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Global Tax Alert

The Italian Supreme Court rules fronting structures constitute unlawful lending

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Between 2006 and 2008, a foreign bank and an Italian bank advanced facilities for approximately €30 million to Italian borrowers. The Italian bank acted as the fronting bank and the credit risk arising from such facilities was shared among the two banks by virtue of an inter-creditor and participation agreement whereby a portion of such facilities was made available to the Italian bank by the foreign bank.

According to the Italian Supreme Court ruling No. 1277 of 2019, the above-mentioned pool financing, implemented by virtue of the inter-creditor and participation agreement, implied the carrying out of lending activity in Italy by the foreign bank. Therefore, the pool financing constituted unlawful lending activity, since the foreign bank lacked the authorization to carry out any such activity in Italy.

The Italian judges identified several indexes evidencing that, through the inter-creditor and participation agreement, unlawful lending activity was being carried out. Such indexes were, in particular the following:

(i) The sharing of the credit risks among the two banks

(ii) The autonomous evaluation of the credit worthiness of the borrowers carried out by the foreign bank

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(iii) The request to each borrower to acknowledge the inter-creditor and participation agreement

(iv) The right attributed to the foreign bank in the management of the relationship with the borrowers

(v) The higher exposure of the foreign bank in respect of the Italian one

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