

3.22 ITALY

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I. FRAMEWORK

On 30 March 2023, the Bank of Italy published the provisions which amended the Circular n. 285/2013, implementing the Title I-bis of the Italian law n. 130/99 applicable to covered bonds – introduced in 2021 by the legislative decree n. 190 – by completing the transposing of the European covered bond legislation in Italy, which has become effective from the following 31 of March.

The Italian regulation on covered bonds was in large part already compliant to the EU legislation. The main provisions introduced regard, in particular, the following topics:

- > an authorisation process for all banks which intend to issue covered bonds under new programmes established after the 31 march of 2023 and a prior notification to the Bank of Italy for the issuance of covered bonds under programmes already into force;
- > the removal of the previous limits for the transferring of eligible assets to the SPV, differentiated in relation to the capital requirements of the issuer, and the introduction of internal operating limits set by the issuer, considering specific elements;
- > the introduction of: the hedging derivative contracts as eligible assets in the cover pool; a liquidity buffer requirement; disclosure requirements; the new labels “European covered bonds” and “European covered bonds (premium)”; the overcollateralisation to benefit from the preferential prudential treatment.

The new regulation has confirmed the “Obbligazioni Bancarie Collateralizzate” (OBC), introduced by the art. 13-bis of the decree law n. 18/2016. This is a collateralised bond comparable with the European Secured Notes (ESN) for his structure – double recourse instrument – and for the eligible assets in the cover pool – established, notably, by SME loans. Secondary regulation of the Minister for the Economy and Finance will specify some features such as the definition of eligible assets and the issuance rules.

II. STRUCTURE OF COVERED BONDS ISSUANCE

The new framework has confirmed the “dual recourse” structure of the Italian covered bond transaction (Obbligazioni Bancarie Garantite – OBG) already in force, as follows:

- a) Bank issues covered bonds (or another bank) transfers’ eligible assets forming a segregated cover pool to a special purpose vehicle (SPV), whose sole corporate purpose is the purchase of such assets and the granting of guarantees for bond issued in favor of the bondholders up to the amount of the segregated assets;
- b) The SPV purchases the transferred assets by means of a loan granted or guaranteed to it by a bank (not necessarily the same bank transferring the assets);
- c) The eligible assets of the segregated cover pool are applied to satisfy the rights attaching to the covered bonds and the counterparties of derivative for risk hedging purposes, and to pay the costs of the transaction.

The national legislator has exercised the discretion provided by the covered bond European legislation of allowing the issuance of covered bonds with extendible maturity structures.

The maturity extension is subject to specific triggers and, in the event of the insolvency or resolution of the bank issuing the covered bonds, it does not affect the ranking of covered bond investors or invert the sequencing of the covered bond programme’s original maturity schedule.

III. AUTHORISATION AND NOTIFICATION PROCESS

Banks intending to launch new covered bonds programmes after the 31 March of 2023 (the date from which the new framework has become effective) must apply for authorisation from the Bank of Italy, which grants or denies it within 90 days from the date of the application; the information relating to the authorisation is included in the register under art. 13 of the Italian Consolidated Banking Law (CBL, legislative decree n. 385/1993). The bank may proceed with the issuance after the mentioned registration, informing the Bank of Italy within 10 days following the same.

After the authorisation, the issuer intending to make changes to programmes that impact on compliance with the requirements established by the new framework, must notify it to the Bank of Italy and can apply the amendments after 60 days from the communication.

The issuing bank must also promptly inform to the Bank of Italy when the programme is closed, and on the positive refund of the bonds issued.

Banks intending to launch a new covered bonds issuance under programmes established before the 31 March of 2023 must notify – the first time – the Bank of Italy at least 30 days before the issuance certifying that the programmes have been updated in compliance with the new framework. The communication shall be accompanied by the following documents: (i) a statement from the issuer's strategic supervisory body confirming compliance with specific new regulatory provisions; (ii) a report of the Asset Monitor.

Moreover, only at the initial phase, banks shall provide to the Bank of Italy by 30 June 2023 a general information about the status of all existing covered bond programmes.

IV. STRUCTURE OF THE ISSUER AND IMPACT OF INSOLVENCY PROCEEDINGS

All the Italian banks, both significant and less significant, can issue covered bonds under programmes authorized by the Bank of Italy (see paragraph III).

The previous regulatory provisions, which allowed to bank compliant with high level of capitalisation to issue covered bonds without authorisation of the competent Authority, have been removed.

The SPV assignee is a financial intermediary, registered in the "special list" provided for by article 106 of the Banking Law, and therefore subject to the Bank of Italy's supervision.

The guarantee granted by the SPV to the bondholders is irrevocable, first-demand, unconditional and independent with respect to the obligations of the issuer. It is enforced in case of non-payment, resolution or compulsory administrative liquidation of the issuing bank, up to the amount of the segregated assets.

