

Italian Banking License

Licensing Requirements and Procedure – Change of Control Authorization – Overview of the Regulatory Capital Framework

A Concise Guide – October 2021

Section I

Licensing Requirements and Procedure

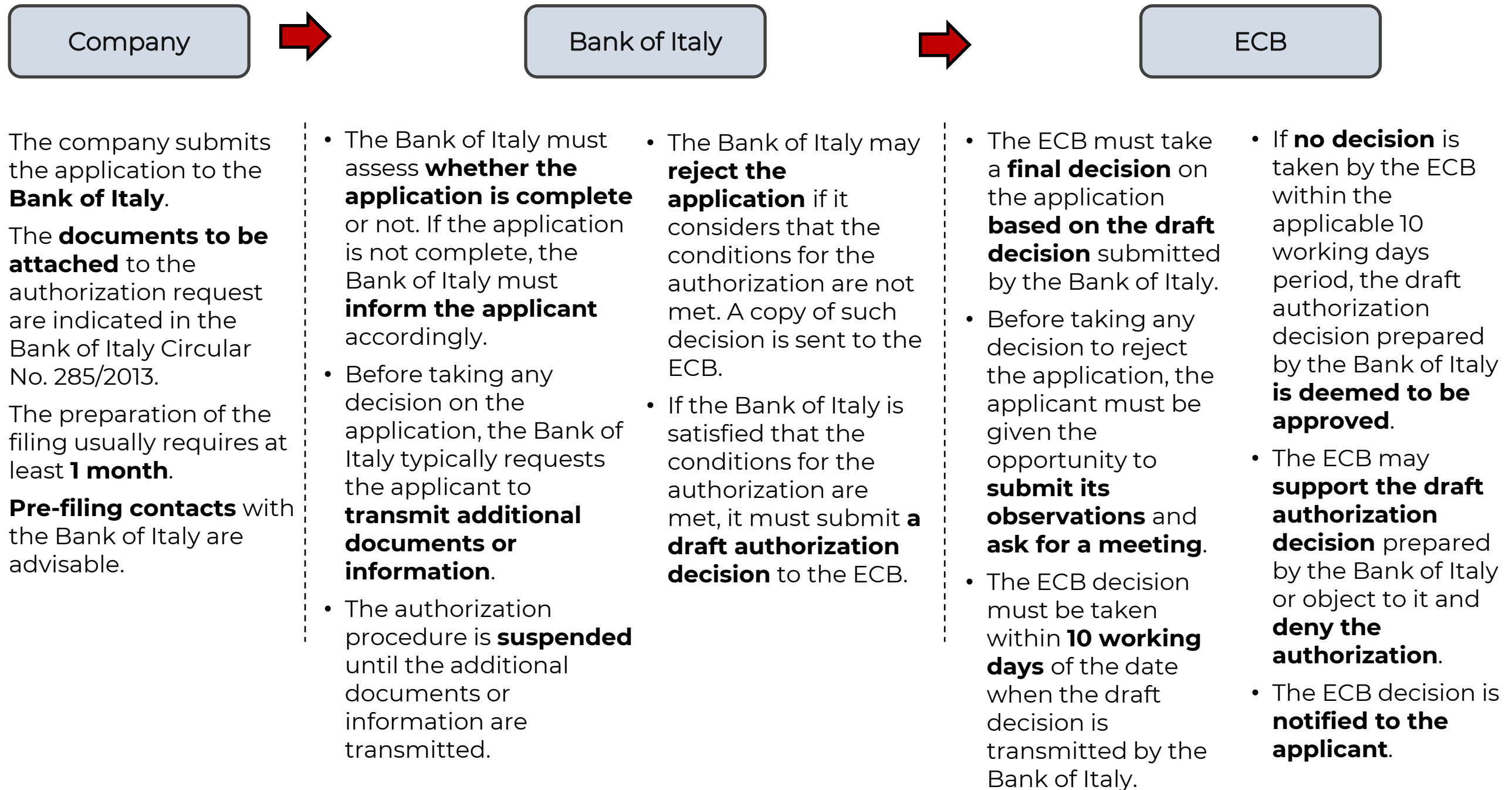
- ▶ Under Italian law **deposit-taking and lending** activities can be performed only by **Italian banks** duly authorized to operate as such – or, alternatively, by (i) **Italian branches of non-EU banks** or (ii) **EU banks** operating in Italy under the free provision of services or right of establishment in accordance with the **EU “passporting” rules**.
- ▶ The authorization to operate as an Italian bank is granted by the **European Central Bank (ECB)** acting together with the **Bank of Italy**.
- ▶ Following the authorization, an Italian bank is subject to the **supervision of the ECB and the Bank of Italy**, which exercise their supervisory powers in accordance with the rules governing the functioning of the **Single Supervisory Mechanism (SSM)**
 - ❑ In case of “**less significant**” banks, the supervisory responsibilities are exercised directly by the Bank of Italy.
 - ❑ Banks that are qualified as “**significant**” are subject to the direct supervision of the ECB.
- ▶ Additional supervisory powers can be exercised by **other Italian regulatory authorities** – such as the Italian financial services regulator (**CONSOB**), the Italian insurance regulator (**IVASS**) or the Italian Financial Intelligence Unit (**UIF**), etc. – with respect, for instance, to investment services, insurance distribution or AML-CTF matters.
- ▶ Following the authorization an Italian bank may operate **throughout the EU territory** (as well as in the other jurisdictions that are part of the **European Economic Area**) with **no need to get any local banking license** – *i.e.* on the basis of a regulator-to-regulator notification procedure, which does not require any separate or new authorization.

