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HIGHLIGHTS

EU, decision now pending on Italy's accounts

The European Commission is assessing the latest figures on the performance of the Italian economy. Next Tuesday, the Commission will publish new economic forecasts, possibly lower forecasts than its last estimates in February. Italy continues to be at the risk of proceedings on two fronts: for excessive debt and for macroeconomic imbalance. According to market economists the 0.2% recovery in the January to March period could be due to exports. If so, Italy's recovery could prove to be one-off. The latest data published by Eurostat at the end of April evidenced a net increase in public debt (from 131.4% of GDP in 2017 to 132.2% of GDP in 2018).

Assilea: euro 6.7 billion in new leasing contracts during the 1st quarter

The leasing and rental market has registered 178,000 new contracts in the first quarter of the year, for a value of approximately euro 6.7 billion. The number of instrumental leasing contracts is up, driven by the good performance of operational leasing, with +7.5% in the number of contracts and +16.2% in value terms (+23.7% for operations in excess of euro 50,000), and by concluded contracts for property to be built achieving +17.9% against a slowdown in finished property leasing.

Operational instrumental leasing evidences interesting performance, with an increase in volume in all value groupings and especially for operations in excess of euro 50,000 which have grown +11.1% in volume and in value. In financial instrumental leasing there was a large increase in small ticket volumes (+9.9%) against a reduction in higher value contracts. The downturn in automotive registrations is weighing on the number of lease contracts drawn up, dragging down the overall result for the entire leasing industry (-14.7% in volume, -12.9% in value). The general performance of the automotive segment has been only partially offset by the good performance of the commercial vehicle segment, which is up in both volume and value, with excellent performance in long-term rentals. Pleasure boating exhibits very strong performance with +25% in volume and +39.2% in value.

(Source: Adnkronos, 17 April 2019)

GACS renewal: the changes introduced with Law Decree 22/19

Law Decree no. 22 of 25 March 2019, published in the Official Gazette of 25 March 2019, has brought changes to the **Guarantee on the securitisation of non-performing loans** ("GACS") legislation. In particular, article 20 of the Law Decree has further extended the Italian GACS scheme by authorising the Minister of the Economy to grant the state guarantee for a period of twenty-four months starting from the date of the European Commission's agreement to the GACS granting regime. Among the changes made, letter f-bis) introduces the obligation to include in the securitisation documentation the substitution of the entity in charge of loan collecting (i.e. the Servicer), following the enforcement of the guarantee, when the ratio of cumulative net collections to expected net collections based on the recovery plan evaluated by the external credit assessment agency is below 100% for two consecutive interest payment dates, including the relevant date for enforcement of the GACS.

REOCos, UTP and real estate securitisations: the latest development *

Exactly twenty years after the adoption of the securitisation law and just over four months from the mini-reform of Law 130/99 introduced by the 2018 budget law (see Newsletter no. 62), the Italian lawmakers have come back again to this topic to fill in some obvious gaps in the law and make further adjustments. This has been done in the context of Law Decree no. 34 of 30 April 2019 (the so-called Growth Decree), containing a wide range of necessary and urgent measures to promote the growth of a still-stagnating economy.

With respect to the changes to the securitisation law specifically, leaving aside certain minor amendments, we feel that the scope of the reform has focused on three main key areas, namely:

- the regulation of so-called Reocos;
- the regime applicable to the new securitisation of real estate asset and registered movable asset;
- innovations supporting the deleverage of "non-perfoming exposures" and, in particular, the "unlikely-to-pay exposures" (UTPs).

