

Gennaio 2014

The “Destinazione Italia” Decree: New life for Minibonds and Trade Receivables Securitizations

Luca Vestini e Tancredi Marino, Pavia e Ansaldo - Milan

Contents: 1. Background; 2. The Italian Corporate Bonds Regime; 3. The “Destinazione Italia” Decree; 3.1 New Life for Minibonds; 3.1.1 Floating charges to secure Italian corporate bonds; 3.1.2 Insurance companies and pension funds to invest in Italian corporate bonds; 3.1.3 Additional tax incentives for Italian corporate bonds; 3.2 Collateralized Debt Obligations; 3.3. New Life for Trade Receivables Securitizations; 4. Conclusions.

1. Background

Already in 2012, the laws that govern Italian corporate bonds had been extensively amended to give Italian small and medium size enterprises (“SMEs”) access to the funding necessary to survive and expand their businesses.

The new legislation enables unlisted SMEs to issue commercial papers (*cambiali finanziarie*)¹ and notes (*obbligazioni finanziarie*)² with a view to providing some relief to companies in a country where 90% of businesses used to be funded by bank loans, but where banks have increasingly tighten lending.

The Italian Law Decree no. 145 of 23 December 2013 (the “*Destinazione Italia Decree*”) has now lifted a number of other restrictions on corporate bonds offerings, particularly in terms of security and regulatory laws and has introduced additional tax and other incentives that are intended to pave the way to a new and improved Italian corporate bonds regime.

Unsurprisingly, in a market that is in a desperate need of new sources of liquidity, the *Destinazione Italia* Decree has also made some significant changes to the Italian Securitization Law (Law no. 130/99, hereinafter “**Law 130**”) and the Italian Factoring

¹ *Cambiali Finanziarie* are short-term debt instruments similar to UK or US commercial papers with a debt maturity that ranges from 1 to 36 months.

² *Obbligazioni Finanziarie* are notes that usually have a long maturity (for example at least 36 month for certain types of subordinated notes).

Law (Law no. 52/1991, hereinafter “**Law 52**”) that are intended to allow Italian companies (and SMEs in particular) to obtain financing through trade receivables facilities.

This note will first provide a summary of the most significant aspects of the Italian corporate bonds regime as amended in 2012, with a focus on the additional changes made by the *Destinazione Italia* Decree. Then, this note will summarize the changes made by the *Destinazione Italia* Decree to Law 130 and Law 52 and describe how trade receivables deals will be affected by the new laws and regulations.

2. The Italian Corporate Bonds Regime

Italian corporate bonds have been traditionally issued by large companies. As mentioned, in the course of 2012, this market has been increasingly opened to SMEs. Debts instruments issued by SMEs are commonly referred to as “Minibonds”.

Pursuant to the European Commission Recommendation no. 361 of 6 May 2003, SMEs are those companies that: (i) have fewer than 250 employees; and (ii) do not exceed an annual turnover of €50M and a balance sheet of €43M. Micro-enterprises (less than 10 employees with a total turnover of less than €2M) are not allowed to issue corporate bonds under Italian law.

The main rules governing Italian corporate bonds are those contained from Section 2410 to Section 2420*ter* of the Italian Civil Code in relation to offerings of notes issued by Italian joint-stock companies (“**Italian SPAs**”) and Section 2483 of the Italian Civil Code in relation to offerings of notes issued by limited liabilities companies (“**Italian LLCs**”).

Law no. 43/1994 governs offerings of commercial papers.

Both the Italian Civil Code and Law n. 43/1994 have been amended in the course of 2012 by the Law Decree no. 83/2012 (subsequently converted into Law no. 134/2012) and the Law Decree no. 179/2012 (subsequently converted into Law no. 221/2012), (the “**2012 Legislation**”).

Under the 2012 Legislation, Italian SPAs can turn to the bond market provided that they satisfy the following conditions:

1. Notes and commercial papers can only be issued up to an aggregate value equal to twice the issuer’s share capital together with its legal or available reserves, as indicated in its most recent financial statements.
2. The issuer’s most recent financial statements are approved internally and audited by external auditors.