All the amounts obtained by the liquidation procedure will become part of the cover pool and therefore used to satisfy the rights of covered bondholders.

In case of compulsory administrative liquidation of the issuing bank, the bondholders compete to the distribution of bank assets together with unsecured creditors, including derivative counterparties, for the eventual residual amount still due following the guarantee enforcement.

In the event of inadequacy of segregated assets, the bank issuing the covered bonds is responsible, for what is still due, for the SPV obligations towards the derivative counterparties.

The redemption of the subordinated loan granted by the issuer to the SPV is junior to any outstanding claims of covered bondholders, derivative counterparties, and transaction costs.

V. ELIGIBLE ASSETS

Under the new Italian framework, the assets eligible for the cover pool are the following:

- (a) those compliant with the article 129(1) of Regulation (EU) No 575/2013 (CRR), if the bank issuing the covered bonds meets the requirements of paragraphs 1a to 3 of the same article;
- (b) high-quality liquid assets pursuant to the delegated regulation n. 2015/61 (that are not issued by the credit institution issuing the covered bonds itself, its parent undertaking, other than a public sector entity that is not a credit institution, its subsidiary or another subsidiary of its parent undertaking or by a securitisation special purpose entity with which the credit institution has close links);
- (c) short-term exposures (equal or less than 90 days) to credit institutions that qualify for credit quality step 1 or 2, or short-term deposits to credit institutions that qualify for credit quality step 1, 2 or 3.

Notably, with reference to the eligible assets not originated by the issuing bank, this latter shall carry out a creditworthiness assessment of the debtors before the transfer the assets to the cover pool or verifies that the assessment criteria adopted by the originator is compliant with the new provisions.

The derivative contracts are included in the cover pool, in particular, exclusively for risk hedging purposes and only if the credit institutions counterparties qualify, at least, for credit quality step 3. The discretion assigned the competent authorities by the art. 129 of CRR who may, after consulting EBA, allow exposures to credit institutions that qualify for credit quality step 3 in the form of derivative contracts (if specific conditions are met), has been exercised.

Among the other things, the derivative contracts should be sufficiently documented, their volume is adjusted in the case of a reduction in the hedged risk, they are removed when the hedged risk ceases to exist and they cannot be terminated upon the resolution or compulsory administrative liquidation of the bank that issued the covered bonds.

The supplementation of transferred assets subsequent to the initial assignment shall be carried out by way of the transfer of additional eligible assets. Substitution of eligible assets included in the segregated cover pool with other assets of the same kind originated by the issuer bank is permitted provided that this is expressly set out and regulated in the issuance programme and term sheet.

VI. COVERAGE AND LIQUIDITY REQUIREMENTS

In line with the EU covered bond directive, in order to ensure investor protection, the new Italian framework has confirmed specific coverage requirements – by requiring covered bond programmes to comply at all times to them – and has introduced the liquidity buffer which covers the maximum cumulative net liquidity outflow over the next 180 days.

The coverage requirements are calculated taking into account: the nominal value of all cover assets and of outstanding covered bonds; the net present value of cover assets and of outstanding covered bonds; the interests and other revenues created by the cover assets and interests and costs related to outstanding covered bonds.

The liquidity buffer is composed by the following liquid assets:

- > high-quality liquid assets pursuant to the delegated regulation n. 2015/61 (that are not issued by the credit institution issuing the covered bonds itself, its parent undertaking, other than a public sector entity that is not a credit institution, its subsidiary or another subsidiary of its parent undertaking or by a securitisation special purpose entity with which the credit institution has close links);
- > short-term exposures (equal or less than 90 days) to credit institutions that qualify for credit quality step 1 or 2, or short-term deposits to credit institutions that qualify for credit quality step 1, 2 or 3.

In addition, OBG shall be subject, among other things, to a minimum level of 5 % of overcollateralisation to benefit from the preferential prudential treatment under CRR and to use the label “European covered bonds (premium)”.

VII. RISKS GOVERNANCE

With regard to the complexity of the contractual aspects and the possible impact on the banks’ financial situation deriving participation in issue programmes, the issuer bank shall identify and carefully assess and control the risks related with this operational framework.

In particular, such assessments and procedures shall include measures to ensure, on a continuative basis, that the risks assumed are in line with the institution’s risk appetite and strategy defined in the overall RAF (Risk Appetite Framework).

In relation to above, under the new framework, the issuer bank shall set internal operating limits to the eligible assets that may be transferred, in line with their internal policies, risk management objectives and operative tolerance thresholds of the RAF (including those related to the liquidity risk management, the overall level of encumbered assets and non-performing loans). These limits are updated in relation to changes in the bank’s strategy and operations.

