

Granting of loans by Italian securitization vehicles under Law 130/1999: Bank of Italy's implementing provisions

1. Background

On 8 March 2016, the Bank of Italy issued the long-awaited implementing provisions¹ (the "**Implementing Provisions**") on the granting of loans by Italian securitization vehicles under law no. 130 of 1999 (the "**Securitisation Law**"). The Securitisation Law was amended by Law Decree no. 91 of 24 June 2014 (the "**Competitiveness Decree**", converted into Law no. 116 of 11 August 2014) to enable special purpose vehicles for the securitization of receivables incorporated under the Securitization Law ("**SPV**") to provide loans to certain parties, an innovation introduced in order to broaden the spectrum of available funding sources as an alternative to bank loans.

Under Article 1, paragraph 1-*ter*, of the Securitisation Law, SPVs may provide loans to entities other than individuals and micro-enterprises² provided that:

- a. the borrowers are selected by a bank or financial intermediary listed in the register referred to in art. 106 of Legislative Decree of 1 September 1993, no. 385 (the "**Banking Act**"). Such entities can also carry on the activities set out in Article 2, paragraph 3, letter c) of the Securitisation Law (*i.e.* servicing activities);
- b. the notes issued by the SPV to obtain the financial resources necessary for the provision of the loans are intended for qualified investors, as defined in art. 100 of Legislative Decree of 24 February 1998, no. 58; and
- c. the bank or financial intermediary that selects the borrower retains a "*significant economic interest*" in the transaction in accordance with the procedures laid down in the implementing provisions of the Bank of Italy.

¹ The implementing provisions were included in the Bank of Italy circulars no. 285 of 17 December 2013 (Supervisory provisions for banks) and no. 288 of 3 April 2015 (Supervisory provisions for financial intermediaries) with a special new chapter entitled "Granting of loans by special purpose securitization vehicles under Law 130/1999"

² As defined in Recommendation 2003/361/EC of the European Commission.

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2. The Bank of Italy's Implementing Provisions

The Implementing Provisions govern certain aspects of the provision of financing by the SPV and, in particular, retention requirements, the selection criteria for borrowers, information for investors and the role of the servicer of the transaction.

(i) Maintenance of a significant economic interest in the transaction (the "retention rule")

Banks and financial intermediaries that select borrowers for the loans granted by the SPV must maintain an economic interest of at least 5% in the transaction. That interest must be maintained - although the purpose of this is different and distinct from that provided for in the prudential regulation - in the manner set out in art. 405 of EU Regulation no. 575/2013 ("**CRR**") and the relevant delegated regulations.

The economic interest in the transaction must be maintained continuously for the entire duration of the same. In addition, the bank or the intermediary who is subject to the retention rule cannot enter into transactions the substantial effect of which is the transfer to, or the assumption by, third parties of the risk inherent in the economic interest retained (*e.g.* guarantees, credit derivatives, other transactions).

The retention requirement must be respected in all financing transactions by the SPV, regardless of whether or not the securitization transaction carried out by the SPV constitutes a "securitization" pursuant to art. 4, no. 61, of the CRR. As a result, the retention also applies in the context of a securitization in which there is no tranching (*i.e.*, the issue of a single class of notes).

(ii) Criteria for the selection of borrowers

Banks and financial intermediaries that select borrowers for loans provided by SPVs must apply (A) the assessment of creditworthiness criteria, (B) the procedures for evaluation of the granting of credit, and (C) the risk control systems under the applicable laws in relation to lending activities carried out on their own account. The Implementing Provisions provide that the lending activities carried out by the bank or financial intermediary may not be made up of, exclusively or primarily, the maintenance of the economic interest required for the completion of these transactions. In relation to EU banks operating in Italy and the EU financial intermediaries permitted through mutual recognition, it is necessary to refer to the criteria for the granting of loans, the methods for measuring risks and the exposure monitoring systems laid down by the home Member State regulation that implement the provisions of art. 79 of Directive 2013/36/EU ("**CRD IV**").

(iii) Information for investors

Banks and financial intermediaries that select borrowers for loans granted by SPVs must inform the securitisation's noteholders of the level of commitment (*i.e.*, retention) assumed, and must also ensure the accessibility of the significant information in accordance with the provisions of art. 409 of the CRR and relevant delegated regulations.

(iv) Monitoring by the Servicer

The servicer of the securitization has a specific monitoring role. In particular, under the Implementing Provisions the servicer must:

- a. check that the retention of at least 5% (or a higher amount agreed between the parties) as described in paragraph (i) has been complied with;

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- b. check that the selection of borrowers takes place on the basis of a formal process clearly documented attesting the application of the criteria set out in paragraph (ii);
- c. ensure that investors have received information on the level of commitment assumed by the banks and financial intermediaries, and that the significant information relevant to the transaction is accessible and regularly updated.

The participants in the securitization transaction – in particular, the SPV and the entity which selects the borrowers for the loans, if different from the servicer – must undertake to provide information to the servicer so that the latter can carry out the monitoring activities entrusted to it.

In the event that the entity acting as servicer is also in charge of selecting the borrowers for the loans, it must ensure that the above mentioned monitoring activities are carried out by a separate and independent division from the departments which carry out the credit evaluation and lending activities.

3. Preliminary considerations

Provisions allowing SPVs the possibility to grant loans to certain entities was met with great interest by participants in the market, as it is – together with the granting of loans by credit funds and insurance companies – a means of accessing further credit outside the traditional banking industry.

It is a novelty with enormous potential and could be used for both traditional securitizations, as well as in more structured and innovative transactions involving, for example, distressed assets transactions relating to companies which are in financial difficulties which need to obtain new finance as part of a turnaround and/or debt restructuring in order to maximize credit recovery for creditors.

Although the Implementing Provisions regulate the main aspects of the granting of loans, some regulatory issues have not been fully clarified by the legislation, among which we would highlight the following:

- a. **Legislation on bank transparency:** the legislation does not clarify if the SPV is subject to the legislation on transparency and customer relations provided for in the Banking Act, nor the supervisory disclosure *vis-à-vis* by the Bank of Italy (in contrast to the provisions recently set out in Decree Law 18/2016 – the "Banks Decree" – for the granting of loans by Italian and EU alternative investment funds);
- b. **Role of the sponsor - involvement of other parties:** to allow the SPV to be fully operational in the granting of loans, together with the "sponsor" (*i.e.* the bank or financial intermediary which selects borrowers and hold the "retention") it may be necessary to involve a third party who assists the SPV in the negotiation of the financing and the subsequent management of the contractual relationship with the borrowers themselves. These activities, which are not among those entrusted to the servicer by the Securitisation Law, should be carried out by another person or entity appointed by the SPV and which is not mentioned in the Implementing Provisions; and
- c. **"Mixed" Securitization:** the legislation does not clarify whether the granting of loans by an SPV must be in the alternative to the purchase of receivables by it or if an SPV can (as is hoped) carry out securitization transactions which provide for, on the basis of the same segregated assets, both the purchase of receivables and the granting of loans by the SPV.

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