3. Only in respect of offerings relating to commercial papers, it is required the assistance of a sponsor³.

The quantitative limits set out under (1) above can be exceeded if either of the following requirements are satisfied:

- The exceeding part of the offering is only distributed among qualified investors, provided that if the debt instruments are subsequently passed onto a non-qualified investor, the qualified investor will have to reimburse the principal amount as well as any interest due under the bond when the original issuer defaults;
- Notes are secured by a first ranking mortgage over the issuer's real estate assets for an amount equal to 66% of the value of the assets;
- The corporate bonds are listed on regulated markets or any other multilateral trading facility⁴; or
- The corporate bonds are structured so to allow the investors to convert them into equity.

Offerings of notes and commercial papers issued by Italian LLCs are subject to the same restrictions set out above for Italian SPAs but it is to be noted that Italian LLCs can only distribute their debt instruments among qualified investors.

Consob (the Italian supervisory authority) has identified three types of qualified investors:

- A. banks, financial institutions, financial investment companies, insurance companies and other regulated entities;
- B. large companies with a balance sheet of at least €20M and a turnover of at least €40M; and
- C. other financial intermediaries such as, for example, special purpose entities ("SPVs") created in the context of securitization transactions.

Under the 2012 Legislation, notes and commercial papers can be issued in a dematerialized form and SMEs are also allowed to issue notes with subordination and profit participation clauses, provided that:

- I. the debt's maturity is not less than 36 months;

³ Sponsors have been defined to include: banks, financial institutions, asset management firms and other financial intermediaries. Under the new rules, they have to retain a certain portion of the issued debt instruments until maturity.

⁴ For a list of multilateral trading facilities in the EU please check: <http://mifiddatabase.esma.europa.eu>

- II. the subordination clause specifies that the issuer's creditors are to be paid in preference of the noteholders (with the noteholders to be paid only ahead of the shareholders); and
- III. any profit to be paid on the notes is composed of a fixed as well as a floating element, with the reimbursement of the principal to be made fully, in any event.

There are a number of significant tax incentives that have been introduced by the 2012 Legislation:

- ❖ First, issuers without stock-market listings are allowed to deduct the cost of servicing the bond debt from their tax bill⁵, provided that the notes are traded on regulated markets or other multilateral trading facilities in Italy or in another white list country⁶.
- ❖ Second, any cost relating to the offering can also be deducted from the issuer's tax bill in the tax period in which they have been incurred, thus effectively representing a substantial tax credit for issuers.
- ❖ Third, no withholding tax (currently at 20%) shall be paid by professional investors, whether established in Italy or not, on interest and other floating profits paid on notes and commercial papers issued by SMEs, provided that they are traded on regulated markets or other multilateral trading facilities in Italy or in another white list country.

To make the bond market a real alternative to bank loans for SMEs, the Italian Stock Exchange in Milan set up a platform in 2012, called ExtraMot Pro, that allows institutional and other qualified investors to trade bonds issued by SMEs without stock-market listings.

In response to these developments, the credit agency Standard and Poor's is in the process of providing a mid-market evaluation setting out its views on the creditworthiness of mid-market companies in Italy. Standard and Poor's mid market evaluations are not intended to be credit ratings but they will range from MM1 (highest) to MM8 (lowest) and MMD (default).

3. The “Destinazione Italia” Decree

Destinazione Italia is a recent governmental plan aimed to attract foreign investments to Italy and promote the interests of Italian SMEs.

⁵ In line with the tax rules applicable to bank loans, interest are in any case deductible within the limit of 30% of the issuer's EBITDA.

⁶ White list countries are those that generally exchange information and cooperate with Italy in relation to tax matters (Ministerial Decree dated 4 September 1996, as amended).

As explained in the plan's website – www.destinazioneitalia.gov.it (which includes a good English version) - it consists of 50 measures whose goal is to reorganise and reform a number of key areas including tax and employment law, energy and civil and commercial justice, among others.

Section 12 of the *Destinazione Italia* Decree contains provisions that (A) are intended to help SMEs to obtain more funding from debt capital markets investors and (B) change Law 130 and Law 52 with a view to incentivizing the use of trade receivables facilities.

3.1 New Life for Minibonds

Here are the new rules and incentives introduced by the *Destinazione Italia* Decree for corporate bonds:

3.1.1 Floating charges to secure Italian corporate bonds

Offerings of corporate bonds with a maturity longer than 18 months and that are only distributed among qualified investors can now be secured by the so called “*Privilegio Speciale*”.

The “*Privilegio Speciale*” is a security provided by Section 46 of the Italian Banking Act (“**IBA**”), similar to the English law floating charge, and that originally could only be granted by borrowers to secure their bank loans.

