Senate of the Republic

VI Commission (Finance and Treasury)

Survey on the use and distribution of financial derivative instruments and of securitizations in public administrations

Hearing of the Under-Secretary to the Economy and Finance Ministry (MEF)

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Rome, 25 February 2009

Foreword

Mr. President, Honorable members of the Commission,
the use of derivatives in managing local authorities' debt has been, over the past fifteen years, the object of a considerable legislative production, on whose evolution I shall refer to later. In an early stage, these laws focused exclusively on the need to protect Government bodies that found it convenient to borrow in currencies other than theirs, from the risk of exchange.

Later, with the review of regulations on bond issues and the introduction of criteria for renegotiating local authorities' debt, the right to the use of derivatives has also been extended, this time to allow Government bodies to enact their own strategies for debt management in a more flexible and efficient manner.

As frequently emphasized also in the appropriate regulatory fora, the efficiency of debt management is measured combining two basic parameters: total cost and exposure to market and credit risks. The characteristic of flexibility can make derivatives extremely useful in pursuing the goal of efficiency; in fact, through the use of these instruments one can implement a strategy of reshaping the flows related to a liability position with the objective of either a reduction in the cost of financing, which essentially means a reduction in interest payments, or of a redefinition of the risk profiles implicit in the activity of borrowing on the market.

The first fundamental decision that the debt manager is called to make is in fact between borrowing at a fixed or a floating rate.

If the fixed rate is chosen, the borrower prefers the risk factor, giving certainty to future flows that it will pay until the contracted debt matures, which will in no way be exposed to the variability of market trends. By contrast, in normal conditions, i.e. in the presence of a positively sloped interest rate curve, setting the cost of debt with a medium to long term outlook results in a heavier burden in terms of interest expenditure. This added burden is the price for the risk reduction.

When, instead, the borrower chooses to focus on containing the cost of debt, he will opt for floating rate, which, while being exposed to the volatility of market variables, in normal conditions, allows a savings in terms of interest expenditure. This savings is, in contrast, the compensation of increased exposure to changes in interest rates.

The optimal mix between the risk and cost parameters should of course be determined at the contracting of either the credit, loan or bond issue, but such a combination will not necessarily be the best match over the debt's lifetime because of fluctuations in market variables and of the consequent changes in one's expectations. What derivatives, if used reasonably, allow the operator, in the presence of a change in one's forecasts of future interest rates, is the possibility to alter that combination during the life of the debt without incurring the cost of renegotiating the original debt, which in some cases may even be totally unworkable.

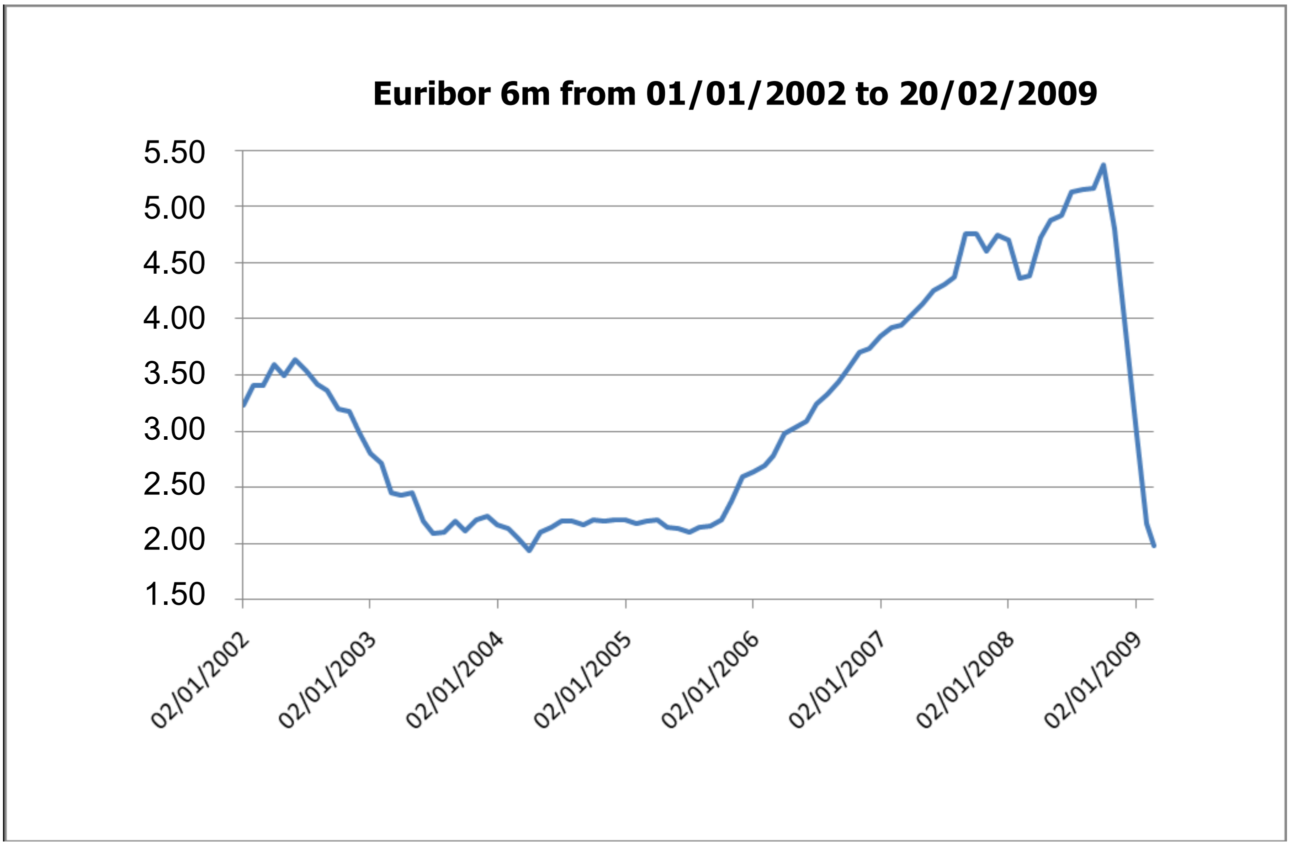
The opportunity of accessing new markets that arises from the possibility of bringing the exposure of debt to market variables (exchange rates and interest rates) to the desired level through the use of derivative instruments should also not be overlooked as a significant intent in terms of efficiency. The practical effect is that of a broadening and diversifying of the investor base with no effect on the chosen risk profile.

The norms on derivatives introduced beginning with the 2002 Budget Law were aimed at delimiting local authorities' scope of action – for Regions in fact, the provision is of the so-called "yielding" kind, whereby they can waiver at any time by a regulation of their own – through an accurate selection of derivative transactions. The rationale for this selection lies in the fact that only the simpler types of transactions are consistent with a debt management strategy aimed at protecting from exposure to financial risk or at containing the expected cost of debt. Along with the selection of transactions, the legislation also provided criteria for a prudent management of counterparty risk, typical of these instruments.

Over time, the regulatory framework for the use of derivatives by local and regional authorities has been supplemented on the basis of two sets of considerations. On the one side, during monitoring, some cases of improper use of derivatives were observed, which resulted in a taking of risk far exceeding the benefit gained in terms of cost reduction. In addition, the physiological dynamics of market developments were not always consciously evaluated by the bodies that contracted derivatives.

Therefore, a set of norms was introduced whose aim was to promote transparency on the effects of these instruments and, consequently, to promote the awareness of public administrators of the possible outcomes of the decisions taken with regard to debt management.

In other words, we have arrived, through a legislative process increasingly focused on giving responsibility to public administrators, to the definition of the obligation to integrate the individual contracts with a documentation as clear and comprehensive as possible, showing the effects of the derivative on the underlying debt, rendering the authorities capable of verifying the effectiveness of the decisions to be made. The legislator's hope is that the authorities take just this approach, not only implementing it at the conclusion of a new contract, but also during the life of present contracts, to consciously monitor the effects of market trends on the management goals set. It is precisely in the medium to long period that a debt management strategy is evaluated, beyond the compulsive manifestations of market trends of which the last year and a half have been a very significant example, with short term rates at their highest absolute levels since the euro was introduced, as is evident from the chart below.



An assessment which, by contrast, is based solely on current market data, while very significant for those engaged in derivative trading and who thus work with a short term outlook, risks distorting the information content for those who use derivatives to manage debt – therefore with a medium to long term point of view. A negative mark to market derivative value means that, based on the current interest rate curve, the flows that the operator will pay are worth more today than those it will receive until the contract expires; so, only in the case in which the operator closes the position in derivatives beforehand, would this value be paid to the other party. But if this does not happen and the position is maintained until maturity – and this is the case of those who use derivatives in a non-speculative way – the operator only owes what had been contractually agreed. The evaluation of the effectiveness of debt management through the use of derivatives, in terms of the risk and cost combination adopted, can only be made once the overall position will come to its maturity. In case the derivative increased ex-post the cost of debt, that may still be due to the fact that risk containment was privileged in view of a sound and prudent management, and this choice has resulted in a cost that represents the price of protection.

It should anyhow be emphasized that, especially in the case of a public entity, the occurrence of periods during which the derivative contract produces very expensive effects on its balance sheet, because of chance market trends, can in no way justify that the obligations deriving from the contract be questioned.

