



Capital Markets Focus Team

The Capital Markets Focus Team have unrivalled experience in both equity and debt capital markets. Our team has advised on the most prominent privatisation and listing transactions, not to mention public M&A (takeover bids and takeover bids with share swaps) in Italy over the past 15 years. Our team of debt capital markets experts have overseen, in coordination with our banking and insurance regulation team, numerous issues and structuring operations concerning equity-linked products, retail and corporate bonds, securitisations and financial instruments eligible for calculation within the banks' regulatory capital.

In addition to our vast knowledge of the Italian market, we can advise on the key international markets thanks to our network of law firms worldwide. This also enables us to provide a direct placement service for foreign investors.

During the 20th Global ABS in Barcelona, a special focus was dedicated to the Italian NPLs market and the opportunities for this market to provide in the next future a financial tool for resolving the NPLs overhang that affects Italian Banks, especially following the enactment of the Italian Guarantee Scheme, so called "*Garanzia Cartolarizzazione Sofferenze*" ("**GACS**"), by Italian law decree No. 18 of 14 February 2016, as converted with modifications into the Italian law No. 49 of 8 April 2016 (the "**Decree**").

GACS is one of the solutions identified by the Italian government, to contribute to the stabilization of the Italian banking sector, by reducing the country's huge stock of bad loans. The main purposes of the GACS should be to increase the credit worthiness of the senior asset backed securities, hence potentially attracting a wider range of investors, and to incentivise banks to workout non-performing loans and improve their liquidity.

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GACS is an irrevocable, unconditional, first demand guarantee to be granted by the Italian Ministry of Economy and Finance (the “MEF”), to secure principal and interest payments under the senior tranches of asset-backed securities (the “**Senior Notes**”) issued by a special purpose vehicle incorporated under Italian law 30 April 1999, No. 130 (the “**SPV**”) whose underlying assets are receivables (including leasing receivables) owned by banks or financial intermediaries having their registered office in Italy (each a “**Seller**”) and classified as non-performing (the “**NPLs**”).

The MEF, upon request of the relevant Seller, is authorised to grant the GACS for a period of 18 months from the date of the entry into force of the Decree (*i.e.* 16 February 2016), with a possible extension for a further period of 18 months with the prior approval of the European Commission.

Since GACS is a measure aimed at facilitating the dismissal of the big volume of non-performing claims accumulated by the Italian banks, the Decree requires - as condition for the effectiveness of the guarantee - that the relevant Seller assigns for a consideration more than 50% of the junior notes issued by the SPV and subscribed by the Seller and, in any case, an amount of junior notes (and, if any, mezzanine notes) sufficient to allow the Seller to achieve a derecognition of the NPLs from its balance sheet (and, at group level, from the consolidated balance sheet) on the basis of the applicable accounting principles.

As consideration for the GACS, the MEF is entitled to receive an annual fee, calculated at market rates, in order to ensure the aid-free nature of the guarantee according to the EU rules. The remuneration is determined according to the methodology set forth in the Decree and increases during the years so as to incentivise an accelerated recovery of the NPLs backing the notes¹. Payment of the remuneration will rank senior to payments due to the hedging counterparties and to the senior noteholders, but junior to payments of taxes, servicers’ and agents’ fees and interest accrued on the Liquidity Line (as defined below), if any.

¹ In particular, the market price of the GACS is based on three different baskets of credit default swaps each of which relating to different Italian issuers and to different ratings of the Senior Notes issued in the context of securitisation transactions having NPLs as underlying assets.

In order to benefit of the GACS, the Senior Notes shall be assigned a rating at least investment grade from an External Credit Assessment Institution recognized by the European Central Bank (“**ECAI**”); in case a second rating is required by the applicable legislation, also the second rating may be issued by an ECAI established in the European Union and registered under Regulation (EC) No. 1060/2009, as amended (the “**CRA Regulation**”) and shall be at least equal to investment grade. Alternatively, the investment grade rating may be private and solely addressed to the MEF. In case of a private rating, the rating agency selected by the Seller - among rating agencies accepted by the Eurosystem - shall be approved by the MEF. The SPV shall undertake not to request the withdrawal of the rating assigned by the relevant ECAI until full redemption of the Senior Notes.

The Decree also sets out the main features of the securitisation transaction, including the following:

- a. the purchase price of the NPLs will be not higher than their net book value (*i.e.* gross book value net of depreciations (*valore lordo al netto delle rettifiche*)) as resulting from the relevant Seller’s balance-sheets;
- b. the SPV shall issue at least two tranches of notes (senior and junior tranches), but may also issue one or more tranches of mezzanine notes, whose interest payments are subordinated to the payment of interests of the Senior Notes but could be senior to the repayment of principal on the Senior Notes;
- c. the junior notes shall not be redeemed or partially repaid until the other tranches (senior and mezzanine) have been redeemed in full;
- d. the SPV shall appoint an external and independent servicer (different from the Seller and not belonging to the Seller’s group) (the “**External Servicer**”) to service and manage the NPLs in order to avoid that the recovery activity will be adversely affected by any conflict of interest. The decision (if any) of the noteholders and/or the SPV to replace the External Servicer shall not negatively affect the rating assigned to the Senior Notes;
- e. the SPV may enter into (i) hedging arrangements in order to reduce interest rate risks; and (ii) a liquidity credit facility in order to manage the risk of mismatch between the recoveries deriving from the NPLs and the interest due on the Senior Notes, for an amount sufficient to keep the minimum level of financial flexibility consistent with the creditworthiness of the

