

ITALY INTRODUCES DYNAMIC RANKING FOR BANKING CAPITAL INSTRUMENTS

Italy has introduced a dynamic ranking for banking capital instruments by implementing Directive 2019/879/EU (the "**BRRD II**") into domestic law by means of Legislative Decree No. 193 of 8 November 2021 (the "**BRRD II Implementing Decree**") approved on 4 November 2021 and published in the *Gazzetta Ufficiale* on 30 November 2021. The BRRD II Implementing Decree provides that subordinated instruments which do not qualify (or cease to qualify) as own funds items shall rank higher than own funds item (including instruments only partly recognised as own funds items) and lower than senior non-preferred instruments.

Furthermore, the BRRD II Implementing Decree has established a minimum denomination requirement for certain eligible liabilities instruments and the annulment of investment contracts with retail investors concerning such instruments where they do not meet such minimum denomination requirements.

ARTICLE 48(7) OF THE BRRD II

On 29 September 2020, the Council of the European Union and the European Parliament adopted the Directive 2019/879/EU (the "**BRRD II**"), amending Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (the "**BRRD**").

The BRRD II, among other changes to the original directive, added a new paragraph 7 to Article 48 of the BRRD which requires each Member State to ensure that claims resulting from own funds items (*elementi di fondi propri*) (including instruments only partly recognised as own funds items (*elementi di fondi propri*)) have, under national laws governing normal insolvency proceedings, a lower priority ranking than any claim that does not result from an own funds item (*elementi di fondi propri*).

Article 48(7) however does not specify whether the new provision applies to instruments issued before the implementation of BRRD II, and its wording has been interpreted and implemented in different ways by various Member States of the European Union.

Key issues

- Italy has introduced a dynamic ranking for banking capital instruments.
- Subordinated instruments which do not qualify (or cease to qualify) as own funds items shall rank higher than own funds item (including instruments only partly recognised as own funds items) and lower than senior non-preferred instruments.
- The EBA raised awareness of potential infection risk arising from legacy instruments. Dynamic ranking could mitigate such risk, but this should be checked on a case by case basis.
- A minimum denomination requirement for certain eligible liabilities instruments has been set and investment contracts with retail investors concerning such instruments will be void if the instruments do not meet the minimum denomination requirements. Investment firms will have to ensure that subordinated and senior non-preferred instruments issued by EU and third-country banking entities comply with the Italian minimum denomination requirements if they are to be sold to Italian retail investors.

For example, some Member States opted not to make any modifications to the creditor hierarchy; whilst others adopted a "**dynamic ranking**" (*i.e.* the instrument changes its ranking depending on its regulatory classification) which applies either only to future instruments or also to all outstanding ones.

THE BRRD II IMPLEMENTING DECREE

The BRRD II Implementing Decree, approved by the Italian government on 4 November 2021, introduces point *c-ter*) to Article 91 paragraph 1-*bis*) of the Legislative Decree no. 385 of 1 September 1993 (as amended from time to time, the "**Italian Banking Act**") transposing Article 48(7) of the BRRD II.

The amended Article 91 of the Italian Banking Act provides for the following dynamic ranking:

- subordinated instruments which do not qualify as own funds items (*elementi di fondi propri*) shall rank higher than own funds items (*elementi di fondi propri*) (including instruments only partly recognised as own funds items (*elementi di fondi propri*)) and lower than senior non-preferred instruments (*strumenti di debito chirografario di secondo livello*);
- if own funds items (*elementi di fondi propri*) cease to be recognised as such, they will rank senior to own funds items (*elementi di fondi propri*), thus their ranking will follow their regulatory classification.

Given that Article 91 of the Italian Banking Act does not specify the timeframe from which these provisions apply, they should be applicable also to instruments issued before the promulgation of the BRRD II Implementing Decree.

However, Article 91 of the Italian Banking Act does not seem to address the case of legacy instruments that will qualify as a different kind of own funds items (*elementi di fondi propri*) (*e.g.* a legacy Tier 1 instrument that will qualify as a Tier 2 instrument), given that it does not provide for ranking rules in relation to the different layers of own funds instruments.

