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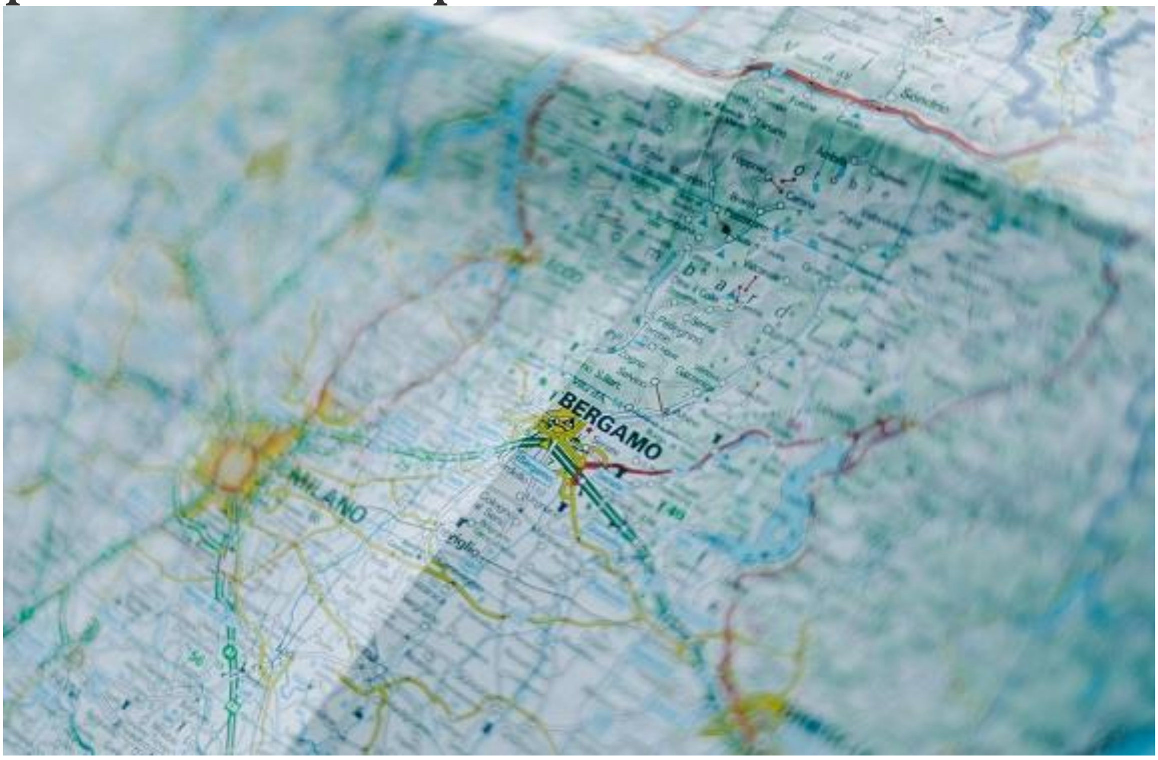
Italian NPL salary-securitization to help puncture European debt balloon



By Tom Brown

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Specialist debt servicer Banca Ifis has pioneered a new securitization structure that will allow more investors to buy defaulted loans, offering some relief for European economies facing a rise in non-performing loans as the bloc recovers from Covid-19.

Banca Ifis, one of the first companies to enter Italy's defaulted-debt market, has structured the first NPL transaction backed by collateral featuring "wage garnishment", where a judge has placed an order on the employer of a debtor to hold back up to one-fifth of their salary every month to satisfy creditors.

In the aftermath of the sovereign debt crisis, investors weren't interested in buying loans that no one would pay back. Securitizing the defaulted assets and selling them was worth it so long as a government guaranteed part of the risk, but creditors often had to wait years for loans to start paying again — with no guarantee to investors as to when and how frequently the loans would be repaid, often making investment unprofitable.

Wage garnishment orders seek to address this problem, giving investors regular, predictable cashflows. In Ifis NPL 2021-1, a €1.323bn securitization, arrangers JP Morgan and Deutsche Bank split the portfolio two ways.

A minority of the deal, 30.7%, is secured on Italian properties. These are old loans, with a weighted average seasoning of 15 years, made up of borrowers who still have not been able to repay their debt, some since even before the financial crisis.

Foreclosure in Italy is a long and arduous process. Mortgages can take months and even years to sell. Even then, Italian law dictates that an auction must be held to sell the property, which can lower the asset's value if no one shows up.

Here, the second part of the portfolio comes in. Some 69.3% of the loans are unsecured, but they come with garnishment orders, a first in the NPL market.

"This is a 'model', a pioneering operation that could very well be replicated in Italy and in other countries, taking into account the legal framework of each country," said a source close to the deal. "NPLs are progressively becoming a new asset class open to a broader range of investors."

The innovation comes in shifting the debt away from the borrower, who — being in default, shows unpredictable patterns of repayment — to the employer, which is under a court order to repay the debt to the servicer, then through the SPV, and into the pocket of the investor holding a securitization bond.

Banca Ifis is one of the few servicers able to identify loans where a wage garnishment order is feasible. This requires intensive behind-the-scenes work, ascertaining whether the borrower has a job, or if they already have debt outstanding.

"Ifis has been the first servicer in Italy to massively invest in these new products — so they have been working over the last five or six years to build up this infrastructure," said a bank source close to the deal. "It requires a lot of asset managements to set up the servicing capability."

Once identified, the servicer is able to buy loans and eventually acquire enough to structure a securitization. But in a random selection of NPLs, less than half of them will typically be available for 'garnishing'. Banca Ifis is currently the only such servicer that has been able to identify and acquire these loans in bulk, but there is no reason why servicers in Greece, Spain and other jurisdictions would not be able to do the same.

"It is fully replicable, in the sense that we do believe there can be other senior transactions in this space," said a banking source who worked on the deal. "This pioneering first try with these assets will help the other older assets successfully compete their workout process."

Extra garnish

There is a period when a borrower can object to the garnishment, but for those in this deal that has elapsed, so all the borrowers concerned are obliged to pay monthly until the debt is paid off.

This even extends into pensions after retirement for indebted borrowers, with caps in place to stop the repayments reaching more than one fifth of the pension payments.

"Moderately regular cashflows are expected from the ODA [wage-garnished] portfolio, because the seizure of borrower incomes or pensions generates monthly payments, although recovery cashflows are generally spread over several years," said Paula Lichtensztein, senior structured finance representative at Scope Ratings.

Job losses are the largest worry when anticipating payments from borrowers on wage garnishment, with repayment becoming more certain as the life of the loan shortens.

If the debtor does not fulfil payments, Banca Ifis can start legal proceedings for judicial recovery.

Upon retirement, the repayment of the loan is still at risk of "life events", meaning death.

Ratings agencies use a number of factors to predict how long a borrower is likely to live, including their gender and whether they work in the private or public sector.

“It makes cashflow much more steady compared to what you have in traditional secured or unsecured NPLs,” said the bank source.

With the latest turning point for the NPL market, Banca Ifis has effectively taken an NPL portfolio and structured it to behave like a reperforming transaction, which should in theory attract far greater demand from investors who otherwise would have hesitated before putting money to work in a securitization backed by soured loans.

The combination of wage-garnished unsecured loans with highly-seasoned mortgage loans may help reassure investors looking to invest in cheap, high yielding bonds.

This new transaction may well allow for banks and other lenders to get better returns by securitizing defaulted assets than they would have from pure portfolio sales, which could make the difference when it comes to repairing Europe’s economy once lockdowns are lifted.

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