisfied himself as to the rights of the beneficiary. How long this will take depends on a number of facts, including the size and complexity of the insolvent company, the complexity of the security arrangements, and the types of assets over which the security is held. Practical delays in disposing of the assets will depend on the nature of those assets. If the issuer is relying on a security interest over government bonds, for example, it should be possible to dispose of them within hours of entering in their possession. Conversely, if the issuer is relying on security over a dozen factories dotted across central Europe or 5,000 cars, it is simply not possible to effect an immediate disposal. In each case, Standard & Poor's may seek comfort from the transaction participants as to the time necessary to turn the assets into cash that can be used to pay the noteholders. 4.5 SECURITY AS STRUCTURAL ENHANCER: CORPORATE SECURITIZATION In some transactions, security is not intended to play the role of equivalence to a true sale but to provide the noteholders with some enhancement to the credit quality of the notes. This is the case in many corporate securitizations (see Part I, section 5). In line with Standard & Poor's general approach to corporate securitization, when analyzing security provided in the context of this type of transaction, Standard & Poor's seeks to understand the role of the security package in the overall credit structure of the transaction. For example, in an English corporate securitization, the operating company may be providing security over all or substantially all its assets for the primary reason of allowing the noteholders or their representative to appoint an administrative receiver following the company's insolvency. The administrative receiver is expected to manage the whole business of the operating company through the insolvency process. Where the capacity to manage the company through insolvency is a key component of the rating sought, Standard & Poor's generally seeks legal comfort that the security is valid and sufficient for the appointment of the administrative receiver. Issues relating to practical delays in enforcement or the costs of disposal of the security do not, all other things being equal, necessitate the analysis that is otherwise required when security is employed in a structured financing as a true sale equivalent. In some cases, the security plays an even smaller role in the credit matrix of the transaction. For example, it may be there is a disincentive for third-party creditors to seek the company's insolvency, following the same reasoning as that set out in the SPE criteria (see Part I, section 3.2). In other cases, the insolvency regime of a particular jurisdiction may give de facto preference to the views of secured creditors representing a substantial part of the company's debt over the view, for example, of the existing management of the company. In both of these situations, Standard & Poor's normally seeks comfort only that the security is valid and would survive insolvency. By the same token, though, the benefit of the security package in these situations in achieving a higher rating on the proposed debt issuance is likely to be considerably smaller than that of a security package that operates as a true sale equivalent. 4.6 SECURITY AS RATING ENHANCER 4.6.1 General Considerations In some circumstances Standard & Poor's has been asked to rate transactions with the benefit of facilities from a third-party provider (for example, liquidity providers, account banks, swap counterparties) that was unrated or did not have a sufficient rating to sustain the desired rating on the notes. Requests of this nature of have been made on the strength of security to be provided by the third-party provider for the benefit of the SPE or the noteholders. In order to give credit for the security provided in these cases, Standard & Poor's may request that comfort be provided that, notwithstanding the insolvency of the third-party provider, the SPE will be able to rely on the security to meet its obligations under the debt in a timely manner. This means the security should perform the same role as a security package provided by an originator and designed to be equivalent to a true sale. Standard & Poor's generally considers such rating-enhancement security in the same way as true sale equivalent security and expects market participants to consider the issues discussed above in relation to true sale equivalence (see Part I, section 4.4). 4.6.2 Security as Rating Enhancer in Derivatives Contracts and ISDA Security Opinions One particular situation where Standard & Poor's is often asked to analyze a security arrangement for the purposes of enhancing a rating is in the context of derivatives. This may be the case in a synthetic securitization, for example, where a financial institution is purchasing credit protection from an SPE pursuant to a credit default swap. It may also occur in more traditional securitizations, for example, where a financial institution is providing a currency or interest-rate swap to enable the SPE to convert the assets' cash flows into a cash flow that will enable it to meet its obligations under the rated instruments. In both cases, the financial institution involved may be proposing to collateralize its obligations under the swap contracts to an SPE by the granting of a security interest over collateral in favor of an SPE. In many cases, Standard & Poor's has been invited to forgo legal opinions regarding such security and to rely instead on the International Swap Dealers Association (ISDA) opinions. These are opinions that have been sought in many different jurisdictions by ISDA as to the efficacy of security arrangements entered into on standard documentation approved by ISDA ("ISDA security opinions").

As a general rule, Standard & Poor's understands that these opinions reflect the current best legal views as to the law relating to security and derivatives and, on that basis, Standard & Poor's does not generally take issue with the contents of these opinions. In certain circumstances, however, reliance on the ISDA security opinions alone may not be sufficient for rating purposes. For example, cross-border legal issues specific to a particular rated transaction may or may not be addressed in the ISDA security opinions. When analyzing the value of a particular security package provided in the context of a derivative, as a general matter Standard & Poor's expects comfort to be provided that the relevant criteria set out in this guide have been satisfied. This may require the provision of a specific legal opinion from transaction counsel. Where an ISDA security opinion exists in appropriate form and addresses the criteria issues specific to the transaction at hand, the additional legal comfort may merely consist of a confirmation that the relevant ISDA security opinion is applicable to the transaction. 4.7 CONTINGENT TRANSFERS OR PERFECTION Transactions that are generally not ratable above the credit rating of the originator (transferor) fall into two categories: Those that involve transfers that are effective as a contractual matter against the transferor, but not against its creditors, regulator, or insolvency officer; and Those that contain solely the promise of the transferor to grant security or sell assets in the future (whether or not accompanied by a power of attorney). These transactions rely on trigger events to perfect the sale of, or the security interest in, an asset prior to an insolvency or reorganization of the transferor. For example, in a hypothetical proposal, a transferor purports to sell assets to the issuing SPE but does not perfect the sale by notifying the obligor as required by law. (Note that reference is made here to transactions where the law requires notification of the underlying obligors to effect a sale opposable to third parties, including any insolvency officer of the transferor, and not where the notification is necessary to make the sale opposable only to the obligor.) In another example, the transferor agrees to pledge assets to secure its obligations but does not perfect the pledge by notifying the obligors and, where required, filing notarial deeds in the appropriate recording offices. In such case, the creditor does not hold a perfected, first-priority security interest, unlike creditors of enhanced rating secured financings discussed above. Instead, in each case the transferor delivers to the SPE or the trustee prepared notices and a power of attorney that enable the SPE to perfect the transfer or security on a future date after the occurrence of a trigger event, such as a downgrade of the transferor. Under the governing law, however, the power of attorney may not be enforceable in a transferor's insolvency. If the trigger event does not occur, the obligors will not be notified and/or notarial deeds will not be filed, and the transferor's other creditors therefore have no means of determining that the transferor sold or pledged these assets. Consequently, the transfer or pledge exists as a contractual right against the transferor only and is not valid against a regulator, liquidator, receiver, or any third-party creditor. In the examples given above, both transactions rely only on the occurrence of a trigger event sufficiently prior to the insolvency to perfect the sale or the pledge and to protect the transfer from challenge in an insolvency proceeding. This in itself may create additional legal issues. For example, since the transfer of security occurs on a future date, there is no contemporaneous exchange for value at the closing of the transaction. This may subject the transfers to further scrutiny by regulators, creditors, liquidators, or receivers as gratuitous or preferential transfers. Many jurisdictions impose long pre-insolvency "suspect" periods during which gratuitous or preferential transfers can be avoided. Failure to perfect in a timely manner (or the avoidance of the transfer perfected too close to the date of insolvency) may lead to default on the rated debt. In both examples, if an insolvency occurs before the trigger event, the holders of the rated securities are, at best, unsecured creditors of the transferor. In many cases they may be viewed as subordinated unsecured creditors. If the transaction documents provide for recourse only to the assets but not to the transferor, the liquidator may use the assets to pay other debts of the transferor, either in preference to or pari passu with the holders of the rated debt. Once the assets are exhausted, the holders of the rated debt have no claim against the transferor and receive no distribution in a liquidation or reorganization. Therefore, a promise to deliver security or assets in the future does not add to the creditworthiness of an SPE's promise to pay principal and interest in the future. Similarly, a power of attorney that is unenforceable in an insolvency cannot enhance the promise to pay principal and interest. Moreover, the presence of a trigger event may provide an incentive to a transferor to seek reorganization or bankruptcy protection earlier than otherwise expected, in an effort to prevent the transfer of assets. It could also encourage creditors of the transferor to petition for liquidation of the SPE; by avoiding the transfer or the perfection of a security interest the creditors can share in assets that will not be available to them after the transfer occurs or security interest is perfected. For regulated entities, such as banks or other financial institutions, the trigger may well accelerate regulatory intervention. Most regulators are able to declare moratoria on payments and other transfers (which generally include the exercise of powers of attorney) to preserve the assets and the liquidity of the transferor. Therefore, the trigger event may serve as the catalyst for an early default in the transaction. A transaction that relies on the promise of a future transfer (which is merely a contractual right) is fraught with uncertainty. In most jurisdictions, a breach of contract is not enforceable by specific performance. If the transferor breaches its promise to transfer the assets, the sole remedy of the noteholders may be an action for damages in local courts. Complex, costly, and time-consuming litigation is generally not a ready substitute for creditworthy collateral. Irrevocable powers of attorney may mitigate the risk of breach of contract, but, depending on the jurisdiction, they may be avoidable in an insolvency or reorganization procedure. If this happens, the noteholders become, at best, unsecured creditors of the transferor. 5. Corporate Securitizations 5.1 OVERVIEW Corporate securitization, also known as "hybrid securitization" or "whole business securitization", is not a particular securitization technique but a label applied to a very broad range of transactions. These transactions provide structural credit improvements over and above a simple corporate secured loan, but may fall short of the full isolation from the originator's credit risk that is the hallmark of traditional securitizations. Most corporate securitizations borrow structural elements from traditional securitizations (for example, the use of SPEs, cash reserves, or liquidity facilities). In all cases, however, payment of principal and interest on the rated notes is dependant, at least in part, on the continuation of a particular business activity, rather than the self-liquidation of a financial asset such as a pool of mortgages or the payment of a lease stream, as in the case of traditional securitizations. Ratings assigned in corporate securitization transactions address the likely payment of principal and interest on the rated obligations on time in accordance with the terms of the indebtedness. This is in contrast to ratings assigned to bank loans, which address the likelihood of recovery of the secured debt following a default. 5.2 GENERAL LEGAL CONSIDERATIONS When analyzing a corporate securitization from a legal standpoint, one of the key considerations is whether the rating scenarios that underpin the rating require an analysis of the survivability of the structure following the initiation of formal insolvency proceedings against the originator. When Standard & Poor's analysis takes into account the insolvency of the originator and seeks to conclude that interest and principal may be paid notwithstanding such insolvency, then it is said that the debt has been rated "through insolvency." By definition, traditional securitizations are always rated through insolvency. This is not always the case for corporate securitizations. As a general matter, corporate securitizations rated through insolvency are more likely to have a greater rating differential above the business score/corporate credit rating of the originator than those that are not rated through insolvency. In that sense they are closer to traditional securitizations. Corporate securitizations rated through insolvency generally also require greater legal analysis, since the aftermath of formal insolvency is almost entirely driven by the relevant legal insolvency regime. In contrast, transactions where the rating is predicated on the analysis that the originator's insolvency will lead to an interruption on the payment of interest and principal on the notes usually rely on structural enhancements to lower the risk of formal insolvency proceedings being initiated. By way of example, Standard & Poor's has rated a French wine corporate securitization through insolvency. The structure provided a sufficiently robust form of security to allow Standard & Poor's to reach the conclusion that the likelihood that the SPE could seize the wine and market it itself, notwithstanding the formal insolvency of the originator, was compatible with the rating assigned. Similarly, U.K. public house (pub) securitization transactions rely on a security package that is designed to enable the holders of the rated notes, indirectly, to take control of the securitized pubs and operate them through a replacement servicer, notwithstanding the original owner's insolvency. In contrast, it has not been possible to rate through insolvency businesses entirely reliant on state concessions, which may be cancelled following insolvency. Also, it has not been possible to rate through insolvency regulated utilities where the local regulatory regime makes it impossible or extremely unlikely that the noteholders can have any meaningful say in the operation of the business following formal insolvency. This does not mean that these transactions cannot be rated as corporate securitizations, but merely that the basis of analysis is different from those rated through insolvency. 5.3 CORPORATE SECURITIZATION STRUCTURES There is no paradigm corporate securitization structure. Depending on the industry, the legal jurisdiction, the quantum of debt, the size of the rating differential sought, the actual financial and business situation of the originator, and the legally available structural enhancements, there is no limit to the diversity of structures that can claim the name of "corporate securitization". Accordingly, every corporate securitization requires a tailor-made analytical approach. This approach is based on Standard & Poor's general criteria consistently applied but, by definition, varies with each transaction's idiosyncrasies. In that respect, corporate securitization has been likened to a child's building block set. The blocks in the set are always the same, legally available structural enhancements. However, with the existing transactional building block set any number of constructions can be made. Once the construction is made, Standard & Poor's attempts to match it with its criteria set and determine what, if any, credit can be granted to the structure. Some of the enhancements traditionally seen in corporate securitizations are the following: Covenants. Often the originator will provide a set of detailed contractual covenants that are more tailored and extensive than those that would be seen in a traditional secured loan. Whereas most secured loan covenants are concerned with maintaining the overall financial position of the borrower, corporate securitization covenants are more likely to be prescriptive about the conduct of the securitized business itself. Triggers. A sub-category of covenants, corporate securitization may contain "triggers". These are specified events that, if they occur, will require a particular set of actions to be taken. Often these triggers are set to capture deteriorations in the business that has been securitized and will lead to some form of corrective action, for example, a more conservative financial policy and/or an acceleration of the payments on the rated notes. Security. Many corporate securitizations rely on some form of security. This may be to prevent disposal of key assets or ward off third party attempts at filing the originator for bankruptcy or seizing the key assets of the business after insolvency Liquidity facilities. Since corporate securitization ratings speak to the likelihood of timely payment of interest and principal, a transaction may need to be able to cope with cash flow difficulties at the originator level. For example, it may need to address cash flow interruption resulting from the initiation of insolvency proceedings against the originator. These issues are often dealt with through the provision of a liquidity facility provided by a suitably rated third-party financial institution. Cash reserves. Sometimes liquidity issues may be dealt with through a cash reserve instead of, or in addition to, a liquidity facility. SPE. Most corporate securitizations make use of an SPE as the issuer of the rated notes. This has a number of advantages in being able to further insulate the payment of principal and interest from difficulties at the originator level. The SPE, for example, is usually the beneficiary of the liquidity facility so that drawings under the facility can be passed on to noteholders notwithstanding the insolvency of the originator. As there is potentially no limit to the diversity of structures that can claim the name of "corporate securitization", there are accordingly no legal criteria specifically applicable to corporate securitization. It is therefore better to describe Standard & Poor's approach. First, the market participants present a proposed structure to Standard & Poor's analytical team. They discuss the enhancement they believe the structure brings above the originator's business score/corporate credit rating. They then further discuss with the analytical team how they believe the structure is expected to perform in given scenarios. This process assists in identifying the analytical approach that is appropriate to a given structure. Usually, this process also draws attention to a number of legal aspects of the transactional structure on which the rating analysis needs to rely. As a general matter, once these legal aspects have been identified, Standard & Poor's expects to be satisfied that the legal analysis that underpins them is sufficiently robust to support the rating sought. In the process of satisfying itself as to such robustness, Standard & Poor's will — all other things being equal — apply its general criteria, as set out in this book. For example, if a proposed corporate securitization relies on key assets being transferred to an insolvency-remote SPE, then Standard & Poor's would expect such entity to meet the SPE criteria set out in Part I section 3 of this book. Similarly, to the extent that Standard & Poor's would expect to see a legal issue addressed in counsel's opinion in a traditional securitization, it would equally expect to see the issue addressed by counsel in a corporate securitization where that issue has been found relevant to the rating analysis. In addition, because each corporate securitization analysis is tailor-made, market participants should avoid making assumptions as to the acceptability of any particular structural enhancement based on its appearance in a previously rated transaction. It is entirely possible that such enhancement was not relevant to the rating analysis in that previous transaction. Equally, it is possible that, although relevant, such enhancement was effectively performing a different role in the analysis. In other words, it would not necessarily be the case that because a particular rating was given in respect of a U.K. water utility corporate securitization containing a particular legal feature it will follow that a similar rating can be given to an Italian water utility corporate securitization or a U.K. pub transaction. Market participants are therefore encouraged to discuss potential transactions with Standard & Poor's as early as possible. 6. Tax In securitizations, comfort should be provided that either there are no taxes payable by the SPE or that any such taxes have been calculated and may be paid out of the available cash flow while still leaving sufficient amounts to meet principal and interest on the rated debt. In addition to these entity-level tax considerations, multijurisdictional transactions create certain additional tax issues that should be considered. 6.1 WITHHOLDING TAX Whenever cash flows across a jurisdictional border, there is a heightened risk that the tax authorities in the jurisdiction from which the cash left may require part of that amount to be remitted to them in the form of withholding tax. This is often the case in cross-border structured finance transactions, where cash is passed from payers in one country to an SPE in another country. To the extent that an SPE's ability to make payment on its rated debt relies on these third-party payments, Standard & Poor's rating analysis considers whether these payments are subject to withholding tax. Withholding tax risk may occur in respect of payments under a swap and other derivative agreements entered into by the issuer for hedging purposes and any form of external credit enhancement, such as a letter of credit, liquidity facility, or guarantee. It may also arise on payments derived from a pool of underlying assets, such as loans, bonds, or other securities (collateral) and receivables that secure the SPE's rated obligations. To the extent that any withholding tax is imposed on any of these payments, an equivalent amount should be deducted from the relevant transaction's cash flow model in determining the amounts available to the SPE to meet its obligations on the rated debt. The risk of withholding tax in a transaction can either be mitigated structurally or addressed in a legal opinion. Structurally, the risk of withholding tax is mitigated if the third-party payer is required to gross up its payment obligations so that the issuer receives the same amount it would have received had no such tax arisen. This assumes that the gross-up obligation is legal, valid, binding, and enforceable under the applicable law. Reliance on this gross-up obligation creates a rating dependency on the gross-up provider. Alternatively, if the transaction parties can demonstrate that even net of applicable withholding tax there is sufficient cash flow to allow payment in full on the rated debt under the various stress scenarios, Standard & Poor's does not request any additional comfort on withholding tax risk. Comfort may also be provided in the form of a legal opinion confirming that, under the law of the jurisdiction of the third-party payer, no withholding tax obligation arises on payments to the SPE. Although opinions as to withholding taxes should come from external legal counsel, it may be appropriate in certain jurisdictions for these opinions to be given by qualified accountants. With respect to withholding tax on swaps, derivatives, and external credit enhancement, Standard & Poor's accepts opinions from internal counsel to the relevant counterparty. In lieu of these opinions, Standard & Poor's may also accept an unqualified written representation from counterparties in swap and derivatives transactions confirming that the relevant third-party payer is not required to withhold tax from any payment to the issuer. The representation should be in a form commonly accepted in standard financial transactions (for example, ISDA form tax representations). For certain types of credit enhancement, Standard & Poor's may ask the enhancement provider to deliver a similar representation. In addition to withholding tax arising with respect to payments made by counterparties with whom the issuer has directly contracted (for example, swap counterparties and credit enhancement providers), this tax may also arise on payments from a pool of underlying collateral securing the SPE's obligations. If payments on the rated debt depend on payments from the collateral being made free of withholding tax, comfort may be requested that the withholding tax risk has been mitigated. In the context of collateralized debt obligations (CDO) transactions, a written representation, in the form commonly delivered in standard financial transactions, from either the arranger and/or collateral adviser (as appropriate), may be accepted. This representation may be accepted in lieu of an opinion on the assumption that the arranger and/or collateral adviser have undertaken the requisite legal due diligence to confirm that there are no withholding tax risks when structuring the transaction and selecting the collateral. For transactions involving revolving or ramp-up periods, Standard & Poor's expects the parties to the transaction to demonstrate that, post-closing, the transaction will not be subject to withholding tax risks. This comfort may be provided in the form of deemed representations, for example, or through the definition of the collateral's eligibility criteria, confirming that the collateral purchased after closing is not subject to withholding tax. Additionally, in the context of CDO transactions, Standard & Poor's may accept a legal memorandum from tax counsel in the relevant jurisdiction stating that the collateral sold to the SPE is not subject to withholding tax. Provided the specific collateral purchased by the SPE falls within the ambit of the memorandum, Standard & Poor's may not request any further opinions or representations on the issue of withholding tax on the collateral. Notwithstanding the foregoing, on a case-by-case basis, Standard & Poor's may ask that the issue of withholding tax be addressed in a legal opinion. For example, opinions may be appropriate for new types of collateral or nonstandard contracts, or where the obligor or originator of the collateral is located in a jurisdiction where the issue of withholding tax is not well settled. 6.2 PERMANENT ESTABLISHMENT AND BRANCH OR AGENCY Many SPEs in international transactions are incorporated in zero- or low-tax jurisdictions. However, the SPE will often employ an agent (such as a collateral manager) or own pools of assets located in high-tax jurisdictions or have strong links with other high-tax jurisdictions, such as the country of the asset manager. Such transactions carry a risk that the tax jurisdiction in which the assets or the essential parties to the transaction are located may take the view that the SPE, although located elsewhere, has a local "permanent establishment" or a "branch or agency". This, in turn, may result in the SPE becoming taxable in that high-tax jurisdiction. The issue of whether a foreign corporation, such as the SPE, is taxable in a particular jurisdiction is generally determined by applying a combination of legal and practical tests. Standard & Poor's may request that comfort be provided on this issue on a case-by-case basis. 6.3 DOUBLE-TAX TREATIES Transactions are sometimes structured to provide the SPE with the benefit of a double-tax treaty, so that it can either receive amounts free of withholding tax or avoid being taxed in another jurisdiction. Depending on the treaty and transaction structure, the SPE may have a legal entitlement to the benefits of the treaty or may only have such entitlement if it receives confirmation or authorization from the relevant tax authority. In the former case, Standard & Poor's may request a tax opinion confirming that the SPE may rely on the mandatory provisions of the relevant double-tax treaty. In the latter case, Standard & Poor's may request comfort that such confirmation or authorization has been granted. 6.4 STAMP DUTY OR REGISTRATION TAX It may be that in order for the true sale of the securitized assets to have occurred or be enforceable against third parties (as distinguished from binding only against the transferor and the transferee) or be proven in court, a stamp duty or registration tax must be paid. These cases fall within one of the following categories: The duty or tax must be paid at the time of the transfer or within a set period thereafter. Failure to make the payment cannot be remedied later or cannot be remedied without the involvement of a third party outside of the SPE's control (for example, the transferor, the transferor's insolvency officer, or the tax authority). In such circumstances, comfort should be provided that the relevant payment has been made. The duty or tax can be paid later (although possibly with monetary penalties) and payment can be made by or on behalf of the SPE without the involvement of a third party outside of the SPE's control. In these circumstances, comfort should be provided that, at any point when the SPE may be required to make such payment, the SPE will have sufficient funds to do so. This can be done by funding a cash collateral account in the SPE's name containing the necessary amounts or by finding a third-party provider of funds (for example, a subordinated loan provider) that is suitably rated and agrees to advance the necessary funds to the SPE when required. Alternatively, if Standard & Poor's is satisfied that the stamp duty or registration tax will not be payable until a certain date in the future, the SPE may accumulate a cash reserve from excess spread to set aside the necessary amounts prior to the date on which payment is required. 