GACS Securitisation deals in the Italian NPL space

Key evidences, new regulatory framework and market expectations for 2020

Portfolio Solutions Group

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Foreword & Content

In this report, we identify and discuss the key features of the GACS tool that are taking centre stage in the Italian Non-Performing Loans ("NPL") landscape

The financial crisis negatively affected the European banking sector and contributed to a build-up of non-performing exposures (NPEs) on many banks' balance sheets. Although the joint efforts of banks, supervisors, regulators and macroprudential authorities have led to a slow improvement in NPE ratios in recent years, the overall **level of NPEs remains high** by historic standards, especially in Italy.

The "*Garanzia sulla Cartolarizzazione delle Sofferenze*" (GACS), introduced in February 2016 envisages that the Italian State provides a guarantee on the **senior notes repayment in rated Non-Performing Loans securitization transactions.**

The guarantee's objective is to **reduce the bid-ask price spread** between originators (selling banks) and investors and **increase the number and volume of NPL transactions.**

The GACS decree has been **renewed** in May 2019, for a period ranging from 24 to 36 months. The new GACS framework has envisaged some substantial amendments in order to make the **senior notes repayment more certain and further tie the servicer's compensation to the transaction's performance.**

To date, **25 GACS transactions** have been completed, accounting for an overall gross volume approximately of € 71 bn. A few GACS transactions are **performing below their initial expectations** (actual recoveries are lower than those expected in initial servicers' business plans).

The underperformance is not only due to an underestimation of the **onboarding process** by the servicers, as previously observed by the Rating Agencies, but also because of the servicers difficulty to respect their initial expectations.

In the next months, Bank of Italy is going to run a **rigorous control** over the companies managing the NPL exposures involved in GACS deals. Servicers and Credit Collection Companies will be assessed on multiple aspects ranging from the technological systems used to the number of people employed.

Moreover, following the spreading of Coronavirus (COVID-19), the Italian Authorities implemented certain measures to limit the contagion and narrow the bad effects on the Italian economy. Within this context, **the Decree n. 17 of 16/03/2020 "Cura Italia" will ease the disposal of NPLs.**

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Italian Banking NPL Scenario

NPL deleveraging across the Italian banks

NPL deleveraging through market tools

According to the recent EBA Transparency Exercise published in November 2019, European banks confirmed a stronger capital position compared to the previous years and the steady decline of nonperforming loans (NPLs).

This trend was supported by banks' de-leveraging and de-risking, which resulted in a Risk Weighted Assets reduction of slightly less than 10% during the last ten years.

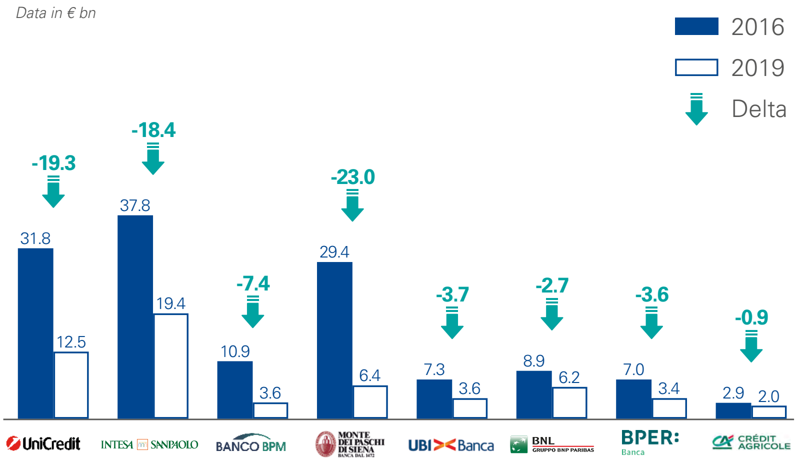
During the 2019, the largest NPL transaction has been closed by **Banco BPM** with the disposal of **€7.3bn** mixed secured - unsecured bad loans portfolio with a GACS scheme.

The Italian banking system improved its asset quality, but banks are facing more and more challenging NPE ratio targets in each release of their industrial plans.

Regulatory pressure to reduce the large amount of bad loans and UtPs lying in their balance sheets which is reflected in an aggregate NPE ratio is still higher than the EU average.

Coverage rations seem to be stable. Compared to the amount of NPLs to be disposed, UtPs' stock results to be of a greater amount.