KEY REQUIREMENTS



Requirement	Description
Legal Form	The bank must be established as an Italian joint stock company, cooperative company or limited liability company .
Registered and Administrative office	The bank must have its registered and administrative office in Italy .
Minimum Capital	The paid-in capital of the bank must be of at least Euro 10 million (5 million in case of cooperative banks).
Business Plan and Company Documents	The bank must submit a business plan (so-called “programme of activity”), along with its memorandum and articles of association.
Relevant Shareholders	The relevant shareholders of the bank (i.e. any shareholder holding 10% or more of the share capital or voting rights of the bank or exercising a significant influence / control, including the respective ultimate controlling shareholder) must have adequate good reputation and comply with certain professional competence and correctness requirements .
Senior Management	The directors, general managers and statutory auditors of the Italian bank must comply with the applicable fit and proper requirements (i.e. they must have sufficient professional experience, adequate good reputation, etc.).
Close Links	The bank must not have any close link with the related group or other persons which may prevent the exercise of supervisory powers by Italian authorities.

AUTHORIZATION PROCEDURE



- The statutory term to complete the application is **180 days**.
- The Bank of Italy / ECB may however **suspend the procedure** to ask for additional documents / information.
- As a matter of fact the overall procedure requires at least **6-8 months**.

- ▶ Italy and Milan in particular are becoming an **attractive place for the setting-up of pan-European Fintech / financial services platforms** for a number of reasons, including the following:
 - ❑ Italy is among the few **G7 economies** in the EEA and one of the **most significant markets** in the EEA for banking, payment and investment services.
 - ❑ Italy has a **high reputation** in terms of regulatory supervision, especially due to the role of the Bank of Italy.
 - ❑ The supervisory reputation of other EEA countries has been **affected by recent financial scandals** or **is not particularly high**.
 - ❑ **Lower cost** of high-quality human resources compared to other countries and **ability to attract young international talents** due to the international outlook of the city and the attractiveness of the Italian life style.
 - ❑ **Lower operational costs** (e.g. rent, cost of living, etc.) compared to other European financial centres (e.g. Paris).
 - ❑ **Thriving start-up ecosystem** with a pro-active administration promoting the development of Fintech.
 - ❑ **Tax incentives** for the attraction of human resources (e.g. Italian “repatriation” regime).
 - ❑ **Tax and other incentives** for the setting-up of Fintech companies and start-ups.
- ▶ Several **EEA Fintech unicorns and operators** are setting-up their pan-European hub or a significant presence in Milan.

