

Filling the gap

Italy's non-performing loans update

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Foreword

Record pipeline and jumbo deals – the Italian non-performing loans (NPL) market finally gains traction

After years of conversations but little action, the Italian non-performing loan market is finally gaining traction. Banca Popolare di Bari's €480m state-guaranteed NPL securitisation paved the way, and Banca Monte dei Paschi di Siena's (BMPS) upcoming €27.6bn NPL securitisation and UniCredit's jumbo €20bn NPL transaction are now set to shake up the long dormant market for Italian problem loans.

So far this year, Debtwire has monitored 23 closed deals in Italy involving NPLs for a gross book value (GBV) of €19.7bn – including Cerved's acquisition of BMPS's NPL management platform Project Juliet, which on its own manages NPLs with a combined GBV of €9bn. Debtwire is also monitoring 14 ongoing deals for €64.6bn – these figures do not include rumoured deals or transactions with undisclosed counterparts. The pipeline suggests that in 2016 the Italian market is on track to exceed, by a wide margin, 2015 NPL sales, which, according to PwC, totalled €19bn.

That is good news, but with the IMF estimating that Italian lenders are saddled with roughly €360bn of NPLs, the sector still has a long way to go. Due to the ongoing struggles of Italian SMEs, the volume of Italian NPLs has mushroomed over the past few years.

In an increasingly regulated environment where banking is becoming a utility-like low-risk and low-return business, keeping an adequate regulatory capital level while providing a decent return on equity is challenging.

The ECB's extended rock-bottom interest rates make it extremely difficult to generate enough income to absorb the necessary losses to clean up problematic loans.

Moreover, following the introduction of the European banking recovery and resolution directive (BRRD) in 2014, governments can no longer directly recapitalise their banking sector without facing potential censure for state aid. However, without a state-sponsored systemic solution, cleaning up NPLs will remain piecemeal and slow-going.

Italy also lacks specialised courts to deal with insolvency issues and legal tools to enable out-of-court enforcement of collateral, according to an ECB survey.

But over the last two years, the Italian government has taken steps to ameliorate the country's legal framework and make it more creditor friendly. With Decree 83/2015, it amended the insolvency law to speed up asset recovery, strengthen creditor protection and allow the cram down of financial creditors. In February 2016, the Italian government unveiled a guarantee mechanism (GACS) to cover senior tranches of NPL securitisations.

Banca Popolare di Bari was the first lender to successfully close the securitisation of an NPL portfolio by taking advantage of the state guarantees, retaining the senior tranche and selling mezzanine and

junior tranches to Davidson Kempner Capital Management. Other Italian lenders are following in Bari's footsteps, with the largest ongoing deals all involving state guarantees, according to Debtwire data.

The Italian NPL market is becoming increasingly polarised between complex ad hoc solutions and sales of small portfolios by Italian lenders, market participants say.

For example, Italian bank-backed rescue fund Atlante is pivotal in saving venerable lender BMPS by agreeing to invest up to €1.6bn in junior mezzanine debt to help recapitalise the bank. At the other end of the scale, second-tier lender Credito Valtellinese closed NPL portfolio sales at 35% and 41% of GBV, Debtwire data shows.

However, in some cases, a lack of information and uncertainty over closing deals are putting investors off. Italian NPL sales often involve large unsecured portfolios and many mixed portfolios, and investors are increasingly pushing for better-quality data, uniform portfolios and a clear judicial timetable to get a hold of the assets.

Meanwhile, contributions to the Atlante fund have proven expensive for the already battered Italian banking system. The €4.5bn fund and its new €1.75bn side fund dubbed Atlante 2 designed to buy NPLs, could be at risk of running out of money after having already invested €2.5bn to save Banca Popolare di Vicenza and Veneto Banca, in light of the commitment to BMPS' securitisation. This could lead up to a situation similar to the one in Portugal whereby the fragile Italian system will be forced to again prop up Atlante's resources.

More and more investors are circling the Italian NPL market, as evidenced by the number of attendees at the Banca IFIS Venice conference in September.

Some deals are still getting withdrawn due to unbridgeable bid-ask spreads, while others achieve only partial sales. For example, Banca Popolare dell'Emilia Romagna managed to sell just half of the €900m NPL portfolio it offered in six clusters. Algebris bought a €200m mixed portfolio from the bank for approximately €40m (20% of GBV), while Cerberus bought a €250m two-thirds unsecured portfolio for less than €20m.

