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Client**Alert**

Milan Office

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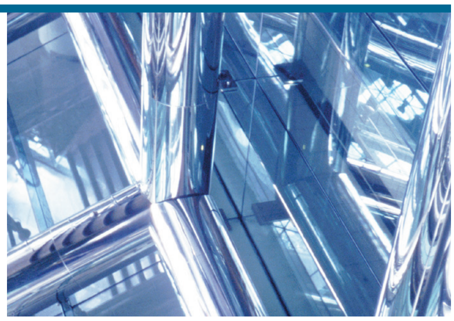

Bank of Italy rules to implement Capital Requirements Directive IV – *consultation document on prudential supervision for banks and banking groups*

On November 27, 2013 the Bank of Italy submitted for public consultation a draft circular setting forth the new prudential supervision rules ("*disposizioni di vigilanza prudenziale*") for banks and banking groups (the "**Draft Circular**"). The Draft Circular will be adopted in the framework of the future implementation in Italy of Directive no. 2013/36/EU (the "**Capital Requirements Directive IV**" or "**CRDIV**") and in connection with the application of EU regulation no. 575/2013 (the "**Capital Requirements Regulation**" or "**CRR**").

In August 2013 the Bank of Italy had published for consultation and comment an illustrative document on the actions planned by the Italian regulator for the application of CRDIV and CRR and the exercise of certain discretions permitted by such legislation[1].

The purpose of this Client Insight is to solicit a discussion in order to collect views to be reflected in a response to the public consultation on the Draft Circular. This Client Insight is based on the Draft Circular; the final circular may differ from the Draft Circular. This Client Insight will be updated to reflect material changes in the final published circular as well as any further step that may be taken in the framework of the implementation of Basel III rules in Italy.

The Draft Circular will replace the current rules on prudential supervision of banks and banking groups set out in the Bank of Italy's circular no. 263 (as amended)[2] and further supervisory rules contained in the Bank of Italy's circular no. 229 (as amended)[3], e.g. on cross-border operations. Further provisions of circular no. 229 (e.g. on collection of savings and branches) may also migrate to the final text of the Draft Circular in future.

The structure of the final circular is expected to be set out as follows:

- provisions concerning the implementation of CRDIV (Part I);
- certain non-harmonised supervisory rules reflecting best practices (Part II); and
- rules aimed at easing the application of CRR, rules reflecting the exercise by the Bank of Italy of certain discretions under CRDIV and CRR and procedural rules (Part III).

The Draft Circular only contains certain provisions under Part I on:

- banks' freedom of establishment and freedom to provide services;
- capital buffers;

1. See document "*Applicazione in Italia del regolamento (UE) n. 575/2013 e della direttiva 2013/36/UE*" submitted by Bank of Italy to public consultation in August 2013 at http://www.bancaditalia.it/vigilanza/cons-pubblica/proc_in_corso/Applicazione_reg. Bank of Italy also published new draft supervisory rules for banking groups in October 2013 to reflect certain amendments to the existing legal framework in connection with CRDIV and CRR: see document "*Disposizioni di vigilanza- gruppo bancario*" at http://www.bancaditalia.it/homepage/notizie/vigilanza/Provv_partecipazioni_detenibili_211013/doc_cons_211013.pdf.
2. "*Nuove disposizioni di vigilanza prudenziale per le banche*".
3. "*Istruzioni di vigilanza per le banche*".

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Should you be interested in sharing any comments or views regarding the above, please contact us at Alert.Milan@whitecase.com. We would be happy to discuss your feedback and include it in our response to the Bank of Italy's consultation.

- internal capital adequacy assessment process ("**ICAAP**") and supervisory review and evaluation process ("**SREP**").

The Bank of Italy will publish one or more consultation documents specifically dealing with the other sections[4].

The Draft Circular first identifies, for each regulated entity, the supervisory rules of the circular which apply to it on an individual, consolidated and sub-consolidated basis, as the case may be.

Set out below is an overview of certain provisions included in the Draft Circular.

Banks' freedom of establishment and freedom to provide services

The Draft Circular reflects CRDIV rules on the establishment of branches (or provisions of services) in other EU Member States by Italian banks as well as in Italy by banks incorporated in other EU Member States[5].

Capital buffers

The Draft Circular imports CRDIV rules on the following capital buffers:

- *capital conservation buffer* to meet at any time the own funds requirement under CRR (Article 129 of CRDIV);
- *counter-cyclical capital buffer* to absorb the risk to the banking sector of excessive credit growth or credit crunch (Article 130 of CRDIV);
- *G-SII buffer (global systemically important institution buffer) and O-SII buffer (other systemically important institution buffer)* specific to systemically important banks, at a global or domestic level, to comply with additional capital requirements and compensate for the higher risk that such banks represent to the financial system (Article 131 of CRDIV).

Small and medium-sized investment firms ("**SIM**")[6] have been exempted from the capital conservation and counter-cyclical capital buffer requirements in accordance with the discretions granted to EU Member States by CRDIV.

Failure to comply with such combined buffer requirements triggers restrictions on distributions[7] and the need for the bank to adopt a capital conservation plan on necessary remedial actions (Articles 140 and 141 of CRDIV).

At this stage no provision is included on the systemic risk buffer under Article 133 of CRDIV as the Italian level-1 rules for CRDIV implementation on this point have not been enacted yet.

ICAAP and SREP

Rules are provided both on ICAAP to be carried out by the banks and banking groups and SREP to be conducted by the Bank of Italy.

As for ICAAP, specified provisions are included in accordance with Articles 83 and 87 of CRDIV on the identification and measurement of market risks and the risk of excessive leverage as well as (in the context of the measurement of credit risk) of its country and transfer risk components.

As regards SREP, the Draft Circular specifically empowers the Bank of Italy in accordance with Article 104 of CRDIV, *inter alia*, to require banks and banking groups to limit variable remuneration, prohibit interest payments on financial instruments which are calculated as own funds and impose specific liquidity requirements (including restrictions on maturity mismatches between assets and liabilities) based on the evaluation of levels and composition of liquidity buffers.

The Draft Circular is aimed at setting out a further milestone in the process of implementation of the EU capital requirements framework in Italy and reorganization of the supervisory rules applicable to banks and banking groups. Further initiatives are expected to be taken by the competent authorities to ensure an ordered transition to the new Basel III rules.

Comments to public consultation may be sent to Bank of Italy until 12 December 2013.

4. Namely:
   (a) Part I - authorization for the activity of banks, banking groups and the register of banks and banking groups, corporate governance, remuneration policies, internal control mechanisms, business continuity, transmission of information, liquidity risk management and country-by-country reporting;
   (b) Part II - *inter alia*, covered bonds, depositary banks of collective investment undertakings and pension funds, conflict of interest, participations held by banks and banking groups and Bank of Italy's power to request information and conduct inspections;
   (c) Part III - rules to ensure application of CRR on, inter alia, own funds, capital requirements, credit risk (and inherent adjustments), securitization, counterparty risk, operational risk, market and settlement risk, large exposure and leverage.
5. Such provisions also apply to financial institutions ("*società finanziarie*") as defined by Article 59 of Italian Legislative Decree no. 385 of 1 September 1993 (as amended), e.g. other credit institutions, financial holding companies, issuers of payment instruments, money brokers and asset management companies.
6. Investment firms are categorized as small or medium-sized in accordance with EU Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises.
7. The Draft Circular sets forth technical rules on the calculation of the so-called "maximum distributable amount".