Section II

Change of Control Authorization

- ▶ **Purchasing a controlling interest in an existing Italian bank** is an alternative path to enter into the Italian market **without getting a new banking license**.
- ▶ There has been a **significant trend** in recent years of foreign banks or investment funds **purchasing controlling interests in Italian banks** which are struggling to recover due, among others, to the following reasons:
 - ❑ Deficiencies in the business models adopted by several Italian banks with a limited attitude to the digitalisation of their banking or payment services.
 - ❑ Capital shortfalls and high NPL ratio.
 - ❑ Limited size of several Italian banks competing with territorial cooperative banks.
- ▶ The acquisition of control of a local bank could **shorten the authorization procedure** if the acquisition is negotiated and executed rapidly:
 - ❑ The statutory term of the change of control authorization procedure is **60 business days** (as opposed to **180 calendar days**).
 - ❑ The assessment on the business plan and the internal organizational structure made by the Bank of Italy and the ECB would be focused on the **changes that the acquiror** intends to implement (*i.e.* no need to assess the business plan or internal organizational structure of the target bank from scratch).

CHANGE OF CONTROL AUTHORIZATION – CONDITIONS



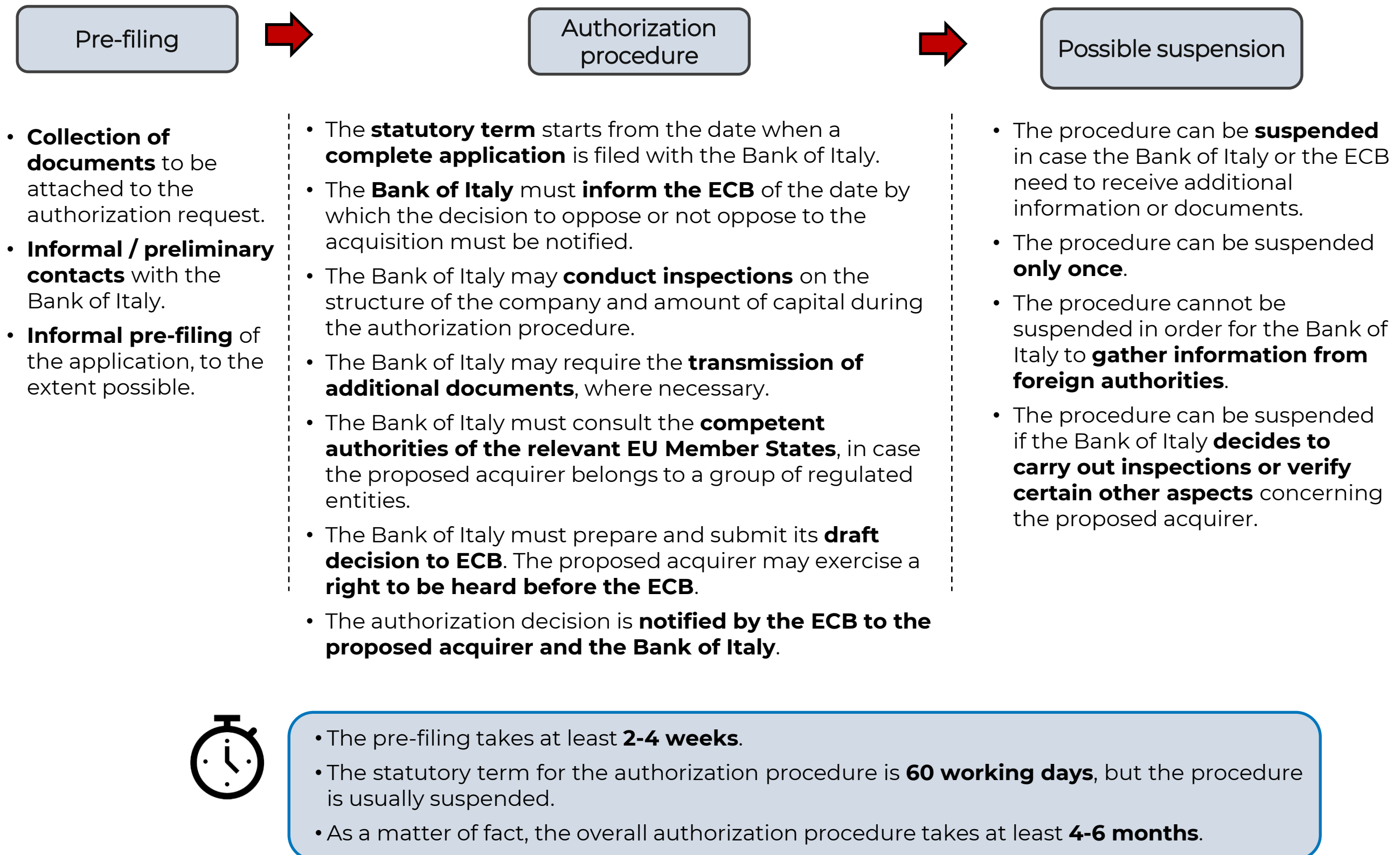
Condition	Description
General principle	<ul style="list-style-type: none">▶ The acquisition of a controlling shareholding in an Italian bank is subject to the prior authorization by the Bank of Italy and the ECB, which assess whether the acquisition ensures the sound and prudent management of the target bank, by evaluating the quality of the potential acquirer and the financial soundness of the acquisition project.
Relevant thresholds	<ul style="list-style-type: none">▶ The authorization requirements are triggered in case of acquisition of shareholdings:<ul style="list-style-type: none">❑ amounting to 10% or more of the share capital or voting rights of the target bank (or of any company having relevant shareholdings in the target bank);❑ conferring the possibility to exercise significant influence (<i>influenza notevole</i>) on the target bank, also in case the shareholding is below the 10% threshold referred to above;❑ granting the exercise of control on the target bank.
