

# Italian Government Guarantee for Italian Banks' Debt Securities

On 23 December 2016 the Italian government adopted Law Decree No. 237/2016 (the "Decree"), which provides, on one hand, for a State guarantee in relation to debt securities issued by Italian banks as well as in relation to emergency liquidity assistance transactions and, on the other, for measures relating to the recapitalisation of Italian banks. This Briefing note analyses the State guarantee scheme only.

The Decree came into force on 23 December 2016 and will need to be converted into law by 23 February 2017, potentially with amendments to be approved by the Italian Parliament. Finally, the Decree provides that the Italian Treasury (after discussions with the Bank of Italy) is required to issue implementing regulations (which are yet to come).

## Key issues

### Italian State guarantee

- Eligibility requirements for applicants
- General principles
- Eligibility requirements for securities
- Application process

## 1. Italian State guarantee in relation to debt securities issued by Italian banks

Pursuant to Article 8 of the Decree, the Italian Ministry of Economy and Finance (the "MEF") is authorised from 23 December 2016 until 30 June 2017 to grant a State guarantee in respect of newly issued debt securities issued by Italian banks with a duration ranging from 3 months to 5 years, or, in case of covered bonds (as referred to in article 7-bis of law No. 130 of 30 April 1999) ("Italian Covered Bonds") a duration of less than 7 years (the "State Guarantee").

This State Guarantee is subject to approval from the European Commission. In addition, the 30 June 2017 deadline may be extended by the MEF for a period of up to further 6 months, subject to the prior approval of the European Commission.

### 1.1 Eligibility requirements for applicants

Italian banks must have their registered office (sede legale) in Italy in order to benefit from the guarantee. For the purposes of granting the State Guarantee, the relevant competent authority pursuant to Council Regulation (EU) No. 1024/2013 of 15 October 2013 (the "Authority"), i.e. the Bank of Italy or the European Central Bank, will assess whether an applicant complies with certain criteria, including its capital adequacy ratios and its ability to meet relevant obligations under the debt securities issued.

### 1.2 General principles

The Decree sets forth certain general principles applicable to the State Guarantee (as well as to the other transactions contemplated by this Decree, such as the State Guarantee in relation to emergency liquidity assistance referred to at 2 below, together the "Transactions"). These include limiting the number of Transactions each bank may carry out to those strictly necessary and providing that banks that carry out Transactions be subject to quarterly reviews by the MEF with the support of the Bank of Italy to be provided to the European Commission.

In addition, banks applying for the State Guarantee must carry out the Transactions in such a manner as not to abuse, or obtain undue benefits from, the support received, such as by highlighting the existence of the State Guarantee in marketing materials.

Furthermore, in order to encourage recourse to issues with shorter maturities, the principal amount of State Guaranteed debt instruments with a maturity of over three years issued by a bank cannot account for more than a third of the aggregate principal amount of all State guaranteed debt instruments issued by it. Further, the aggregate amount of the Transactions approved for each bank cannot exceed the bank's capital as calculated for supervisory purposes. The Bank of Italy will monitor banks carrying out the Transactions regarding compliance with these limits and will notify the MEF of the results of such monitoring. The MEF will subsequently notify the European Commission of the results.

### 1.3 General Characteristics of the State Guarantee

The State Guarantee is a first demand guarantee which is unconditional and irrevocable. It covers all sums due under the debt instrument in relation to both principal and interest.

### 1.4 Fees

The fees payable by Italian banks as consideration for the State Guarantee depend on the duration of the guaranteed financial instruments. In summary, the fee is divided into two parts, a base fee of a fixed percentage and a fee based on risks which is measured with reference to ratings (for debt having a maturity of less than one year) or credit default swap (for debt having a maturity of more than one year). Alternative criteria are used to determine the applicable fees for banks that do not have a rating or in respect of which credit default swaps are not traded.

The fee is: (i) applied on an annual basis, (ii) payable quarterly in arrears and (iii) calculated with reference to the nominal amount of the financial instruments issued by the bank.

Following consultation with the Bank of Italy, the MEF may alter the calculation criteria and the size of the fees in order to take account of changes in market conditions. These changes would not affect Transactions already in existence

### 1.5 Eligibility requirements for securities

The types of securities capable of being covered by the State Guarantee are debt instruments issued by Italian banks which have the following characteristics:

<b>Issue Date</b>	<ul style="list-style-type: none"> <li>After 23 December 2016 (even if issued in the context of existing programmes)</li> </ul>
<b>Duration</b>	<ul style="list-style-type: none"> <li>Newly issued debt securities: at least three months and not more than five years</li> <li>Italian Covered Bonds (as defined above) at least 3 months and not more than seven years</li> </ul>
<b>Redemption</b>	<ul style="list-style-type: none"> <li>Bullet redemption at final maturity</li> </ul>
<b>Denomination</b>	<ul style="list-style-type: none"> <li>Euro</li> </ul>
<b>Status</b>	<ul style="list-style-type: none"> <li>Senior, non-subordinated debt</li> </ul>

Structured securities or complex products will not be eligible, nor will those which incorporate a derivative component. Finally, the State Guarantee may not be granted in any circumstances in respect of debt instruments that qualify as regulatory capital.

