



## Italian NPL Guaranteed by the Italian Government: Law Decree Approved

On February 14, 2016, the Italian Government approved the law decree (*“decreto-legge”* or the *“Decree”*) that regulates, *inter alia*, the release of a guarantee by the Italian Government for non-performing loan (*“NPL”*) transactions.

As confirmed by the EU Commission, the guarantee released by the Italian Government would not constitute a state aid, subject to the terms set out by the EU Commission.

### Summary of the Decree

According to the Decree, the guarantee of the Italian Government (the *“Guarantee”*) can be released in the context of securitization transactions having the following features:

- The NPL portfolio is sold to an Italian securitization vehicle (*“SPV”*) that issues asset-backed securities/notes pursuant to the Italian securitization law (i.e., Italian law no. 130 of April 30, 1999).
- The seller of the NPL portfolio is a bank having its registered office in Italy.
- The portfolio comprises monetary receivables (including monetary receivables deriving from leasing agreements) that are classified as non-performing claims (*“sofferenze”*).
- The non-performing receivables are sold to the SPV for an amount that is not higher than their net book value (*“valore netto di bilancio”*).
- The SPV issues at least two different classes of notes having a different ranking (*“Notes”*).
- The most junior class of Notes will not receive any payment as principal, interest, or other form of remuneration until the full repayment of the principal of the other classes of Notes.
- The SPV can issue one or more classes of mezzanine Notes that, for the payment of interest thereon, (i) rank junior to the payment of interest on the senior Notes and (ii) rank senior to the payment of principal on the senior Notes;
- The SPV may enter into hedging agreements for the exposure toward the interest rate risk.
- The SPV may also enter into liquidity facility arrangements to cover potential shortfalls in the cash flows of the transaction that are consistent with the credit rating assigned to the Notes.
- The Guarantee is released only in respect of the senior tranche of the Notes issued by the SPV.
- The senior Notes that are the object of the Guarantee have been previously assigned with

an investment grade rating by one of the recognized rating agencies (i.e., external credit assessment institutions or “ECAI”). The credit rating for the Senior Notes can also be issued in form of a private rating addressed exclusively to the Italian Ministry of Economics and Finance (in such case, the relevant ECAI proposed by the selling bank will be approved by the Italian Ministry of Economics and Finance).

- The rating fees are borne by either the seller or the SPV.
- The SPV shall not request the withdrawal of the rating by the relevant ECAI until the repayment in full of the principal on the senior Notes.
- The servicer of the relevant NPL portfolio (“NPLs Servicer”) will be different from the seller and will not be a member of the banking group of the seller. Any resolution of the holders of the Notes to replace the NPLs Servicer will not affect the credit rating of the senior Notes.
- The senior Notes and the mezzanine Notes will bear interest at a floating rate.
- Any repayment of principal for the senior Notes and the mezzanine Notes before the maturity date will be determined on the basis of the collections and recoveries in respect of the underlying NPL portfolio, net of the any costs for the collection and recovery of the relevant claims.
- The payment of interest on the senior Notes and the mezzanine Notes will be made in arrears on a quarterly, semiannual, or annual basis.
- The remuneration on the mezzanine Notes can be postponed upon the occurrence of certain conditions or otherwise can be made subject to certain targets for the collection and recovery of the underlying portfolio.
- The Decree also provides for the order of priority of payments under the transaction, by using the collections and the recoveries from the underlying NPL portfolio (and the cash flows deriving from the hedging agreements and the liquidity facility arrangements executed in the context of the transaction), net of the amounts due to the NPLs Servicer for its activity.

In addition, the Decree specifies that:

- The Guarantee for the senior Notes can be released by the Italian Ministry of Economics and Finance for

a period of 18 months from the entry into force of the Decree. This period can be extended for a further 18 months by means of a decree of the Italian Ministry of Economics and Finance, subject to prior approval by the EU Commission.

- The Guarantee is released against payment of a guarantee fee (determined on the basis of the cost of credit default swaps of Italian companies with certain credit ratings set out in the Decree, in respect of the credit rating assigned to the senior guaranteed Notes).
- The Guarantee is effective only once the selling bank has sold with consideration at least 50 percent plus 1 of the junior Notes and, in any event, an amount of the junior Notes and, if any, of the mezzanine Notes, that allows the de-recognition of the relevant NPL portfolio from the seller’s accounts (and from the consolidated accounts) on the basis of the accounting principles that apply as of the financial year of the perfection of the transaction.
- The Guarantee is unconditional, irrevocable, and on first demand for the benefit of the holders of the senior Notes.
- The Guarantee covers the payment of interest and principal on the senior Notes as set forth in the relevant contractual terms, for the entire duration of the senior Notes.
- The Guarantee is issued with a decree of the Italian Ministry of Economics and Finance, on the basis of a duly documented application to be made by the selling bank to the Italian Ministry of Economics and Finance.
- The Guarantee can be enforced by the holders of the senior Notes within nine months from the maturity of the senior Notes, in the event of a failure to pay, in full or in part, of principal or interest due on the senior Notes.
- Payment under the Guarantee can be demanded if the failure to pay is not cured within 60 days from the due date. In such case, the holders of the senior Notes, in agreement with and through the representative of the noteholders, will deliver a notice of demand to the SPV for the unpaid amount under the senior Notes. After 30 days from the SPV’s receipt of the notice, and within no later than six months, if the failure to pay continues, the holders of the senior Notes, in agreement with and through the representative of the noteholders, can request payment under the Guarantee. Within 30 days

of receipt of this payment demand, the Italian Ministry of Economics and Finance will make the payment to the holders of the senior Notes in the unpaid amount of interest and principal as due at the original due date, without any default interest or expenses.