Types of acquisitions	<ul style="list-style-type: none">▶ Acquisitions of direct or indirect shareholdings.▶ Acquisitions made jointly with other persons or entities (<i>acquisti di concerto</i>).▶ Involuntary acquisitions (<i>i.e.</i> the thresholds are involuntarily reached or crossed, following an event that modifies the allocation of the shareholdings or voting rights, such as for instance a rights issue).

CHANGE OF CONTROL AUTHORIZATION – CRITERIA



Criteria	Description
General	<ul style="list-style-type: none">▶ The assessment made by the Bank of Italy and the ECB with respect to the proposed acquisition entails a certain degree of discretion as to whether the acquisition ensures the sound and prudent management of the target bank.▶ The Bank of Italy and the ECB conduct a comprehensive assessment of the purpose and structure of the acquisition.
Reputation of the proposed acquirer	<ul style="list-style-type: none">▶ The potential acquirer must be of adequate good repute and comply with certain correctness and professional competence requirements.▶ If the potential acquirer is a legal entity, the good standing, correctness and professional competence requirements must be met by the members of its board of directors and its senior executives.
Financial soundness of the proposed acquirer	<ul style="list-style-type: none">▶ The financial soundness of the proposed acquirer is assessed taking into account the type of business pursued and envisaged by the target bank.▶ In case of leveraged acquisitions, the Bank of Italy and the ECB also assess the level of the leverage, the related impacts on the regulatory capital position of the target bank / group (e.g. prudential consolidation), and the creation of any security interests (e.g. pledge) on the shares of the target bank
Reputation and experience of those we will direct the business	<ul style="list-style-type: none">▶ The directors, statutory auditors and general managers of the target bank must be fit and proper and comply with the rules on interlocking directorates.
Suspicious of money laundering and terrorist financing	<ul style="list-style-type: none">▶ The Bank of Italy and the ECB also evaluate whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, money laundering or terrorist financing is being or has been committed or attempted, or whether the proposed acquisition may increase the risk thereof.