1. Top 8 Italian Banks - Gross Bad Loans analysis

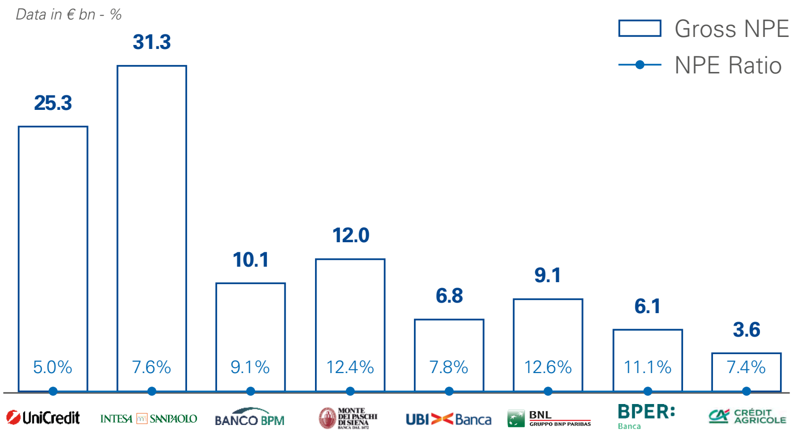


Gross Bad Loans Ratio

2.5%	4,7%	3,2%	6,7%	4,1%	8.6%	6.2%	4.1%

Source: Financial reports as of 31/12/2019 and 31/12/2016, BNL Financial report as of 31/12/2018, Credit Agricole Financial report as of 30/06/2019

2. Top 8 Italian Banks - Gross NPE



NPE Coverage Ratio

65,2%	54,6%	45,0%	48,8%	39,0%	55.0%	51,0%	53,4%

Source: Financial reports as of 31/12/2019, BNL Financial report as of 31/12/2018, Credit Agricole Financial report as of 30/06/2019

Target Gross NPE Ratio

EBA Guidelines on the Target Gross NPE Ratio

The effects of high levels of NPEs on funding costs and capital and profitability can seriously jeopardize institutions' ability to run a viable and sustainable business model.

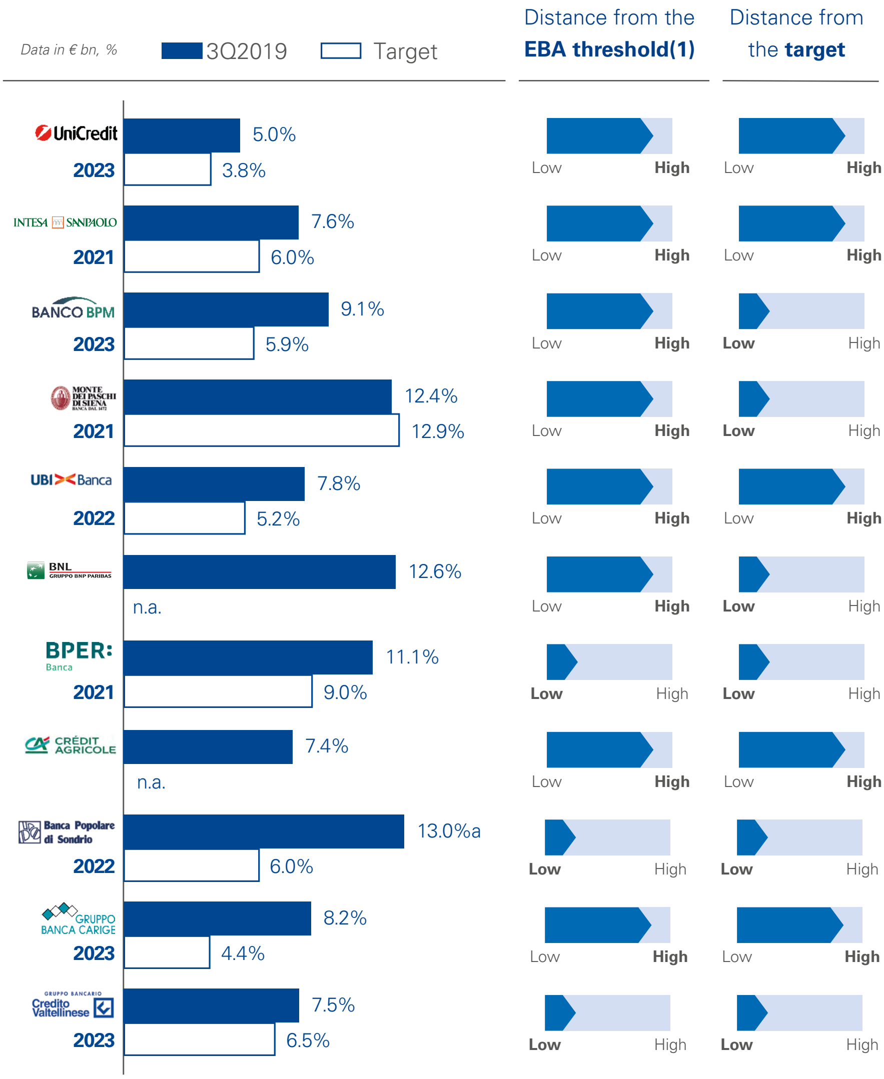
When credit institutions have a gross NPL ratio at 5% or above, they should establish an NPE strategy and fulfil all related operational and governance aspects in accordance with the EBA guidelines.

