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The Italian NPL market

Why investing in
Italy?

April 2011



Foreword & Content

Foreword

Given the recent increase in activity on loan portfolios in a number of key banking jurisdictions across Europe, including Italy, and the complexity of the Italian NPL market, we thought useful sharing the main features of the current market and the reasons on why this market might be interesting from an investor perspective.

As per our extensive experience in advising both buyers and sellers in the main NPL deals arranged in Italy we would be happy to provide you with further insights on such market and on how turning your investment goals into a successful transaction.

Kind Regards

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Content

1. **The macroeconomic and real estate market environment**
2. **The Italian banking system in a nutshell**
3. **Do banks need to urgently sell NPLs?**
4. **How big is the Italian NPLs market?**
5. **The NPLs management**
6. **Past NPLs transactions and investors interest**
7. **Closing remarks**

1 The macroeconomic and real estate market environment

A slow moving economy but with a liquid Real Estate market

After a negative trend in 2009, Italian GDP recorded a positive result (+1,3%) and is expected to grow over the next couple of years, even if at a slow pace.

Unemployment rate in 2010 stands at 8,5%, below Euro area average (10,6%) and is expected to remain stable¹.

In 2010 the amount of loans to Italian non financial institutions increased by 1,6%, versus an average of 0,4% of the Euro area countries, thus confirming the positive attitude towards the Italian system².

Real estate market has been more stable than other European countries during the 2008-2009 turmoil period and has booked a +1,6% increase in turnover volumes in 2010, driven by commercial and residential, versus a 0,7% average Euro area. This is also due to the high saving rate of Italian families and the common investment of Italians in the housing market (ca. 80% of Italians live in a property house).

In terms of real estate price trend, 2011 is expected to start to grow again after the downwards results achieved in 2009 and 2010, which resulted, in any case, lower compared to other European Countries.

Key Message: Despite the slow economic growth, in Italy the lending business to individuals and corporates grow more than other European countries and the real estate market volumes and prices are more stable, due to the saving rate and the common investment of Italians in the real estate market

1. Source: Eurostat data
2. Source: ABI Monthly Outlook – February 2011

Table 1: GDP data

	GDP - percentage change on previous year			
	2009A	2010F	2011F	2012F
Italy	-5,2%	1,3%	1,1%	1,4%
France	-2,6%	1,6%	1,6%	1,8%
Germany	-4,7%	3,6%	2,2%	2,0%
UK	-4,9%	1,3%	2,2%	2,5%
Spain	-3,7%	-0,1%	0,7%	1,7%
Euro Area (16 countries)	-4,1%	1,7%	1,5%	1,8%

Source: Eurostat

Table 2: Real Estate turnover

Country	2010F Volumes	% Change YoY				
		2007	2008	2009	2010F	2011F
Italy	111.500	4,9	-3,6	-10,0	1,6	2,7
of which: Residential	91.200	5,0	-4,3	-10,1	1,9	NA
Offices	7.000	7,1	1,3	-6,6	-1,4	NA
Commercial	7.800	4,1	2,6	-2,6	2,6	NA
France	135.150	3,0	-1,2	-18,7	0,8	2,5
of which: Residential	67.900	3,7	-0,4	-27,9	0,4	NA
Offices	26.450	2,1	0,0	-6,8	1,0	NA
Commercial	19.100	3,2	-2,6	0,0	2,2	NA
Germany	166.600	4,8	-0,5	-9,6	2,4	3,4
of which: Residential	96.900	5,5	-0,4	-13,6	1,5	NA
Offices	26.500	3,5	-1,3	-1,3	2,3	NA
Commercial	29.600	4,0	1,1	-0,4	4,6	NA
UK	112.300	2,7	-2,0	-11,3	1,4	1,5
of which: Residential	45.500	3,6	-0,8	-18,4	0,7	NA
Offices	27.000	2,1	-3,5	-6,8	4,2	NA
Commercial	28.000	2,7	-2,0	-11,3	1,4	NA
Spain	74.700	7,3	-7,9	-17,6	-5,0	-1,6
of which: Residential	36.600	7,7	-12,9	-24,7	-5,7	NA
Offices	12.500	4,3	1,4	-9,9	-5,7	NA
Commercial	13.200	7,3	-7,9	-17,6	-5,0	NA
Avg EU 5	600.250	4,4	-2,6	-13,3	0,7	1,2
of which: Residential	338.100	5,0	-3,1	-18,0	0,4	NA
Offices	99.450	3,1	-1,0	-5,8	1,1	NA
Commercial	97.700	3,6	0,2	-1,2	1,9	NA

