

How to take Italian direct lending to the next level



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There is still caution to be overcome, but borrowers are increasingly turning to non-bank lenders due to accommodating regulation and various perceived benefits

Traditionally, lending activity in Italy has been reserved for banks and other financial institutions subject to regulatory and prudential supervision, in a predominantly bank-driven economy, with few alternative lenders and small debt capital market offerings when compared to the US or UK. This article examines whether the time has come for direct lending to flourish in Italy.

Facilitating access to an evolving market

From 2014 onwards, the economic environment started to change. To stimulate the economy, the Italian government introduced various measures designed to increase the availability of non-banking debt to Italian borrowers consistent with EU legislation fostering the implementation of private debt.

Legislative Decree No 44 (the AIFM Law) came into force in March 2014 and laid down the foundations of the “deregulation” process for lending in Italy. The AIFM Law introduced



significant changes to Legislative Decree No 58 dated 24 February 1998 (TUF), in particular by amending the definition of collective investment undertakings (organismi di investimento collettivo del risparmio, or OICR) and substantially authorising Italian alternative investment funds (AIFs) to invest in credit, including by providing facilities using their own balance sheet, much like direct lending.

Subsequently, the Bank of Italy enacted regulation covering investment management services and provided

terms and conditions under which Italian AIFs may invest in credit or provide debt financing. The Italian Ministry of Economy and Finance also enshrined this right among the activities that funds would be entitled to exercise.

Coincidentally, the reform of lending activity was, to that point, applicable to Italian AIFs only, so the extension to EU AIFs was a welcome change for Italian borrowers.

In 2016, new provisions were introduced in the TUF to allow Italian and, subject to certain conditions, EU AIFs to undertake direct lending activity in Italy (also subject to compliance with certain conditions, including the following: an equivalent authorisation for the EU AIFs in their original jurisdiction; their establishment as closed-end AIFs; compliance with regulations (including risk mitigation) equivalent to those applicable to Italian AIFs undertaking credit investment; and, more importantly, prior notice to the Bank of Italy of their intention to begin a lending activity.

Notwithstanding the revolutionary

scope of these post-2014 measures, direct lending in Italy was initially slower to grow than expected, owing to such forces as traditional Italian monetary policy, cheaper bank financing, and the strong familiarity of Italian borrowers with traditional lenders, much like in the early days of direct lending in the UK or US.

New faith in direct lending structures

While caution around the direct lending market remains in Italy, it is palpably decreasing as time goes by, as evidenced by figures showing the growth, in recent years, of the market.

Information made available by the Associazione Italiana del Private Equity, Venture Capital e Private Debt (the Italian association for private equity, venture capital and private debt, or AIFI) reveals that 2022 saw an all-time high for direct lending deals in Italy, with an overall value of more than €1.9 billion. In addition, almost 50 percent of 2022 investments were made by international investors, with an increased average ticket size of more than €50 million per transaction.

Why did Italy see such growth in 2022?

On the one hand, this growth was made possible by the increasing appetite of international investors for greater internal rates of return and portfolio diversification towards the Italian market and by the consequent focus in raising new AIFs, often paired with environmental, social and governance features, a growing focus area for international investors.

On the other hand, private lenders demonstrated their worth to Italian borrowers with timely and certain execution coupled with tailor-made flexibility. In addition, the ‘take-and-hold’ dynamic allows borrowers to establish strong relationships with direct lenders and facilitates an alignment of interests. Furthermore, the rise of reference rates has affected pricing across

How English law structures can drive Italian markets

English law and English courts have long since established their centrality among international lenders looking to lend to European borrowers

The influence of English legal structures in financing documentation is so strong that “Loan Market Association-style” forms have become a cornerstone of financing transactions under Italian law, even given the peculiarity of the Italian regulatory system using LMA-like bond structures for tax-efficient secured lending.

Sponsors and direct lenders are therefore able to translate familiar provisions and features of the English market into the Italian one, driving significant transactional efficiency and understanding, leading to increased and more diversified direct lending in the Italian market.

While collateral has long been a point of interest for many non-UK European jurisdictions, creditors’ interests will be sufficiently covered by extensive Italian collateral, the enforceability of which, through judicial and out-of-court procedures, is widely recognised. The use of LMA-style documentation to drive this will further bolster lender protections.

Reliable and enforceable security interests, combined with innovative instruments and structures (involving English documentation and other creditor-friendly protections), have served to enhance the protections that had previously dulled interest in Italian direct lending by increasing remoteness from Italian insolvency risks.

the lending spectrum, and relationship lending, which is flexible, has extensively compensated any difference between traditional and direct lending.

Conclusion

With the right assistance from experienced advisers, particularly those familiar with cross-border financing and restructuring matters, international investors seeking to enter the Italian market will not need to worry so much that they can effectively structure and document local Italian direct lending transactions from an international angle.

Direct lenders will therefore enjoy a much stronger position in Italy, particularly given the improved accessibility of the Italian market and the attractiveness of Italian borrowing opportunities. With rising inflation

and cost of capital driven by European Central Bank rate increases, direct lending has finally come to serve the expanding financing demands from Italian small and medium-sized enterprise borrowers, just as access to the traditional banking market becomes increasingly difficult.

Aspirational borrowers will thus be pushed to benefit from alternative lending sources, which have become more competitive for pricing and viewed as well ahead of traditional banks in terms of flexibility, speed of delivery and comprehension of specific needs. ■

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