Major Italian banks have to put extra efforts in order to meet their targets and in the upcoming 2/3 years extraordinary disposals are expected. Further deleveraging is required to meet EBA Guidelines, 5% threshold to consider a bank as a high-NPL bank.

In Italy, this trend is confirmed also by the recent industrial plans released by the major Italian banks such as Banca Popolare di Sondrio, UBI Banca, Banca Carige as well as UniCredit that seem to be the banks most committed to reach the EBA target.

Additional efforts need to be put in place by other key players in the Italian financial market to meet the EBA requirements in the upcoming years.

3. 3Q2019 – Target gross NPE ratio



Source: Financial reports as of 31/12/2019, BNL Financial report as of 31/12/2018, Credit Agricole and Carige Financial report as of 30/06/2019, Popso Financial report as of 30/09/2019

Italian Banks Asset Analysis Correlation

NPE Ratio and Coverage

The financial crisis negatively affected the European banking sector in various ways, and it contributed to the build-up of a large stock of non-performing exposures (NPEs) on banks balance sheets.

High levels of NPEs - at microprudential level - areassociated with lower profitability and lower efficiency. At macroprudential level, are connected with stagnant growth, as capital is tied up in NPEs and there is decreased new lending into the real economy.

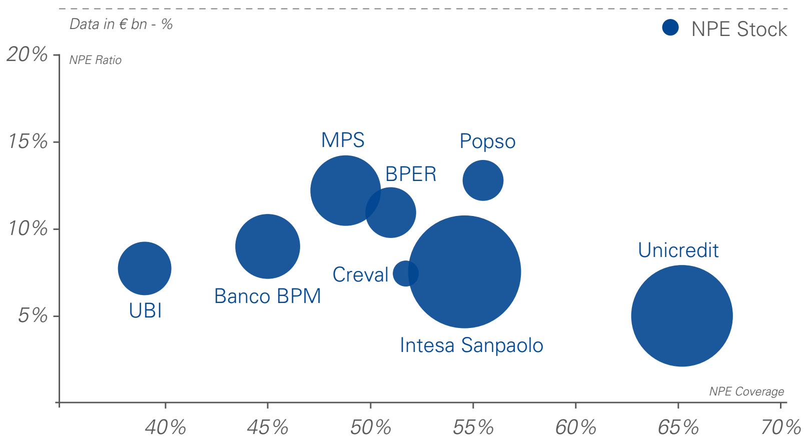
In Italy, MPS shows the highest NPE ratio while UniCredit has the lowest NPE ratio with the highest NPE coverage.

It seems no strong correlation is observed between the two variables as the NPE Coverage is unique to every bank and depends on several factors such as portfolio vintage, weight of secured component and write-off policies.

Banks with a high NPE ratio pay a significant discount in terms of capitalization compared to their NAV.

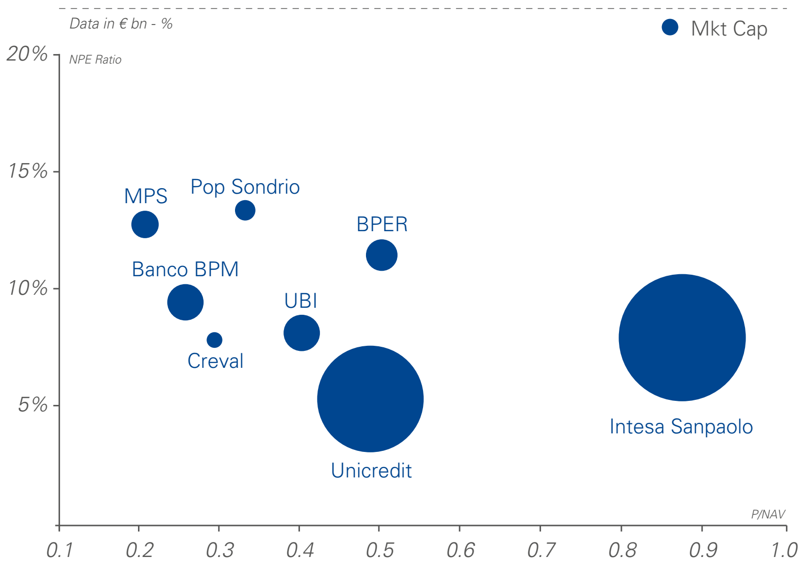
A negative trend correlation seems occurring between the variables probably due to the fact that the banks with less liabilities have an higher NAV.

