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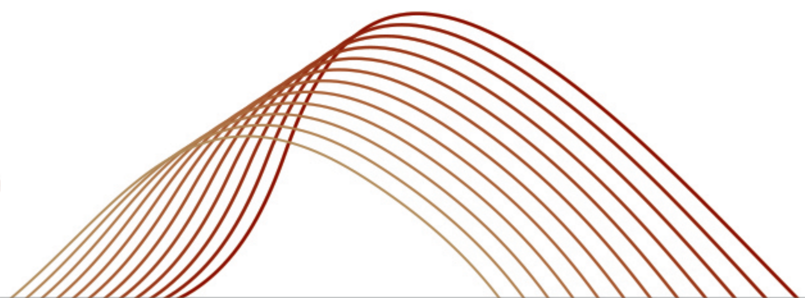

February 2016

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Alternative Lending in Italy: A Significant Step Forward

By Alberto Del Din, Bruno Cova, Ugo M. Giordano, Sofia De Cristofaro & Marc-Alexandre Courtejoie

Background

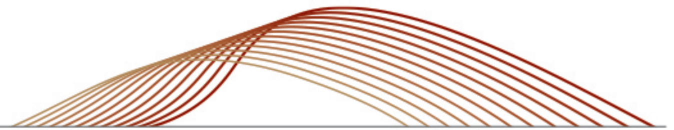
Since the summer of 2012, faced with the drying up of bank lending caused by the financial crisis, successive Italian governments (the Monti, Letta, and currently Renzi governments) have introduced several measures to favour the influx of non-bank debt into Italy, with a view to supporting the re-start of the real economy. The initial interventions consisted in the progressive lifting of the corporate and tax restrictions which had historically cut off Italian private companies from the capital markets, enabling them to issue so-called "minibonds". Most recently, the focus of the reforms has moved to the erosion of the concept of lending as activity restricted to banks, Italian financial intermediaries and EU financial companies, by broadening it to include a number of other players.

Indeed, in June 2014, the Renzi Decree,[1] by amending the tax provisions on withholding tax on interest payments and on the registration tax treatment of loans and collateral, opened the door to a number of alternative money providers, i.e., Italian and EU investment funds, Italian and EU insurance companies, and Italian securitisation vehicles, engaging in lending in Italy. Since then different pieces of legislation have filled the picture and brought the regulatory framework surrounding lending in Italy in line with the new tax framework.[2]

Whilst provisions were soon enacted to govern lending by Italian insurance companies[3] and Italian AIFs ("Italian Credit Funds"),[4] and draft regulatory provisions regarding lending by Italian securitisation vehicles were published for consultation in March 2015, the long-awaited regulation of the Italian Ministry of Finance No. 53 of 2 April 2015 defining lending as a restricted activity was seen as a missed opportunity as it did not provide important pieces of the puzzle, i.e., the conditions under which the foreign players selected in the Renzi Decree (EU investment funds and EU insurance companies) would be allowed to lend into Italy, but rather insisted on the old requirements of full-blown Bank of Italy authorisation, permanent establishment in Italy, and minimum capitalisation for EU financial companies not controlled by EU banks wishing to engage in lending in Italy.

Finally, Italian Law Decree No. 18 of 14 February 2016 (the "Decree") has filled the regulatory gap and clarified the conditions under which EU investment funds will be allowed to lend in Italy as detailed below.[5]

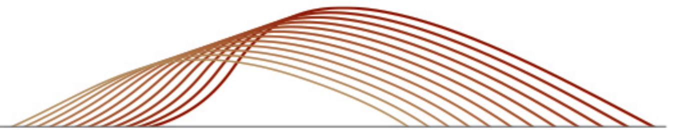
The Decree has entered into force on 16 February 2016; however, being in the form of emergency legislation, it will need to be converted into law within 60 days from its publication, so amendments to its provisions are still possible. Further, the new provisions will require the issue of implementing regulations by the Bank of Italy. This process, while seemingly cumbersome, does



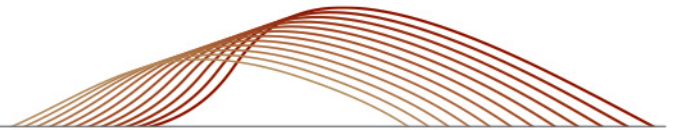
offer market players a number of useful opportunities to reflect on the new provisions and feed in comments and requests for adjustments to the Italian law-maker and regulator.