Source: European Outlook 2011 - Scenari Immobiliari

Table 3: Real Estate price change

Country		% Change YoY		
		2009	2010F	2011F
Italy	Residential	-6,5	-2,5	1,2
	Offices	-2,5	-1,4	0,3
	Commercial	0,5	1,0	1,7
France	Residential	-9,5	1,2	2,0
	Offices	-3,1	-1,4	0,0
	Commercial	-5,2	-2,3	0,5
Germany	Residential	-5,0	1,5	4,0
	Offices	-7,3	-2,1	1,5
	Commercial	-0,2	0,3	1,2
UK	Residential	-25,0	-3,2	-1,0
	Offices	-10,5	-2,4	0,7
	Commercial	-5,6	-4,7	-2,1
Spain	Residential	-20,3	-10,6	-2,5
	Offices	-15,2	-5,6	-1,7
	Commercial	0,5	1,0	1,7

Source: European Outlook 2011 - Scenari Immobiliari

2 *The Italian banking system in a nutshell*

The industry landscape

The Italian banking system includes about 500 credit institutions³. These institutions are mainly represented by banking institutions (groups or individual banks) (ca. 91%) and the remaining part by specialized credit institutions (financial intermediaries – ex art 107) active mainly in the leasing, consumer credit and factoring business.

All credit institutions can be broken down in the following 5 clusters⁴:

- Top – which include the first 2 banking groups with extensive international activities
- Large – which include the subsequent 5 credit institutions with mainly domestic operations and a national coverage
- Medium – which include the subsequent 13 credit institutions having a multiregional presence
- Small – which include the subsequent 79 credit institutions active on a regional / local basis, and
- Mutual and saving banks: about 400 institutions, most in the form of cooperative

Despite its fragmentation, the industry is pretty much concentrated, being 48% of the customer loans provided by the 2 major groups, 71% by the 7 major groups and 87% by the first 20 groups.

Key Message: Investing in the assets of the first 7 Italian credit institutions gives access to almost two third of the existing lending business and provides to a good geographical diversification

Table 4: Customer loans by cluster

Clusters	Asset Range (bn €)	# Institutions	% of total customer loans	Credit Institutions included
Top	Above 600	2	48%	Unicredit and Intesa SP
Large	60-600	5	23%	MPS, Banco Popolare, Ubi Banca, BNL and Mediobanca
Medium	15-60	13	16%	BPER, Dexia, BPM, Cariparma, Carige, BP Vicenza, Credem, DB, CreVal, BP Sondrio, Veneto B., B Marche, ICCREA
Small	Below 15	79	7%	B. Sella, UGF, Findomestic, Fideuram, B. Etruria, Mediolanum, Santander, etc
Mutual & saving banks	Below 15	ca 400	6%	BCC, Casse Rurali, Casse Raiffeisen

Source: PwC estimate based on 2009 Fast ABI data

The Italian assets value

According to Bank of Italy /ABI data, at the end of 2010⁵ loans provided by domestic credit institutions to residential customers equal to €1,846 bn, of which €493 bn provided by the banking institutions to families (mainly in form of first lien mortgages) and €968 bn to non financial institutions (mainly corporate and, the remaining part, public entities).