Floating charges granted in accordance with Section 46 of the IBA hover over assets that the chargor is free to deal with and often comprise a shifting pool which, provided that the registration requirements below are complied with, may be turned over on a regular basis in the ordinary course of the chargor's business.

They generally cover the following asset classes:

- plants and machinery;
- raw materials, inventory, finished products and commodities;
- any of the above assets that are acquired with the proceeds of the corporate bonds; and
- receivables arising out of the sale of the above assets.

The use of floating charges to secure corporate bonds will particularly benefit those issuers that often do not own any real estate property and cannot afford to pledge their assets to secure the offerings of their debt instruments as a pledge would inevitably imply the transfer of the pledged assets to the secured creditors or a custodian.

The document creating the “*Privilegio Speciale*” will specify the assets that are covered and the general conditions of the bond offering that is securing. To be enforceable

against third parties (e.g. creditors of the issuer other than the bondholders), the document must be notarised and registered with the competent office of the court in the district in which the relevant parties are based.

The *Destinazione Italia* Decree has also introduced the possibility to appoint a representative of bondholders in the document creating the “Privilegio Speciale” so to make sure that all the details that have to be registered won’t have to be amended when the bonds are subsequently transferred onto other investors.

3.1.2 Insurance companies and pension funds to invest in Italian corporate bonds

The *Destinazione Italia* Decree has also clarified that corporate bonds and other debt instruments issued in the context of securitization transactions shall be eligible in terms of assets (A) that can be used by insurance companies as technical reserves and (B) are in line with the investment limits set out for pension funds, even when they are not listed on any regulated market or any other multilateral trading facility and have not received an independent rating.

The IVASS (the Italian supervisory authority over insurance companies) is soon expected to issue a new regulation setting out all the details relating to how insurance companies can use these debt instruments to cover their technical reserves obligations.

These provisions are intended to increase the number of entities that can invest in Italian corporate bonds (including minibonds) and ultimately the liquidity of the Italian corporate bond market that is expected to finally take off.

3.1.3 Additional tax incentives for Italian corporate bonds

Taxes that could potentially apply to a bond offering in Italy and the related security included: registration tax, stamp duty, mortgage tax or taxes relating to the granting of other forms of security. The *Destinazione Italia* Decree has now introduced a new rule whereby issuers can decide to opt for the application of the more favorable regime of the 0.25% substitute tax which will replace any other applicable tax. The 0.25% substitute tax shall apply to the aggregate principal amount of the debt offering and extend to the granting of any security, even when they are given by third parties, in connection with the debt offering and on the occurrence of any subsequent change such as the transfer of the bonds or their cancellation.

Issuers will have to opt for the application of the 0.25% substitute tax in the corporate resolution authorizing the debt offering. The taxpayer liable for the payment of the substitute tax is the financial intermediary that has arranged the debt offering or the issuer, when no financial intermediary participates in the transaction.

In addition, the withholding tax exemption for corporate bonds has been extended by the *Destinazione Italia* Decree to investment funds whose investors are exclusively “qualified investors” under Italian law and whose assets are for the most part invested in

corporate bonds. Therefore, no withholding tax shall apply to the payment of interest and other profits made by issuers of corporate bonds, including SMEs without stock-market listings, for the benefit of such investment funds.

3.2 Collateralised Debt Obligations (“CDOs”)

The *Destinazione Italia* Decree is also trying to re-energize the market for CDOs by allowing banks to issue bonds (other than ordinary covered bonds under Law 130) that are secured by a number of debt instruments, which include: (i) corporate bonds issued by Italian companies without stock-market listings; (ii) securities issued by securitization SPVs that have corporate bonds as underlying assets; (iii) trade and other receivables owed to SMEs; (iv) receivables arising out of factoring facilities or leasing agreements. All such assets were previously excluded from those that can guarantee the issue of covered bonds under Law 130. The new provisions have been designed to help banks to invest in: (a) corporate bonds issued by and (b) trade receivables owed to Italian companies.