4. Relation between Coverage NPE and NPE ratio



Source: Financial reports as of 31/12/2019, Popso Financial report as of 30/09/2019

5. Relation between P*/NAV and NPE ratio**



Source: Financial reports as of 31/12/2019, Popso Financial report as of 30/09/2019
(*) 3m average price
(**) Equity net of intangible assets

Key Evidences on Completed GACS deals

GACS deals - Key features

Key recent dynamics

25 GACS transactions were completed between 2016 and 2019 for a total **GBV of € 71.1 bn; 10 deals** on total number of transactions had a deal size ranging from € 1 to 5 bn.

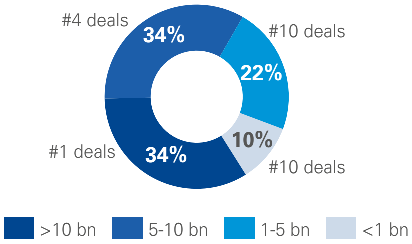
Around **65% of securitized loans** are backed by mortgages on real estates properties. In terms of GBV, the largest completed transaction has been **Siena NPL 2018** with a gross book value equal to **€ 24 bn**.

Servicers' business plans reported **an average expected GDP** of about **38.8%** (in terms of GBV).

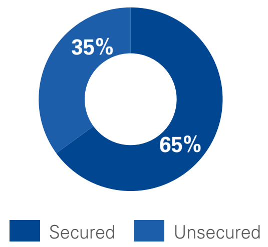
The average pricing from completed GACS were **26.1%.** Meanwhile, **the average tranching** has been about **85%** of senior notes.

6. Main data

Deal size breakdown (% GBV)

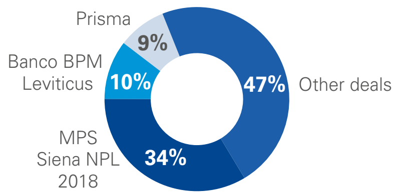


Secured vs Unsecured (% GBV)

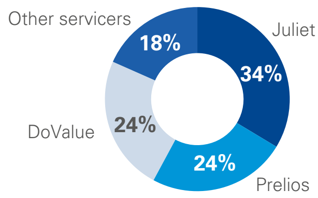


7. Key players involved

Deal breakdown (% GBV)

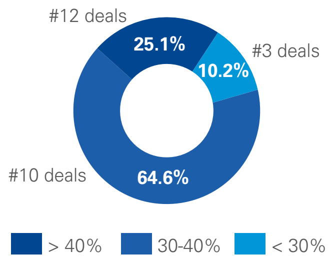


Servicer breakdown (% GBV)

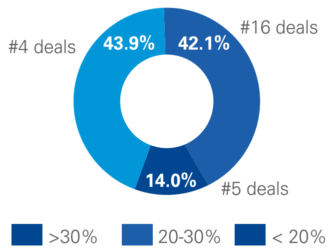


8. Focus on expected recoveries and Pricing

Expected GDP breakdown (% GBV)