### 1.6 Application process

The application process starts with the applying bank submitting an application form (the format of which will be provided by the MEF within 15 days from the entry into force of the Decree) simultaneously to both the Bank of Italy and the MEF. The application form must specify, amongst other things, the bank's requirement for liquidity (including any anticipated future requirement for liquidity), the characteristics of the guaranteed Transaction(s) which the bank is seeking and any other guarantee which has already been granted or which has already been applied for under the Decree.

The Authority will assess the applying bank's fulfilment of the own funds requirements under Article 92 of Regulation (EU) No 575/2013 and the absence of any regulatory capital deficiency resulting from any stress test conducted at the national level or under the Single European Mechanism. The State Guarantee may be granted also to banks that (i) although they do not fulfil the above conditions, require emergency liquidity assistance, provided that they have positive net assets and subject to a prior positive decision by the European Commission and (ii) are subject to resolution, or are bridge institutions, pursuant to the BRRD, subject to the European Commission's prior approval.

In the case of a positive assessment by the Authority, the Bank of Italy will state its view as to the adequacy of the conditions and the volume of liquidity applied for by the bank (taking into account the bank's size and level of capitalisation). The assessment will also state the amount of the bank's regulatory capital, the amount of the relevant State Guarantee and the relevant fees to be paid. Both assessments are promptly communicated by the Bank of Italy to the Treasury Department, usually within 3 working days following the date of submission of the application.

The decision of the Treasury Department will usually be made within five working days following the date of receipt of the Bank of Italy's assessment. The Treasury Department will inform the applying bank and the Bank of Italy of its decision in such a way as to ensure that such communication is prompt and remains confidential.

With respect to banks which do not fulfil the own funds requirements set out above or in case the State Guarantee is granted for debt issuances with an aggregate nominal amount higher than Euro 500 million and amounts to more than 5% of the applying bank's debt, the bank is required to present, within two months from the granting of the guarantee, a restructuring plan which should confirm the bank's profitability and ability to collect funds in the long term without State intervention. The

restructuring plan is also provided to the European Commission for the assessment of the compliance with the State aid regulations.

Certain restrictions (e.g. on payment of dividends, discretionary payments on Additional Tier 1 instruments etc.) apply to those banks that do not fulfil the own funds requirements, to banks subject to BRRD resolution and to bridge institutions.

### **1.7 State Guarantee intervention**

The Decree also sets out a procedure (the "Procedure") via which State Guarantee intervention may occur. A bank which is unable to fulfil its guaranteed obligations (a "Defaulting Bank"), must submit a detailed application to request State intervention. The application must be filed at least 30 days in advance of the due date for payment of principal or interest (except in case of reasonable urgency when it may be made in a shorter timeframe), be sent to the Treasury Department of the MEF and to the Bank of Italy, the relevant documentation attached and must specify the debt instruments and contractual obligations for which it is seeking State intervention and the corresponding amounts owed. The Treasury Department will verify the admissibility of the application on the basis of the Bank of Italy's assessment. Finally, the Treasury Department will make available the funds required for payment of creditors by the day preceding the due date.

Furthermore, Article 8, paragraph 4 of the Decree provides that the Procedure is without prejudice to any further act that may be carried out by any noteholder of other secured creditor in accordance with the provisions of Article 5, paragraph 1 of the Decree.

### **1.8 Consequences of State Guarantee intervention**

Following State Guarantee intervention, the Defaulting Bank is required to repay to the MEF the sums received and paid out, plus interest at the legal rate until the date of repayment. The Defaulting Bank is also required to present a restructuring plan for the assessment of the compliance with the State aid regulations. This plan must be sent to the European Commission within two months of the bank's default.

## **2. State Guarantee in relation to emergency liquidity assistance**

The MEF is also authorised, for six months from the entry into force of the Decree, to issue a State Guarantee in relation to financing granted discretionally by the Bank of Italy to provide emergency liquidity assistance to Italian banks.

The MEF may grant the State Guarantee as collateral in relation to financing granted by the Bank of Italy to provide emergency liquidity assistance (ELA). The applying banks must be Italian banks, fulfil the same requirements provided for the State Guarantee in relation to debt securities and provide a restructuring plan. The State Guarantee is irrevocable but the Bank of Italy must enforce any other collateral provided by the financed bank before enforcing the State Guarantee.

This briefing note does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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