

# Renegotiation Decree does not Trigger Automatic Rating Action on Italian RMBS

## Analysts

Michele Cuneo  
+39 02 87 90 87 230  
michele.cuneo@fitchratings.com

Daniela Di Filippo  
+39 02 87 90 87 243  
daniela.difilippo@fitchratings.com

Ilaria Farina  
+39 02 87 90 87 242  
ilaria.farina@fitchratings.com

## Overview

The provisions of law decree N. 93/2008 (converted into law on 17 July 2008), which introduces a loan renegotiation scheme for Italian mortgage borrowers, will not result in automatic rating action on the ratings assigned to Italian RMBS notes.

The decree provides that the renegotiation scheme can be requested by borrowers only if the lender - or in the case of RMBS, the notes' issuer - has agreed to implement it. For this reason, it is unlikely that Fitch will take rating actions on the outstanding ratings of Italian RMBS unless the issuer decides to implement the renegotiation scheme or unless the prepayment rate on transactions where the scheme is not implemented is expected to rise significantly and is likely to result in negative impacts.

The undertaking of a rating action in case of implementation will in turn depend on the transaction's features, namely the share of loans that can be renegotiated, the way in which the renegotiation scheme is operationally implemented, the credit enhancement available to the RMBS notes, and the quality of the underlying collateral, as well as the structural features of the deal.

## The Renegotiation Scheme

The renegotiation scheme applies to all floating rate mortgage and floating instalment loans granted prior to 27 May 2008 for the purchase, construction or refurbishment of the abitazione principale (main residence, defined as the place where the owner or his/her "close family members" live).

Financial institutions which decide to implement the renegotiation scheme have to provide the eligible borrowers with the proposal for renegotiation by 29 August 2008. The acceptance of the proposal must be communicated by the borrower to the lender or to the financial intermediary within three months from the delivery of the relevant proposal. The renegotiation of the loan will be effective starting from the first instalment due after 1 January 2009.

Technically, the renegotiation consists of a cap to the instalment payable by the borrower which postpones the payment of any "excess over the cap" due to interest rate increases until after the original maturity of the loan. In particular:

- the cap to the instalment will be equal to the instalment resulting from applying the average interest rate paid by the borrower during 2006 to the original balance of the loan for all mortgage loans granted prior to 31 December 2006. The cap will be equal to the instalment computed by applying the interest rate applied to the first instalment for all mortgage loans granted after that date;
- any difference between the instalment due on the loan and the cap, if positive, will not be immediately payable but will be debited in a "side account" in which interest will accrue at a rate equal to the minimum of the 10-year interest rate swap (IRS) - fixed on the renegotiation date - plus a margin not higher than 0.50% and the rate of interest applying to the mortgage loan;

- negative differences will be credited in the side account until its balance is zero;
- the side loan will be repaid when the principal of the mortgage loan has been fully repaid, through the payment of a series of fixed-amount instalments equal to the cap;
- no additional guarantees will be required from the borrowers exercising the renegotiation right and the side account will be backed by the mortgage backing the loan.

In case of a securitised loan, the decree provides that the “side account” can be held by an entity different from the issuer and that in such case, the mortgage in favour of the “side account holder” will be effective only upon full repayment of the loan. The legal implications of this provision with respect to the relationships among the borrower, the issuer, the lender or a possible third-party side account holder are, at the moment, not clear. Fitch will seek additional clarification to better understand the possible impact of such legal implications on RMBS.

### Impact on RMBS

Fitch expects that each lender will find its own way to operationally implement the renegotiation based on the features of its mortgage products. Therefore, it is currently not possible to draw any general conclusions, except that the scheme proposed by the decree would clearly alter the portfolio cash flows and create potential mismatches with the interest rate to be paid to the RMBS notes.

Depending on the way the scheme is implemented and on the amortisation features of the underlying loans, the alteration could be limited to the portfolio’s interest flows (and therefore to the transaction’s excess spread), although it could also impact the principal repayment profile of the loans, affecting in turn the redemption of the RMBS notes.

Should an RMBS issuer decide to implement the renegotiation scheme, Fitch would assess the impact on the rating of the notes by considering:

- the operational implementation of the scheme and its impact on the portfolio’s flows;
- the share of loans that can be renegotiated;
- the credit enhancement currently available to each note class;
- the current underlying collateral composition and performance;
- structural features of the deal, especially in relation to the hedging agreement the issuer has entered into.

The same approach will be followed when assigning ratings to new RMBS transactions where the issuer has decided to offer the renegotiation scheme to its borrowers.

Should the issuer decide not to offer the renegotiation option, Fitch will, in addition to its normal analysis, test transaction-specific high prepayment scenarios to take into account the possibility that the originator or other lenders could be incentivised to offer refinancing options to those borrowers eligible for renegotiation. In such instances, the transaction-specific stresses will be disclosed in the presale and new issue rating reports.

Copyright © 2008 by Fitch, Inc., Fitch Ratings Ltd. and its subsidiaries. One State Street Plaza, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. All of the information contained herein is based on information obtained from issuers, other obligors, underwriters, and other sources which Fitch believes to be reliable. Fitch does not audit or verify the truth or accuracy of any such information. As a result, the information in this report is provided "as is" without any representation or warranty of any kind. A Fitch rating is an opinion as to the creditworthiness of a security. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed, suspended, or withdrawn at anytime for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of Great Britain, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.