Norms

The financial ordering of local authorities presents itself today as a complex structure of norms, based on Heading V of the Constitution, updated with the changes made by Constitutional Law no. 3 of 18 October 2001.

This text, besides redrawing the regulatory and administrative profiles – respectively of the State, of Regions and of local authorities – with the new Article 119 identified the authority and scope of responsibility required to outline the financial autonomy of local authorities.

Law no. 131 of 5 June 2003, needed to coordinate the existing order with the constitutional reformation, did not provide specific rules for the implementation of Article 119, postponing this delicate coordination to a subsequent legislative act; however, in defining the general terms of the transfer of administrative functions under Article 118 of the Constitution, it established, at Article 7, Paragraph 7, that the Court of Auditors must verify the compliance of a balanced budget for municipalities, provinces, metropolitan cities and Regions, both in relation to the objectives of the Internal Stability Pact, and to the obligations deriving from Italy's partaking to the European Union; in fact, according to the text of the article, the regional sections of the Court of Auditors must "*verify, while respecting the collaborative nature of management control, the pursuit of the principle or program objectives set by state or regional laws, according to their competence, as also the sound financial management of local authorities and the functioning of internal controls*".

The local authorities' financial regulatory framework was then supplemented with the norms contained in laws and regulations now in force, which define the overall profile of autonomy of the bodies themselves.

A brief summary of how this framework is outlined follows.

For ordinary Regions Law no. 281 of 16 May 1970 is still in force, which, at article 10, defines the conditions, limitations, constraints and forms of control of borrowing transactions (loans and bonds).

The conditions of bond issues, in particular, must be adopted by the Regional Board, "*after obtaining the assent of the Interministerial Committee for Credit and Savings*".

Local authorities in the strict sense are subject, instead, to the provisions of Legislative Decree no. 267 of 18 August 2000 ("Consolidated Act on Local Authorities" – TUEL), which in Heading III defines, among other things, the conditions to resort to borrowing by the same bodies, with the obligation to cover in particular the burdens deriving from borrowing and the costs of management (Article 203);

TUEL establishes the regulatory responsibilities of directors and executives of local authorities, and their treasurers: Article 148 refers to the rules of management control of local authorities, subject to the Court of Auditors and to the related legislation, while Article 211 stipulates that "*for any damage caused to the entrusting body or third parties, the treasurer is accountable with all his own activities and assets. The treasurer is responsible for all deposits payable to the entity, however they are made*".

Article 30, Paragraph 15 of the 2003 Budget Law, which provides for the nullity of acts and contracts set up in violation of the investment constraint provided by Article 119 of the Constitution should be remembered, with regards to the question of responsibility.

Regions and local authorities, since the 1999 Budget Law (Article 28), are subject to the Internal Stability Pact under which the MEF (State General Accounting Department) is awarded the power to carry out the monitoring of expenditure and deficit values at the aggregate level for both local authorities and for Regions.

Regarding the forms of financing that resort to the market, local authorities are subject to: the discipline of Article 35 in Law no. 724 of 23 December 1994; the rules of the relevant implementation norm Ministerial Decree no. 420 of 5 July 1996, that establish detailed conditions for the issuance of bonds by local and regional authorities; the regulation of Article 41 in Law no. 448 of 28 December 2001, and its relative implementation (Ministerial Decree no. 389 of 1 December 2003).

Ministerial Decree no. 420 of 5 July 1996, that regulates the implementation of Law no. 724, in turn provides detailed rules for the issuance of bonds and for the coverage of the exchange risk of bonds issued in foreign currency.

As a matter of fact, regarding the specific regulation of bond issues, it should be noted that by well-established practice these have occurred ever more frequently within standard market programs (EMTN documentation for the euro area or Global for the USD area) and under the jurisdiction of English law.

Article 41 of the 2002 Budget Law has subsequently taken the responsibility of balancing multiple and diverse needs of public finance management:

- diversification of local finance and development of its autonomy;
- overall economy of public financing transactions;
- monitoring Government debt, both in terms of stocks and of flows,

with the intent of making Government bodies' use of instruments on the financial market more flexible and transparent, at the same time making them responsible with respect to the convenience of financial conditions and with respect to the distribution of costs over time.

Given the large number of interested parties[1], it is essential to ensure that access to financial markets occurs in an orderly manner, avoiding the overlapping of different public entities on the same market segment in a short period of time. Such cases could, in fact, lead to a crowding of issues, with a possible worsening of the individual conditions of financing.

Awareness of the importance that these issues gain in a context of an expansion of decentralized finance has led, with Article 41, to the introduction of access coordination of local authorities to capital markets by the MEF. Moreover, with the norms of Article 41, the legislator has recognized the need to increase the opportunities of recourse to a variety of funding channels, abolishing bond issuance at par to

[1] More than 8,000 municipalities, 20 Regions and the Autonomous Provinces of Trento and Bolzano with their particularities, 105 provinces and all aggregations of local authorities covered by the norm.

facilitate any subsequent tranches of the same security, and removing the requirement of the amortizing structure.

The rationale underlying the former limitation of the amortizing structure had the clear and understandable intent to avoid postponing the normally more onerous burden, that of the repayment of principal, to future financial years. In order not to ignore this principle Article 41 had ordered, in the case of the issuance of a bullet bond, a required amortization through the creation of a special fund or conclusion of a specific swap that, for the institution's budget, would make the terms of payment with the two possible structures (amortizing or bullet) equivalent.

As explained in more detail below, we have seen that the bullet issue did not, in reality, represent a determining factor in widening the investor base, nor was it sufficient to create liquidity conditions such as to give rise to a secondary market of these instruments; in contrast, the inherent complexities in setting up a fund or an amortization swap were likely to increase overall risk, and often also the total cost, of the transaction. It is for this reason that the 2009 Budget Law has reinstated the requirement for local authorities to issue only bonds with amortizing structures.

Returning to Article 41, with a view to more institutional autonomy and in a market environment that offered the opportunity, through the use of derivatives, to benefit from a general context of declining rates, the right to resort to these instruments has been extended, at first limited to foreign exchange risk coverage (compulsory) in the case of foreign currency issues. The conversion of existing liabilities into bonds or their renegotiation was also allowed, respecting the condition of reducing the financial value of the liabilities borne by the bodies.

Given the importance of improving the quality and completeness of the information as much as possible, drawing directly from the source from which the debt originates, Article 41 also established to monitor local authorities' debt.

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By virtue of the highly technical-financial contents in the provisions of Article 41, a joint decree by the Economy and Interior Ministries has been programmed, of a regulatory nature, explaining criteria and procedures for the application of the primary norm.

This regulation was written with the aim of ensuring, on the one hand, the ability to know the debt of local authorities and, on the other, the respect of the principles of transparency, economy and caution in activities that resort to the market.

With regard to the content monitoring – aimed at building a database at the Treasury Department, to be mentioned later – this has been planned on a quarterly basis, together with other requirements of data transmission.

To complete the picture, in addition to the various forms of debt, an inventory of all transactions in derivative instruments was also ordered.

It might be appropriate, at this point, to reiterate an important concept: a derivative is not a debt, but a contract governing the exchange of monetary flows that, if necessarily tied to an underlying liability – such as is the case of local authorities' debt – changes the original profile of payments.

As for the coordination of market access, given that the risk was a of simultaneous presence of Government bodies on the market – enough to worsen the conditions of funding, a minimum threshold of 100 million euros was established above which begins the obligation of prior notification. It was deemed, in fact, that deals below that value would not alter market conditions.

The provisions intended to ensure a prudent and cautious management of counterparty and market risk were laid down in Articles 2 and 3 of the Decree and are intended to enable all those transactions that provide the opportunity to benefit from favorable market conditions, but without permitting reckless risk-taking.

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As mentioned above, Article 41 allowed local authorities to place bonds with single reimbursement at maturity, in order to achieve savings in the cost of debt with respect to the placement of securities with "amortization installments" because, on the latter, the market usually requires a premium in terms of yield offered to compensate the so-called reinvestment risk of the amounts paid in principal. At bullet issue, bodies were required to pay the amounts that replicate debt amortization, into a fund managed by the intermediary according to contractually predefined criteria, enough to ensure the availability of the amount required for the entity to reimburse investors or, alternatively, to conclude an amortization swap with qualified intermediaries aimed at repaying the outstanding principal at maturity.

Swap amortization had a much more widespread use compared to the fund. However, in practice, the need to simulate the flow of amortization installments has led to highly structured transactions, with important implications in terms of credit risk, without providing considerable advantages in terms of lower costs or better distribution among the investors and therefore, with Article 62, Paragraph 2 of Decree-Law no. 112 of 25 June 2008, as amended by the 2009 Budget Law, this possibility has been permanently eliminated.

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Another important element introduced by Article 41 is represented by the provisions relating to the use of derivatives by local authorities, later governed by Ministerial Decree no. 389 of 1 December 2003, which identifies the derivative transactions which, according to current types on the market, may be concluded with the aim of giving greater solidity to the bodies' balance sheets. This above all through the explicit linkage between the real underlying liabilities and derivative transactions to cover the exchange or interest rate risk, so as to avoid unsafe so-called "synthetic" exposures that are not in direct relation with the local authority's liabilities.

Among the various types of transactions on the market, those with a low risk profile, or that even help the protection against market risks, were admitted: this has required a greater detail at the more technical level, exemplifying the range of instruments that can be used. Moreover, the concern to avoid postponing the costs of debt to future financial years has led to the exclusion of the possibility of extending the duration of the derivative beyond the expiry of the underlying liability.

