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“Festina lente” in NPL management in Italy

“Festina lente”, (“make haste slowly”) was one of the favourite sayings of the Roman emperor August related to military operations¹. It could also be useful in the management of Non-Performing Loans.

International Monetary Fund: in Italy “NPL reduction strategies and targets needs to be ambitious and credible, aided by supervisory assessments of banks’ capacity to resolve NPLs in a realistic and timely manner”². “Timely”, in other words, “quickly”.

Usually, a quick solution for managing NPLs is their sale. One of the main problems is the “fair” transfer price. In Italy, buyers would like to pay less than 10% of the nominal value, a very low price, because the legal recovery proceedings last not less than 4/5 years, during which servicers must support management costs and pay interests on funding raised for the business. For sellers, this low prize would result in a strong capital loss.

In Italy, the impaired loans were 146 billion euros at the H1³ 2010, 341 H2 2015, 324 Q4 2016. The impaired loans / total assets ratio increased from 9,4% H1 2011 to 18,7% H1 2015, with a very small decline to 18,0% Q4 2016⁴. Experts forecast an explosion of NPL deals in 2017.

Deal prize in Q1 2017 was, in average, less than 10% of nominal value. Deal prize forecasts for 2017: 11% consumer, 33% secured⁵.

¹ “Nihil autem minus perfecto duci quam festinationem temeritatemque convenire arbitrabatur. Crebro itaque illa iactabat: σπεῦδε βραδέως (*Speude bradeos*). Et, sat celeriter fieri quidquid fiat satis bene”, Suetonius, *De Vita Caesarum*, 25.4 http://www.latin.it/autore/svetonio/de_vita_caesarum/!02!divus_augustus

² IMF, “Italy Staff Concluding Statement of the 2017 Article IV Mission” 12.6.2017 <https://www.imf.org/en/News/Articles/2017/06/12/ms061217-italy-staff-concluding-statement-of-the-2017-article-iv-mission>;
Carli Andrea, “IMF calls for additional measures on NPLs: they are worth 21% of Italian GDP” *Il Sole 24 Ore*, 28.7.2017 <http://www.italy24.ilssole24ore.com/art/business-and-economy/2017-07-27/fondo-report-154658.php?uuiid=AEpB3c4B>
Il Sole 24 Ore, July 28, 2017 - Andrea Carli.

³ H1 half first; Q4 quarter four.

⁴ Banca Ifis, “Market watch–Speciale NPL: la mappa dei crediti deteriorati realizzata da Banca Ifis” 20.4.2017 <https://www.bancaifis.it/comunicati-stampa/market-watch-speciale-npl-la-mappa-italiana-dei-crediti-deteriorati-realizzata-banca-ifis/>
“Market watch NPL – The Italian Scenario”, April 2017 https://www.bancaifis.it/wp-content/uploads/2017/04/Market-Watch-NPL-Aprile_-Stampa-20170420.pdf

⁵ Banca Ifis, “Market watch NPL – Italian scenario”: Italia, fucina di NPL, 104 miliardi complessivi saranno venduti entro il 2017. Prezzi medi tra l’11% (consumer) e il 33% (secured)” 17.7.2017 <https://www.bancaifis.it/comunicati-stampa/market-watch-npl-italian-scenario-luglio/>
Banca Ifis, “Market watch NPL – The Italian Scenario”, July 2017 https://www.bancaifis.it/wp-content/uploads/2017/07/Market-Watch-NPL-July-2017_-Stampa_20170717.pdf

“ ... in Italy there are so many problems that the value of loans drops. The first is the slowness of the legal system: ... if bankruptcy procedures could be reduced by two years (currently last on average 7.8 years), prices would increase by 10-12%. The second is the inefficiency of banks in handling these claims; .. it should be necessary a sort of ‘face lift’ for portfolios bad loans, this means sorting the loans by computer, breaking them down by type of loan and by geographic area. Then, there’s the real estate problem; .. there are 500,000 real estate executions pending, but in the 2015 auctions were closed for only 12,000 properties ... and there is a huge problem related to values of real estate in areas on city outskirts, .. which are very depressed”.

Longo Morya, “Italian non performing loans in search of a price”, *Il Sole 24 Ore*, 31.1.2017 <http://www.italy24.ilssole24ore.com/art/markets/2017-01-31/npls-eba-plan-131515.php?uuiid=AEFFZHL>

But it seems that Italy is on the way to recovering a “*meditated, patient NPL management*” as well, as already tested; it will not be very quick, but it will bring interesting results.

In 1996 Banco di Napoli, one of the biggest Italian bank, had strong financial problems and its assets were almost completely cleared. The rescue plan was very complex. Amongst others:

- 6,3 billion-euro impaired debts (38,000 risk positions) transferred to a special vehicle (*Società per la Gestione delle Attività S.G.A. s.p.a.*), at a transfer value in line with the expected realizations, i.e. the 70 (SEVENTY) % of the nominal value (i.e. 4,4 billion euro);
- a funding by the Bank of Italy to purchase the bad loans at a 1% borrowing rate; money to be invested in BTP-public bonds (7% interest rate), to be pledged to guarantee the funding.

