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# CORONAVIRUS - IMPACT ON LOANS IN ITALY AND THE SECURITISATION AND COVERED BOND MARKETS

## WIDE SUSPENSION BY THE ITALIAN GOVERNMENT ON LOAN REPAYMENTS BY INDIVIDUALS AND SME'S HAVE BEEN INCLUDED AMONG THE EMERGENCY RELIEF MEASURES APPROVED

Through the so called "*Decreto Cura Italia*" (the "**Covid Decree**")[1] the Italian Government has recently enacted a set of measures to address the impact of the Coronavirus outbreak on the Italian economy. These measures became effective on publication of the Covid Decree in the Italian Official Gazette on 17 March 2020 and need to be enshrined into law by the Parliament within 60 days. The measures included in the Covid Decree aim at providing temporary aid to families, companies and enterpreneurs dealing with the isolation and disruption caused by the spreading of the pandemic. Core measures to mitigate the consequences of the turmoil include payment holidays under loan agreements.

## THE COVID DECREE IN BRIEF

The Covid Decree applies to the entire Italian territory and clearly aims at alleviating the consequences of the heavy lockdown measures that have been adopted by the Italian Government, that have become more and more restrictive in proportion to the worsening of the health situation in Italy [2].

### Key issues

- The Covid Decree contains emergency financial measures, including provision of payment holidays and loan extensions for loans advanced to individuals, entrepreneurs and SMEs.
- As the Coronavirus (Covid-19) outbreak continues to spread, there has been increased concern on the downsides of a new legislation recognising a wide moratoria for Italian loan debtors, in particular for securitisation transactions and covered bond issuances having as collateral mortgage loans and loans to SMEs.
- Investors and financial operators should understand that the new measures regarding the payment of loan instalments are not new in the Italian legislative landscape, but are rather based on provisions enacted in the past by the Italian government, regulators and industry to support Italian debtors following the 2008 financial crisis.

[1] Law Decree of 17 March 2020, no. 18 (*Misure di potenziamento del Servizio sanitario nazionale e di sostegno economico per famiglie, lavoratori e imprese connesse all'emergenza epidemiologica da COVID-19*) published in the Official Gazette of 17 March 2020 no. 70).

[2] The Italian Government has issued several decrees dealing with the outbreak of the Coronavirus, including Law Decree no. 6 of 23 February 2020, Law Decree no. 9 of 2 March 2020 and Decrees of the President of the Council of Ministers dated 23 February 2020, 1 March 2020, 4 March 2020, 8 March 2020, 9 March 2020 and 11 March 2020.

## Measures for Italian first-home owners

The new measures approved (also) through the Covid Decree allow eligible debtors under a mortgage loan agreement executed for the purpose of purchasing a "first home" real estate property ("*prima casa*" or "*unità immobiliare da adibire ad abitazione principale*")[3] to suspend payment of any principal and interest instalments for no more than 2 times during the life of the relevant mortgage loan, provided that the suspension can have an aggregate maximum duration of 18 months (the "**Suspension**")[4]. If the Suspension applies, the mortgage loan is consequently extended for the same period of time and, once the 18-month period ends, any outstanding instalments must be paid by the borrower according to the original conditions of the mortgage loan agreement.

The Covid Decree provides for a 9-month temporary regime (the "**Temporary Regime**"), expanding the existing legal framework that already deals with payment suspensions in certain circumstances. Pursuant to the Temporary Regime the Suspension can be requested upon occurrence of certain adverse events (after the loan is advanced and no later than 3 years from the date of request) affecting the borrower including, in addition to the termination of employment relationships, borrower's death or recognition of disability or civil invalidity (already existing under the previous legislation)[5], the following:

- the suspension from work or reduction of working hours for a period of at least 30 days even where the issuance of measures of income support is pending;[6]

- the fall in the turnover (*calo del fatturato*) of self-employed individuals with a VAT code number and independent

