ISSUANCE OF NOTES UNDER EMTN IN DEMATERIALIZED FORM. THE BPER CASE (AND MORE)

by Federico Morelli

BPER's recent issuance represents a market first in the Italian legal landscape. For the first time, an Italian bank has issued notes under its EMTN in Italy (and not in London) and in dematerialized form (and not in global note form). This structure, which has not precedents among Italian banks[1], seems to set the way for a paradigm shift, favored by Brexit and in line with the progressive abandonment of the terms and conditions (*regolamento del prestito*) governed by English law, in favor of that governed by Italian law. The same structure is applicable to a standalone issuance.

BPER's issuance

On December 12, 2022, BPER issued the "EUR 500,000,000 Callable Fixed-to-Floating Senior Non-Preferred Note due 2028"[2], under its EMTN programme[3].

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[1] Only CDP, and already for a long time, has an international issuance program exclusively under Italian law.

[2] The Final Terms if that issue are available at https://www.luxse.com/pdf-viewer/103298751.

[3] "EUR 6,000,000 Euro Medium Term Note Programme" of November 22, 2022 available at https://www.luxse.com/pdf-viewer/103276718.

These notes are governed by specific terms and conditions that expressly provide for the possibility to issue notes in dematerialized form, pursuant to the obligation to dematerialize (Article 83-bis of Legislative Decree 58/1998) financial instruments issued in Italy.

These notes were issued in Italy and dematerialized pursuant to the aforementioned Article 83-bis. This allowed BPER (i) to have the notes held through Monte Titoli, (ii) to provide the function of paying agent in relation to its own notes (thus saving the costs associated with having a different paying agent authenticate the notes in London), and (iii) to avoid the complexities of paper notes in global (global notes) and definitive (definitive notes) form, since the notes were issued exclusively in book-entry form.

These notes are currently traded on the regulated market of the Luxembourg Stock Exchange.

It all started with Brexit

Since the first issuance of a Eurobond[4], debt issuances in international markets have taken place according to a common market practice that has been established over the years. Over time, market participants have shown effective reliance on such proven structure in order to minimize operational risks and standardize internal procedures.

In particular, one of the main aspects that institutional investors have systematically considered when deciding to allocate investments in notes issued by Italian issuers concerns the possibility that the issuance is governed by English law and thus the possibility to set out contractually the choice for the English jurisdiction. Institutional investors consistently showed clear preference for the exclusive jurisdiction of the English courts as they consider that a final judgment released by an English court is (i) predictable as to its content and (ii) promptly released.

The upcoming impacts of Brexit will probably affect such two propositions above, in particular when an increasing number of disputes will be decided by a new breed of English judges that will be "Brexit native" (i.e. judges that have been nominated after Brexit whose legal education will include English law only) who will probably struggle at taking decisions based on pure EU law.

In addition, a further layer of complexity could be that a decision awarded by an English court has to be acknowledged and enforced in Italy (*exequatur*) and in this respect, to the extent that the competent jurisdiction clause is exclusive it will benefit from the Hague Convention of 30 June 2005 on the choice of jurisdiction, while an asymmetric jurisdiction clause should previously meet all the requirements set forth under article 64 of the Law 31 May 1995, no. 218 as subsequently modified.
It cannot be ruled out that longer acknowledgement procedures will reasonably affect the timing and the overall responsiveness of the English Court's final judgment.

As a consequence, current times seem to induce Italian issuers to seek for alternative issuance structures, with a view to cost reduction and an efficient simplification of the documentation.

[4] The first issuance of a Eurobond was by an Italian issuer, Autostrade per l'Italia S.p.A., in 1963 in the context of financing the completion of work related to the Autostrada del Sole highway.

In what follows, it is intended to show how notes issued in Italy would benefit from a more protective legal environment, led by Monte Titoli, which could significantly reduce certain costs related to the issuance of notes.

Terms and conditions

Many EMTNs[5], especially of bank issuers, already include two sets of terms and conditions, one governed by Italian law and the other by English law. Recently, as mentioned in the previous section, market practice seems to show a preference by the banks for issuances of notes governed by Italian law, even if many base prospectuses still provide for the double set of terms and conditions.

There is no apparent reason why the issuers should still pay the cost of keeping a double set of terms and conditions (that are substantially identical, but for the bail-in acknowledgment clause, the governing laws clause and the jurisdiction clause and some minor tweaks).

Instead, it seems appropriate to introduce an adjusted set of terms and conditions for dematerialized issuances, which can either stand alongside or replace the terms and conditions under Italian law that provide for issuance in global form.

Global Note

A massive layer of complexity is then provided by the circumstance that notes are still issued outside of Italy (tipically in London) to avoid the obligation to dematerialize the securities and still issued in paper form as global note.

