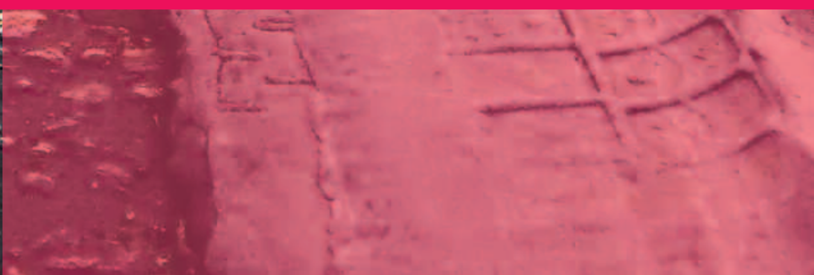
Italy Perspectives

Autumn/Winter 2012/2013

Notebook on refinancing and restructuring

CLIFFORD CHANCE



Contents

3 Foreword

1

4 Italy joins the club: demystifying the UK Scheme of Arrangement

2

8 Accessing liquidity pools: how to overcome the Italian challenges

3

11 When the going gets tough: a perspective on 18 months of restructuring

4

14 Refinancing wall or wave: how to cut through the surf

5

17 Alternative financing sources: key constraints revisited

20 Restructuring: about us

22 Our panelists

About this publication

This publication summarises the discussions regarding Italian restructuring and refinancing, from the first series of meetings held in Autumn/Winter 2012/2013.

We are grateful to all attendees for their valuable time and contribution to the discussion.

Foreword

This Notebook is a summary of the principal questions and answers discussed during the first 'Italy Perspectives', a series of five panel discussions on Refinancing and Restructuring held by Clifford Chance in Milan between October 2012 and January 2013.

We thank all the attendees and contributors to the first Series and look forward to meeting you all in the next Italy Perspectives series that we will be launching shortly.

"A few words of introduction on what these sessions are about. It occurred to us that we needed to offer a more immediate way of sharing our knowledge and views on the legal challenges we experience on transactions, in a format that breaks a little with the traditional seminar, with lengthy slides and little or no interaction. Our idea, with this Perspective Series, is to recreate, in front of you, the dynamic of how you normally interact with us – in a face-to-face meeting or conference call – where we brainstorm together on questions and answers, with a focus on what really impacts the business - not just issues but also solutions.

The current programme focuses on refinancing and restructuring. We will look at how macro-economic effects impact on the Italian market and, in particular, on the availability of and appetite for future debt financings.

Each session will be hosted in Milan and will bring together practitioners from our Italian and international offices and we hope to stimulate interaction and lively debates".

Charles Adams
Italy Managing Partner
Milan, October 24 2012

1

Talk 1 – 24/25 October 2012

Italy joins the club: demystifying the UK Scheme of Arrangement

**Panelists: Giuseppe De Palma,
Prof. Carlo Giampaolino and
Philip Hertz**

Moderated by Charles Adams

Last Summer the UK Companies Court sanctioned a scheme of arrangement ("Scheme") for Seat Pagine Gialle S.p.A. ("Seat"). This is the first time that a UK Scheme has been used to implement the restructuring of an Italian company and it has been described as a landmark decision.

In this first session, the cross-border team who represented the senior creditors on Seat looked at how a Scheme might be applied in future Italian debt restructurings. They considered situations where a Scheme might be applied for restructuring loans and bonds. They also looked at the costs and process involved and the risk of potential challenges from dissenting creditors.

The panel explored a range of questions in relation to the Seat case, drawing upon the experience of Clifford Chance's network and the contribution of key market players in attendance on the day.

Key outcomes

What is a UK Scheme?
A Scheme is a statutory procedure which allows a company to make an arrangement with its shareholders or creditors (or any class of them) which, if approved by the required majority and sanctioned by the court, will be binding on all of them, whether or not they voted in favour of the Scheme. The relevant law is set out in Sections 895-901 of the Companies Act 2006. Schemes have been used for over 140 years in the UK for a number of different purposes, for example the implementation of takeovers and mergers. Since 2008, following the onset of the financial crisis, Schemes have increasingly been applied as a tool to implement debt restructurings.

What is the advantage of using a Scheme and how does it work in practice?
One of the main advantages of a Scheme is that it can be used by a company to restructure its debts without the need for unanimity in circumstances where this would otherwise be required under the terms of the relevant credit documentation.

It is necessary to produce Scheme documentation which includes the Scheme's rules and a short explanation setting out in simple terms to all creditors why the Scheme is required and detailing its commercial effects. An application is made to a court for permission to call meetings of creditors. The Scheme documentation is then sent to creditors who are called to vote on the Scheme at a specifically convened meeting.

The Scheme must be approved by creditors representing 75 percent in value of the debt and a majority in number of the creditors. If approved by the required majority, the Scheme must be sanctioned at a formal UK court hearing and an office copy of the court order is delivered to the registrar of companies for registration.

What will the UK courts consider when deciding whether to sanction the Scheme?
In exercising its powers of sanction, the court will want to see:

(i) that the creditors were fairly represented by those who attended the meeting, that the majority of relevant creditors are acting in good faith and are not simply coercing the minority in order to promote their own interests, and

(ii) that the arrangement is such that an intelligent and honest person, who may be an affected creditor acting in respect of his interest, might reasonably approve. However, the court will not dwell on the substance of the commercial terms of the arrangement since, if it has been approved by a majority of creditors, as in such cases, the Scheme is assumed to be a good deal for creditors generally.

How long does it take to get a Scheme approved?
Clearly, the overall timing of a Scheme implementation will depend on the length of commercial negotiations but, normally, there is a period of five to seven weeks between Scheme documents being posted to creditors and the Scheme becoming effective. Bearing this in mind and the fact that as mentioned above the required documentation is not generally speaking burdensome, the cost involved can be considerably less than that involved in other restructuring options.

How have Schemes come to be applied outside the UK?
Schemes of arrangement have been successfully applied to companies across a number of European jurisdictions including Metrovacesa (a Spanish entity), Telecolumbus, Rodenstock GmbH (German entities) and, most recently, companies in the Vivacom group (Bulgarian and Dutch entities). So long as it can be shown that the overseas company has sufficient connection with the UK for a UK court to have jurisdiction over it, it can be subject to a Scheme to deal with its creditors. In this context, UK debt law will be sufficient to demonstrate such a connection.

