3.20 ITALY

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I. FRAMEWORK

The legislative decree n. 190 of 5 November 2021 (hereinafter, called the new framework) has implemented the new European framework on covered bonds.

The new primary disposals apply to covered bonds issued after the entry into force of the further implementing provisions of the Bank of Italy; covered bonds issued before, continue to be regulated by the previous Italian framework.

Until the issue of the new Bank of Italy rules, the current Italian covered bond framework is mainly regulated by:

> the Law no. 130 of 30 April 1999, which contains also disposals governing the securitisation;

> the regulation of the Minister for the Economy and Finance of 14 December 2006, which established secondary rules, mainly concerning the type of assets eligible for the cover pool, the maximum allowed ratio between covered bonds and assigned assets, the characteristics of guarantee to be provided to bondholders by the SPV;

> the supervisory regulations issued by the Bank of Italy, in relation to the requirements to be complied with by issuing banks, the criteria to be adopted to evaluate the cover assets and the relevant formalities to integrate such assets, as well as the formalities to check that the banks are complying with their obligations.

Under decree law n. 18/2016, article 13-bis, the Italian legislator had set the compliance for "Obbligazioni Bancarie Collateralizzate" (OBC). This instrument is a collateralised bond comparable with the European Secured Notes (ESN) for his structure – double recourse instrument – and since the nature of the eligible assets in the cover pool, mainly: SME loans, corporate bonds, aircraft loans and ship loans.

The new legislative decree n. 190/2021 has confirmed the OBC regulation; secondary regulation of the Minister for the Economy and Finance will specify some features such as the definition of eligible assets and the rules for the issuances.

II. STRUCTURE OF THE ISSUE OF COVERED BONDS

The new framework has confirmed the structure of a covered bond transaction already in force, as follows:

a. Bank transfers' eligible assets to a special purpose vehicle (SPV), whose sole corporate purpose is the purchase of such assets and the granting of a guarantee for the issued securities over which bondholders have a senior claim;
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 bank transferring the assets (or another bank) issues covered bonds;
d. The assets purchased by the SPV are applied to satisfy the rights attaching to the covered bonds and the counterparties of derivative agreements entered into for hedging the risks related to the assets, and to pay the costs of the transaction.

Bondholders hold a preferential claim on the cover assets and the covered bonds are direct, unconditional obligations of the issuer.

The national legislator has exercised the discretion of allowing the issuance of covered bonds with extendible maturity structures such as the calculation of the principal for extendable maturity structures will be based on the final maturity.

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

III. STRUCTURE OF THE ISSUER

According to the new framework, the Bank of Italy authorizes the programme for the covered bond issuance, verifying compliance with at least the following conditions: (i) an adequate programme's definition; (ii) adequate policies, processes and methodologies aimed at investor protection for the approval, amendment, renewal and refinancing of loans included in the cover pool; (iii) staff dedicated to the administration and control of the covered bond programme covered bond have adequate qualifications and knowledge; (iv) compliance with the new framework and further implementing provisions. The Bank of Italy will issue further disposals on the requirements for the abovementioned authorization.

Under the current Bank of Italy's regulation, covered bonds can be issued by banks with the following prerequisites:

> own funds not lower than EUR 250 million;

> a total capital ratio not lower than 9%.

It is also provided that these requisites must be fulfilled by the transferring banks as well (i.e. cover pool providers) if they are not the issuers.

There are no business restrictions to the issuer's activity, hence there is no special banking principle that needs to be enforced.

Since October of 2018, anticipating the principles expressed in the new European directive, banks who are not compliant with the prerequisites above may lunch a covered bond programme prior a specific communication to the Bank of Italy, giving evidence of several requirements, accompanied by a report from the compliance function.