Following on that same rationale, but also to avoid that the use of derivatives might in any way increase the risk profile – both market and credit – taken on in debt management, where, in letter *f)* of Article 3 of the regulation, derivative transactions that restructure existing liabilities are foreseen, it was established that it is not possible to pass the financial burden of present exposures to future periods, concentrating it near maturity.

Therefore, the types of transactions used are limited to:

- interest rate swaps, consisting of a contract between two parties that make the commitment to regularly exchange interest flows, connected to the main parameters of the financial market, in ways, times and conditions specified in the contracts themselves;
- purchase of an interest rate cap, which sets a floating rate threshold level beyond which the buyer of the cap (in this case the entity) pays a predetermined fixed rate;
- purchase of an interest rate collar, in which the buyer (in this case the entity) is guaranteed an interest rate level to be paid, varying within a minimum and maximum predetermined level;
- purchase of forward rate agreements, contracts in which two parties agree on an interest rate that the buyer of the forward agrees to pay on a set capital at a future date.

These transactions must be carried out in the so-called "plain vanilla" form, i.e. in its simplest form, without any extra features that can expose the body to additional financial risks arising from changes in interest rates; neither are derivatives containing levers or financial parameter boosters admitted, such as, for example, paying twice the Euribor rate under certain market conditions.

The use of instruments such as cap and collar was limited to their purchase, since it was deemed that these types of transactions should only be used to protect from interest rate hikes.

The presence of an amount to be settled upon completion of the transaction of a maximum of 1% of the nominal in the contract was, however, allowed, that amount in turn must not exceed the amount of debt which the transaction aimed to cover. This possibility was found to be used often in contracts awarded by medium and small Government bodies, with the aim of a limited funding rather than of a proper compensation of changed financial flows: therefore, with the provision contained in Paragraph 9 of Article 62 of Decree-Law no. 112 of 25 June 2008 – converted with amendments by Law no. 133 of 6 August 2008 and then merged into Article 3 of the 2009 Budget Law – the accounting nature of such amounts has been declared, providing that they be classified as debt for all intents and purposes, thus transposing into national law what was decided in a recent announcement by Eurostat to member countries. In fact, a swap, at inception, should be born balanced, with equal so-called pay and receive "legs" as calculated with the structure of interest rates at the time. The up-front, however, causes an initial imbalance and is, in essence, a kind of financing; so it is proper to consider it a debt.

The same purpose of limiting risk exposure, has, in addition, inspired the provision that reiterates the requirement of the appropriate credit rating of the intermediaries that are counterparties of derivative contracts, and establishes the indication of splitting among multiple counterparties the total amount of derivative transactions when they are above 100 million euros. That statement does not involve the reshaping of derivative transactions concluded before the regulation; however, for the purposes of this principle of diversification, the entity must, at the conclusion of new derivative products, take into account the exposure already gained.

Certainly, in light of recent events, the parameter was seen to be less robust than previously thought. There are other parameters that can be considered, but none of these is decisive. Therefore, rating must still be considered at least a mandatory pre-requisite.

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The perception that the regulatory framework outlined above, although quite accurate, was not applied with the required caution and awareness, led to new legislation during the preparation of the 2007 Budget Law. This law (no. 296 of 27 December 2006) introduced further legislation in regards to the use of derivatives by Regions and those entities referred to in Legislative Decree no. 267 of 18 August 2000, and has expanded the definition of borrowing contained in Article 3, Paragraph 17 of Law no. 350 of 14 December 2003, also in light of a ruling by Eurostat in September 2006, concerning the debts of the health sector, which I shall return to later.

In particular, Paragraph 736 confirms certain principles to which the authorities must comply in legislative and/or administrative activity regarding the management of their debt through derivative transactions. The recourse to the legal instrument is clearly intended to combine respect for the autonomy of local finance with the essential attention to the overall economy of transactions entered into by the entities for debt management.

The guidelines that result from the norm can be detailed as follows:

1. The goal of derivative activity must be to give more solidity to the bodies' balance sheets through the containment of the final cost of transactions, to be assessed in relation to exposure to market risks taken on with the same transactions. In other words, the conditions for the transactions must be the result of a balance between two variables: total cost and market risks.

2. There must be a match between the nominal of liabilities and of the position in derivatives that cover it. One can conclude derivatives which have as their underlying liability another derivative only if the authority needs to restructure a stance as a result of a change in the underlying amount, a case already contemplated in the newsletter of 27 June 2004 (explaining Ministerial Decree no. 389 of 1 December 2003), to which specific reference is made.
3. Containment of the credit risks assumed must be sought. In this case too, a prudent behavior already introduced into the regulation with the implementation of Article 41 of Law 448/2001 (Ministerial Decree no. 389 of 1 December 2003) is elevated to the level of a general principle. That principle, as was its regulatory premise, must be implemented by the entity's verification of the creditworthiness of counterparties with whom it enters into transactions in derivative instruments. Such counterparties must, in fact, have a sufficiently reliable rating, assigned by at least one of the major internationally recognized rating agencies (presently S&P's, Moody's and Fitch Ratings).

Paragraph 737 was introduced in order to, at least partially, remedy the weakness of the rules contained in the original text of Article 41, resulting from the absence of a sanction in case of default by the bodies addressed by the same and, to this end, introduces two new paragraphs.

Indeed, Paragraph 2-ii of Article 41 – as amended – provides that the contracting authorities, as a condition of the effectiveness of the contract, at the close of each transaction and prior to the signing of the contracts, must possess all final contractual documentation relating to each transaction and must transmit it to the Treasury Department.

In this way, it was decided to support monitoring by making the contract ineffective in case of failure of advance transmission; besides, the latter allows a cross-check with data from the quarterly communication mentioned above.

The obligation of transmission relates to contracts, supplemented by additional documentation they may call for, detailing also the underlying transactions, with the only exception of data that is not verifiable on the market when the contract is signed, which may be communicated as soon as they are available (just as an example, one can postpone the communication of the value of an interest rate that is determined after the closure of the transaction already transmitted).

Paragraph 2-iii of Article 41 of Law 448/2001 transformed into an obligation the existing right of the Ministry to notify the Court of Auditors of any transactions entered into that breach existing legislation, for the adoption of measures of its competence.[2] Moreover, the Treasury Department retains the power of informing at the same time the State General Accounting Department to possibly begin audit controls.

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[2] This notification occurred, to date, in 16 out of 250 contracts signed and communicated since 1 January 2007.

In 2008 a new series of legislative initiatives was necessary, to precisely adapt rules, whose purpose was to promote greater transparency about the conditions and increased awareness of the effects of derivative contracts on underlying debt. The first attempt at this was Article 1 of Law no. 244 of 24 December 2007 (2008 Budget Law), Paragraphs 381 to 384, which introduced in fact a general requirement of transparency in the drawing up of contracts of derivative financial instruments and of awareness about their potential impact on the institution's balance sheets.

Regarding transparency, obligation has been provided for the contracting parties to supplement contracts with documentation containing information – to be defined in later regulations – on the financial conditions prevailing at the time of the conclusion (Paragraph 382); with regards to awareness, instead, administrators of bodies are obliged to demonstrate their knowledge of the characteristics and risks of the transactions actually carried out and to quantify the costs and commitments arising from such contracts with a special note attached to the budget (Paragraph 383). Both norms have been given a penalty consisting of the nullity of the contracts in the event of a breach (Paragraph 384).

The logic underlying these three provisions is quite clear: the use of derivatives must be, within the sphere of public activity, inescapably part of a mindful strategy of debt management. To be able to decide clearly on the opportunity whether or not to conclude a contract, a public administrator must have a clear and accurate view of the characteristics of the product in use, of the risks associated with the influence that the parameters of the market have on the components of the product itself and therefore, must be certain of the effects on the debt positions to which the product refers and even more, in general, on the effects that the strategy has on the balance sheets. The same awareness has to be, then, maintained during the life of the contract, in order to be able to verify the effectiveness of the strategy with changes in market conditions.

The regulatory content of Paragraph 381 and following has been taken up, expanded and harmonized during 2008 with a set of rules on local authorities' debt, and the new text merged into Article 62 of Decree-Law no. 112 of 25 June 2008, entitled "Containment of the use of derivatives and borrowing by Regions and local authorities". The final text now in force is the result, however, of a number of changes, applied first before its conversion, and then with Article 3, Paragraph 1 of Law no. 203 of 22 December 2008 (2009 Budget Law).

The original text of Article 62 poses a twofold objective:

1. amend the law relating to local authorities' borrowing, *(a)* by repealing the provision that allows the issuance of securities with single reimbursement at maturity (so-called "bullet") to return to the previous situation where an amortization schedule for principal and interest was mandatory also for bond issues, and *(b)* limiting the maximum duration of amortization schedules (both of issues and of other debt instruments) to thirty years;
2. temporarily block the signing of new contracts for derivative financial instruments, pending the new regulations defining the types of transactions allowed for the debt management of local authorities, and the criteria and conditions for their conclusion. The restriction, awaiting the

implementing regulation, is anyhow operational for one year from the entry date of the Decree-Law (26 June 2008).