6.5 SECONDARY TAX LIABILITY In some transactions the SPE is structured as a subsidiary of another company (usually the transferor) rather than as an orphan SPE. However, care must be taken that, by having a shareholding link with an operating company the SPE does not, under the relevant tax legislation, become liable on a secondary basis for the taxes payable by that operating company. This would occur under some principle of "tax grouping". To the extent that, in the relevant jurisdiction, the SPE may become liable for another party's taxes, this risk should be mitigated or the liability quantified and comfort provided that payment of such taxes would not inhibit or prevent the SPE from meeting its obligations on the rated debt. 7. Commingling 7.1 CREDIT LOSS OR LIQUIDITY STRESS Commingling occurs whenever cash belonging to an SPE is mixed with cash belonging to a third party or is deposited into an account in the name of a third party, such that, in the insolvency of that third party, the cash is "lost" or "frozen". The cash becomes "lost" if, following the insolvency of the third party, the SPE's claim to the money is treated at law as an unsecured debt of the insolvent entity. Under Standard & Poor's criteria, an unsecured debt claim is treated as a total credit loss for the SPE. On the other hand, the cash becomes "frozen" if, following the insolvency of the third party, the SPE retained a proprietary claim over the money so that the money did not form part of the insolvent entity's bankruptcy estate. The cash can also be "frozen" if the account where the cash is held is subject to a valid security interest in favor of the SPE. Although the SPE's rights to obtain the money has a solid grounding in law, there is uncertainty as to how long it will take for the SPE to assert these rights as against the bankruptcy trustee and competing creditors of the insolvent holder of the cash. For this reason, when cash is viewed as frozen following insolvency, it is generally not treated as a total credit loss, but as a liquidity strain on the transaction. The length of time necessary for recovery is a question that needs consideration on a jurisdiction-by-jurisdiction basis and focuses both on the legal theory and local practical experience. Accordingly, a transaction in which the rating on the debt is higher than that on the third party should demonstrate features that enable Standard & Poor's to conclude that the SPE can meet in full and on a timely basis its current obligations under the rated debt, notwithstanding the delay in cash flows caused by the third party's insolvency. 7.2 INSOLVENCY OF THE TRANSFEROR/SERVICER The most common, though not exclusive, type of commingling seen in securitization transactions occurs when the underlying obligors continue to make their payments under the transferred receivables to a third-party account bank where the accounts are held in the name of the transferor. Under most legal systems, if the transferor has sold the receivables to the SPE but continues to collect the proceeds from these receivables on behalf of the SPE and deposit them into an account in the transferor's (or third-party servicer's) name, the collections are likely to be treated as having been lent by the SPE to the account holder. In the insolvency of the account holder, the SPE's right to these collections is a right to repayment of the "loan". This is an unsecured claim, which is treated as a credit loss to the SPE unless appropriate measures are taken to mitigate this risk. This risk is typically addressed in one of three ways. In common law jurisdictions, the account holder is usually able to declare a trust over the sums standing to the credit of the relevant account representing collections from the securitized receivables. In this case, Standard & Poor's requests an opinion that the trust is valid and fully constituted. Alternatively, the account holder can grant effective security over the account. This is often difficult in many civil law countries, where pledges on running accounts are quite onerous to create as they often need to be "refreshed" every time new sums are credited to the account. When such security is granted, Standard & Poor's requests an opinion that the security is valid. The opinion should also set out the likely delays in the SPE enforcing that security in the relevant jurisdiction, taking into account any potential stays on enforcement in an insolvency of the account holder. Any such delays should not result in the SPE failing to meet its obligations under the rated debt in a timely fashion. Likewise, if local law allows the use of segregated accounts opened in the name of the servicer but earmarked for the benefit of the SPE, Standard & Poor's may request a legal opinion confirming that the SPE has immediate access to the cash without any interference or delay caused by the servicer's insolvency. Finally, there are jurisdictions where the usual provisions of the law treating collections as a loan to the account holder have been specifically removed by the local securitization law. This is the case in Italy where, under the provisions of Law No. 130 (the Italian securitization law) the SPE retains its proprietary rights over collections under certain circumstances, notwithstanding that the collections are held in an account in the name of a third party. Similarly, French law dated Aug. 1, 2003 on securitization funds (fonds communs de créances) expressly allows the creation of dedicated accounts opened in the name of the servicer for the benefit of the fund, on which the servicer's creditors may not take any enforcement measures, including in the event of bankruptcy proceedings. In this case, Standard & Poor's may request a legal opinion confirming that the account is protected under the new law and that the fund has immediate access to the cash. 7.3 ACCOUNT BANK SET-OFF Collections may also be lost in the insolvency of the account holder where the account bank is allowed to assert a set-off. The commingled cash may be lost where the account holder owes money to the account bank flowing from other, probably unrelated, obligations and the account bank is allowed, under the terms of the account or under general principles of law, to set off the amounts owed to it by the account holder against money standing to the credit of the account, including money belonging to the SPE. Most bank account standard terms explicitly allow the account bank to set-off obligations of the account holder against amounts standing to the credit of the bank account. Generally, in order for Standard & Poor's to give credit to cash collections standing in an account in the name of a party other than the SPE, comfort should be provided to the effect that the bank is not entitled, as a legal matter, to effect a set-off (for example, because the bank is aware of a declaration of trust by the account holder in favor of the SPE). In addition, Standard & Poor's may request that the bank contractually waive its rights of set-off over the account. This should provide comfort that the bank will not exercise self-help remedies in the insolvency of the account holder on the basis that it was not aware of the real economic ownership of the account funds. 7.4 ACCOUNT BANK INSOLVENCY When a bank becomes insolvent, the risk to money held by the SPE or the servicer at the bank is not technically a commingling risk. However, there is often confusion between commingling risk and account bank insolvency risk, particularly when the transferor is a financial institution and is also the account bank for the transaction. It therefore seems appropriate to deal with the point in this section of the criteria. Almost invariably, when a person deposits cash with a bank, that person's rights over the bank account constitute a debt owed by the bank to the account holder, usually payable on demand. Since banks normally do not grant security to their account holders, the debt owed by the bank is an unsecured debt and is treated accordingly in the insolvency of the bank. Therefore, consistent with Standard & Poor's approach to unsecured debt of an insolvent company, all money held with an account bank that does not have a rating sufficiently high to support rating on the debt is generally treated as money that is not available to the SPE. To avoid issues with the potential insolvency of the account bank, we have observed that transactions are generally structured in one of two ways: (i) the money is moved into a suitably rated account, or (ii) the money is invested in suitably rated eligible investments, which, in turn, are chosen so as to allow proper security to be obtained over them, thereby protecting the SPE's interests in the event of insolvency of the bank holding the money. 8. Segregation Criteria 8.1 GENERAL In addition to stand-alone SPEs established to issue one or more series of equally rated securities, in many multijurisdictional transactions the sponsors of the securitization find it cost-effective to set up one vehicle to issue multiple tranches of differently rated securities. In this manner, the sponsor reduces the need for capital contributions and administrative and audit expenses, and maximizes name recognition of the issuing SPE. When a single entity issues differently rated securities backed by assets of different credit quality, however, Standard & Poor's seeks comfort that, if one series defaults, the holders of that series do not have an incentive to seek recourse against other assets of the SPE, resulting in the SPE's insolvency. Toward this end, Standard & Poor's has developed criteria for these transactions. To date, Standard & Poor's has generally applied these criteria to structured transactions involving "synthetic" securities issued by "program issuers." A synthetic security is one that repackages existing securities (for example, tradable securities such as Eurobonds) into a debt issue that is rated primarily on the basis of the creditworthiness of the asset securities and a currency or interest-rate swap, or other similar agreement, designed to modify the cash flows from the asset securities. A program issuer issues multiple series of synthetic securities under documentation that has been established in standard form for each series. Typically, each series issued by the program issuer is secured by a separate portfolio of asset securities and a separate swap agreement for the related cash flows. Synthetic security transactions typically involve multiple jurisdictions and governing laws. Standard & Poor's relies on the transaction arranger to identify the relevant jurisdictions and applicable laws, particularly the law applicable to the program issuer, the governing law of the transaction documents, and the laws applicable to the assets, the security interests, and any custodial arrangements. Standard & Poor's believes that by implementing the following disincentives to the filing or petitioning of a bankruptcy petition against the SPE, a single SPE may be used to issue multiple series of debt collateralized by discrete pools of assets that may carry independent ratings (or may be unrated): The program issuer should be a bankruptcy-remote SPE, generally organized in a jurisdiction where it is not taxable. The program issuer should issue separate series of debt obligations. Assets relating to any particular series, including any related proceeds, should be held separate and apart from assets relating to any other series, and the program issuer's obligations, including fees, expenses and any enforcement expenses, should be on a series-by series basis only. Any swap transaction entered into by the program issuer for a series should be separate from any other swap transaction for any other series. A first, fixed charge or equivalent first-priority security interest that survives the program issuer's insolvency should be created and perfected over the assets, on a series-by-series basis. The series should not be cross-collateralized or cross-defaulted, because this would result in each series becoming a supporting rating for the others and is inconsistent with different ratings for the different series. Each series of notes should include limited-recourse provisions that survive the program issuer's insolvency, confirming that each series has recourse only to the assets charged to that series, is nonrecourse to the other assets of the SPE, and does not constitute a claim against the SPE if the cash flow from the series designated charged assets is insufficient to repay the debt in full. The noteholders, all transaction participants, and any creditors should agree not to file, or join in any filing of, a bankruptcy or insolvency petition against the program issuer. For each series, only the trustee should be entitled to exercise remedies on behalf of the noteholders. Each program issuer should agree to provide the documentation for each series it issues to Standard & Poor's for its review (prior to issuance of the series) whether or not the series is to be rated by Standard & Poor's. A detailed discussion of some of the criteria points raised above follows below. 8.2 NO TAXATION IN JURISDICTION OF ORGANIZATION "The program issuer should not be taxable in its jurisdiction of organization." The program issuer's exposure to potential liabilities to preferred creditors should be minimized. In many jurisdictions, preferred creditors include the tax authorities, and a tax lien could attach to all of the program issuer's assets, not just those that relate to the series that gives rise to the liability. In addition, this lien often ranks ahead of the noteholders' secured claim to the same assets. In practice, enforcement of the tax claim or resulting lien may divert cash flow from assets unrelated to the series in question and could result in a bankruptcy or insolvency proceeding against the program issuer. Even if a noteholder ultimately receives payment in full, the timing of payments may be affected by such a proceeding. In the rating context, where the likelihood of default for the various series of rated notes differs, a tax liability arising from the assets backing one series could nevertheless equally affect all series. For the purpose of rating debt issued by program issuers, Standard & Poor's generally considers whether the program issuer could be exposed to a tax liability which, if not met, could result in the scenarios just mentioned. Standard & Poor's regards an entity as not taxable when it is organized in a jurisdiction that has no corporate or other applicable taxes or when it has received a specific tax ruling to that effect from the appropriate authorities. In some jurisdictions, a tax-neutral program issuer may satisfy this criterion. A tax-neutral program issuer is one that is subject to taxation but is not expected to have any taxable income because it its projected revenue will be offset by an equal amount of deductions or exemptions. In addition, in certain jurisdictions, program issuers have received tax rulings to the effect that a specified annual payment would satisfy any tax liabilities that might arise in connection with its contemplated activities. When a program issuer's tax liability has been quantified by the applicable tax authorities and the transaction provides for either the payment of such liabilities from sources consistent with the ratings on the program or the full tax liability of the issuer has been prefunded, Standard & Poor's may conclude that the program issuer is not taxable for purposes of this criterion. 8.3 SEPARATION OF SERIES AND SEGREGATION OF ASSETS AND OBLIGATIONS "The assets, including any proceeds from these assets, should be held separately on a series-by-series basis and not commingled with the assets for any other series, and the program issuer's obligations, including fees, expenses, and any enforcement expenses, should be on a series-by-series basis only." The program issuer's records should include separate accounts to which the assets will be credited, clearly identifying the assets and the related series. The books and accounts of the trustee and any custodian to which the assets will be credited should include separate entries clearly identifying the assets, the related series, and the capacity in which the party is acting. Similarly, the program issuer's obligations should be on a series-by-series basis. If any of the program issuer's secured obligations are stated generally, such as the payment of fees and expenses, and not on a series-by-series basis, the program issuer's failure to fulfill its obligations relating to one series may entitle the trustee or the noteholders of other series to exercise remedies. This may result in the same likelihood of default for each series. The unambiguous identification of the assets and obligations on a series-by-series basis is also essential from the perspective of limitations on creditors' rights. If a creditor purportedly has agreed to look only to specified assets for satisfaction of its claims, but the assets have been imprecisely identified or commingled to the extent that they cannot be segregated from other assets of the program issuer, then it may be determined that the creditor has not effectively agreed to the limitation. The creditor may then have an incentive to attempt to recover against the program issuer's assets generally in an insolvency, bankruptcy, or liquidation proceeding. "Any swap transaction entered into by the program issuer for a series should be separate from any other swap transaction for any other series." The swap agreement, if any, relating to a series will modify the cash flows from the asset securities. If the swap for one series will, by its terms, be affected by events affecting the swap for another series, then each series becomes a supporting rating for the other and should have the same rating. Cross-defaults, cross-termination events, and the netting of payments among swap transactions are some of the provisions that result in the conclusion that the swaps are not separate. For purposes of documentation, the clearest method of documenting separate swap transactions is to use a separate master agreement (including a schedule and confirmation) for each series. The program issuer, however, typically enters into a swap with the same counterparty for each series and the parties seek to reduce paperwork. As long as the legal effect is to create separate agreements and such agreements are properly drafted, other methods of documentation, such as a master swap agreement and schedule with separate confirmations, may be acceptable. For example, a separate confirmation for each series may incorporate the standard terms of a master agreement while deleting provisions in the master agreement, such as netting and the "single agreement" provisions set out in the master agreement, and expressly providing that separate transactions are to be created with respect to each confirmation. 8.4 SECURITY INTERESTS AND LIMITATIONS ON CREDITORS' RIGHTS "A first, fixed charge or equivalent first-priority security interest that survives the program issuer's insolvency should be created and perfected over the assets, on a series-by-series basis." This criterion is central to Standard & Poor's view that the incentives for creditors of the program issuer to begin bankruptcy or insolvency proceedings in the event of a default by the program issuer on its obligations would be reduced. Where such a charge is in place, the noteholders of each series should have the first claim on the related assets upon the enforcement of their security. A corollary to this statement is that no noteholders of another series should have a first claim to those assets. If, even when the program issuer is subject to insolvency, bankruptcy, or liquidation proceedings, there is little to be gained by the noteholders of any series in addition to realizing their security over the assets relating to their series, then the noteholders' incentive to begin such proceedings should be reduced. Similarly, if all of the program issuer's assets are subject to first-priority perfected security interests that survive even when the program issuer is subject to insolvency, bankruptcy, or liquidation proceedings, any unsecured creditors of the program issuer should have little to gain by beginning proceedings against the program issuer. As a general matter, Standard & Poor's requests opinions addressing the perfection, and survival of the stated security interest in the assets for each series in an insolvency of the program issuer. These opinions are requested from counsel in the jurisdictions in which the program issuer is established and the law under which the security interest has been created. "Each series of notes should include limited-recourse provisions that survive the program issuer's insolvency and confirm that each series has recourse only to the assets charged to that series, is nonrecourse to the other assets of the SPE, and does not constitute a claim against the SPE if the cash flow from the series designated charged assets is insufficient to repay the debt in full." For each series (including unrated series), the related noteholders and other secured parties, including the swap counterparty, if any, and the trustee, should agree to look only to the assets pledged as security for the series and not to any other assets of the program issuer for satisfaction of the program issuer's obligations under the related notes. This is generally referred to as the "limited-recourse provisions" and should be included in any notes or global securities as well as all agreements, including the relevant security document. If any series is issued without effective limited-recourse provisions, the risk is that noteholders of that series may be entitled to satisfy the program issuer's obligations to them from any of the program issuer's assets. This would provide a significant incentive for holders of defaulted notes to begin bankruptcy or insolvency proceedings or to take other actions to attempt to have recourse to the program issuer's assets that are pledged to other series. Even if the attempt to reach the program issuer's other assets does not ultimately succeed because of the prior security interests of the other noteholders, it may prevent timely payments of amounts due to the other noteholders. "Each program issuer should agree to provide for the review by Standard & Poor's of each series it issues (prior to issuance of the series), whether or not rated by Standard & Poor's." The effectiveness of the mechanisms discussed above in reducing the incentives for parties to initiate a bankruptcy or insolvency proceeding against the program issuer depends on the effectiveness of the documents for each series issued, including any unrated series, in separating the series and creating segregation. If the documents for any series do not effectively separate and segregate, Standard & Poor's may be unable to conclude that the program issuer continues to be a bankruptcy-remote entity. In rating terms, this means that all series (including series already issued and rated) should be rated the same as the series with the greatest likelihood of default. Standard & Poor's requests, as a general matter, that each program issuer provide for the review and surveillance by Standard & Poor's of all series issued (whether rated and unrated) in order to enable Standard & Poor's to rate segregated issues and to provide ratings confirmation for the outstanding rated series. The insolvency and other laws in multiple jurisdictions may be relevant in evaluating the effectiveness of the specific criteria discussed in this section. The transaction arranger and its counsel are responsible for satisfying Standard & Poor's that all applicable criteria are met in the relevant jurisdictions. 9. Guarantee Criteria The term "guarantee" can apply to any form of guarantee, including a parent guarantee, a debt purchase agreement, a surety bond, or an insurance contract. In structured transactions that use guarantees as a form of credit enhancement, the evaluation of the creditworthiness of the primary obligor (the guaranteed entity) shifts to an evaluation of the creditworthiness of the guarantor and the compliance of the guarantee with certain criteria. The guarantee criteria are intended to minimize the risk that a guarantor may be excused from making a payment necessary for paying the holders of rated debt. The following criteria are those which Standard & Poor's would normally expect to be satisfied before giving credit to the rating on the guarantor in place of the rating on the guaranteed entity. These are therefore criteria for rating substitution. This does not mean that a valid guarantee that does not meet these criteria cannot be given some value in certain structures. In particular, guarantees provided in corporate securitizations may, depending on the transaction structure, provide some benefit, even if they do not comply fully with the criteria set out in this chapter. However, noncompliant guarantees are unlikely to be sufficient on their own to sustain a rating on the notes equivalent to that on the guarantor. Guarantees that Standard & Poor's is asked to rely upon as rating substitution guarantees should comply with the following criteria: The guarantee is one of payment and not of collection. In other words, the guarantee is one in which the guarantor is agreeing to make payment directly and not one in which the guarantor is agreeing to act as a collection agent only. The guarantor agrees to pay the guaranteed obligations on the date due and waives demand, notice, marshaling of assets, etc. In other words, the guarantee should be a promise by the guarantor to pay the guaranteed obligations on demand, rather than merely a promise by it to pay any deficiency remaining after the beneficiary has exhausted all of its remedies against the collateral and the primary obligors. The guarantor's obligations under the guarantee rank pari passu with its senior unsecured debt obligations. The guarantor's right to terminate or amend the guarantee is appropriately restricted. The guarantee is unconditional, irrespective of value, genuineness, validity, or enforceability of the guaranteed obligations. The guarantor should waive all other circumstances or conditions that would normally release a guarantor from its obligations. The guarantor should also waive its rights of set-off, counterclaim, etc. In connection with lease transactions, the guarantee should also provide that, in the event of a rejection of a lease in a bankruptcy proceeding, the guarantor will make the lease payment, notwithstanding the rejection and as though the rejection had not occurred. The guarantee includes a statement that the guarantee is reinstated if any guaranteed payment made by the primary obligor is recaptured as a result of the primary obligor's bankruptcy or insolvency. The holders of the rated notes are beneficiaries of the guarantee. In case of cross-border transactions, the risk of withholding tax with respect to payments by the guarantor may need to be addressed. PART II: LEGAL OPINIONS 1. General For each securitization rated by Standard & Poor's it expects to see appropriate legal opinions dealing with the issues of law raised by the structure that are relevant to the rating. It is not possible to set out a complete list of all the items that should be addressed in legal opinions as each transaction has its own issues. To maximize the likelihood of a smooth rating process, Standard & Poor's urges legal counsel to the transaction to produce drafts of the legal opinions as early as possible, and to discuss any matters that they expect may be problematic with the analyst assigned to the transaction or a member of Standard & Poor's legal department. 2. Legal Opinion Issues Without limiting the discussion in this paper, unless the transaction exhibits unusual features, the following items should generally be addressed in the legal opinion, namely that: For true sale transactions, a true sale has been effected that would be recognized in the insolvency of the transferor and not be subject to any successful challenge or recharacterization as a secured loan by any creditor or insolvency administrator of the transferor, and comfort that the assets are not subject to any restrictions on assignment; For the purposes of supporting the SPE's insolvency remoteness, all non-negligible assets of the SPE that are contemplated in the transaction documents are subject to effective security that would be upheld by the relevant courts, including in the event of insolvency proceedings of the SPE, and not be subject to any successful challenge by any creditor or insolvency administrator of the SPE; The limited-recourse provisions set out in the documents would be recognized by the relevant courts as legal, valid, binding, and enforceable and be upheld in the event of insolvency proceedings of the SPE, and not be subject to any successful challenge by any creditor or insolvency administrator of the SPE; The nonpetition provisions set out in the documents would be recognized by the relevant courts as legal, valid, binding, and enforceable; The subordination/priority of payment clauses (the "waterfall provisions") set out in the documents would be recognized as legal, valid, binding, and enforceable, and be upheld in the event of insolvency proceedings of the SPE, and not be subject to any successful challenge by any creditor or insolvency administrator of the SPE; Where relevant, no substantive consolidation principle applies and the insolvency of a parent company would not automatically result in the insolvency of its subsidiary; There are no consents, licenses, or similar requirements required in respect of the transaction, or that such consents, licenses, or similar requirements have been obtained; Where an opinion is given subject to the nonexistence of any violation of local public policy or mandatory principles of local law, counsel confirm that, on the face of the documents reviewed, nothing has come to their attention that would cause them to believe that any such violation may exist; For SPEs, the SPE would, if found liable to corporate tax, be viewed as corporate tax neutral and/or, if not, that the amount of potential corporate tax liability is quantified; Comfort regarding the nonapplicability of VAT or withholding tax to cash flows in the transaction and/or the amount of the potential VAT or withholding tax liability is quantified; and No registration tax or stamp duty is payable in relation to the execution of the transaction documents or in relation to the notes, or any such registration tax or stamp duty is quantifiable. Depending upon the circumstances, Standard & Poor's may also request a corporate opinion to the following effect: That each party to the transaction is duly organized, validly existing under the laws of the jurisdiction of its formation, and is in good standing under the laws of such jurisdiction and any other jurisdictions in which it is required to qualify to do business; That each party to the transaction has the full power and authority to carry on its business and to enter into the transactions documents to which it is a party and the transactions thereby contemplated; That the execution, delivery, and performance of the transaction documents by the relevant party do not violate any law, regulation, order, or decree of any governmental authority or constitute a default under or conflict with the organizational documents or other agreements governing or to which the relevant party is a party; That no approval, consent, order, or authorization is required in connection with the execution, delivery, and performance of the transaction documents other than those approvals, consents, orders, and authorizations that have been obtained in connection with the closing of the transaction; and That the payments set forth in the transaction documents do not violate applicable usury laws. Standard & Poor's may also request such other legal opinions that it considers relevant to the rating analysis. Standard & Poor's generally expects to see legal opinions from counsel in the relevant jurisdictions opining on pertinent aspects of their local law in relation to the matters discussed. 