- Upon payment by the Italian Ministry of Economics and Finance under the Guarantee to the holders of the senior Notes, the Italian Ministry of Economics and Finance is subrogated to the rights of the holders of the senior Notes and will recover the amounts paid by it under the Guarantee (plus the interest accrued at the legal interest rate from the date of the payment made under the Guarantee until the date of the recovery and the expenses incurred for the recovery).
- The Italian State and any public administrations or any companies directly or indirectly controlled by public administrations cannot purchase the mezzanine Notes or the junior Notes.
- Implementing regulations may be issued, with a non-regulatory decree, by the Italian Ministry of Economics and Finance within 60 days from the conversion into law of the Decree.

## Legal Issues to be Considered

**Retention.** The Decree makes reference to a tranching transaction that, as such, falls within the definition of “securitization” under the EU legislation, and no exemption would apply because the Guarantee is released only in respect of a portion of the underlying portfolio (i.e., the portion financed by the senior Notes). Therefore, the “originator” or the “sponsor” (both as defined under the EU legislation) would retain a 5 percent net economic interest in the transaction. The retention by the selling bank would be subject to an analysis of the impact on the de-recognition of the assets from its accounts, which is a requirement for the effectiveness of the Guarantee. In this respect, it is relevant that the Decree provides—as one of the requirements to be satisfied for the release of the Guarantee—that the bank sells 50 percent of the junior tranche and the mezzanine tranche to the market. This would be relevant for compliance with the retention rule by the selling banks, although it remains necessary to achieve the de-recognition of the relevant portfolio according to the applicable accounting principles.

**Rating.** The investment grade rating on the senior Notes can be either a private rating or a public rating. In the latter case, two credit ratings will be assigned by two independent ECAI according to the EU legislation on rating agencies (so-called CRA3).

**Payment of Interest on Junior Notes.** The Decree provides that:

- The most junior class of Notes will not receive any payment as principal, interest, or other form of remuneration until the full repayment of the principal of the other classes of Notes.
- The SPV can issue one or more classes of mezzanine Notes that, for the payment of interest thereon, (i) rank junior to the payment of interest on the senior Notes and (ii) rank senior to the payment of principal on the senior Notes.

It is therefore expected that the legal structure of the transactions will contemplate the issue of one or more classes of mezzanine Notes, to allow the payment of a certain remuneration to the investors (other than the investors in the senior Notes) during the amortization of the senior Notes.

**State Aid.** The guarantee system highlighted above has been deemed compatible with State aid rules by the EU Commission as it does not contain any State aid element. Indeed, the Italian Government will receive a remuneration at market conditions for such guarantees and will take a limited risk since it will cover only the senior notes, once the market has already tested the soundness of the overall securitization transaction (i.e., after the selling bank will have sold more than 50 percent of the junior notes). The EU Commission’s hard line taken against Italy is in fact consistent with its enforcement policy over the last two years, according to which banks in distress could no longer be rescued with State aids unless shareholders and junior creditors had first borne the burden of the losses. Following the recent entry into force of the Bank Recovery and Resolution Directive (applicable in Italy from January 1, 2016), the bail-in principle has become fully applicable. In the event of a bank crisis, not only shareholders and junior creditors but also senior bond holders and depositors with savings exceeding EUR 100,000 will be exposed up to 8 percent of the

passivities of the bank, before any public funding can be engaged into the rescue via the resolution funds.

For this reason, the Italian Government's guarantees for the various securitization vehicles have been approved by the Commission only on condition that the guarantees will be issued and priced at standard market conditions.

**Registration Tax.** According to the Decree, the purchase of a real estate asset at a court auction will be subject to a fixed EUR 200 registration tax in lieu of the 9 percent registration tax usually applicable, provided that the real estate asset will be re-sold within 24 months of the purchase date. This tax advantage applies until December 31, 2016. In the event that the purchaser fails to re-sell the real estate asset within 24 months, the 9 percent registration tax applies.

## Conversion into Law

The Decree will be converted into law within 60 days of its approval. Once it is converted into law, implementing regulations may be issued with a nonregulatory decree by the Italian Ministry of Economics and Finance (within 60 days from the conversion into law of the Decree).

We expect the first transactions to be realized once these additional steps are duly perfected and the relevant legal framework is complete.

## Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at [www.jonesday.com/contactus/](http://www.jonesday.com/contactus/).

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