The regime applicable to Reocos

Likely this is the measure most expected by the market, following the flop of the scheme as initially configured. As NPL market operators know very well, the Italian Revenue Agency (*Agenzia delle Entrate*) has recently stepped in on this subject on two separate occasions, rejecting two tax ruling requests which concluded with the statutory fiscal neutrality of the "special purpose vehicles" (*società veicolo*) (i.e., in more familiar terms, the Reocos). The Italian Revenue Agency's main argument to support this rejection was that the real estate or registered movable assets acquired by the REOCo as part of its operations were not segregated by operation of law. In addition, the argument in support of the opposite thesis proposed by the applicants (that is that all proceeds of the Reoco's activity are to be applied by law to the securitisation company) was pretty weak based on a strict interpretation of the law.

With the explicit intention of dispelling any doubts about the Reoco's fiscal neutrality (as can be easily seen from the Explanatory Report annexed to the Growth Decree), paragraph 4 of article 7.1., by incorporating – *mutatis mutandis* – the same language used for the segregation of loans transferred to securitisation companies, now specifies that the amounts in any way received by the "support special purpose vehicle" (as the Reoco has been renamed, with a formula which is certainly evocative but lacks elegance and is largely superfluous) as a result of the holding, management or disposal of "real estate assets and registered movable assets as well as other assets and rights granted or constituted, in any form, as security for the securitised receivables" acquired by the REOCo (hereinafter, the "Assets and Rights"):

i) are attributable to the securitisation company and are solely intended for the fulfilment of the rights incorporated in the notes issued by it and for the payment of transaction costs;

ii) constitute, together with the Assets and Rights, separate assets in all respects from those of the Reoco itself and from those relating to other securitisations, no legal action therefore being permitted on them by creditors other than the securitisation company acting in the interest of the noteholders.

In addition, the transfer of the Assets and Rights to the Reoco can now be carried out (even in the absence of a "pool" (*blocco*)) in accordance with the "simplified" formalities provided for by paragraphs 2 and 3 of article 58 of the Consolidated Banking Act (i.e., publication in the Official Gazette and registration in the companies' register, with no need for additional formalities or entries to be effected in public registers). Paragraphs 3, 4 and 5 of the same article

will also apply when the interaction with the various counterparties comes into play.

Nor has the support offered to this instrument by the law stopped here. Article 7.1 has been supplemented with four new paragraphs (4-bis, 4-ter, 4 quater and 4-quinquies) which introduce the same number of favourable tax provisions. First of all, registration, mortgage and cadastral taxes will be applied in a fixed amount, both on the acquisition (including through judicial or insolvency proceedings) of the Assets and Rights by the Reoco and on their subsequent resale by the latter to "first-home buyers" or to entities carrying out business activities which have declared their intention to re-transfer the Assets and Rights to third parties in the following five-year period (and which will be then actually doing so). Likewise, registration, mortgage and cadastral taxeswill apply in a fixed amount in case of any assumption of debt and guarantee of any kind, granted by any party at any time, in favour of the securitisation company or "other lender" and in relation to the securitisation transaction, when relating to the Assets and Rights acquired by the Reoco, as well as with respect to any related subrogations, deferrals, encumbrances or cancellations (whether in whole or in part), including any related assignment of receivables. The scope of the formulation used by the law is such to possibly embrace a vast number of cases of management and disposal of the Reoco's assets. In particular, the reference to "other lender" is of interest. Such reference may be consistent with both the possibility that the Reoco accesses external financing channels, additional and alternative to the securitisation company itself (as regards e.g. capital expenditures, running costs and deposits pursuant to article 580 of the Italian Code of Civil Procedure), and a transaction in which the underlying real estate asset is transferred to a third party along with the relevant debt while a new lender takes over the original loan.

Turning our attention to some aspects of a corporate nature connected with the operation of the Reoco, although the reform does not provide any precise indication on the control structure of the Reoco, the destination of the Reoco's proceeds to the securitisation company (see paragraph i) above seems to us to have removed the very necessity for the securitisation company to have direct control over the Reoco. This would be in line with the majority view already emerged in the practice and which has ruled out the securitisation company's possibility to hold investments in other companies beyond in those cases expressly provided for. We would therefore tend to conclude that the Reoco will be owned by an entity traceable to the investor in the securitised portfolio or (following the scheme already usually used for securitisation companies) by a an "orphan" third party (e.g. a Dutch foundation). The implications of such a control structure in terms of liabilities of the parent company for the exercise of management and coordination activities are expected to be the subject matter of careful assessment.