IV. COVER ASSETS

Under the current framework, the eligible assets as coverage for covered bonds can be:

a) Residential mortgage loans with a maximum LTV of 80% or commercial mortgage loans with a maximum LTV of 60%;

b) Claims owed by (or guaranteed by) the following entities:

  > public entities of EEA member countries and Switzerland with a maximum risk-weight of 20%;

  > public entities of non-EEA member countries with a risk weight of 0% and other entities of non-EEA member countries with a risk weight of 20% (these claims can represent up to 10% of the cover pool)

c) Notes issued under a securitisation transaction backed (for a minimum of 95%) by the claims under the abovementioned letters a) and b), with a maximum risk-weight of 20% under the Standardised approach.

As provided for by the regulation of the Minister for the Economy and Finance, assets must have at least equal liabilities, both on the nominal and NPV bases, and the revenues arising from cover assets must be sufficient to pay coupons to bondholders and to cover the cost of derivative transactions.

The supplementation of transferred assets subsequent to the initial assignment shall be carried out by way of the transfer of additional eligible assets or supplementary eligible assets, under specific requirements.

As regards the transferring of eligible assets to the SPV, the Bank of Italy sets different limits according to the different regulatory capital levels of the issuer (see Figure 1).

> Figure 1

	Regulatory capital level	Transfer limitations
Class A	Tier 1 ratio ≥ 9% and Core Equity Tier 1 ratio ≥ 8%	No limitations
Class B	Tier 1 ratio ≥ 8% and Core Equity Tier 1 ratio ≥ 7%	Eligible assets can be transferred up to 60% of the total
Class C	Tier 1 ratio ≥ 7% and Core Equity Tier 1 ratio ≥ 6%	Eligible assets can be transferred up to 25% of the total

Under the new framework, the following assets will be eligible:

(a) those pursuant to Article 129(1) of Regulation (EU) No 575/2013, if the bank issuing the covered bonds meets the requirements of paragraphs 1a to 3 of Article 129 of that Regulation;

(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 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 accordance with point (c) of Article 129(1) of Regulation (EU) No 575/2013.

The Bank of Italy will issue further disposals on eligible assets.

V. ASSET-LIABILITY MANAGEMENT

With aim to allow the SPV to fulfil its obligations, issuing banks are required to adopt proper asset-liability management techniques and to perform specific controls, to ensure that the proceeds from the cover pool assets are always sufficient to pay the coupons on the covered bonds, and the overall cost of the transaction.

The new framework has confirmed specific coverage requirements to ensure investor protection and introduced the cover pool liquidity buffer which covers the maximum cumulative net liquidity outflow over the next 180 days. In this regard, the national legislator has exercised the discretion to calculate the liquidity buffer for the period which goes from 31 to 180 days later, until the overlap with the 30-day liquidity coverage requirement of the LCR rules will be removed.

The Bank of Italy could issue further disposals on this item.

VI. COVER POOL MONITOR AND BANKING SUPERVISION

As far as regulatory supervision is concerned, the Bank of Italy sets and monitors, on an ongoing basis, the abovementioned eligibility requirements for issuing banks.

Under the current Bak of Italy regulation, considering the complexity of the contractual aspects and the possible impact on the banks' financial situation, decisions regarding participation in issue programmes shall be preceded by the identification and careful assessment of the objectives pursued and the related risks, by the management body.

In particular, at least every six months and for each operation, issuers have to check: i) the quality of the cover pool; ii) compliance with the predetermined ratio between outstanding covered bonds and cover assets; iii) compliance with transfer limitations and asset integration requirements; iv) the performance of any derivative agreement entered into in order to hedge risks.

As far as information flows are concerned, it is provided that issuing/transferring banks shall acquire from all the parties involved in the structuring of the covered bonds, information relating to the possessory titles of the transferred assets and to their performance

This information is necessary to issuing/transferring banks in order to perform both the abovementioned controls in terms of cover pool monitoring and the regulatory reporting (i.e. reporting of defaulted loans to the Bank of Italy's Centrale dei Rischi).