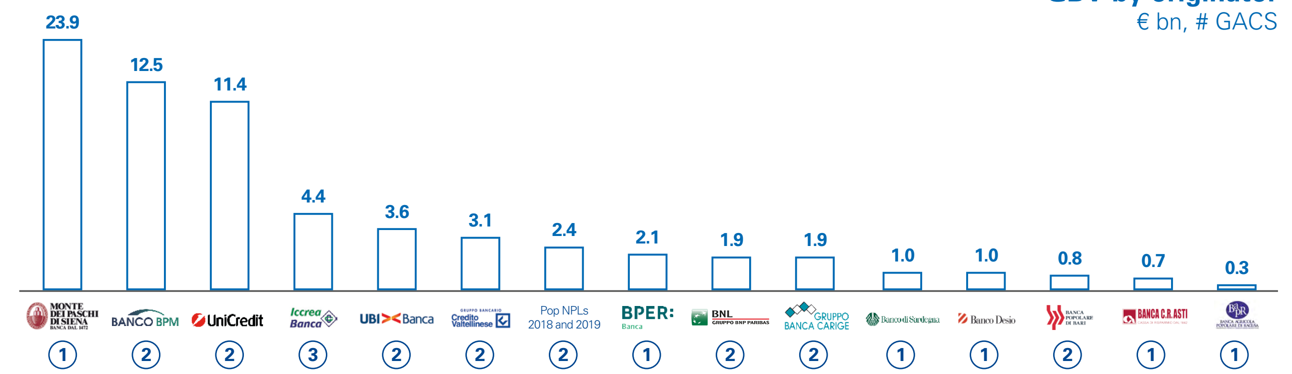


Price range breakdown (% GBV)



Source: KPMG analysis from rating agencies' reports

GBV by originator
€ bn, # GACS



GACS' performance - Key figures

Focus on the Servicers' Business Plan performances

Italy still exhibits important credit strengths that balance the weakening fiscal prospects.

It is expected an increasingly efficient foreclosure and bankruptcy court proceedings in Italy due to the recent changes in the law for legal proceedings. That is going to speed up the collection recovery process for the securitized deals with exposure to NPLs.

Overall the selected sample shows actual **cumulative gross collections** in line with the initial business plan.

However, if we extend the analysis to 20(1) GACS for which information is available, we observe **10 transactions below the BP.**

This trend signals servicers difficulty to respect their initial expectations.

Bank of Italy has recently announced a rigorous control that will run for a couple months over the companies managing the NPL exposures involved in GACS deals. Servicers and Credit Collection Companies will be assessed on multiple aspects.

Project Name	Issue Date	CCR (2)	NPV CPR (3)	€ mln – Cum. Gross Collections actual	€ mln – Cum. Gross Collections inital BP
Bari NPL 2016	Aug-16	**93.0**	**101.0**	60	69
Brisca	Jul-17	**120.2**	**111.0**	133	100
Bari NPL 2017	Nov-17	**90.1**	**96.9**	21	25
4Mori Sardegna	Jun-18	**106.8**	**134.3**	52	59
2Worlds	Jun-18	**96.4**	**122.2**	104	108
Maggese	Jul-18	**101.0**	**104.0**	41	44
Juno 1	Jul-18	**158.3**	**100.3**	48	30
Maior	Aug-18	**111.9**	**125.1**	183	170
BCC NPLs 2018 – 2	Dec-18	**100.0**	**151.0**	55	49
Juno 2	Feb-19	**131.3**	**100.3**	55	42
Leviticus SPV	Feb-19	**98.0**	**104.0**	352	371

Cum. Gross Collections actual   Cum. Gross Collections inital BP

Source: DBRS performance report on rated GACS securitizations. The selected sample show the performances on some of the main GACS deals closed across Italy where available data at the last payment date have been provided by the Servicers/Investors)

(1) The 20 GACS include: the sample, Elrond, Fino1, Siena NPL, Red Sea, BCC NPLs 2018, Ibla, Aqui, Pop NPL 2018 and Riviera; (2) Ratio between actual cumulative net (or gross) collections and cumulative net (or gross) collections projected as per the initial servicer's business plan according to agreement guidelines; (3) Ratio between the sum of the net present value of the net collections of the aggregate debt pertaining to the same borrower that have either been collected in full or sold or written off and the sum of the target price of all the claims that have either been collected in full or sold or written off as detailed in the servicer's business plan