CHANGE OF CONTROL AUTHORIZATION – PROCEDURE



Section III

Overview of the Regulatory Capital Framework

► **Basic requirements** (% RWA):

- ❑ CET 1 \geq 4.5%
- ❑ Tier 1 Capital (CET 1 + AT 1) \geq 6%
- ❑ Total Capital (CET 1 + AT 1 + T 2) \geq 8%

► **Buffer requirements** (% RWA):

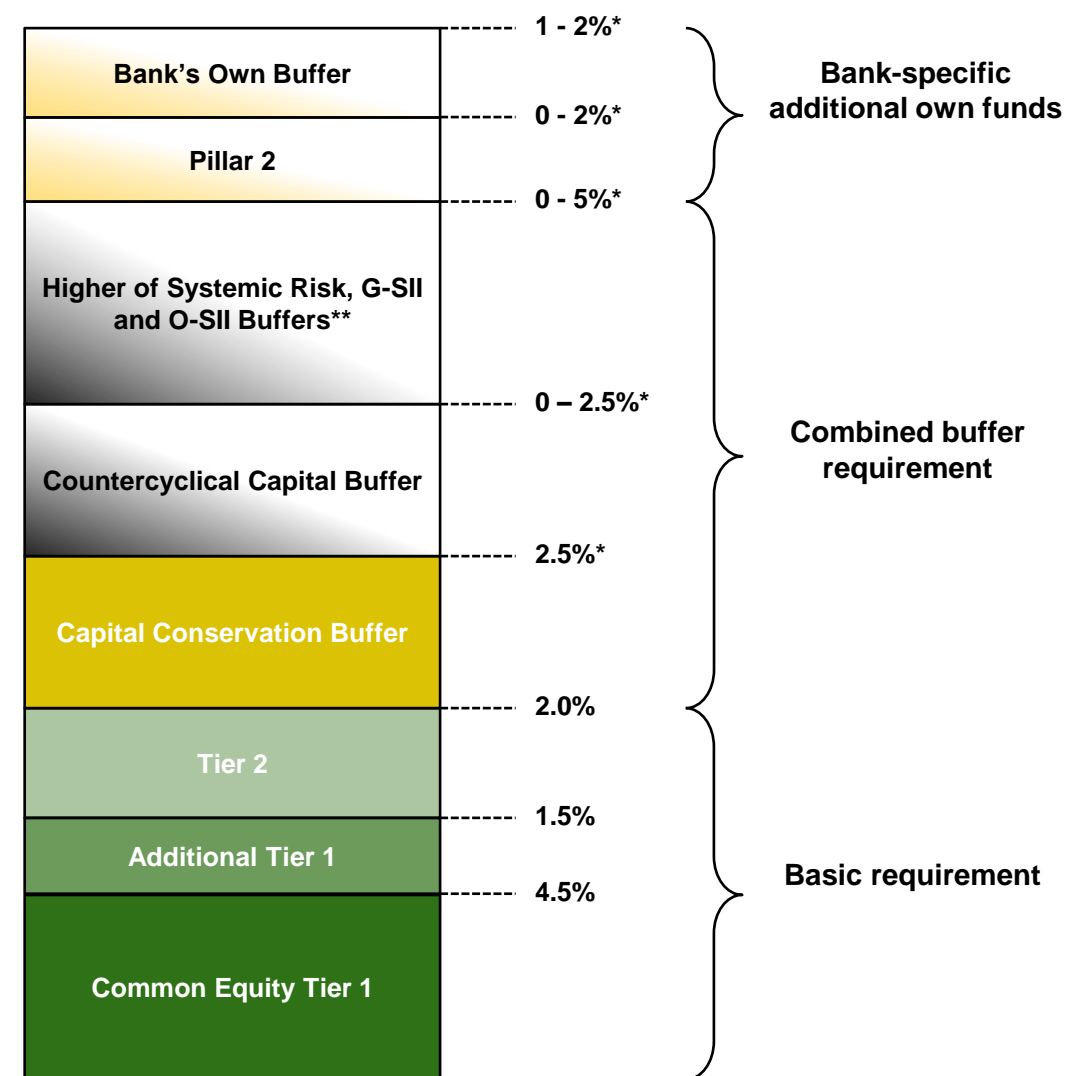
- ❑ Capital conservation buffer → 2.5%
- ❑ Countercyclical capital buffer → 0-2.5%
- ❑ Systemic risk buffer → 0-5%