"A Scheme is simply a compromise agreement, it is basically a contract between the company and its creditors. If you need 100% unanimity and you can't get it, then the Scheme may be the answer."

Philip Hertz, Partner, London

What additional considerations will be required to apply Schemes to an Italian company?

Once jurisdiction has been established, for example by reason of a UK law governed loan agreement, the UK court will consider two further questions before it will approve a Scheme with respect to an Italian company:

(i) Could the same outcome be achieved by an equivalent or similar procedure available in Italy? For example, could the same outcome be achieved with an Italian court assisted procedure under article 182 *bis* of the Italian Bankruptcy Law? If the answer is yes, the UK court is unlikely to sanction the application of the UK Scheme for an Italian company.

(ii) Is there a reasonable prospect that an Italian court will recognise the Scheme? If the answer is no, the UK court is unlikely to sanction a Scheme since to do so would bind creditors within the UK jurisdiction, but leave creditors outside the UK free to enforce their rights under the underlying contractual arrangements.

Could a Scheme be applied to an Italian law governed facility agreement by simply agreeing to change the governing law to UK law?

Clearly these considerations are relevant on the assumption that a majority vote is required to amend the governing law of the underlying loan documentation. Whilst it cannot be excluded that a dissenting creditor may challenge the application of the Scheme in these circumstances from a strictly legal perspective, the application of the Scheme following the amendment by a majority vote of the governing law provisions should not in principle affect the analysis of whether an Italian court would recognise the Scheme, once the Scheme has been approved by a UK court.

Is the Scheme an Italian insolvency procedure?

Prior to the Seat restructuring there was a fundamental misconception in the Italian legal and business communities that the Scheme was an insolvency procedure (*procedura concorsuale*). The fear was that the Scheme would be perceived as being in competition with local insolvency proceedings and, accordingly, it was thought that national regulators, courts and/or criminal prosecutors may have perceived its use as an attempt to bypass the protection afforded by Italian Insolvency law and the rules on insolvency jurisdiction set out in accordance with the EC Insolvency Regulation. But the Scheme is not an insolvency process and does not come within the scope of the EC Insolvency Regulation.

What would happen if whilst a company is applying for the Scheme, a dissenting creditor files for insolvency?

Generally, prior to considering a Scheme it is highly advisable to secure standstill arrangements with any individual or groups of lenders, given that ongoing Scheme negotiations will not prevent a bankruptcy court from issuing an insolvency declaration.

That said, the implementation of a Scheme prior to any hearing scheduled for the bankruptcy declaration may have such a positive impact on a company's financial position so as to avoid a bankruptcy declaration in any event.

"For the purpose of getting the UK court to approve a Scheme of arrangement you don't actually need to go to the Italian court to get an order recognising the Scheme.

You just need the opinion of a prominent academic to confirm that the Scheme is likely to be recognised in Italy."

Philip Hertz, Partner, London

"How likely is a challenge by a dissenting creditor in an Italian court?
What is interesting from our international experience is that this risk has not materialised so far. In practice, any such challenge would probably arise following the approval and sanctioning of the Scheme by a UK court. By this time the risk would be limited to a relatively small number of dissenters. Add to this the time and resources required to challenge the Scheme against the prospect of an earlier payment, and the likelihood of a challenge reduces even further."

Can the Scheme be applied to other financial arrangements such as bonds?
UK law provisions relating to Schemes are extremely flexible and can be applied in all circumstances involving a company and its creditors.

There is a technical issue that arises with respect to bonds relating to the fact that in a bond structure it is the paying agent / trustee who is the issuer's formal creditor and not the individual bondholder. That said, when applying the Scheme for the first time to an issuer and its bondholders, we were able to establish that the bondholders had direct rights of requesting delivery of definitive bonds, thus successfully involving bondholders in the Scheme in their capacity as ultimate creditors in the bond structure.

Doesn't Italian law in any event provide that the amendments to bond notes can be effected by simple majority?
The Italian Civil Code provides that amendments to bonds can be effected by simple majority. The relevant law is found in articles 2415 et seq. of the Civil Code. This is lower than the 75% majority required by the Scheme and in any event, where a local legal instrument is available that adequately achieves the compromise sought between the company and its creditors, this would be the preferred solution, also bearing in mind that the UK court is likely to refuse the approval of the Scheme in these circumstances. That said, Schemes could potentially provide a useful tool in bond restructurings where the relevant provisions of the Civil Code do not apply (e.g. accrued interest provisions).

"The reality is that the Scheme is not an insolvency procedure and does not prevent access to the protection afforded by Italian law.

The proof of this is that in the case of Seat the Scheme was implemented in conjunction with an Italian out-of-court procedure under article 67 of the Italian Bankruptcy Law."

Prof Carlo Giampaolino, Partner, Milan

Talk 2 – 7/8 November 2012

Accessing liquidity pools: how to overcome the Italian challenges

Panelists: Carlo Galli, Tony Lopez, Giuseppe De Palma and Franco Grilli Cicilioni

Moderated by Charles Adams

Outside of Italy in the leveraged-finance market, we have been experiencing for some time now the strong shift from a European bank-driven market to a more US-oriented capital market. Until recent reforms in Italy removed certain obstacles to bond issuance by non-listed companies, the Italian experience of the high-yield markets remained relatively moderate. This is now changing, prompting a lot of interest in how Italian corporates can access the high-yield markets.

In the second session, drawing upon the considerable experience of Clifford Chance's international leveraged finance and high-yield team, the panel discussed the legal characteristics of this 'US-oriented' market and considered how the recent reforms of the Italian legislative framework have facilitated access to the high-yield liquidity pool.

What is this 'US liquidity pool'?

The US high-yield bond market for lower-grade issuers developed in the 1970s and 1980s. It was a tool initially employed aggressively to fund leverage buyouts in a manner that sometimes made international headlines. Originally, sub-investment grade bonds related only to issuers which had previously been investment grade and then 'fallen from grace', as it were. Gradually, market players realised that, with an adequate portfolio of sub-investment grade bonds, a good return on invested capital could be achieved even accounting for the higher default level. This led to the development over time of extremely large high yield bond funds (assembling portfolios of even 100 different bond issues from around the world) managed by highly sophisticated fund managers with extensive experience in credit analysis.

How are these high yield bonds structured and what is their relationship with senior secured loans?