GACS' performance - Recovery drivers

Drivers Evolution

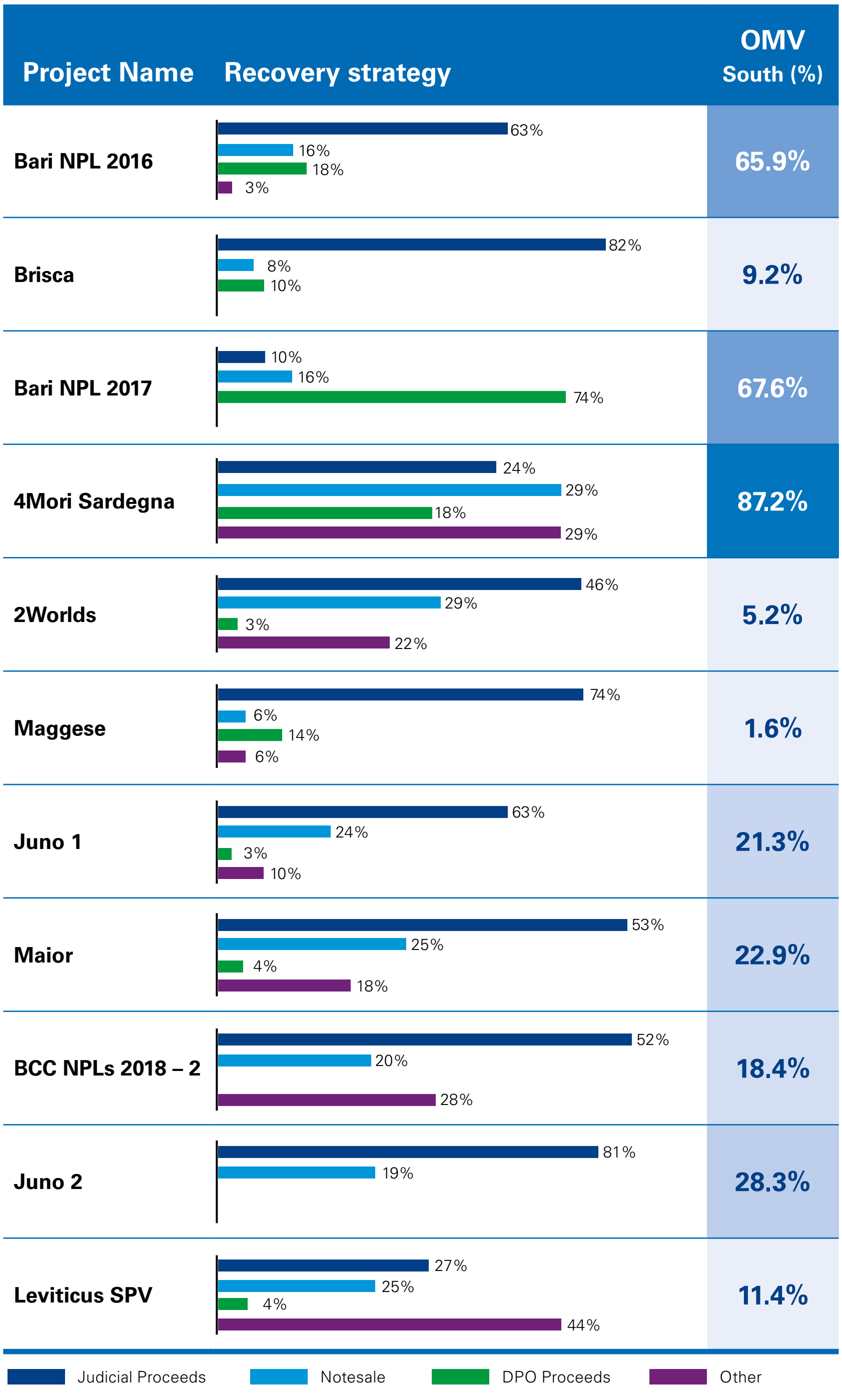
The composition of the recovery drivers observed for the selected sample of GACS, shows how servicers rely on the disposal of portions of portfolio under management to achieve immediate inflows and meet collections expectations included in their initial BP dispose.

Moreover, this trend may affect the overall quality of the portfolios underlying the securitizations.

The slower judicial system in the south of the country is forcing lenders to seek out-of-court resolutions to speed up and improve their recovery process.

Data show that most of the sale procedures in southern/central regions have concluded with an extrajudicial resolution, compared with the evidences from the north. Statistics also show that a few procedures in southern regions have concluded with the sale of the property compared with other regions of Italy.

That seems consistent with the latest observations on the collections provided by the Servicers so far.



Source: DBRS performance report on rated GACS securitizations

(1) Ratio between actual cumulative gross collections and cumulative gross collections projected as per the initial servicer's business plan; (2) Ratio between actual cumulative gross collections less notesales and cumulative gross collections projected as per the initial servicer's business plan

The New Regulatory Wave

The new regulatory wave

Through the Law of 20th May 2019, the Italian government has renewed the GACS scheme (24 months from the date of approval of the European Commission and 12 months-extension period), introducing some relevant updates and amendments.

