NEWSLETTER NO. 48

INNOVATIVE INTEGRATIONS TO THE ITALIAN SECURITIZATION LAW AIMING AT FOSTERING THE DISMISSAL OF NON-PERFORMING LOANS BY BANKS AND FINANCIAL INTERMEDIARIES

1. Introduction and background

Law Decree no. 50 of 24 April 2017 (which is going to be converted into law within next June 23, hereinafter the "**Decree**") significantly innovates Law no. 130/1999 (s.c. "**Italian Securitisation Law**" or "**ISL**"), thereby re-shaping certain features of the Italian securitization market and bringing new opportunities for banks and investors.

The Decree adds a new Article 7.1 to the Italian Securitization Law, expressly designed to regulate "*the securitization of non-performing loans by banks and financial intermediaries".*
Indeed, these new rules are part of recurring efforts by the Italian Authorities to support credit institutions by fostering the offload/securitization of their impaired assets which threaten their stability. As is known, the issue has become crucial following the entry into force in 2016 of the EU led bail-in legislation whereby banks' insolvency jeopardizes the position of an increasing number of stakeholders, virtually including the entire spectrum of equity and debt holders of banks[1].

In the framework above, in 2016 (i) the "GACS" state guarantee scheme was enacted to render more "appealing" notes incorporating securitized NPLs, by granting a public guarantee aimed at reducing the *bid-ask spread*[2]; and (ii) the Bank of Italy issued implementing provisions on the granting of loans by Italian securitization vehicles to entities other than individuals and micro-enterprises subject to

[1] The "bail-in" together with other "*resolutions tools*" are regulated by Directive 2014/59/EU of the European Parliament and the Council of 15 May 2014, establishing a framework for the recovery and resolution of credit institutions and investment firms ("**BRRD**"). It is worth noticing that the Decree (containing heterogeneous provisions relevant to various economic sectors) has also expressly exempted retirement funds from the scope of application of the bail-in.

[2] Law Decree no. 18 of 14 February 2016 converted into law no. 49 of 8 April 2016.

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certain criteria (including retention requirements, selection criteria for borrowers and servicer's monitoring duties)[3].

The main innovations brought about by the Decree concern:
(i) the **widening of the range of activities that Italian securitization vehicles are entitled to carry out**; and
(ii) the introduction of certain **new rules easing the securitization of leasing contracts**.

2. New rules on the securitization of impaired assets

2.1 Scope of application

The new rules shall exclusively apply to the **transfer of claims**:

(i) "*falling within the definition of* ***impaired loans***" ("*crediti deteriorati*" pursuant to the relevant regulatory provisions)[4], whether or not they have already undergone, or may currently be undergoing a restructuring process or similar proceedings;

(ii) "*are* ***transfered by banks and financial intermediaries*** *[…] with registered office in Italy"* (*Article 7.1, Section1, ISL*).

2.2 New activities allowed to Italian securitization vehicles

Under the new rules, Italian securitization vehicles purchasing impaired loans are now entitled, "*in order to improve the expectation*

[3] Bank of Italy's Circulars no. 285/2013 and 288/2015, as amended on March 8, 2016 following changes to the Italian Securitization Law allowing for the first time Italian securitization vehicles to provide funding (Law Decree no. 91/2014, converted into Law no. 116/2014).

[4] Therein including assumedly NPLs (formerly known as "sofferenze"), unlikely to pay (formerly known as "incagli") and past-due ("*scaduti*").

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for successful collection of assigned claims and foster the turnaround of the assigned debtors", to:

(i) *"**grant loans**"* to the benefit of the assigned debtors themselves, subject to certain conditions (Article 7.1, Section 2, ISL)[5]; in such case the management of both the assigned claims and of the granted loans has to be performed by a bank or a financial intermediary (Article 7.1, Section 7) and

(ii) *"**acquire or subscribe for shares, quotas and other securities and participating instruments deriving from the conversion of part of the claims of the transferor*** […] ***in the framework of economic and financial recovery plans*** *which may be agreed upon with the transferor* [or] *other restructuring agreements* [contemplated by the Italian Bankruptcy Law[6], or] *similar*