Most of customer loans are represented by loans and advances, while the financing through leasing counts for ca. 6.3% of the total customer loans, consumer credit for ca. 5.1% and the factoring business for ca 0.8%⁶.

Key Message: Out of €1,846 bn loans, €493 bn are provided by the banking institutions to families, mainly in the form of first lien mortgage

3. PwC estimate based on 2009 Fast ABI data.

4. Clusters have been identified according to the credit institutions ranking by 2009 total assets as per Fast ABI data

5. PwC estimate based on ABI Monthly Outlook – March 2011 (Summary) and Bank of Italy data (Bollettino Statistico)

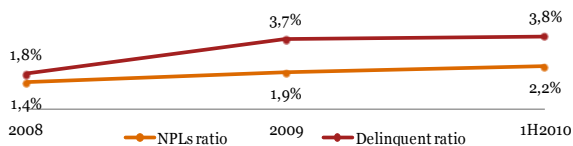
6. The breakdown has been estimated by PwC based on Bank of Italy data (Bollettino Statistico)

3 Do banks need to urgently sell NPLs?

A worsening in the asset quality

With no surprise the asset quality in the last 3 years has worsened. Focusing on the 3 clusters⁷ Top, Large and Medium above mentioned, the net NPLs ratio (NPLs defined as “sofferenze” as per Bank of Italy criteria over customer loans) raised from 1.4% (2008) to 2.2% (June 2010). In this context, also the Delinquent ratio moved up to 3.8%, with Delinquent defined as all loans in arrears classified, according to Bank of Italy, in “esposizioni scadute e/o sconfinanti”, in “partite incagliate” and as “esposizioni ristrutturare”.

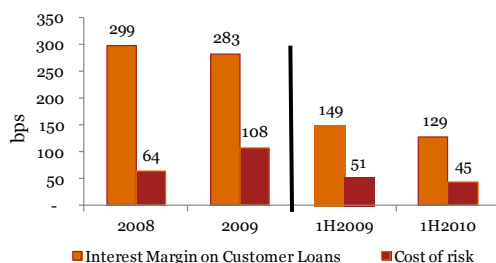
Chart 1: Top, Large and Medium clusters – NPLs and Delinquent ratios (net of provisioning)



Source: PwC analysis on June 30, 2010 FAST ABI data

For the same panel of banks, the consequence of the worsening in the asset quality has been an increase of the banking provisioning (Cost of Risk⁸), eroding banking profitability as shown in Chart 2.

Chart 2: Top, Large and Medium clusters – Interest Margin and Cost of Risk trend (in bps)



Source: PwC analysis on June 30, 2010 FAST ABI data

Any pressure for assets sale?

Despite the raise of the NPLs stock provided by the worsening in asset quality and the structural lengthy legal process in the recovery management, compared to other European markets, Italian banks have not disposed of significant volumes of assets over the last three years. Though, in Q1 2011 the market has shown clear signs of awakening.

As usual, transactions will be driven by capital relief needs and by the capacity of the credit institutions' balance sheet to absorb losses.

With respect to capital needs, the new Basel III framework will add further tensions to capital management officers who have already a hard job in managing the asset growth. According to the Bank of Italy estimate, the impact of the new reform will be equal to €40 bn as additional capital required. The estimate was run on June 2010 figures of the 22 Italian banks⁹ participating to the Quantitative Impact Study of Basel III conducted by the Basel Committee and the CEBS.

Key Message: There is not a urgency in reducing NPLs, but the structural lengthy in the legal recovery process, the growth in the lending business, Basel III requirements and the increase in revenues will inevitably drive to asset sales

On the other hand, in terms of revenues and the capacity to absorb losses, the Italian banking system has shown signs of improvement in the last years: banks included in the Top, Large and Medium clusters⁷ increase revenues of a CAGR of 12% from 2006 to 2009, reaching in Dec 2009 €74.4 bn and in June 2010 €35.7 bn. Pressure though remain given the financial market dynamics (funding shortage/cost), macroeconomic conditions and regulatory costs (protection of investors/clients, transparency and tariffs).

