

Italy's new rules on notes and commercial paper

June 15, 2012

The Italian Cabinet adopted today a Law Decree (the “Decree”)¹ introducing important measures aimed at stimulating the Italian economy. The Decree introduces, *inter alia*, new rules on: (i) the exemption from the limitations on the issuance of notes provided for in Article 2412, paragraph 1 of the Civil Code; (ii) the issuance of Non-Listed Securities (as defined below) by Non-Listed Companies (as defined below); (iii) commercial paper (*cambiali finanziarie*); and (iv) the tax regime applicable to Securities (as defined below) issued by Non-Listed Companies.

The new regime promotes the issuance of notes and commercial paper by corporate issuers that are not listed on a regulated market, and their placement with professional investors, creating a competitive alternative to loan financing. It prevents direct or indirect shareholders of such issuers from subscribing to non-listed notes or commercial paper, and, as a consequence, promotes shareholders' capitalization of the companies.

Within 60 days of publication on the Italian Official Journal (which is expected in the next few days), the Decree must be converted into law by the Italian Parliament.² The Decree has been adopted “subject to further revisions” and therefore the text may still be amended in the next few days.

- ***Exemption from the limitations on the issuance of notes***

Article 2412 of the Civil Code, which sets forth limits on the total principal amount of notes that an Italian corporate issuer may have outstanding from time to time, discouraged the issuance of notes by companies which are not listed on a regulated market.³ With the entry into force of the Decree, all issuers (*i.e.*, both listed companies and companies not listed on a regulated

¹ The new rules described in this memorandum are included in Article 32 of the Decree.

² Law Decrees enter into force, unless otherwise specified, on the day following their publication on the Official Journal; however, they must be converted into Law by Parliament within 60 days of this publication, otherwise they cease to be effective retroactively.

³ According to Article 2412, paragraph 1 of the Civil Code, a company may not issue notes whose aggregate amount exceeds twice the aggregate of its share capital, its legal reserve and the available reserves as shown in the latest approved financial statements.

market) that issue notes to be listed on a regulated market or on a multilateral trading facility or notes that include a right to subscribe to or purchase the issuer's stock, will be able to benefit from the exemption.

- ***Issuance of Non-Listed Securities by Non-Listed Companies***

The Decree introduces new requirements for issuances by companies, other than banks and micro-sized enterprises (as defined by European Commission recommendation No. 2003/361 of May 6, 2003)⁴, that have no securities listed on a regulated market or a multilateral trading facility ("Non-Listed Companies"). In particular, issuance by Non-Listed Companies of commercial paper (*cambiali finanziarie*) and/or notes that are not offered to the public nor admitted to trading on an Italian or EU regulated market or multilateral trading facility ("Non-Listed Securities") must satisfy the following conditions: (i) a sponsor must be involved in the issuance and underwriting stages; (ii) the issuer's latest annual financial statements must be audited; and (iii) the Non-Listed Securities must be offered only to qualified investors that are not direct or indirect shareholders of the issuer and thereafter must circulate only amongst such type of investors.⁵

In particular, the sponsor must: (i) ensure the liquidity of the Non-Listed Securities, at least at predefined intervals, until maturity; (ii) hold in its portfolio, until maturity, an amount of the Non-Listed Securities issued not lower than certain thresholds;⁶ (iii) periodically assess, at least half-yearly, the value of the Non-Listed Securities; and (iv) classify the issuer, through its formalized models, in a risk category identified through procedures that take into account the enterprises' creditworthiness bearing in mind European Commission Communication 2008/C 14/02, as amended, concerning the

⁴ The European Commission recommendation No. 2003/361 of May 6, 2003 concerning the definition of micro, small and medium-sized enterprises provides that "1. [t]he category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. 2. Within the SME category, a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. 3. Within the SME category, a micro-sized enterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million."

⁵ The innovation introduced by the new rules is particularly significant considering that under the previous regime commercial paper could be issued only by banks, listed companies and non-listed companies that fulfilled certain requirements (such as the realization of profits during each of the three previous years).

⁶ The sponsor must hold at least 5% of the first Euro 5 million of the value of the Non-Listed Securities issued, plus an additional 3% of the value of the Non-Listed Securities issued greater than Euro 5 million but lower than or equal to Euro 10 million, plus an additional 2% of the value of the Non-Listed Securities issued that exceeds 10 million.

revision of the method for setting reference and discount rates.⁷ Moreover, the placing of Non-Listed Securities towards qualified investors controlling the sponsor is subject to the existing rules about conflict of interest. Companies other than small or medium-sized enterprises⁸ may choose not to appoint a sponsor or may exempt the sponsor from compliance with the sponsor' obligations listed above.

- ***Issuance of notes with a subordination clause and/or with a profit participation clause***

Under the Decree, Non-Listed Companies may issue notes (i) with a subordination clause, which establishes the priority of the claims of the issuer's creditors (other than the shareholders) over those of the noteholders⁹ and/or (ii) with a profit participation clause, provided in each case that such notes have a maturity of at least 60 months. Profit participating notes represent a type of floating rate notes whose coupon reflects a fixed component and a variable component linked to the profits of the issuer. In accordance with Article 32, paragraph 21 of the Decree, the fixed interest rate component cannot be lower than the applicable Official Rate of Reference (*Tasso Ufficiale di Riferimento*), whereas the variable interest rate component must be paid annually by the issuer to the noteholders within 30 days after the approval of the financial statements.¹⁰

- ***New rules on commercial paper***

The Decree promotes the issuance of commercial paper (*cambiali finanziarie*) by introducing the ability for Non-Listed Companies to issue commercial

⁷ The classification must be done at least half-yearly and at anytime extraordinary factors may impact its assessment. There are five risk categories for an issuer's creditworthiness (strong, good, satisfactory, weak, and bad) to be matched, for secured transactions, with a guarantee level classification of high, normal, or low. The sponsor must make the adopted classification public and must timely update its content anytime it is necessary.