The previous transfer limits, graduated on the total capital ratio and Tier 1 ratio at the consolidated level of the issuer, have been removed.

Moreover, the management body shall ensure that the risk management structures of the issuer bank verify at least once every six months and for each transaction, among other things: (i) the quality and integrity of the transferred assets collateralizing the bonds; (ii) the compliance with the internal transfer limits, with maximum ratio between the covered bonds issued and the transferred cover assets and with liquidity buffer requirement; (iii) the effectiveness and adequacy of the risk protection provided by derivative contracts; (iv) the investor information.

VIII. COVER POOL MONITOR

An external asset monitor (AM) appointed by the issuer shall monitor the transaction regularity, the compliance with specific requirements of covered bonds framework, the collateral integrity and the investor information.

The AM must be an auditing firm possessing the professional skills required to perform such duties and must be independent from the bank engaging it (e.g. it cannot be the same firm appointed to audit the accounts of the issuing bank) and of any other person participating in the transaction.

It has to report at least once a year to the control body of the bank and a copy of that report shall be submitted also to the Bank of Italy.

It is involved also in the notification process for covered bonds issuance under programmes established before the 31 March of 2023 (see paragraph III).

IX. TRANSPARENCY REQUIREMENTS

According to the new Italian framework, the banks issuing covered bonds publish on their website, at least on a quarterly basis, information on their covered bond programmes, in order to allow investors to assess the profile and risks of that programme.

The new framework sets minimum information, in line with covered bond EU directive, including, among other things, the following: (i) the nominal value and net present value of the cover pool and outstanding covered bonds; (ii) a list of the International Securities Identification Numbers (ISINs), if attributed; (iii) the composition of cover pool, in relation to the geographical distribution and type of assets; relevant information regarding the market risk, including interest rate risk and currency risk, and credit and liquidity risks; (iv) the

levels of coverage adopted respect the minimum required, in relation to the requirements provided by the law, contractual agreements, or voluntary adopted by the issuer.

It's worth noting that the disclosure obligation is fulfilled through the publication of the templates defined by the European Covered Bond Council (Harmonized Transparency Template – HTT) on the issuer bank's website, if they are compliant at least with the information established by the law.

On this subject, since 2012, some Italian OBG issuers have participated to the mentioned ECBC initiative. The OBG transparency template is available online on the Covered Bond Label website (<https://www.covered-bondlabel.com>) and each participating OBG issuer has published a completed version on its own website.

X. PRUDENTIAL TREATMENT AND LABELS

The OBG issued by Italian banks in accordance with Title I-bis of the law n. 130/99 and the relative implementing provisions are admitted to the preferential treatment of the art. 129 (4)(5) of CRR. The OBG issued before the 31 March of 2023, which are compliant with the previous national and European framework, continue to be eligible for preferential treatment until their maturity.

The OBG issued by Italian banks in compliance with the requirements of Title 1-bis of the law n. 130/99, and the relative implementing provisions, may be traded using the "European covered bond" label. If they satisfy also the requirements under article 129 of the CRR (including, among the other things, the minimum level of overcollateralisation), may be traded using the "European covered bond (premium)" label.

The Italian OBG issued before the new framework continue to be label as covered bonds.

XI. SUPERVISION

The Bank of Italy is the national Authority designed to the supervision on the compliance of covered bonds framework, in order to ensure the sound and prudent management of the issuing banks, the market stability and the protection of bondholders.

In relation to above, the law attributes specific information, regulatory and inspection supervisory powers to the Bank of Italy.

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Issuers joint to the Fact Book survey: Banca Monte dei Paschi di Siena, Banca Nazionale del Lavoro, Banca Popolare dell'Alto Adige (SUDTIROLER VOLKSBANK) (starting 2020), Banca Popolare di Sondrio, Banco BPM, BPER Banca*, Cassa di Risparmio di Bolzano (Sparkasse), Crédit Agricole Italia, Credito Emiliano (CREDEM), Deutsche Bank, Iccrea Banca, Intesa Sanpaolo**, Mediobanca, Unicredit.

* Effective from the 28th November 2022 Banca Carige was merged by absorption into BPER Banca.

** Intesa Sanpaolo acquired control of UBI Banca on August 5, 2020, and merged it by incorporation on April 12, 2021.



COVERED BOND LABEL: Credito Emiliano (1 pool), BANCO BPM (1 pool), Crédit Agricole Italia S.p.A. (1 pool), Intesa Sanpaolo S.p.A. (4 pools), Banca Popolare dell'Alto Adige (SUDTIROLER VOLKSBANK) (1 pool), UniCredit S.p.A. (2 pools).

For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website www.coveredbondlabel.com or via the following QR code:

