

European NPL 2017 Review and Outlook: European NPL transactions to see sustained flow in 2018 as regulatory initiatives and increased investor interest fuels supply and demand.

With approximately €1tr of non-performing loans sitting on European banking books, NPL disposals were a key priority for banks during 2017. Italian institutions generated the majority of headline transactions, but Portugal, Greece and Spain were also responsible for noteworthy flow.

Securitisation played a key role in the NPL domain throughout 2017. A number of long-awaited transactions from UniCredit, Banca Carige and CreVal were completed in Italy, while Portugal's Caixa Economica Montepio Geral tested investor appetite for its debut NPL ABS and Greece's Attica Bank structured a bespoke NPL securitisation. Activity in the asset servicing sector added further dynamics to the NPL scene, with Italy leading the way with M&As and consolidations.

Private equity firms, meanwhile, were responsible for a handful of non-performing and re-performing loan securitisations, with deals backed by Irish portfolios sponsored by Mars Capital and Lone Star, and Spanish portfolios sponsored by Blackstone. 2018 looks set for sustained flows of NPL transactions across Europe, fuelled by increasing investor interest from overseas funds, along with impending regulatory initiatives such as European Banking Authority stress tests, implementation of IFRS 9 and the European Central Bank's NPL provisioning proposals.

"Italy has an NPL ratio between 16% and 18% and the benchmark in Europe is 2%-4%," said Vito Ruscigno, co-head of NPL and distressed assets at PwC in Italy. "An important deleveraging task still lies ahead."

ITALY

Securitisation

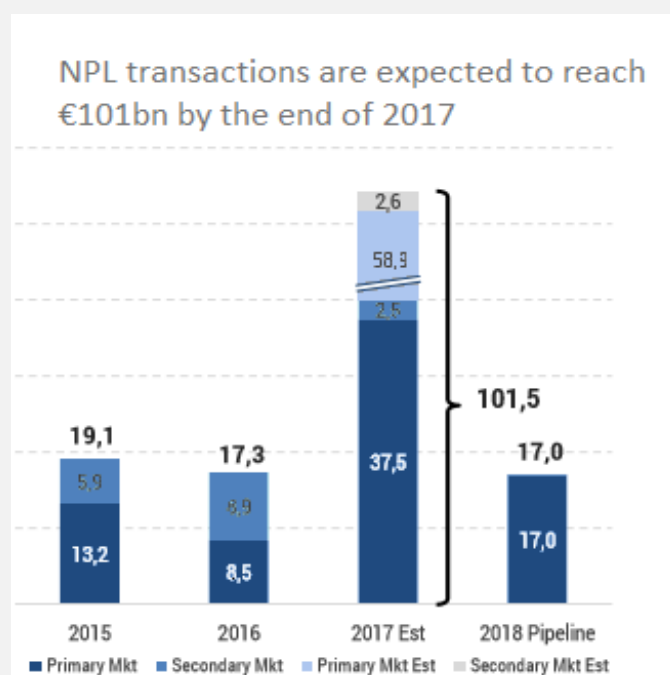
According to Banca IFIS, NPL transactions from Italy could reach €101bn in 2017. Furthermore, the increasing disposal trend is starting to have a positive impact on the net balance between new and closed bad-loan positions.

Securitisation has played a vital role in the offloading of NPL portfolios from Italian balance sheets, with the majority of investors opting to use securitisation SPVs to buy portfolios. Moreover, regulatory amendments proposed in June to Law 130 were deemed likely to further boost the appeal of securitisation SPVs by adding flexibility to the securitisation SPVs of NPL and UTP (unlikely to pay) loans. The amendments include the option for debt to equity swaps, the ability to restructure companies, and some additional features to help dispose of complex asset classes such as non-performing financial leasing contracts.

"The Italian NPL market is quite open and straightforward for investors that are able to purchase portfolios through the securitisation SPVs," commented Andrea Giannelli, partner at Legance. "The biggest barriers to entry in this market are competition for portfolios, as well as the need to have some sort of servicing capability, which is crucial to maximize the value of the portfolios purchased."

Publicly rated NPL securitisations from Italy came slowly but surely to the fore in 2017. Banks completing deals included Credito Valtelinese (**Elron**) and Banca Carige (**Brisca**), UniCredit (**Fino 1**) and Banca Popolare di Bari (Bari 2017 NPLs). The banks made use of the Italian governmental 'GACS' guarantee - available to senior tranches of publicly rated securitisations with a minimum Triple B rating. The scheme was renewed for 12 months in September this year, but its future is unclear in the context of the government election in 2018.