In its conversion, in August 2008, the text of Article 62 was revised and reorganized, primarily from a lexical viewpoint, with a more detailed arrangement of rules contained in the various paragraphs. The main innovation, compared to the text prepared by the Government, was the inclusion of the list of transactions that constitute borrowing according to Article 3, Paragraph 17 of Law no. 350/2003 (2004 Budget Law), to which, premiums received at the conclusion of derivative products (so-called "upfront") were added.

Finally, the last amendment to Article 62 was finalized by Article 3 of Law no. 203 of 23 December 2008 (2009 Budget Law) whose text is characterized by a more fluid and clear articulation of the rules, also because of the fact that the paragraphs containing provisions on debt, of a permanent nature, were separated from those that govern activities in derivatives. With regards only to content, Article 62, as amended by the 2009 Budget Law, confirmed the block of transactions in derivatives, already provided by the original text of the decree-law, for the minimum period of one year, allowing though – unlike the earlier version – the restructuring of existing derivatives that, by effect of changes in the underlying liabilities, no longer represent effective hedges; it also confirmed the ban for bodies to issue bullet bonds and the maximum duration of thirty years for all forms of debt.

In addition, the norm established – thus restoring and expanding the content of Paragraphs 381 and following of the 2008 Budget Law – that, on pain of nullity of the contract, derivative transactions, concluded after its entry into force, must provide specific information within the contract, as well as certification by the public administrator of having obtained full understanding of the nature of the instrument and its effects on the balance sheet. The nullity of the contract may be invoked only by the bodies.

The purely technical provisions relevant to the necessary information, to be written in Italian in the contract, have been entrusted to one or more subsequent regulations of the Ministry of Economy, to be adopted after consulting the Bank of Italy and Consob, likewise, rules must define the types of derivative transactions allowed for local authorities, to enable legislators to make a possible consideration with respect to the indications provided in 2003 with the previous regulation. Finally, provision was made for the monthly transmission to the competent offices of the Court of Auditors, by the Treasury Department, of all documents received from 1 January 2009, concerning the derivative contracts of local authorities.

It is clear that this last piece of legislation has maintained the logic underlying the requirements of the 2008 Budget Law, including the related aid of the penalty for a breach of the rule, with the added support of the rigorous control of the directors' activity by the Court of Auditors, which is no longer within the random checks on local authorities, but is of a more "concentrated" nature on that specific market transaction.

MiFID

Derivative contracts fall under the category of “financial instruments” provided for by Article 1, Paragraph 2 of Legislative Decree no. 58/98 and subsequent supplements and modifications. Consequently, placement and trading of derivative contracts, whether they are treated on a regulated market, or whether they are treated outside of those markets (so-called “over the counter” contracts – OTC), set up an investment service and, therefore, are subject to a reservation of law and regulated by European guidelines and the related national rules of implementation.

As is known, this discipline has been recently reviewed in the implementation of MiFID. The implementation of the Directive has led to a revision of the concept of “financial instrument”. The new definition included in the cited Article 1 of the TUF (Consolidated Act on Finance) makes a word for word copy of the EU Directive. All types of derivative financial instruments are listed under “financial instruments”. Consequently, trading of derivative financial instruments is an investment service reserved to intermediaries qualified in Italy or in other European Union countries.

MiFID has fully harmonized EU rules on the conduct of investment services. The space left for national legislators to integrate the EU framework is nearly none; this directive is in fact called a directive of maximum harmonization. Following the completion of the Financial Services Action Plan (one of the backbones of the so-called Lisbon strategy) one can now say that, with reference to financial markets, regulation is largely in the hands of the European Community legislator. The supervisory set-up remains decentralized and delegated to the decisions of the national authorities.

With respect to the articulate and complex system of rules that constitute the framework on investment services, it is important, to what we are presently discussing, to address the issue of standards of behavior, that must be kept by authorized intermediaries. The obligations of intermediaries also identify the extent of their liability for signing agreements that are not balanced or harmful to customers.

The main principle, already present in the rules which existed prior to the implementation of MiFID, is the requirement for the broker to always act with diligence, honesty and transparency, to better serve the interests of clients and for the integrity of markets.

The Directive separates the rules of conduct and the information obligations that are required of intermediaries during the provision of investment services primarily as a function of the type of client, and that differentiation – as we shall see – also detects if it is a local authority that is a client of the intermediary. The level of client protection is thus graded from the bottom upwards, depending on whether it is identified in the European terminology as “eligible counterparty”, “professional client” or “retail client”.

In the case of transactions with eligible counterparties, the financial intermediaries, that the EU directive calls “investment firms”, are not obliged to observe any of the information and conduct requirements, except those relating to conflicts of interest. In this case, the European legislator has recognized the substantial position of parity between the two parties and retained it not necessary to intervene with regulations to protect the structurally "weaker" party. It's the same directive that defines a list of subjects that member States are obliged to classify as eligible counterparties and the Italian State is the only Italian public entity that is part of that list. Member States then have the power to classify other subjects as eligible counterparties. The MiFID implementation decree has decided not to include additional Italian public subjects among eligible counterparties.

In the case of professional clients there are important additional requirements added to those required in dealing with eligible counterparties. In particular, the following must be respected: the obligation to serve the client's interests to the best of their ability; the general principles of correct conduct and clarity of information; the obligation to acquire information on the client to assess the "adequacy" or "pertinence" to the service to be performed; the obligation to perform transactions on the most favorable terms for the client (best execution).

It must be stated that the level of protection granted to professional clients is significantly less compared to that granted to retail clients. One recognizes also in this case that experience and know-how in the financial field reduces the need to protect the professional client.

Moreover, from this perspective, MiFID considerably renews the previous system, since it places the burden on the part of the intermediary to properly assess the client's knowledge, experience and ability to understand the risks if they ask to be treated as a professional investor. In the old regime a client's simple "self-certification" was enough, now instead, one needs an assessment by the intermediary based on objective elements (to have carried out transactions of significant size and frequency with respect to the market in question, to have a financial wealth of at least 500,000 euros, to work or have worked in the financial sector).

In light of the foregoing, the classification of a subject among professional clients is a particularly delicate passage. Legislative Decree 164/2007, which implemented the Directive, amended Article 6 of the TUF attributing the regulatory powers for the identification of professional clients. In the case of public professional clients, the legislator, also taking into account the profiles of public finance that are affected by the classification, provided that they be identified by rule of the Minister of Economy and Finance, issued after consulting Consob and the Bank of Italy. The Ministry has prepared a draft decree and submitted it to public consultation. The procedure for the enactment of the regulation is nearing completion.

MiFID professional clients are divided into two subcategories: real and potential, the latter being subjects that may apply to be treated as professionals. This sub-division, as we shall see, has important implications on the scope of the intermediary's responsibility.

MiFID contains in Annex II, the subjects that should be regarded as professional clients by right: among these are regional governments. The draft decree prepared by the Ministry limits itself to the implementation of this provision, by classifying Regions as professional clients by right. No other public entities are added. In case a broker intends to negotiate a financial derivative with a Region, it must inform the legal representative that it will be treated as a professional client, unless the Region requests treatment as a retail client. It is important to underline this possibility for customers to request a system of greater protection. It is provided for by the Directive for eligible counterparties and for professional clients by right, and has possibly significant implications on the degree of liability of those responsible for the financial management of Regions. One must also keep in mind that Regions could seek treatment as retail clients only for certain specific financial products or services, understandably for the complex ones such as, precisely, derivative financial instruments.

The second part of Annex II of the Directive regards clients that may be treated as professionals. The procedure in this case includes an assessment by the investment firm of the client's skills, knowledge and experience. The broker must take all possible reasonable steps to ensure that the client is able to make their own investment decisions and to understand the risks involved. It is precisely this burden of assessment that significantly modifies the level of responsibility of the investment firm compared to when it treats with a professional client by right. The burden of assessment is also the most significant innovation of the intermediary's responsibility with respect to the organization in force in Italy before the implementation of the EU directive, which – as already mentioned – only required a declaration by the client on the possession of the necessary skills to implement the less protective regime reserved for qualified operators.

The draft regulation prepared by the Ministry of Economy and Finance, and submitted to public consultation, identifies first of all the parameters that can enable public entities to seek treatment as professional clients. The business turnover parameter indicated in the Directive has changed, requiring a threshold level of revenue exceeding 40 million euros per year. Secondly, the decree introduces a quantitative parameter that ensures that the public body asking to be treated as a professional client operates significantly and steadily on the financial market; indeed, it is stated that the public entity must have carried out financial transactions of a total nominal or notional value of more than 100 million euros in the year preceding the conclusion of the contract. Finally, it requires that the financial management personnel are qualified.

Data[3]

Together with the monitoring of debt, which developed efficiently, the flow of information relating to transactions in derivatives was, however, less significant in the past, and this has resulted in the adoption

[3] The source of the data provided is the result of monitoring at the Treasury Department, which is based on information provided by the entities and photographs the situation at 31 December 2008.

in the 2007 Budget Law of the measures already mentioned, regarding the nullity of contracts concluded without prior notification to the Treasury Department.

This measure has resulted in a significant increase in the flow of information relating to these contracts as early as the end of 2006, once it was known that the requirement would take effect from 1 January the following year.