While upcoming jumbo deals have boosted the pipeline, the state guarantee – a useful but complex and expensive tool – and Atlante will not be able to save all Italian banks. With Italy still lumbering under a fragmented banking system, more action is needed to whittle away at its NPL mountain.

by Alessia Pirolo and Antonio Vanuzzo

State of the market

Italy is getting serious about trying to reduce a mountain of non-performing loans held by the country's banks. In September 2016, Banca IFIS organised the conference "NPL meeting" in Venice to discuss the NPL situation in Italy. This report presents an overview of the market, potential solutions as well as comments from financial services experts who attended the conference.

A wave of restructuring and consolidation is hitting the Italian financial services sector. This is especially true for second-tier lenders, battered by mismanagement, opaque lending policies and Europe's continued macroeconomic crisis. NPLs weigh heavily on Italian banks – especially, given that Italy is an extremely bank-centric country. In 2015, Italy had a total of €360bn worth of NPLs – 18% of total gross loans – and a 12 percentage point increase from 2008, according to IMF data.

Clean sweep

If the country's lenders are to restore their profitability; maintain high regulatory capital to offset potential macroeconomic shocks; and boost lending to SMEs, then providing business opportunities to prospective buyers of Italian NPLs, including private investors, has become a top priority.

Reforms in the banking sector and the judiciary system are intended to reduce the private sector debt overhang by aiding the restructuring of viable businesses, speeding up the shuttering of unviable ones and facilitating faster and more fulsome debt collection.

The good news is that legal and tax reforms over the past year have improved investor confidence. Moreover, GDP recovery is expected to continue – albeit at a sluggish pace – to 0.9% in 2017 and 1% in 2018 up from just 0.7% projected for 2016, according to the European Commission.

In addition, 2016 has seen improvements in the implementation of sell-side strategies that foster liquidity in the market and banks are beginning to manage portfolios proactively to reduce their NPL overhang. Italian banks must now position these NPLs to hold up in comparison with assets in similar markets in order to appeal to investors who are increasingly looking for alternative assets and opportunities in a low-interest rate environment. Conference attendants agreed that a pro-active approach is necessary to chip away at the debt mountain.

So far in 2016, Debtwire has recorded 23 closed deals in Italy involving NPLs for a gross book value of €19.7bn – including Cerved's acquisition of Banca Monte dei Paschi di Siena's (BMPS) NPL management platform Project Juliet, which on its own manages €9bn worth of NPLs. As of November, Debtwire data also shows 14 live loan transactions with a GBV of €64.6bn, which includes a mixed portfolio of BMPS valued at €27.6bn. The BMPS deal involves a securitisation backed by a guarantee from the Italian state and the involvement of the rescue fund backed by Italian banks, Atlante, as underwriter of the junior mezzanine notes.

Speaking at the NPL conference in Venice, Paolo Petrigani, CEO of Atlante fund manager Quaestio Investment, said he expected the market to open up following a first big transaction, indicating that the acquisition of BMPS' portfolio by Atlante could be a potential bellwether deal.

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€19.7bn

combined value of recorded closed NPL deals in Italy in 2016

23

number of closed NPL deals in Italy in 2016

"We hope that the deal we are working on can liven up the market and encourage other investors to follow suit. With our resources alone, we cannot solve the problem of NPLs in Italy," said Petrigani. "This solution can only come from the capital market, which is not only made up of foreign investors or specialised funds, but also includes insurance companies, social security and pension funds – a number of institutions that have problems with returns now. A return of 6%, and perhaps a good credit rating, would more than satisfy these institutions."

New hopes

In addition, complementary and synchronised systemic government reform initiatives are also trying to support the offloading of NPLs.

Consolidating banks and allocating NPLs to a new entity is one such

measure. For example, in November 2015, an Italian government and Bank of Italy rescue plan worth €3.6bn for four regional banks – Banca Marche, Banca Popolare dell'Etruria e del Lazio, Banca Popolare di Ferrara, and CariChieti – involved the creation of a “bad bank” that took on bad loans, for an estimated €8.5bn GBV.