Twenty years later, in 2016: 5,6 billion-euro impaired debts (34,000 risk positions) recovered, i.e. the 89% of the price paid to acquire them in 1996. With various recovery ratios (revenues / price paid) according to the different cluster of risk positions:

- up to 154 thousand euro, 140% recovery ratio (22,300 risk positions);
- from 155 to 515 thousand euro, 93%;
- from 516 to 2,600 thousand euro, 87%;
- over 2,600 thousand euro, 83%.

An average recovery ratio of 92%, which lowers to 89%, if you consider a 3% related to the costs of legal proceedings (a very low amount). And, last but not least, 500 billion-euro profit reserves ⁶. How was it possible?

Four main reasons:

- in 1996 the impaired debts transferred to the S.G.A. had already been written off by 30%;
- from 1996 to 2007 the values of real estate rose twice as much (and from 2008 to 2016 they fell by 30%);
- until the early Nineties the mortgage loan to value was rarely higher than 50% (it increased until 90-95% in the subsequent years, until 2008);
- the financing by the Bank of Italy for the purchase of bad loans was granted at a 1% borrowing rate, the revenue was at 7% (“*a kind of quantitative easing ‘ad bancam’*” ⁷).

⁶ Italian Parliament, “*Disposizioni in materia di procedure esecutive e per investitori in banche in liquidazione – Schede di lettura – D.L. 59/2016 – A.S. n. 2362 . Article 7*”, May 2016

<http://documenti.camera.it/leg17/dossier/pdf/D16059.pdf>

Occorsio Eugenio, “*Roberto Romagnoli il Re Mida degli Npl: così il Banco di Napoli è diventato un affare*”, la Repubblica, Affari & Finanza, 3.7.2017, page 6

http://www.repubblica.it/economia/affari-e-finanza/2017/07/03/news/roberto_romagnoli_il_re_mida_degli_npl_cos_il_banco_di_napoli_diventato_un_affare-169825823/

⁷ Marchesano Mariarosaria, “*Miracolo bad bank – La vera storia della Sga a venti anni dal crac del Banco di Napoli*”, Guida editori, &goWare, 2016

Zingales Luigi, “*What Banco di Napoli’s non-performing loans can teach the Atlante Fund*”, “*How Many Non-Performing Loans Are Hidden in the ‘Unlikely to Pay’?*” e “*Quel ‘tesoretto’ della bad bank del Banco di Napoli*” in *Il Sole 24 Ore*, 7 / 14 / 20.8.2016

<https://europaono.com/2016/08/08/zingales-cosa-insegnano-ad-atlante-sofferenze-del-banco-napoli-what-banco-di-napolis-nonperforming-loans-can-teach-atlante-fund/>

<https://europaono.com/2016/08/15/quante-sofferenze-si-nascondono-negli-incagli-how-many-non-performing-loans-are-hidden-in-the-unlikely-to-pay/>

<http://www.ilsole24ore.com/art/commenti-e-idee/2016-08-20/quel-tesoretto-bad-bank-banco--napoli-204514.shtml?uuid=ADmk807>

Nonetheless, in my opinion, there is another reason: the very low amount of the cost of legal proceedings, as a result of “*a meditated, patient management*” (Bank of Italy)⁸. According to Roberto Romagnoli, who was S.G.A. leader for many years, “*Legal actions must be taken but every debtor is a person and it is necessary to pursue, with infinite patience and diplomacy, a communication with him, looking for a compromise*”.

Therefore, NEGOTIATION IN BANKRUPTCY doesn't only prove useful to prevent NPLs⁹ but also to manage them. And S.G.A., from now on, will have an essential role in developing a balanced asset management in Italy.

Another interesting initiative is the Bill filed in Parliament in March 2017. For debts up to 500.000 euro each (59 billions euro overall, about 10 millions risk positions), the debtor might ask the bank to buy the debt, written among NPL, at the value entered in the bank's balance sheet or at the price at which it would be sold to third parties¹⁰. A potential huge saving in judicial proceedings, time and money. Will it be approved ?

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⁸ “*Banche venete, Bankitalia, lo Stato non ci perde, forse ci guadagna*”, Ansa 23.6.2017
http://www.ansa.it/sito/notizie/economia/2017/06/23/banche-veneteclima-positivo-a-bruxelles_f9c38d5a-a6a6-475d-8a8d-6d23377a2808.html

⁹ Matteucci G., “*Early disclosure of business crisis in Italy*”, Eurofenix Spring 2017, page 28
<https://www.insol-europe.org/publications/eurofenix-past-issues>

¹⁰ Capozzi Fiorina, “*Banche, alla Camera la proposta per agevolare i piccoli debitori. Che non piace a chi specula sui crediti deteriorati*”, Il Fatto Quotidiano, 26.3.2017
<http://www.ilfattoquotidiano.it/2017/03/26/banche-alla-camera-la-proposta-per-agevolare-i-piccoli-debitori-che-non-piace-a-chi-specula-sui-crediti-deteriorati/3451341/>