1990s – Structural Subordination

Up to the late 1990s, high yield bonds would typically be issued at the holding company level and be structurally subordinated. The bonds were structured so as to be repayable only after the senior bank debt had been discharged and coupon and other payments on the bonds could be blocked if an event of default occurred under the senior loan. In a bankruptcy scenario, with the senior debt made available directly to the operating company, senior lenders would have direct access to the assets as collateral whilst the holding company's primary asset would be the equity in the operating company, which would almost always be wiped out in the event of insolvency.

2000 – Senior Subordinated Guarantees

Following the market contraction in the late 1990s which highlighted the weaknesses in the above structure, from the early 2000s, guarantee release provisions were introduced so that the structurally subordinated notes would be accompanied by senior subordinated guarantees. The guarantee release provisions essentially provided that if the senior secured creditors were to enforce share pledges, dispose of the company and recover for themselves, the guarantees would stay in place unless there was an independent third party valuation confirming the fairness of the sale price. Given the difficulty in obtaining such an opinion in a distressed situation, this effectively became a negotiating tool for noteholders in a default scenario. This structure held up to the beginning of the global crisis in 2007.

Today

Following the financial crisis, managers of this US liquidity pool leveraged the fact that in Europe they were in effect replacing - at least in part - senior secured credit facility debt to require terms that offered them a similar position to that of senior secured creditors (as had been the case in the U.S. for a number of years).

Whilst the terms of these issues are by no means uniform, particularly in terms of the quality of security offered, for some of the new senior secured bonds, the terms combine several of the most attractive features of the senior secured loan and the unsecured high yield bond markets.

What is a super senior financing?

Even where all senior secured bank debt of a company has been replaced by senior secured bonds (as in the case of Cable Europa of Spain, for example) companies will always require some form of working capital bank credit facility to cover fluctuating working capital requirements. Senior secured bonds are now commonly issued to sit alongside a so-called 'super senior' revolving credit facility, which is put in place to meet the borrower's working capital needs and/or to help the credit rating of the borrower. This 'super senior' revolving credit facility ranks *pari passu* with the high yield bonds but enjoys 'super' priority with respect to the payment of proceeds upon the enforcement of security. In other words, bondholders continue to maintain control over security enforcement but the resulting proceeds will be applied first in repayment of the revolver.

Is there a rule as to how much of a capital structure of a company can be a super senior revolver?

Clearly, bondholders will want this to be a minority portion of the capital/debt structure of the issuer. We have seen some deals where the super senior credit position reached 35/40% of the overall debt. In these circumstances, it becomes difficult to truly speak of a senior secured bond given that the super senior revolver is likely to take up most if not all of the proceeds of enforcement. The norm in our experience would be for the super senior revolving facility to represent from 10 to 15% of the overall debt.

Key features

	Senior Secured Loan	Senior Secured Bond	Super Senior Working Capital Facility	Unsecured Bond
Ranking	Senior pari passu	Senior pari passu	Super Senior	Structurally subordinated
Security	Secured	Secured	Secured with priority on enforcement proceeds	Unsecured
Covenants	Strong covenant package providing early warning of potential default	Limited covenant package	Potentially stronger covenant package but broadly aligned with Senior Secured Bond	Limited covenant package

The Italian Market

What were the barriers which prevented Italian corporates from accessing bond markets?

Until recently there were a number of barriers facing Italian corporates who were considering the issuance of debt instruments. In particular, non-listed companies were at a disadvantage as compared to listed companies with respect to both the size of the offering - which could not exceed twice the company's net worth (unless certain exemptions applied) - and with respect to taxation, in so far that interest payments were virtually non deductible and subject to 20% withholding tax. So until very recently, Italian high-yield transactions involving un-listed groups were, for the most part, indirect structures where the issuers sit somewhere within the group whether at topco or subsidiary level, a significant departure from bondholders' best credit position. These structures were accompanied by weak Italian guarantee/security packages and in some cases, uncertainty as regards the tax treatment.

What has changed?

The new rules[1] now provide that - to the extent that the bonds are listed on a regulated market or multilateral trading facility: (i) non-listed companies are no longer subject to a restriction with respect to the size of the offering (ii) interest payments on bonds issued may be deducted, provided that investors are 'qualified investors' and are not direct or indirect shareholders of the issuer and (iii) bond issuances are exempt from withholding tax provided that the bonds are listed on a regulated market or multilateral trading facility.

Bearing in mind the requirements of investors as set out above, what are the specific Italian issues to be borne in mind in the case of Italian issuances?

In Italy we are starting to see direct debt issuance structures (i.e. where the main Italian operating company issues the bonds and incurs the super senior revolver) where sharing of the security becomes easier to achieve but we are likely to continue seeing some indirect issuances, particularly where the issuing group has significant operations outside of Italy or if the operating company is for some reason restricted in the incurrence of debt (e.g. in a dividend-recap transaction). In indirect issuances, the ability of the bonds and the debt at the Italian topco level to share guarantees and security becomes key, as does, by implication the corporate benefit and financial assistance analysis, which will determine the availability of a meaningful guarantee coverage within the relevant structure.

From a security/guarantee coverage perspective, bearing in mind bondholders' requirement that they should ideally benefit from the same security package offered to senior lenders, the following should also be borne in mind:

- The Privilegio Speciale (in some respects analogous to the UK floating charge) - cannot be granted to non-banking institutions, or to secure bonds.
- *Imposta Sostitutiva*, the 'substitutive tax' which replaces all taxes[2] that would otherwise be payable on a number of security documents under Italian law does not apply to bond structures, which makes it effectively impracticable for bond structures to be secured on Italian real estate.
- Security may be shared if it is granted to each secured creditor, however, there is no concept of trust under Italian law and that also certain mandatory rules of Italian law need to be taken into account when structuring the security package (for example rules relating to noteholders' meeting provisions).
- Structures which involve international (i.e. not just Italian) operations and that are able to offer increased guarantee coverage, should meet with more favourable investor reaction than purely domestic structures but recent experience suggests that in this very liquid and booming high-yield market, investors' requirements can be less stringent.