Of particular interest to ABS investors in 2018 will be the public marketing of GACS-guaranteed NPL ABS notes from UniCredit's Fino Securitisation 1. The bank has announced that it will be instrumental in creating a liquid market for NPL ABS by offering investors the GACS tranche - the first bank to do so. Other banks have opted to retain the GACS tranche, given its minimal risk weighting.



Source: Banca IFIS Market Watch NPL – The Italian Scenario, November 2017

Outlook

The pipeline is building for NPL deal flow from Italy in 2018. This includes bilateral portfolio trades as well as securitisations. Mr Ruscigno expects that around €60bn of NPLs will be offloaded by banks in Italy in 2018, including the deconsolidation of the NPLs of the two Venetian banks Veneto Banca and Banca Popolare di Vicenza, plus ongoing sales from banks such as UniCredit, Intesa and MPS.

Scope Ratings has forecast volumes of as much as €40bn-€45bn in gross book value (GBV) of sold assets in the NPL ABS sector. In its 2018 Structured Finance Outlook, the rating agency said it expects market-placed deals will continue to rise, with investor appetites driven by the improving expectations for real estate, following a house price correction of about 30% (real terms) since the 2008 peak.

This forecast is, however, sensitive to Banca Monte dei Paschi di Siena's potential €27bn (GBV) transaction. If it does not go ahead, the forecast may drop to around €13bn-€18bn in GBV, but this is in any case significantly more than what has been done in 2017 (around €8bn GBV so far).

Servicing Dynamics

Continuing the trend seen in 2016, consolidation and M&A within the Italian NPL servicing industry have been rife throughout 2017, as large investment houses and private equity funds bought into credit management companies or entered into joint ventures with local experts. Some opted to service captive portfolios; others are seeking to service portfolios across the market.

This month, for example, Banca Carige announced a binding agreement to sell its NPL management platform to Credito Fondiario in addition to a multi-year servicing agreement for a NPL portfolio. Earlier this year, Cerved entered into a JV with Quaestio, manager of the Italian rescue fund Atlante II, through which it obtained the right to manage half of the securitised portfolio from Monte dei Paschi di Siena (the 'Juliet' portfolio).

Other notable transactions included KKR's purchase of Rome-based special servicer Sistema, Varde Partners purchase of 33% of the equity of Guber, Bain Capital's acquisition of HARIT and David Kempner's acquisition of 44.9% of Prelios. In a move that bucked the M&A trend, however, Lone Star Funds sold its Italian NPL servicing business, CAF, along with a portfolio of NPLs to Lindorff-Intrum in December. CAF is one of the largest servicers of Italian NPLs and one of just a few rated credit management companies in Italy that can service exposed banks and certain securitisation vehicles for non-performing loan collection.

"We expect consolidation within the servicing industry to continue in 2018 as more international funds come to Italy to buy servicers or DCAs that are scalable," said Mr. Ruscigno. "We also expect more M&A activity between existing players in the servicing market, for example larger

servicers acquiring smaller ones that have a speciality in a certain asset class."

The servicing market remains polarised, however, with over half of the market's NPLs serviced by doBank, a platform owned by Fortress with estimated AUM between €80bn and €90bn NPLs in a market totalling €200bn. According to Massimo Famularo, Managing Director at Distressed Technologies, the market for NPL servicers will grow in the coming year. Along with the existing stocks of NPL exposures, there will be up to €130bn in UTPs, he said. "Trying to make an educated guess, we can expect that some 50% of UTPs will become non-performing."

The rate at which the servicing market is growing is not necessarily consistent with the pace at which the NPL market is growing and is thus a concern for some investors. "Investor interest in Italy's NPL stocks remains high and new regulations that are due to come into effect from January 2018 on NPL provisioning will incentivise sellers to offload portfolios," said Amelia Colvin, MD Global Head of Distressed and Non Performing Assets at Cadogan Securities. "However, the chief complaint from investors is lack of servicer capacity - particularly the ones with the right skills."

Overview of the top 10 servicers in Italy (data at 30/06/2017) - Ranking by revenues

Company	Revenues H1 2017 (€m)	Total bad loans AuM(€bn)	Other NPLs AuM(€bn)	Servicing Performing (€bn)	Master Servicing AuM (€bn)	Ebitda H1 2017 (€m)
do Bank	104.8	77.5	1.5	1.8	43.5	30.3
Cerved	46.0	12.1	1.5	11.7	-	11.9
MBCredit	39.5	5.0	-	-	-	18.4
Fire	20.8	2.4	0.5	0.4	-	1.0
Guber	18.9	8.9	-	-	-	n.a.
Adv. Trade	16.9	4.3	-	-	-	3.3
Cr. Fondiario	16.9	1.2	1.3	1.4	11.2	n.a.
FBS	12.7	8.0	0.1	-	-	n.a.
Cribis	12.0	2.1	12.9	7.6	-	n.a.
CAF	11.5	7.6	-	0.2	-	4.2

Source: PwC Italia's December 2017 NPL Report.