[3] The payment holiday is not applicable to any loans that (i) at the time of the request have been delinquent for more than 90 consecutive days, or have been accelerated (*decadenza dal beneficio del termine*) or terminated (*risoluzione*) or where the mortgaged asset was subject to enforcement procedures started by third parties; (ii) benefit from public subsidies (*agevolazioni pubbliche*) and (iii) are insured for the same events covered by the Suspension.
[4] The right to request the payment Suspension has been implemented by the "*2008 Budget Law*" (Italian Law number 244 of 24 December 2007, as amended in respect of this subject matter by Law no. 92 of 28 June 2012).
[5] With the exclusion of termination by mutual agreement, termination for age limits with entitlement to old-age or retirement pension, disciplinary dismissal, resignation not linked to a cause and, with respect to relationships pursuant to art. 409, section 3 of the Italian code of civil procedure (*i.e.* self-employed persons under a collaboration contract (agents, trade representatives *etc*.)) excluding also the withdrawal by the employer with cause and the withdrawal by the collaborator not linked to a cause. Civil invalidity must be not lower than 80%.
[6] Event introduced by Law Decree no. 9 of 2 March 2020.

contractors (*lavoratori autonomi* and *liberi professionisti*) during a quarter falling after (or within the shorter term between the date of request and) 21 February 2020. The borrower must self-certify that such downturn is higher than 33% of the revenues in the last quarter of the year 2019 and suffered as a consequence of the shutdown or restriction of the borrower's business activity in connection with the provisions issued by the authorities under the Coronavirus emergency.

The costs of the Suspension are partially borne by a fund (*Fondo di solidarietà*, the "**Fund**")[7]. The Temporary Regime specifies that the Fund should cover compensatory interests up to 50% of interests accrued on the loan during the Suspension. Borrowers must satisfy certain requirements to request the Suspension and contextually benefit from the aid of the Fund. In particular, the borrower at the time of request must be the owner of the real estate property financed through the mortgage loan agreement and the relevant loan must be for an amount not exceeding €250,000 and that has been in amortisation for at least 1 year. The Covid Decree disapplied other existing requirements, including those relating to the borrower's income threshold, also with respect to the possible access to the aid provided by the Fund [8]. Upon meeting the requirements, the bank should give effect to the Suspension within 30 business days from the date on which CONSAP (Concessionaria Servizi Assicurativi S.p.A.), as the managing company of the Fund, notifies the borrower that the aid of the Fund is granted or, in the case of loans subject to securitisation or covered bond transactions, within 45 business days.

Once the Temporary Regime set by the Covid Decree ceases to be effective, the set of rules under the previously existing legislative framework will remain applicable.

[7] Before issuance of the Covid Decree, the existing legal framework established that the Fund covers the borrowing costs for an amount equal to the interests accrued on the loan amount outstanding during the Suspension, calculated by using the reference interest rate applied to the mortgage loan, net of the margin applicable to the reference rate (*spread*), which will be borne by the debtor together with the principal component when the Suspension expires.
[8] These requirements have been set by the decree issued by the Ministry of Finance no. 132 of 21 June 2010, as amended by the Decree of the Ministry of Finance no. 37 of 22 February 2013, which requires that the borrower acceding to the aid of the Fund has an income status indicator (*indicatore della situazione economica equivalente (ISEE)*) not exceeding €30,000.

## Measures for Italian SMEs

The Covid Decree also contains large-scale moratoria to support micro-enterprises and small and medium-sized enterprises (jointly, "**SMEs**"), so identified in accordance with the definition set by the European Union [9]. Such measures apply to all type of loans, excluding non-performing loans (*esposizioni creditizie deteriorate*) by: (i) freezing the lenders' right to revoke credit facilities; and (ii) suspending by operation of law the payment of all mortgage loans and other financings repaid by way of instalments, in each case until 30 September 2020.

These measures operate only if the borrower self-certifies that it has suffered a temporary lack of liquidity (*carenze di liquidità*) as a direct consequence of the Coronavirus outbreak.