According to current practice, now (i) issuers tend to issue Italian law regulated notes in London and (ii) related payments mechanisms are agreed in an agency agreement that is governed by Italian law but allows the notes to be issued outside of Italy, in order to have them in global form.

Otherwise, payments on the English law notes would be governed by an English law agency agreement, in line with pre-Brexit common practice. This leads to the current practice to have two separate agency agreements, one governed by Italian law (applicable to Italian law notes), and the other by English law (applicable to English law notes).

In addition to the above, the entire global note structure seems byzantine. Below, please find a brief summary of the relevant major aspects that show the complexity of such legal system.

> *Global notes represent the entire issue and are held by (or on behalf of) the clearing systems (Euroclear / Clearstream). Noteholders do not necessarily hold the notes as they either hold them directly in accounts at the clearing systems or indirectly through custodians who have accounts at the clearing systems.*
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> *Any transfer of notes between accounts can be effected by electronic instructions to the clearing systems. Circulation of the notes is then governed by Belgian (Euroclear) or Luxembourgish (Clearstream) law (lex loci rei sitae).*

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[5] In the foregoing, we will simply refer to notes issued on a stand-alone basis as "eurobonds" and to issuance platforms as well as to the relevant drawdown notes as "EMTN".

A Global Note can be issued in the form of:

- a Classical Global Note, that can be bearer or registered, which requires a physical annotation on an attached schedule to indicate the outstanding amount of the issuance and is deposited with, and serviced by, common depositories appointed jointly by the clearing systems.

- a New Global Note, that can be bearer only, which indicates the outstanding amount of the issuance referring to the records of the clearing systems. New Global Notes are deposited with common safekeepers and serviced by common service providers, each appointed jointly by the clearing systems.

Then, in case of bearer notes, the global note is issued to a financial institution acting on behalf of both the clearing systems. Such financial institution, who is also holding the notes, is referred to as "common depositary" in case the note is a Classic Global Note or "common safekeeper" if the note is a New Global Note.

Payments on the securities are made by the issuer to the common depositary or the common safekeeper (as the case may be) which then credits the holder's account in the clearing system.

In case of registered notes, the structure is analogous but for the fact that a nominee company associated with the common depositary or the common safekeeper (as the case may be) is entered in the register as the holder of the securities. The issuer will then make payments to the nominee (and not to the common depositary or the common safekeeper) which then credits the holder's account in the clearing system.

In both cases above, Euroclear / Clearstream will also act as common safekeeper for any New Global Note that is intended to constitute Eurosystem eligible collateral.

In addition to the above, a global certificate is issued as a Temporary Global Note, subject to conversion into a Permanent Global Note, according to the terms and conditions of the issue.

A Temporary Global Note is issued for the period between the issue date of the notes and the end of the TEFRA D restricted period, during which distributors generally may not sell the securities to a U.S. person or in the U.S. (lock up period). The restricted period is most often 40 days from the issue date.

Once the lock-up period is terminated the so-called seasoning of the note is complete, and restrictions on the sale of the notes into the U.S. are lifted.

The clearing systems collect certificates from noteholders confirming non-U.S. beneficial ownership before exchanging the Temporary Global Note into a Permanent Global Note (or definitive bonds).

A Permanent Global Note is then issued when the Temporary Global Note has passed the lock-up period and has been certified as being held by a non-U.S. beneficial owner. Permanent Global Note can be issued directly on the issue date only in the limited cases where the relevant issuance does not require a TEFRA D certification.

The above-mentioned structure entails an additional problem whereby, if the issuer fails to issue definitive notes (whose issuance is a cost for the issuer), a noteholder holds exclusively rights against the clearing systems (and not against the issuer, since the noteholder does not have any privity of contract with the issuer).

To sort out this, a trustee must be appointed (and trustee's fees should be paid by the issuer) or, alternatively, a deed of covenant should be executed, so as to confer to the accountholder rights against the issuer, provided that such accountholders are sufficiently designated as the beneficiaries of the deed poll.

In addition to the above, a contractual link must be established also between the issuer and the clearing systems by means of three separate documents, and namely:

- an Issuer-ICSDs Agreement,

- an Issuer Effectuation Authorisation, and

- a common safekeeper election form.

Instead, should the notes be issued in Italy, they would be issued in dematerialised form and held through Monte Titoli (Euronext Securities). No agency agreement (and related fees to the paying agent) is necessary, since Monte Titoli would provide payment services required by the terms and conditions.

Similarly, since the notes are dematerialized, no paper global note should be prepared (either temporary or permanent), the noteholder should not request the definitive notes and no authentication of the title by the local paying agent would be required.

Besides, the terms and conditions qualify as an agreement between the issuer and each noteholder, and rights on the securities result for the book entries on the securities accounts instead of being embedded in the paper form certificate. Therefore the noteholder is directly entitled to enforce his/her rights against the issuer (and not in first instance against Monte Titoli or the clearing system).

