REFORM OF SECURITISATION LAW UNDER DISCUSSION IN THE ITALIAN PARLIAMENT

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Dear Friends,

As you may be aware of, a reform of Law no. 130 of 30 April 1999 (the "Securitisation Law") is currently under discussion in the Italian Parliament as part of a wider package of measures aimed to support the Italian economy. The draft bill (*disegno di legge n. 4444-A*) is expected to be passed by June 23.

Originally, lawmakers had in mind a much more ambitious reform of the Securitisation Law with a view to coordinating provisions chaotically introduced over the last few years and possibly clarifying the scope of certain tools which had limited use in the market. Practical reasons have suggested, in the end, to follow a narrower approach focusing on a limited set of new provisions specifically targeting the regime applicable to NLPs and their collateral.

By this note we would like to brief you on some key features of this possible new regime and share some preliminary thoughts regarding its implications and possible improvements. This note is based on the text which has already made its way through the lower chamber of the Italian Parliament and that is likely to be passed without amendments by the senate. In preparing this note we have assumed that the reader is familiar with the existing version of the Securitisation Law and the issues associated with these types of transactions.

The reform bill is expected to insert a new article 7.1 in the Securitisation Law. Article 7.1 will be comprised of 8 paragraphs, each dealing with a specific matter.

Scope of the reform

Paragraph 1 sets out the general scope of the new regime by specifying that the provisions of article 7.1 apply only to receivables classified as "impaired" (*deteriorati*) in accordance with the applicable supervisory regulations, transferred by banks and financial intermediaries enrolled with the register (*albo unico*) kept by the Bank of Italy under article 106 of the Legislative Decree no. 385 of 1 September 1993 (the "Italian Banking Law"), having their registered seat in Italy.

In this respect, it would have been preferable for the scope of the reform to be wider so as to cover any assignments of NPLs *originated* (as opposed to *transferred*) by banks and financial intermediaries. It is not unusual, in fact, for these types of assets to be resold by the securitisation vehicles that have acquired them in the first place to other securitisation vehicles. This improvement would likely increase the post-sale marketability of the receivables with possible favorable implications on the initial pricing. In addition, this would avoid a discrimination which appears to be arbitrary.

Financing assigned debtors

Under paragraph 2, securitisation vehicles will be allowed to advance loans to assigned debtors with the view to increasing the chances of recovery and helping borrowers to return being current. As a regulatory requirement, a bank or a financial intermediary will have to act as "sponsor" retaining a 5% net economic interest in the transaction.
Considering that direct lending by securitisation vehicles is already permitted under the current Securitisation Law subject to satisfaction of the retention requirement (see article 1, paragraph 1-*ter*, of the Securitisation Law), the innovation associated with paragraph 2 is that, under certain conditions, securisation vehicles can now "mix" within the same securitisation transaction two activities (acquisition of receivables, on the one hand, and direct lending, on the other hand) that are believed to be the subject matter of two different types of transactions under the Securitisation Law [1]. Although we welcome this innovation, we can anticipate that this "mix" will raise a number of interpretation issues which will probably require Bank of Italy to revise its supervisory instructions on direct lending by securitisation vehicles.

Securitisation vehicles and reorganisation procedures

Paragraph 3 will allow, in the context of reorganisation plans agreed between the assignor and the assigned debtors or other restructuring procedures under Italian law, securitisation vehicles to:

a) subscribe for or acquire equity or quasi-equity instruments in the assigned debtors, in exchange (whether in whole or in part) of the assigned receivables;

b) advance loans to the assigned debtors with the view to increasing the chances of recovery and helping borrowers to return being current.

Notably, distributions and payments received by the securitisation vehicles under the aforementioned equity or quasi-equity instruments and loans will be treated for all purposes as payments made by the assigned debtors (and, therefore, will be segregated by operation of law in favour of the noteholders).
With respect to a) above, pursuant to paragraph 8, securitisation vehicles subscribing for or acquiring equity or quasi-equity instruments will have to appoint a person adequately experienced and with all the authorisations and licenses required by the law to manage and administer the instruments in the interest of the noteholders.
Loans referred to in b) above will be exempted from the statutory subordination regime applicable to shareholders' loans advanced to companies under financial constraints (*i.e.*, in circumstances where equity contributions would be required; see articles 2467 and 2497-*quinquies* of the Italian civil code).
In addition, the advance of such loans by securitisation vehicles does not seem to be subject to satisfaction of the "retention requirement" by a sponsor under article 1, paragraph 1-*ter*, of the Securitisation Law.