3. Legal Opinion Language As a general matter, clear and unambiguous opinions should be expressed on key elements of the structure. For this reason, expressions such as the following may not be consistent with the highest rating categories: "The courts should …" (rather than "will" or "would"); "Although opinions on the matter differ, the majority view seems to be …"; "It is generally held that …"; "It appears more likely, on balance, that …"; "There are good arguments that …"; "In the absence of judicial precedent, no opinion can be averred on …"; or "On balance, it is probably correct that …". Similarly, the use by counsel of a general insolvency or bankruptcy qualification to qualify legal opinions given on key structural issues detracts from the legal integrity of the structure and is generally inconsistent with high levels of ratings. Legal counsel to transactions are invited to contact any member of Standard & Poor's legal department to seek clarification of any of these points. As noted above, these requirements are not exhaustive but are set out to provide guidance and are subject to change. APPENDIX I: ASSET-SPECIFIC CRITERIA – GENERAL This appendix to the guide reproduces selected criteria articles that apply in part because of the specific nature and types of collateral being securitized. Asset-specific criteria apply in addition to Standard & Poor's structure-specific and jurisdiction-specific criteria, including opinion requirements, set forth elsewhere in this guide. The articles that follow represent a compilation of previously published asset-specific criteria articles relevant to European structured finance transactions. To the extent that the following articles do not canvass asset-specific criteria for a particular asset type, please consult with Standard & Poor's to discuss the asset type to determine whether or not there are any other criteria that might apply. Criteria Regarding Legal Opinions In The Context Of CDOs (originally published on May 12, 2003) The CDO market, and particularly the non-U.S. CDO market, is still a relative newcomer to the securitization scene. As such, Standard & Poor's believes that it may be useful to identify those criteria that it has developedin the context of CDO transactions. The general methodology set out here should be viewed as providing a set of principles to guide market participants to the legal criteria issues likely to be raised in the context of Standard & Poor's rating process for CDO transactions. They apply to all types of CDOs that involve the legal transfer, by way of sale or participation or otherwise, of the underlying debt to a special-purpose entity (SPE). This paper does not deal, therefore, with synthetic transactions where the assets are not transferred to the issuer. The criteria are summarized in the reference table set out at the end of this paper. Non-synthetic CDOs generally fall into two categories, which for the sake of simplicity are called "balance-sheet" CDOs and "arbitrage" CDOs. Balance-sheet CDOs are effected by financial institutions that wish to divest themselves of part of their banking assets. Usually these will be assets that the institution has generated itself through its lending activities or that were purchased some time previously with the intention that the institution will hold them. Usually these transactions are carried out to release regulatory or economic capital and/or reprofile the financial institution's balance sheet. The assets disposed of would not usually be booked in the relevant institution's trading book. Arbitrage CDOs are set up for the purpose of taking advantage of imperfections in the market's pricing of financial assets. From the legal point of view, their key feature in Standard & Poor's eyes is that the securitized assets are purchased in the open market from a variety of market sellers who are unconnected with the rated transaction. As a rule of thumb, Standard & Poor's generally treats a transaction as an arbitrage CDO where: The assets are purchased directly by the securitization vehicle from third-party market participants; or The assets are purchased from a financial institution that has itself purchased them from a third-party market participant in the previous three months and where the assets were always booked in that institution's trading book. The distinction is important because certain risks relating to the sale of the assets and particularly preference risks in the insolvency of the seller are likely to be much less acute in an arbitrage CDO than in a balance-sheet transaction. This is because, as a practical matter, a sale at open market value using the normal procedures and sale documentation of the international capital markets is considerably less likely to be challenged by the liquidator of an insolvent seller. 1. The Laws Governing CDOs Turning now to the legal aspects of CDOs there are potentially seven legal systems in play: The law of the seller of the assets — i.e., the country whose law will govern any potential insolvency of the seller. Under principles of international law, whether a sale is to be treated as a preference and/or the asset purported to be sold is treated as still remaining in the estate of the insolvent seller is to be determined under the law governing that seller's insolvency. That is, in the vast majority of cases, the law of the country in which that company is incorporated. The law of the contract transferring the assets — i.e., the law chosen by the parties to govern the sale or participation agreement. This law is at the option of the parties but is usually the law of England or the law of the State of New York. This is the law that determines whether the document signed by the parties and purporting to effect a sale actually achieves the anticipated result. The law of the underlying debts — i.e., the law chosen by the original lender or lenders and the original borrower (or issuer) to govern the asset being sold or participated. It is this law that determines whether the debt is valid, but also whether it is capable of being sold or participated in the manner contemplated by the transaction. Under the law of most jurisdictions, if a debt governed by the law of jurisdiction A cannot be assigned, for example, under the rules of jurisdiction A then the courts of jurisdiction B will hold that a purported assignment under their own law will fail, even if, had B's law governed the debt, the assignment would have been valid. The law of the underlying debtor — i.e., the law of the jurisdiction in which the underlying debtor is incorporated and in which it has the majority of its assets. Irrespective of whether the underlying debt has been sold to a securitization vehicle, any enforcement of the debt against a defaulting debtor would need to get the cooperation of the courts of that debtor's home jurisdiction. The reason is that, under general rules governing national sovereignty, even if a creditor gets a judgment in its own jurisdiction against a debtor in another jurisdiction (for example, because both the creditor and the debtor agreed to a "choice of forum" clause in the loan agreement, which mandated the creditor's own courts as the proper forum to hear a dispute), that creditor cannot enforce against the assets of the debtor located in the debtor's home jurisdiction without the explicit agreement of the debtor's home courts. Anything else would violate the national sovereignty of the debtor's country. This raises issues such as, would the debtor's home court recognize the SPE as the creditor — in other words, would the local courts recognize the validity of the sale or participation from the originator to the issuer? The law of the issuer — i.e., the law of the jurisdiction of incorporation of the issuer. This is the law that will determine whether the issuer is capable of owning the assets, of issuing the rated notes, and whether it is likely to suffer adverse tax charges as a result of owning the assets. The law of the transaction documents — i.e., the law chosen by the market participants to govern the various issuance documents in the CDO transaction including the rated notes and other ancillary contracts, such as liquidity facilities and hedging agreements (other than the document transferring the underlying assets which is dealt with above). The law of third-party providers — i.e., the law of incorporation of providers of various facilities to the issuer. This will include asset managers, trustees, liquidity facility providers, and hedge counterparties. First, it should be noted that in many transactions, these laws will overlap. It would be very unusual for the law of the transaction documents not to be the same as the law governing the transfer agreement and probably that of many of the underlying debts. The other possibility, though, is that in an international CDO it is perfectly plausible for the underlying debtors to be governed by the laws of a multiplicity of countries. In respect of the laws set out in the fifth, sixth, and seventh points above, CDOs are no different from any other securitization and Standard & Poor's would expect to see the same opinions as are common for all structured finance transactions. In respect of the legal systems mentioned in the first four points, Standard & Poor's sets out its views below. Law of the Seller The concern would be that, in the insolvency of the seller/originator the sale would either be struck down or reversed under the relevant law's preference rules. Here, because of the greater comfort to be derived in the case of arbitrage CDOs, Standard & Poor's generally does not require a "true sale" opinion in such transactions. In the case of balance-sheet CDOs, however, Standard & Poor's generally expects to see a true sale opinion in respect of the seller. In conformity with Standard & Poor's published criteria, the opinion should provide comfort that the transfer of the assets to the SPE would be considered a true sale, would not be recharacterized as a loan by the originator to the vehicle, and would not be set aside in the originator's insolvency. In addition, in jurisdictions with strong "substantive consolidation" rules, such as the U.S., a nonsubstantive consolidation opinion may be required, depending on the structure. For sellers within the EU, the determination of the relevant law governing the seller's putative insolvency may need to take into account the EU insolvency regulation (Council Regulation (EC) No. 1346/2000). For transactions that are partially arbitrage CDOs and partially balance-sheet CDOs, Standard & Poor's would expect to see a full true sale opinion in respect of any seller whose assets were sold to the vehicle as a balance-sheet transaction. Law of the Contract Transferring the Assets For arbitrage CDOs where the sale of the assets has taken place under standard types of documents in general use in the international capital markets, Standard & Poor's is generally satisfied that it is extremely unlikely that the markets are using inappropriate legal forms. Accordingly, Standard & Poor's would not expect to see any legal opinions confirming direct sales from third parties unconnected to the transaction. In arbitrage CDOs where a financial institution has warehoused the assets so that there is only one seller and that seller is also closely connected with the securitization transaction, it is not improbable that the form of documentation used to transfer the assets has been drafted specifically for the rated transaction. In those circumstances, Standard & Poor's may request either (i) an opinion from counsel qualified in the jurisdiction of the law governing the sale to the effect that the transfer agreement effects a sale; (ii) a representation by the seller that the sale has taken place on the same standard documentation and according to the same procedures that such seller uses for sales and/or purchases to unconnected participants in the capital markets; or (iii) a representation by the seller that, under the laws of the jurisdiction governing the contract of sale, the transfer agreement effects a sale. In balance-sheet CDOs, Standard & Poor's may request an opinion from counsel qualified in the jurisdiction of the law governing the sale to the effect that the transfer agreement effects a sale. Law of the Underlying Debt The main concern here would be that the law of the underlying debt prohibits the transfer of that debt either absolutely or in the manner set out in the transaction documents. As mentioned above, in such circumstances, the courts, wherever situated, are likely to find that the purported sale of the assets to the SPE had failed. Standard & Poor's views this risk as one that should be eliminated through proper due diligence by the arrangers and the originators. In many CDOs involving the sale of well-known capital market instruments (such as Eurobonds), the arrangers and/or originators will be large financial institutions that have a substantial business trading such instruments in the normal course of their operations. Standard & Poor's expects that these institutions will have done all the due diligence necessary to ascertain the tradability of these instruments many years previously and therefore considers it to be unnecessarily onerous to require the same work to be done again and again for each transaction. Standard & Poor's considers that it is up to such market participants to ensure that the transfer method selected is appropriate to the assets sold. In cases of unusual instruments, though, Standard & Poor's may request legal opinions from counsel qualified in the jurisdiction of the debt for comfort that there are no issues that may negatively affect the rated notes. Law of the Underlying Debtor The essence of an asset-backed transaction is that, in the insolvency of the originator, the issuer of the asset-backed notes is able to derive the economic benefit of the transferred assets. In the case of debts, this includes the capacity to enforce the payment of the debt by the underlying debtor. Both as a matter of legal theory and a matter of practice, this generally requires the assistance of the courts in which that debtor has substantial assets located, normally the debtor's jurisdiction of incorporation. As mentioned above, the concern would be that, under the law of the debtor's jurisdiction, a sale of that debtor's payment obligation would bind the debtor only if certain specific steps had been taken (for example, written notification of that debtor). In the absence of such steps, the local court would simply not recognize the SPE as being the lawful creditor. It is, however, extremely unlikely that, if the court does not recognize the SPE as the owner of the debt, the court would then conclude that the debt has disappeared altogether. The near-universal conclusion of a failure to transfer the asset under the debtor's home jurisdiction is that the original owner (i.e., the originator) still remains, in the eyes of that country's courts, the legal owner and, accordingly, the entity entitled to enforce the debt. Unfortunately, if that originator is insolvent, the SPE will no longer be able to rely on a contractual undertaking by the originator to pursue the defaulting debtors on behalf of the vehicle. This has led Standard & Poor's to the following conclusions: whether Standard & Poor's gives credit to debts transferred through a CDO will vary depending on whether there is an agent or trustee acting on behalf of a group of creditors, the issuer has the benefit of a power of attorney, there is a meaningful economic incentive for the originator's liquidator to enforce the debt, or none of the above. Agent or Trustee In the case of many instruments, an agent is mandated to act on behalf of a group of lenders. This will be the "facility agent" on syndicated loans or the "note trustee" on secured bonds. In these circumstances, the debtor's jurisdiction needs only to recognize the agent's or trustee's rights to enforce the debt on behalf of the lenders. This is a matter for due diligence at the time of the entering into force of the underlying debt. From the point of view of the SPE, it is necessary that the agent or trustee recognizes only it and not the originator as a "lender" under the facility or as a "noteholder" under the terms and conditions of the notes. Legally, this should be dealt with under the law of the underlying loan, as set out in "Law of the Underlying Debt". Accordingly, Standard & Poor's will assume that appropriate due diligence was conducted at the time of the entry into the underlying debt instrument to ensure the rights of the relevant agent or trustee and, if it receives the comfort referred to above in relation to the law of the underlying debt, Standard & Poor's generally does not expect to request any additional legal comfort relating to the jurisdiction of incorporation of the debtors. Power of Attorney In certain circumstances, the issuer may have the benefit of power of attorney granted by the originator. Pursuant to such power, the issuer would legally be entitled to enforce the originator's rights against the creditors. If the transaction relies on the effectiveness of such power, Standard & Poor's generally would expect to receive a legal opinion from counsel qualified in the jurisdiction whose law governs such power and, if different, the law of the seller to the effect that the power is valid, would survive the insolvency of the seller, and would be recognized by the courts in the jurisdiction of the relevant underlying debtor. Based on such opinions, Standard & Poor's would generally not request any additional comfort relating to the jurisdiction of incorporation of the debtors. Incentives In circumstances where there is no agent acting on behalf of all the lenders and where the jurisdiction of the debtor fails to recognize the transfer of the debt to the SPE, the vehicle would need to rely on the originator to enforce the debt on its behalf. Once the originator is insolvent, however, it is almost invariably the case that such contractual obligations to enforce on the vehicle's behalf will no longer bind the originator. Nevertheless, there may be transactions where the originator retains a meaningful economic interest in the transferred assets. For example, the assets may be transferred under a master trust type structure where the originator retains an undivided interest in a percentage of each transferred loan. To the extent that Standard & Poor's can identify a meaningful economic interest being retained by the originator such that the liquidator of the originator will have an incentive to pursue the defaulting debtors, no additional legal opinion from the debtors' jurisdiction may be requested. If reliance is placed on such incentive, however, Standard & Poor's may request to see a paragraph in the true sale opinion (if required) provided from counsel in the seller's jurisdiction indicating that, if the liquidator or other insolvency officer of the seller did enforce the debts in its own name, any collections recovered would, to the extent of the SPE's interest in the debts, be handed over to the SPE and could not be retained by the liquidator or other officer as part of the insolvency estate of the seller. No Incentives and No Agent In circumstances in which there is no incentive for a liquidator or insolvency officer of the seller to recover from defaulting debtors and no agent to do so on behalf of the SPE, Standard & Poor's may request some comfort that the vehicle is able to recover the debts itself. If there are additional steps that must be taken before the SPE is able to do so, these steps should be identified and Standard & Poor's may request comfort as to what provisions have been made to address this issue and that these steps are able to be taken in a timely manner. To obtain comfort that the SPE can enforce the debts in the debtor's home jurisdiction, Standard & Poor's may request a legal memorandum written by counsel qualified in the debtor's jurisdiction of incorporation. This memorandum, though, is not a legal opinion. A legal opinion is a statement about the transaction at hand. It requires the counsel to read all the relevant transaction documents and do any additional searches in local registries and other sources necessary to reach the relevant legal conclusion about the transaction. The legal memorandum referred to in this paragraph is a memorandum describing the general law as to assignments of the type contemplated in the transaction. If requested, the memorandum should set out whether and on what conditions the SPE would be entitled to enforce the transferred debt. Counsel, though, will not be required to opine on the specific transaction and whether that transaction complies with the rules for a valid assignment in the relevant jurisdiction. In addition, it is not the intention of Standard & Poor's to request such memoranda each time a transaction is effected. Whenever Standard & Poor's receives a memorandum in respect of a given jurisdiction, it will determine whether the jurisdiction is such that credit can be given to debts owed by debtors incorporated in that jurisdiction. If certain steps are necessary in that jurisdiction to perfect the sale to the SPE, Standard & Poor's may request comfort that these steps are addressed by the transaction documents. If assets transferred in CDOs have debtors in a jurisdiction that Standard & Poor's has previously considered acceptable for the type of asset transferred, then no additional opinion or memorandum may be required for such assets. Since the law changes and all transfer mechanisms may not be treated equally in any particular jurisdiction, Standard & Poor's urges market participants to check, at the outset of their transaction, whether any particular jurisdiction has been considered acceptable by Standard & Poor's in respect of the type of transaction they wish to conduct. Additional Steps In circumstances in which there is no incentive for a liquidator or insolvency officer of the originator to enforce, no agent or trustee to do so on behalf of the SPE, and no effective power of attorney, it is possible that legal analysis may reveal that certain steps need to be taken in the debtor's home jurisdiction to make the transfer of the assets binding upon it. Often these steps involve the giving of notice of the transfer to the debtor. Provided these steps may be taken legally after the transfer, Standard & Poor's generally does not consider it necessary for such steps to be taken immediately on the closing of the transaction to obtain the highest rating categories if either (i) legal advice indicates that these steps can be taken at any time by the vehicle itself or the trustee for the rated notes — notwithstanding, for example, the insolvency of the seller; or (ii) if these steps can be taken only by a third party (for example, the seller), such third party being rated at least 'BBB' and the transaction documents provide that, on a lowering of the rating on such party below 'BBB' or withdrawn, such party will be obligated to effect the relevant steps immediately and in any case within 30 days. Please note that this "trigger" at 'BBB' is only consistent with high rating levels if the relevant additional steps can be taken swiftly and at little meaningful cost. If the taking of such steps does incur a cost, Standard & Poor's may request comfort that a source of cash has been identified that will be available to meet such costs. This may require some form of cash reserve. 2. Withholding Tax Should any withholding tax fall to be paid on the underlying loans following the assignment of these loans to the SPE, such tax may need to be factored into the relevant transaction's cash flows to prevent a shortfall in the cash received by the vehicle and needed to pay the rated notes. To obtain comfort that this is not necessary, Standard & Poor's may request: A representation from the arranger, originator, or collateral manager that the relevant loans/bonds contain an effective gross-up clause entitling the vehicle to obtain sufficient funds to account for any tax and retain the same cash amount as it contracted to receive; or Legal comfort from tax counsel in the relevant debtor's country stating that debt of the type sold to the vehicle does not attract withholding tax; or A demonstration that, even net of applicable withholding tax, the cash flows generated by the assets are sufficient to allow payment in full on the rated notes under the various stress scenarios applicable to the transaction. Rules of Thumb Concerning Opinions Required ARBITRAGE CDO BALANCE-SHEET CDO A. With trustee/agent* B. With valid power of attorney** C: With economic incentive on seller to enforce*** Without A, B, or C Law of seller ("true sale") X ((((((((Law of transfer agreement X ((((((((Law of asset X X X X X Law of debtor Same as for balance-sheet CDO X X X (Law of issuer ((((((((((Law of transaction documents ((((((((((Law of third party providers O O O O O Key: ((- Opinions needed. (- Legal memorandum. X – Opinions not needed. O – Opinion to be delivered if required (the usual rules). *There is a trustee or agent acting for the creditors of the assets. **There is a valid power of attorney surviving insolvency and giving the issuer power to enforce the asset. ***There is an incentive post-insolvency for the seller to enforce the asset for the issuer. Please note that this table is for guidance only and that Standard & Poor's reserves the right to request legal opinions whenever it considers that any aspects of the proposed transaction require further or deeper legal comfort to be provided. APPENDIX II: JURISDICTION-SPECIFIC CRITERIA – GENERAL This appendix to the guide reproduces selected criteria articles that apply in part because of the jurisdiction of collateral being securitized. Jurisdiction-specific criteria apply in addition to Standard & Poor's structure-specific and asset-specific criteria, including opinion requirements, set forth elsewhere in this guide. The articles that follow represent a compilation of previously published jurisdiction-specific criteria articles relevant to European structured finance transactions. To the extent that the following articles do not canvass specific criteria for a particular jurisdiction, please consult with Standard & Poor's to determine whether or not there are any other criteria that might apply. LEGAL ISSUES IN ITALIAN ASSET-BACKED SECURITIZATIONS (originally published on Oct. 29, 2004) The Italian securitization market has evolved much since the initial publication of Standard & Poor's legal criteria pertaining to transactions structured in this jurisdiction. This article is a revision of the one published in September 2001 and reflects Standard & Poor's experience of the development of the Italian structured finance market since then. This criteria paper is dedicated to commentary on legal issues that arise in the context of Italian asset-backed transactions based on Italian Law No. 130 of April 30, 1999 (the Securitization Law), and to describing the general methodology used by Standard & Poor's when reviewing the legal aspects of such transactions. It does not address the legal issues that arise in relation to other kinds of structured finance transactions, such as secured loan transactions ratable as structured finance, asset-backed transactions based on Italian Law No. 52 of February 1991, or securitizations carried out by public entity originators on the basis of special laws. Owing to the almost limitless combination of jurisdictions, structures, asset types, laws, and transaction parties that one might encounter in a structured finance transaction, it is not possible to have criteria that anticipates every issue in every jurisdiction. This paper is not exhaustive and does not seek to set out every legal issue that may be involved in or relevant to an Italian asset-backed transaction, nor does it purport to set out a full analysis of the complex legal principles that are discussed. In addition, this paper should not be considered to constitute legal advice. The general methodology set out herein should be viewed as providing a set of principles to guide market participants to the legal criteria issues likely to be raised in the context of Standard & Poor's rating process for Italian asset-backed transactions based on the Securitization Law. The purpose of this paper, along with Standard & Poor's other legal criteria guides, is to further Standard & Poor's continuing effort to serve its customers by providing insight into its rating criteria and processes. Market participants seeking a rating from Standard & Poor's continue to be invited to familiarize themselves with all the published criteria that may be relevant to their transaction. In particular, for a more extended discussion of some of the issues addressed by this paper, market participants are invited to examine "Legal Criteria for U.S. Structured Finance Transactions — April 2004" (available on RatingsDirect and on Standard & Poor's Web site at www.standardandpoors.com). Section I: General Italian Issues 1. Special-Purpose Entity (SPE) The initial structuring considerations for any securitizations focus on how assets can be transferred so that an insolvency of the transferor would not adversely affect the payment of principal and interest on the rated securities. Generally, to achieve this goal, the assets are transferred by means of a true sale (see section I.2) to an SPE in a manner designed to provide comfort that this entity is "bankruptcy remote", that is, unlikely to be subject to voluntary or involuntary insolvency proceedings. In this regard, Standard & Poor's is concerned about the incentives of the SPE, or its equity holders, to resort to voluntary insolvency proceedings and the incentives of the creditors of the SPE to apply for its insolvency. The bankruptcy-remote analysis is also concerned with whether the creditors of the SPE's shareholders would have an incentive to make a claim against the assets of the SPE to satisfy the shareholders' obligations. 1.1 LEGAL STATUS OF THE SPE The vast majority of Italian asset-backed transactions in the past five years have been structured as a sale of the assets to an SPE established pursuant to the Securitization Law. This Law sets out certain mandatory provisions relating to the securitization entity (the SPE, which is also the issuer — see Endnotes 1) and to its relationship with assigned debtors and third-party creditors. These provisions are substantially more favorable than would be the case for a normal company purchasing receivables. Under the Securitization Law, the SPE must be registered as a financial intermediary and, as such, is regulated by the Bank of Italy. In addition, the noteholders are protected by the principle of "destination" and the principle of "segregation", respectively set out in Articles 1.1 (b) and 3.2 of the Securitization Law. Under the principle of destination, amounts paid by the underlying debtors whose receivables have been assigned to the SPE can be applied only in satisfaction of the asset-backed notes and in payment of associated transaction costs. Under the principle of segregation, "the receivables relating to each transaction constitute segregated assets for all purposes from those of the company and from those of any other transaction. In respect of each group of segregated assets ("patrimonio separato"), no action by creditors other than the holders of the notes issued in order to finance the purchase of the receivables is permitted" (from Article 3.2). Standard & Poor's is satisfied that the principle of segregation does effect the legal and economic equivalent of a valid security interest over the assets that are covered by the Securitization Law. Furthermore, under Article 4.2 of the Securitization Law, after notice of the sale of a portfolio of receivables has been published in the Official Gazette of the Republic of Italy ("Gazzetta Ufficiale") (see section I.2), the only enforcement proceedings that are permitted against the sold receivables are those aimed at protecting the rights contemplated by Article 1.1 (b). Despite the provisions of the Law, and notwithstanding the undoubted additional comfort provided by the Bank of Italy's supervisory function, the Securitization Law does not, in and of itself, constitute the SPE as a bankruptcy-remote entity. Despite the segregation principle, the opening of formal insolvency procedures against the SPE would almost certainly result in a temporary interruption of the cash flows as various parties seek to determine their rights and, possibly, to contest the rights of others. In addition, certain ancillary contracts necessary for the noteholders to be paid in full (for example, swap agreements) would in all likelihood fall away in the event of an SPE's bankruptcy.

