Non-Performing Loans in Italy

How Do Investors Value Italy's Bad Loans?

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Size and Scope of the NPL Problem in Italy

- Italy is the 4th largest economy in the European Union
- European Central Bank (ECB) estimates of Italian NPLs equal to Euro 360 billion ($402 billion dollars) and continues to grow
- Public Debt to GDP is estimated at 135%
- Italy has a low employment rate and is considered among the weakest economies in the EU
- There are over 600 individual lending institutions in Italy; Consolidation must occur; No one solution fits all banks!

Size and Scope of the NPL Problem in Italy

- Delayed actions have had a negative impact on investor and consumer confidence
- Analysts at Berenberg estimate the Euro 360 billion of NPLs equates to 18 percent of banking system assets
- Analysts also fear that banks may be holding another Euro 45 billion which have yet to be deemed NPL
- Of the Euro 360 billion outstanding NPLs as much as Euro 200 billion was lent to borrowers already deemed insolvent. Of those, Euro 85 billion have not already been written down

NPL Issues Unique to Italy

- ECB has imposed restrictions on the Italian governments' so-called "bail-in" to rescue Italian banks
- Italian banks with support of the government sold senior subordinated debt (bonds) to 60,000 retail investors
- Approximately one-third to one-half of the Euro 60 billion of bonds were sold to small retail investors
- According to new EU banking rules (imposed by Germany) a large percentage of these small retail investors would lose money before a single Euro of public money can be used to rescue the faltering banking system
- The Judicial System in Italy is highly inefficient and historical precedents indicate that the average loan recovery can take up to eight years!

NPL Issues Unique to Italy

- Banks have written down bad loans to approximately 40 percent of original face value
- Actual recovery rate of NPLs from 2011-2014 amounted to approximately 40 percent of the original loan amount
- Savvy international NPL investors that have reviewed multiple portfolios of NPLs indicate that the current market value (trans-actable value) is between 18 to 20% of the original book value
- Goldman Sachs has estimated the GAP between the Bid-Ask price will require a capital infusion of approximately $38 billion to shore-up bank balance sheets. Credit Suisse estimated the banking sector will need Euro 30 billion to "solve the NPL issue"

NPL Characteristics in Italy

- NPL's are under-reported and over-valued based on investor reviews of sample portfolios
- As much as 80% of the borrowers are non-financial corporate borrowers
- Unlike in Ireland or Spain, the majority of Italy's nonperforming loans are not real estate secured (residential mortgages) or backed by real estate collateral
- Corporate unsecured loans have a historical low recovery rate and is highly dependent on an efficient judicial system
- A weak economy and lack of government consensus between the PM Matteo Renzi and Pier Carlo Padoan, Minister of Finance as to the appropriate actions to "kick-start" the economy has led investors to delay aggressive action for fear of "catching a falling sword"

Failed Government Efforts To Date

- M Matteo Renzi faced a political backlash over a Euro 3.6 billion rescue plan for four small banks after thousands of retail investors lost money and mounted protests. Mr. Renzi indicated that the government may have to pay a "social subsidy" to subordinated (junior) bond holders in saving Banca Etruria, Banca Marche, CariFerrara and CariChieti

- New "bail-in" rules to come into force next year (2017) will force losses on junior creditors before taxpayer funds can be used to rescue failed banks

- The ECB under its own pressures (and from those in Germany) will not allow the use of ECB funds to back-stop Italian government bail-in plans

- Government supported effort to create a fund (Atlante Fund I) was supported by a consortium of large banks

Failed Government Efforts To Date

- Atlante Fund I to date has been ineffective in changing the dynamics in Italy
- In 2015, a total of only Euro 19 billion of bad loans were sold at market value
- Recent efforts to fund Atlante Fund II a consortium of Italian pension funds has been met with mixed results and many complain that Atlante 2 was "over-paying" for NPLs at Monte dei Paschi

Investor Concerns

- There is no “organized process” for disposing of nonperforming loans in Italy
- The large GAP between the bid and ask price requires significant bank capital infusions in an environment where banks shares are down as much as 70-80%
- Investor and consumer confidence is at an all time low to be attempting to raise new capital for the banks
- Italy is facing weak economic prospects for recovery exacerbated by geo-political issues (migrants) and a slowing global economy

Investor Concerns

- Debtors are under no pressure to resolve debts given the weak judicial system
- Unlike Spain and Ireland that had a large amount of residential NPLs, there is no "benchmark" by which investors can value Italian NPLs
- The large percentage of unsecured corporate loans comprising Italian NPLs requires investor to have a strong onshore "servicing platform". To date investors have been reluctant to build these platforms due to a lack of disposal activity

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