Given the technical complexity of derivative transactions, the detailed analysis of each contract normally requires a certain expenditure of resources and time. However, in some cases, the failure to make contract terms meet with the rules may be evident even with a quick reading made upon receipt of the anticipated communication. When the case arised, the Office responsible for monitoring informally reported the obvious irregularity to the institution, which, in most cases, declined to complete the transaction. We can therefore conclude that the introduction of the rules contained in the 2007 Budget Law has produced positive effects not only with regard to the detection of the trend, but also in terms of increased awareness on the part of some bodies, which have thus avoided concluding irregular transactions.

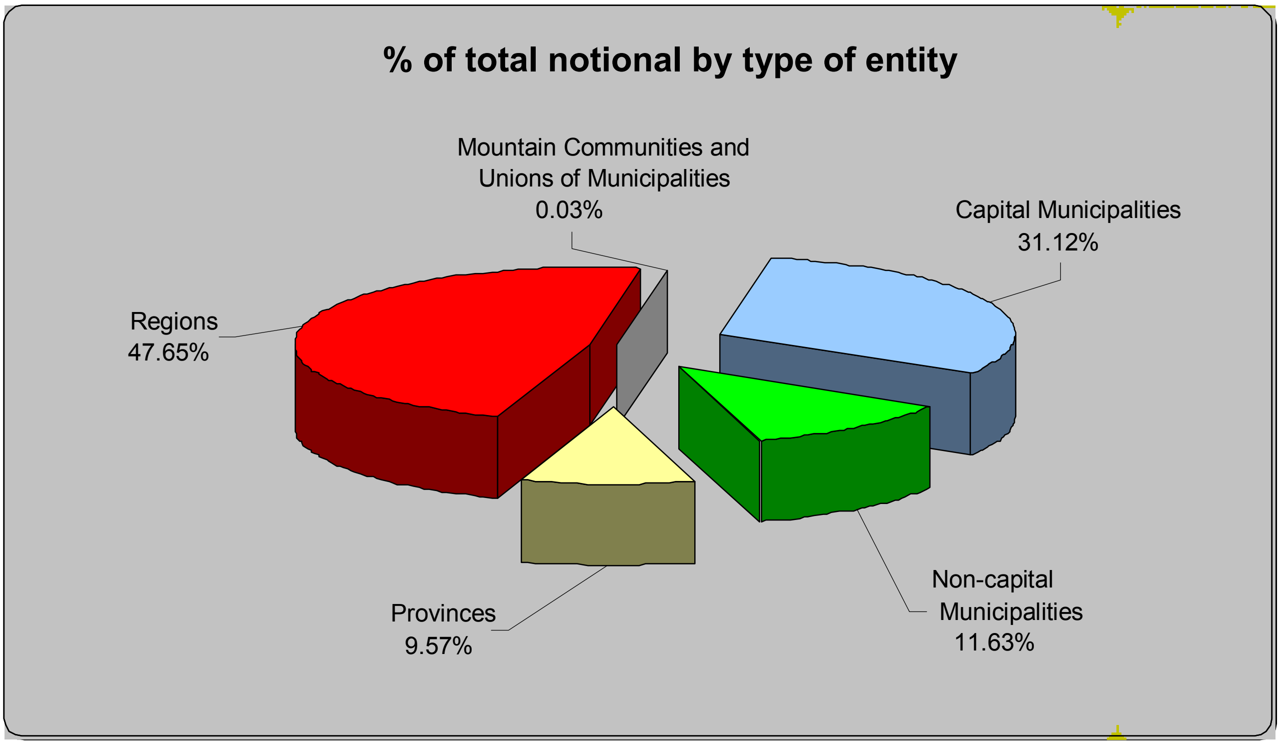
Regarding the quantitative aspects of the trend, according to data reported by local authorities affected by the monitoring obligations pursuant to Article 41 of Law 448/2001 – obligations from which municipal enterprises are still excluded, since they are outside the scope of public administration – as reported in late December 2008: i) about 600 among Regions, provinces, municipalities and mountain communities had outstanding derivative transactions in late December 2008; ii) their total notional amounts to nearly 35.5 billion euros for more than 1,000 contracts.

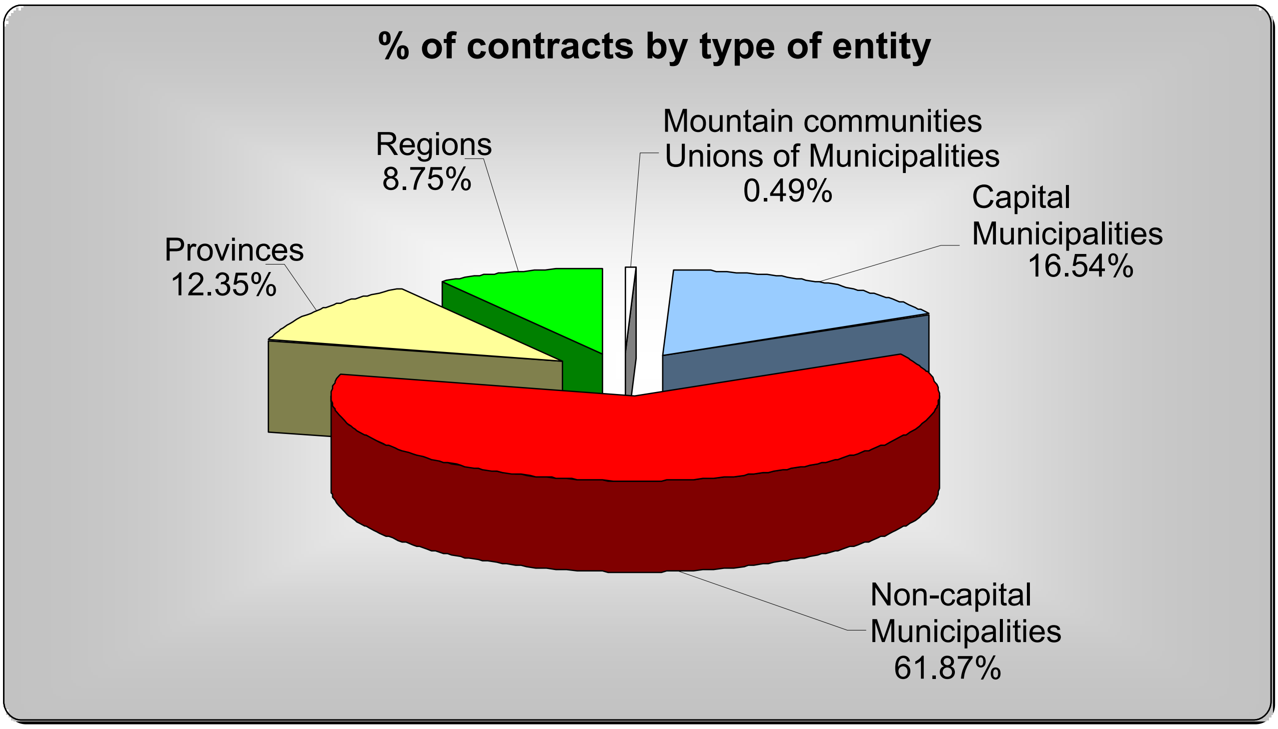
The breakdown by number of entities involved sees – as is natural – a large prevalence of municipalities, both capital (7.6%) and non-capital (81.6%), followed by provinces (7.1%) and Regions (3 %), with a residual component of mountain communities (0.7%).

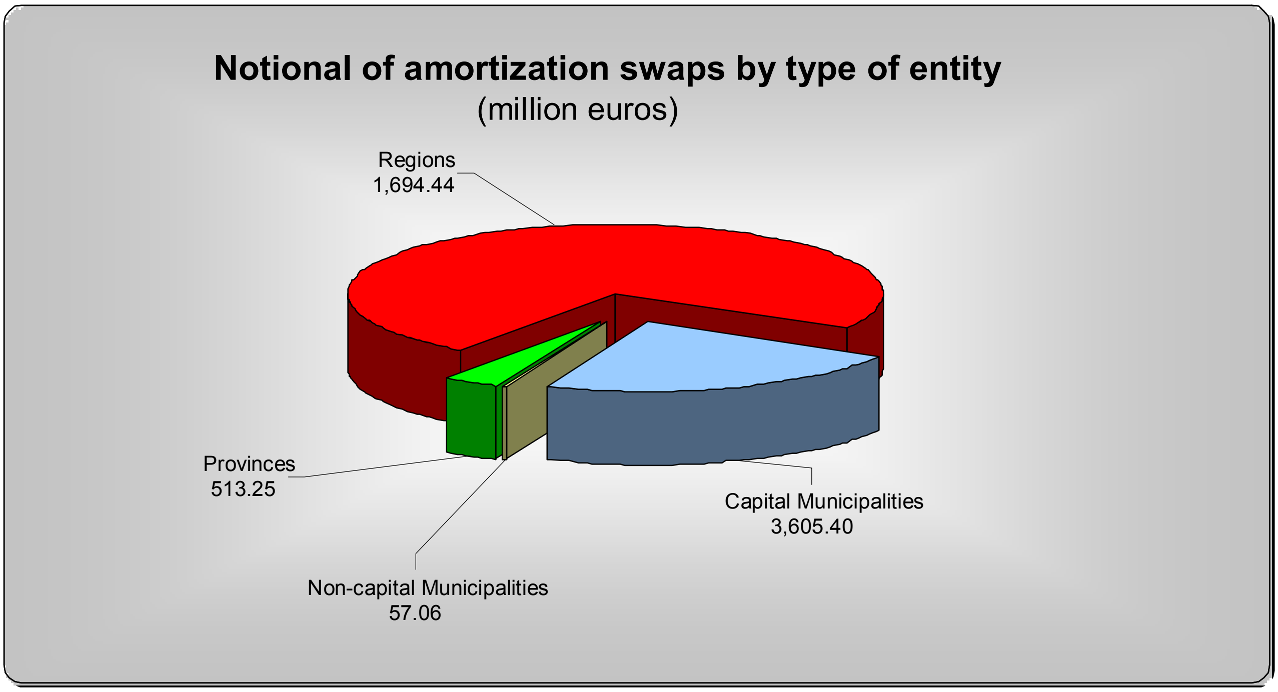
When analyzing the trend from the perspective of the total notional amounts of contracts entered into by the categories of authorities, Regions are characterized as the most active with on the whole about 16.9 billion euros contracted (47.6% of the total), followed by municipalities that are provincial capitals with almost 11 billion euros (31.1%), demonstrating that almost 80% of the volume observed refers to a small number of bodies (18 Regions and around fifty capitals). This is followed by provinces and non-capital municipalities, with respectively 3.4 and 4.1 billion euros (together approximately 21.2% of the total) and finally a small residual amount related to mountain communities and unions of municipalities (0.1%).