Accordingly, Standard & Poor's expects to see the SPE benefit from such additional elements that would enable it to satisfy the bankruptcy-remoteness criteria. 1.2 BANKRUPTCY REMOTENESS As noted above, the Securitization Law does not, in and of itself, constitute an SPE created thereunder as a bankruptcy-remote entity. For an asset-backed transaction to receive a rating from the highest categories, the SPE that owns the assets or issues the rated debt or both should comply with Standard & Poor's bankruptcy remoteness criteria. Standard & Poor's regards an entity that satisfies these criteria as being sufficiently protected against both voluntary and involuntary insolvency risks. The criteria can be divided into: Restrictions on objects and powers; No reorganization or changes of ownership; Debt limitations; Separateness covenants; Independent director; and Security interests over assets. Each of the above elements is important to the overall concept of bankruptcy remoteness. Regardless of the specific organizational structure of the SPE, these elements should, generally, be addressed in the relevant constitutive and/or transaction documents. 1.2.1. Restriction On Objects And Powers Under Article 3 of the Securitization Law, the sole corporate object of the SPE must be to carry out the securitization. The SPE should confirm the restrictions provided for by the Securitization Law and covenant to restrict its activities to those needed to effect the transaction. The SPE should not engage in unrelated business activities unless the parties to a transaction are willing to allow the rating to reflect the effect of these activities on the SPE's resources, cash flows, and ability to pay its obligations. The above restrictions should appear in the constitutive documents of the SPE as well as in a contract to which the noteholders or their representative or trustee is a party. In addition, the documents should provide that they cannot be amended for so long as the rated debt is outstanding. 1.2.2. No Reorganization Or Changes Of Ownership The SPE should agree not to engage in any liquidation, merger, or asset sale (other than as provided for in the relevant transaction documents) or amendment of its organic documents, so long as the rated debt is outstanding. 1.2.3. Debt Limitation The SPE should be restricted from incurring additional indebtedness, except in cases where such indebtedness would not affect the rating on its existing borrowings. Additional indebtedness that should not, in principle, affect the rating on existing borrowings is indebtedness that is either fully subordinated to the rated notes or has been assigned the same rating by Standard & Poor's as the rated notes in a given transaction (at the time of issuance and at all times thereafter). In either case, the debt of the SPE should be nonrecourse to the SPE or any of its assets other than cash flow in excess of amounts necessary to pay holders of the rated notes, and should not constitute a claim against the SPE in excess of the cash flow attributable to that debt. Standard & Poor's also generally requests nonpetition language in any agreement between the SPE and a creditor whereby the creditor agrees not to file/petition the SPE into bankruptcy and not to join in any bankruptcy filing/petition for the SPE. If an entity is established to serve as the issuer for multiple issuances of debt that are not rated the same or are not expressly subordinated, under certain circumstances, this entity may nonetheless be viewed as an SPE by Standard & Poor's (see section I.1.4). 1.2.4. Separateness Covenants Separateness covenants are designed to provide comfort that the SPE will hold itself out to the world as an independent entity, on the theory that, if an entity does not act as if it has an independent existence, a court may use principles such as "piercing the corporate veil", "sham company", or "substantive consolidation" to bring this entity and its assets into the controlling party's insolvency proceedings. An important element of Standard & Poor's bankruptcy-remote analysis is comfort that the SPE's assets would not be deemed to be part of the controlling party's estate if the latter is declared insolvent. In this regard, the SPE should agree to abide by the separateness covenants set out in the "Legal Criteria for European Structured Finance Transactions". Standard & Poor's understands that Italian law does not recognize the opening of insolvency proceedings against a company solely because another entity in its group (including its parent) has itself filed for bankruptcy. In addition, Standard & Poor's understands that there is no doctrine of "substantive consolidation" in Italy, whereby the assets of a solvent subsidiary are consolidated in the insolvency estate of an insolvent parent. The only exception is, Standard & Poor's understands, where the separate corporate existence of the subsidiary is deemed to be a sham. This could occur, for example, where all the assets of the subsidiary are commingled with those of its parent, where it is impossible to determine which property belonged to one and which to the other, and where no proper and separate accounting records have been held. Accordingly, so long as the SPE and the originator agree to abide by the aforementioned separateness covenants, and subject to certain other conditions discussed below, the originator may hold shares in an Italian SPE. 1.2.4.1. Shareholding Typically, shareholders of an Italian SPE are required to assume a number of explicit undertakings as to the management of the SPE and the transfer of their shares, aimed at preventing interference with the transaction. Standard & Poor's is concerned that under Italian law these undertakings would not be enforceable against a bankruptcy of the shareholder and, in particular, that a liquidator in bankruptcy would be at liberty to dispose of the shares in the SPE in favor of an entity not bound by undertakings in relation to the management of the SPE. In order to minimize the risks outlined above, Standard & Poor's requests that the controlling or sole shareholder of an SPE be a bankruptcy-remote entity (for example, a Dutch "stichting") or an entity subject to prudential supervision aimed at reducing the likelihood of a bankruptcy, such as banks or, in Italy, financial intermediaries supervised by the Bank of Italy. 1.2.4.2. The Originator as a ShareholderIn order to obtain certain favorable tax groupings, Italian originators may wish to have a controlling interest in the SPE. Standard & Poor's does not view this as incompatible with a high rating level. Nevertheless, a controlling shareholder may, under Italian law, impose certain acts on its subsidiary, notwithstanding the opposition of that subsidiary's board of directors. To reduce the risk of interference by a controlling shareholder affecting the credit of the rated notes, Standard & Poor's expects to see at least one other shareholder of the SPE. This shareholder should be an independent entity unconnected to the originator. Furthermore, the constitutive documents of the SPE should contain provisions according to which no action that would negatively affect the rating on the notes and which under Italian law may be decided by a resolution of the shareholders (rather than by the directors) is undertaken without a special majority vote. The special majority should be set at a level that requires the favorable vote of the independent shareholder for the resolution to be passed. Finally, the nonindependent majority shareholder should covenant for the benefit of the noteholders that it is aware of the securitization-related obligations of its subsidiary and that it would not direct the SPE to breach these obligations. 1.2.5. Independent Director Standard & Poor's requests that at least one of the directors of the SPE is independent from the transaction participants. The constitutive documents of the SPE should provide that the favorable vote of the independent director be required in order to pass any resolution of the board of directors which could negatively affect the rating on the notes. Standard & Poor's expects the independent director, within the boundaries of his or her legal duties to the company, to review the operation of the SPE and to provide information to the representative of the noteholders or the trustee if he or she becomes concerned as to the governance of the SPE. 1.2.6. Security Interests Over Assets As a general matter, Standard & Poor's requests that an SPE grants a security interest over its assets to the holders of the rated notes. In connection with this criterion, Standard & Poor's generally also requests a security interest opinion, which confirms that the holders of the rated notes have a perfected security interest that survives the SPE's insolvency. As noted above, Standard & Poor's is satisfied that the principle of segregation set out in the Securitization Law effects the legal and economic equivalent of a valid security interest over the assets that are covered by the Securitization Law. Under this principle, the noteholders have an effective security right over the receivables backing the transaction and the collections derived from these receivables. Despite certain academic musings, Standard & Poor's is satisfied that the right of segregation also extends to funds standing to the accounts of the SPE held in Italy and into which collections have been paid, subject to that cash being traceable (for further information on the treatment of cash in accounts, see section I.3). If the segregation principle were not extended to collection accounts, the conclusion would be that the Law was meant to cover only actual coins and notes paid by underlying debtors. Since practically no-one pays in this manner in Italy, such a narrow interpretation of the Securitization Law would be illogical. However, if the collections are mixed with income deriving from other sources (such as swap or liquidity facility proceeds) not necessarily protected by the principle of segregation, uncertainty may arise that could jeopardize the benefit of the segregation and therefore allow challenges to be raised in relation to the amounts deposited in the relevant account. This might result in a temporary interruption of the cash flows coming from the relevant account and could negatively affect the timeliness of payments of interest and principal to the noteholders. Accordingly, Standard & Poor's expects to see an account solely dedicated to collections (impressed with the segregation principle) where these collections may be held separate from other funds. One exception is the commingling of funds strictly limited to the time technically necessary in order to transfer the relevant cash to a separate account. In this case, proper security is created over this cash for the benefit of the noteholders (for example, a charge or pledge over the proceeds of the swap or of the liquidity facility). In addition, the ability of the issuer (and its agents) to credit and debit the issuer's accounts should be limited to what is necessary to make the payments contemplated under the transaction documents. Furthermore, in a classic securitization the SPE also owns, in addition to the portfolio of receivables and the collections pertaining thereto, a series of assets of economic value that are not covered by the segregation principle. These could include, for example, the benefit of derivative contracts (currency and interest-rate swaps), liquidity facilities, and subordinated loans. They might include "eligible investments". These might also include assets outside of Italy. In the case of these assets, it may be unclear, at best, whether the courts of the jurisdiction where the assets are located and to which one would need to turn to seize these assets would recognize an Italian legal principle, such as the segregation rights set out in the Securitization Law. As a result, whenever an SPE owns assets that are of non-negligible value and are not clearly covered by the segregation principle, Standard & Poor's expects the SPE to grant a security interest over these assets. 1.3. RESPONSIBILITY OF ISSUER AND SERVICER UNDER THE SECURITIZATION LAW The Securitization Law and the regulations of the Bank of Italy provide additional comfort to the actual operation of the statutory principles of segregation and destination mentioned above, by laying upon the SPE and the servicer in a securitization certain responsibilities, including the protection and preservation of the interests of the noteholders. In particular, the SPE and the servicer, in carrying out their activities in the context of the transaction, should, according to the Securitization Law and the regulations of the Bank of Italy, respectively comply with a number of mandatory guidelines, including the following. The issuer should: Ensure the effective separation between the pools of assets pertaining to different transactions and the separation between these pools and the other assets of the company (by keeping separate dedicated accounts and accounting records for each transaction); Guarantee the transparency of the transaction toward the investors and the market; and Restrict its activities to those relating to the transaction's management. The servicer should ensure that: The collection and recovery of the claims and the payment and cash management activity comply with the law and the prospectus; Collections are directed to the dedicated accounts of the issuer in relation to the transaction and avoid any confusion between the separate pools for each transaction and the other assets of the company; The interests of the noteholders are protected in all stages of the transaction, avoiding in particular any situations of conflict of interests; and Collections occur in accordance with the scheduled maturities. According to the Securitization Law, the servicer must be a regulated entity (a bank or a financial intermediary enrolled in the Special Register held by the Bank of Italy pursuant to Article 107 of the 1993 Banking Act). Furthermore, according to a communication of the Bank of Italy dated Nov. 3, 2003, the servicer is subject to certain capital adequacy requirements that vary depending on the aggregate amount of receivables in relation to which it carries out its servicing activity, must comply with certain IT standards, and is required to establish adequate internal proceedings to guarantee the continuity and effectiveness of its activities. 1.4. "SEGREGATED ISSUERS" AND "MASTER TRUST" STRUCTURES In addition to the standalone SPEs established to issue one or more series of equally rated securities, in some cases, market participants may seek to use the same SPE to carry out more than one securitization (a "segregated issuer"), or to issue different series of notes over time backed by a global pool of receivables (a master trust SPE). 1.4.1. Segregated Issuers It is possible for an Italian SPE established under the Securitization Law to issue different series of notes over time backed by separate pools of receivables. This is the case even when the different series have different ratings or when some of the series are rated and others are not. When a single entity issues differently rated securities backed by assets of different credit quality, consideration must be given to mitigating the risk that, if one series defaults, the holders of that series do not have the incentive to reach other assets of the issuer, resulting in the issuer's bankruptcy. Toward this end, Standard & Poor's has developed criteria for these transactions. To date, Standard & Poor's has applied these criteria generally to structured transactions involving synthetic securities issued by "program issuers". A "synthetic" security is one that repackages existing securities. The rating on a synthetic security is based primarily on the creditworthiness of the assets and a currency or interest-rate swap, or other similar agreement, designed to modify the cash flows from the assets. A program issuer is one that issues multiple series of synthetic securities under documentation that has been established in form for each series. Typically, when a program issuer issues multiple series of synthetic securities, each series is secured by a separate portfolio of asset and a separate swap agreement for the related cash flows. Synthetic security transactions typically involve multiple jurisdictions and governing laws. Standard & Poor's continues to rely on the transaction arranger to identify the relevant jurisdictions and applicable laws, particularly for the law applicable to the program issuer, the governing law of the transaction documents, and the laws applicable to the assets, the security interests, and any custodial arrangements. The insolvency and other laws in multiple jurisdictions may be relevant in evaluating the effectiveness of the specific criteria discussed in this section. The transaction arranger and its counsel are responsible for satisfying Standard & Poor's that all applicable criteria are met in the relevant jurisdictions. 1.4.1.1. Summary of Segregation Criteria For ease of reference a summary of the key criteria points is set out below: The program issuer should be a bankruptcy-remote, orphan SPE, generally organized in a jurisdiction where it is not taxable. The program issuer should issue separate series of debt obligations. Assets relating to any particular series, including any related proceeds, should be held separate and apart from assets relating to any other series, and the program issuer's obligations, including fees, expenses, and any enforcement expenses, should be on a series-by-series basis only. Any swap transaction entered into by the program issuer for a series should be separate from any other swap transaction for any other series. A first-fixed charge or equivalent first-priority security interest (whether on the basis of the segregation principle under the Securitization Law or otherwise) should be created and perfected over all of the assets on a series-by-series basis that would be upheld even in the program issuer's insolvency. The series should not be cross-collateralized or cross-defaulted because this would result in each series becoming a supporting rating for the others and is inconsistent with different ratings for the series. Each series of notes should include limited-recourse provisions that survive the program issuer's insolvency, confirming that each series has recourse only to the assets charged to that series, is nonrecourse to the other assets of the SPE, and does not constitute a claim against the SPE if the cash flow from the series designated charged assets is insufficient to repay the debt in full. The noteholders, all transaction participants, and any creditors should agree not to file, or join in any filing of, a bankruptcy or insolvency petition against the program issuer. For each series, only the trustee or representative of the noteholders should be entitled to exercise remedies on behalf of the noteholders. Each program issuer should agree to provide the documentation for each series it issues to Standard & Poor's for its review (prior to the issuance of the series), whether or not the series is to be rated by Standard & Poor's. For a detailed discussion of the issues addressed by this section, market participants are invited to examine "Legal Criteria for European Structured Finance Transactions". 1.4.2. Master Trust SPE In the past few years, a number of Italian securitizations have been structured as master trusts, with the relevant SPE issuing different series of notes over time backed by a "global pool" of receivables available for all the notes issued under the master trust program, possibly supplemented by additional transfers of new receivables. In a master trust securitization the noteholders agree in the terms and conditions of the notes to share their collateral with noteholders of subsequent issues. This results in different series relying on the same "global pool" of receivables, which itself could be supplemented by additional transfers of new receivables. This replicates, economically, the Anglo-Saxon master trust structures. In order to rate debt issuances from a master trust structure, Standard & Poor's expects to be provided with documentation related to all the series issued by the same SPE on the same basis, as set out under section I.1.4.1. 2. Transfer of the Assets and True Sale For structures involving a sale and transfer/assignment of assets (that is, receivables), Standard & Poor's looks to the transaction participants to provide comfort on how assets can be transferred/assigned under Italian law so that a bankruptcy, insolvency, or corporate reorganization of the transferor would not adversely affect the timely payment of principal and interest on the rated securities. A true sale of the assets is a sale that is immediately opposable against the transferor, its creditors, its insolvency officer, and the assigned debtors, vesting full legal title to the assets in the SPE. This transfer legally separates the credit risk of the assets from that of the transferor. Standard & Poor's normally expects a true sale of the assets to be made opposable against the parties described above no later than the closing date, so that the SPE, as owner of the assets, would be able to collect scheduled payments and enforce security against the debtors. An opinion confirming that a transfer of assets constitutes a true sale of the assets is generally requested. 2.1. PUBLICATION IN THE OFFICIAL GAZETTE AND REGISTRATION IN THE COMPANIES' REGISTRAR Under the Securitization Law the sale of the receivables to the SPE becomes opposable against third parties in the insolvency of the seller only upon publication of the relevant notice in the Official Gazette (Article 4.1 of the Securitization Law). Until publication, if the transferor is placed into insolvency proceedings, its liquidator is entitled to ignore the sale and help itself to the receivables for the benefit of the unsecured creditors of the insolvent company. This transfer crystallizes the debtor's ability to set off against the transferor. It also terminates the debtor's right to receive good discharge of the debt by paying the transferor. Article 4.1 of the Securitization Law, however, contains a reference to Article 58 of the Banking Act, which has been recently amended. Article 58 of the Banking Act currently requires that the purchaser of the receivables gives notice of the sale through its registration in the Companies' Registrar ("Registro Delle Imprese") and its publication in the Official Gazette. The appropriate extent of the application of this further requirement is the subject of current discussion among the Italian legal community, the outcome of which cannot be predicted. Standard & Poor's will continue to closely monitor developments in the relevant debate and, depending on the outcome of the discussions, may modify its criteria as appropriate. In the interim, Standard & Poor's expects that, in addition to the publication of the notice of sale in the Official Gazette, notice of the sale is given by means of its registration in the appropriate Companies' Registrar. Pursuant to the Securitization Law, once notice of the sale of the receivables has been published in the Official Gazette and registered with the Companies' Registrar, no formal notice of the sale need be given to each debtor according to Articles 1264 and 1265 of the Italian Civil Code (which otherwise impose a general rule that transfers of claims must be formally notified to or accepted by assigned debtors to make the transfer effective against them and third parties). Although publication in the Official Gazette and registration in the Companies' Registrar can usually be expected to follow the sale in a few working days, there is no enforceable obligation of the Italian government or of the Companies' Registrar to procure, respectively, publication or registration, or to procure either within any given timeframe. Since publication, together with registration in the Companies' Registrar, creates the true sale with respect to the issuance of the rated notes, publication in the Official Gazette and registration with the Companies' Registrar should take place on or before the closing date. Legal opinions delivered by transaction counsel should confirm that publication and registration have been effected. Standard & Poor's notes the existence of structures where the transaction documents provide that purchase funds are not paid by the SPE to the transferor until publication in the Official Gazette and registration with the Companies' Registrar have taken place, where provision is made to cover the expense of any negative carry. In this case, Standard & Poor's expects to receive appropriate legal opinions addressing the consequences of an insolvency of the transferor occurring before publication in the Official Gazette and registration with the Companies' Registrar. 3. Commingling One of the factors that may affect the cash flow available for a transaction is known as "commingling" (other factors such as claw-back, debtor set-off, and withholding taxes are addressed in later sections). The issue of commingling occurs whenever cash belonging to the SPE is mixed with cash belonging to a third party or goes into an account in the name of a third party in such a way that, in the insolvency of that third party, this cash is "lost" or "frozen". This cash would become "lost" if, following the insolvency of the third party, the SPE's claim to the money is treated at law as an unsecured debt of the insolvent entity. Under Standard & Poor's criteria, this unsecured debt claim would be treated as a total credit loss for the issuer. On the other hand, this cash would become "frozen" if, following the insolvency of the third party, the SPE retained a proprietary claim over the money so that the money did not form part of the insolvent entity's bankruptcy estate. The cash could also be "frozen" if the account where the cash is held was the subject of a valid security interest in favor of the SPE. In both cases where the cash is "frozen", although the SPE's rights to obtain the money would have a solid grounding in law, the question would arise as to how long it would take for the SPE to assert these rights as against the bankruptcy trustee and competing creditors of the insolvent holder of the cash. For this reason, such cases would be treated not as total credit losses but as liquidity strains on the transaction. Accordingly, the transaction should demonstrate features that enable the SPE to meet its current obligations under the rated notes, notwithstanding the delay in cash flows caused by the third party's insolvency. 3.1. INSOLVENCY OF THE TRANSFEROR/SERVICER The most common type of commingling seen in Italian transactions arises when the underlying debtors often continue to make their payments under the sold receivables to a third-party account bank in accounts in the name of the transferor, acting as servicer. Regardless of the fact that the transferor has sold the receivables to the SPE by means of a true sale, if the transferor, acting as servicer, or another third-party servicer, collects the proceeds of the receivables on behalf of the SPE, once the collections are in an account in the name of the transferor or servicer, they are treated in principle as being exposed to the bankruptcy risk of the transferor or servicer. As a result, Standard & Poor's treats the collections as a credit loss unless appropriate measures are taken to mitigate this issue. As an exception to the general absence of protection against the insolvency of a transferor or servicer holding the collections on behalf of the SPE, Standard & Poor's understands that, so long as the collections are collected by the originator and/or the servicer in its capacity as agent ("mandatario") for the issuer, the mere fact that the money stands in an account in the name of the originator/servicer would not, in and of itself, deprive the collections of the protection of the Securitization Law. Standard & Poor's understands the preferred legal view is that, in the insolvency of the transferor/servicer, so long as the collections had not been commingled with other funds, the collections would not fall into the bankruptcy estate of the transferor/servicer, provided that the ability of the transferor/servicer to credit and debit the relevant account were at all times limited to the instructions received by the SPE or to the provisions of the transaction documents and that in any case the transferor/servicer had no power to dispose of the collections for its own interest. As a result, Standard & Poor's may not treat money held in an account in the name of the transferor and/or servicer as a credit loss so long as the following conditions are met, namely that: The collections go into a dedicated account or set of accounts and therefore are not commingled with other funds belonging to third parties (including the transferor and/or servicer); The documents make it explicit that the transferor and/or servicer is collecting the collections as agent for the SPE on the basis of an enforceable mandate bearing an undisputable date ("data certa"), and that the transferor and/or servicer has no power to dispose of the collections for its own interest; The account bank acknowledges the SPE's right to the funds standing to the credit of the account held by the transferor and/or servicer, and waives any set-off rights against the nominal account holder (see section I.3.3); and The account bank is appropriately rated. If these conditions are met, Standard & Poor's may treat the presence of the SPE's funds in a third-party account as a liquidity stress. The length of the period during which it is assumed the cash is delayed by an account holder's insolvency varies, taking into account the rating sought (higher ratings driving more conservative and therefore lengthier periods) as well as the specific conditions of the transaction and the relative slowness of the Italian judicial process. If these conditions are not met, there are nontrivial risks that, in the insolvency of the transferor and/or servicer, the SPE would be left with only an unsecured claim in the bankruptcy. In these circumstances, the amounts standing to the credit of these accounts are treated as being lost to the transaction. 3.2. INSOLVENCY OF THE ACCOUNT BANK When a bank becomes insolvent what happens to money held by the SPE or the servicer with a bank is not strictly speaking a commingling issue, but it seems appropriate to deal with it at this stage for the two issues may be connected at a practical level (for example, where the transferor/servicer is also the account bank) and both relate to the credit of the relevant transaction party. Almost invariably, when a person deposits cash with a bank, that person's rights over the bank account constitute a debt. The account reflects a debt owed by the bank to the account holder, usually payable on demand. As banks are not in the habit of granting security to their account holders, the debt owed by the bank is a normal unsecured debt and is treated accordingly in the bank's insolvency. As a result, consistent with Standard & Poor's approach to unsecured debt of an insolvent company, all cash held with a bank not rated highly enough for the rating on the notes is treated as not available to the SPE. Moreover, the statutory segregation principle under the Securitization Law does not provide any protection for a situation where the funds belonging to the SPE or the servicer are entrusted to a third party (for example, the account bank) and the third party becomes insolvent. To avoid issues with the potential insolvency of the account bank, transactions should be structured in one of two ways: To move the funds into a suitably rated account; or To invest the funds in suitably rated eligible investments, which in turn should be chosen so as to ensure that proper security may be obtained over them, thereby protecting the SPE's interests in the event of the insolvency of the bank holding the investments. 3.3. ACCOUNT BANK SET-OFF Collections may also be lost in the insolvency of the account holder where the bank holding the account is allowed to assert a set-off. In other words, collections may be lost where the holder of the account (for example, the transferor or the servicer) owes funds to the account bank flowing from other, probably unrelated, obligations and is allowed under the terms of the account agreement (or even by operation of Italian law) to set off the amounts owed to it by the account holder against funds standing to the credit of the account, including funds belonging to the SPE. Most bank account standard terms explicitly allow the account bank to set off the obligations of the account holder against amounts standing to the credit of the bank account. Under general principles of Italian insolvency law, in the event of a bankruptcy of the transferor and/or servicer, unless the bank has formally acknowledged the ownership of the SPE over the cash standing to the credit of the bank account, that bank could use its right of set-off in relation to any amounts due to the bank by the transferor and/or servicer. This set-off risk may be mitigated where the account bank specifically acknowledges the SPE's title to the money and waives in writing any set-off rights over that cash, or where the likely set-off risk is estimated and treated in the cash flow models as a credit loss. 4. Preference/Claw-Back Risk 4.1. INSOLVENCY OF THE ORIGINATOR; CLAW-BACK OF THE SALE OF THE PORTFOLIO Pursuant to Article 67 of the Italian Bankruptcy Law and the Securitization Law, the sale of receivables by the transferor may be subject to an insolvency claw-back ("revocatoria fallimentare") in two circumstances: If the sale was not at an undervalue, within three months of the transfer, but only if the transferor was insolvent at the time of the transfer and the liquidator can prove that the transferee was, or ought to have been, aware of the insolvency; or If the sale was at an undervalue, within six months of the transfer, but only if the transferor was insolvent at the time of the transfer and the transferee cannot prove that it was not, and ought not to have been, aware of the insolvency. Following a successful claw-back claim, the liquidator would get the receivables back. The SPE would then be entitled to receive back the purchase price. However, the obligation to return the purchase price would merely be another unsecured payment obligation of the transferor and would become part of the general insolvency proceedings. From a ratings perspective, this money would be viewed as a total credit loss. In the case of transferors that have a current rating in the investment-grade category, reliance is placed on the transferor's rating as a strong indication of the transferor's solvency. For transferors that do not have a current Standard & Poor's rating or whose rating is in the speculative category, Standard & Poor's generally expects to see: Solvency certificates signed by the managing director ("amministratore delegato o unico") or the finance director ("responsabile finanza") of the transferor (or another appropriate person or body); Good standing certificates (for example, "camera di commercio industria artigianato agricoltura — ufficio registro delle imprese — certificato di iscrizione nella sezione ordinaria abbreviata") of the transferor, showing that it is not, and has not been in the past five years, subject to any insolvency or reorganization proceedings; Certificates of the appropriate bankruptcy court ("tribunale civile — sezione fallimentare") confirming that no insolvency petitions have been filed against the transferor in the past five years; and All of the above dated shortly before the date of the initial transfer and, in the case of transactions with a revolving structure, a solvency certificate on the date of each subsequent transfer or on a periodic basis. Clearly, these certificates are not legally dispositive and a court could choose to ignore them in determining whether the SPE was or ought to have been aware of the insolvency of the transferor. Nevertheless, in the absence of genuine fraud, these certificates should provide favorable evidence to strengthen the SPE's plea of ignorance. Where the transferor has an investment-grade rating on the closing date of the transaction but where further sales of receivables are expected (for example, in the case of revolving transactions), the transaction documentation should provide that, if the transferor were to lose its investment-grade rating, it would agree to provide solvency certificates as described above. 