Consistently, no trust deed and no deed of covenant would be necessary.

Subscription and Dealer/Programme Agreements

The legal structure for these agreements would remain substantially the same developed in the market practice, but for some appropriate adjustments.

Amendments would be indeed necessary to reflect the new framework in (i) the choice of law clause, (ii) the jurisdiction clause and (iii) the condition precedents, with specific reference to the opportunity to have (i.e. to pay also for) an English law opinion covering the programme and each subsequent issuance of notes.

Indeed, the parties should opt for the Italian law as the governing law of the agreement. Being the issuer an Italian company and the issuance entirely subject to Italian law there is no reason to opt for a different legal environment, also considering the limited goldplating that has been applied to EU law provisions.

This point might trigger some resistance by some intermediaries who might again show some concern as to (i) the predictability of the decisions of the Italian judges due to the complexity of the technicalities surrounding an issuance of debt instruments and (ii) the expected timeframe to reach a final decision, compared to tested issuance structures under English jurisdiction.

This argument, however, does not really seem conclusive since both goals (predictability and promptness) can be reached by means of an arbitration clause whereby issuer and intermediary each appoints one arbitrator, that will jointly appoint the third arbitrator that will chair the collegium.

The above should also permit to avoid costs related to the appointment of a process agent in London and any other cost related to the enforcement of the issuer's rights in England.

ISIN Code

Some market operators raised a point concerning the ISIN Code of a bond issuance under the Italian structure. The relevant ISIN code would not be marked as "XS" but as "IT" and this should, theoretically speaking, induce investors to consider such "IT" note as less appealing than the same note issued by the same issuer under an "XS" code. This argument seems to make reference to an increased country risk that should affect Italian law issuances.

In this respect, please note that ISIN code does not embed any country risk (nor any additional country risk) that is not already captured by the issuer risk, which depends on the issuer and not on the issuance structure. Investors – and in particular sophisticated investors –will take their investment decisions based on fundamentals of the issuer (as evidenced by the prospectus, the annual report and others) and not on the ISIN code that will not reduce nor increase the issuer's risk.

The same has been explicitly demonstrated in the BPER issue mentioned in the opening, where the pricing of the stock did not give evidence of any impact related to the different IT coding, also despite the adverse market conditions such as the one at the end of November.

English law opinion

Finally, being a full Italian law regulated issuance there are no aspects that are relevant under English law that need to be covered by an English law opinion, whose costs can then be saved by the issuers.

Bondholders' Meeting

The issue related to the bondholders' meeting is still left open for bank issuers, with respect to which Article 12 paragraph 3 of the Legislative Decree 385/1993 (the Italian Banking Act) expressly disapplies Article 2415 of the Civil Code.

This rule suggests that, in an issue under Italian law, there is no regulatory basis for a bank to provide for the possibility of making changes to the contractual relationship established with bondholders on an exclusively majority basis (and as an exception to the general principles of contract law).

On this point, however, there appears to be no case law and it is still the subject of a heated debate in the doctrine.

Form of the documentation and listing venues

No variations will be provided for in this respect.

The prospectus would still be prepared in English language, with the same structure stemming from the Prospectus Regulation, in order to keep it readable for the investors, who would not have to make any changes in their own procedures for analysis.

Similarly, no variations will be provided for the listing venues involved (first of all, CSSF/Luxembourg Stock Exchange and CBI/Euronext Dublin), with the issuers free to opt for the respective home state authorities responsible for reviewing the prospectus.

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Herebelow, a summary table shows the differences between the current structure and the proposed new Italian law structure, to highlight the actual cost reduction that issuers could reach.

	Current structure	*New Italian structure*
Terms and conditions	two sets: - one governed by Italian law - one governed by English law	one set governed by Italian law
Programme Agreement / Subscription Agreement	governing law: English law jurisdiction: Court of London	Substantially the same content but: governing law: Italian law jurisdiction: Courts of Milan or Rome / arbitration clause
Global note	Temporary Global Note and subsequently Permanent Global Note. Possibility to request a definitive note (not in global form)	NO: full dematerialisation of the securities
Place of issuance	London	Italy
Agency Agreement	necessary to carry out payments under the notes	NO: Monte Titoli provides for payment services Non-banking companies may appoint a payment agent
Trust Deed / Deed of Covenant	YES	NO
Clearing System	Euroclear / Clearstream	NO: securities are held through Monte Titoli, and in any case eligible to circulate on Euroclear or Clearstream via bridge accounts
Process Agent	Not mandatory but systematically requested by subscribers	NO
Listing Agent	YES	YES
Programme Manual	if required	if required
Closing Agenda	if required	if required
ISIN	XS	IT
UK law legal Opinion	YES	NO
Enforcement costs in UK	YES	NO
Jurisdiction	Courts of London / English courts	Arbitration Courts of Milan or Rome

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