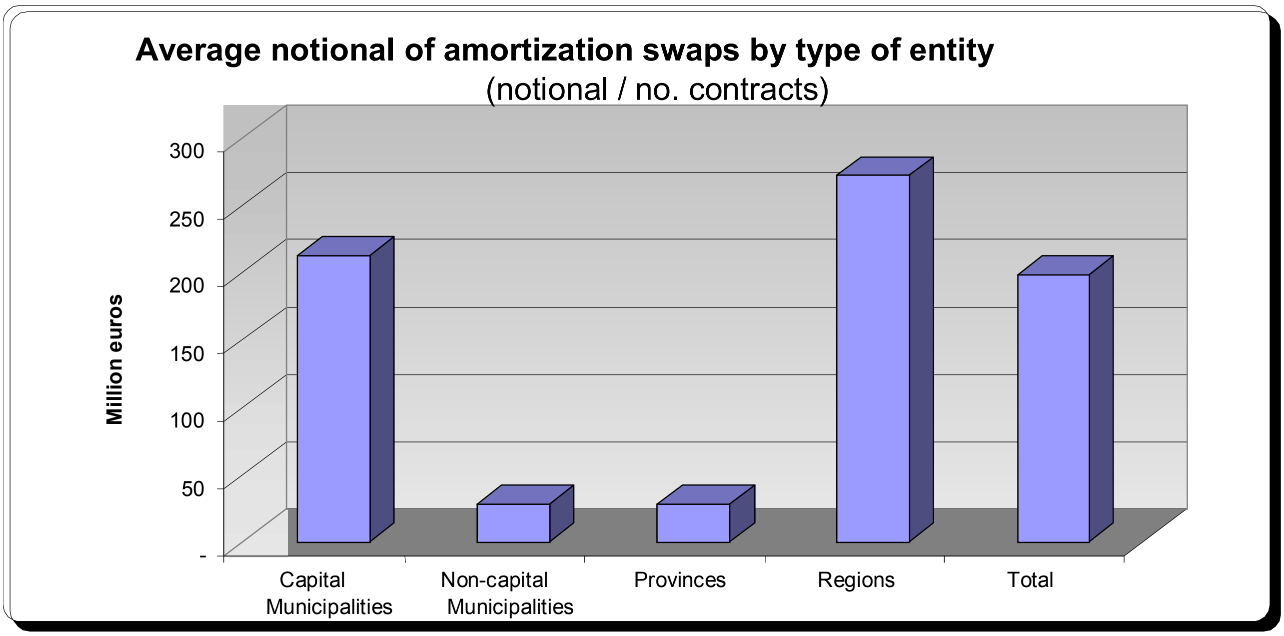
Furthermore, 59.5% of the total notional involving derivatives was concluded with foreign counterparties, while the remaining 40.5% relates to transactions with Italian banks or Italian subsidiaries of foreign banks (still subject to national regulatory supervision). In this regard, then, it is noted that the foreign counterparties surveyed are less than twenty and that the top ten still represent over 90% of the reference notional amounts reported, confirming a high level of specialization required of the intermediaries and of the resulting concentration of this market segment.

