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New Italian Rules to Create a More Favorable Regulatory Regime for the Issuance of Corporate Bonds

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On February 21, 2014, Italy enacted Law No. 9 (the “New Law”), which, among other things:

- **reduces the tax cost of taking security in connection with notes offerings;**
- **expands the array of security that can be granted in connection with the issuance of notes;**
- **introduces new rules which render the investments in corporate bonds more attractive and tax efficient also for investment funds, insurance companies and pension funds; and**
- **allows the structuring of securitization transactions having corporate bonds as underlying assets and the issuance of collateralized bank bonds secured by corporate bonds.**

The New Law converted into law the final version of a set of new rules originally set out in Law Decree “Destinazione Italia” No. 145, dated December 23, 2013 (the “Initial Law Decree”). In the wake of the key legislative changes introduced in 2012, the New Law introduces new rules, to further increase flexibility and create a more favorable regulatory environment for the issuance of notes by non-listed companies (with a focus on small- and medium-sized companies), in line with the Italian government’s recent policy to render the Italian bond market more dynamic, thereby allowing Italian companies to become more competitive in the debt capital markets and access multiple sources of financing. This client publication will focus on the key amendments introduced by the New Law regarding corporate bond issuances and should be read in conjunction with our previous client publication on this topic: “New Rules Open Bond Markets to Italian Non-Listed Companies” dated June 28, 2012¹ and the related client publication “Update – New Rules Opening the Bond Markets to Italian Non-Listed Companies Approved in Final Form: A Move in the Right Direction.”²

¹ For a copy of this Client Publication, please click [here](#).

² For a copy of this Client Publication, please click [here](#).

This client publication has been prepared with the contribution of professionals of Studio Tremonti Vitali Piccardi Romagnoli e Associati, our “best friend” Italian tax firm.

The New Law Provides Useful Tools to Further Improve the Ability of Italian Corporates to Efficiently Access Debt Capital Markets

The rules enacted in 2012 provided a boost to notes issuances, mainly by sizeable issuers (*i.e.*, generally issuers with an EBITDA of at least €40 million in notes transactions of around €200 million or more in size). Smaller Italian companies, with more limited turnover, did not manage to access the market directly, in particular due to the transaction costs and liquidity requirements typically associated to the direct access to the debt capital markets. In practice, the 2012 rules did not create a market for small- and medium-sized issuers, which therefore did not find suitable financing alternatives to bank lending to fund their growth and overcome the continuing difficult credit market conditions.

The new rules included in the New Law, enacted in 2014, aim at achieving two fundamental goals: (i) to increase the competitiveness of Italian issuers in the debt capital markets arena and concurrently decrease the cost of funding for Italian issuers, by broadening the scope of the security that can be offered in connection with a notes offering; and (ii) to broaden the investor base for non-listed and unrated notes, including those issued by small- and medium-sized companies, and create a local “private debt” market.

The main new measures relevant to the bond market include:

- (i) the extension of the 0.25% substitute tax (*imposta sostitutiva*) regime (calculated on the aggregate principal amount of the debt issuance), previously available only for bank loans, to the security package for corporate bonds; under the previous regime, a security package supporting a note issuance would have implied a significant tax cost, in particular where real estate assets were part of the security package (*e.g.*, mortgage tax equal to 2.00% of the secured amount, plus registration tax equal to 0.50% of the value of the security provided), which, *de facto*, resulted in Italian issuers being unable to offer property as security in support of their notes issuances;
- (ii) the availability of the statutory special lien (*privilegio speciale*) as a form of security in support of corporate bonds, previously available only in bank loan transactions;
- (iii) the extension of the 20% withholding tax exemption also to interest payments on (or other profits generated from) notes held by investment funds whose unit-holders are exclusively qualified investors (as defined under Italian law)³ and whose assets are primarily invested in corporate bonds or similar financial instruments;
- (iv) the relaxation of the requirements that insurance companies and pension funds must comply with in order to invest in corporate bonds or units of certain types of funds investing in corporate bonds; and
- (v) the possibility to structure securitization transactions and collateralized bank bond issuances backed by corporate bonds.