7. With the exception of Dexia given its peculiar business and ICCREA given the unavailability of the data

8. With Cost of Risk calculated as the ratio between the provisioning on the NPLs and the total customer loans (gross of provisioning)

9. The 22 banks count for a 75% of the total assets of the Italian banking system

4 How big is the Italian NPL market?

NPLs market size

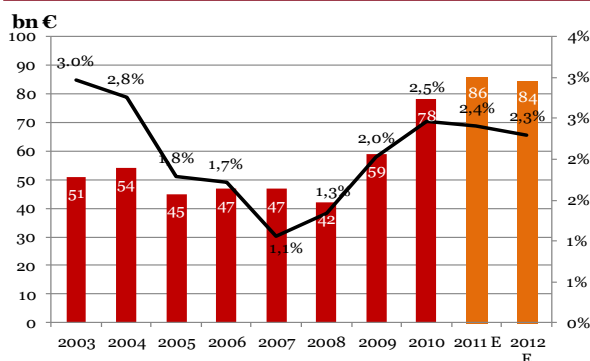
The gross NPLs stock significantly increased in the period 2008 – 2010 (CAGR at 36.3%) reaching €78 bn in December 2010. ABI outlook suggests a further increase in 2011 and a slight decrease for 2012¹⁰.

The vivid recent grow is even more evident in comparison to the last year figures at the European level: in 2010 the Italian NPLs stock grew by 32% while the UK, Spanish and German market grew, respectively, at a rate of 14%, 11% and 7%.

In terms of the ratio between the NPLs and the customer loans (NPLs ratio – net of provisioning), this has increased significantly in the last years reaching 2.5% in 2010. In the next 2 years this ratio is expected to decrease given the combined effect of the deceleration of NPLs growth and the increase in customer loans.

In terms of coverage ratio (provisioning over gross NPLs value), at the end of 2010, the value was equal to 39.7%¹⁰.

Chart 3: Trend of gross NPLs stock and net NPLs ratio



Source: PwC analysis on Bank of Italy / ABI data as per ABI Monthly Outlook – February 2011

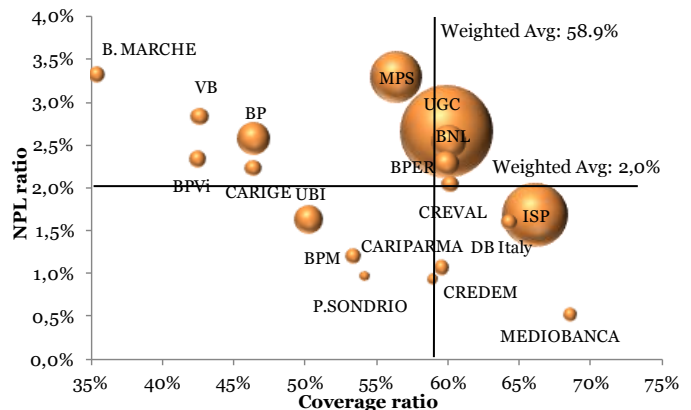
Peer analysis

Chart 4 shows the results of a peer analysis in terms of NPLs ratio and coverage ratio among the credit institutions included in the Top, Large and Medium clusters⁷, while the size of the bubbles represent the size of gross NPLs value.

The peer analysis illustrate the wide range existing among different credit institutions in terms of coverage ratio, spanning from 35.4% to 66.2%. All remaining conditions equal, Mediobanca, Intesa San Paolo (ISP) and Deutsche Bank Italy (DB Italy) are better positioned for a sale.

The overall positioning into the below chart, could be considered just indicative of the best potential strategic options of the bank for its assets (i.e. sell, outsource, hold), due to the need for a portfolio stratification analysis which might highlight different coverage ratios among asset classes and hence different strategies to follow.