4.2. INSOLVENCY OF DEBTOR; CLAW-BACK OF PREPAYMENTS The Securitization Law provides that, subject to the due completion of all the formalities required in order to make the sale of the receivables to the SPE opposable against third parties (see section I.2), payments made to the SPE in respect of the securitized receivables by debtors who are capable of being declared bankrupt (such as entrepreneurs and corporations) are not subject to insolvency claw-back ("revocatoria fallimentare") actions under Article 67 of the Bankruptcy Law. However, pursuant to Article 65 of the Italian Bankruptcy Law, prepayments made by debtors are liable to claw-back risk if made within the two years prior to the declaration of bankruptcy of the relevant debtor, regardless of whether the debtor was insolvent at the time the payment was made. According to the prevailing opinion of Italian legal scholars and Decision No. 1153 of April 10, 1969, of the Italian Supreme Court, the provisions of Article 65 would not apply to prepayments made by a debtor under a loan agreement, if the debtor exercises the right to prepay amounts due under the loan agreement in accordance with the terms of such agreement. The reason is that payments that have been anticipated pursuant to a contractual right of the relevant debtor have to be considered as payment of a debt that falls due upon the exercise of this right and not as payments of a debt that is not yet due. However, the Italian Supreme Court, in decision No. 4842 of April 5, 2002, held that the provisions of Article 65 apply to debt payments made on or before the date on which the relevant debts fall due, as the date has already been fixed, irrespective of whether the loan agreement entitled the debtor to prepay the amounts due. As a result, whenever debtors who are capable of being declared bankrupt are allowed to make prepayments on the loans under the relevant agreements, Standard & Poor's expects participants to identify the risk of prepayments and to provide legal comfort to the effect that, in the event of a debtor's insolvency, no meaningful risk exists that a claw-back action can be taken according to Article 65 of the Bankruptcy Law. If the risk of any claw-back action pursuant to Article 65 of the Bankruptcy Law cannot be excluded, the question would arise as to what elements have been built into the transaction structure to mitigate the risk. For example, one of these mitigants may apply to transactions backed by mortgage loans, to the extent that the relevant mortgages would revive against a debtor's insolvency if a claw-back action is carried out pursuant to Article 65 of the Bankruptcy Law. 5. Debtor Set-Off In all asset-backed transactions, it is a concern that, on the insolvency of the transferor, the receivables sold to the SPE may be decreased by the amounts that the underlying debtors may set off against other obligations due to them by the transferor. The classical case of debtor set-off would occur when a bank sold, for example, a pool of car loans, some of which had been made to the bank's own customers. Upon the insolvency of the bank it is likely that some, if not all, of these customers would have money owed to them by the bank, namely the amounts standing to the credit of their current accounts. Depending on the jurisdiction, these bank customers may be entitled to deduct from the amounts due under the sold car loans the amounts standing to the credit of their accounts with the seller at the time of the latter's insolvency. This would reduce the amount that the SPE was entitled to collect on the securitized receivables and could, depending on the amount of this reduction, cause a loss to the noteholders. This form of set-off may be recognized at law and results in a legal diminution of the debt. In addition to this legal set-off, there is also the risk of a practical set-off. This would occur when a debtor is faced with the loss of money due to it by the now insolvent seller. Having neither consented nor, in some cases, been notified of the sale of his or her receivable, the debtor may simply refuse to pay on the grounds that, irrespective of the legal position, the actions of the seller were iniquitous. In the case of a practical set-off, however, the right of the issuer to recover the sold receivable from the underlying debtor is not legally impaired. Nevertheless, the SPE can expect delays in recovering the amounts due to it. For this reason, Standard & Poor's treats legal set-off as a credit loss to the transaction, while practical set-off is treated as a liquidity stress. In determining the nature and amount of the set-off risk, the law of the jurisdiction and the business of the transferor is a relevant consideration. There are cases where the existence of mutual rights between the underlying debtors and the transferor are extremely unlikely, for example, where the transferor is a special-purpose lender who does not have a deposit-taking business. In other cases, the existence of "no set-off" provisions in the contract between the debtors and the transferor may be dispositive, as a matter of law, in removing the rights of set-off. In relation to the right of debtors to set off amounts due to the transferor with amounts due to them by the transferor, the general view of Italian legal commentators is that publication of the notice of sale in the Official Gazette and registration of the sale in the Companies' Registrar constitute notice to the underlying obligors of the sale of the receivables to the SPE and that, therefore, upon the date when this publication and registration have occurred, all the set-off rights crystallize. The underlying debtors retain the right to set off any amounts due to him or her as of that date, but all amounts due to these debtors by the transferor following that date can no longer be set off against the sold receivables. Where the transferor is a bank with which debtors hold accounts, the issue of set-off may arise in relation to the obligation of the transferor to return amounts deposited by the debtors in the relevant accounts. Under Italian law, a bank account is effectively treated as a box. In that box there is money due by the bank to the account holder. When money is withdrawn from the account, the law deems that money to have come from the oldest money deposited. When new money is deposited in the account, this creates a new debt. Accordingly, as the underlying debtor withdraws and deposits money in his or her account, the amount that he or she can set off diminishes because every withdrawal diminishes the debt capable of set-off and every deposit creates a new debt that, after publication in the Official Gazette and registration in the Companies' Registrar, is no longer capable of set-off. For this reason, in the case of most financial institutions, set-off due to retail bank account holdings is a swiftly diminishing issue. In quantifying the set-off risk, Standard & Poor's generally has regard to the representations made by the transferor as to the existence and size of the obligations due by it to underlying debtors at the time of publication in the Official Gazette and registration in the Companies' Registrar. 6. Usury Law The Italian law on usury, Law No. 108 of March 7, 1996, prevents lenders from applying interest rates equal to or higher than certain rates (the usury rates) set every three months on the basis of a decree issued by the Italian Treasury. On Dec. 29, 2000, the Italian Government issued a decree (Law Decree No. 394), which was made law by the Italian Parliament on Feb. 28, 2001, to settle a controversy over the correct application of the provisions of the usury law that had arisen as a result of certain rulings, which held that the compliance of fixed-rate loans with the usury rates not only had to be verified in relation to the usury rate applicable at the time the relevant loan agreement was entered into, but also in relation to the usury rates set from time to time throughout the life of the loan. According to this interpretation, an originally lawful interest rate, depending on the general trend of interest rates, was liable to become usurious with the result that the contractual provision regulating the borrower's obligation to pay interest on the relevant loan became null and void in its entirety. Law Decree No. 394 of Dec. 29, 2000, as interpreted and confirmed by the Italian Constitutional Court in decision No. 29 of Feb. 25, 2002, determines that the interest rate is usurious under the usury law only if the interest rate agreed on by the parties exceeded the usury rate applicable at the time the loan agreement was entered into. The decree also provides, as an exceptional measure, that interest rates due on fixed-rate loans, qualifying as "mutui" in accordance with a Ministerial Decree of Sept. 20, 2000, and payable in installments falling after the date on which the decree came into force (Dec. 31, 2000), are to be substituted with a lower interest rate fixed in accordance with parameters set out in the decree. To mitigate this risk, representations are typically provided in the transaction documents by the transferors confirming that at the time the relevant loan agreement was entered into the relevant interest rate was in compliance with the usury rate applicable at the time. These representations may include confirmation whether any loans in the relevant portfolio are subject, as described above, to the lower fixed interest rate applicable after Dec. 31, 2000, pursuant to Law Decree No. 394 of Dec. 29, 2000. 7. Privacy Law Under the Italian legislation regulating personal data processing, recently consolidated in Legislative Decree No. 196 of June 30, 2003 (the Privacy Law), any entity that collects and processes personal data of any third parties has a number of obligations. The assignment of the receivables in securitizations entails the delivery by the transferor to the SPE of all the documents related to the receivables and also the communication of personal data regarding the assigned debtors. Although this information is typically controlled by the servicer or another entity on behalf of the SPE, the SPE is under an obligation to file a notification concerning this personal data to the authority in charge of the protection of personal data. As the failure to comply with the provisions of the Privacy Law may result in a liability for the SPE, Standard & Poor's expects to see appropriate legal opinions confirming that either all the required formalities under the transaction have been accomplished or that these formalities were not required. 8. Tax In securitizations, comfort should be provided that either there are no taxes payable by the issuing SPE (and, if relevant, any intermediate SPE) or that any such taxes have been calculated and that the liability is accounted for and can be paid out of the available cash flow while still leaving sufficient amounts to meet principal and interest payments on the rated notes. In addition to these general considerations, multijurisdictional transactions create certain additional concerns that should be addressed. Without attempting to be exhaustive, what follows is a summary discussion of Standard & Poor's understanding of those tax issues that often arise in the context of Italian securitizations. 8.1. ITALIAN CORPORATE TAX In general, Italian SPEs are subject to corporate income tax (IRES) and regional tax on productive activities (IRAP). However, pursuant to the accounting regime applicable to financial statements of SPEs (Legislative Decree No. 87 of Jan. 27, 1992, and a regulation issued by the Bank of Italy on March 29, 2000, regarding balance-sheet schemes of securitization entities) and on the basis of a general principle of substance over form, the assets and liabilities acquired and assumed by companies incorporated under the Securitization Law in relation to each securitization must be treated as off-balance-sheet assets and liabilities for accounting and regulatory purposes and are to be recorded only in the integrative notes ("nota integrative") to the financial statements. This off-balance-sheet treatment implies that the balance sheet of SPEs does not include in the assets and liabilities account ("stato patrimoniale") the assets and the liabilities deriving from, and connected to, the receivables, the notes, and the transaction documents and that the profit and loss account ("conto economico") of SPEs does not include the positive and negative components of income deriving from, and connected to, each securitization carried out by the relevant SPE. As a result of the off-balance-sheet treatment of securitizations in Italy and the restrictions on the activities of the SPE imposed by the Securitization Law, no taxation is expected to arise on any income to the SPE. The above conclusion can be derived from Article 83 of the 1996 Italian Presidential Decree No. 917 (according to which positive and negative income items are included in the computation of the taxable income only to the extent that they are required to be included in the profit and loss account of the taxpayer). The conclusion has been recently confirmed by Circular No. 8/E of Feb. 6, 2003, issued by the Italian Revenue Agency, according to which, as a result of the segregation principle introduced by the Securitization Law, any positive component of income perceived by an SPE in the course of a securitization from the underlying assets should not be considered as a taxable income of the relevant SPE itself. Only those amounts, if any, available to the relevant SPE after fully discharging obligations toward the noteholders and any other creditors in respect of any costs, fees, and expenses in relation to a securitization should be imputed for tax purposes to, and therefore represent taxable income of, the SPE. In light of the above, Standard & Poor's considers that the tax neutrality of the SPE may be achieved and expects that appropriate tax opinions are delivered by transaction counsel confirming this position. 8.2. VAT As with other potential tax liabilities, Standard & Poor's expects counsel to opine as to whether Italian VAT may apply to any of the cash flows or payments being made to or from Italian counterparties. If transaction counsel identify an Italian VAT liability, Standard & Poor's expects that the VAT liability has been quantified and accounted for by the structure. 8.3. WITHHOLDING TAX Whenever cash flows across a jurisdictional border, there is a heightened risk that the tax authorities in the jurisdiction from which the cash left would require part of that amount to be remitted to it in the form of withholding tax. This is often the case in cross-border structured finance transactions, where cash is passed from payers in one country to an SPE issuer in another country. To the extent that an issuer's ability to make payment on its rated notes relies on these third-party payments, Standard & Poor's rating analysis considers whether these payments are subject to withholding tax. Withholding tax risk may occur in respect of payments under a swap and other derivative agreements entered into by the issuer for hedging purposes and any form of external credit enhancement, such as a letter of credit, liquidity facility, or guarantee. It may also arise on payments derived from a pool of underlying assets, such as loans, bonds, or other securities (collateral) and receivables that secure the issuer's rated obligations. To the extent that any withholding tax is imposed on any of these payments, an equivalent amount should be deducted from the relevant transaction's cash flow model in determining the amounts available to the issuer to meet its obligations under the rated notes. The risk of withholding tax in a transaction can either be mitigated structurally or addressed legally. Structurally, the risk of withholding tax is removed if the third-party payer is required to gross up its payment obligations so that the issuer receives the same amount it would have received had no such tax arisen. This assumes that the gross-up obligation is legal, valid, binding, and enforceable under the applicable law and that reliance on this gross-up obligation will create a rating dependency on the gross-up provider. Alternatively, if the transaction can demonstrate that even net of applicable withholding tax there is sufficient cash flow to allow payment in full on the rated notes under the various stress scenarios, Standard & Poor's does not request any additional comfort on withholding tax risk. Legally, comfort may be provided in the form of a legal opinion confirming that under the law of the jurisdiction of the third-party payer, no withholding tax obligation arises on payments to the issuer. In lieu of these opinions, Standard & Poor's generally accepts an unqualified written representation from counterparties in swap and derivatives transactions confirming that the relevant third-party payer is not liable to withhold tax from any payment to the issuer. The representation should be in a form commonly accepted in standard financial transactions (for example, ISDA form tax representations). For certain types of credit enhancement, Standard & Poor's may request that the enhancement provider delivers a similar representation. SECTION II: SPECIFIC ITALIAN ASSET-TYPE ISSUES This section sets out a number of asset-specific issues, which Standard & Poor's has identified in relation to certain specific types of assets seen in Italian securitization transactions. Readers are reminded that this paper is not exhaustive and does not seek to set out every legal issue that may be involved in or relevant to an Italian asset-backed transaction or asset-type, nor does it purport to set out a full analysis of the complex legal principles that are discussed. 1. Future Flows In order to understand the legal issues arising from future flow transactions, it is important to separate future flows into three distinct categories: Receivables from existing contracts for services not yet performed (future contracted receivables); Receivables from expected future contracts (future uncontracted receivables); and Cash receipts that are not receivables, as this term is ordinarily understood, that is, a right to claim a payment from a debtor on a due date (future cash flows). Future contracted receivables are amounts that it is expected will come due from existing framework contracts but where the services have not yet been performed. These include amounts due from existing telephone customers in relation to calls not yet made. Future uncontracted receivables are amounts that are expected to come due from contracts to be entered into in the future by the originator. Future cash flows are sometimes erroneously described as "future receivables". They are, in fact, cash receipts where the payment of the cash is contemporaneous with the contract. Toll-road payments would fall into this category, as would payments for cinema or theatre performances. Unbilled receivables, meaning amounts due under a contract where the originator has fully performed its obligations relating to that receivable but where the debt has not yet been recorded in the originator's systems and/or the bill has not yet been sent to the customer, can be substantially treated as existing receivables and therefore are not considered as future flows for the purpose of this section. Future flows raise issues at two different levels: the first issue is whether, theoretically, future flows constitute an eligible collateral for a securitization under the Securitization Law (eligibility); the second, more specific issue regards the enforceability of the sale of future receivables or future cash flows to the SPE (enforceability). 1.1. ELIGIBILITY SPEs created under the Securitization Law are subject to a statutory restriction on the activities they may carry out and may engage in activities only related to the securitizations (see section I.1). Accordingly, these SPEs are meant mainly to purchase portfolios of "receivables" and issue the related notes. The issue of eligibility is whether future receivables or future cash flows may be deemed to be "receivables" within the scope of the Securitization Law and, therefore, whether a purchase of future receivables or future cash flows by the SPE complies with the provisions of the Securitization Law. Pursuant to a Ministerial Decree of April 4, 2001, future contracted receivables and future uncontracted receivables, not yet existing but which are expected to be generated in the ordinary course of the originator's business, can be purchased by SPEs regulated by the Securitization Law, provided that the relevant receivables are sufficiently identified or identifiable. Future cash flows probably cannot be purchased by a Securitization Law SPE, as it is unclear whether they may be deemed to constitute "receivables" within the scope of the Securitization Law. 1.2. ENFORCEABILITY The second issue is whether, even if a sale has taken place, the cash paid by the debtor after the seller has become insolvent belongs to the SPE or whether it falls into the insolvency estate of the seller to be used by the liquidator. According to a principle repeatedly confirmed by decisions of the Italian Supreme Court, when future receivables eventually come into existence, they initially do so as an asset of the seller. In other words, the future receivables cannot effectively be transferred to the relevant purchaser unless they have first come into existence as assets of the seller. As a result, if the seller is insolvent at the time the future receivables come into existence, in accordance with the general principles of Italian bankruptcy law, these receivables would be trapped in the seller's insolvency. In decision No. 15141 of Oct. 26, 2002, the Italian Supreme Court seems to depart from the aforementioned principle. In this decision, in addressing the issue of the assignment of future contracted receivables (in this case, future employee salaries) the Italian Supreme Court stated that, in principle, where the receivables are future but are likely to mature on the basis of the stability of the relationship that they arise from, this assignment is valid and effective against other creditors of the assignor, with regard to future receivables arising up to a maximum of three years from the date of assignment. It is currently uncertain whether this decision will be followed by other relevant decisions, confirming or extending the principle set forth therein, in relation to future contracted receivables in general. 2. Assets in Addition to Receivables Transactions may sometime provide for the sale to the SPE of assets or rights in addition to the receivables (for example, real estate properties and leased automobiles or equipment). It is uncertain whether the purchase by the SPE of assets or rights in addition to receivables complies with the provisions of the Securitization Law. If the transaction is covered by the Securitization Law then, depending on the nature of the other assets or rights transferred to the SPE, some consideration should be given as to whether these assets or rights give rise to any risk of liabilities. For example, there may be liabilities deriving from the operation of equipment or vehicles, or from the collapse of buildings. 3. Commercial Mortgage-Backed Securities In the case of transactions based on receivables arising from "mutuo fondiario" mortgage loans and relating to portfolios with a significant concentration of receivables, such as typically found in CMBS transactions, one risk that should be considered is the statutory right of debtors to obtain the release of mortgaged real estate properties securing the loan upon partial repayment of principal under the loans. Under Article 39, paragraph 5 of the Banking Act, if a mutuo fondiario loan is secured with mortgages perfected over more than one real estate property, on partial repayment of the loan the relevant debtor is entitled to request that one or more of the properties be released from the mortgage, provided that the continuing mortgages over the residual properties constitute a sufficient security in accordance with the provisions regulating mutuo fondiario loans (that is, the principal amount advanced to the borrower must not exceed 80% of the value of the mortgaged property). The risk is that the application of this rule may create an unexpected change to the composition of the security supporting the mortgage loans. 4. Leases In Italy, three key questions typically arise in respect of the securitization of lease receivables. The first is whether the future lease payments fall into the category of future contracted receivables, so that upon the originator's insolvency these rental payments cease to be available to the issuer, or whether they are assimilated to existing receivables, in that the service rendered by the lessor (namely the provision of the leased equipment) has been fully completed and the rentals are merely the staged payments for that service. The second question is whether the leases that are the subject matter of the securitization can be cancelled without the SPE's consent by the liquidator of the original lessor even after that lessor has sold the lease rentals to the SPE pursuant to the Securitization Law. The third is whether, in the case of a default by the lessee, the SPE can obtain the benefit of the leased equipment either through its re-lease or through its sale. This question is particularly important in cases where the originator is insolvent, as before its insolvency, it is merely a matter of contract between the originator and the issuer as to who obtains the economic value of the equipment. After an originator's bankruptcy, if the issuer wishes to assert a claim against the equipment, this claim should be legally capable of defeating any challenge by the originator's liquidator. 4.1. ASSIGNABILITY OF RENTALS Whether the future lease rentals are existing receivables depends on whether the services to be provided by the lessor have been entirely discharged. Determining whether this is the case involves a case-by-case analysis of the lease agreements being securitized. Although there are few precedents for guidance, leases that can be described in economic terms as finance leases are generally treated by the courts as existing receivables and can therefore be securitized. It should be borne in mind, however, that the expression "finance lease" is not a legal term of art but an accounting concept. Broadly, these are leases where the equipment has been delivered, the lessor has no operating duties (such as maintaining the equipment), and the rentals are calculated to pay for the entire purchase price of the equipment plus a finance charge. At the end of a finance lease, title to the equipment usually vests in the lessee through some device or other (for example, a call option on the title for a nominal amount). In contrast, rental payments on operating leases are very unlikely to be viewed other than as future receivables and, therefore, are unlikely to be suitable for securitization. 4.2. LIQUIDATOR TERMINATION The question whether, in the event of the lessor's bankruptcy, the liquidator thereof can cancel existing finance leases has been much debated in the past. The opinion of a large number of leading Italian scholars was that the liquidator did not have this right of termination. Furthermore, from 1989, a number of decisions of the Italian Supreme Court (Corte di Cassazione), in making a distinction among finance leases between "leasing traslativo" (purchase leasing) and "leasing di godimento" (use leasing), set forth legal principles based on which a leasing traslativo would have likely survived a bankruptcy of the lessor, while it was less clear if a leasing di godimento would do so. On April 9, 2003, the Italian Supreme Court held, in decision number 5552, that the liquidator of a bankrupt lessor had the right to terminate existing finance traslativo leases. The Italian Government, however, introduced Article 7 of Law Decree No. 354 of Dec. 24, 2003, converted into law with Law No. 45 of Feb. 26, 2004, which provides that the adjudication in bankruptcy proceedings of companies authorized to carry out financial activity in the form of financial leases, is not a cause of termination of the financial lease agreements, including traslativo leases, and does not allow the liquidator in bankruptcy to decide for the termination of the leases. In addition, the lessee retains the right to purchase the leased equipment on expiration of the lease by paying the price agreed in the lease. 4.3. BENEFIT OF EQUIPMENT The question of whether the SPE can benefit from the value of the equipment if the lessee either cancels the lease or defaults, in circumstances where the originator is insolvent, is now considered. In a transaction where title to the leased equipment has been sold to the SPE at the close of the transaction and appropriate legal opinions confirming the true sale of this equipment are provided, credit may be given in the transaction cash flows to the value of the equipment. In circumstances where the equipment is not transferred to the issuer, arguments have been put forward that the issuer can nevertheless obtain the benefit of the sale proceeds of the equipment or new rentals generated by the re-lease of this equipment, where the original lease has been terminated. This argument is made where the originator assigns, at the same time as the rentals on the current leases, any sale proceeds or future rentals associated with the equipment. In addition to this sale of future proceeds, the position of the issuer is sometimes buttressed by having the originator provide an irrevocable power of attorney to the SPE, entitling the latter to deal with the leased assets in the insolvency of the originator ("mandato in rem propriam"). Under this structure, it has been claimed that the liquidator would have to hand over to the SPE any proceeds of sale or future rentals as a priority payment before paying the other unsecured creditors. Standard & Poor's understands however that the legal community has not yet developed a common view on this issue in relation to transactions in which the equipment is not transferred to the SPE. This is due to questions surrounding the survivability of both the power of attorney and the assignment of future uncontracted receivables following the insolvency of the lessor (see section II.1). 4.4. LEASE SUBSIDIES Italian law provides for a number of circumstances in which public subsidies may be granted to lessees under financial lease agreements either through certain authorized banks ("concessionario") including through authorized agents thereof, or directly to the lessee (in the form of a tax credit for the benefit of the lessee). In the analysis of lease receivables securitizations in which the relevant lessees have the benefit of subsidies granted in connection with the relevant lease agreements, consideration should be given to any negative effect that the granting of the subsidies may have on the transaction. In particular, the following are some issues that may need to be addressed: Whether there are any formalities required for the assignment to the SPE of the lease receivables supported by subsidies; Whether there is any risk of early termination of the lease agreement in the event of failure to receive or revocation of the subsidies; Whether the lessees have, either by law or by contractual provision, a right to set off their obligation to pay to the lessor the rentals under the lease agreements with any claim (including for damages, indemnities, and compensation) in relation to the subsidies; Whether amounts paid by the lessees as rentals under the lease agreements may be used or set aside for the restitution of subsidies granted to the lessees, should this restitution be requested either by law or by contractual provision; Whether the subsidies constitute payment obligations of the public entity toward the lessor, and whether any formalities are necessary in order to perfect an assignment of the payment obligations to the SPE to make the assignment enforceable against the public entity. 5. Consumer Loans In consumer loan-backed transactions, a number of specific issues are typically raised in relation to compliance with consumer protection legislation, including: The requirement that debtors receive prior written notice of any assignment of the relevant receivables; Debtor set-off rights; The existence of exclusivity agreements between the lender and the suppliers of goods or services purchased by the debtor; and The presence of unfair terms in the loan agreements. 5.1. PRIOR WRITTEN NOTICE REQUIREMENT Law No. 142 of Feb. 19, 1992, provides that debtors under consumer loan agreements must receive 15 days' prior written notice of any assignment of the rights of the lender under these agreements. Law No. 142 has been repealed by the Banking Act with the exception of the provisions on consumer loans, which remain in force pending the issue by the relevant supervisory authorities of implementing regulations. It is unclear whether the issue of implementing regulations also regards the aforementioned provision. Accordingly, if the debtors have not been given 15 days prior written notice of the assignment of the relevant receivables, consideration should be given as to whether legal comfort can be provided confirming that the transfer of the receivables would nonetheless be effective against them. 5.2. SET-OFF RIGHTS The general view of Italian legal commentators in relation to the issue of set-off is that on the date of publication of a notice of sale of the receivables in the Official Gazette (and registration with the Companies' Registrar), all the set-off rights crystallize and that debtors retain the right to set off any amounts due to him or her as of that date, although all amounts due to these debtors by the originator following that date can no longer be set off against the sold receivables (see section I.5). However, under Article 125, Paragraph 3, of the Banking Act, debtors in consumer loans are entitled to exercise their set-off rights against the assignee of any lender under a consumer loan agreement at any time, even following the publication of a notice of sale of the receivables in the Official Gazette (and registration with the Companies' Registrar). As a result, unless a legal opinion can be given to the effect that the debtors would not be entitled to exercise any set-off rights following the publication in the Official Gazette and registration in the Companies' Registrar, additional credit enhancement may be necessary or amendments to the structure of the transaction may be needed in order to mitigate the set-off risk. 5.3. EXCLUSIVITY AGREEMENTS Under Article 125, Paragraph 4, of the Banking Act, in the event of any default by the suppliers of goods or services purchased by a debtor under a consumer loan, to the extent that an exclusivity agreement exists between the lender and such suppliers, the relevant debtor would have the right to seek redress against the lender. In order to mitigate this risk, the transaction documents may include representations by the originators confirming that no such exclusivity agreements exist. Notwithstanding the absence of exclusivity agreements between the originator and the relevant suppliers, a risk still exists that debtors may nonetheless attempt to exercise their right to seek redress as described above, negatively affecting the ability of the SPE to fulfill its payment obligations. Accordingly, a structure may consider taking additional steps to mitigate this risk. 5.4. UNFAIR CONTRACTUAL TERMS Article 1469 of the Italian Civil Code regulates unfair terms in consumer contracts by providing that any clause in a consumer agreement that contains a material imbalance between the rights and obligations of the consumer under the agreement is deemed to be unfair and is not enforceable against the consumer, irrespective of the good faith of the consumer's counterparty. In order to mitigate this risk, the transaction documents may include representations by the originators confirming that the agreements do not contain any clauses that could be deemed to be unfair to the debtors. Legal comfort may also be provided from counsel to the originator to the effect that the standard contracts generating the receivables to be securitized do not contain any clauses that could be deemed to be unfair to the debtors. 6. Public Entity Debtors After notice of the sale of a portfolio of receivables has been given by means of registration in the Companies' Registrar and publication of the notice of sale in the Official Gazette (see section I.2), the relevant sale becomes effective against, among others, any third party and assigned debtors. No formal notice of the sale need be given to each debtor pursuant to Articles 1264 and 1265 of the Italian Civil Code (which impose a general rule that transfers of claims must be formally notified to or accepted by assigned debtors to make the transfer effective against them and third parties). However, the transfer of claims owed by public sector entities is regulated by the special provisions of Royal Decree No. 2440 of Nov. 18, 1923 and, in relation to receivables arising from supply or construction agreements, of Law No. 2248 of March 20, 1865. According to Royal Decree No. 2440, in order to make the transfer of a receivable effective against a public entity debtor, certain formalities must be carried out in respect of the transfer, including formalization of the transfer by means of a public deed or authenticated private agreement (a separate deed for each public entity), notification of the relevant public entity through a court bailiff and, in the case of receivables arising from supply or construction agreements regulated by Law No. 2248, acceptance and acknowledgment by the relevant public entity, unless the transferor has performed all its obligations under the agreement under which the receivable arises (in which case no acceptance and acknowledgement is required). There have been no judgments as to whether the provisions of the

