Ten (plus one) things to consider when you do a leveraged finance deal in Italy

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Legislative changes in Italy (starting from 2012) facilitated leveraged transactions facilitating security in both bank and bond financings and aligning bond and bank finance options. These changes have catalyzed creditors' appetite for Italian leveraged finance transactions and helped fuel a resurgence in M&A activity in Italy. Here are ten (plus one) things to consider when doing a leveraged finance deal in Italy:

1. Regulatory framework for lending in Italy

Lending in Italy has traditionally been reserved to Italian-licensed and EU-passported banks or financial institutions authorized by the Bank of Italy. However, recent reforms allowed Italian insurance companies and securitization SPVs as well as Italian and EU alternative investment funds to conduct lending activity in Italy subject to certain conditions. Funds may also lend under IBLOR structures (i.e. through an EU-based 'fronting' bank which sub-participates risk to participants), on a tax transparent basis.

2. Financial Assistance

Save for specific exceptions (i.e. merger leveraged buy-out transactions under article 2501-*bis* of the Italian civil code or the whitewash procedure under article 2358 of the Italian civil code), it is not permitted under Italian law for a company to give financial assistance (whether by means of a loan, security, guarantee or otherwise) to support the acquisition, directly or indirectly, or subscription of its own shares.

Article 2501-*bis* of the Italian civil code applies to a merger between companies, one of which has incurred debt to acquire control of the other, and if, as a result of the merger, the assets of the acquired company constitute general collateral (*garanzia generica*) securing, or constituting a source for, the repayment of such debt.

For joint stock companies (*società per azioni*) a whitewash procedure is provided for under article 2358 of the Italian civil code to guarantee and/or secure acquisition indebtedness up to the amount of distributable profits and available reserves, as set out in the most recent annual financial statements of the Italian company. Whitewash procedures are both common and necessary in leveraged buyout transactions.

3. Corporate Benefit

An Italian company entering into a transaction (which include the grant of a security interest or a guarantee) must receive real and adequate benefit in exchange for its participation. As a general rule, the corporate benefit must be assessed for each company involved in the transaction on a stand-alone basis, although in certain circumstances the interest of the group to which such company is a member may also be considered. The risk assumed by an Italian company must not be disproportionate to the direct or indirect economic benefit it receives. In the case of upstream and cross-stream security interests or guarantees for the financial obligations of group companies, examples of corporate benefits may include receipt by the Italian company of financial consideration in the form of access to cash flows through intercompany loans from other members of that group.

4. Granting security in Italy

Security may be granted over a broad class of assets. Use of the notarial form is required for certain types of security (e.g. special liens (*privilegio speciale*) over moveable assets, pledges over participation in a limited liability company, mortgages over real properties and registered moveable assets, pledges over intellectual property rights, pledges or assignments of receivables arising against a public entity). Security documents must clearly identify (i) the assets subject to security interests, (ii) the secured creditors (to be listed therein other than for bond issuances, where security may be created in favour of a representative ("*rappresentante*") of the noteholders) and (iii) the main financial terms of the secured contracts. Perfection formalities with respect to the security are required by law. Re-registration of the security is necessary upon transfer of loans (but not securities), together with relevant perfection formalities.

A non-possessory pledge over non-registered moveable assets (whether a general pledge or covering specific assets only) has been recently introduced by Decree Law No. 59/2016 to enhance creditors' rights, and the legislative process to implement such sort of floating charge is currently ongoing. The charged assets remain in possession of the pledgor (i.e. it may transform, or dispose of, the charged assets) and in the event of transformation or disposal of the collateral, the charge will automatically extend to the relevant transformed asset(s)/proceeds of the sale of the collateral/replacing asset(s).

