

# Steps taken to backstop the Italian Banking System: Atlas fund, NPL state guarantee and insolvency reforms

May 2016

On 11 April 2016, the Italian government announced the launch of the Atlante (“**Atlas**”) fund, a private fund which will acquire shares in Italian banks and purchase non-performing loans (“**NPLs**”).

On 15 April 2016, Law Decree No. 18/2016 (the “**Decree**”) came into force which implements a state guarantee scheme to facilitate the securitization and sale of NPLs.

On 29 April 2016, the Atlas fund closed with subscriptions of euro 4.25 billion. On the same date, the Italian government approved a decree to accelerate NPL enforcement proceedings.

## Atlas Fund

On 11 April 2016, the Italian government announced the launch of the “Atlante” (“**Atlas**”) fund.

Atlas is a private alternative investment fund in which a number of Italian banks, insurers, banking foundations and other investors, including state financing agency Cassa Depositi e Prestiti, have invested. The fund is managed by Quaestio Capital Management Sgr (“**Quaestio**”), a Milan-based alternative investment fund manager.

Quaestio announced on 29 April that total subscriptions to the fund were euro 4.25 billion. Subscribers include Intesa Sanpaolo (euro 1 billion), UniCredit (euro 1 billion) and UBI Banca (euro 200 million) as well as the Cassa Depositi e Prestiti (euro 500 million).

The maximum leverage of the fund has been set at 110%.

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## Purpose of the Fund

The purpose of the Atlas fund is to:

- (i) act as a **backstop facility for capital increases** by Italian banks. The fund will acquire shares which are issued via rights issues and public offerings but which remain unsubscribed in the primary market; and
- (ii) **purchase NPLs and property assets** from Italian banks.

## Backstop Facility for Capital Increases

Up to 70% of the fund has been earmarked for equity investments in the capital increases of under-capitalised banks between now and June 2017.

The first transaction undertaken by the fund will be the acquisition of 99.3% of the shares of Banca Popolare di Vicenza which remained unsold during the offer period which closed on 29 April. UniCredit had previously undertaken to underwrite the capital increase of Banca Popolare di Vicenza alone, but subsequently entered into an agreement with Quaestio such that Atlas purchased the entirety of the capital increase.

According to media reports, Quaestio received authorization from the European Central Bank and the Bank of Italy to acquire more than 50% of the bank's shares and Consob exempted the fund from the requirement to launch a mandatory tender offer should it reach the relevant threshold. Quaestio has indicated that it will not exercise "direction and control" over banks in which it owns shares and according to media reports it will now restructure Banca Popolare di Vicenza and sell or merge it.

## Purchasing NPLs and property assets

Until 30 June 2017, up to 30% of the fund has been earmarked to invest in NPLs and property assets of Italian banks. After 30 June 2017, 100% of the cash which has not used to buy bank shares may be used to buy NPLs.

In particular, the fund could be used to acquire notes comprising the junior tranches of securitisations of NPL portfolios by Italian banks. Atlas would purchase some or all of the junior notes and other investors, benefiting from a State Guarantee (as defined below), would purchase the senior notes.

**Next Steps:** If Atlas agrees to buy the junior notes in an NPL securitisation, the State Guarantee for senior notes combined with an acceleration of enforcement procedures for NPLs generally (see below) should make the senior tranche a more attractive investment for private equity funds, hedge funds or other purchasers.

The question of pricing remains contentious. In theory, this mechanism should have the effect of increasing the price which purchasers are willing to pay for the acquisition of NPLs, narrowing the gap with the valuations currently ascribed to NPLs on the balance sheets of Italian banks. However, media reports indicate that tensions remain between purchasers and sellers regarding appropriate levels.

According to Moody's, the credit rating agency, while the launch of the fund should prove "credit positive" for the weaker Italian banks, they remain concerned about the absence of external capital entering the banking system. Transactions undertaken by the fund could lead to contingent liabilities and weaker capital ratios for the healthier banks.

Initial indications are that the European Commission does not consider the creation of the Atlas fund to be an infringement of EU state aid rules, although this is not based upon a formal decision process.

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## State Guarantee for NPL Securitisations

Italian government guarantees for securitised NPLs (“*garanzie sulla cartolarizzazione delle sofferenze*” or “GACS”) (each a “**State Guarantee**”) are now available to Italian banks and financial intermediaries following the conversion into law of the Decree. See our Newsflash of 12 February 2016.

State Guarantees will be issued during a period beginning on 15 April 2016 and ending 18 months later<sup>1</sup> to guarantee senior notes issued pursuant to securitization transactions carried out by banks incorporated in Italy (each an “**Originator**”) where the underlying assets are NPLs. A fund of euro 120 million has been set aside for this purpose for 2016.

**Structuring Requirements:** To qualify for the issuance of a State Guarantee, a securitization transaction must:

- (i) provide for NPLs to be transferred to a securitisation vehicle at a price no higher than their net book value as at the transfer date;
- (ii) comprise at least two tranches, a junior and senior tranche;
- (iii) in respect of the junior notes, provide that noteholders do not receive payment of principal, interest or other remuneration until the principal of senior tranches of notes has been repaid in full;
- (iv) pay a floating rate of interest on the senior notes (and mezzanine, if any)
- (v) in respect of senior notes, hold an investment grade credit rating from a recognized rating agency; and
- (vi) involve the appointment by the Originator of an independent NPL servicer.

Once awarded, a State Guarantee will only be effective if in the transaction the Originator:

- (i) sells at least 50% plus one note of the junior notes to private investors; and
- (ii) sells a sufficient amount of the junior and mezzanine tranches to achieve accounting de-recognition of the NPLs sold.

**Enforcement of Guarantee.** The first sentence of Article 11 states that a State Guarantee can be enforced within nine months of the maturity date of the notes, and therefore appears to indicate that enforcement action can only begin after the maturity date. On the other hand, the second sentence allows enforcement to commence after non-payment of interest. There is therefore some confusion in the Decree regarding timing of enforcement of the guarantee. This inconsistency was raised by the ECB in its review of the draft Decree, but not resolved in the final text.

**Pricing.** The Italian government will charge Originators for providing State Guarantees. The cost of the guarantee will consist of an annual fee, which will be determined based on the then current market price of credit default swaps for Italian issuers whose credit ratings correspond to those of the notes being issued.

## Bankruptcy Reform

When announcing the launch of the Atlas fund on 11 April, the Italian government also announced that it would introduce new measures to accelerate bankruptcy proceedings so that purchasers of NPL receivables would be able to take enforcement action within a reasonable period of time.

A decree was approved by the Italian government on 29 April 2016 and published in the Italian Official Gazette No. 102 of 3 May 2016. It is intended to increase certainty and speed to proceedings, partly by the increased use of technology. Measures include:

- (i) shorter time limits in which borrowers may object to enforcement decisions;
- (ii) the ability for a judge to issue a provisional enforcement order for claims which are not opposed within those time limits;
- (iii) increased use of technology in court hearings and creditors’ meetings;
- (iv) the ability to remove an administrator who does not comply with the timetable established for an insolvency procedure; and
- (v) the creation of a digital register of proceedings, to be managed by the Ministry of Justice.

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<sup>1</sup> Such period may be extended for a further period of 18 months, subject the approval of the European Commission.

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