Securitization Law supersede the provisions of Royal Decree No. 2440 and of Law No. 2248, with respect to the effectiveness of a transfer as against a public entity debtor. In the absence of any guidance in the law, it is unclear whether a transfer solely by means of the Securitization Law of receivables owed by public entity debtors is binding on such debtors. In addition, even if the issuer eventually formalizes the transfer of the receivables — as required under Royal Decree No. 2440 — after the date of this transfer, the public entities may argue (on the basis of several decisions of the Italian Supreme Court) that the debt was not enforceable by the issuer as the transfer had not been made at the outset by means of a public deed or authenticated private agreement. If a transfer is not so binding, the issuer is dependent on the originator for enforcement of these obligations and, on the originator's insolvency, enforcement may become difficult in practice. In order to mitigate the risk associated with the assignment of debts due from public entities, the public deeds or authenticated private agreements in relation to each public entity may be executed by the SPE and the transferor on transfer of the receivables. If the execution of the public deeds or authenticated private agreements take place in a foreign jurisdiction, these deeds or agreements may be required to bear an "apostille" in order to be notified to Italian public entity debtors. The SPE should be entitled under the transaction documents to proceed with the notification to the public entity debtors either at any time or upon the occurrence of specified events. In relation to the notification to the public entity debtors of the public deeds or authenticated private agreements, it is uncertain whether under the Italian tax law this notification would constitute a case of use ("caso d'uso") and thus be subject to registration tax. In order to mitigate this risk, a tax opinion may be sought confirming that no registration tax would be imposed on the SPE on this notification taking place or, the potential tax may be quantified and accounted for by the structure. Another issue to be considered is the ability of a public entity debtor to suspend payments on an obligation that it owes. Under Royal Decree No. 2440, a public entity (not the debtor public entity) which has a claim against a third party (such as the originator) who is itself a creditor of another public entity (such as the debtor public entity) may request the debtor public entity to suspend any payments toward this third party (for example, the originator). This suspension of payments ("fermo amministrativo") constitutes a precautionary measure, which aims to protect the claims of the public entity requesting the suspension pending the verification of the existence, the amount, the title, and the maturity of the obligations of the public entity debtor. To the extent that, following this verification, it is ascertained that the same third party is at one time the creditor of the debtor public entity and has payment obligations toward the public entity that requested the suspension, the public entity debtor is entitled to set off the amounts due by it with the amounts due by the relevant third party to the public entity that requested the suspension. In the context of a securitization, until the SPE actually notifies the debtor public entity with the public deeds or authenticated private agreements confirming the transfer of the receivables, a debtor public entity may receive, and accept, a request of suspension of payments from a public entity seeking to enforce its claims against the originator as the former owner of the receivables. On this suspension taking place and the transferor informing the SPE thereof, the SPE should be able to notify the relevant public entity debtor regarding the assignment of its receivables to the SPE. The risk related to the suspension of payments can be viewed either as a total credit loss or as a liquidity stress (that is, a timing issue), depending on whether the suspension may or may not subsequently result in a set-off. This depends mainly on whether, on receipt of the notification, the debtor public entity deems the transfer of the receivables to the SPE from the originator enforceable against them: if this transfer is recognized as enforceable, the relevant debtor public entity should determine that it has no obligations toward the debtor of the public entity that requested the suspension, that is the originator, and would therefore not perform any set-off but rather terminate the suspension of payments; otherwise, if the debtor public entity determines that its payment obligations under the receivables are toward the originator and not toward the SPE, it would set off these payment obligations against the amounts due by the originator to the public entity that requested the suspension. SECTION III: LEGAL OPINIONS 1. General For each Italian securitization rated by Standard & Poor's, it expects to see appropriate legal opinions dealing with the issues of law raised by the structure that are relevant to the rating. It is not possible to set out a complete list of all the items that should be addressed in legal opinions as each transaction has its own issues. To maximize the likelihood of a smooth rating process, Standard & Poor's urges legal counsel to the transaction to produce drafts of the legal opinions as early as possible, and to discuss any matters that they expect may be problematic with the analyst assigned to the transaction or a member of Standard & Poor's legal department. 2. Legal Opinion Issues Without limiting the discussion in this paper, unless the transaction exhibits unusual features, the following items should generally be addressed in the legal opinion, namely that: For true sale transactions, a true sale has been effected that would be recognized in the insolvency of the transferor and not be subject to any successful challenge or recharacterization as a secured loan by any creditor or insolvency administrator of the transferor, and comfort that the assets are not subject to any restrictions on assignment; The transaction complies with the requirements of the Securitization Law and with all applicable laws; The receivables purported to be sold meet the requirements for a "blocco" (a pool) (see Endnotes 2); The transaction has been notified to the Bank of Italy pursuant to Article 129 of the Banking Act and received a "nihil obstat", or that this notification was not required; Under the Securitization Law, the securitized assets are segregated in favor of the noteholders (see Endnotes 3); All the formalities required under Law 130 to make the sale of the receivables and of the relevant security enforceable against all parties have been accomplished, including confirmation of the publication of the notice of sale in the Official Gazette and confirmation of registration of the sale in the Companies Register; The issuer has been enrolled in the Special Register held by the Bank of Italy pursuant to Article 107 of the Banking Act; For the purposes of supporting the SPE's insolvency remoteness, all non-negligible assets of the SPE that are contemplated in the transaction documents are subject to effective security that would be upheld by the relevant courts (whether pursuant to the Securitization Law or otherwise), including in the event of insolvency proceedings of the SPE and not be subject to any successful challenge by any creditor or insolvency administrator of the SPE; The limited recourse provisions set out in the documents would be recognized by the relevant courts as legal, valid, binding, and enforceable; The nonpetition provisions set out in the documents would be recognized by the relevant courts as legal, valid, binding, and enforceable; The subordination/priority of payment clauses (the "waterfall provisions") set out in the documents would be recognized as legal, valid, binding, and enforceable, and be upheld in the event of insolvency proceedings of the SPE, and not be subject to any successful challenge by any creditor or insolvency administrator of the SPE; Where relevant, no substantive consolidation principle applies under Italian law and the insolvency of a parent company would not automatically result in the insolvency of its subsidiary; Where an opinion is given subject to the nonexistence of any violation of local public policy or mandatory principles of local law, counsel confirms that, on the face of the documents reviewed, nothing has come to their attention that would cause them to believe that any such violation may exist; For SPEs, the SPE would, if found liable to corporate tax, be viewed as corporate tax neutral and/or, if not, that the amount of potential corporate tax liability is quantified; Comfort regarding the nonapplicability of VAT or withholding tax to cash flows in the transaction and/or the amount of the potential VAT or withholding tax liability is quantified; and No registration tax or stamp duty is payable in relation to the execution of the transaction documents or in relation to the notes, or any such registration tax or stamp duty is quantifiable. Depending upon the circumstances, Standard & Poor's may also request a corporate opinion to the following effect: (i) that each party to the transaction is duly organized, validly existing under the laws of the jurisdiction of its formation, and is in good standing under the laws of that jurisdiction and any other jurisdictions in which it is required to qualify to do business; (ii) that each party to the transaction has the full power and authority to carry on its business and to enter into the transaction documents to which it is a party and the transactions thereby contemplated; (iii) that the execution, delivery, and performance of the transaction documents by the relevant party do not violate any law, regulation, order, or decree of any governmental authority or constitute a default under or conflict with the organizational documents or other agreements governing or to which the relevant party is a party; (iv) that no approval, consent, order, or authorization is required in connection with the execution, delivery, and performance of the transaction documents other than those approvals, consents, orders, and authorizations that have been obtained in connection with the closing of the transaction; and (v) that the payments set forth in the transaction documents do not violate applicable usury laws. Standard & Poor's generally expects to see legal opinions from counsel in the relevant jurisdictions opining on pertinent aspects of their local law in relation to the matters discussed. 3. Legal Opinion Language As a general matter, clear and unambiguous opinions should be expressed on key elements of the structure. For this reason, expressions such as the following may not be consistent with the highest rating categories: "The courts should…(rather than "will" or "would"); "Although opinions on the matter differ, the majority view seems to be…"; "It is generally held that…"; "It appears more likely, on balance, that…"; "There are good arguments that…"; "In the absence of judicial precedent, no opinion can be averred on…"; and "On balance, it is probably correct that…". Similarly, the use by counsel of a general insolvency or bankruptcy qualification to qualify legal opinions given on key structural issues detracts from the legal integrity of the structure and is generally inconsistent with high levels of rating. Legal counsel to transactions are invited to contact any member of Standard & Poor's legal department to seek clarification of any of these points. As noted above, these criteria are not exhaustive but are set out to provide guidance and are subject to change. In writing this paper, Standard & Poor's would like to thank Maisto e Associati, Milan, Clifford Chance, Milan, and Luigi Chessa for their assistance and advice, although the content of this paper remains, of course, the responsibility of Standard & Poor's. Endnotes 1) While the Securitization Law contemplates the possibility that the issuer of the asset-backed notes is different from the purchaser of the receivables, this paper assumes, in keeping with market practice, that the issuer and the purchaser are the same entity. 2) It is a requirement of law that, in order to benefit from the Securitization Law, the receivables be of the same nature so as to be able to form a blocco. We recognize that whether receivables form a pool is a matter of fact and not, technically, the subject matter for a legal opinion. However, the opinion should set out the reasons why, in the informed opinion of the legal advisers, the definition of the receivables set out in the transaction documents meets the legal requirements for the creation of a pool. 3) Standard & Poor's expects legal counsel to the transaction to identify any claims (for instance, senior expenses), which, in addition to the claims of the noteholders for the payments of interest and repayment of principle under the notes, in the view of legal counsel, benefit from the segregation principle under the Securitization Law. LEGAL ISSUES IN GERMAN ASSET-BACKED SECURITIZATIONS (originally published on Sept. 11, 2003) This criteria paper seeks to identify certain key legal issues that arise in the context of German asset-backed transactions based on Standard & Poor's Ratings Services' experience in the German asset-backed market, and to provide insight into Standard & Poor's rating methodology and processes. This paper is primarily a practitioner's guide rather than an academic treatise. For this reason it does not seek to set out every legal issue that may be involved in an asset-backed transaction, nor does it purport to be a full legal analysis of the complex underlying legal principles that are discussed. Rather, it focuses on issues that, in Standard & Poor's experience, often arise in practice, and on the manner in which Standard & Poor's has adapted and applied its global criteria to these issues. Finally, this paper is not a complete list of all the issues that can be and are relevant to German structured finance transactions nor should it be considered to constitute legal advice. Market participants seeking a Standard & Poor's rating continue to be invited to familiarize themselves with all the published criteria that may be relevant to their transaction. Standard & Poor's ratings criteria can be found on Ratings Direct, Standard & Poor's on-line credit analysis system, at www.ratingsdirect.com, under Criteria. The published criteria are also available on Standard & Poor's Web site at www.standardandpoors.com. Under Resource Center, select Ratings Criteria, then Structured Finance. 1. Initial Analytic Considerations The initial analytic considerations for most securitization transactions involving obligations that are to be rated focus on four key issues: (i) identification of the assets or risks to be transferred; (ii) determining the type and desired credit risk profile of the obligations to be issued; (iii) designing the mechanism of assignment/risk transfer; and (iv) determining the method or type of issuance of the proposed obligations. 1.1 ASSETS/RISKS TO BE TRANSFERRED The German structured finance market has seen two distinct classes of originator emerge: banks and nonbank entities or corporates (referred to in this article as "nonbanks"). For the German nonbank sector, the main driver behind securitization has traditionally been lower-cost financing. For the German banking sector, although low-cost financing has been an important driver behind many securitizations, they have also used securitization as an important tool toward balance sheet and regulatory capital management. For the nonbank sector, the assets that have been securitized have generally been trade receivable-type assets (i.e., receivables generated through operating activities). For the German banks, because of the various rationales for securitizing, they have securitized a variety of assets including bank loans of various types including auto loans, residential mortgages, corporate loans, consumer loans, and bond portfolios. 1.2 CREDIT RISK PROFILE In analyzing transactions, the desired credit risk profile of the obligations to be issued is a function of the creditworthiness of the assets and the risks associated with them, the value of any credit enhancements, and the relationship of the various parties to those assets and risks. For example, in a transaction where the assets to be securitized have an implicit credit quality of 'A' but the desired rating on asset-backed notes to be issued is 'AAA', the asset-backed notes generally require additional credit enhancement, external credit support, or subordination to achieve the desired rating. 1.3 DESIGNING THE MECHANISM OF ASSIGNMENT/RISK TRANSFER Save for the German Mortgage Bank Act ("Hypothekenbankgesetz") and the German Law on Covered Bonds and Similar Bonds of Public Law Credit Institutions ("Gesetz über die Pfandbriefe und verwandten Schuldverschreibungen öffentlich-rechtlicher Kreditanstalten") relating to covered bonds ("Pfandbriefe", "Kommunalschuldverschreibungen", or "Kommunalobligationen"), Germany does not have a specific legislative framework designed to facilitate securitization. Standard & Poor's does note, however, the recent legislation to improve the general framework for securitizations of bank receivables in Germany (see section 10). At the time of writing, German securitizations are structured on the basis of applying general provisions of German law. German securitizations can generally be divided into those that use an SPE and those that do not. 1.4 SPE STRUCTURES For those transactions involving SPEs, as in other jurisdictions, German securitizations are sometimes based around the paradigm structure of an originator selling assets to an insolvency-remote SPE formed for the sole purpose of issuing debt and using the proceeds to finance the purchase price for the assets. With the development and use by the financial markets of derivative contracts documented on ISDA forms of contract (or the corresponding German standard forms), however, synthetic securitization structures have evolved where instead of a legal assignment of assets in return for a payment of a purchase price, the originator and the SPE synthetically replicate the sale transaction without a legal assignment of assets. In the past, for various reasons discussed below, synthetic structures have been far more commonly used in the German securitization market than in other European jurisdictions. Standard & Poor's notes that almost all SPEs used in German securitizations are incorporated outside of Germany. The most popular jurisdictions of incorporation for SPEs used in German securitizations traditionally include Jersey, Guernsey, The Netherlands, Luxembourg, and Ireland. As a general matter,securitization transactions that use SPEs and are seeking a rating on their debt should satisfy Standard & Poor's bankruptcy-remoteness criteria, a summary of which is in section 2. 1.5 NON-SPE STRUCTURES For those transactions not involving SPEs, Standard & Poor's notes the increased use by German banks of direct credit-linked note issuances under the umbrella of the banks pre-existing MTN program documents. Typically, the payment of principal and interest on these credit-linked notes are linked to the performance of a discrete pool of assets. The goal of such credit-linked note structures is usually to obtain regulatory capital relief for the bank involved from the risks that these discrete assets would normally impose upon the balance sheet of the bank. Standard & Poor's notes that some German banks occasionally choose to collateralize the credit-linked notes with a view to delinking the credit risk of the notes from credit/insolvency risk of the bank issuing the notes. 1.6 METHOD/TYPE OF ISSUANCE OF RATED OBLIGATIONS As alluded to above, securitization structures usually involve the issuance of debt obligations for which a rating is sought. In the German securitization context this typically means asset-backed debt issued by a non-German SPE, backed by German assets, or for non-SPE structures, debt issued directly by, for example, a German bank, with the repayment of principal and servicing of interest being tied or credit-linked to the performance of a discrete pool of assets. Apart from these debt obligations, German mortgage and public sector banks issue and seek ratings for covered bonds, the structure and issuance of which is governed by a special framework under German law. 2. SPE Criteria 2.1 CHARACTERISTICS OF INSOLVENCY REMOTENESS Standard & Poor's criteria specify that, for an asset-backed transaction to receive a rating from the highest categories, the SPE that owns the assets or issues the rated debt or both should comply with Standard & Poor's insolvency-remoteness criteria. Standard & Poor's regards an entity that satisfies these criteria as being sufficiently protected against both voluntary and involuntary insolvency risks. The criteria can be divided into the following: Restrictions on objects and powers; Debt limitations; Limited recourse and nonpetition language; Independent director; No reorganization or changes of ownership; Separateness covenants; and Security interests over assets. Each of the characteristics is important to the overall concept of insolvency remoteness. Regardless of the jurisdiction or specific organizational structure of the SPE, these elements should, generally, be addressed in the relevant organizational or transaction documents or both. These characteristics are set out in full in Standard & Poor's publication "Legal Criteria in European Structured Finance Transactions" in Part I, section 3 (the article is available to subscribers of RatingsDirect and on Standard & Poor's Web site at www.standardandpoors.com). For ease of reference each of the points is briefly explained below. 2.2 RESTRICTION ON OBJECTS AND POWERS The SPE should covenant to restrict its activities to those needed to effect the transaction. The SPE should not engage in unrelated business activities unless the parties to a transaction are willing to allow the rating to reflect the effect of these activities on the SPE's resources, cash flows, and ability to pay the SPE's obligations in a full and timely manner. These restrictions may be set out either in the SPE's constitutional document or in a binding contract with the noteholders or their representative. Standard & Poor's notes that there is, with certain exceptions, no ultra vires doctrine in German law, so that German entities are generally able to enter into binding transactions with third parties even where such transactions are prohibited by their constitutional documents. Standard & Poor's generally does not, however, consider this an obstacle to the establishment of insolvency remoteness of German SPEs, provided that the internal restrictions on the SPE's management are sufficiently clear. 2.3 DEBT LIMITATIONS The SPE should be prohibited from incurring any additional indebtedness, except in cases where such indebtedness would not affect the rating on its existing borrowings. The one exception to this criterion applies to SPEs that comply with Standard & Poor's "segregated issuer" criteria. For guidance on the criteria for issuance of additional debt from a securitization entity, see Part I, section 8 in "Legal Criteria in European Structured Finance Transactions". 2.4 LIMITED RECOURSE AND NONPETITION LANGUAGE All debt and money payment obligations incurred by the SPE should be limited recourse to the cash available to the SPE in accordance with a preagreed order of payment priorities. All parties to the securitization that contract with the securitization entity should covenant not to file for the insolvency of the SPE nor take any legal action that would or would be likely to result in the insolvency of the SPE until at least 12 months from the repayment of the last maturing rated obligation. 2.5 INDEPENDENT DIRECTOR Standard & Poor's requests that at least one of the directors of the SPE be independent from the participants in the transaction. Standard & Poor's expects the independent director, within the boundaries of his or her legal duties to the company, to review the operation of the SPE and to provide information to the note trustee if he or she becomes concerned about the governance of the SPE. 2.6 NO REORGANIZATION OR CHANGES OF OWNERSHIP The SPE should not engage in any dissolution, liquidation, consolidation, or asset sale (other than as provided in the relevant transaction documents), or amendment of its memorandum or articles so long as the rated securities are outstanding, without prior written notice to Standard & Poor's. 2.7 SEPARATENESS COVENANTS Separateness covenants are designed to provide comfort that the SPE holds itself out in the world as an independent entity, on the theory that if the entity does not act as though it has an independent existence a court may use the principles of "piercing the corporate veil" or "alter ego" or "substantive consolidation" to bring the SPE and its assets into the parent's insolvency proceedings. The involvement of an overarching parent could otherwise be a threat to the independent existence of the SPE. An important element of Standard & Poor's insolvency remote analysis is the existence of comfort that the SPE's assets would not be treated as part of the insolvency estate of its parent or an originator. In this regard, the SPE should agree to abide by the separateness covenants set out in "Legal Criteria in European Structured Finance Transactions". In addition, Standard & Poor's may request legal opinions to the effect that the SPE would not be consolidated with either of its parent or originator. These legal opinions, if requested, should be delivered in respect of the jurisdictions in which the parent or originator are situated, because it is the insolvency law applicable to them and not the SPE that is relevant to the question of consolidation. German insolvency law does not contemplate the substantive consolidation of assets and liabilities of an insolvent debtor with those of its parent or another affiliate. Under general principles of German corporate law, however, a parent can incur liability for the debts of its subsidiary under "piercing the corporate veil" principles. The requirements under German case law for these principles to apply are substantially similar to those applicable in other jurisdictions. The situations in which "piercing the corporate veil" may occur include cases in which there is a commingling of assets, material "undercapitalization", lack of separateness, willful acting with prejudice to the company or its third-party creditors, or (under more recent German case law) other acts of a controling shareholder that put the continued life of the company in jeopardy. In unusual circumstances, the application of these principles can also result in liability of a subsidiary for the debts of its parent, which from a rating perspective is obviously the more relevant risk where nonorphan SPEs are used. In transactions involving nonorphan SPEs with German parents, Standard & Poor's may request a German nonconsolidation opinion, which also provides comfort that, on the face of the transaction documents, there is nothing that causes counsel to believe that "piercing the corporate veil" principles may create a risk. Equivalent legal opinions from counsel in other jurisdictions may also be requested where the insolvency or corporate laws or both of those jurisdictions might become applicable. 2.8 SECURITY INTERESTS OVER ASSETS As a general matter, Standard & Poor's requests that an SPE grant a security interest over its assets to the holders of the rated debt. The purpose of this general security interest is primarily to diminish the incentives for any potential third-party creditor to seek to initiate insolvency proceedings against the SPE. To the extent that there are no free-floating and available assets for such a creditor to seize or share in, the likelihood of such an action may be reduced. In connection with this criterion, Standard & Poor's generally also requests that a legal opinion be delivered confirming (i) that the security interests purported to be created by the documents create legal, valid, binding, and enforceable security interests that are fully perfected, and (ii) that in the event of an insolvency of the SPE, the security interests would not be capable of being set aside or successfully challenged by any creditors or insolvency administrator of the SPE. Typically in German true sale transactions, Standard & Poor's notes that German law-governed security interests are given by non-German SPEs over their German assets. In this scenario, Standard & Poor's generally requests (i) a German legal opinion confirming the creation and perfection of security and its efficacy through insolvency as a matter of German law, and (ii) a legal opinion from the jurisdiction of the SPE confirming that the German security interests created by the SPE will be recognized and upheld by the courts in the jurisdiction of the SPE, even through insolvency of the SPE. 3. Security Interests In the context of structured finance transactions, one will typically see security being given over assets by one party in favor of another. The security rights given underpin contractual obligations of the security provider in the event of default under those contractual obligations or the insolvency of the security provider. From Standard & Poor's perspective, the analysis of the security arrangements in any structured finance transaction is dependent on the level of reliance the arranger is seeking to place on these arrangements. The support security arrangements provide to a transaction can range from supporting the insolvency remoteness of an SPE to providing access to collateral that is meant to provide credit support for a transaction. Indeed, it is a significant feature of the German market that the rating of many (usually synthetic) transactions relies on the efficacy of a security interest rather than a "true sale" of assets. Most German structured finance transactions use one or both of the following forms of security: (i) "pledge" ("Pfandrecht"), (ii) a "transfer/assignment for security purposes" ("Sicherungsübereignung/Sicherungsabtretung"). 3.1 PLEDGE A pledge is a security device recognized under sections 1204 et seq. of the German Civil Code ("Bürgerliches Gesetzbuch"). It is considered an accessory security right, in that it is accessory to the obligation that it secures. Accordingly, a pledge will terminate upon full satisfaction of the obligations secured by it. A pledge may only be validly granted to the creditor of the claim secured by the pledge. In the case of a pledge over tangibles such as physical assets, perfection of the pledge is effected by delivery of possession over the pledged asset to the pledgee (or its agent). In case of a pledge over intangibles, such as claims or receivables, notice must be given to the debtors under those claims to perfect the pledge. Where notification of a pledge of claims/receivables is impracticable or undesirable, parties usually consider as an alternative the use of the security device "transfer/assignment for security purposes". Although pledges of tangibles result in possession of the asset's being transferred from the pledgor to the pledgee, a pledge does not effect a transfer of title in the asset to the pledgee. 