In February 2016, the Italian government also unveiled an NPL securitisation scheme (GACS) that allows banks to transfer NPLs to special purpose vehicles, which will be financed by issuing notes of various tranches. The senior tranche will be backed by a guarantee by the state provided the rating agencies issue an “investment grade” rating.

Over the past few years, the bid/ask spread for secured portfolios has been wide, due to the low level of provisioning and the lengthiness of Italian court procedures, causing uncertainty in the recovery of assets. This makes it difficult for investors to assess the return on their investment, as collection of assets and recovery time remain uncertain.

Roberto Nicastro, chairman of the four “good banks” established in late 2015 after spinning off the bad loans mentioned above, said he foresees significant growth for the NPL market as many of these variables are being

mitigated. He pointed to the judiciary, which determines the timeframes with which enforcement actions are made and how they vary across provinces.

Over the past year, two enforcement procedures have been legislated to tighten recovery timeframes in Italy from 48 to 90+ months to 36 to 48 months, bringing them closer to EU averages of 12-24 months.

- The first is Law Decree 132, implemented in August 2015. This is intended to reduce the time it takes to offload NPLs and increase their tax deductibility. Write-offs in Italy are not tax deductible without a court declaration of insolvency, which can take several years.
- The second is Law Decree 119, enacted in June 2016. This is expected to further reduce bureaucratic hoops through the digitisation of enforcement procedures and increasing protection for creditors.

“Structural reforms to improve the time and the certainty of recovery would be the biggest driver of the resolution of this market,” concluded Jose Brena, head of distressed asset management at UniCredit, which has been among the top sellers of NPLs in Italy so far in 2016.

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Top three closed deals in 2016 by GBV

Name	GBV €m	Acquisition price €m	Collateral type	Seller	Buyer
Project Juliet	9,000 (only portfolio management)	105	NPL management platform	Banca Monte dei Paschi di Siena	Cerved
Portfolios Vesta and Eris (Project Compilation)	2,000	50	70% unsecured, 30% secured	GE Capital, RBS	AnaCap
Project Elipso (Project Compilation)	1,200		70% unsecured, 30% secured	GE Capital, Credit Agricole	FBS

Source: Debtwire

As of 25 November 2016/ Figures do not include rumoured deals or transactions with undisclosed counterparts

A journey of discovery

Pro-active portfolio management by sellers and portfolio segmentation is aiding buyers to perform due diligence and align the buyer/seller price gap. New securitisation mechanisms have increased sales prices, making Italian NPLs more attractive to buyers.

Banks as sellers of NPLs have taken some decisive steps to implement deleveraging strategies and a more in-depth portfolio management approach. With portfolio segmentation and higher quality data, price discovery is also becoming increasingly transparent.

To ensure that the price gap is bridged, banks need to invest in compiling data, otherwise they will be disadvantaged on price, as buyers are generally risk averse.

Buyers hungry for data

Buyers can be comfortable with the market, provided that more data becomes available, helping them to better understand and price risk and predict cash flows.

"It is not a matter of size, but a matter of creating good market conditions," said Alessandro Scorsone, strategic sales project manager at Poland-based debt collector KRUK Group, at the conference in Venice.

He emphasised the need to provide the right data as a first step for attracting buyers. "We need precise, detailed and electronic information to perform our own portfolio analysis. Our main focus is in retail unsecured business so far in Italy," he said. "And it's really important for us – due to the fact that we implement statistical models in the evaluation of portfolios – to have detailed and complete information from the originator."

"It must be an approach where cash flows are properly evaluated," said Fabrizio Vitiello, group head of alternative fixed income at Generali Group. "Of course, it will never

Over the past few years, NPL deals mostly involved selling off entire portfolios; however segmentation and securitisation is increasing, following efforts to process data and classify portfolios. For example, the securitisation of a €480m Popolare di Bari NPL portfolio in August gave a positive signal to the market.

be the same due diligence as the one carried out by the principal, because it should not be a duplicate. Nevertheless, you must have quality underlying information and the ability to check if the equity buffer is sufficient."

Over the past few years, NPL deals mostly involved selling off entire portfolios; however segmentation and securitisation is increasing, following efforts to process data and classify portfolios. For example, the securitisation of a €480m Banca Popolare di Bari NPL portfolio in August gave a positive signal to the market.