1 Introduced by Law Decree No. 83 of 22 June 2012.
2 Which can range from 0.5% to 2% of the secured amount.

Talk 3 – 22/23 November 2012

When the going gets tough: a perspective on 18 months of restructuring

Panelists: Charles Adams, Adrian Cohen, Giuseppe De Palma and Paolo Sersale

Moderated by Carlo Galli

As we emerge from the second wave of financial restructurings across Europe, we are perhaps experiencing the calm before the next inevitable storm. Indeed some commentators have warned that Europe may face a triple-dip recession. So, as we gear up for a further wave of restructurings, we are conscious of the fact that de-leveraging companies to a more sustainable level may not, alone, lead to recovery. Concurrent organisational restructuring is needed, and lenders more than ever may need to be open to taking on equity-like positions.

For the next round of restructurings, can we benefit from the tools available and experience learned in the English market?

So far, the number of company failures has been less than expected, in part as a result of macro-economic policies across Europe aimed at keeping interest rates low and the lenders choosing not to crystallise their debts and avoiding write-down of their debt. Short term fixes have also helped keep the number of failures surprisingly low. As a consequence of this approach, the phenomenon of the 'zombie company' has become prevalent in the UK and in other European jurisdictions. In the current climate even regulators, appear to be suggesting that restructurings must pick up pace and the rate of company failures will have to increase, quite radically, so that from a policy perspective, capital becomes available to be invested more efficiently by financing the more profitable companies.

Many debtors are also likely to need restructuring at an organisational level.

From an English law perspective what we have seen in the last round of restructurings is a number of formal insolvency processes being used in tandem with other restructuring mechanisms. By way of example, pre-pack administrations have been used in conjunction with Schemes of arrangement or company voluntary arrangements. Schemes of arrangement have been used to address the financial restructuring aspects of businesses in distress and pre-pack administrations have provided the technique to restructure the operational side of the business.

This combined approach has been used frequently in the second wave of restructurings, with companies initiating a pre-pack insolvency proceeding which aims to streamline the business at an operational level (including changes to their supply, real estate assets and workforce). In this context, the company can cherry-pick the more successful parts of the business with strong input by management and the sponsor.

Pre-packs affect creditors, suppliers, employees and all other stakeholders of the business. They can result in the profitable aspects of the business being rescued and being continued free from certain liabilities. This can have a real impact on junior creditors in circumstances where the value in the business breaks in the senior debt, so that following a pre-pack, the junior debt is left behind in the defunct part of the business. In some cases previous management has been criticised where they continue to operate the business in the post pre-packed form. This aspect has given rise to adverse publicity but for now, the UK government has not yet chosen to act on its original intention of making pre-pack solutions more difficult and it has been recognised that in appropriate circumstances they can have a positive effect on business rescue.

The rise of the 'zombie companies'

"Figures from R3, the insolvency industry trade body, show that one in 10 companies in the UK is able to pay only the interest on their debts but not reduce the debt itself, a common characteristic of zombie companies. This is up 10 per cent in the past five months to 160,000 groups, with 70,000 groups struggling to make their interest payments.

"In some parts of the continent the problem appears even more severe. The lowest rates of insolvency in 2011 were from Greece, Spain and Italy, the three countries whose economies have struggled most. Fewer than 30 in every 10,000 companies fail in these countries – this at a time when nearly one in three groups is loss-making, according to Creditreform, a risk management group".

Financial Times, 8 January 2013

"We are going to see many more formal insolvency procedures rather than short-term fixes. *Concordato preventivo* can be used for very different situations. It will, in appropriate circumstances, be a flexible restructuring mechanism, and unlike other formal insolvency processes, will not signify the end of the business."

Giuseppe De Palma, Partner, Milan

New legislation in Italy has made available new restructuring tools, what effects are these new tools likely to have on the Italian market?

In light of new tools created under the Decree to Promote Growth promulgated in the summer, the *concordato preventivo* is no longer viewed negatively by shareholders and lenders. The new tools are more flexible and encourage business rescue. The ability to file for insolvency protection even before having

prepared a debt restructuring plan, encourages recovery. Because the debtor has a 180-day period to file a restructuring plan, this may be too long for creditors and suppliers, who are left aware of the debtor's distress, but are not provided with any solutions on how the business may be successfully restructured.

At present, the process for the *concordato preventivo* remains a court-driven, lengthy process, and until the courts become more efficient it's going to be difficult to expect suppliers and creditors to continue to supply and lend their support for as much as six months before a restructuring plan is even devised.

The new *concordato preventivo* process

- Protection is available before a restructuring plan is filed (up to 180 days later).
- Supervised by the court where the company has its registered seat: this can lead to smaller courts having to supervise proceedings without any prior experience, and without any sense of urgency. Absent transferring the registered seat to the jurisdiction of a court more used to dealing with restructurings such as Milan, there is no mechanism to choose a different court.
- The new *concordato* allows for some cram-down of creditors, even if the creditors are not divided into classes.

New action by the Bank of Italy allowing creditors to own ordinary shares in debtor companies opens up the question of whether lenders should have a more direct role in governance. Are lenders ready, and willing, to take on this more active role?

A sizeable portion of debtors in Italy require operational reorganisation. Lenders are still likely to offer waivers and will be unwilling to call a default until they know whether a solution exists. Without a solution, crystallisation of their debts will not be attractive: creditors may also be deterred by the loss of control in the *concordato* process, which is driven mainly by management and the courts. These factors may therefore result in lenders taking an equity stake in the next round of restructurings.

Historically, many lenders could not or would not own ordinary shares or exercise control over the debtor company. Now, however, the solution may be found in hybrid tools such as equity-participation instruments *(strumenti finanziari partecipativi, or SFPs)* created under the Italian corporate law reform in 2003. SFPs are hybrid instruments, granting equity ownership in the company, but without any voting rights or being able to elect more than one director on the board.

"The reality is that we will be facing a different type of restructuring: less financial and more operational. Different solutions will have to be considered including that of hybrid equity-participation instruments (*strumenti finanziari partecipativi*, or SFPs). The open question really becomes whether the banks should take a more active role in the company governance."

Paolo Sersale, Partner, Milan

How can the peculiarities of the Italian market affect the restructuring process?

The lenders' market is often very fragmented, and it is difficult, if not impossible, to demand the attention, and to obtain the cooperation, of all the creditors of a company. Creditors need to be aware that reaching a consensus or making use of the new pre-insolvency cram-down mechanisms may be the only way of avoiding a formal meltdown. It may also involve adjustments to the capital structure. Similarly, the courts need to change their approach to the *concordato* process so that it offers a realistic and practical solution to facilitate the transition from distress to recovery, minimising the period of uncertainty for creditors, employees and suppliers alike.

