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## DECREE PASSED INTRODUCING GOVERNMENT GUARANTEE SCHEME FOR ITALIAN SECURITISATIONS OF NON-PERFORMING LOANS

On 10 February 2016, decree no. 18/2016 (the "**Decree**") was passed which, following the agreement reached with the EU late last month, sets out the details of the Italian government guarantee scheme for senior tranches of securitisation ABS backed by NPLs.

It is hoped that the scheme will help to alleviate the serious problem of non-performing loans on the balance sheets of Italian banks, estimated to make up around 17% of total loans, as compared with the EU average of 6%.

This Finance Law Alert is an update of our newsletter published on 1 February 2016 entitled "[\*Italian Finance Ministry announces Government guarantee scheme for Italian NPL Securitisations\*](#)".

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### Summary

- **State guarantee of senior ABS backed by NPLs**
- **Scheme initially available for 18 months and may be extended**
- **Guarantee fee will increase over time, price linked to single name CDS**
- **Guaranteed tranche must have investment grade credit rating**
- **Seller bank must own less than 50% of junior tranche**
- **Independent servicer**
- **Structural features may include swap agreement and liquidity line**
- **Decree sets out payment waterfall for application of issuer's funds**

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### State guarantee of senior ABS backed by NPLs

The State will provide an irrevocable, unconditional, first demand guarantee for asset-backed securities issued as part of a securitisation transaction whose underlying assets are non-performing loans. The scheme will initially be available for 18 months, extendable by further decree with the prior approval of the European Commission.

The guarantee will only cover the most senior tranche of notes, and the mezzanine and junior tranches must be fully subordinated to such guaranteed senior tranche.

To qualify for the guarantee scheme, the NPL seller must be an Italian bank; the Decree therefore appears to preclude guarantees for NPL securitisations where the portfolio has already been sold by the originator bank to a third party purchaser.

The purchase price of the NPLs may not be higher than their net book value (gross value net of adjustments).

### **Making a claim under the guarantee**

Noteholders may call under the guarantee following failure by the issuer to pay interest or principal, at any time up to nine months after the final maturity date.

Before making a demand under the guarantee, the noteholders must, acting through the representative of the noteholders, make a written demand to the issuer for the unpaid amounts. Following the expiry of 30 days without payment by the issuer, the noteholder will have six months to call under the guarantee.

The guaranteed amount is payable by the State within 30 days of the demand. No interest or other expense may be claimed under the guarantee over and above unpaid amounts owing under the senior notes.

### **Guarantee fee will increase over time**

The State will charge a guarantee fee being an annual percentage of the principal amount outstanding of the guaranteed senior tranche.

The guarantee fee will increase over time, both to cover for the higher risk associated with longer duration of the bonds and to create an incentive for early recovery of the underlying debt.

The price for the first three years is calculated as an average of the mid-price of three-year benchmark single name CDS over the six months prior to the issuance of the guarantee.

The Decree specifies three "baskets" of Italian corporate and bank issuers including Enel, Eni, Unicredit, Telecom Italia, Intesa Sanpaolo and Assicurazioni Generali. The rating of the issuers in each basket correlates with the rating assigned to the senior tranche. Any such issuer which is downgraded, shall be excluded from the relevant basket.

In the fourth and fifth year the price will increase (5-year CDS) and from the sixth year onwards the guarantee will be fully priced (7-year CDS). In addition, after three years there will be a supplemental premium which also steps-up at the five year mark.

The guarantee fee is paid by the issuer in accordance with the payment waterfall described under the heading "Priority of Payments" below.

### **Investment grade credit rating**

Issuance of the guarantee by the Italian State is conditional upon the senior tranche receiving an investment grade public credit rating from at least one

independent rating agency accepted by the Eurosystem. Where two credit ratings are required, the second may be from a rating agency registered under Regulation (EC) No. 1060/2009 (the CRA Regulation).

As an alternative to a public rating, the issuer may obtain a private rating addressed to the Ministry of Economy and Finance from an independent rating agency accepted by the Eurosystem.

### **Off-balance sheet treatment**

The guarantee will also be conditional upon the seller bank owning less than half of the junior notes issued under the securitisation, or in any case, that the receivables are recognised as not being on its balance sheet under applicable accounting rules.

### **Independent servicer**

The ABS issuer will be required to appoint an external independent servicer to recover the underlying debts which does not belong to the same group of companies as the originator bank, in order to prevent conflicts of interest.

### **Swap and Liquidity**

The Decree provides that the ABS issuer may enter into a swap agreement to mitigate interest rate risk and/or a liquidity line so that it can meet its senior expenses on each payment date, including interest on the senior notes.

The senior notes and (if issued) mezzanine notes will bear interest at a variable rate payable in arrears quarterly, semi-annually or annually, calculated on the relevant tranche's principal amount outstanding. The Decree provides that payment of interest on the mezzanine notes (if issued) can be made conditional upon performance targets relating to recoveries on the underlying portfolio being met.

### **Priority of Payments**

The Decree sets out the payment waterfall in accordance with which the issuer's available funds deriving from the loans forming the collateral (net of amounts payable to the servicer) will be distributed on each payment date, as follows:

1. Taxes
2. Fees and costs of the issuer's service providers
3. Fees and interest on the liquidity line (if any)

4. Guarantee fees
5. Amounts under the swap agreement (if any)
6. Senior note interest
7. Principal under the liquidity line (if any)
8. Mezzanine note interest (if issued)
9. Senior note principal
10. Mezzanine note principal (if issued)
11. Interest, principal and additional return on the junior tranche.

Accordingly, early repayment of principal of the notes may occur in accordance with the waterfall, subject to the availability of funds.

### **Next steps**

The Decree came into force on 15 February 2016 on publication in the Official Gazette.

It must be converted into law within 60 days and further amendments may be introduced during the conversion process.

The Decree also provides that the Italian Ministry of Economy and Finance may introduce implementing rules within 60 days of conversion of the Decree into law.