[5] Namely: **loans** may be extended (now also in the framework of economic and financial recovery plans and similar restructuring agreements which may be agreed upon with the transferor) to **entities other than individuals and micro-enterprises** provided that:
a) the **borrowers are selected by a bank or financial intermediary** (listed in the register *ex* Article 106 of the Italian Banking Act, i.e. the Legislative Decree 385/1993); such bank or intermediary can also carry on the servicing activities (as defined in Article 2, paragraph 3, letter c), ISL);
b) the **ABS notes** issued by the SPV to obtain the financial resources necessary for the provision of the loans are **intended for qualified investors only** (as defined in Article 100 of the Italian Securities Act, i.e. Legislative Decree 58/1998); and
c) the selecting bank or financial intermediary above **retains a significant economic interest** in the transaction (i.e. at least 5%) in accordance with the implementing provisions of the Bank of Italy (*Article 1, section 1-ter* of the ISL, referred to by the newly enacted Article 7.1 of the ISL).
It is noted that the conditions above were already provided for the granting of loans by the 2014 reform, but in a different context (not specifically intended to tackle the NPL issue and favor the turnaround of debtors and not in the context of recovery/restructuring plans/arrangements, as is now expressly provided for).

[6] The admitted restructuring plans/agreements with debtors under the Italian Bankruptcy Law (Decree no. 267/1942) include: the s.c. *concordato* (art. 124), the

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agreements or procedures aiming at the turnaround/restructuring which may be implemented pursuant to other applicable laws[7]*"* (Article 7.1, Section 3, ISL).

In the event the securitization vehicle takes part in any such restructuring plan, it shall identify, in the interests of the noteholders, a person/entity having appropriate competence and duly authorized pursuant to the relevant laws and regulations, who will be in charge of the management and administration of the assets/participating instruments above, with appropriate powers of representation[8].

Consistent with the *rationale* of the securitization, any sums/proceeds howsoever deriving out of the abovementioned participating instruments – as well as any payments made by the assigned debtors – shall be ***"exclusively dedicated to the satisfaction of the rights incorporated in the notes and the repayment of the transaction costs"*** (Article 7.1, Section 3, ISL).

2.3 Managing of collateral assets

New provisions are addressed to make more effective the managing of the underlying assets collateralizing the assigned claims and, as the case may be, to maximize the outcome of their liquidation.

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s.c. *concordato preventivo* (art. 160), the s.c. *accordi di ristrutturazione* (art. 182-bis) and the s.c. *concordato con continuità aziendale* (art.186-bis).

[7] In the case above, the rules on the subordination of (a) shareholders' loans and (b) financing by entities exercising direction and coordination over the borrower, shall not apply (Articles 2467 and 2497-*quinquies* of the Italian Civil Code).

[8] Should such an administering/managing entity be a bank, a financial intermediary, a brokerage company or a SGR, the same will also be in charge of checking the compliance of the activities carried out by the securitization vehicle with the law and the prospectus, as the case may be (Article 7.1, Section 8, ISL).

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Namely, "***a special purpose vehicle*** [in addition to the Italian securitization vehicle] *may be incorporated as a limited company* ["società di capitali"] ***having as its exclusive corporate purpose the acquisition, managing and appreciation, in the exclusive interest of the securitization transaction, of real estate assets, registered movable properties and any other assets and rights****, regardless of their nature, howsoever* ***granted as guarantee*** *of the securitized claims*": this is a sort of managing entity (the "**Managing Entity**") (Article 7.1, Section 4, ISL).
Also in this case, "*any sum howsoever deriving out of the possession, management or dismissal of such assets and rights"* owed by the Managing Entity" to the Italian securitization vehicle – as well as any amount paid by the assigned debtors - "*are* ***exclusively dedicated*** *to the satisfaction of the rights incorporated in the issued notes and payment of the transaction costs*".

2.4 New provisions on securitized leasing contracts

The amended Italian Securitization Law also aims at fostering the securitization of leasing contracts by allowing the **transfer not only of the claims arising out of leasing contracts, but also of the leased assets underlying the leasing contracts** (which may occur in case of repossession of such assets by the lending banks following a default or breach of contract).
Accordingly, also the assets underlying leasing contracts (even if terminated), together with any possible legal relationships resulting out of such contracts, may be purchased, managed and appreciated by the Managing Entity referred to above; moreover, also in this event, any sums/proceeds deriving from such contracts and relationships shall be dedicated to the payment of the transaction costs and repayment of the noteholders.

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However, when in addition to the assets underlying the leasing contracts also the relevant leasing contracts (or the legal relationships deriving out of their termination) are transferred, the Managing Entity shall be:

(i) "*consolidated within a credit institution's balance sheet*" (even if it is not part of a banking group); and

(ii) "*set up for a specific securitization transaction and liquidated upon completion of the relevant transaction*"[9].