Some perplexity (which in all probability will be dispelled by the practice) arises, however, with the specification inserted in paragraph 4 of article 7.1 according to which the Reoco acquires the Assets and Rights directly "*or through one or more additional support vehicle companies, authorised to assume, in whole or in part, the original debt*". In this regard it could be asked, among others:

- what is the legal basis (contractual or corporate) of the relationship between the "first level" Reoco and the "second level" Reocos;
- unless the "first level" Reoco will act just as a "Reoco Holding", what would be its role given that, according to a strict interpretation of the law, "second level" Reoco would seem to be required to acquire, manage and refurbish the Assets

and Rights as well as to take on the original debt either totally or partially, thus completing the entire production process; in this regard the Explanatory Report does not appear to be very enlightening as it simply points out that it is now permissible to "*form even more than one support special purpose vehicle for the activity of acquisition, management and increasing the value of assets, performed in the exclusive interest of the securitisation*";

- what are the implications for the "first level" Reoco's operation of the incorporation in the law of a specific reference to the Reoco's assumption of the original debt, that is to say whether this reference is to be understood *strictu sensu* as a reference to the taking on of the debt (*assunzione di debito*) pursuant to article 508 of the Italian code of civil procedure, or – as would seem preferable to the authors – as a reference to a broader phenomenon of sucession in the debt (which would include a wider range of takeover mechanisms such as assumption of debt (*accollo*) and expromission).

Lastly, it should be noted that the provision of law expressly confirming that the Assets and Rights constitute separate assets in all respects from those of the support special purpose vehicle itself and from "*those relating to other securitisations*" would suggest that, with exception of the support vehicle companies mentioned in paragraph 5 of article 7.1 (so-called LeaseCos), the same Reoco may operate for the benefit of several securitisation transactions.

Lastly, it should be noted that the reference to the fact that the "assets and rights" constitute separate assets in all respects from those of the support vehicle company itself and from "those relating to other securitisations" would suggest that, with exception of the support vehicle companies mentioned in paragraph 5 of article 7.1 (so-called LeaseCos), the same REOCo may operate for the benefit of several securitisation transactions.

Real estate and registered movable asset securitisations

In our previous contribution to this Newsletter we observed that due to the laconic nature of the provision introduced ("*securitisation of the proceeds deriving from the ownership of real estate assets, registered movable assets and in rem or individual rights concerning those same assets*"), the scope and implications of new letter b-bis) of article 7, paragraph 1 of the law were far from being clear, to put it mildly. To bridge the gap in sufficient interpretative foundations, the lawmakers have now added to the usual reference to the application of the other provisions of the law "insofar as compatible" cited at the beginning of article 7, a new set of *ad hoc* provisions which, almost in response to our original perplexity, clarifies – albeit implicitly – that the securitisation company can in fact become the owner of the real estate assets, registered movable assets and other in rem or individual rights whose proceeds would be securitised. The same concept is expressed in explicit terms in the Explanatory Report.

The new legal framework defines the boundaries of the this type of securitisation with clarity and lucidity:

a) securitisation companies securitising real estate assets or registered movable assets may not carry out other types of securitisations;

b) the assets and rights intended to fulfil the rights of the noteholders of each securitisation transaction and the relevant hedging counterparties must be identified;

c) the noteholders and the other creditors of the securitisation company in the context of the securitisation transaction will have recourse only to the segregated assets (this constitutes an innovation compared to the ordinary statutory regime applicable to securitisation companies securitising loans);

d) the real estate assets, registered movable assets and other in rem or individual rights identified as pertaining to the securitisation, and any any amount deriving therefrom, constitute in all respects separate assets from those of the securitisation company itself and from those relating to other securitisations; no legal action is permitted on such separate assets by the creditors of the securitisation company other than the noteholders, the hedging counterparties and the "grantors of loans";

e) from an operational viewpoint, the securitisation company will have to appoint an asset manager with appropriate expertise and holding the necessary qualifications or authorisations, to whom the securitisation company will assign, in the interest of the noteholders, the tasks of managing and administering the underlying assets and grant powers of representation.