Greece

With €103bn of non-performing exposures, Greece has the largest NPL ratio in Europe. This market was subject to increased investor interest in 2017, with the outlook for 2018 looking promising. According to a recent survey by law firm Ashurst, 84% of investors surveyed highlighted Greece as one of their top two target markets in Southern Europe for investing in NPLs, while 75% of Greek financial institutions surveyed felt it was very likely they would bring a NPL portfolio to market in the next 12 months.

Notable transactions from the region in 2017 included the sale of a €3bn book of unsecured consumer loans from Eurobank (Project Eclipse) and a debut NPL ABS from Attica Bank. The NPL ABS involved the sale of securitised NPLs and shares in a NPL asset management company to Aldridge EDC Speciality Finance. The deal securitised a €1,045m non-performing loan book and was issued in the form of a €415m Series A bond and a €630m Series B bond.

Portugal

In Portugal, Caixa Economica Montepio Geral completed its first NPL ABS,¹ **Evora 2017-1**, and in doing so became the first NPL securitisation from Portugal. Backed by a portfolio of secured (47%) and unsecured (53%) NPLs from Caixa Economica Montepio Geral with a gross book value of €580m, the deal's equity and mezzanine tranches were placed in the market with the involvement of over 50 investors. The senior tranche was not sold to investors, however. The bank is rumoured to be working on a repeat transaction for 2018.

More broadly, Portugal has been subject to increased NPL sales activity and investor interest, against a backdrop of a recovering economy in 2017. It is estimated that around €4bn-€4.5bn in NPL portfolio sales will have been completed by year-end. And although the total value of NPL sales is not likely to be dramatically higher in 2017 than in 2016, the nature of the assets being sold is changing. Previously most NPL sales consisted of unsecured portfolios, but now portfolios are increasingly fully or partly secured.

Meanwhile three Portuguese banks - Banco Comercial Portugues, Caixa Geral de Depositos and Novo Banco - set up a joint platform to manage NPLs in 2017. The platform will manage distressed debt with a nominal value of €5m or more per debtor. The platform does not envisage sales, however.

Outlook

The outlook for NPL sales and securitisations from jurisdictions other than Italy looks promising for 2018. Moody's forecasts further transactions in 2018, from large banks, existing issuers, and private equity sources, as regulators continue to urge originators to clean up their balance sheets.

Moody's expects Ireland will remain at the forefront for specialist activity in NPL and reperforming loans through portfolio sales (year-to-date €2.3bn). Research analysts at Morgan Stanley predict opportunistic portfolio sales and securitisations to fund acquisitions seen in 2017 will continue in 2018, with AIB likely to play a bigger role. Moody's also expects more NPL activity from Portugal and Italy.

Meanwhile investor demand for other northern European NPL portfolios could lead to new markets being

developed, with Germany touted as one possible contender as incoming accounting and regulatory capital changes could incentivise banks to resolve NPL portfolios.

According to Kanav Kalia, director at Oxane Partners, there will be further deal flow from Italy in the coming months, but more so once deal flows dries up in Spain and other jurisdictions that are a hot target for investors at present.

"Currently, we are seeing a lot of traction in Spain, which is a top market these days considering Spain is going through one last splash of NPL portfolio sales," he said. "Also, the Spanish market has matured quite enough over the years, which is the reason a good portion of the deals are happening via the secondary market, adding further deal flow to the market. Other than Spain, we are also supporting investors in Portugal and we expect to see more deals there in the coming few months."

Market participants will meanwhile be keeping a keen eye on provisioning proposals, announced this year by the ECB and due to come into force in early 2018. The ECB announced Guidance on NPLs in March this year with a view to harmonising provisioning practices in European ECB-supervised banks. This was followed by an 'Addendum' in October, which proposed a prudential provisioning backstop that would require banks to fully provision unsecured NPLs over two years and secured NPLs over a seven-year period.

In early December the ECB said it would review the date from which it will apply the 'Addendum' to newly-classified NPLs. It will also review the wording and provide further clarifications in the final text. It is unclear, however, whether the ECB will also request that old stocks of NPLs be treated with the same provisioning as newly classified NPLs. Banks are waiting for the announcement in Q1 2018.

Morgan Stanley analysts said that while there is no uniform action plan yet, recent comments from the supervisor suggest that the ECB is reviewing plans submitted by banks and will be reaching out to those whose targets are not deemed feasible. "We think this translates into more NPL provisioning and more aggressive disposals next year, more so due to the stress tests that the EBA will run in 2018," they added.