The accomplishments to be performed pursuant to leasing contracts transferred under these new rules shall be carried out either by the person appointed as servicer in the securitization or by an entity identified *ad hoc,* with the appropriate competence and duly authorized to carry out financial leasing[10].

2.5 Formalities for the perfection of the transfers

The transfers of claims not *en bloc* made by banks and financial intermediaries under these new rules shall be published through the **filing with the companies' register and publication on the Official Gazette** (*i.e.*, the usual means to publicize transfers of claims under the Italian securitization law) thereby indicating (i) the transferor, (ii) the transferee, (iii) the date of the transfer, (iv) brief information on the type of contracts originating the assigned claims, (v) the website on which the transferor and the transferee will make available the relevant information on the transferred claims up to

[9] The limitations of the Managing Entity's corporate purpose, operations, and capability to incur debt shall be duly represented in the by-laws and in the relevant contracts to which the Managing Entity is a party.

[10] Such entity can also be a bank, a financial intermediary, a brokerage company or a SGR (Article 7.1, Section 8 of ISL).

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their full collection/extinction, and, upon request by an assigned debtor, the confirmation of the completed transfer.
Upon completion of the formalities above, **no more actions will be admitted on the sums paid by the assigned debtors except those aimed at restoring the rights of the noteholders or paying senior transaction costs**[11].
Starting from the date of publication on the Official Gazette, the transfer will be effective *vis à vis* the assigned debtors and the privileges and guarantees of any kind, howsoever existing in favor of the transferor, as well as any annotation in the public records of the transfer of the assets underlying the leasing contracts, will retain their validity and ranking in favor of the transferee without need for any formality or further annotation (Article 7.1, Section 6, ISL).

3. Concluding remarks

This reform was long-expected not only by banks and financial intermediaries, to whom it is primarily targeted, **but also by other market players**, such as investors, service providers and other operators in the securitization sector, in the pursuit of **much broader strategic objectives of economic and financial recovery of the banking industry and general support to indebted undertakings**.

The "market" has indeed been urging these changes to gain a new tool – or better to enhance an old one –, in contemplation of the increasing number and amount of distressed assets and the proliferation of restructuring plans of any kind, often encompassing the conversion of claims into equity/participating instruments and connected issues of management of the collateral assets.

[11] Moreover, in derogation to any other applicable provision, the assigned debtors will not be entitled to set-off any claim (arisen subsequent to the formalities above) they might have towards the transferor against the claims purchased by the securitization vehicle.

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In the light of the above, this new reform cannot but be welcomed because it proposes to both expedite the dismissal of NPLS by banks and foster the turnaround of assigned debtors through the granting of new funding: a form of alternative lending which is becoming more and more noticeable.

Indeed, while, on the one hand, the reform brings about innovative provisions designed to open new opportunities and scenarios for banks, investors and borrowers, on the other hand, it validates certain practices which – by "stretching" the former rules – had led to structure securitizations somehow anticipating the newly legitimated "model"[12].

One of the main innovations consists in the widening of the activities which Italian securitization vehicles can now legitimately carry out, beyond the traditional boundaries of Article 3 of ISL (whereby their exclusive corporate purpose is "*the carrying out of one or more securitization transactions*").
The spectrum of activities that can be performed by Italian securitization vehicles is no longer limited to the "static" management of the purchased claims, but encompasses more "dynamic" actions (including, *inter alia*, the holding of equity interest which can now be transferred along with the claims and the managing of the collateral assets through dedicated "managing entities"); all this is reducing more and more the distance between Italian securitization vehicles (which, we notice, are no more under the Bank of Italy supervision) and other supervised entities.

[12] It is noted however that certain "new" provisions do not really embody an actual innovation, but rather constitute specification or broadening of scope of provisions already into force (among these: the granting of funding by securitization vehicles which had already been provided for by the 2014 reform).

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Some perplexities may be raised on the limitation of the scope of the new rules to the transfer of claims made by banks and financial intermediaries having their *"registered office in Italy"* but we deem that the provision should be red in a EU-compatible manner so as to avoid undue limitations.
However, should the nation-based limitation be interpreted strictly, a significant portion of market participants could be prevented from accessing the new tools; this could be violative of the European Treaties by virtually infringing the general principle of non-discrimination and, more specifically, the freedom to provide services (set out by Article 56 et seq. of the Treaty on the Functioning of the EU). The position of the European Commission should therefore be monitored over the coming months, to see whether an adjustment to the limitation at issue is required to prevent possible infringement proceedings.

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