From the viewpoint of a historical-economic analysis of this instrument, real estate securitisations have fulfilled and lend themselves to fulfil multiple functions in accordance with the different aims pursued by operators, including the following:

i) financing/refinancing of investments by real estate companies and investment funds;

ii) disposal of non-core immovable assets in order to increase share value;

iii) financing for the acquisition of new immovable assets by inventors;

iv) cash creation for entities which do not intend to immediately dispose of their immovable assets (advance sale); in this regard one may think of the application potential of the instrument with respect to the real estate portfolio of banks in an era of increasing digitalisation of the banking business and the need to plan the management of staff redundancies;

v) cash creation by the public administration as an alternative to the use of public debt;

vi) development of real estate projects by specialist developers.

In all these cases, from the lender's perspective, the instrument seems to provide a valid response to the need to ensure a rapid access to the collateral in the event of borrower default, without the complications and delays of the mortgage enforcement process.

From a legal point of view, we note that the reference to "grantors of loans" among the entities which can act on the separate assets (see paragraph d) above) seems to suggest that the securitisation company may seek financial resources for the project's execution outside the funding provided by the subscribers of the notes. This is a particularly interesting circumstance, considering the securitisation company's probable need to finance the company's capital expenditures and running costs. In this regard, interpretation guidance for the reconstruction of additional profiles of this type of securitisation could be possibly drawn from the securitisations of the real estate portfolio of the Italian Republlic carried out in the early 2000s .

A second aspect which certainly deserves further study is the possible overlap of "real estate" securitisations, on the one hand, and Reocos, real estate investment funds and more generally ordinary real estate companies, on the other hand, in order to demarcate the borderlines of operation and function of the these various instruments.

Then, in our opinion, there would seem to be arguments to support that, even in the event of the issue of several tranches of notes in the context of the same securitisation of the real estate assets or registered movable assets, the provisions contained in the STS Regulation would not apply (and, in particular, the requirement for the transferor or the sponsor to maintain a 5% net economic interest and the various related disclosure obligations).

Finally, it will be necessary to carefully assess the tax regime applicable to these types of securitisations and, in particular, their fiscal neutrality. We feel that, in this respect, the similarities with the Reocos will be taken in due consideration.

New provisions on UTPs

As for the measures supporting the deleverage of UTPs, the main innovations introduced in paragraph 4-ter of article 4 consist of the possibility:

a) to accompany the transfer to the securitisation company of the receivables deriving from loans already disbursed by the originator, with the takeover, by another bank or financial intermediary, of the originator's commitments and disbursement faculty under the existing credit line or credit facility agreement, pursuant to article 58 Consolidated Banking Act – and therefore without the need for the borrower's consent -; and

b) to maintain the current account to which the credit line is linked with the originator and to keep – after the assignement of the UTPs - the application of the funds credited to this account for the payment of debts arising from the credit line agreement or facility according to the procedures contractually provided for initially.

The innovation seems to derive from the consideration that, in the case of UTPs, the transfer of receivables occurs in the context of a financing relationship which, although compromised to some extent, is still live and in effect, and therefore in the presence of disbursement commitments, exacerbates the negative consequences of the dichotomy between receivable ownership and contract ownership. In the past, in such circumstances the parties involved in the transaction would end up facing the following possible scenarios:

- keeping the originator bank involved in the investor's post-acquisition management of the portfolio (with all the complications of the necessary back-to-back agreements and the originator bank's tendential mistrust or open opposition);
- obtaining the borrower's consent to the transfer of the disbursement obligation to another bank or financial intermediary (inevitably attributing the borrower with negotiating leverage it did not previously have);
- proceeding with a transfer of the loan agreements to another bank or financial intermediary pursuant to article 58 of the Consolidated Banking Act (potentially with all additional liabilities, known or otherwise, to those strictly connected with the disbursement obligations).