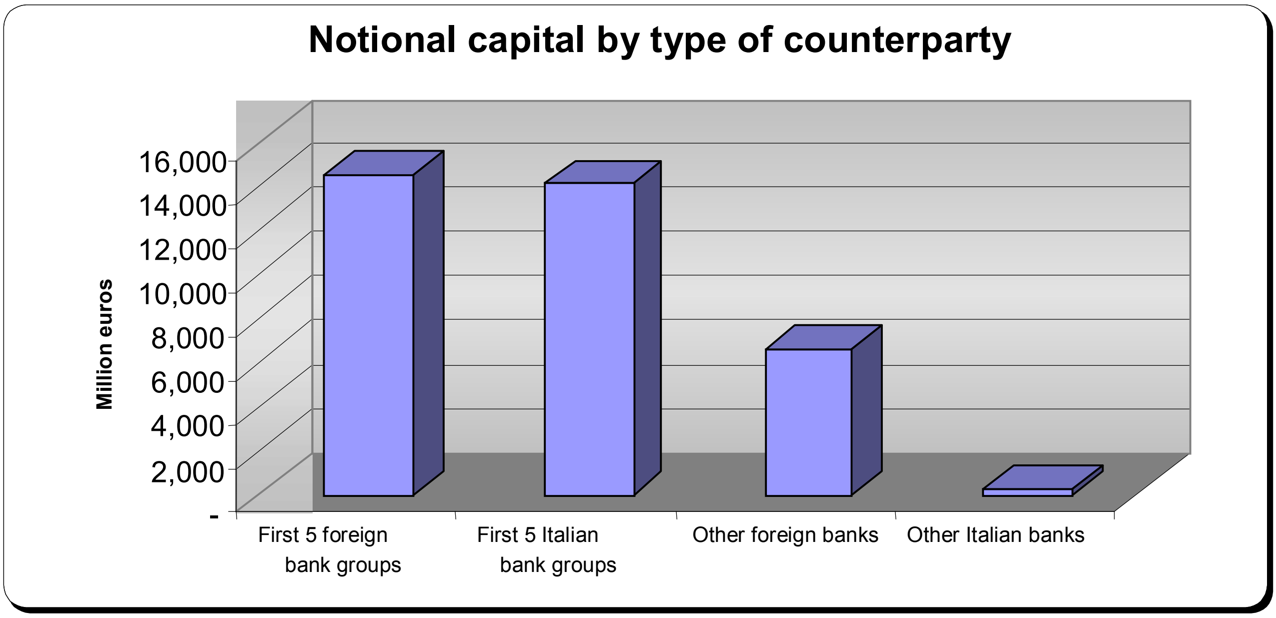
Data as of 31 December 2008

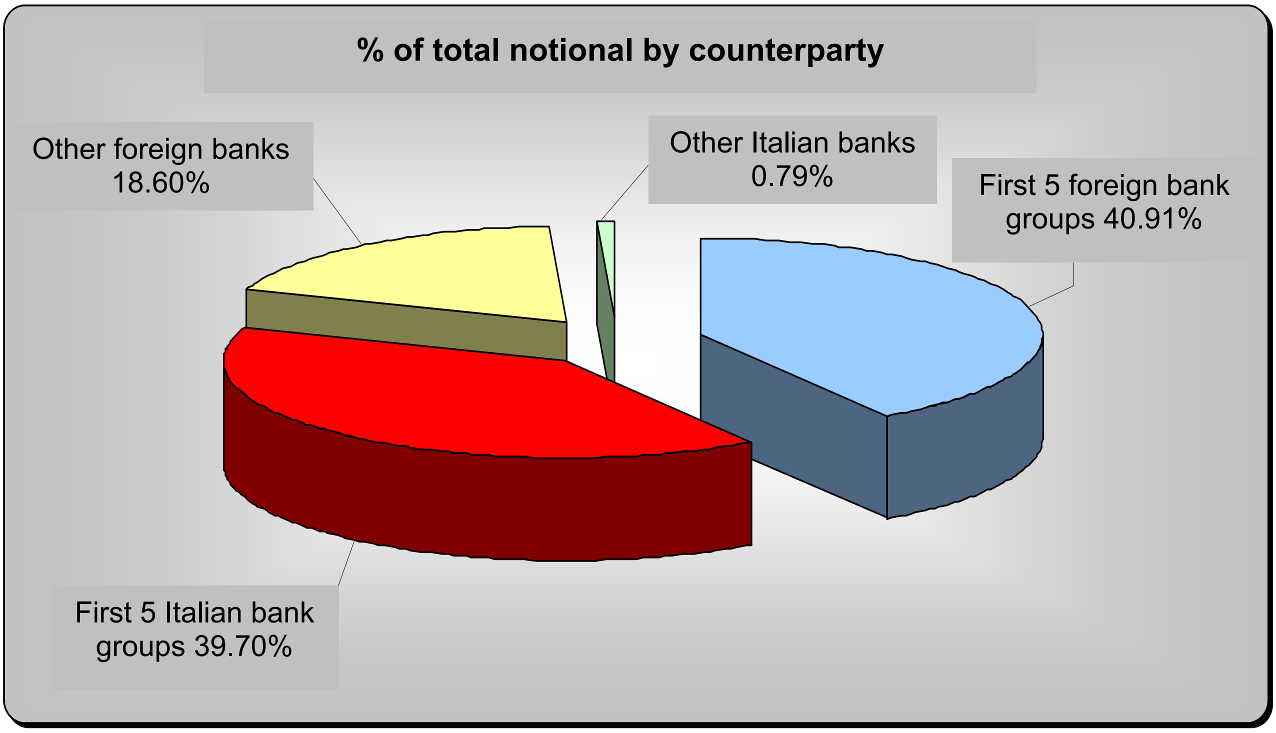


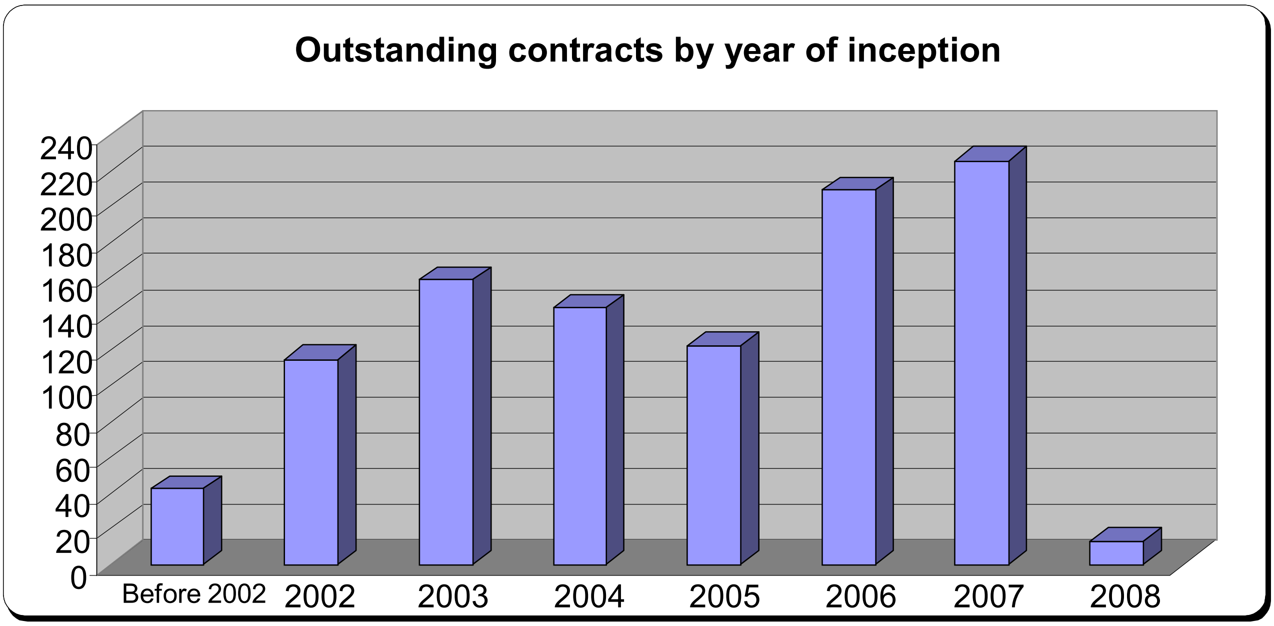



Notional of amortization swaps by type of entity
(million euros)
Regions
1,694.44
Provinces
513.25
Capital Municipalities
3,605.40
Non-capital Municipalities
57.06


Average notional of amortization swaps by type of entity
(notional / no. contracts)
Million euros
300
250
200
150
100
50
-
Capital Municipalities
Non-capital Municipalities
Provinces
Regions
Total


Notional capital by type of counterparty
Million euros
16,000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
-
First 5 foreign bank groups
First 5 Italian bank groups
Other foreign banks
Other Italian banks


% of total notional by counterparty
Other foreign banks 18.60%
Other Italian banks 0.79%
First 5 foreign bank groups 40.91%
First 5 Italian bank groups 39.70%



Analysis of average notional by type of entity		
Type of entity	**Average notional per contract**	**Average notional per entity**
Mountain Communities	2,660,534.28	3,547,379.03
Capital Municipalities	64,899,014.96	239,844,185.71
Non-capital Municipalities	6,483,460.91	8,398,128.59
Provinces	26,711,458.91	78,891,983.29
Regions	187,681,313.81	938,406,569.07
Unions of Municipalities	1,020,767.46	1,020,767.46
Total average notional	**34,486,040.96**	**58,889,784.23**

Securitizations

The technique of securitization has experienced a period of great development and deployment since the late 90s, allowing the rapid large-scale sale of certain assets, whose intrinsic profitability is made a guarantee of appropriate structured bond instruments – ABS (Asset Backed Securities). The better the quality of those assets, the more solid will the title be considered and this should be reflected in the bond's credit rating. What, however, occurred in recent years is that in several cases, the AAA rating was assigned, by the major credit rating agencies, to ABS securities and other structured products, collateralized, at least in part, by poorly performing assets, such as, for example, American sub-prime mortgages. The implosion of the US housing market thus began in 2007 to undermine confidence in the integrity of these structured products, and the crisis spread in such a wide and indiscriminate manner that all segments of the securitization market virtually collapsed, regardless of the quality of individual ABS issues.

For this type of financial instrument, as well as for others, it is not thus the instrument itself to be problematic, but rather the imperfect knowledge and assessment of the characteristics that distinguish it on the part of all those who deal with it, each one in their role on the market.

Securitizations carried out in recent years by Government bodies, particularly those implemented under the coordination of the MEF (relating to real estate and credit assets of various public bodies), as well as having contributed at least in part to the reduction of public debt, have also made it possible to improve the knowledge of capital possessed and, consequently, to work more effectively towards its exploitation. For example, the ability to collect contributory credits by social security funds was greatly increased as a result of securitizations.

One must not ignore that the only securitization transaction among the many carried out under the leadership of the MEF that presented critical issues was SCIP2; it must be stated that the reasons for these problems are due to legislative action following the completion of the transaction, which first produced a block on property sales, then a loss of value, and finally, with the onset of the crisis in the property sector, a significant slowdown of the process of property sales.

Other securitizations, however, were the focus of recent public opinion, since they were used by public health authorities to recover sums due for the provision of goods and services. They are, therefore, securitizations sponsored and implemented by private entities, which had as underlying assets credits to Regions and/or local health or hospital authorities, whose terms of payment had been modified through settlement agreements entered into with such public entities.

The significance of the trend, while it has attracted the attention of the European statistical bodies leading to an increase in public debt according to Maastricht criteria, it has also highlighted in some Regions, a problem of capability and efficiency in delivering goods and services to the health care sector and in related payments, allowing the central Government to intervene with appropriate re-entry plans, in order to bring the management of the health care service to an efficient reorganization of services and to a correct accounting in the balance sheets.

Therefore, in this case too, it is not the type of transaction to cause problems, but its use in avoiding to deal with deeper and systemic problems, perhaps without fully mastering the more technical aspects.

At this point, a parenthesis about the rules of Eurostat's accounting classification of such transactions is required.

It is well known that in 2002 European statistical authorities set the criteria to determine whether or not transfers made through securitization were to be considered real sales of assets. On that occasion some basic rules were established:

- There must be a genuine transfer of risk from the grantor to the firm issuing the securitization, therefore ABS bond issues must not be backed by collateral
- The amount received immediately at the sale must be at least 85% of the market value of the assets yielded
- Securitization of future revenues is seen as a monetary anticipation by the market and thus a debt of the granting administration.

Between 2005 and 2006, Eurostat reconsidered the rules of securitization accounting, considering further study on the nature of such transactions necessary, despite that the decision taken in July 2002 had already set out the registration rules mentioned above, duly incorporated in the compilation of statistics on public finance.

Following the work of a special task force and the later consultation of the Committee for Monetary, Financial and Balance of Payments statistics (CMFB), a profound revision of the classification principles of securitizations emerged, with important implications for deficit and debt parameters monitored under the procedure to control excessive deficit laid down in the Maastricht Treaty.

Thus, in March 2007, statistical experts have adopted a series of decisions that, while not involving a backwards reclassification of transactions already registered under the previous rules, have seriously affected the possibility of resorting to this technique of asset transfer by the public administration. The new rules are summarized as follows:

- Securitization of tax credits, or other similar credits in the national accounts system (such as contributory credits), is regarded as the granting of a loan to the Government, and no longer as a sale of assets. This is according to the observation that the State may always, directly or indirectly, maintain control over the tax or contributory flow through the measures of governmental intervention; for this the sale of these assets can not be considered unconditional and definitive.

- When a securitization contains a provision for the payment of a deferred price, it must be regarded as a form of borrowing, because, even in cases where the risks of the sale of the assets were actually transferred to the buyer, it is not so for extra profits, that return to the original owner of the assets.

- If there are terms of substitution of assets sold in bulk through securitization, unless such substitution is done to rectify marginal material errors, there is no real sale and the proceeds of the securitization are a form of borrowing.

- If the Government intervenes to compensate ex post the issuer of a securitization, in any form, the transaction should be reclassified as debt in the year in which the compensation takes place.

As can be seen, from 2007, any securitization performed according to the standards of this market would have increased the debt according to European rules.