⁸ As defined by European Commission recommendation No. 2003/361 of May 6, 2003, see footnote 6 above.

⁹ As specified in Article 32, paragraph 20 of the Decree, Non-Listed Companies that issue notes with a subordination clause must comply with Article 2435 of the Civil Code, which provides that within 30 days after the approval of the financial statements, Non-Listed Companies must file with the Italian Companies' Register a list of the shareholders as of the date of such approval, detailing the number of shares owned by such shareholders as well as a list of the persons, other than the shareholders, that benefit from any rights or security over such shares.

¹⁰ The methods of calculation of the variable component of the interest rate are set at the moment of issuance, cannot be amended until the note matures, are calculated on the basis of objective criteria, and cannot be influenced by resolutions of the board of directors or at shareholders' meetings of the issuer. As provided for in Article 32, paragraph 25 of the Decree, Italian usury law No. 108/1996 does not apply to the variable interest rate component of profit participating notes.

paper, as specified under the section “*Issuances of Non-Listed Securities by Non-Listed Companies*” above. With the entry into force of the Decree, companies can issue such instruments in dematerialized form.¹¹ In addition, the Decree encourages the issuance of commercial paper by reducing the minimum period of maturity of commercial paper, and extending its maximum period of maturity, providing that such instruments can be issued with maturities from one month to 18 months after the issue date.¹² The total amount of outstanding commercial paper must not exceed the company’s current assets as shown in the latest approved financial statements.¹³

- ***Amendments to tax rules applicable to Securities issued by Non-Listed Companies***

The Decree also contemplates tax amendments aimed at ensuring that commercial paper (*cambiali finanziarie*) and notes issued by Non-Listed Companies (the “Securities”) benefit from the same, more favorable regime currently applicable to securities issued by banks and listed corporations. In particular, the Decree provides for a:

- Full Deductibility of Interest Expense, whereby the rule currently limiting the tax deductibility of interest expense accrued on Securities¹⁴ will not apply to interest accrued on such Securities insofar as they are held by qualified investors that are not direct or indirect shareholders of the issuer.

It is foreseeable that issuers will need clear guidance as to the evidence to be provided to demonstrate compliance with the above-mentioned holding requirement in order to have absolute certainty on the full interest expense allowance, which is a key feature to ensure the success of the Securities on the market. Conceivably, the tax administration will have to devise an effective and stream-lined

¹¹ In order to be able to issue commercial paper in dematerialized form, the company must send a request to an authorized centralized deposit system (*società autorizzata alla prestazione del servizio di gestione accentrata*), which must contain certain information, including the company’s unconditional undertaking to pay all amounts due at maturity.

¹² Under law No. 43 of January 13, 1994, commercial paper could be issued with maturities from 3 months to 1 year.

¹³ For further details, please see Article 32, paragraph 6 of the Decree.

¹⁴ Pursuant to Article 3, paragraph 115, of Law No. 549 of December 28, 1995, tax-deductible interest expense accrued on securities issued by non-listed companies cannot exceed the official reference rate set, at the time of issuance, by the European Central Bank increased by two-thirds if the securities are not listed, or doubled, if they are listed.

certification procedure, which, for instance, could resort to Decree No. 239 (as defined below) procedures, by simply including in the related certificate form currently used for white-listed country holders the additional information so required, and replicate such procedures for all other holders, including Italian holders.

- Tax Exemption on Interest Income Earned by Certain Foreign Investors: the scope of Legislative Decree No. 239 of April 1, 1996 (“Decree No. 239”) is extended to include Securities listed on a regulated market that are issued as of the effective date of the Decree.

This is an important development as it enables non-listed issuers to access international capital markets without having to bear a tax gross-up cost: under Decree No. 239, foreign Securities’ holders resident in white-listed countries will benefit from an exemption from the ordinary 20% final tax applicable on the relating interest income if, among other things, they are the beneficial owners and comply with certain standard certification procedures.

Moreover, the Decree includes the following tax measures:

- Full Deductibility of Issuance Expenses: any expenses resulting from the issuance of securities falling within the scope of Decree No. 239 are now fully deductible in the year in which they are paid, regardless of any different timing imputation for accounting purposes.
- Monitoring Obligations: the issuance of non-listed Securities will be strictly monitored by the Italian tax authorities for anti-avoidance purposes, as issuer will be obliged, *inter alia*, to communicate to the Italian Tax Agency any data referring to the issuance of such securities within thirty days. Administrative guidance could be issued in connection with such obligation.
- Special Rules on Subordinated Profit Participating Notes: the variable portion of the remuneration accrued on subordinated contingent profit participating notes whereby capital distributions would be limited to the dividend amounts paid out of the annual profits, shall be accounted for as a special profit and loss account provision and, as such, treated as an expense that, while not deductible under ordinary rules, would instead be fully deductible for corporate income tax purposes.

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If you have any questions concerning this memorandum, please feel free to contact Pietro Fioruzzi in our Milan office (+39 02 7260 8214), Vania Petrella (+39 06 6952 2204) or Claudio Di Falco (+39 06 6952 2207) in our Rome office or any of our other Italy-based partners and counsel listed under Capital Markets or Tax Practice Areas under the “Practices” section of our website at www.clearygottlieb.com, or any of your regular contacts at the firm.

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