Conditions for Lending by EU Investment Funds

	REQUIREMENT	COMMENTS/IMPLICATIONS
1.	Fund type: the investment fund must be an EU AIF, i.e., an undertaking for collective investment "falling within the scope" of Directive 2011/61/EU (the "AIFMD"), which is established in an EU member state other than Italy.	• EU investment funds, which fall outside the scope of the AIFMD either because they do not meet the "AIFs" definition in Article 4(1) or pursuant to Articles 2(3) and 3(1) thereof (e.g., family offices, holding companies, securitisation vehicles, joint ventures, pension funds, employee participation or savings schemes, funds whose sole investors are the investment manager and/or its affiliates) would not qualify. • So-called small EU AIFs, which *are exempted from* the scope of application of a large part of the AIFMD pursuant to Article 3(2) thereof appear unlikely to qualify, as long as they do not opt-in under the AIFMD.[6] • When it becomes possible for Non-EU AIFMs to manage EU AIFs under the single authorisation regime of Article 37 of the AIFMD, EU AIFs managed by Non-EU AIFMs should qualify. • Non-EU AIFs, regardless of the nationality of the fund manager, would not qualify.
2.	Authorisation in the home member state: the EU AIF must be authorised by its home regulator to invest in loans in its home member state, including loans originated by the AIF itself.	• The authorisation can be express (e.g., for regulated funds in EU countries which provide for some form of lending restriction, it can be set out in statutory instruments and then confirmed by the home regulator's authorisation of the individual AIF), in which case the relevant documentary evidence should be provided to the Bank of Italy. • Arguably, the authorisation should be deemed in place also when it is not express but can be derived from the overall legal framework applicable to lending and investment funds in the home jurisdiction (e.g., in EU countries where there is no lending restriction and investment funds are allowed to invest in loans, including those which they originate),[7] in which case, based on Italian past regulatory practice it may be expected that the Bank of Italy's implementing regulations will provide that a legal opinion to this effect may suffice.
3.	Authorisation in Italy: the manager of the EU AIF must notify the Bank of Italy of its intention to engage in direct lending in Italy and the EU AIF may not start operations until 60 days have passed from this notification, within which deadline the Bank of Italy may deny permission to lend directly in Italy.	• The application process, which will be detailed in the Bank of Italy's implementing regulations, will likely focus on providing evidence that the requirements mentioned under points 2 and 4-6 of this table are satisfied. • As this is not a matter covered by any European Directive, the assessment by the Bank of Italy is unlikely to be a rubber-stamp exercise and will entail a review of the merits of the application and of the supporting documentation.
4.	Investors: the EU AIF must be in closed-ended form and its framework of operation ("*schema*	• The concept of 'framework of operation' normally encompasses the fund's legal form (i.e., if it is constituted under the law of contract or under