[1] In these circumstances, pursuant to paragraph 7, management of the claims and the loans advanced by the securitisation vehicle has to be delegated to a bank or a financial intermediary enrolled with the register (*albo unico*) under article 106 of the Italian Banking Act.

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Paragraphs 4 and 5 will introduce what is probably going to be seen as the most important aspect of this reform. In particular:

a) paragraph 4 introduces the possibility for a special purpose entity ("SPE") incorporated in the form of a limited liability company (*società di capitali*) and having an *ad hoc* corporate object, to acquire, manage and valorize, in the exclusive interest of a given securitisation transaction, real estate and other types of assets collateralising the securitised receivables. The amounts deriving from the management and disposal of these assets and due by the SPE to the securitisation vehicle will be exclusively destined, by operation of law, to the satisfaction of the rights incorporated in the asset-backed securities issued by the relevant securitisation vehicle and towards the costs of the transaction; and

b) under paragraph 5, the SPE may acquire, together with leased assets (*beni oggetto di locazione finanziaria*), the relevant leasing contracts or (in the event of leasing contracts which have been already terminated) the residual legal relationships; in this case, the SPE will have to be incorporated as a single transaction special purpose entity (to be liquidated upon consummation of the transaction) and be consolidated in the financial statements of a bank. The SPE will then be subject to the tax regime generally applicable to companies which carry out leasing activity (leasing companies), and will benefit from the special transfer tax regime applicable to leasing companies in the event of sale of real estate assets being the subject matter of terminated leasing contracts (*contratti risolti per inadempimento*) or upon exercise of the lessee's right to acquire the asset at the end of the leasing (*i.e.*, registration, mortgages and cadastral taxes in a lump sum of Euro 200 each, as opposed to the generally applicable proportional taxation on the value of the underlying assets, depending on the circumstances[2]).

We note as follows:

i) the SPE is not *per se* a bankruptcy remote vehicle nor the assets acquired are automatically segregated by operation of law in favour of the "securitisation transaction";

ii) no guidance is provided in paragraph 4 as to the ownership of the SPE; in theory, the SPE could be owned by the noteholders, the arranger or sponsor of the securitisation, or a third party (including, for example, the Dutch foundation or the trustee acting as shareholder of the securitisation vehicle); due to the general prohibition for securitisation vehicles to hold equity instruments (subject to expressed exceptions), it is doubtful that the SPE may be owned by the securitisation vehicle itself;

iii) the SPE may need financing to fund running costs (including capital expenditures, tax associated with the acquisition of the assets, especially in case of real estate assets); funding is expected to be provided through shareholders loans or revolving facilities by banks or financial intermediaries;

[2] That is registration tax at a rate ranging from 9% to 12%, and mortgage and cadastrial taxes at a rate ranging from 2% to 4%.

iv) the law does not define the type of legal relationship to be established between the SPE and the securitisation vehicle; however, this relationship will have to be consistent with the other features of the new regime: the institutional purpose of the SPE (which seems to be the set-up of a legal scheme intended to separate legal title over the assets from previous owners - *i.e.* the assigned debtors or the lessors-assignees, as the case may be - and the management and disposal of the assets in the exclusive interest of the relevant securitisation transaction) and the destination of the amounts deriving from such activity of management and disposal to the satisfaction of the rights incorporated in the asset-backed securities issued by the relevant securitisation vehicle and towards the costs of the transaction; it cannot be excluded that the above will translate in the following types of contractual arrangements:

- a mandate by the securitisation vehicle to the SPE with respect to all or certain assets being the subject matter of enforcement procedures, whereby, in the absence of bidders at the auction, the securitisation vehicle may elect to apply for the assignment (*assegnazione*) of the relevant real estate assets pursuant to article 590-*bis* of the Italian code of civil procedure and to nominate the SPE as the third party assignee; and the SPE will remit to the securitisation vehicle all amounts deriving from the management and disposal of the assets net of the SPE's operating costs;

- similarly, in the circumstances referred to in paragraph 5, an arrangement whereby the SPE will acknowledge and accept that, as a result of the assignment of the legal relationships with the lessees and the transfer of the leased assets, the SPE will also step in the assignor-lessor's obligation *vis-à-vis* the securitisation vehicle to remit to the latter all amounts deriving from the management and disposal of the leased assets (less the SPE's relevant operating costs);

v) from a tax standpoint, the possible "conduit status" of the SPE resulting from the arrangements discussed in iv) above, coupled with the required exclusive *ad hoc* corporate object of the SPE and the destination regime of the proceeds of the SPE's activity, may entail the tax neutrality, at the level of the SPE, of the income generated by the management and disposal of the assets;

vi) unlike previous versions of the reform, no mention is made to an *ad hoc* transfer tax regime for the acquisition of real estate assets by SPEs; in this respect:

- in the event of real estate assets acquired by the SPE as a result of its nomination as third party assignee (*terzo assegnatario*) by the securitisation vehicle pursuant to article 590-*bis* of the Italian code of civil procedure, registration, mortgages and cadastral taxes will be due in a lump sum of Euro 200 each if the tax regime introduced by article 16 of Law Decree no. 18/2016 (as amended by Law no. 232/2016) due to expire on 30 June 2017, is extended, and the SPE resales the relevant assets in the following 5 years;

- in the circumstances referred to in paragraph 5:

  - should the real estate assets be acquired by the SPE together with the residual legal relationships resulting from terminated leasing contracts, the transfer of the real estate assets should be subject to the special tax regime applicable to leasing companies in the event of sale of real estate assets being the subject

matter of terminated leasing contracts (*i.e.*, registration, mortgages and cadastral taxes in a lump sum of Euro 200 each) notwithstanding the fact that the transfer of the real estate assets would occur in connection with the sale of the relevant leasing receivables (as opposed to the liquidation of the real estate assets, as it was probably originally intended at the time of the adoption of this special tax regime);

- in case of acquisition by the SPE of real estate assets together with the relevant leasing contracts (not yet terminated), no registration, mortgage and cadastral taxes will be due if the transaction is carried out as a transfer of legal relationships identifiable as a pool (*cessione di rapporti giuridici individuabili in blocco*) under article 58 of the Italian Banking Act, should the relevant requirements be satisfied;

vii) as a final remark, we are not clear why the new law does not contemplate the possibility for the SPE to be incorporated in the form of a real estate investment fund or other collective investment scheme; this appears to be particularly advisable with respect to paragraph 5 considering that real estate investment funds are already authorized to grant leasing financing; similarly, we would have expected that, in the circumstances referred to in paragraph 5, SPEs would have to be consolidated in the financial statements of a bank *or a financial intermediary*.

Perfection formalities

Paragraph 6 is meant to improve legal certainty in respect of formalities required to be complied with (including for tax purposes) for the perfection of the transfer of receivables and relevant security (in particular, mortgages) to securitisation vehicles. For these purposes, the current Securitisation Law uses the regime set out in article 58 of the Italian Banking Act, which requires the publication of a notice of transfer on the Italian Official Gazette and the registration thereof with the competent enterprises' registry. Under the current perfection mechanism, the portfolio to be assigned needs to qualify as a "plurality of monetary claims identifiable as a pool" (*insieme di crediti pecuniari identificabili in blocco*) on the basis of objective predetermined criteria (the so-called "block criteria"). However, the identification of block criteria has proved to be a challenging exercise in case of NPL portfolios due to the fact that the receivables to be included in the portfolio are often selected on a case-by-case basis (in order to balance the buyer's discounted expected cash flows, on the one hand, and the seller's provisioning level for the relevant assets, on the other hand).

As a solution, paragraph 6 proposes the introduction of a new perfection mechanism still based on the publication of a notice of transfer on the Italian Official Gazette and the registration thereof with the competent enterprises' registry but without any need for the NPL portfolio to qualify as a "plurality of monetary claims identifiable as a pool". This will be achieved by incorporating the following information in the notice of transfer: name of the assignor, name of the assignee, date of assignment, receivables' typology and period of origination, website through which the assignor and the assignee will make the details of the assigned receivables available to the assigned debtors and will provide, upon request of the latter, confirmation of the assignment.

Unfortunately, it is unclear whether the mechanism set out in paragraph 6 is able to capture the sale of single debt positions (so-called single names) which constitute an important part of the banks' divestment strategy of "large exposures".

In addition, we are not clear as to whether the reference contained in paragraph 6 to "the registrations in public registries of the deeds of transfer of assets being the subject matter of

leasing contracts falling within the scope of the transfer" as one of those ancillary rights and security that continue to have the same effect and ranking also in favour of the purchaser of the receivables, is intended (and has a legal meaning) or is just a left-over from the text of article 58 of the Italian Banking Act which was presumably used as the drafting basis for the new provision of law.

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