The ingenious solution adopted by the lawmakers (namely the takeover of just the disbursement commitments of the originator by another bank or financial intermediary) will inevitably require negotiation to resolve a series of problems related to the relationship between the securitisation company and the successor bank or financial intermediary whenever there are competing claims of one and the other against the assigned debtor (e.g. in the event of the securitisation company's failure to purchase the loan derived from the disbursement made by the bank or financial intermediary, and more generally, situations in which the bank or financial intermediary is required to directly assume the risk of future disbursements). It is easy to foresee that the negotiation will focus on topics such as the position of each party in the order of priority for payments (waterfall), the constraints to the enforcement of security and guarantees (first and foremost mortgages, if any), and other key aspects of governance.

Difficulties in interpretation may reasonably arise with regard to the final provisions regarding the legal regime applicable to sums credited to the current account held with the assignor bank. The law provides that:

i) collections (credited to the account) constitute separate assets in all respects from those of the assignor bank acting as depository and from those relating to other transactions;

ii) no actions are permitted on the separate assets by creditors other than the noteholder or the successor bank or finance company (rectius, financial intermediary);

iii) the provisions of article 3, paragraphs 2 and 2-bis apply mutatis mutandis, namely the segregation provisions, respectively,

of the securitised loans (article 3, paragraph 2) and the current accounts opened by the securitisation company with its own depository bank or the servicer (article 3, paragraph 2-bis), including the exemption of the depository bank from the suspension of payments regime as well as the express derogation from the order of distribution of the liquidation proceeds, in the event that the depository bank is subject to proceedings pursuant to Section IV of the Consolidated Banking Act or other insolvency proceedings in general.

Perplexity arises:

- on the one hand, from the transposition of mechanisms originally thought to apply to a single bilateral relationship (depository bank/servicer vs. securitisation company current account holder) to a more complex set of relationships (namely the current account relationship between the assignor depository bank and the assigned debtor current account holder on the one hand, and on the other, the debt relationship between the assigned debtor and the assignee securitisation company/successor bank or financial intermediary) which does not seem to envisage a direct obligation of the assignor depository bank vis-à-vis the assignee securitisation company/successor bank or intermediary with regard to the sums credited to the current account and their remittance; and
- on the other hand, from the coordination between the segregation regime applicable by operation of law to the funds standing to the credit of the current account and "the procedures contractually provided for initially" for the account transactions (see paragraph b) above).

Moreover, the language used by the law appears to be sufficiently broad (see paragraph ii) above) to capture possible/probable conflicts between claims of other creditors of the assigned debtor current account holder in relation to the current account balance, and competing claims of the assignee securitisation company/successor bank or intermediary, and that the law resolves it favour of the latter.

Conclusions

As the reader may have already appreciated at this point, the changes made to the securitisation law are incisive and wide-ranging changes which, with no need for great foresight skills, are likely to expand the application potential of the securitisation, and to do so by far. In our opinion, the revitalisation of the regulation of Reocos is likely to have a positive effect on recovery timing and amount and this may result in an increase of the price levels offered by investors to Italian banks (once such positive effect on the recovery is consistently verified and incorporated in the underwriting business plans).

As is usual for reforms of this latitude, jurists (and first and foremost business lawyers) will be required work hard to coordinate and rearrange legal concepts and practices in order to (re)define in detail the contours of a legal framework which, more and more over recent years, seems to be primarily intended to identify outputs and destinations rather than routes to follow.

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