³ “Qualified Investors,” as defined by Article 34-*ter*, letter b) of Consob Regulation No. 11971 of May 14, 1999, as amended (which cross-refers to Article 26, paragraph 1, letter d), of Consob Regulation No. 16190 of October 29, 2007, as amended), include, *inter alia*, (a) persons authorized to operate in both Italian and foreign financial markets (*e.g.*, banks, investment firms, insurance companies and pension funds); (b) large companies (*e.g.*, companies satisfying at least two of the following criteria: (i) total assets of at least €20,000,000, (ii) net revenues of at least €40,000,000 and (iii) own capital resources of at least €2,000,000); (c) institutional investors whose main activity is investment in financial instruments, including companies dedicated to the securitization of assets; (d) other institutional investors requesting to be treated as qualified investors; and (e) national and regional public entities.

Italian Corporates Can Now Propose to Investors More Appealing Security Package Structures

Substitute Tax ("*Imposta Sostitutiva*") Extended to Security Interests Securing Notes Obligations

The New Law extends the applicability of the substitute tax (*imposta sostitutiva*) of 0.25% to security provided in connection with a notes offering.

The old tax regime provided for a wide range of taxes applicable to the security interests related to corporate bonds (registration tax, stamp duty, mortgage tax and/or land registry tax, depending on the type of security), which could have determined a significant aggregate tax cost, in particular where real estate assets were part of the security package (e.g., mortgage tax equal to 2.00% on the secured amount, plus registration tax equal to 0.50% on the value of the security provided).

Pursuant to the New Law, issuers can now opt for the application of a 0.25% substitute tax, which will therefore replace any other applicable tax. This will translate into a significant reduction in tax costs and essentially in the ability for Italian companies to now offer to investors security packages contemplating real estate assets with no significant impact on the overall cost structure of the transaction. The substitute tax regime will apply to the aggregate principal amount of the notes issued and will also extend to (i.e., the initial payment of the 0.25% substitute tax will cover) any subsequent change (replacement, amendment, cancellation, etc.) of such transactions, or transfer of such security (including as a consequence of the transfer of the related secured notes).

An issuer will be required to expressly indicate in the corporate resolution authorizing the notes offering whether or not it intends to benefit from the application of the 0.25% substitute tax option. The financial intermediaries involved in the placement of the notes will be responsible for the payment of the substitute tax and the issuer will be jointly liable. If no financial intermediaries participate in the notes offering, then the issuer itself will have to pay the substitute tax.

The Special Lien "*Privilegio Speciale*" Now Available Also to Secure Corporate Bonds

The New Law introduces the possibility to use the special lien (*privilegio speciale*)⁴ set forth under Article 46 of the Legislative Decree No. 385 of September 1, 1993 (the "Italian Banking Act"), previously available only to secure certain bank financings, as a form of security interest in support of corporate bonds, provided that (i) the notes are subscribed only by "qualified investors" as defined under Italian law and (ii) the subsequent circulation of such notes is reserved exclusively to "qualified investors." The latter requirement may result in the "*privilegio speciale*" being available mainly in connection with private placements with bi-lateral arrangements with qualified investors that normally hold the notes for the whole tenure of the bond, whereas in a typical 144A and/or Regulation S offering with listing of the notes, the notes may more easily flow in the hands of investors that may not necessarily fall into the definition of "qualified investors" as set out under Italian law.

New Rules to Facilitate the Creation of a Market for Notes Issuances by Small/Medium-Sized Companies

The New Law also introduces changes that should facilitate the structuring of notes offerings by small/medium-sized companies, principally by creating a favorable regulatory environment for corporate bond investments by certain specialized debt funds, insurance companies and pension funds and by allowing the structuring of securitization transactions and the issuance of collateralized bank bonds backed by corporate bonds. This may result in lower

⁴ The "*privilegio speciale*" can cover several types of corporate assets, such as plants, equipment and machinery, raw materials and inventory, finished products, commodities, assets acquired using the proceeds of the corporate bonds or receivables deriving from the sale of any of the foregoing assets. It is similar to a "floating charge."

transaction costs due to bilateral negotiation, standardized documentation and simplified due diligence and disclosure, as well as the creation of diversified portfolios of investments in corporate bonds that can then be placed with the broader market.