Relevant legal references

- Italian Insolvency Law – R.D. 16 March 1942 n. 267 (as amended on 28 September 2012)
- European Insolvency regulation - Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings
- 'Hybrid' debt instruments: subordinated bonds and financial instruments under Article 2411 of the Italian Civil Code
- 'Quasi-equity' instruments: especially strumenti partecipativi under Article 2346, sixth paragraph, of the Italian Civil Code

Talk 4 – 13/14 December 2012

Refinancing wall or wave: how to cut through the surf

Panelists: Charles Adams, Fabio Diminich, Franco Grilli Cicilioni and Ferdinando Poscio

Moderated by Carlo Galli

It has been clear for some time that the primary source of refinancing for the large part of existing Italian bank debt would be the capital markets. Market indicators suggest that this trend is likely to accelerate in 2013. Over the past twelve months partners in our banking and capital markets teams have teamed up and have been monitoring and analysing Italian borrowers as they come up to market, to understand what trends are evolving and how better to prepare for a shift from bank lending to capital markets. This session discussed the outcome of the above-mentioned analysis.

What type of Italian borrowers have you been monitoring?
We focused on corporates (excluding financial institutions and sovereigns that have access to different funding sources) with debt in issuance maturing before 2016 and divided the borrowers into the following three categories, which represented our 'targets' (and those of our investment bank clients):

- *large, investment grade, listed companies or frequent issuers* we found approximately 20 names of which 15 had been to market over the period of our monitoring;
- *leveraged borrowers with more than €300 million of original debt, maturing before 2016:* the category included approximately 25 names when we started monitoring;
- *single-purpose borrowers,* e.g. project or real estate finance borrowers: we excluded these borrowers from our monitoring since the refinancing solution for these borrowers was likely to be tailor-made and less impacted by market trends.

"For the large investment grade issuers, we have seen a tightening of terms (such as negative pledge) and we have also seen requests for security, something previously unheard of in the 'frequent issuer' space."

Franco Grilli Cicilioni, Partner, Milan

What is the global scenario for issuance of debt securities?
From the world of high yield bonds, which overall has been active in 2012, especially in the first four months and in September through November, it is fair to say that it has been a very good year. The forecast for the market in the first quarter of 2013 may be affected by the expected fiscal cliff in the United States, which may slow down the market. If the US high yield bond market slows or shuts down, Europe will follow.

However a word of caution. In 2012, much of the action was from seasoned, repeat issuers, who were able to exploit their 'readiness to issue' to select the correct timing to maximise investor/yield appeal. Issues from first time issuers were very few, and certainly not as many as we would have expected given the booming market. It is clearly still the case that not many new issuers are willing to invest the costs and time to become 'issue-ready'. This is a potentially a problem since, the 'windows' for issuance in the high-yield market are relatively tight and there is still much volatility so timing is crucial and the issuer must be ready to take full advantage.

How do you see the Italian market for issuance of high yield bonds?
From the 'outside' the uncertain political process in Italy may not be helpful in giving investors confidence to buy into Italian issuers. Until we, and the world, discover who will govern and whether they will follow through with Monti's reforms, the appeal of Italian issuers may remain limited. Investors, and especially high yield investors, are sensitive to geographical diversity, in terms of the jurisdictions where the revenues are generated. If there is political uncertainty, investors may be reluctant to invest in 'pure' Italian risk.

"If there is political uncertainty, pure Italian risk is probably going to be a bit more problematic. Investors are always going to like geographic diversity of revenues and assets."

Fabio Diminich, Partner, London

What about investment grade borrowers?
For the large investment grade corporates we witnessed a frequent use of their established EMTN programmes, in 2012, but again we did not see the number of newcomers to the corporate bond market that we would have expected. We've also seen far more attention on covenants in recent issuances, with a tightening of terms (such as negative pledge) even for frequent issuers. We have also been involved in discussions on security for bond issuance, something that was previously virtually unheard of in the 'frequent issuer' space. What we have also clearly witnessed is a significant downturn in investment grade bank lending as the Eurozone crisis took its toll (we counted just 4 names going to market and the volumes, significantly down from 2011, were distorted by one single jumbo transaction (Snam).

What are the macro characteristics of the leveraged borrowers and what type of contractual provisions are in place to help (or restrict) refinancing, in particular partial refinancing?
Of the 25 names we originally identified, over the course of 2012 two have been sold to industrial buyers, two went into serious restructuring and two were deleveraged through a high yield bond issuance. That in itself provides an interesting statistic and also suggests that the pace of refinancing (or restructuring) will have to pick up in 2013.

Our analysis of the structure and contractual arrangements for these borrowers revealed that less than half had significant international operations/subsidiaries, thus lacking the

geographical diversity that the high-yield bond investors would like to see. Less than a third of cases had senior and subordinated (mezzanine/second lien) debt. The significance of this is that structures that have different layers of bank debt are more likely to have a pre-agreed flexibility built in the intercreditor agreement that gives the borrower a greater degree of flexibility to extend the maturity of the senior debt at least up to the final maturity of the subordinated tranche, without seeking the unanimous consent of all creditors. So in the vast majority of cases we looked at, the extension of the original maturities would require the consent of all creditors.

Of the original 25 names, only five have (or have had) a high yield bond in issue: again, only those capital structures that have (or have had) a bond may have a mechanism built into the intercreditor agreement to allow for refinancing through bonds or for a replacement of debt within the overall ratio of permitted debt. In other words, 80% of the borrowers we analysed, have documentation that assumes that the refinancing will occur through bank debt, and not bond debt. An amendment of the intercreditor arrangements to allow for a bond refinancing would typically require the consent of all parties to those arrangements.

Italian Leveraged Structures:

- Less than 50% had significant international operations
- Less than 20% contemplated the possibility of a bond refinancing
- Only 30% had a 'yank the bank' provision that would allow the 'neutralisation' of dissenting lenders

Source: Clifford Chance Proprietary Analysis on 25 borrowers, 2012

So what conclusions do you draw looking forward to 2013 on leveraged borrowers?

