Italy: the legal framework for the purchase of Italian NPL's by European investment funds

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1. Introduction

In recent years Italy has been a lively market for the supply of non-performing loans (NPLs), reaching the level of 70 billion Euro of transactions during 2018. Such trend is expected to continue during 2019, mainly in light of regulatory measures required to be adopted by Italian lenders. In particular, within the supervisory review and evaluation process (SREP) that is carried out yearly, the ECB has imposed to Italian banks to address the NPL issue by increasing the overall coverage level of NPLs' outstanding stock on their balance sheets.
Starting from 2014, the Italian government has passed several measures that ease NPLs' transactions; in particular, procedural rules on debt recovery in Italy have been updated and the scope of entities authorized to operate as debt purchasers has been expanded (traditionally, debt purchase has been deemed to be qualified as a lending activity in Italy, and was reserved to banks and other financial intermediaries regulated by the Banking Act). In the latter respect, Italy enacted several legislative provisions that progressively allowed investment funds, insurance companies and securitisation vehicles (in respect of securitisation SPV's the most recent measures are contained in Italy's 2019 Budget Law) to grant credit in Italy, under certain conditions.
Among the most interesting provisions are those intended to allow investment funds to engage in lending activities. In particular, the Finance Act now allows investment funds to engage in direct lending and debt purchase, provided, inter alia, that credit is granted to borrowers that do not qualify as "consumers" and certain transparency measures are adopted.
Interestingly, such option is conferred not only to Italian funds, but also to EU alternative investment funds (AIFs), which may engage in lending activities in Italy, provided that they follow a specific authorisation procedure. It is must be underlined that, at this stage, non-EU funds are not allowed to grant credit in any form.

2. The authorisation procedure

The authorization procedure to be followed by an EU AIF that seeks to provide lending activities in Italy, is carried out by the Bank of Italy, and aims to ensure, in accordance with the provisions of the Finance Act, compliance with the following requirements:

i. the EU AIF must be authorized by the competent authority of its home Member State to grant credit in its country of origin;

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ii. the EU AIF must have a closed-ended form and its operating scheme, as regards the modalities of participation, must be similar to that of an Italian AIF that invest in loans;
iii. the rules of the home Member State of the EU AIF regarding risk containment and fractioning, including leverage limits, must be equivalent to those applicable to Italian AIFs that engage in lending activities towards Italian commercial borrowers and/or invest in receivables in Italy. Equivalence to the Italian rules can be verified with reference to the EU AIF's rules or by-laws, provided that the competent authority of the home member State ensures compliance with them.

In order to allow the authority to assess the existence of the requirements listed above, at least 60 days before commencing investments in receivables or lending activities in Italy EU AIFMs must send a prior notice to the Bank of Italy, accompanied by a series of documents.

Following receipt of the notice by the EU AIFM, the Bank of Italy verifies its completeness; where it deems it to be incomplete, it requires the necessary integrations. As soon as the authority has verified the application's completeness (or all necessary integrations have been provided by the AIFM), the Bank of Italy will inform the interested party of the receipt of the documentation. Within 60 days from such notification, if the operating conditions provided for by law are not met, the Bank of Italy may prohibit the fund from operating in Italy.

If within this period Bank of Italy does not oppose a ban on the start of operations, the manager may then start the operation of the AIF in Italy.

3. Documents to be submitted

Among the documents to be submitted, the relevant legislation includes, inter alia, AIF's rules or by-laws, a declaration of the AIFM's legal representative that singles out the legislative provisions deemed to be equivalent to the Italian ones, the latest AIF's financial statements, etc.

It seems of particular relevance that AIFMs are required to submit to the Bank of Italy also an illustration of the AIF's "operating scheme", of which the Finance Act requires the analogy with that of the Italian AIFs. In this regard, it is specified that the document must contain a description of the procedures for the subscription and redemption of shares of the AIF, its object and investment policy, as well as any side letters subscribed or to be subscribed with fund participants.

With reference to the documentation to be presented, the Asset Management Regulation currently in force does not include a requirement for the AIFM to submit a program of operations related to its activities in Italy (differently, such requirement was included in the draft of the Asset Management Regulation initially submitted for public consultation). Such exclusion appears to be relevant, since it confirms that the regulation encompasses also one-off operations by EU AIFs, similarly to those of private equity funds, which not necessarily carry out on-going investment transactions but rather a number of individual deals (which normally provide for a drawdown mechanisms where investors will be required to remit payments, in proportion to their commitments, whenever funding needs for specific investment activities of the fund occur).

4. When authorisation is needed?

From a practical standpoint it remains to be understood which activities are subject to the prior authorization procedure, since the Finance Act simply states that such authorization is required to be obtained in relation to “lending activities” carried out “in Italy”.

In this regard, leaving aside operational schemes that certainly fall within the scope of application of the authorization procedure (such as, typically, the supply of loans in Italy on a stable and continuous basis), two scenarios might deserve further investigation:

- a single credit transaction effected in Italy;
- lending activities in favor of an Italian borrower when no preparatory activity (such as the research of borrowers or advertisement) by the EU AIF is affected in Italy.

The first case concerns a single transaction, in which the EU AIF seeks for a specific funding opportunity in Italy and proceeds to grant credit in favor of a single Italian borrower. Different elements suggest that in this scenario the authorization procedure would be necessary. Firstly, the lack of any reference to a program of operation appears to indicate that such procedure applies also to one-off transactions. Secondly, the fact that the protection objectives underlying the legislation on credit funds (expressed, inter alia, by the prohibition of lending to consumers) are relevant also in relation to single transactions.

With reference to lending activities towards an Italian borrower in the context of activities carried out entirely in a EU Member State other than Italy, the nationality of the borrower does not seem relevant per se, since the granting of credit might take place on the direct initiative of such borrower, that autonomously engages the EU AIF in order to obtain credit (so called “genuine reverse solicitation”). Differently, where certain typical activities relating to lending where performed by the AIFM’s representative in the Italian territory (such as, promotion / placement activities including the invitation at the conclusion of the loan agreement and the negotiation and signing of the agreement itself), these might be viewed by Italian authorities as an indicator that the credit is granted in Italy and hence, that it should be subject to the Italian rules on credit funds.