

## Italian Measures for the Government's Subscription of Subordinated Bank Securities

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On November 28, 2008, as part of a law decree enacting various fiscal stimulus measures, the Italian Government adopted a new bank capitalization program directed at “healthy” Italian banks whose shares are listed on a regulated exchange.<sup>1</sup> The law decree (No. 185/2008) was published in the Italian Official Gazette on November 29, 2008 (“Decree 185”).<sup>2</sup>

### 1. General

Article 12 of Decree 185 empowers the Ministry of Economic Affairs (the “Ministry”) to put in place a bank capitalization program similar to those already approved by other EU Member States. The program is open to banks that, although not undercapitalized, wish to increase their capital ratios in the current financial turmoil.<sup>3</sup> The Ministry is authorized to subscribe to eligible securities under Decree 185 through December 31, 2009. The Government expects that the issuing banks will in turn “provide an adequate flow of financing to the economy”.

<sup>1</sup> For a discussion of the Italian Government’s measures directed at under-capitalized banks and further stabilization and liquidity enhancement measures announced in October 2008, see our Alert memorandum dated October 2008, available at [http://www.cgsh.com/files/News/18af8322-410f-4d9a-a3a9-cdb0016e3637/Presentation/NewsAttachment/12e4e937-a048-41de-ad31-d4df53c2f088/CGSH%20Alert%20Memo%20-%20Stabilization%20Measures\\_Italy\\_Alert%20Memo.pdf](http://www.cgsh.com/files/News/18af8322-410f-4d9a-a3a9-cdb0016e3637/Presentation/NewsAttachment/12e4e937-a048-41de-ad31-d4df53c2f088/CGSH%20Alert%20Memo%20-%20Stabilization%20Measures_Italy_Alert%20Memo.pdf). A further memorandum will discuss the significant amendments these measures are undergoing as part of the Parliament ratification process, which is expected to be completed within the next two weeks.

<sup>2</sup> Decree 185 is effective from its date of publication in the Official Gazette, but must be ratified by Parliament within 60 days of its thereafter.

<sup>3</sup> The program is not effective until the Ministry adopts implementing regulations, which must be promulgated within 30 days.

## 2. Eligibility

Participation to the capital strengthening program is voluntary (although it cannot be excluded that the Ministry or the Bank of Italy will exert moral suasion to convince eligible banks to participate). Only Italian banks and bank holding companies whose shares are listed on a regulated market are eligible to apply. Thus, smaller banks, including most local and regional cooperative banks, are excluded from the program.

## 3. Terms of the New Securities

The instruments that the Ministry may subscribe to pursuant to Decree 185:

- (i) must be eligible for inclusion in the issuer's regulatory capital (Decree 185 does not specify whether the securities must qualify for Tier 1 or Core Tier 1 treatment);
- (ii) do not carry voting rights;
- (iii) may be convertible, at the option of the issuer, into ordinary shares;
- (iv) may provide for redemption or repurchase of the securities, at the option of the issuer, with the prior approval of the Bank of Italy (which will have to ensure that the redemption or repurchase does not jeopardize the financial or solvency position of the bank or its group);
- (v) may provide for payments thereon to depend, in whole or in part, upon the availability of distributable profits; and
- (vi) may be issued by a resolution of the same corporate body empowered to issue subordinated bonds (generally the board of directors). If the securities are convertible instruments, the conversion is conditional upon the approval of the required share capital increase at a shareholders' meeting.

## 4. Conditions for the Ministry's Involvement

The Ministry's subscription of the financial instruments is conditional upon the following requirements:

- (a) the transaction as a whole must be financially sound and carried out on prevailing market terms,<sup>4</sup> and must serve the purposes of ensuring an adequate flow of credit to the national economy and the adequate capitalization of the Italian banking system;

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<sup>4</sup> These requirements are necessary to avoid the capital injection being considered state aid under EU state aid rules.

- (b) the issuing bank or bank holding company must have entered into a memorandum of understanding with the Ministry whereby it has undertaken certain commitments concerning “the level and terms of credit to be extended to small and medium-size enterprises and families, as well as a dividend policy coherent with the need to maintain adequate capital levels”; and
- (c) there must be adopted, by the issuing bank or bank holding company, a code of ethics providing for, among other things, rules governing the remuneration of the issuer’s top management. The code of ethics, once adopted, will have to be communicated to the Italian Parliament.

The subscription of the securities will be based on an assessment by the Bank of Italy of the economic terms of any proposed transaction and of the possibility for the issuer to include the issuance in the issuer’s regulatory capital.

It is likely that the memorandum of understanding and the code of ethics referred to under (b) and (c) above will be standardized documents agreed upon between the Ministry and the Italian Banking Association.

#### 5. Expedited Procedure for Corporate Actions

Decree 185 introduces a simplified approval process for the adoption of shareholders’ resolutions in the context of bank recapitalization transactions. These rules also apply to bank recapitalizations by the Italian government carried out under Law Decree No. 155/2008 in favor of undercapitalized Italian banks.

In particular, in the context of such transactions, shareholders’ resolutions concerning (i) share capital increases with waiver of shareholders’ pre-emptive rights or (ii) delegation to the board of directors of the power to increase a company’s share capital may be adopted with the standard quorums applicable to rights issues. Terms for convening such shareholders’ meetings are reduced to 15 days.

#### 6. Transaction Funding and Reporting

Decree 185 does not set forth the aggregate amount of funds the Italian Government will earmark to finance the transactions that may be carried out under Decree 185. Decree 185 only states that the necessary resources will be identified, by a Prime Minister decree, on a case-by-case basis, by reducing the funds made available for certain expense items in the Italian state budget or by issuing government bonds.<sup>5</sup>

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<sup>5</sup> In a press conference called to illustrate Decree 185, the Ministry reportedly estimated at €10 to 12 billion the volume of the Italian banks’ requests under this program.

The Ministry shall report to the Italian Parliament on an annual basis about bank lending activities by region and economic sector. It is unclear whether this reporting obligation concerns the lending volumes by all Italian banks or only by the Italian banks whose securities the Ministry will subscribe to. Although similar data is already reported by the banking system on a quarterly basis, Decree 185 requires banks to provide data concerning their lending activities to the Italian government representative (*prefetto*) in the relevant province.

7. Conclusions

It is difficult to anticipate whether many Italian listed banks will actually take advantage of the capital strengthening program described above. The actual financial terms of the securities will be contained in the Ministry's implementing measures. Thus, at this stage, banks may not yet assess the advantages and/or merits of the program. Moreover, it is still unclear how onerous, invasive and strict the terms of the undertakings that will be included in the memorandum of understanding to be entered into by the Ministry and each issuing bank will be.

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Please do not hesitate to contact Giuseppe Scassellati-Sforzolini in our Rome office (+39 06 695 221) or Valentina Zadra in our Milan office (+39 02 726 081) should you have any questions concerning the above.

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