3.2 TRANSFER/ASSIGNMENT FOR SECURITY PURPOSES A transfer for security purposes or security assignment is a security device that is based upon the transfer of title provisions in the German Civil Code. A security transfer/assignment is considered a nonaccessory security right, in that the extinguishment of the secured debt does not necessarily result in the termination of the security right. Unlike a pledge, a security transfer/assignment may be made to a person other than the creditor of the secured obligation. In addition, a security transfer/assignment, again unlike a pledge, does not require either notice or delivery for the security interest to become effective. A security transfer/assignment results in a full transfer to the secured party of the title in the collateral that is subject to the security transfer/assignment with the grantor of the security holding a right to the return of the collateral upon full satisfaction of the secured obligations. 3.3 INSOLVENCY ISSUES As part of the rating analysis of a structured finance transaction, arrangers and their counsel are generally requested to explain and provide legal comfort as to the effect of insolvency of the debtor on the security interests provided. Standard & Poor's may request that the insolvency discussion include comfort (i) on the rights held by secured creditors over security collateral in relation to the insolvency administrator; (ii) on the ability of secured parties to directly enforce their security rights; (iii) on the ability of secured parties to enforce their security interests without deduction for costs and expenses of the insolvency estate from the proceeds of the collateral; and (iv) on the ability of the secured parties to enforce their security rights on a timely basis. The analysis of the latter point is dependent on a number of factors, including (i) the type of security interest, (ii) how the collateral subject to the security interest is held, and (iii) who has possession or control over the collateral. What follows is a summary discussion of the various security insolvency issues as understood by Standard & Poor's from the opinions delivered by German counsel in rated transactions. For the purposes of the discussion that follows, the analysis will focus on issues relating to movables and accounts receivable. 3.4 SECURED CREDITORS — INSOLVENCY RIGHTS German insolvency law creates a distinction between how the different rights of contractual counterparties of the insolvent debtor (including secured creditors) are to be viewed in the insolvency of the debtor. Specifically, the German Insolvency Code ("Insolvenzordnung") divides creditors into two categories: those to which a "Right of Separation" ("Aussonderung") applies and those to which a "Right to Separate Satisfaction" ("Absonderung") applies. 3.5 RIGHT OF SEPARATION (AUSSONDERUNG) A "Right of Separation" will generally apply to those assets that no longer belong to the debtor (i.e., where legal and beneficial ownership have been transferred) and, accordingly, the creditors entitled to separation are not "insolvency creditors" in the normal sense, but rather they have a right to demand from the insolvency administrator a removal of the assets concerned from the insolvency estate. For example, this would apply to the purchaser in a true sale transaction in respect of the assets sold. However, secured creditors, including those that have obtained a security interest in the form of a security transfer/assignment (i.e., on the basis of a transfer of legal, but not beneficial, title), generally have no right of separation, but merely a right to separate satisfaction. A creditor entitled to separation would not share in any costs or expenses of the insolvency proceedings. This is important because of the "haircut" provision discussed in the following. 3.6 RIGHT TO SEPARATE SATISFACTION (ABSONDERUNG) A "Right to Separate Satisfaction" will generally apply to those assets in respect of which a creditor has a security interest. In this case, the assets subject to such security interest do form part of the insolvency estate of the debtor, save that the secured creditors have a preferential right in respect of the assets and the proceeds thereof over the rights of unsecured creditors of the debtor (or, where applicable, any lower-ranking secured creditors). The right exists only to up the amount of the secured claim; any surplus belongs to the insolvency estate. Examples of security rights under which a secured creditor will have a right to separate satisfaction are a pledge (by which neither legal nor beneficial ownership is transferred) and a transfer/assignment for security purposes (by which legal but not beneficial ownership is transferred). 3.7 DIRECT ENFORCEMENT OF SECURITY INTEREST IN INSOLVENCY Section 173(1) of the Insolvency Code states that an insolvency creditor's right to directly enforce or foreclose upon collateral will not be affected by insolvency proceedings unless the insolvency administrator is entitled to such enforcement under the Insolvency Code. Under section 166 of the Insolvency Code, an insolvency administrator may only foreclose upon (i) moveable tangible assets (including, generally, securities) if the insolvency administrator is in possession of that asset or (ii) claims/receivables that have been assigned for security purposes (as opposed to a pledge). If an insolvency creditor is entitled to foreclose upon the collateral directly, this right is qualified by the discretion of the competent insolvency court to set a deadline on foreclosure by the creditor upon application by the insolvency administrator. 3.8

DEDUCTION OR "HAIRCUT" ON ENFORCEMENT BY INSOLVENCY ADMINISTRATOR In the event that an insolvency administrator is entitled under section 166 of the Insolvency Code to foreclose on collateral that is subject to a security arrangement, the insolvency administrator is obliged to enforce the collateral on behalf of the secured creditor and transfer the proceeds from such enforcement to the secured creditor. Sections 170 and 171 of the Insolvency Code, however, permit the insolvency administrator to deduct from the proceeds of enforcement as fees payable to the insolvency estate the costs for the identification and assessment of the asset in question and its realization. Specifically, the Insolvency Code provides that the insolvency administrator may deduct from the enforcement proceeds 4% for the identification and assessment of the asset and an additional 5% (generally) for enforcement costs, plus any applicable VAT (the "haircut provisions"). The application of the haircut provisions to collateral posted under security arrangements may be problematic to the rating analysis where the cash flow model is assuming and dependent upon 100% of collateral proceeds' being available to service the rated obligations. 3.9 TIMELY ENFORCEMENT OF SECURITY INTERESTS In the context of a structured finance transaction, Standard & Poor's credit ratings speak not only to the issue of ultimate repayment of principal and interest on the rated obligations, but also to the issue of timely payment of interest or principal or both in accordance with the terms and conditions of the rated obligations. Whether timely enforcement of security interests is relevant to the rating analysis for a particular transaction depends on the role that the security interests and their related collateral are playing in the structure presented to Standard & Poor's for analysis, and on the existence of any structured or financial liquidity enhancement to bridge the gap when no enforcement takes place. For example, in a transaction involving an SPE where the SPE grants security over its assets in favor of a note trustee, the security interests and their efficacy through insolvency go toward supporting the disincentive to filing argument and the analysis that the SPE is an insolvency-remote entity (see section 2 for a more detailed discussion of bankruptcy remoteness). The timeliness of enforcement of those security interests by the note trustee is, therefore, not all that significant to the rating analysis. This situation is to be contrasted with a structure where collateral is being posted by a third party in favor of an SPE, or by a non-SPE issuer in favor of the noteholders, to support the rating on the notes issued. In these circumstances, timely access to the collateral under the security arrangements, including in the insolvency of the security provider, is important, as it will determine whether there will be sufficient funds available to meet the relevant payment obligations in accordance with the terms and conditions of the notes on a timely basis. Applying the general security discussion above, a transfer for security purposes or pledge of moveable tangible assets where possession is not delivered to the secured creditor, or a security assignment of claims/receivables, would be problematic where timing is at issue because, although the right to separate satisfaction would be preserved, there is a practical timing issue involved in the insolvency administrator's realizing the collateral on behalf of the secured creditor. In addition, the haircut provisions of the Insolvency Code would also apply to the proceeds realized, creating a credit stress. A scenario where moveable tangible assets (generally including securities) are delivered as collateral into the possession of a SPE under a pledge or a transfer for security purposes is favorable from a timing perspective, because the SPE would be entitled to enforce upon the collateral without application of the haircut provisions of the Insolvency Code. Even in the absence of any discussion about the legal right of the secured party to "immediate" enforcement, however, Standard & Poor's considers that such enforcement would still be likely to involve some practical delay and, depending on the circumstances, some form of liquidity may be requested to cover this delay. Table 1 gives a summary of various security interests and how they fare when measured against issues of post-insolvency enforcement and haircut provisions. Table 1 Insolvency Administrator Security Enforcement Rights and Recovery of Costs SCENARIOS INSOLVENCY ADMINISTRATOR ENFORCEMENT RIGHT DEDUCTION FROM ENFORCEMENT PROCEEDS Moveable tangible assets (generally including securities) in possession of insolvency administrator Y Y Moveable tangible assets (generally including securities) not in possession of insolvency administrator N N Claims/receivables assigned for security purposes Y Y Claims/receivables pledged N N 3.10 GERMAN BANKING ACT — MORATORIUM In the context of German banks' providing security, an additional issue that merits consideration when looking at the question of timely enforcement of security interests is the effect of an imposition of a moratorium under section 46a of the German Banking Act

("Kreditwesengesetz"). Under section 46a of the Banking Act, the German Federal Financial Supervisory Authority ("Bundesanstalt für Finanzdienstleistungsaufsicht" or "BAFin") may impose a moratorium on payments to be made by a bank. German counsel in their opinions generally explain that a moratorium under section 46a of the German Banking Act may be construed to result in a deferral of the due date of all payment obligations of the relevant bank. In this regard counsel refer to the views of some legal authors that a secured creditor would not be able to exercise the security right because the moratorium would mean that no obligation of the bank is due, and that general principles of German law require a secured obligation to be due and payable to entitle the secured creditor to enforce its security. German lawyers have, however, generally provided comfort that, notwithstanding these views, a section 46a moratorium would not prevent a secured creditor from enforcing its collateral where possession of the collateral has been transferred to the secured party, or where the restriction on enforcement would not result in a liquidity benefit for the relevant bank, on the basis that (i) section 46a of the German Banking Act does not expressly exclude the enforcement of collateral for an obligation that is subject to moratorium, (ii) as a matter of contract law parties may provide that an obligation that is not yet due may be performed out of the proceeds of a specific asset, and (iii) from a pragmatic perspective no purpose is otherwise served by the BAFin's restricting the enforcement of collateral during a moratorium, when the preserved collateral will in any event ultimately be used to satisfy the claims of the secured creditor. Standard & Poor's has been satisfied that this analysis generally provides grounds for discounting a risk of delay in the enforcement of bank-provided security due to a section 46a moratorium. 3.11 SECURITY INTERESTS — CONCLUSION Regardless of which security device is employed in any particular structure, Standard & Poor's may request an explanation of how the security arrangements are structured to support the rated obligations commensurate with the rating requested. Where relevant to the rating analysis, Standard & Poor's may request legal comfort about the efficacy of such security arrangements, including opinion comfort on each of the matters discussed above. 4. Transfers of Assets/True Sale For structures involving a sale and transfer/assignment of assets (i.e., receivables) Standard & Poor's looks to the transaction participants to provide comfort on how assets can be transferred/assigned under German law so that a bankruptcy/insolvency or corporate reorganization of the transferor would not adversely affect the timely payment of principal and interest on the rated securities. As a legal matter, a transfer can be thought of as fulfilling three specific goals, depending on whether it is valid and enforceable: As a contractual matter, against a solvent transferor and resulting in the transferee having priority against third-party creditors while the transferor is solvent; Against the regulator (if any), debtor in possession, or an insolvency administrator of the transferor, an insolvency or reorganization proceeding, and against other creditors of an insolvent transferor; or Against the account debtors, enabling the transferee to enforce the assets directly without relying on the transferor (for example, the ability to instruct the account debtor to make future payments to the transferee, or the ability to foreclose on a mortgage or repossess an automobile upon default). As a general matter, a true sale of an asset is a transfer that meets all three goals. An unperfected transfer may meet only the first two goals above, but may not be recognized in an action against the account debtor. An unperfected transfer also may be more likely to be challenged in an insolvency or corporate reorganization proceeding. A promise to transfer assets in the future is only enforceable against the transferor and so would meet only the first goal. Although the word "transfer" is often used without regard for its breadth, being able to define the breadth of transfer required for securitization and accomplishing the necessary formalities can lead to successful transactions. 4.1 GERMAN TRUE SALE Some countries have enacted securitization statutes that clearly delineate the conditions and formalities under which the transfer must take place for the transfer to be a true sale. At the time of writing, no such special legal framework exists in Germany. There is no explicit legal authority in Germany for what constitutes a true sale in a structured finance transaction and, accordingly, true sale transactions are structured under the existing general legal framework provided by German law. The prevailing German view is to apply the principles that have been established by the German courts for distinguishing true or genuine factoring ("echtes Factoring") from untrue or nongenuine factoring ("unechtes Factoring") to the question of true sale of receivables. True factoring means that the sale of receivables is without recourse to the seller, whereas untrue factoring is more akin to a collection arrangement in that the assignee has recourse to the assignor with respect to any shortfall in collections. In discussing this issue, German counsel point toward a decision of the German Federal Supreme Court in Civil Matters ("Bundesgerichtshof"), which decided that the transfer of the credit risks relating to the assigned receivables is an important factor for determining whether the assignment is to be considered a true factoring. German counsel also point out that, for an assignment to qualify as true factoring, a transfer of the economic chances associated with the assigned receivables may also be required. In legal opinions discussing true sale, German counsel point to issues to be considered in determining whether a transaction should be viewed as resulting in a true sale, including the following: The amount and variability of purchase discounts provided by the originator to the purchaser and the ratio borne between the credit enhancements provided by the originator to the purchaser and the historic default ratio of the assets being assigned; The provision by the originator to the purchaser of buyback options or guarantees for defaulted assets; The payment by the purchaser to the originator of unexpected economic surplus; Adjustments in the purchase price for assets depending on the realized amount of defaults; and The amount and payment of servicing fees being dependent on the realized amount of defaults. Although not necessarily determinative for the legal characterization of any transfer of assets, Standard & Poor's notes the issuance by the German Institute of Accountants (IDW) of a guideline dated Oct. 31, 2002, regarding the accounting treatment of asset-backed securities transactions (the "IDW Guideline"). The IDW Guideline provides that a sale for accounting purposes will only be achieved if the seller of receivables assigns the legal title to the receivables to the buyer and if the buyer assumes the entire credit risk with respect to the receivables. The IDW Guideline addresses the issues of credit enhancements and discounts and states that for the transfer to be recognized as a true sale from an accounting perspective the sum of all credit enhancements and discounts should be measured against and should not exceed the market discount rate in factoring transactions and, depending on the structure, should also not exceed the historic default ratio. As noted above, the absence of any explicit legal authority in Germany for what constitutes a true sale means that the structuring of true sale transactions presents challenges to the parties involved in such transactions to effect that true sale treatment of the transaction, both from a legal and accounting perspective, is achieved. Although there are German term true sale transactions that have been and continue to be structured, Standard & Poor's has noted the German securitization market's past preference for structuring synthetic transactions, where the economic risks of a true sale transaction can be replicated without the need for a legal assignment of assets. 4.2 SALE RECHARACTERIZATION RISK The importance of structuring a transfer as a true sale is underscored by the recharacterization risk that would otherwise manifest itself in the context of a securitization of claims/receivables. If a purported true sale transaction is not structured to effect a true sale of the assets, in the event of an insolvency of a seller, the transaction may be recharacterized as a secured loan arrangement, with the purchaser viewed as having lent the purchase price to the seller of the assets in return for a promise to repay the funds secured by a security assignment of the "sold" claims/receivables. As discussed in "Security Interests", section 166 of the German Insolvency Code provides that in an insolvency of the seller, its insolvency administrator would be entitled to enforce upon the claims/receivables that have been assigned for security purposes. Apart from the question of timeliness that such a collection would introduce into a securitization, the proceeds of the realization would be subject to the haircut provisions of the German Insolvency Code, putting at risk the purchaser's ability to make full payment on the rated obligations. The inability to mitigate this risk effectively would have a negative impact on the ratings to be assigned to any asset-backed notes supported by these receivables. 4.3 RESTRICTIONS ON ASSIGNMENT In any transaction involving the transfer of assets, part of the analysis that needs to be performed by the parties is whether there are any restrictions on assignment of those assets. As a matter of general contract law, German law recognizes that a creditor cannot validly assign a claim if the creditor and the debtor of the claim have contractually restricted the assignment. In true sale transactions, Standard & Poor's generally expects the arrangers and their counsel to provide an analysis of the underlying claims being assigned and whether there are any restrictions on assignment. As part of this analysis, Standard & Poor's may request comfort that counsel have reviewed a sample form of the contract(s) that are representative of the pool of claims being assigned and confirm whether the forms of contract provide for any restriction on assignment. The review of the sample form of contract should be supported by a representation by the originator that the claims being transferred are all documented on the sample form(s) of contract reviewed by its counsel. To the extent counsel identify a contractual restriction on the assignment of the claims, those claims may need to be excluded from the pool of assets being transferred. Standard & Poor's understands that section 354a of the German Commercial Code ("Handelsgesetzbuch") provides that, notwithstanding any contractual restriction on assignment, a claim may be validly assigned if the claim arises by way of a commercial transaction ("Handelsgeschäft") and the parties to the contract under which the claim arises are merchants ("Kaufleute"). Reliance on section 354a is however problematic from a rating prospective in that the relevant account debtors are able to discharge their debt by making payment to the assignor (whether or not notice of the assignment has been given to them), thereby continuing to expose the assignee to the credit risk of the assignor. Accordingly, all other things being equal, Standard & Poor's generally does not consider that reliance on section 354a enables transactions to reach the highest rating categories and/or be rated without reference to the rating of the seller. 4.4 TRANSFERS OF ASSETS — CONCLUSION For structured finance transactions that rely on a true sale arrangement, Standard & Poor's generally requests true sale opinions. Table 2 compares true sale, pledge, and security assignment. Table 2 True Sale, Pledge, and Security Assignment Compared TRUE SALE PLEDGE SECURITY TRANSFER Perfection required? N Y N Transfer of title? Y (legal and beneficial) N Y (legal, but not beneficial) Accessory right? N/A Y N Right of separation on insolvency (Aussonderung)? Y N N Right to separate satisfaction on insolvency (Absonderung)? N Y Y N/A--Not applicable. 5. Contingent Transfer Structures that rely on trigger events to perfect the sale of assets or to perfect security interests at a future date often are called contingent transfer or contingent perfection structures. The term "contingent" may imply more comfort than the legal analysis reveals — perfection of collateral or the transfer may not be possible in the future. Prospective issuers contend that transactions that rely solely on the occurrence of certain postclosing events (the trigger events) to transfer (or perfect the transfer of) assets at a future time should be rated under traditional structured finance methodology. Thus, they argue that debt of an 'A-' obligor that agrees to transfer a pool of assets when the obligor is downgraded below 'BBB' should be rated 'AAA' because the assets have an implicit 'AAA' credit quality. They argue that Standard & Poor's should look only to the implicit credit quality of the future assets, which is at 'AAA' level, and not to the issuer credit rating on the transferor, which is rated 'A-'. At first, the argument seems appealing. If a highly rated transferor agrees that at some time in the future it will deliver assets (or perfect the delivery of assets), then an investor should be better off than if he had relied solely on a promise of the transferor to pay principal and interest. The trigger event would be some specified event, including a default by or downgrade of the transferor. On closer examination, however, a promise to deliver assets in the future is only worth as much as the creditworthiness of the transferor. At the time the transaction is closed, the investor has no additional security or assurances that a trigger event will actually occur or will occur early enough so that the transfer or perfection can take place. If the transferor becomes insolvent before the trigger event occurs, there may be no assets. As a general matter, Standard & Poor's believes that the trigger-event mechanism may serve to increase the incentive of the transferor, receiver, liquidator, regulatory supervisor, or other creditors to exercise rights before the trigger event and frustrate the transfer of assets. If this happens, the rated noteholder would be an unsecured creditor of the transferor. Thus, Standard & Poor's is of the general view that transactions using contingent transfer or contingent perfection mechanisms may be challenged in obtaining ratings higher than the transferor's issuer credit rating. 6. Preference Risk and Avoidance of Transfer Almost all jurisdictions contain rules whereby transfers that would otherwise have been valid can be set aside in the insolvency of the transferor. These rules usually require that, at the time the transfer took place, the transferor was already insolvent or became insolvent as a result of the transfer. Using the example of an SPE that has purchased assets from an originator, in case of a successful preference claim, the insolvency administrator would get the assets that were sold and transferred returned to the estate of the insolvent originator. The SPE would then be entitled to receive back the purchase price. However, the obligation to return the purchase price would merely be another unsecured payment obligation of the originator and would become part of the claims in the general insolvency. From a ratings perspective, this money would be a total credit loss. To the extent that there are transfers in a transaction (whether by way of true sale or the posting of collateral under security arrangements) that underpin the rating analysis, Standard &

Poor's may request a legal opinion from counsel in the jurisdiction of incorporation of the transferor (and, where applicable, from counsel in other jurisdictions where insolvency proceedings might be opened in respect of the transferor) that sets out exactly the circumstances in which the transfer could be voided or set aside. Such opinion should (i) set out why such circumstances are not relevant to the transaction at hand and/or (ii) to the extent such circumstances are relevant, provide comfort on why the transfers could not be set aside. 6.1 GERMAN LAW PREFERENCE RULES Under German law, any assignment or transfer of rights or assets or any payments can be challenged, inter alia: Outside of insolvency proceedings, by any creditor of the transferor that has obtained an enforceable judgment or other enforceable instrument against the transferor in respect of an outstanding debt if (i) the transfer was effected with the intention known to the transferee of prejudicing other creditors of the transferor and the transfer was made in the 10 years before the challenge, or (ii) the transfer was without consideration and was made in the four years before it was challenged; or Upon the opening of insolvency proceedings of the transferor by an insolvency administrator under sections 129 to 147 of the German Insolvency Code, which provide that legal acts made before the opening of insolvency proceedings that disadvantage insolvency creditors may be avoided if certain prerequisites are met. In analyzing the applicability of sections 129 to 147 of the German Insolvency Code to securitization transactions, German counsel in their opinions usually draw attention to the provisions of sections 130 to 133 of the German Insolvency Code as being relevant. Section 130 of the German Insolvency Code provides that any legal act that granted a creditor security or satisfaction will be voidable if (i) it was taken within the last three months before the filing of an application for the opening of insolvency proceedings, provided that the debtor was insolvent at the time when the act was taken and the creditor was aware of the debtor's insolvency, or (ii) it was taken after the filing for the opening of insolvency proceedings with respect to the debtor, provided the creditor was aware of either the debtor's insolvency or the filing for the opening of insolvency proceedings. Section 132 of the German Insolvency Code provides for a similar test in relation to legal transactions resulting in immediate adverse effects on other creditors of the debtor. An exception to these rules applies in the case of a transaction for which contemporaneous consideration of equal value is given ("Bargeschäft", section 142 of the German Insolvency Code). Section 131 of the German Insolvency Code provides that a legal act that granted a creditor security or satisfaction to which such creditor was not entitled — or not entitled in such a way or at such time — will be voidable if (i) it was taken during the last month before the filing of an application for the opening of insolvency proceedings or after such filing, (ii) it was taken during the second or third month before the filing of an application and the debtor was insolvent at the time of the act, or (iii) it was taken during the second or third month before the filing of an application and the creditor was aware that the transaction was detrimental to other creditors of the debtor. Section 133 of the German Insolvency Code provides that the insolvency administrator may also avoid any legal acts taken by the debtor with the intention — as known to the relevant other party — to prejudice the debtor's other creditors if the act was taken in the 10 years before the filing of an application for the opening of insolvency proceedings or after such filing or — subject to a two-year preference period — any agreement entered into by the debtor with a related person by which the debtor's other creditors were directly adversely affected. Under section 134 of the German Insolvency Code, additional grounds for avoidance may exist in a transaction that was entered into without consideration. The preference risks described in section 130 to 133 of the German Insolvency Code and above (subject to the final exception set out in the paragraph following) can from a ratings perspective typically be addressed by the delivery of a separate solvency certificate by the transferor to the transferee at the time of each transfer. The delivery of a solvency certificate, signed by a senior officer of the originator, should among other things confirm that (i) the transferor is solvent at the time of the transfer, and (ii) the transaction was not undertaken to prejudice the transferor's other creditors. Clearly, such certificates are not legally binding upon a court and a court could choose to ignore them in determining whether the SPE was or ought to have been aware of the insolvency of the originator. Nevertheless, in the absence of genuine fraud, such certificates should provide favorable evidence to strengthen the SPE's plea of ignorance. This is important since, under section 130, the transferee's knowledge of insolvency is a key component of the test. The solvency certificate should contain such other representations and warranties as transaction counsel deem necessary for counsel to provide a favorable opinion on the mitigation of any preference risk. In cases where the originator has an investment-grade rating on the closing date of the transaction, reliance will be placed on the rating on the originator as a strong indication of its solvency and no certificate may be requested. In cases where the originator has an investment-grade rating on the closing date of the transaction but where further sales of receivables are expected (for example, by way of substitution of maturing assets), the transaction documentation should provide that, should the originator ever lose its investment-grade rating, it will then comply with the criteria for a non-investment-grade originator (for example, the provision of solvency certificates). For transactions that may revolve frequently, delivery of solvency certificates may be requested at defined intervals (i.e., typically every three months). The preference risk described in section 131 would not usually occur in a traditional securitization transaction since no anticipatory satisfaction of debt or granting of security to which the SPE was not entitled should take place. On this basis, the preference risk described in section 133 is designed much more clearly to prevent a debtor's fraud on its creditors or other exceptional circumstances that do typically not exist in a traditional securitization transaction. Standard & Poor's is, as a general matter, comfortable that this section is unlikely to be invoked by an insolvency court unless it can be demonstrated that assets were sold at a gross undervalue or that other exceptional circumstances exist. Unless, therefore, the sale price of the assets is subject to a very substantial discount to their face value or their fair market value (or other exceptional circumstances obtained), Standard & Poor's generally does not see the risk of a section 133 preference as meaningful, even in the context of highly rated deals. 