It must be stated that, beyond the issues of accounting, securitizations conducted in the past have allowed the Governments involved to take a more accurate census of assets held and also, in some cases, to increase their profitability.

SUMMARY TABLE OF SECURITIZATION TRANSACTIONS				
		REDUCTION EFFECT:		
YEAR	**TRANSACTIONS**	**DEBT**	**NET BORROWING**	**PROCEEDS**
1999	*INPS 1*	0	0	4,647,055,000
2000	*INAIL*	0	0	1,348,000,000
2001	*INPS2*	1,190,043,000	0	1,706,500,000
	LOTTO	0	0	2,996,633,511
	SCIP 1	0	0	1,994,448,582
2002	*INPS 3*	1,959,070,705	0	2,999,070,705
	SCIP 2	6,596,403,486	6,596,403,486	6,596,403,486
2003	*INPS 4*	2,998,842,433	0	2,998,842,433
	SCIC PERSONAL LOANS	4,227,749,076		4,227,749,076
	SCIC LOCAL AUTHORITIES	538,939,500	0	538,939,500
2004	*SCIC RESEARCH*	1,242,950,988	0	1,242,950,988
	INPS 5	3,548,154,915	0	3,548,154,915
2005	*INPS 6*	4,999,211,001	0	4,999,211,001
Grand Total		27,301,365,104	6,596,403,486	39,843,959,197

The Proceeds column expresses the revenues obtained through securitizations, which do not necessarily coincide with the effect of reducing the debt and the deficit (net borrowing) according to Maastricht criteria. These effects are highlighted in the respective columns and reflect the accounting rules dictated by Eurostat in July 2002.

The PERSONAL LOANS, LOCAL AUTHORITIES and RESEARCH transactions specified in the table were all performed with the same issuer: SCIC. The first are two distinct parts of the same transaction of 2003 and regard credits transferred from INPDAP, while that of 2004 (Research) regards credits towards the research and technological innovation sector transferred from the Ministries of University and Research and of Productive Activities.

Region	Initial debt stock	Debt stock 31/12/2005	Debt stock 31/12/2006	Debt stock 31/12/2007	Debt stock 31/12/2008	Settlement agreement
2003						
Sicilia	785,384,947	523,589,965	436,324,971	349,059,976		October 2002
2004						
Lazio	568,048,637	397,634,046	284,024,318	170,414,591		March 2004
Lazio	214,172,848	149,920,994	107,086,424	64,251,854		June 2004
2005						
Lazio	115,552,350	92,441,880	69,331,410	46,220,940		October 2004
Abruzzo	419,148,776	398,191,337	356,276,460	314,361,582		2004
Lazio	671,147,535	559,289,613	335,573,768	111,857,923		December 2004
Campania	2,570,662,351	2,570,662,351	1,285,331,175			2005
Campania	397,200,004		397,200,004	369,717,980		2005
2006						
Abruzzo	448,563,076	448,563,076	433,610,974	403,706,769	373,802,564	December 2005
Lazio	510,095,300	510,095,300	408,076,240	306,057,181		October 2005
Lazio	1,202,314,298		1,202,314,298	1,021,967,154		March 2006
Lazio	820,260,195		820,260,195	738,234,175		August 2006
Lazio	248,692,020		248,692,020	223,822,818		April 2006
2007						
Abruzzo	227,108,147		227,108,147	211,967,604	196,827,061	4 December 2006
Abruzzo	166,765,743		166,765,743	155,648,026	144,530,310	4 December 2006
Abruzzo	137,262,025		137,262,025	45,754,008		4 December 2006
Campania	898,170,837		898,170,837	873,824,698	842,616,673	March 2007
Campania	3,451,670,256		3,451,670,256	3,358,205,106	3,238,269,210	March 2007
Sicilia	596,804,776		596,804,776	533,129,456		March 2007
Total Securitizations	**14,449,024,121**	**5,650,388,561**	**11,861,884,040**	**9,298,201,842**	**4,796,045,818**	
Total transfers not guaranteed (by settlement agreements)	1,705,610,011	473,319,853	1,389,431,294	1,319,999,436	709,166,411	
Total health sector debts	**16,154,634,132**	**6,123,708,414**	**13,251,315,334**	**10,618,201,278**	**5,505,212,229**	

DERIVATIVES AND THE CRISIS

The term “derivatives” denotes a very broad class of financial instruments characterized by the fact of existing only in function of other instruments that constitute the underlying premise.

This includes both quite simple instruments, such as interest rate or currency swaps, and others that are very complex. The first (swaps) are normally used to synthetically transform, through an agreement in which the two parties exchange cash flows, a liability from a fixed to a floating rate or vice versa, or to change the payment of a liability from one currency to another (e.g. from dollars to euros).

Even the commonly used financial market options are derivatives, which have different degrees of complexity.

However, the derivatives that have created the current crisis are very complex instruments, which are characterized not only by complicated structuring mechanisms, but also by so-called financial leverage components that amplify the effects under certain circumstances, making them difficult to fully understand and master.

Just as an example, some synthetic securities, called CDOs (Collateralized Debt Obligations), were widely distributed in the past few years, built as collections of different instruments, whose only common characteristic was having received the same credit rating by the agencies. By way of mere example, these containers could include:

- Securities resulting from securitizations of real estate loans, which were in themselves already structured, as the repayment of principal and interest depended on the solvency of borrowers, often different in terms of solvency;
- Securities resulting from securitizations of credits, these too not always homogeneous in terms of the solvency of debtors;
- Bonds of private companies (corporate).

Moreover, often, the yield on these composite instruments was further pegged to the performance of certain stock indices, or bound by a set of terms and options which would modify the structure at the occurrence of certain events on the financial market, often with multiplying factors that greatly amplified the effects when the conditions to exercise the options came into being.

The spread of these instruments produced, primarily as a result of the US housing market crisis, the explosive trend of activating these clauses, which made a huge number of financial assets unmanageable and difficult to evaluate.

It is not these derivatives that the law 448/2001 (2002 Budget Law) allows Italian local authorities to use, moreover within clear limits and outlined by later regulation (Ministerial Decree no. 389 of 2003). The need to give local authorities a little more management flexibility arose, at the time, from the need to regulate a situation that, in the absence of a rule that expressly prohibited it, had seen a disorderly swelling of certain activity in this field, especially by some Regions. Moreover, the introduction of certain kinds of derivatives was within an opening-up to the restructuring of existing liabilities, in order to allow bodies not to be bound to pay very high fixed-rate contracts signed in previous years and benefit from falling interest rates that occurred with the introduction of the euro in 1999.

It is also true that local authorities were not always able to make good use of this possibility, and sometimes, even with the advice of the banks structuring the transactions, they have evaded existing rules or have not carefully assessed long-term effects. Precisely for this, first with the Decree-Law 112/2008 and then with the 2009 Budget Law, the entire subject was reorganized and derivative activity has been blocked, and will resume only when a new and more detailed regulation will be adopted.

To these considerations, one must add that the 2008 financial crisis produced such negative effects on the functioning of the interbank market that also normal instruments, like fixed to floating interest rate swaps, generated unexpected costs, with Euribor at very high levels for many months, quite unusual and far from the monetary rates to which it had normally been connected in the past. Now, fortunately, the latter condition is being reabsorbed.

Accounting of Interest Rate Swap (IRS) transactions in local authorities' balance sheets

Interest Rate Swap transactions require the following accounting entries:
a) accounting of the liquidity premium (anticipation of interest – up-front);
b) accounting of net positive flows and of net negative flows.

a) The liquidity premium, determined on the basis of a present rendering of hypothetical savings for the entire duration of the transaction, is an extraordinary income for the entity, deemed by many an atypical form of borrowing, to be accounted for in the balance sheet in Capital Income (Heading 4 of Income both for Regions and for local authorities). This guideline has been expressed repeatedly by the Court of Auditors and by the Local Finance Observatory (Accounting Standard no. 3, Item no. 47). It follows that the up-front demands the respect of the same conditions and limitations established for any form of recourse to borrowing, including the prohibition of using it to finance current expenditure (Article 119 of the Constitution).

b) The net positive and negative flows arise from differentials in interest rates and are accounted for in the balance sheet in Current Income (Heading 3 of income, both for Regions for local authorities) and in Current Expenditure (Heading 1 of Expenditure for both types of entities). The methods of accounting for such transactions were defined in the decrees of the Minister of Economy and Finance regarding the encoding, methods and timing to implement SIOPE (Public Entity Transactions Information System) for Regions and local authorities (Ministerial Decree of 14 November 2006 and Ministerial Decree of 5 March 2007). These arrangements have provided for special measures, found in Heading 3 of Income and in Heading 1 of Expenditure, to detect active and passive interest arising from derivative transactions. Like all choices regarding SIOPE data collection, also that concerning the accounting of derivative transactions is the result of collaboration, within working groups, of all the authorities involved in the project: the State General Accounting Office, the Ministry of the Interior, ISTAT, the Bank of Italy and representatives of associations of entities (CINSEDO, UPI, ANCI). As a precaution it is considered appropriate that positive net flows have a commitment to face negative net flows that may occur in the future. In particular, positive net flows may be destined to the credit depreciation fund (Heading 1 of Expenditure), which would take on the function of "risk fund" that, being non-binding, would be a share of surplus tied as guarantee of future net negative flows.