It is clear that the legislative changes favouring the issuance of bonds by non-listed Italian companies, coupled with the weakness of the European banking sector, means that fund raising in Italy is becoming more capital market oriented and we think that this trend is likely to accelerate. For the time being, it is also a 'US high-yield' market. While this market is enjoying a boom-time (as evidenced by the recent Cerved transaction), as we have discussed not all Italian deals readily lend themselves to the investor requirements of the US high yield market and in any event, there is no guarantee that the US markets will remain open for Italian issuances given the political and economic uncertainties.

One possible market trend is that the European banks will be able progressively to create a less US-oriented market, aimed at an investor base that has greater appetite for European and Italian risk but this process may take time and with final maturities approaching, there will be a need for other solutions if we are to avoid wholesale restructuring. The structures we (and our clients) are focusing on, for those transactions where a full refinancing isn't readily available, are a combination of partial bond refinancing and 'amend & extends' of the existing loans. The principal challenges we face in this regard, borne out by our analysis, is that the existing documentation for Italian leveraged deals is not as 'flexible' as in other jurisdictions when it comes to introducing changes to the capital structure, such as bonds or so-called 'hollow-tranches' (a loan tranche funded by a bond).

"The documentation adopted in Italian deals is not as flexible as in other jurisdictions when it comes to consenting to additional layers of debt. We will need to be creative and hope that the high-yield market will continue to be open for Italian borrowers."

Charles Adams, Partner, Milan

Moreover, while traditionally Italian deals had relatively small syndicates of lenders (making it theoretically easier to get an overall consent), some of the latest deals to come to market before the financial crisis were widely syndicated and there may be large numbers of institutions, many of whom hold individually only a very small portion of the debt. So there is a significant risk that to get the deal done, one will need consents from institutions (that may, depending on the deal, be one institution with a significant portion of debt or many creditors each holding small pieces of debt) that are looking to get out of the deal. All of this may prevent or significantly slow down implementation and add uncertainty and significant cost, to the refinancing transactions. While in a bank-dominated market, as was the case previously in Italy, this uncertainty and cost could be absorbed and managed, it is more challenging in a capital-market oriented scenario, bearing in mind the significant investment the borrower has to make to launch a high-yield bond (rating etc.), the periodic shutting down of the 'windows' for issuance and the inherent volatility of these markets. So we conclude that there will be interesting but challenging times ahead!

Talk 5 – 10/11 January 2013

Alternative financing sources: key constraints revisited

Panelists: Lucio Bonavitacola, Giuseppe De Palma and Carlo Galli

Moderated by Charles Adams

There has been much talk recently of a 'funding gap' for a significant number of Italian companies that will not be able to finance or refinance themselves in the traditional banking market, which is shrinking across Europe. We have examined in other Talks how fund-raising in Europe is going to become more capital market-oriented but increasingly there is talk of how 'shadow banking' might also have a role to play in plugging this funding gap. Of course the liquidity of 'non-banking' institutions (CDOs and CLOs) has been available to the Italian leveraged market for some time but always intermediated by the banking system. So the question we have been asking ourselves is whether we are seeing any changes in the Italian market and any interest for setting up and exploring new channels for non-banking liquidity.

What is shadow banking?

'Shadow banking' essentially refers to market-funded (rather than bank-funded) credit intermediation activities which take place outside the regulated banking system. The term encompasses a very wide range of activities and players which differ enormously from market to market. What has caught the attention of regulators and the media alike in the years following the financial crisis is the sheer size of shadow banking, which rivals the traditional banking system in the intermediation of credit to businesses. So, whatever we call it, 'non-bank lending' is taking on a systemic importance.

"'Shadow banking' is an imprecise term that has sinister connotations that we need to move away from. A more neutral definition is that of the Financial Stability Board (FSB) which talks of 'non-banks performing credit intermediation'."

Lucio Bonavitacola, Partner, Milan

'Shadow banking' in numbers

- The Financial Stability Board (FSB) has roughly estimated the size of the global shadow banking system at around €46 trillion in 2010. This equals 25-30% of the total financial system, and half the size of bank assets.
- Historically, this was divided between US and China and now it is apportioned some 35% in Asia, 55% in the US and around 20% in Europe.
- However, according to FSB estimates, the share of these assets in Europe has sharply increased in recent years.

Are we seeing concrete examples of 'non-banks' lending in the market?

It is easy to suppose that a consequence of the implementation of regulations such as Basel III which introduce more stringent capital and liquidity requirements for regulated credit institutions will be the involvement of 'non-banks' in a larger share of the funding activities that were previously the domain of Europe's banks. However, we are not really yet seeing this happen on the ground, either in Italy or elsewhere in Europe, and from a regulatory perspective we see a trend of infection of the more stringent approach applied to banks spreading now to non-banks.

So, for example, the Financial Stability Board has recently outlined recommendations to promote enhanced regulation of banks' interactions with shadow banking entities.[1] The European Commission announced it is planning to propose new regulations to "*rein in risky financial activities that take place outside the regular banking system.*" In March 2012, the European Commission issued a consultation paper seeking commentary on the need for new regulations. Following this European Parliament Committee on Economic and Monetary Affairs published a draft report on shadow banking in August 2012. The FSB published for public consultation in November 2012 an initial integrated set of policy recommendations to strengthen oversight and regulation of the shadow banking system.

These proposals to an extent echo the conservative approach of the Italian regulators towards the non-banking financial market.

What are the regulatory barriers in Italy?

In Italy banking activities are restricted to banks and a limited category of recognised financial intermediaries such as those recorded in the register held with the Bank of Italy (article 106 *Testo Unico Bancario*). What is different about Italy is that the regulatory restrictions apply not only to the core business of banking (such as deposit-taking and connected activities) that are typically regulated in all jurisdictions but also to lending activities.

So from an Italian perspective, third party lending (in its broadest sense) is limited to regulated entities that are required to comply with applicable statutory requirements and the relevant implementing measures adopted by Bank of Italy and CONSOB. The consequences of a violation of the restrictions set forth in art. 106 of TUB are severe: the exercise of a financial activity on a public basis by an entity not enrolled in the Bank of Italy's registry is a criminal offence[2].

What consequences has this had on the Italian market?

As a result of the above regulatory framework, access to the non-bank liquidity has been limited in the Italian market and the flow of funds from non-banking entities that are not regulated in Italy has had to be intermediated by Italian banks through complicated 'fronted' structures.