UK-based AnaCap's head of credit Justin Sulger said: "We have an appetite for secured portfolios and we have invested quite heavily in that. But the reality is that those deals have lagged and a lot of that buying is still to come."

However, Sulger warned that some of the measures such as GACS and Atlante may actually slow buying interest: "As some of these other solutions are considered – although they may be needed from a systemic

€64.6bn

of live NPL deals as of November 2016

14

live NPL transactions in Italy as of November 2016

standpoint – they go against our investment approach, because they typically are going to be deals that are led by other parties, not by the investor," he said. "There are consulting services and rating agencies involved in securitisation. That is fine, and most of those parties know what they are doing, but the problem is that none of that replaces the need for us as an equity investor to do our own analysis."

Malcolm Jackson, managing director of tactical opportunities at US PE firm Blackstone, said their focus over the past three years has been on finding local partners and accumulating good quality data.

"I think we will also see an auction market opening up," he said. "At the moment, what is restricting the auction market is just the sheer variety of debt which is trying to be sold in single transactions, so you are seeing unsecured, secured, and commercial SMEs all bundled together. That instantly cuts down the buyer universe. As the market matures and is able to isolate the single types of debt, we will see

the multiplayer auction space increasing. For more complex situations and large transactions, we will see bilaterals.”

Seller's toolkit

On the sell-side, UniCredit has noted a pick-up in the process of deleveraging and aligning price expectations between buyers and sellers of NPLs. Indeed, UniCredit has agreed to the sale of the €1.2bn Project Sandokan, which includes significant real estate collaterals, and is looking to offload a portfolio worth €20bn (Project Bastiglia/FINO), according to Debtwire data.

“Whenever you can't bring the data to the table to support your thesis of what you think the value is, you are going to be discounted,” said UniCredit's Jose Brena. “The banks have spent a lot of time preparing the packages, looking at what they have and looking at what can be done to supplement the information. The banks are also becoming a little bit more realistic in terms of their expectations. I think the momentum is forcing the two sides to get closer together.”

Along with UniCredit, Intesa Sanpaolo has also been chipping away at its NPL stock of €64.7bn over the past 12 months, reducing it to €59.7bn and, in November, launched a €2.5bn disposal consisting of both secured and unsecured loans.

Top five buyers by value in 2016

Buyer	GBV €m
AnaCap	2,000
Banca IFIS	1,242
FBS	1,200
Pimco and GWM	1,200
KRUK Group	940

Top three buyers by number of portfolios in 2016

Buyer	Number of portfolios
Algebris	4
Banca IFIS	4
Credito Fondiario	2

Top five sellers by value in 2016 (closed deals)

Seller	GBV €m	Number of portfolios
UniCredit	2,140	2
GE Capital, RBS	2,000	1
GE Capital, Credit Agricole	1,200	1
Banco Popolare	752	2
Heta Asset Resolution	657	1

Source: Debtwire

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Technological rescue

Digital collaboration and information sharing platforms help buyers do due diligence while clustering and improved data quality result in higher prices for sellers.

A lack of adequate information on individual assets and cash flow in portfolios has put a dampener on offloading NPLs. Draft guidance issued by the ECB in September on NPL management calls for banks to organise and publicise data with the help of special dedicated staff, in addition to building a deleveraging strategy.

Timely and efficient processes are needed to be able to crunch the data from thousands of SMEs, but creating digitised databases also has the ability to engage banks and multiple investors at the same time to create bilaterally selected portfolio clusters.

In some cases, Italian banks have started to make their portfolios more transparent and to improve their communication with buyers. Technology plays a key role in overcoming the valuation gap and digitisation also aids in the management of transactions, allowing banks to know which parts of the portfolio are attractive to investors, which results in more sustainable restructuring.

Razi Amin, managing partner at Aspen Capital Solutions, said: "To this day, banks and investors rely on overly manual processes, and they also have disparate IT systems, which cannot talk to one another. Data is important, and part of the technology should support real-time availability of data to the investors as well as interactive segmentation between the bank and the investors."

Time is of the essence

Time is a crucial aspect in deleveraging the high volume of Italian NPLs, according to Amin. "It does not matter whether those non-performing loans are sold or retained by the bank, because

every day that these companies are deprived of new money we are denying them the opportunity to restructure themselves, restore profitability and employment," he said. "The inability to attract new money for struggling but viable SMEs needs to be addressed straight away, because otherwise they are degrading value, forcing banks to set aside greater amounts of provisioning and diluting the bank's equity holders," he explained.