Key Updates	Description	Already provided by market standard	Main features before the normative update
Servicer substitution	After senior bondholder GACS enforcement, in case of two consecutive interest payment dates where the ratio between net cumulative recoveries and net recoveries expected in servicer's business plan is less than 100%, the servicer substitution is envisaged	✗	Right for the mezzanine noteholders to ask for the servicer substitution was provided after a number of consecutive breaches of one between (i) the cumulative collection ratio[1] and (ii) the profitability ratio[1],after a defined grace period
Servicer payment	Any fee due to the servicer shall be subject to the achievement of performance goals connected with portfolio's recoveries. Whenever, at any servicing fee payment date, the ratio between net cumulative recoveries and net recoveries expected in servicer's business plan is less than 90%, a portion not less than 20% of the total due fee shall be deferred to the total reimbursement of senior note or to the date when the ratio returns greater than 100%	✓	Deferability and reduction of servicing fees due was provided whenever one between (i) the cumulative collection ratio[1] and (ii) the profitability ratio[1] was breached
Interest payment on mezzanine notes	Whenever the ratio between net cumulative recoveries and net recoveries estimated in the portfolio business plan is less than 90% at the mezzanine interest payment date, the related interest is deferred since the completion of the reimbursement of senior notes capital or since when the ratio is greater than 100%	✓	Mezzanine interest payment would not occur if one between (i) the cumulative collection ratio[1] and (ii) the profitability ratio[1] was breached[2]
Rating issuance	The senior notes rating shall be equal to BBB or equivalent	✗	Decree-law 14/02/16 n. 18 envisaged a rating at least equal to investment grade (BBB-). The new rule will result in more conservative tranching of the securitization

(1) Cumulative collection ratio and profitability ratio will further be defined in page 7.
2) This mechanism is not present for only one transaction out of the 21 successfully completed in Italy

Next market expectations in the NPL Space

A very active NPE market in the coming years

2017 and 2018 were record years in the primary market, mainly thanks to jumbo securitizations secured by GACS.

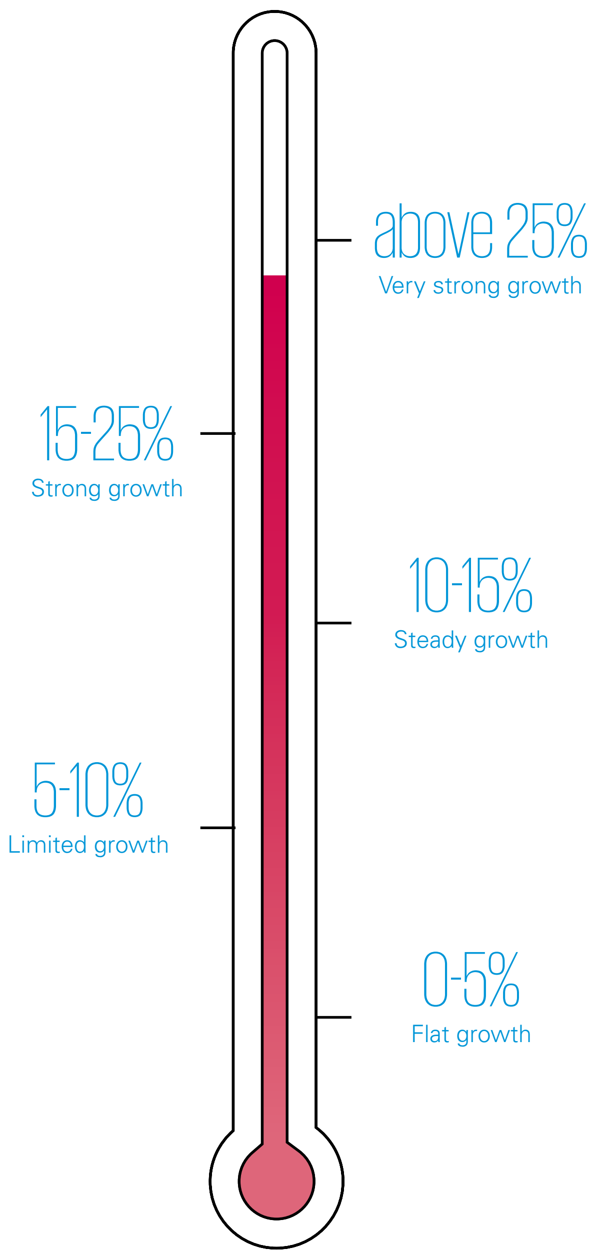
The **new regulatory wave** envisages the extension of the Government Guarantee for a further period of 24 - 36 months, while providing for a greater involvement of special servicers in coming transactions' performance.

We expect these regulatory amendments to give further comfort to all the parties (i.e. banks / sellers, Italian Government, third party notes' investors) about the financial stability of the new transactions, leaving space for a **period of intense M&A activity in Italy.**

Lively secondary market is expected in the upcoming months resulting from (i) speculative funds undergoing deleveraging process to focus on new geographies / new investments, (ii) GACS secured SPVs need to accelerate collections and (iii) first wave SPV going towards to the termination date.