► **Pillar 2 requirements:**

- ❑ Bank-specific additional buffers applied by competent authorities.
- ❑ Pillar 2 requirements → binding nature
- ❑ Pillar 2 guidance → non-binding add-on imposed by competent authority (regulatory expectation).

► **Leverage ratio** (Total capital / Total assets):

- ❑ Minimum ratio of 3% (non-risk based parameter)
- ❑ Possible add-ons in case of G-SII



Source: European Commission, 'Capital Requirements – CRD IV / CRR – FAQs', 16 July 2013. *Assumed upper bounds (values can be higher). **In certain cases, can be the sum of SII and systemic buffer.

- ▶ Under the EU framework banks are also required to comply with the **minimum requirement on own funds and eligible liabilities (MREL)** – which is the EU legal concept corresponding to the total **loss absorption capacity requirement (TLAC)** introduced by the Financial Stability Board.
- ▶ The MREL requirement was **introduced in 2016** in order to allow resolution authorities to apply the **bail-in tool** in case of a **bank resolution** in an effective and credible manner.
- ▶ For those banks in respect of which the resolution strategy does not consist in the **winding-up of the institution**, the MREL requirement can be **higher than the minimum capital requirement**, as it includes also the amount that is necessary to ensure that the institution is fully recapitalized after the losses have been absorbed.
- ▶ Liabilities of a bank must **meet certain eligibility requirements** in order to be included in the MREL capital.
- ▶ Except in case of G-SII or other significant institutions, the **minimum MREL requirement** is determined by competent authorities on the basis of a “Pillar 2” approach – i.e. taking into account the specific situation and risks of the relevant bank as well as the relevant resolution strategy – and is calculated as a percentage of:
 - ❑ The risk-weighted assets (RWA) of the bank (risk-based parameter); and
 - ❑ The total leverage ratio exposure (i.e. total balance sheet assets) (non-risk based parameter).
- ▶ Starting from 1 January 2024, EU banks will be subject to **specific disclosure obligations** with respect to their **MREL capital**.

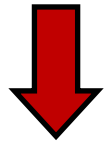
BANK CREDITORS' HIERARCHY IN ITALY

- ▶ Italy is one of the few countries in the EEA which introduced a **general depositor preference** in its bank creditors' hierarchy.
 - Deposits that are not insured under the national deposit insurance scheme rank higher than other bank liabilities in case of insolvency or resolution.
- ▶ In addition to ordinary senior or subordinated debt, Italian banks are allowed to issue senior **non-preferred debt instruments** to satisfy their minimum MREL / TLAC requirements.
- ▶ CET 1 capital instruments are normally represented by **ordinary shares**, while Tier 2 and Additional Tier 1 instruments are issued in the form of **subordinated debt**.

Italian Creditors' Hierarchy

Uncovered deposits of natural persons and SMEs
Uncovered deposits of entities other than natural persons and SMEs
Preferred senior bonds and liabilities
Senior non-preferred debt instruments
Subordinated liabilities
Tier 2
Additional Tier 1
Common Equity Tier 1

Seniority
(from senior to junior)



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