No 20% Withholding Tax on Interest Payments to Investment Funds

The legislative changes made in 2012 had extended to non-listed companies the exemption from the applicability of the 20% withholding tax on interest payments, previously available only for notes of listed companies, provided, *inter alia*, that the notes issued were listed on a regulated market or multilateral trading facility.

The New Law further expands this beneficial tax regime. In particular, pursuant to the New Law, the 20% withholding tax will not apply to any interest payment made on (or other profit generated from) notes (or other similar financial instruments) held by investment funds, regardless of whether the notes (or such other similar financial instruments) are listed on a regulated market or multilateral trading facility, provided that (i) the units of the relevant investment fund are owned exclusively by “qualified investors” as defined under Italian law,⁵ and (ii) the assets of the investment fund are invested primarily in corporate bonds or similar financial instruments.

These new provisions should facilitate the structuring of transactions between small/medium-sized companies and investment funds specializing in corporate bond investments (including the specialized funds that have been set up over the last few months by various financial institutions, such as, among others, BNP, Muzinich, Mps and Finint), and expand the spectrum of financing options available to small/medium-sized companies.⁶

Insurance Companies and Pension Funds Can Now More Easily Invest in Italian Corporate Bonds

The New Law eases the requirements that insurance companies and pension funds must comply with in order to invest in non-listed and unrated corporate bonds or similar financial instruments issued by Italian companies (other than banks and micro enterprises⁷), or units of investment funds or instruments issued by special purpose securitization vehicles (“SPVs”) holding such securities.

In particular, the New Law clarified that any investments made in non-listed and unrated corporate bonds or similar financial instruments issued by Italian companies (other than banks and micro enterprises), or units of investment funds or instruments issued by SPVs holding such securities shall be treated as (i) assets eligible to be accounted for purposes of insurance companies’ statutory technical reserves (within the limits to be set forth by the Italian Insurance Companies Supervisory Authority (*Istituto per la Vigilanza sulle Assicurazioni* or “IVASS”)); and (ii) investments complying with the investment limits applicable to pension funds in accordance with applicable law.

⁵ See Note 3 above.

⁶ Further note that the New Law provides that the scope of the guarantee fund set out under Article 2, paragraph 100, of Law No. 662, dated December 23, 1996, guaranteeing the loans granted by banks and other financial institutions in favor of small- and medium-sized enterprises, shall be expanded to support and guarantee also investment management companies investing (on behalf of the funds they manage) in bonds issued by small- and medium-sized enterprises. The Italian Ministry of Economic Development together with the Italian Ministry of Economy and Finance shall issue a decree implementing the foregoing principle and setting forth the conditions and requirements to benefit from the protection afforded by such guarantee fund.

⁷ The term “micro enterprises” encompasses enterprises that employ less than 10 persons and have total annual revenues and/or an annual balance sheet not exceeding €2 million (see EU Commission Recommendation 2003/361/EU dated May 6, 2003).

Following the publication of the Initial Law Decree, on January 23, 2014 (while the enactment of the New Law was still pending), IVASS issued a note (the "IVASS Note") in which it indicated how the applicable insurance rules (Regulation No. 36/2011) would change:

- (i) insurance companies will be permitted to invest in and treat as part of their technical reserves (a) notes and similar financial instruments (including subordinated or participation bonds) issued by companies other than banks and micro enterprises up to an amount not to exceed 3% of the total amount of technical reserves to be covered (in each case, regardless of their maturity date and whether the relevant notes or similar financial instruments are listed on a regulated market or multilateral trading facility or rated), and (b) instruments issued by SPVs established in connection with securitization transactions involving notes (see below for further details) up to an amount not to exceed 3% of the total amount of technical reserves to be covered, even if non-listed or unrated;
- (ii) the threshold for the maximum concentration of investments in a single investment fund will be increased from 1% to 3%, but only with respect to investment funds whose main investment is represented by notes and similar financial instruments issued by companies other than banks and micro enterprises and instruments issued by SPVs involving notes; and
- (iii) as to investments in units of investment funds investing mainly in notes and similar financial instruments issued by companies other than banks and micro enterprises and instruments issued by SPVs involving notes, IVASS indicated that no additional change to the regulations was needed, as any investment in such fund units will be classified in either of the classes described under sub-paragraph (i) above, depending on the nature of the prevailing investment (see above).