Senior Notes (the **Liquidity Line**);

- f. the payment waterfall in accordance with which the SPV's available funds will be distributed on each payment date. In summary, interest on the Senior Notes shall rank after (i) taxes (if any), (ii) amounts due to any issuer's service providers, (iii) interest on the Liquidity Line (if any), (iv) GACS' remuneration, and (v) amounts due to any hedging counterparties. Principal repayments under the Senior Notes will rank junior to principal repayments under the Liquidity Line (if any) and interest payments under the mezzanine notes (if any). Principal, interest and any other amount due under the junior notes shall be fully subordinated to any other payment.

The Decree provides the Senior Notes (and the mezzanine notes, if any) shall comply with the following requirements:

- i. they have a floating interest rate;
- ii. the repayment of principal before the final maturity date depends on the cash flows deriving from the recovery of the NPLs, net of the recovery costs ;
- iii. the payment of interest coupons is made in arrears quarterly, semi-annually or annually and the coupon is calculated on the basis of the outstanding nominal value of each note at the beginning of the relevant interest period.

In addition to the above, according to the Decree interest on the mezzanine notes may be, under certain conditions, deferred or subordinated to the full redemption of the Senior notes or conditional upon the fulfilment of performance targets in the recovery of the NPLs.

The Italian State, the public administrations and the companies controlled, directly or indirectly, by public administrations cannot purchase the junior or the mezzanine notes issued in the context of securitisation transactions in relation to which the GACS has been requested.

Enforcement of GACS

Upon failure by the SPV to pay in whole or in part any amounts due as principal or interests under the Senior Notes, the GACS shall be enforced no later than 9 months after the final maturity date of the Senior Notes, in compliance with the procedure set out below.

Should the failure to pay last for more than 60 days from the relevant due date, the senior noteholders - with the agreement of (“*di concerto*”) and through the representative of the noteholders - shall send to the SPV a request of payment in respect of the amount due and unpaid. If after 30 days from receipt by the SPV of the relevant payment request, no payment has been made by the SPV, the senior noteholders - with the agreement of (“*di concerto*”) and through the representative of the noteholders - may enforce the GACS, provided that the enforcement of the GACS may be requested by the senior noteholders within 6 months from the date of receipt of the payment request by the SPV.

The MEF shall pay under the GACS within 30 days from the receipt of the (documented) payment request from the senior noteholders. Amounts payable under the GACS will be limited to principal and interest on the Senior Notes and shall not cover any default/additional interests or penalty and costs.

By making the relevant payment, the MEF shall be subrogated to all rights of the senior noteholders with respect to amounts paid under the GACS, subject to the contractual limitations provided for under the transaction documents regulating the securitisation (the “**Transaction Documents**”), such as limited recourse and non-petition provisions².

Some considerations

Pursuant to article 13 of the Decree, the MEF may adopt relevant implementing provisions within 60 days from the entry into force of the law by which the Decree has been converted into law (*i.e.* 15 April 2016).

² The MEF is entitled to recover (i) any amount paid under the GACS, (ii) the interest accrued - at the legal rate - from the payment date to the date of recovery and (iii) the costs incurred for such recovery.

Pending the issuance of the MEF implementing regulations³, it should be noted that certain aspects of the GACS still remain unclear and/or not completely regulated, including the following:

- the procedure to be followed and the documentation to be provided to the MEF for the issuance of the GACS;
- the timing for the granting of the GACS by the MEF; in particular, whether the GACS should be granted simultaneously with the issuance of the Notes (subject to the condition of the assignment for a consideration of at least the 50% plus 1 of the junior notes) or the procedure envisaged for the release of the guarantee necessarily require the prior issuance of the Notes and whether the GACS may be issued only after the assignment of more than 50% of the Junior Notes;
- whether the condition precedent to the effectiveness of the GACS (*i.e.* the assignment for a consideration of at least the 50% plus 1 of the junior notes) can be interpreted in a wider sense to include different transactions, provided that the risks and benefits relating to more than 50% of the junior notes are transferred;
- whether the purchase price to be paid by the SPV to the Seller has to be calculated individually for each NPL or with reference to the aggregate value of the NPLs' portfolio;
- whether the Liquidity Line (if any) granted in favour of the SPV may be set up as cash reserve;
- whether the GACS may be enforced by each senior noteholder individually or with the consent of the other senior noteholders⁴ or necessarily through the representative of the noteholders;
- whether the prior written consent of the MEF is requested for certain amendments to the terms and conditions of the Senior Notes and the other Transaction Documents;
- the events which may affect the enforceability of the GACS;
- structure of the External Servicer's fees and, in particular, to clarify if the relevant payment should be effectively made out of the priority of payments (as it seems from a literal interpretation of article 7, first paragraph, of the Decree).

³ The 60 days term for the issue by the MEF of the implementing rules has already expired.

⁴ Pursuant to Article 11 of the Decree, the GACS may be enforced by "the relevant noteholder" although the request of payment to the SPV shall be sent by "the senior noteholders with the agreement of ["di concerto"] and through the representative of the noteholders (RON)".

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