3.3 New Life for Trade Receivables Securitizations

The *Destinazione Italia* Decree has made a number of very significant changes to the laws that govern securitization transactions in Italy and trade receivables deals in particular. More specifically:

1. In line with the intention to expand the corporate bonds market, the *Destinazione Italia* Decree has extended the application of Law 130 to securitization transactions in which SPVs underwrite or purchase corporate bonds and other similar debt instruments (excluding in any case equity, hybrid or other convertible instruments).
2. Trade receivables securitizations are now explicitly contemplated by Law 130 and transfers of receivables to Law 130 SPVs may happen following the methods provided for by Law 52. This means that:
 - a) Besides the ordinary Law 130 deals, the *Destinazione Italia* Decree provides for structures where the transfer of receivables will not have to be published on the Italian Official Gazette and will be enforceable against third parties (see let. c below) following the methods of Law 52 i.e. by having the evidence of the payment of the receivables certified by the relevant date certain (*data certa*): this will certainly make trade receivables deals structured using Law 130 more effective as often, in this type of deals, the transfer of the receivables happen on a revolving basis and therefore the requirement of the publication on the Italian Official Gazette may cause such structures to be less efficient and more expensive. In addition to this, it is no longer mandatory under Law 130 to transfer receivables to Law 130 SPVs as a pool (*in blocco*) and

therefore portfolios of trade receivables (including those of SMEs) may be transferred onto SPVs more easily.

- b) In addition, it is now provided that the date certain (*data certa*) of the payment of the purchase of the receivables under Law 52 can be obtained by receiving the copy of the bank account in which the funds are credited.
 - c) Most importantly, the transfer of receivables to Law 130 SPVs effected following the methods of Law 52 (as amended) are now enforceable against (a) creditors of the seller of the receivables, (b) other purchasers of the same receivables and (c) the underlying debtors. More precisely, once the receivables are sold to the Law 130 SPV, the underlying debtors will no longer be able to set off (i) any subsequent credit they may have vis-à-vis the seller against (ii) debts then owing to the purchaser of the trade receivables.
3. Law 130 SPVs and servicers can now open bank accounts (for the payment of the receivables transferred onto the SPVs and managed by the servicers) that are fully segregated and bankruptcy remote by operation of law.
 4. Law 130 notes can now be purchased by a sole investor when this is a qualified investor under Italian law.
 5. Section 65 of the Italian Bankruptcy Law will not apply to payments made under the contracts whose receivables have been transferred in the context of a securitization transaction governed by Law 130. This will make such structures even more robust as claw-back of pre-payments made in the two year period ending with the onset of the bankruptcy of the underlying debtors will no longer be possible.
 6. Transfer of receivables of public entities (that previously used to follow a special regime under Italian law) are now subject to the same rules of those transfers effected by and between private entities.
 7. In the event that the securitization transaction is structured by transferring receivables to an investment fund, it is further provided that: (i) the fund's asset management company may be appointed as servicer of the transaction thus ensuring the supervision of the Bank of Italy over it without having to increase its overall costs; (ii) Section 58 of the IBA will also apply to such transfers (and as a consequence the transfer of receivables will have to follow the methods provided therein); and (iii) transfer of receivables will be subject to the more favorable regime of the 0.25% substitute tax.

4. Conclusions

Section 12 of the *Destinazione Italia* Decree has completed the legal framework for Italian corporate bonds that had already been significantly improved by the 2012 Legislation. Offerings can now benefit from an even more favorable tax regime that includes: (i) the possibility for issuers to deduct from their tax bills all the expenses relating to the bond issue; (ii) the opportunity for investors (Italian tax residents or residents in any other white list country, including the investment funds described above) to benefit from the withholding tax exemption; and (iii) the application of the more favorable 0.25 substitute tax.

Investors will also welcome the opportunity for issuers to secure their offerings by granting a floating charge over their assets. Insurance companies and pension funds are now incentivized to purchase corporate bonds as those regulatory impediments that used to prevent them from investing have now been lifted.

Section 12 of the *Destinazione Italia* Decree is also intended to change the fortunes of securitization transactions with a specific focus on trade receivables deals: Italian companies have now a set of new rules that should enable them to obtain the funding that they need to operate their businesses using their most valuable assets (i.e. their trade receivables) as a collateral. Banks, on the other hand, will also benefit from the opportunity to invest in assets (securitization notes and corporate bonds) that can be used for the purposes of Eurosystem refinancing operations.

Finally, it is worth noting that the *Destinazione Italia* Decree will have to be converted into an ordinary law within 60 days from 24 December 2012. It is possible that the provisions of the *Destinazione Italia* Decree may be further modified in this process, in which case a new report that will reflect any such additional change will be published.