The new **Italian Decree n. 17 of 16/03/2020 "Cura Italia" is going to ease the disposal of NPLs through the conversion of Deferred Tax Assets**. Within this context, banks have the chance to benefit of this incentive on NPLs disposal within the end of 2020 up to € 2 bn GBV. Banks have to pay a **yearly fee equal to 1.5%** of the difference between DTA and tax paid. Eligible DTA derives from residual tax losses and ACE ("Agevolazione Crescita Economica") excess, computable for a maximum of 20% of disposed GBV. The benefit on the NPLs disposals can be in the region of above 5% of the GBV.

Italy NPL M&A forecast



Annexes

List of completed GACS deals and key numbers

List of completed GACS with key features

Overview of the completed operations

Year	Operation	Originator	Servicer	GBV (€ m)	Secured (% GBV)	OMV South (%)	OMV Resi (%)	Senior Note (% GBV, € m)
2019	**Pop NPLs 2019**	Multioriginator	Prelios, Fire	827	58.6%	69.2%	54.0%	20.9% (173)
2019	**BCC NPLs 2019**	Iccrea Banca	DoValue	1,325	80.8%	20.0%	44.2%	26.8% (355)
2019	**Iseo**	Multioriginator	DoValue	857	95.5%	28.3%	95.5%	39.1% (335)
2019	**Prisma**	UniCredit	DoValue	6,057	64.0%	38.6%	90.2%	20.0% (1,210)
2019	**Leviticus**	Banco BPM	Credito Fondiario	7,385	50.5%	11.4%	41.6%	19.5% (1,440)
2019	**Juno 2**	BNL	Prelios	968	57.7%	28.3%	34.8%	21.1% (204)
2018	**BCC NPLs 2018-2**	Iccrea Banca	doValue	2,004	58.4%	18.4%	36.9%	23.9% (478)
2018	**Riviera NPL**	Banca Carige	Credito Fondiario	964	48.8%	7.1%	40.6%	18.2% (175)
2018	**Aqui SPV**	BPER Banca	Prelios	2,082	59.5%	43.4%	36.2%	26.2% (545)
2018	**Pop NPLs 2018**	Multioriginator	Cerved	1,578	65.7%	22.2%	41.7%	27.0% (426)
2018	**Ibla**	BapR	doValue	349	67.2%	99.7%	57.8%	24.4% (85)
2018	**Maior SPV**	UBI Banca	Prelios	2,749	46.6%	20.4%	57.3%	22.9% (629)
2018	**Juno 1**	BNL	Prelios	957	30.4%	21.3%	29.2%	14.2% (136)

2018	**Maggese**	Banca di Asti	Prelios	697	**63.4%**	**1.6%**	**46.7%**	24.5% (171)
	BCC NPLs 2018	Iccrea Banca	Prelios	1,046	**70.9%**	**8.5%**	**39.3%**	27.0% (282)
	2Worlds	Banco Desio	Cerved	1,002	**71.6%**	**5.2%**	**44.4%**	28.8% (289)
	4Mori Sardegna	Banco di Sardegna	Prelios	1,045	**56.1%**	**87.2%**	**51.3%**	22.2% (232)
	Red Sea	Banco BPM	Prelios	5,113	**71.6%**	**11.5%**	**54.8%**	32.4% (1,657)
	Aragorn NPL 2018	Creval	Credito Fondiario, Cerved,	1,671	**75.4%**	**23.1%**	**43.4%**	30.5% (510)
	Siena NPL 2018	MPS	Credito Fondiario, Cerved, Juliet, doValue, Credito Fondiario, Prelios	23,939	**57.8%**	**35.2%**	**28.2%**	12.2% (2,918)
	FINO 1	UniCredit	doValue	5,376	**52.0%**	**34.6%**	**49.0%**	12.1% (650)
2017	**Bari NPL 2017**	BP Bari	Prelios	320	**56.1%**	**67.6%**	**43.0%**	25.3% (81)
	Elrond NPL	Creval	Cerved	1,405	**73.5%**	**36.3%**	**37.2%**	33.0% (464)
	Brisca	Banca Carige	Prelios	938	**77.2%**	**9.2%**	**60.3%**	28.5% (267)
2016	**Bari NPL 2016**	BP Bari	Prelios	480	**63.4%**	**65.9%**	**45.1%**	26.4% (127)
	Total			**71,134**	**65.0%**	**32.6%**	**48.1%**	**24.3% (13,837)**

Source: KPMG analysis from rating agencies' reports

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