



*Ministry
of Economy and Finance*

Published in the Official Gazette of March 24, 2016, n. 70

Distribution:

Department of the Treasury

The State General Accounting Department

Bank of Italy

Monte Titoli S.p.A.

CIRCULAR PROT. 5619

Subject: Determination of the CCT and CCTeu coupons in the event of negative interest rates.

The Ministry of the Economy and Finance (MEF) in the past has issued the decrees for the category of government securities called Treasury Credit Certificates (CCTs), whose semi-annual coupons are calculated with reference to the 6-month Treasury Bills (BOTs) yield at issuance increased by a spread of 0.30% on an annual basis, and the MEF still issues European Treasury Credit Certificates (CCTeu), which are securities whose semi-annual coupons are indexed to 6-month EURIBOR, increased by a spread that varies from issue to issue.

The market trend of short-term interest rates has been influenced by the ECB's policy, which has resulted in a negative deposit-facility rate (currently, -0.40%). Such trend suggests the possibility that interest rates on 6-month BOTs and the 6-month EURIBOR may fall below zero, reaching a level that would totally erode and exceed the spread provided for the CCT and the CCTeu (though the assumption for the latter is considered more remote, given the higher spread), thus raising the question about the treatment of virtually negative coupons.

Given this phenomenon is recent and that it had been inconceivable up to only a few months ago, the text of the issuance decrees does not explicitly rule the assumption of negative coupons. This has given rise to the problem of how to interpret the issuance decrees in absence of any specific indications in this regard: whether it might be correct to assume that the coupon could become negative, and in such case, how would the Treasury collect the related counter-value from each individual investor; or whether it should be understood that the lowest limit is equal to zero.

An opinion was requested of the Attorney General's Office with reference to the question, and such office rendered an opinion through a note sent out on 3 December 2015, in conformity with the Consultation Committee's position expressed on 2 December 2015.

In order to resolve the question, the Attorney General's Office applied the principles and legal rules that rule the matter, observing the logic outlined hereunder.

The relationship that is established with subscription of redeemable public-debt securities, in which the nominal amount is equal to the sum to be repaid at maturity, is referable to a type of long-term loan contract. The CCT and CCTeu are instruments incorporating uncertainty due to the variability of the interest rate, but the borrower's obligation to repay the principal is not uncertain. The provisions of the Italian Civil Code with respect to a long-term loan contract provide that such contract naturally has a cost for the borrower only, and not for the lender, who is not required to sustain the risk of a negative interest rate such as to also affect the lender's capital (Article 1813 of the Italian Civil Code, in relation to the obligation to pay back the same amount of money). In essence, the maximum risk for the lender is that of the gratuitousness of the contract. In addition, the Italian Civil Code also provides that services qualified as interest must be for the account of the borrower, and this prevents one from considering, albeit implicitly, that, as such, the services are to be for the account of the lender.

The Attorney General's Office continues by observing that the obligation for interest assumed by the State with the issuance decree is marked by its periodic nature, to be understood not only as the periodic nature of fulfilment, but also as the periodic nature of the cause, namely, as functional dependence on time. In other words, the coupon is due to whoever is the holder of the security at the end of a given six-month period by virtue of the passage of such specific six-month period; the consequences related to the security's yield in a different six-month period cannot be attributed to the aforementioned holder, since such holder does not have any right to an average of the security's overall yield, but only to the remuneration related to that specific six-month period. The coupon thus constitutes not only a periodic obligation, but also an independent obligation.

In consideration of the foregoing, one has to exclude i) the recovery of interest from holders of securities as a result of virtually negative coupons, ii) reductions in interest to be applied to

subsequent coupons, and iii) reductions affecting principal, whose reimbursement must be made at par value pursuant to an express provision.

The Attorney General's Office concludes that the necessary solution is that "the regulation of the relationship includes an implicit provision, whereby, in the event of negative interest rates, the minimum coupon is equal to zero."

In view of the opinion expressed and the logic adopted by the Attorney General's Office, the governance of the relationship as it is defined by the CCT and CCTeu issuance decrees is to be interpreted in a manner whereby in the event of the parameter for determining the coupon (6-month BOT rate or 6-month EURIBOR) falling to a negative level sufficient enough for totally eroding and exceeding the spread, the coupon must be set at zero, and thus without being possible to keep record of any negative differences for the purposes of either subsequent coupons or the reimbursement of principal.

This Circular is published in the Official Gazette of the Italian Republic.

Rome, March 21, 2016

MINISTER OF THE ECONOMY AND FINANCE