Opportunities have reduced even further as a result of the renewed awareness - following the credit crunch - of the additional systemic risk introduced by fronted structures. In our experience large international non-banking players are no longer willing (or are far less willing) to consider fronted structures because they expose the participants to a double-credit risk (that

1 The FSB published in November 2012 its Consultative Documents on Strengthening Oversight and Regulation of Shadow Banking,
2 Article 132 of Testo Unico Bancario (TUB).

of the Italian company and that of the Italian fronting bank). These risks always existed but have clearly been pushed to the forefront as a result of the recent wave of restructurings and the Eurozone crisis.

Why does the Italian regulator adopt this stringent approach and is it likely to change?

The historic drivers of Italy's banking regulatory framework are (i) to reduce the risk of banking activities being used for criminal purposes (e.g. laundering the proceeds of a crime), (ii) to set a code of conduct for operators to ensure an appropriate level of protection for the benefit of borrowers and (iii) to reduce the risk of disruption resulting from adverse trading conditions for banks leading to the possibility of multiple or major bank failures.

That said, other structures permitted by the current regulatory framework (such as '*prestito titoli*' (securities lending), in which entities which are deemed sufficiently solvent (be they a reputable insurance firm or Italian investment fund) effectively engage in what are for all intents and purposes lending activities) would suggest that the fundamental driver behind Italy's regulatory framework is now, as for the European Commission and the FSB, that of addressing the systemic risk posed by the non-banking sector.

For this reason, leaving aside the practical difficulties of trying to get the regulators to focus on this issue at a time of political uncertainty, we do not think it will be easy to change the attitude of the Italian regulators to open up the lending market to non-banking institutions - if anything, we are seeing European regulators move towards greater regulation.

But why is it that regulations have been relaxed for bonds while the situation is still so uncertain for lending? Surely from an economic perspective, it is exactly the same whether a non-banking institution purchases a bond issued by an Italian company or makes a loan to the same Italian company

In spite of the recent market convergence between loans and bonds in refinancings (e.g. in terms of structure, security package, covenant package, etc.), it is difficult at present to envisage a scenario in which it becomes as easy for a foreign non-banking institution to make a loan to an Italian company as it is for that same institution to subscribe a bond.

We are frequently asked why that is. The only simple answer we can give is that the Italian legal and regulatory framework views these two instruments very differently. This difference in approach is deep-seated and is unlikely to change in the short term, notwithstanding market forces and regardless of market convergence. Leaving aside more technical

"Whether you look at it from a tax or a regulatory perspective, clearly the bond is the most effective financing instrument. This is not likely to change in 2013."

Carlo Galli, Partner, Milan

considerations, in the current regulatory climate that is very concerned with systemic risk, bonds are viewed as the 'preferred' instruments since in the eyes of the regulators, the systemic risk in the case of bonds is mitigated by the fact that the instrument is, in principle, freely tradable on a regulated market whilst the banks in a syndicated loan are locked into the loan through to maturity. This of course reveals a disconnect or lag between the view of the regulators and market practice but, as we all know, that is quite common.

What about the tax position?

From a tax perspective, the focus of the authorities is not on the nature of the entities financing the company or the legal form of instrument but on the structure of the transaction and its capacity to facilitate tax evasion. The Italian tax authorities have overcome, thanks to the recent reforms, their historic misgivings on the issuance of bonds by non-listed companies. At its most simple, if the financial instrument utilised to finance an Italian company has certain characteristics such that it may be defined as a bond and that bond is listed on a recognised exchange, a favourable fiscal regime will apply, favourable that is for foreign investors when compared to a loan. So the simple conclusion is that the relevant tax and regulatory regime in place today is such as to make the bond the more effective financing instrument.

Relevant legal references

- The Decree to Promote Growth (art. 2412)
- Green paper on Shadow Banking, European Commission (published 19 March 2012)
- Article 132 of TUB *(Testo Unico Bancario)*
- Article 106 TUB *(Testo Unico Bancario)*

Restructuring – About us

"This firm is renowned for yielding high quality lawyers capable of handling important international mandates. Sources acknowledge the team's dedication and skill in managing multiple clients in large transactions. Chambers sources say: '*The group is always available and adept at handling all parties involved.*'"

Restructuring & Insolvency Italy
(Chambers Europe 2012)

"It impresses interviewees with its experience of complex cross-border transactions and its expertise in finance and corporate matters."

Restructuring & Insolvency Italy
(Chambers Europe 2011)

#1 in Restructuring & Insolvency Europe-wide

Sources say: "It's very proactive, it's got the right team on board and is actively involved in the negotiations."

Restructuring & Insolvency Europe-wide
(Chambers Global 2013)

#1 in Restructuring & Insolvency Global-wide

Sources say: "They understand clients' needs, are responsive, give clear answers and offer exceptional legal advice."

Restructuring & Insolvency Global-wide
(Chambers Global 2013)

Restructuring Team of the Year

IFLR European Awards 2012

Restructuring Team of the Year

Legal Business Awards 2012

"Clifford Chance enjoy such a wide range of contacts with banks they have managed to be on many deals" […] "They have done very big, very good deals" […] "Currently, Clifford Chance is involved in one of the biggest debt restructurings ever seen in Italy."

Restructuring & Insolvency
(Chambers UK 2013)

Key recent restructuring experience in Italy

Seat Pagine Gialle – advising the lender and the coordinating committee in relation to the restructuring of the group.
This transaction included the approval of the first UK Scheme of Arrangement for an Italian business.

Seves – advising the lenders in relation to Seves Group's debt restructuring by way of article 182-bis restructuring agreement.

Limoni – advising the senior coordinating committee in relation to the restructuring of Limoni Profumerie (Italy's largest perfume and cosmetics retail chain).

Ferretti – advising the senior credit support provider agent and second lien coordinating committee formed to assist the debt restructuring of Ferretti Yachts.

EEMS – advising the lenders in relation to EEMS Italia group debt restructuring.