5. Insolvency regime

The main insolvency proceedings (*procedure concorsuali*) are bankruptcy (*fallimento*) and pre-bankruptcy agreement (*concordato preventivo*). If the debtor is distressed (which concept includes insolvency, but may extend to other situations of financial distress), these two restructuring proceedings may also be considered: (i) a debt restructuring plan (known as *piano di risanamento*), conducted on a private and out-of-court basis and based on a plan prepared by the debtor and often also based on private agreements with its main creditors, or (ii) a debt restructuring agreement (known as 182-*bis* or *accordo di ristrutturazione dei debiti*), which is an agreement made on a private basis but then subject to review and approval (*omologazione*) of the Court and published in the Companies' Register. A further available structure is the pre-bankruptcy agreement (*concordato preventivo*) which is a workout agreement with creditors through an in-court procedure based on a plan prepared by the debtor. Certain insolvency procedures apply only to large enterprises such as those set out in the Prodi Law and the Marzano Law, and can provide for an assets disposal plan or a restructuring plan.

The Italian Parliament is currently examining reforms to Italian bankruptcy law, mainly aimed at making insolvency proceedings more efficient. The legislative proposal was approved on 1 February 2017 by one of the two houses of the Italian Parliament and, if passed in both houses, would empower the Government to carry out the reform which is expected to take place in the course of 2017.

6. Bankruptcy claw-back

Under Italian bankruptcy law a transaction may be clawed back, (i) in the case of early repayment by a borrower (including through any other paying entity) of an unexpired debt (i.e. a prepayment of a debt which was not due and payable before the date of opening of the insolvency proceeding) made within two years prior to the commencement of its insolvency proceeding; and (ii) in the case of payment of an expired debt made within the six months prior to the commencement of the borrower's insolvency proceeding, to the extent the bankruptcy receiver proves that the relevant creditor was aware of the debtor's insolvency.

7. Equitable subordination

Shareholder/intercompany loans may be equitably subordinated (by operation of law) to all other debts of the relevant borrower if granted at a time when, taking into consideration the business carried out by the company (among other things): (i) the company's indebtedness was excessively high compared to shareholders' equity, or (ii) the company's financial situation was such that a shareholders' contribution would have been reasonable under the circumstances. In addition, any payment received in repayment of such shareholder/intercompany loans may be clawed-back by a borrower's bankruptcy receiver should the borrower become insolvent within one year from the date such payment is made.

8. Usury

Usury law places a cap on all-in remuneration. The definition of "interest" used to calculate the cap is very broad (it also includes fees and other amounts charged to the borrower). The Bank of Italy sets quarterly thresholds which vary depending on the nature of the financing. In the event of a violation of Italian usury limits, the "punitive" mechanism against lenders is that the borrower ceases to be obliged to pay any interest.

9. Compounding of interest

Particularly relevant for junior/subordinated debt structuring, the compounding of interest is only allowed if (a) the interest is accrued for at least six months and (b) compounding of such interest is made once it is due and payable.

10. Withholding regime for loans and bonds

For direct lending, there is no withholding tax if lending from Italy or, for medium-long term financings (18+ months) if lenders are EU-based financial institutions. The same regime applies to "white-listed" investment funds subject to regulatory supervision, securitization SPVs and insurance companies.

For bond issuances, no withholding tax is due on interest paid to noteholders based in 'white-listed' jurisdictions in respect of medium-long term financings (18+ months) to the extent appropriate certification and deposit requirements or other tax residence disclosure are complied with and subject to certain rules. Bonds must be either listed or, if unlisted, held only by qualified investors (as defined under MIFID).

In other cases, the general rule is that withholding taxes are due on interest payments and commitment (and other) fees payable to non-Italian-based lenders. The withholding tax rate is currently 26%, and may be reduced under double taxation treaties to (usually) 10%.

11. Taking security of *prosciutto* and *parmigiano*

In Italy, there are special rules on obtaining security over *prosciutto* (cured ham) and *parmigiano* (parmesan cheese). *Prosciutti* must be marked and thereafter disposed of only for their manufacturing and sale. With respect to *parmigiano*, there is no need for the cheese to be marked and the pledge is revolving (*rotativo*), meaning that the pledged assets may be replaced by the security grantor.

Italian law therefore makes it hard for a person to be separated from his *prosciutto* and *parmigiano*!

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