These measures, associated with the 20% exemption for interest payments made to investment funds meeting the requirements described above, should stimulate the creation of a local private placement market and broaden the investor base available to small- and medium-sized enterprises (as an alternative to the US private placement market), which should allow small- and medium-sized enterprises to more easily access the capital markets through smaller size transactions with reduced transactional costs (mainly deriving from having to deal with a single party on the basis of a substantially bi-lateral agreement, standardized documentation and simplified due diligence and potentially no listing of the notes).

New Rules on Securitization and on Secured Bank Bonds

Along the same lines, the New Law also introduced:

- (i) new rules on securitization transactions, which (in addition to simplifying certain regulatory requirements applicable to securitization transactions in general) now allow the applications of Italian securitization rules also to securitization transactions carried out through the subscription or purchase of notes or similar financial instruments (other than equity securities, convertible bonds or hybrid instruments) by the company issuing the relevant securitization instruments. As a result, an SPV may be used to pool funds and invest in notes offerings of smaller size, thereby expanding the array of options available for structuring an investment in notes offering by small- and medium-sized issuers;⁸
- (ii) new rules on secured bank bonds, which will allow the issuance of collateralized bank bonds secured by notes or other similar financial instruments or instruments issued by SPVs established in connection with the securitization of such credit assets. These new provisions, by expanding the pool of assets that banks can use to issue secured bonds, are expected to further stimulate investments in corporate bonds (including those of small- and medium-sized companies). The Ministry of Economy and Finance (after consultation with the Bank of Italy) will have to issue implementing regulations specifying the applicable mechanics and requirements.

Conclusion

The New Law introduces numerous significant improvements, which are expected to further boost the Italian bond market with a positive impact both on large-sized companies, as well as small- and medium-sized companies. In particular:

- (i) The new rules will allow Italian issuers to compete more effectively and on a level playing field with other foreign issuers in the debt capital markets arena. Indeed, Italian issuers will now have the possibility to structure notes offerings supported by a stronger security package, which under the previous regime was *de facto* impossible due to the significant tax costs associated with the granting of a security (in particular with respect to the granting of security over real estate assets). Notes offerings supported by stronger security packages should be more palatable to investors, which, in turn, should translate in comparatively reduced costs of financing for Italian companies (cheaper coupons); in addition,
- (ii) The new rules, by (a) improving the tax treatment of interest payments on notes held by investment funds specializing in corporate bond investments (regardless of whether the notes are listed), (b) allowing the structuring of investments in notes through SPVs,⁹ (c) concurrently easing the requirements that insurance companies and pension funds must comply with in order to invest in non-listed and unrated corporate bonds, similar financial instruments, units of funds investing in such instruments, or SPVs having corporate bonds as underlying assets, and (d) at the same time, allowing banks to use investments in notes as security for their bond issues, should increase the dynamism of the Italian bond market for small- and medium-sized Italian companies and stimulate the creation of a “private debt” investor base (*ad hoc* “private debt” funds, SPVs, interested insurance companies and pension funds), thereby expanding the spectrum of financing options available to small- and medium-sized companies. This should reduce the transaction costs (mainly deriving from having to deal with a single party on the basis of a substantially bi-lateral agreement, standardized documentation and simplified due diligence and potentially no listing of the notes) and allocate a portion of the liquidity available in the market to the financing needs of smaller companies.

⁸ Further note that now, as a result of the amendments introduced by the New Law, if the instruments of the SPV are addressed exclusively to “qualified investors” as defined under Italian law (see Note 3 above), then these instruments can be subscribed also by a single investor, with the exclusion of any risk that the transaction loses its nature of securitization transaction.

⁹ Please note, however, that the exemption from the 20% withholding tax on interest payments even if the notes are not listed on a regulated market or multilateral trading facility does not extend to SPVs, which, therefore, will be at a disadvantage vis-à-vis investment funds, which, instead, will benefit from such exemption (see above).