More precisely, the measures apply to the following loan categories:

- revocable credit facilities (*aperture di credito a revoca*) and loans granted against credit advances (*anticipi su crediti*) existing as at 29 February 2020: any amounts granted (whether utilized or not) may not be revoked, in whole or in part, until 30 September 2020;

- loans not subject to instalment amortisation plans (*prestiti non rateali*) falling due before 30 September 2020: these loans and any accessory rights relating thereto are extended by operation of law until 30 September 2020 at the same conditions originally agreed and without further formalities;

[9] SMEs are defined in the EU recommendation 2003/361. The main factors determining if an enterprise is an SME are (i) staff headcount and (ii) either turnover or balance sheet total:

| Company category | Staff headcount | Turnover | or Balance sheet total |
|---|---|---|---|
| Medium-sized | < 250 | ≤ € 50 m | ≤ € 43 m |
| Small | < 50 | ≤ € 10 m | ≤ € 10 m |
| Micro | < 10 | ≤ € 2 m | ≤ € 2 m |

These ceilings apply to the figures for individual companies only. A company part of a larger group may need to include staff headcount/turnover/balance sheet data from that group too. For the relevant details please see: https://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en

- mortgage loans (*mutui*) or loans subject to instalment amortisation plans (*finanziamenti a rimborso rateale*): the repayment of the loan (both for principal and interests) and leasing instalments falling due before 30 September 2020 is suspended by operation of law until 30 September 2020. The amortisation plan relating to the suspended instalments (together with any accessory rights relating thereto) is consistently extended without further formalities in a manner which ensures that no higher charges are borne by the lender or the borrower. SMEs have also the right to request the suspension limited to the sole principal component of the instalments.

A public guarantee scheme applies upon lenders' request through an institutional guarantee fund (*Fondo di garanzia a favore delle piccole e medie imprese*), which may guarantee, among other things, up to 33% the amounts of the instalments due under the loans and other financings subject to amortization and the leasing instalments to which the moratoria applies. Such guarantee is issued by the dedicated fund free of charge and covers both principal and interest payments.

## BANKING INDUSTRY INITIATIVES FOR ITALIAN SMES

Before the approval of the Covid Decree, the Italian Banking Association (*Associazione Bancaria Italiana*, "**ABI**") already promoted the conclusion and extension of a banking convention (the "**ABI Convention**")[10] with the Italian SMEs providing, among other things, the possibility to request (i) a suspension of payments (principal instalments only) for a period of up to 12 months; or (ii) the extension of the duration up to 100% of the residual term of the loan, in each case subject to the possible increase of the rate of interest and request of additional security interests or guarantees by the lender. This measure does not apply automatically and is based on the own decision of the lending bank, subject to its credit procedures and policies. To benefit from this payment holiday, certain requirements must be satisfied:

[10] On 6 March 2020, ABI and the major associations representing the Italian SMEs have entered into an addendum extending the terms of the agreement dated 15 November 2018 named "*Accordo per il Credito 2019*".

- the loan must not be classified as non performing;
- all other instalments must have (i) been timely paid or (ii) in case of late (or partial) payments, not been outstanding for more than 90 days from the date of the request;
- SMEs must have not benefited from the suspension or extension of the duration in the 24 month period prior to the request, except for the easing of terms generally applying by operation of law;
- if the loan is secured, the extension of the loan is conditional to the extension of the guarantee or security interest.

The suspension of the payment of principal instalments is applicable to medium and long-term loans, leasing financings, mortgage current account transactions, provided that the loan is amortising and is subject to a reimbursement plan (principal and interest). If the suspension applies, the amortization plan is extended for a period equal to the holiday granted while interest is paid on the payment dates originally agreed. The rate of interest can be increased to cover any additional financing costs borne by the bank, up to maximum 60 bps.

The extension of the duration is applicable to loans (*mutui*), short term financings and agricultural credit agreements pursuant to article 43 of the Italian Banking Act. Under this option the loan can be extended for a maximum period equal to 100% of the residual term of the amortization plan. For short term financings and agricultural credit, the term is 270 days and 120 days, respectively. In this case too, the rate of interest can be increased by the bank to cover any additional financing costs: in such event, the amount of the instalment calculated pursuant to the new rate of interest must be substantially lower than the original amount agreed.