The monitoring of the regularity of the transaction and of the integrity of the collateral securing investors is performed also by an external asset monitor (AM) appointed by the issuer. 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 Board of Directors and to the internal audit department of the bank.

Although no specific reporting to the Bank of Italy is prescribed by law, in practice the AM will report to the Supervisor any material anomaly found. It must also be considered that the AM's report is reviewed by the bank's auditor which reports regularly to the Bank of Italy. Should such report contain negative evaluations, the bank's auditor is obligated to bring the issue to the Bank of Italy's attention.

The new framework has confirmed to appoint a cover pool monitor to perform ongoing monitoring of the cover pool, which has to report the results at least once a year to the Bank of Italy.

VII. TRANSPARENCY

According to the new 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 Bank of Italy will issue further disposals on this item.

Moreover, on this subject, some Italian covered bond (called "Obbligazioni Bancarie Garantite" (OBG)) issuers has created a transparency template, consistent with the guidelines of the ECBC Label Initiative, since 2012.

The OBG transparency template is available online on the Covered Bond Label website (https://www.coveredbondlabel.com) and each participating OBG issuer has published a completed version on its own website.

VIII. ASSET SEGREGATION AND IMPACT OF INSOLVENCY PROCEEDINGS ON COVERED BONDS AND DERIVATIVES

The SPV 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 from the issuing bank's obligations on the covered bonds. It will be callable upon non-payment and resolution or compulsory administrative liquidation of the issuing bank, and it will be limited to cover pool asset value to ensure bankruptcy remoteness of the SPV.

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

In case the proceeds obtained as a result of the liquidation procedure are insufficient to meet the obligations to bondholders in full, investors would still have an unsecured claim against the issuer for the shortfall, together with unsecured creditors, including derivative counterparties

In the event of inadequacy of the SPV separate 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 of the covered bonds to the SPV is junior to any outstanding claims of covered bondholders, derivative counterparties, and transaction costs.

Under the new framework, the derivative contracts are considered eligible assets if specific requirements are met. Among these, they should be sufficiently documented, they have risk hedging purposes, 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 Bank of Italy can issue further disposals, regarding in particular the eligibility level for the derivative counterparties and the documentation to be provided in relation to derivative contracts.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

Under the new framework, the "Obbligazioni bancarie garantite (OBG)" can be labelled as "European OBG"; if they meet the requirements of Article 129 of Regulation (EU) No 575/2013, as amended by Regulation (EU) 2019/2160 of the European Parliament and of the Council, they can be labelled as "European OBG (Premium)". The Italian covered bonds issued before the upcoming Bank of Italy rules continue to be label as OBG.

The covered bonds issued under the current framework are compliant with the CRR and, therefore, they are admitted to its prudential treatment.

The new OBG national legislation has been set to be compliant with European regulation and it is in line to be admitted to the prudential treatment provided for this class of exposure.

Issuers: Banca Nazionale del Lavoro, Banca Popolare di Sondrio, Banco BPM, BPER Banca, Banca Carige, Credito Emiliano (CREDEM), Crédit Agricole Italia, Deutsche Bank, Intesa Sanpaolo*, Banca Monte dei Paschi di Siena, Unicredit, Banca Popolare dell'Alto Adige (SUDTIROLER VOLKSBANK) (starting 2020), Mediobanca.

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

COVERED BOND LABEL: Banca Carige S.p.A. (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.

In the context of the transposition of the Covered Bond Directive (the final deadline for which was 8 July 2022), the ECBC has undertaken a full review and update of the Covered Bond Comparative Database to take account of the latest regulatory developments. This unique reference tool can be accessed via the link hosted on the Covered Bond Label website (www.coveredbondlabel.com/legislation/comparative_database).

For further national information on the Italian market, please see compare.coveredbondlabel.com/frameworks. To access the "Country Comparison" feature of the database, please see compare.coveredbondlabel.com/compare/select/frameworks.