LEGACY INSTRUMENTS AND INFECTION RISK

On 21 October 2020, the European Banking Authority ("**EBA**") issued an opinion (the "**Opinion**") to clarify the prudential treatment of the so-called "**legacy instruments**" (capital instruments that do not comply with the current definition of own funds) in view of the end of the grandfathering period on 31 December 2021 in accordance with Regulation (EU) No 575/2013 (as amended, the "**CRR**"). In its Opinion, the EBA raised awareness of the fact that a so-called "**infection risk**" (*i.e.* the risk that other layers of own funds or eligible liabilities instruments are disqualified) could be caused by, *inter alia*, clauses of the legacy instruments that might contradict the eligibility criterion of subordination.

For instance, following the end of the grandfathering period, a legacy Tier 1 instrument, which according to its contractual terms ranks *pari passu* with fully eligible Additional Tier 1 instruments, but that would instead qualify as a higher ranking instrument (*e.g.* Tier 2 or eligible liabilities) under the current regulatory framework, could potentially lead to the disqualification of certain other own funds items (*elementi di fondi propri*).

The EBA in its Opinion proposes that, in transposing Article 48(7) of the BRRD II, national legislation should introduce mandatory insolvency rules whereby ranking in insolvency is automatically amended based on instruments' regulatory categories which could provide an additional solution to the risk of infection. The approach that is favoured by the EBA is that such national legislation details ranking rules in relation to the different layers of own funds instruments (CET1, AT1 and Tier 2).

Gioacchino Foti, Partner of the Global Financial Markets Department comments on the amended Article 91 of the Italian Banking Act as follows: "*The application of the dynamic ranking also to outstanding instruments, should help to mitigate the so-called infection risk. However, the Italian legislation does not detail specific ranking rules in relation to the different layers of own funds instruments. Issuers should carefully review the exact terms and conditions of their legacy instruments to verify if there is any potential infection risk arising from these instruments*".

Going forward, Italian issuers should also review and, where necessary, amend the provisions of the ranking clauses in the terms and conditions of their instruments in order to ensure that they comply with the dynamic ranking set out under Article 91 of the Italian Banking Act.

NEW MINIMUM DENOMINATION REQUIREMENTS

In addition to the above, Article 44a of the BRRD II has also left to each Member State the option to set a minimum denomination of at least Euro 50,000 for eligible liabilities. In this respect, the BRRD II Implementing Decree has introduced a new Article 12-ter to the Italian Banking Act, providing for a minimum denomination of Euro 200,000 for all subordinated instruments and Euro 150,000 for senior non-preferred instruments (*strumenti di debito chirografario di secondo livello*) (originally the minimum denomination of senior non-preferred instruments under Italian law was Euro 250,000).

In connection with this, the BRRD II Implementing Decree has also added a new Article 25-quater to the Legislative Decree no. 58 of 24 February 1998 (as amended from time to time, the "**Italian Financial Act**"), which provides that contracts entered into by retail investors for investment services concerning subordinated and senior non-preferred instruments and issued after 1 December 2021 may be declared null and void should the minimum denomination requirements set out in Article 12-ter not be met.

This provision applies also to instruments issued by EU banking entities and by third-country banking entities, notwithstanding any different minimum denomination requirements that may be provided under the legislation of the relevant foreign country. Therefore, investment firms will have to ensure that subordinated and senior non-preferred instruments issued by EU and third-country banking entities comply with the Italian minimum denomination requirements if they are to be sold to Italian retail investors.

CONTACTS



Filippo Emanuele
Partner

T +39 028063 4251
E filippo.emanuele@cliffordchance.com



Gioacchino Foti
Partner

T +39 028063 4335
E gioacchino.foti@cliffordchance.com



Jonathan Astbury
Senior Associate

T +39 02 8063 4262
E jonathan.astbury@cliffordchance.com



Francesco Napoli
Lawyer

T +39 02 8063 4249
E francesco.napoli@cliffordchance.com



Benedetta Tola
Lawyer

T +39 02 8063 4349
E benedetta.tola@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, Via Broletto, 16, 20121 Milan, Italy

© Clifford Chance 2021

Clifford Chance Studio Legale Associato

Abu Dhabi • Amsterdam • Bangkok •
Barcelona • Beijing • Brussels • Bucharest •
Casablanca • Dubai • Düsseldorf • Frankfurt •
Hong Kong • Istanbul • London • Luxembourg •
Madrid • Milan • Moscow • Munich • New
York • Paris • Perth • Prague • Rome • São
Paulo • Seoul • Shanghai • Singapore •
Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.