Loans existing as at 31 January 2020 that are subject to the ABI Convention will benefit from the public guarantee issued by the guarantee fund in favour of Italian SMEs (*Fondo di garanzia a favore delle piccole e medie imprese*). The guarantee should cover the amount of the suspended or extended loans up to 80% of the amount granted by the lender.[11] The request for this type of moratoria can be submitted to banks which acceded to the ABI Convention up until 31 December 2020 and for loans existing as at 31 January 2020. Banks should respond within 30 business days from the date of a request.[12]

For sake of clarity, we note that the moratoria provisions under the Covid Decree and ABI Convention, although addressing similar needs in the context of the crisis caused by the outbreak of the Coronavirus, remain two distinct set of measures available to Italian SMEs.

## GENERAL CONSIDERATIONS ON THE IMPACTS OF THE NEW MEASURES ON ITALIAN SECURITISATIONS AND COVERED BONDS

The approval of the Covid Decree opens the way to possible further measures by the Italian government in response to the Coronavirus outbreak. Discussions are understood to be undergoing within Italian institutions on the possible prorogation of the national lockdown; opposition parties and certain professional associations have commented that the Covid Decree is not sufficient to address the distress calls coming from the Italian production and professional sectors. There are also suggestions that the scope of payment holidays applied to Italian borrowers might possibly be widened in the future, if the crisis persists.

As a result, there has been increased concern on the negative effects that the moratoria for Italian loan debtors might have on Italian securitisations and covered bond programmes.

As described in the introduction to this briefing, the main measures approved with respect to mortgage loans are grafted on the existing legislative framework, which already recognised a right of suspension of mortgage loan payments. The Covid Decree widens (at least for individual mortgage borrowers) the scope of existing payment holidays, but it does not appear at this stage to be causing significant disruption. It is notable that prospectuses of securitisations relating to RMBS assets

[11] https://www.mise.gov.it/index.php/it/incentivi/impresa/fondo-di-garanzia-per-le-pmi
[12] https://www.abi.it/Pagine/news/AllungamentoPrestiti.aspx and https://www.abi.it/Pagine/Mercati/Crediti/Credito-alle-imprese/Accordi-per-il-credito/Nuovo-accordo-per-il-credito-2019.aspx?LinkFrom=Imprese

already addressed, in most cases, the risks relating to these kind of provisions. Additionally, related mitigants already exist in the Italian market. As per a recent article by S&P[13], Italian securitisations provide for a wide use of structural credit enhancements by way of cash reserves, as well as liquidity facilities that can be activated in order to meet Issuers' payment obligations under the notes in the event of shortfalls caused by reduced or limited collections during a certain period of time. The existing mitigants and possibly the composition of the collateral portfolios should in principle be able to address such reduced collections, subject of course to the actual structure of the transaction and a case by case analisys.

The same could apply with respect to securitisations and covered bond programmes involving collateral comprised of Italian SME loans. Although the measures under the Covid Decree are newly introduced and operate by statement of law, several moratoria (as *e.g*. the ABI Convention mentioned in the previous paragraph) have already been in place since 2008 and were applicable on a voluntary basis among the parties. This also means, that servicers have been granted through time more flexible powers in order to deal with these kind of suspensions, extensions and, in general, with the renegotiations of the securitised portfolios.

The moratoria are subject to eligibility criteria and to a request by the eligible borrower. As a consequence, the extension of the impacts on the existing portfolios might be lower than expected. Finally, the costs of the suspensions are partially covered within certain limits by some institutional funds created for such purpose, like the solidarity Fund for individual mortgage borrowers, and the guarantee fund, for the moratoria applicable to Italian SMEs, which means that, hopefully, the economic impact on the issuers should be less invasive. Italy has been the first to issue an emergency legislation including payment holiday measures since the outbreak of the Coronavirus. However, similar measures are under discussion or being approved by other European countries affected by the pandemic.

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[13] https://www.spglobal.com/ratings/en/research/articles/200313-credit-faq-will-mortgage-payment-suspensions-related-to-covid-19-affect-european-rmbs-11388778

For details on the impact of the Coronavirus on European Residential Mortgage Securitisation Markets, please see: https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2020/03/coronavirus-impact-on-european-residential-mortgage-securitisation-markets.pdf

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