	di funzionamento"), particularly as regards investors' participation, must be similar to the one of Italian Credit Funds.	statute), target investors, open or closed-ended form and frequency of subscription and redemption of the units, permitted investments, investment and concentration limits, presence of a custodian, and disclosure to investors.[8] • Italian Credit Funds may be open to retail investor participation; as this involves the application of additional regulations and thus complicates the similarity assessment required by the Decree, we are focusing our analysis in this table on EU AIFs which are non-retail fund in their home member states. • Considering that investment and concentration limits are separately addressed in point 5 below, that the provisions on custodians and disclosure to investors are now set uniformly by the AIFMD, and that closed-ended Italian investment undertakings can now be set up also under statute (in the form of investment companies with a fixed capital, so-called "Sicaf"), this requirement should mainly refer to the provisions identifying the EU AIF's target investors and governing their participation in the fund, including, *inter alia*: (i) the requirement that investment in the EU AIF be restricted to professional investors (as defined by the AIFMD by reference to the concept of professional clients under MIFID) and semi-professional investors (i.e., non-professional investors who subscribe for or purchase units in the fund for an amount not lower than Euro 500,000);[9] (ii) the maximum duration of the fund, which may not exceed 50 years. • It is unclear whether other limitations applicable to Italian Credit Funds, such as the prohibition to invest in loans with a maturity longer than the fund's and the requirement that the fund can only incur debt from banks, licensed financial intermediaries and other entities authorised to originate loans, may come into play.
5.	Leverage and concentration limits: the home member state's provisions on risk management, concentration limits, and permitted leverage should be equivalent to the provisions applicable to Italian Credit Funds. This equivalence may be established also solely on the basis of the EU AIF's fund rules or constitutional documents, provided that the home regulator ensures compliance with such provisions.	• Italian Credit Funds reserved to professional and semi-professional investors are subject to a 1.5 leverage limit and a 10% concentration limit;[10] newly created fund are exempted from compliance with the concentration limit for six months since the date of beginning of operations. • The requirement that analogous limitations be envisaged either in the applicable home member state laws or regulations or in the EU AIF's fund rules or constitutional documents and be policed by the home member state regulator, may raise some doubts as to whether unregulated EU AIFs (such as the newly introduced Luxembourg RAIFs (reserved alternative investment funds)) would qualify for direct lending in Italy.
6.	Borrower type: no lending to consumers will be allowed.	• This restriction applies across the board to all other entities newly authorised to engage in lending in Italy (Italian and EU insurance companies, Italian securitization vehicles,[11] Italian Credit Funds) and appears in line with the policy choices made by other



		EU regulators (in particular the German BaFin and the Central Bank of Ireland).
7.	Regulatory duties in Italy: the EU AIF: (i) will be subject to yet-to-be defined reporting obligations to the Bank of Italy and CONSOB; (ii) may be required to take part, including through an Italian licensed financial intermediary, in the Italian Central Credit Register ("*Centrale dei Rischi*"); (iii) will be subject to the provisions on transparency of contractual terms applicable to bank loan agreements and security documents, for which the fund manager will be responsible.	• Some infrastructure will be needed in order to comply with the on-going reporting obligations currently applicable to banks and financial intermediaries, which the Bank of Italy may extend to EU AIFs authorised to lend in Italy and Italian Credit Funds (including, for example, reporting of defaulted loans into the Italian Central Credit Register and regular reporting on interest rates applied to the various types of loans for the purposes of the periodical setting of usury thresholds). • The provisions on transparency of contractual terms include, *inter alia*, the obligation to disclose to the clients the main economic terms of the loans offered (including calculating and disclosing the APRC ("*TAEG*")), limitations to the right to unilaterally amend contract terms, requirement for all finance agreements to be in writing, and limitation to the capitalization of interest (and thus to the provision of PIK interest). • Particularly if the participation of EU funds in the Italian Central Credit Register will be requested, it can be expected that EU AIFs authorised to lend in Italy may establish an on-going service relationship with a local financial intermediary, to which compliance and record-keeping in respect of all the regulatory duties mentioned in this point 7 will be outsourced.

Concluding Remarks

The Decree has led to a broader—though still not full—liberalisation of lending in Italy by EU investment funds. The measures introduced by the Decree are not entirely satisfactory and may at first sight disappoint market players based in jurisdictions where lending is not a restricted activity. However, against the background of the restrictions historically applicable to lending in Italy, these measures are undoubtedly innovative and offer yet another option in the toolkit for financing Italian corporates, alongside the mini-bonds, the innovative uses of Italian securitisation SPVs, and the participation of supervised professional investors in loans originated and fronted by Italian or EU banks. In parallel with similar developments in other EU countries such as Germany and Ireland, the clarification of the requirements for EU AIFs to lend in Italy may in our view allow investment managers which pursue a medium term EU-wide loan investment strategy to identify a minimum common denominator of structural requirements which would enable a single EU AIF to comply with the requirements applicable to lending by funds in multiple jurisdictions.

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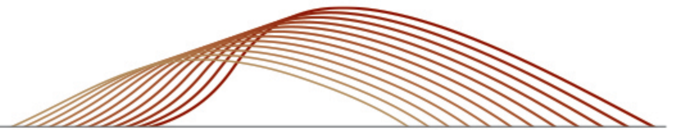

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

London

Ugo Giordano
44.020.3023.5160
ugogiordano@paulhastings.com

Sofia De Cristofaro
44.020.3023.5181
sofiadecristofaro@paulhastings.com

Milan

Bruno Cova
39.02.30414.212
brunocova@paulhastings.com

Marc-Alexandre Courtejoie
39.02.30414.230
marcalexandrecourtejoie@paulhastings.com

Alberto Del Din
39.02.30414.288
albertodeldin@paulhastings.com

[1] Italian Law Decree No. 91 of 24 June 2014—see our Client Alert "Italy Introduces Measures to Facilitate Alternative Funding" of July 2014.

[2] In particular, loans originated by EU investment funds benefit from: (i) no withholding tax on interest received, regardless of whether the fund is tax transparent according to its home member state; and (ii) the same favourable taxation of the security package (i.e., the substitutive tax at the rate of 0.25% of the loan amount) as the one applicable to bank loans.

[3] IVASS Resolution No. 22 of 21 October 2014—see our Client Alert "The Changing Face of Italian Insurance Companies" of November 2015.

[4] Italian Legislative Decree No. 44 of 4 March 2014, amending the Italian Financial Act, as implemented by the Decree of the Ministry of Finance No. 30 of 5 March 2015 and by the new regulation of the Bank of Italy on collective investment schemes of 19 January 2015; additional provisions governing lending by Italian Credit Funds have now been introduced by the Decree.

[5] The Decree also contains provisions on the state guarantee for ABS backed by NPLs originated by Italian banks—please refer to our Client Alert "Italy Introduces Government Guarantee to Facilitate NPL Transactions" of February 2016.

[6] Small AIFs may not engage in lending activity in Ireland (i.e., an Irish loan originating QIAIFs must have a fully authorised manager) but they can engage in lending activity in Germany as loan originating Special Funds, though they will be subject to additional regulatory requirements.

[7] Cases in point would be Luxembourg and the UK. In Italy too, whilst there is now a general provision allowing Italian AIFs to originate loans, an ad hoc Bank of Italy authorisation of each single externally managed Italian Credit Fund would not always be available, as the Bank of Italy is no longer required to expressly approve the establishment and the fund rules of Italian AIFs reserved to professional investors.

[8] This is based on the meaning the expression "framework of operation" was given in the context of the old passporting regime for non-UCITS funds governed by the now repealed Bank of Italy regulation on collective investment undertakings of 14 April 2015.

[9] By contrast, the minimum investment required from semi-professional investors in loan originating German Special Funds is set at Euro 200,000; only professional investors can invest in Irish loan originating QIAIFs.

[10] By contrast, loan originating German Special Funds are subject to a 1.3 leverage limit and a 20% concentration limit, while Irish loan originating QIAIFs are subject to a 2 leverage limit and a 25% concentration limit.

[11] Italian and EU insurance companies and Italian securitisation vehicles are actually subject to a broader restriction in that they may not lend to individuals generally and to micro-enterprises (as defined by the European Commission Recommendation 2003/361/EC).

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