Notable restructuring experience globally

Southern Cross – advising Southern Cross in connection with its high profile restructuring.
Restructuring Team of the Year: Legal Business Awards 2012

KCA Deutag – advising the KCA Deutag group company in relation to the refinancing and restructuring of its senior and mezzanine debt.
Restructuring Deal of the Year: IFLR Europe Awards 2012

Dubai World – acting for Dubai World and its subsidiaries in relation to its multi-bank debt restructuring and all related issues.
Restructuring Deal of the Year and Restructuring Team of the Year: IFLR Middle East Awards 2011; Turnaround Legal Advisor of the Year 2010

EMI – advising Citigroup as bilateral lender in relation to various facilities for the EMI group of companies.
Banking & Finance Team of the Year: The Lawyer Awards 2011

Lyondellbasell – advising Lyondellbasell, the third largest chemical group in the world, on their US$24 billion debt restructuring.
Restructuring Deal of the Year: IFLR Europe Awards 2011

Our Panelists

Philip Hertz
Partner, Banking & Finance
E: philip.hertz@cliffordchance.com
Speaker in Talk 1

Philip Hertz co-leads Clifford Chance's restructuring practice. Philip has pioneered the use of the UK Scheme of Arrangement in restructurings involving debtors incorporated outside the UK. He is a member of the International Association of Insurance Receivers and the Insolvency Lawyers Association.

Charles Adams
Managing Partner for Italy, Banking & Finance
E: charles.adams@cliffordchance.com
Speaker in Talk 3 and Talk 4
Moderator in Talk 1, Talk 2 and Talk 5

Charles Adams is the Italy Managing Partner and a Partner in the Firm's banking and restructuring practice. Charles specialises in Italian and cross-border financings and restructurings and has acted for creditors and steering committees in relation to some of the most significant Italian debt refinancings and restructurings such as Seat Pagine Gialle, Ferretti and Parmalat.

Giuseppe De Palma
Partner, Banking & Finance
E: giuseppe.depalma@cliffordchance.com
Speaker in Talk 1, Talk 2, Talk 3 and Talk 5

Giuseppe De Palma heads the Clifford Chance banking and restructuring practice in Italy. He has advised on some of the principal Italian domestic and cross-border financings over the past 15 years across the full spectrum of loan products. He recently advised the Senior CoCom in relation to the SEAT debt refinancing through a senior secured bond issue, which included the approval of first UK Scheme of Arrangement for Italian business.

Adrian Cohen
Partner, Banking & Finance
E: adrian.cohen@cliffordchance.com
Speaker in Talk 3

Adrian Cohen is a Partner in the finance practice specialising in all aspects of domestic and international corporate restructuring and insolvency law, advising debtors and sponsors, finance and industry creditors and counterparties and officeholders. Italian experience includes advising an international bank on its exposures to the Parmalat group of companies and more recently advising the lenders to Limoni SpA on its debt restructuring.

Ferdinando Poscio
Counsel, Banking & Finance
E: ferdinando.poscio@cliffordchance.com
Speaker in Talk 4

Ferdinando is a counsel in Clifford Chance's Finance & Capital Markets practice, specialising in general and syndicated lending, structured and acquisition finance, and restructuring.

Tony Lopez
Partner, Capital Markets
E: tony.lopez@cliffordchance.com
Speaker in Talk 2

Tony Lopez is a Partner in our US group with extensive experience representing corporate clients, sponsors, and investment banks in high yield debt placements and bank/bond financing commitments. Tony has advised on financings across a range of jurisdictions and has a deep understanding of the requirements of US high yield paper.

Franco Grilli Cicilioni
Partner, Capital Markets
E: franco.grilli@cliffordchance.com
Speaker in Talk 2, and Talk 5

Franco Grilli Cicilioni heads the Italian debt capital markets practice. He advises corporate, financial and sovereign issuers as well as dealers, managers and distributors on the issuance of a broad spectrum of debt and quasi-debt securities.

Fabio Diminich
Partner, Capital Markets
E: fabio.diminich@cliffordchance.com
Speaker in Talk 4

Fabio is a Partner in Clifford Chance's London capital markets practice. He has extensive experience advising underwriters and issuers on high yield debt and leveraged finance transactions in Europe.

Lucio Bonavitacola
Partner, Capital Markets
E: lucio.bonavitacola@cliffordchance.com
Speaker in Talk 5

Lucio is a Partner in the Italian Debt & Capital Market practice. He specialises in banking and financial regulations. He keeps in regular contact with the Regulatory Bodies such as the Bank of Italy and CONSOB.

Carlo Galli
Partner, Tax, Pensions & Employment
E: carlo.galli@cliffordchance.com
Speaker in Talk 1, Talk 2 and Talk 5
Moderator in Talk 3 and Talk 4

Carlo Galli is Head of our Italian Tax practice. He specialises in structuring and advising on the tax aspects underpinning Italian capital market and debt issuances. He has been recently involved in some of the most complex and relevant restructuring cases in Italy. Carlo is a highly-regarded author, public speaker and lecturer at top academic institutions in Italy and internationally.

Paolo Sersale
Partner, Corporate M&A
E: paolo.sersale@cliffordchance.com
Speaker in Talk 3

Paolo Sersale is Head of Italian Corporate M&A practice. Paolo has gained significant expertise in some of the largest corporate restructurings, domestic and cross-border M&A transactions.

Carlo Felice Giampaolino
Partner, Litigation & Dispute Resolution
E: carlofelice.giampaolino@cliffordchance.com
Speaker in Talk 1

Carlo Felice Giampaolino is a Partner in the Italy Litigation practice and a Professor of Commercial and Corporate Law at University of Rome Tor Vergata. He specialises in Corporate, Insurance and Bankruptcy Law and regularly advises office holders or domestic insolvences.

C L I F F O R D

C H A N C E

© Clifford Chance, March 2013.

Clifford Chance Studio Legale Associato, Piazzetta M.Bossi, 3, 20121 Milano

www.cliffordchance.com

Abu Dhabi ▪ Amsterdam ▪ Bangkok ▪ Barcelona ▪ Beijing ▪ Brussels ▪ Bucharest ▪ Casablanca ▪ Doha ▪ Dubai ▪ Düsseldorf ▪ Frankfurt ▪ Hong Kong ▪ Istanbul ▪ Kyiv ▪ London ▪ Luxembourg ▪ Madrid
Milan ▪ Moscow ▪ Munich ▪ New York ▪ Paris ▪ Perth ▪ Prague ▪ Riyadh (co-operation agreement) ▪ Rome ▪ São Paulo ▪ Seoul ▪ Shanghai ▪ Singapore ▪ Sydney ▪ Tokyo ▪ Warsaw ▪ Washington, D.C.
Clifford Chance has a co-operation agreement with Al-Jadaan & Partners Law Firm in Riyadh

J201301160042484