Several laws, such as Decree 132/2015 and 59/2016, are also further encouraging the digitisation of documentation and proceedings. These new measures will take time, but the market is undoubtedly moving forward.

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Razi Amin, managing partner, Aspen Capital Solutions



Live NPL deals 2016

Seller	Name	GBV €m	Collateral type	Bidders	Advisors
Banca Monte dei Paschi di Siena	n/a	27,600	Mixed	Atlante	Fonspa
UniCredit	Project Bastiglia/ FINO	20,000	SMEs, 1/3 real estate	Cerberus, Fortress, Pimco	Morgan Stanley
Rev Gestione Crediti	n/a	8,500	Mixed		Deloitte, Oliver Wyman
Intesa Sanpaolo	n/a	2,500	Mixed	Apollo, Cerberus, CRC, Credito Fondiario, Fortress, Lone Star	
Creval	n/a	1,500	Mixed		J.P. Morgan, Mediobanca, Banca IMI, Bonelli Errede
Carige	n/a	1,000	Mixed		Prelios, Banca IMI
BNL	n/a	1,000	Mainly SMEs		
Hypo Alpe Adria	Project Secondo	528	Real estate, machinery, vehicles and boats	Bain Capital Credit, Credito Fondiario, Creval, Fortress, Goldman Sachs	Mediobanca
Iccrea Banca	n/a	500	Mixed	Apollo, Bayview, Idea-Fimit, Lindorff	
Deutsche Bank	Project Isabel	400	Residential assets		
Banca Mediocredito del Friuli Venezia Giulia	n/a	357	Real estate industrial and commercial		Fisg
Erste Abwicklungsanstalt (EAA), former WestLB	Project Botticelli	340	Residential, commercial and industrial properties and land	Fortress, DE Shaw	KPMG
Carim	n/a	200	Real estate including hotels		EY
Creval	Project San Marco	180	Real estate	Cerberus, Credito Fondiario, AnaCap	Yard

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Past NPL deals 2016

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GE Capital, RBS	Portfolios Vesta and Eris (Project Compilation)	2,000	50	70% unsecured, 30% secured	AnaCap
GE Capital, Credit Agricole	Portfolio Elipso (Project Compilation)	1,200		70% unsecured, 30% secured	FBS
UniCredit	Project Sandokan	1,200		35 real estate properties including hotels, office and residential buildings	Pimco and GWM
UniCredit	n/a	940		Unsecured loans	KRUK Group
Heta Asset Resolution	Project Friuli	657	200	Platform, REOs, leasing contracts	Bain Capital Credit
Banco Popolare	Project Adele	600		SME portfolio	Hoist Finance
Banca Popolare di Bari	n/a	480		Mixed	Davidson Kempner
Locam	n/a	466		Unsecured loans	Banca IFIS
RBS	Portfolio Maya (project compilation)	400		15% secured	LCM Partners
Findomestic Banca	n/a	384		Unsecured loans	Banca IFIS
Cassa Centrale Banca	n/a	338		Mainly unsecured, 17% secured by real estate	Locam
Suedtiroler Sparkasse	Project Spark	320	70	85% real estate	Algebris
Creval	Project Cerere	314			Credito Fondiario
BPER	Project Please-Mixed	250	below 20	2/3 unsecured	Cerberus

Seller	Name	GBV €m	Acquisition price €m	Collateral type	Buyer
Deutsche Bank	n/a	240		Unsecured loans	Banca IFIS
BPER	Project Please-Secured	200	40	Residential and commercial real estate	Algebris
Deutsche Bank	Project Joanna	172	70	Residential and commercial real estate	Algebris
Banco Popolare	Project Arena 3	152		Unsecured loans	Banca IFIS
Hypo Alpe Adria	Project Primo	150		Performing mortgages and REOs	Banca Valsabbina
Creval	Project Gavia	106	41% GBV	Real estate	Credito Fondiario
RBS	Project Door	100	55	Office buildings and hotels	Bank of America Merrill Lynch
Creval	Project Arizona	22	35% GBV	Real estate	Algebris

Source: Debtwire

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