7. Commingling 7.1 CREDIT LOSS OR LIQUIDITY STRESS The problem of commingling occurs whenever cash belonging to the issuer is mixed with cash belonging to a third party or goes into an account in the name of a third party in such a way that, in the insolvency of that third party, such cash is lost or frozen. The cash would become "lost" if, after the insolvency of the third party, the issuer's claim to the money were treated at law as an unsecured debt of the insolvent entity. Under Standard & Poor's criteria, such an unsecured debt claim is generally treated as a total credit loss for the issuer. On the other hand, such cash would become "frozen" if, after the insolvency of the third party, the issuer retained a proprietary claim over the money so that the money did not form part of the insolvent entity's insolvency estate. The cash could also be "frozen" if the account was the subject of a valid security interest in favor of the issuer. In both cases where cash is "frozen", although the issuer's rights to obtain the money would have a solid grounding in law, Standard & Poor's would seek to determine how long it would take for the issuer to assert these rights as against the insolvency administrator and competing creditors of the insolvent holder of the cash. Standard & Poor's would like to stress that such determination is pragmatic rather than formalistic. In other words, Standard & Poor's recognizes that even if the law provides the issuer with an immediately enforceable right of access, the complexities inherent in the insolvency of a large institution are likely to result in a delay in the issuer's being able to assert its rights. After such delay, however, the issuer would be able to access the relevant cash, so such cases would be treated not as total credit losses but as liquidity strains on the transaction. Accordingly, the transaction should demonstrate features that enable the issuer to meet in full and on a timely basis its current obligations under the rated notes, notwithstanding the delay in cash flows caused by the third party's insolvency. Commingled cash may also be lost in the insolvency of the account holder where the account bank is allowed to assert a setoff. In other words, it may be lost where the account holder owes money to the account bank flowing from other, probably unrelated, obligations and is allowed under the terms of the account or under general principles of German law to set off the amounts owed to it by the account holder against funds standing to the credit of the account, including funds belonging to the issuer. Although not the only situations in which commingling can arise, the most common type of commingling seen in German true sale transactions (particularly non-bank-originated transactions) arises from the situation in which the account debtors continue to make their payments under the sold receivables into accounts in the name of the originator. Similar commingling risks seen in German bank-originated transactions arise from the situation in which the banks post collateral to support or enhance the rated obligations. 7.2 ACCOUNT BANK INSOLVENCY What happens to money held with a bank when the bank becomes insolvent is not, strictly speaking, a commingling issue. Nevertheless, there is sometimes a degree of confusion between this issue and the issue of commingling in the strict sense. This is particularly the case when the originator is a financial institution and is also the account bank for the transaction. It therefore seems appropriate to deal with the point here. As a matter of German law, when a person deposits money with a bank, that person's rights over the bank account constitute a debt. Any amounts standing to the credit of a bank account reflect a debt owed by the bank to the account holder, usually payable on demand. Since banks are not in the habit of granting security to their account holders, the debt owed by the bank is a normal unsecured debt and is treated accordingly in the insolvency of the bank. Therefore, consistent with Standard & Poor's approach to unsecured debt of an insolvent company, all money held with a bank that is not rated sufficiently high to support the rating on the notes is generally treated as lost to the issuer. This analysis holds true even when the bank is also the originator. This is because, once deposited with the originator bank, the collections are merged with the bank's general funds and used by the bank in the normal course of its business. To avoid problems with the potential insolvency of the account bank, we have observed that transactions are generally structured in one of two ways: (i) to move the funds into an account maintained with a suitably rated bank, or (ii) to invest the funds in suitably rated eligible investments, which in turn must be chosen so as to allow proper security to be obtained over them, so protecting the issuer's interests in the event of insolvency of the bank holding the money. 8.Set-Off 8.1 GENERAL Set-off risk is the risk that monetary obligations owed by party A to party B may be set off by party A against obligations owed by party B that for some reason party B has not paid. In the context of a structured finance transaction where parties are modeling expected cash flows on a gross level, the exercise of set-off rights would decrease the actual cash flows received by the structure and this may threaten the structure's ability to make full and timely payment on the rated obligations. Set-off risk can materialize in a transaction in a number of ways but is seen most often in relation to debtor set-off and account bank set-off. 8.2 DEBTOR SET-OFF In most asset-backed transactions, it is a concern that, upon the insolvency of the originator, the receivables sold to the SPE may be decreased by the amounts that the underlying debtors set off against other obligations due to them by the seller. The classical case of debtor set-off would occur when a bank sold, for example, a pool of car loans, some of which had been made to the bank's own customers. Upon the insolvency of the bank it is likely that some, if not all, of these customers would have money owed to them by the bank — namely the amounts standing to the credit of their current accounts. Depending on the jurisdiction, these bank customers may be entitled to deduct from the amounts due under the sold car loans the amounts standing to the credit of their accounts with the seller at the time of the latter's insolvency. This would reduce the amount that the issuer was entitled to collect on the securitized receivables and could, depending on the size of the reduction, cause a loss to the noteholders. This form of set-off may be recognized at law and results in a legal diminution of the debt. In addition to this "legal" set-off, there is also the risk of a "practical" set-off. This would occur when a debtor is faced with the loss of money due to it by the now insolvent seller. Having neither consented nor in some cases been notified of the sale of his or her receivable, the debtor may simply refuse to pay on the grounds that, irrespective of the legal position, the actions of the seller were iniquitous. In the case of a "practical" set-off, though, the right of the issuer to recover the sold receivable from the underlying debtor is not legally impaired. The issuer can expect delays, however, in recovering the amounts due to it. For this reason, Standard & Poor's generally treats "legal" set-off as a credit loss to the transaction while "practical" set-off is generally treated as a liquidity stress. In determining the nature of the risk of the set-off and its potential impact, it is necessary to understand the law of the relevant jurisdiction but also the business of the originator. There will be cases where the existence of mutual rights as between the underlying debtors and the originator are extremely unlikely, for example, where the originator is a special-purpose lender that does not have a deposit-taking business. In other cases, the existence of "no set-off" provisions in the contract between the debtors and the originator may be dispositive, as a matter of law, in removing the rights of set-off. Under section 387 of the German Civil Code, if two persons have claims of the same kind (for example, claims for the payment of money) against each other, each person may set off its claim against the claim of the other person as soon as its claim becomes due. The set-off is effected by declaring it vis-à-vis the other person. In certain situations, the set-off right is subject to statutory restrictions, for example, claims against which a valid defense exists may not be set off, and set-off is not permissible against claims arising out of tort if committed intentionally. Generally, set-off rights can be validly excluded by contractual agreement. However, if the relevant clause constitutes a standard business term, the clause may be invalid according to the rules on standard business terms ("Allgemeine Geschäftsbedingungen") as contained in sections 305 et seq. of the German Civil Code (see section 9). 8.3 EXERCISE OF SET-OFF RIGHTS AGAINST ASSIGNEES In addition to the general rules on set-off described in section 8.2, in structured finance transactions involving an assignment of assets, it is important to understand the degree to which the debtors of the underlying obligations that have been assigned may exercise rights of set-off against assignees. Section 404 of the German Civil Code provides that an account debtor may invoke against an assignee all defenses to payment of a claim that the account debtor possessed at the time of the assignment of the claim. Section 406 of the German Civil Code provides that an account debtor may set off against an assignee a claim that the account debtor has against the assignor except where either (i) the account debtor was aware of the assignment of debt at the time at which it acquired the claim against the assignor or (ii) the claim of the account debtor did not become due until after the debtor became aware of the assignment to the assignee and the claim of the account debtor matured after the claim was assigned to the assignee. Under section 407 of the German Civil Code the assignee has to give credit to payments made by the account debtor to the assignor until such time as the account debtor has been notified of the assignment. 8.4 ACCOUNT BANK SET-OFF Another set-off concern arises when cash is held by an account bank in a transaction in the name of a party other than an SPE. Commingled cash may also be lost in the insolvency of the account holder where the account bank is allowed to assert a set-off. In other words, it may be lost where the account holder owes money to the account bank flowing from other, probably unrelated, obligations, and the bank is allowed under the terms of the account or under general principles of law, to set off the amounts owed to it by the account holder against funds standing to the credit of the account — including funds belonging to the SPE. Most bank account standard terms explicitly allow the account bank to set off obligations of the account holder against amounts standing to the credit of the bank account. For Standard & Poor's to give credit to cash collections standing in an account in the name of a party other than an SPE, legal opinions may be requested to the effect that the bank will not be entitled as a legal matter to effect a set-off. In addition, Standard & Poor's may request that comfort be provided that the bank has waived its contractual rights of set-off over the account, even in circumstances where the rights may not exist, and that the bank is notified in writing of the interests of the SPE over cash in the account. This provides Standard & Poor's comfort that the bank is not likely to raise a set-off claim in the insolvency of the account holder, arguing that it was not aware of the real economic ownership of the account funds. 8.5 SET-OFF — CONCLUSION Standard & Poor's generally expects the arranger and its transaction counsel to provide an explanation of the set-off risks that exist in any particular transaction that may affect the ability of the structure to make timely payments of interest and principal on the rated obligations. 9. Standard Business Terms Sections 305 to 310 of the German Civil Code provide that terms of a contract may be set aside by a court as invalid if they constitute standard business terms. Section 305 provides that standard business terms are defined as one or more contractual terms preformulated for a multitude of contracts that one party to the contract, the "user" of such terms, imposes upon the other party as part of the contract. Section 305 further provides that contractual terms do not constitute standard business terms to the extent they have been individually negotiated between the parties. The standard business terms rules are designed to protect the user's counterparty, not the user. According to existing German case law, financial instruments are not exempt from the standard business terms rules. Standard & Poor's notes past practice of certain German counsel to attempt to qualify their entire opinions by the statement that they cannot rule out that terms of the transaction documents may be considered standard business terms under the provisions of sections 305 et seq. of the German Civil Code, and that this could affect the legality, validity, and enforceability of any of the provisions of the transaction documents. Standard & Poor's generally does not consider that it is useful to make such a qualification without also expressing a view as to the applicability of the standard business terms rules to the transaction documents in question. This is particularly the case in the context of structured finance transactions where the efficacy of certain structural elements such as the true sale, security arrangements, the priority of payment provisions, restrictions on setoff rights, limited recourse or the terms and conditions of the notes themselves, are important to the successful operation of the transaction and underpin the rating analysis. Legal counsel typically have been involved in the drafting and the negotiation of the various transaction documents, and they are well acquainted with the terms of them. Accordingly, Standard & Poor's generally expects that should counsel believe it necessary to qualify their transaction legal opinion by reference to the standard business terms rules, counsel should provide a view as to why it is that they believe the specific transaction in question would not be challenged or set aside under these provisions and/or identify which provisions they are concerned about. The absence of legal comfort on this point may lead Standard & Poor's to conclude that the legality, validity, and enforceability of the key provisions of the transaction documents are in question and may result in Standard & Poor's being unable to assign its highest levels of rating to a transaction. 10. Tax In securitizations, comfort should be provided that either there are no taxes payable by the SPE or that any such taxes have been calculated and may be paid out of the available cash flow while still leaving sufficient amounts to meet principal and interest on the rated debt. In addition to these entity-level tax considerations, multijurisdictional transactions create certain additional tax issues that should be considered. Without attempting to be exhaustive, what follows is a summary discussion of Standard & Poor's understanding of those tax issues that most often arise in the context of German securitization transactions. 10.1 WITHHOLDING TAX Whenever cash flows across a jurisdictional border, there is a heightened risk that the tax authorities in the jurisdiction from which the cash left may require part of that amount to be remitted to it in the form of withholding tax. This is certainly the case of proceeds of receivables where the debtor in one country is effectively paying an SPE in another country, as is most often the case in German securitizations involving German debtors whose debts have been assigned to non-German SPEs. This may also occur in respect of payments under swap and other derivative agreements entered into by the SPE for hedging purposes, any form of external credit enhancement such as a letter of credit and collateral posted under security arrangements or otherwise purchased directed by an SPE. Accordingly, Standard & Poor's may request to see a legal opinion from counsel qualified in the jurisdiction of the payer confirming that no withholding tax will be imposed on the payment. Alternatively, if a withholding tax does fall to be paid, the amount may need to be deducted from the cash flows in calculating the amounts available to the SPE to meet its obligations under the rated securities. In respect of withholding tax on swaps, derivatives, and external credit enhancement, it is generally acceptable to Standard & Poor's for such opinions to be issued by internal counsel to the relevant counterparty. Under German tax law, there is generally no withholding tax when interest is paid by a German debtor to a non-German SPE. The same is true for payments under swap and other derivative agreements. Exceptions apply only where a German debtor makes a payment on an equity or hybrid instrument, such as a silent partnership interest, participating loan, jouissance right ("Genussrecht") or convertible bond, or where a bank or financial services institution pays interest in Germany over the counter upon presentation of coupons or other securities in certificated form. These exceptions are usually not relevant for asset-backed securitizations. This also applies to the German domestic withholding tax ("Zinsabschlagsteuer") on interest payments made by, or through, German banks (including German branches of foreign banks). This tax is only withheld on payments made to German resident account holders (or to accounts of the German permanent establishment of a foreign enterprise). The tax is creditable as a prepayment against the final income tax liability of the recipient of the interest income (or, if in excess of such liability, refundable). 10.2 PERMANENT ESTABLISHMENT AND BRANCH OR AGENCY Many SPEs in international transactions are incorporated in zero-tax or low-tax jurisdictions. They often, though, own pools of assets located in high-tax jurisdictions. If the assets default, recoveries may need to be pursued in the local courts, so these transactions may carry a risk that the tax jurisdiction in which the assets are located will seek to maintain that the SPE, although located elsewhere, has a local "permanent establishment" or a "branch or agency". This, in turn, could result in the SPE becoming taxable in that high tax jurisdiction. Almost invariably, the issue of whether a foreign corporation, such as the SPE, is to be deemed as taxable in a particular country is to be determined by applying a combination of legal and practical tests. Therefore, Standard & Poor's generally does not expect that multijurisdictional transactions will have the benefit of legal opinions stating that, as a legal matter, the SPE will not be held taxable in any particular jurisdiction. Nevertheless, in certain circumstances, Standard & Poor's may request a tax opinion setting out the legal criteria that would result in the SPE's becoming taxable in that jurisdiction and setting out the reasons why, under the transaction documents, this risk is removed or mitigated. To the extent that the risk is not removed or mitigated then the impact of the tax effect may need to be sized and the amount may need to be deducted from the cash flows used to calculate the amounts available to the SPE to meet its obligations under the rated securities. As discussed in section 1, almost all SPEs used in German securitizations are incorporated outside of Germany, predominantly in low- or zero-tax jurisdictions. These non-German SPEs, however, own pools of assets located in Germany where taxes are imposed on corporate activity. The question then becomes whether the non-German SPE through its activities whether (i) by way of holding German assets, (ii) by way of servicing German assets by a servicer based in Germany, (iii) by way of contracting with German counterparties under other contractual arrangements, or (iv) by a combination of the foregoing, becomes taxable in Germany because of a permanent establishment ("Betriebsstätte") or a primary place of management ("Geschäftsleitungsbetriebsstätte") — collectively referred to as a "taxable presence" — or through a permanent representative ("ständiger Vertreter"). In addition, a non-German SPE can become taxable in Germany if it holds assets that are secured by German real estate or vessels registered in Germany. Currently, neither German tax law nor the German tax administration provides definitive guidelines as to how a taxable presence or a permanent representative may be triggered by a securitization transaction involving a non-German SPE. Accordingly and where relevant, Standard & Poor's may request an analysis of what the impact to the structure would be in the event the German tax authorities were to view the SPE as having liability to German tax either through a taxable presence or permanent representative. Standard & Poor's has observed that German counsel in their opinions generally confirm that in such an event, the SPE would be subject to German corporate tax ("Körperschaftsteuer") of 26.5% (2003) plus a solidarity surcharge ("Solidaritätszuschlag") of 5.5% (2003), and additionally, in the case of a taxable presence, German trade tax ("Gewerbesteuer"), where applicable, which is discussed in detail under the heading "Trade Tax". German counsel generally confirm that the calculation of the taxable profit for the purpose of German corporate tax (excluding any impact of German trade tax) is based on the difference between gross income and deductible expenses. Assuming positive comfort is given that expenses of the SPE may be considered deductible, as most securitizations are not structured to capture any material taxable profit (i.e., all cash flow from the assets is generally paid out to the various counterparties during the relevant periods) Standard & Poor's may take the view that the SPE would be tax neutral. A tax-neutral SPE is one that is subject to taxation but is not expected to have any taxable income because it is projected that its revenue will be offset by an equal amount of deductions or exemptions. For example, if the SPE is projected to have income of €5 million in any year, but offsets this income with deductible expenses of €5 million, the German taxable profit of the SPE for that year would be zero. Accordingly, the German tax liability of the SPE (again excluding any impact of German trade tax calculations) would be zero. Correspondingly, if when requested comfort cannot be provided that all expenses of the SPE would be viewed as deductible expenses for the purpose of calculating taxable income, the resulting tax liability may need to be sized and reserved for in the projected cash flows for the transaction.

10.3 TRADE TAX

To date, one of the main drivers behind the use of non-German SPEs in securitization transactions has been the liability of German organized entities to German trade tax. Trade tax is calculated separately from the corporate tax but uses the taxable income amount as a starting point. The basis for trade tax is calculated by taking the taxable income under the corporation tax rules and adding to it 50% of the interest (plus fees and expenses, if these are "interest-alike", i.e., if they constitute remuneration for the forbearance of the use of capital) paid by the entity during the relevant period in respect of long-term debt ("Dauerschulden") the entity has outstanding. This aggregate figure is then multiplied by the relevant trade tax percentage to arrive at the trade tax liability. As trade tax is applied at a municipal rather than state or federal level, the applicable trade tax percentage, which varies from municipality to municipality, will depend on which municipality the entity has its taxable presence in. If a German SPE were used in a securitization, the transaction would need to cater for the leakage of cash flows to the tax authorities for the payment of the trade tax liability. In January 2001, Standard & Poor's first commented on reports emanating from the German financial markets that the tax authorities of a number of German states were seeking to establish the principle that foreign corporate vehicles used in securitization transactions involving German assets serviced by German-based services should be treated as "onshore" and, therefore, liable for German tax. These reports appeared to contradict the general market understanding that such structures were not at risk of taxation in Germany. In terms of impact from the perspective of German corporate tax, apart from the administrative burden of filing German tax returns, the non-German SPEs, should they be viewed as having a German taxable presence, were not expected to have any additional tax liability due to their being structured as tax neutral. Nonetheless, of course, as discussed, the corporate tax neutrality of any structure could not eliminate the trade tax liability due to the nature of its calculation. However, on June 6 and July 11, 2003, respectively, the German Small Businesses Support Act ("Kleinunternehmerförderungsgesetz") was passed by the German "Bundestag" and "Bundesrat". This law contains a reform for the trade tax treatment of securitization SPEs to facilitate securitization transactions in Germany with retroactive effect as from Jan. 1, 2003. The effect of this law is intended to eliminate the liability to German trade tax for German SPEs, or non-German SPEs deemed to have a taxable presence in Germany, in relation to 50% of the interest, fees, and expenses paid by the SPE in respect its long-term debt. In particular, the law states that the provisions are intended to provide relief to securitization SPEs that (i) purchase loans, acceptance credits, bills of exchange, or guarantees from banks or offer credit protection to such banks in respect of such assets and (ii) are funded directly or indirectly by debt securities. These provisions are not intended to apply to transactions other than as summarized above and, accordingly, the uncertainty remains on the issue of trade tax liability on funding expenses for SPEs that facilitate securitization in Germany other than through banks. Standard & Poor's may request, save for the aforementioned exceptions, that market participants provide an estimate of the potential German trade tax liability arising from funding expenses for each securitization transaction where a Standard & Poor's rating is being requested. Where relevant, Standard & Poor's assumes that such trade tax liability amounts will not be available to repay any obligations of the securitization transaction and determine whether there is a negative impact on the rating analysis. Mitigation of this impact may result in a request for the provision of additional credit enhancement so that payment of trade tax would not affect the ability of the SPE to meet its obligations on the rated notes. As with all its criteria, Standard & Poor's intends to continue to monitor developments on this issue and modify its criteria approach as appropriate. 10.4 VAT Standard & Poor's may request comfort as to whether German VAT may apply to any of the cash flows or payments being made to or from German counterparties and whether any such VAT liability would affect the ability of the SPE to meet its obligations on the rated notes. 10.5 SECONDARY TAX LIABILITY In some transactions the SPE is structured as a subsidiary of another company (usually the transferor) rather than as an orphan SPE. However, care must be taken that, by having a shareholding link with an operating company, the SPE does not, under the relevant tax legislation, become liable on a secondary basis for the taxes payable by that operating company. This would occur under some principle of "tax grouping". To the extent that, in the relevant jurisdiction, the SPE may become liable for another party's taxes, this risk should be mitigated or the liability quantified and comfort provided that payment of such taxes would not inhibit or prevent the SPE from meeting its obligations on the rated debt. 11. Legal Opinions 11.1 GENERAL For each securitization rated by Standard & Poor's, it expects to see appropriate legal opinions dealing with the issues of law raised by the structure that are relevant to the rating. It is not possible to set out a complete list of all the items that should be addressed in legal opinions as each transaction has its own issues. To maximize the likelihood of a smooth rating process, Standard & Poor's urges legal counsel to the transaction to produce drafts of the legal opinions as early as possible, and to discuss any matters that they expect may be problematic with the analyst assigned to the transaction or a member of Standard & Poor's legal department. 11.2 LEGAL OPINION ISSUES Without limiting the discussion in this paper, unless the transaction exhibits some unusual features, the following items should generally be addressed in the legal opinion: For true sale transactions, a true sale has been effected that would be recognized in the insolvency of the transferor and not be subject to any successful challenge or recharacterization as a secured loan by any creditor or insolvency administrator of the transferor, and comfort that the assets are not subject to any restrictions on assignment; For the purposes of supporting the SPE's bankruptcy remoteness, all non-negligible assets of the SPE that are contemplated in the transaction documents are subject to effective security that would be recognized by the relevant courts, including in the event of German insolvency proceedings of the SPE, and not be subject to any successful challenge by any creditor or insolvency administrator of the SPE; Where collateral is posted as security to support full and timely payment on rated debt, comfort regarding: (i) the nature of the security interest; (ii) the effective creation and perfection of the security interest and its recognition by the German courts, including in the insolvency of the security provider, and that such security interest would not be subject to any successful challenge by any creditor or insolvency administrator of the security provider; (iii) whether in insolvency the security entitles the beneficiary thereof to directly enforce upon the collateral; (iv) whether in insolvency the direct enforcement right over collateral can be exercised on a timely basis; (v) whether the haircut provisions of the German Insolvency Code apply to the enforcement proceeds; (vi) where a prior-ranking security right (prior in ranking to the security trustee's claim for the noteholders) is granted over collateral to a party other than for the benefit of rated noteholders, whether this security right prevents the exercise of the security right by the security trustee on behalf of the noteholders, including in the insolvency of the first-ranking security holder; and (vii) the impact of any moratorium imposed under the German Banking Act on the exercise of collateral security; The limited recourse provisions set out in the documents would be recognized by the German courts as legal, valid, binding, and enforceable; The nonpetition provisions set out in the documents would be recognized by the German courts as legal, valid, binding, and enforceable; The subordination/priority of payment clauses (the "waterfall provisions") set out in the documents would be recognized as legal, valid, binding, and enforceable, including in the event of German insolvency proceedings of the SPE, and not be subject to any successful challenge by any creditor or insolvency administrator of the SPE; If any document with German signatories is governed by a law other than the law of Germany, the choice of that law would be upheld by the German courts; There are no consents, licenses, or similar requirements required in respect of the transaction, including, where relevant, no requirements to obtain a license under the German Act on Legal Advice ("Rechtsberatungsgesetz"); Wherean opinion is given subject to the nonexistence of any violation of local public policy or internationally mandatory principles of local law, counsel should confirm that, on the face of the documents reviewed, nothing has come to their attention which would cause them to believe that any such violation may exist; For SPE transactions, comfort on questions of German tax that: (i) the SPE would, if found liable to German corporate tax, be viewed as corporate tax neutral and/or if not that the amount of potential German corporate tax liability is quantified, and (ii) the SPE would not be liable for German trade tax due to either the provisions of German law or the applicability of any specific tax ruling and/or that the amount of potential liability to German trade tax is quantified; Comfort regarding the nonapplicability of German VAT to cash flows in the transaction and/or the amount of the potential German VAT liability is quantified; Comfort regarding the nonapplicability of German withholding taxes to cash flows in the transaction and/or the amount of the potential German withholding tax liability is quantified; and Comfort regarding the nonapplicability of the standard business terms rules to the terms of the transaction documents, or discussion of the possible impact of such rules on the validity and enforceability of the transaction documents. In addition, for German securitizations where the documents are governed by a law other than German law and/or a non-German SPE is used and/or counterparties to the transaction are located outside of Germany, Standard & Poor's may request to see legal opinion(s) from counsel in the relevant jurisdiction(s) opining on all pertinent aspects of their local law in relation to all the matters discussed in this paper. Further, when the SPE owns property, such as bank accounts, in a jurisdiction other than Germany, Standard & Poor's may request to see a legal opinion from the jurisdiction in which the asset is situated to provide comfort that the security package granted by the SPE will be effective in respect of such asset. As a general matter, clear and unambiguous opinions should be expressed on key elements of the structure. For this reason, expressions such as the following may not be consistent with the highest rating categories: "The courts should …" (rather than "will" or "would"); "Although opinions on the matter differ, the majority view seems to be …"; "It is generally held that …"; "It appears more likely, on balance, that …"; "There are good arguments that …"; "In the absence of judicial precedent, no opinion can be averred on …"; or "On balance, it is probably correct that …". Similarly, the use by counsel of a general insolvency or bankruptcy qualification to qualify legal opinions given on key structural issues detracts from the legal integrity of the structure and is generally inconsistent with high levels of rating. Legal counsel to transactions are invited to contact any member of Standard & Poor's legal department to seek clarification of any of these points. These criteria are not exhaustive but are set out to provide guidance and are subject to change. In writing this guide, Standard & Poor's would like to thank Cleary Gottlieb Steen & Hamilton, Frankfurt am Main, for its assistance and advice, although the content of this paper remains, of course, the responsibility of Standard & Poor's. APPENDIX III: INDEX OF SELECTED EUROPEAN LEGAL CRITERIA ARTICLES "Addressing Commingling Risk in European-Based Securitization Transactions" (published on May 16, 2001). "Legal and Structural Review in Rating CMBS — The Original Corporate Securitization Market" (published on Oct. 1, 2003). "Securitization Without True Sales: They Do Things Differently in Europe" (published on Oct. 6, 2003). "EU Infrastructure Projects: Legal Risks Arising from Competition, State Aid and Related European Union Laws" (published in April 2004). "European CMBS Loan Level Guidelines" (published in September 2004).