Chart 4: Top, Large and Medium clusters – June 30, 2010 NPLs peers analysis¹¹



Source: PwC analysis on June 30, 2010 FAST ABI data

10. Figures and forecast provided by the Bank of Italy / ABI in the ABI – Monthly Outlook – February 2011

11. Definitions: B. MARCHE = Gruppo Bancario Banca delle Marche, BPM = Gruppo Bipiemme, BP = Gruppo Banco Popolare, BPER = Gruppo Banca Popolare dell'Emilia Romagna, BNL = Gruppo Bancario Banca Nazionale del Lavoro, BPVI = Gruppo Bancario Banca Popolare di Vicenza, CARIGE = Gruppo Carige, CARIPARMA = Gruppo Bancario Cariparma Friuladria, CREDEM = Gruppo Credito Emiliano, CREVAL = Gruppo Credito Valtellinese, DB Italy = Gruppo Deutsche Bank, ISP = Gruppo Bancario Intesa Sanpaolo, MEDIOBANCA = Gruppo Bancario Mediobanca, MPS = Gruppo Monte Paschi di Siena, P.SONDRIO = Gruppo Banca Popolare di Sondrio, UBI = Gruppo Unione di Banche Italiane, UGC = Gruppo Unicredit, VB = Gruppo Bancario Veneto Banca

5

The NPLs management

The recovery management

The collection of a NPL in Italy is driven not only by the ability of the servicer or the quality of the claim, but also by external factors, among which the legal framework for mortgage loans plays a relevant role.

In comparison to other jurisdictions, the Italian judicial system is fragmented and legal enforcement procedures are complex and lengthy, judicial competence for solving a dispute is split between several different courts and will depend on the property's geographical location and the type of legal action being undertaken.

It takes an average of five to seven years for a foreclosure procedure on a real estate property in Italian courts to be completed, from the time lawyers are instructed to the time an auction date is set for the sale of the property. Occasionally procedures last more than 10 years whereas some recent foreclosure procedures, incepted after the introduction of some changes to the regulation, reached the sale process in less than 3 years. The speed of the process varies from court to court, due to differences in staffing, workload, the extent of computerised records available, and work ethic.

As a consequence of the length of the recovery legal process, often extrajudicial agreements could be the best viable route even in case of a secured asset and the choice on the recovery strategy to follow can have a strong impact on the servicer performance.

Key Message: Given the complexity of the recovery process, a change in the Servicer might lead to improve recovery performances

Who service the NPLs?

The servicing of NPLs in Italy is carried out by three kind of players:

- Internal Recovery Departments – an internal department within the credit institution who manage the NPLs
- Captive Special Servicers – Specialized product companies within banking groups for recovering NPLs and for acting as the group service organization for their management (ex. Unicredit Credit Management Bank, Gestione Crediti Banca MPS, etc)
- Non Captive Special Servicers – Independent operators servicing both domestic banks or international investors (Italfondionario, Pirelli RE Credit Servicing, etc)

A list of the main Italian NPLs Special Servicers follows:

Table 5: NPLs Special Servicer main players

Company	AUM (GBV mln)	AUM reference date & source	# of employees	Servicer Evaluation Rating (where publicly available)
CAPTIVE SPECIAL SERVICERS (with eventually third party business)				
Unicredit -Credit Management Bank	32,996	30 Nov 2009 S&P Report	738	S&P - STRONG May 2010
Gestione Crediti Banca MPS	12,000	31 Mar 2010 S&P Report	292	S&P - ABOVE AVERAGE Jul 2010
SGC Banco Popolare	3,116	31 Dec 2009 Annual Report	n.a.	n.a.
BCC Gestione Crediti	n.a.	n.a.	15	n.a.
NON CAPTIVE SPECIAL SERVICERS				
Italfondionario	28,680	31 Dec 2009 Annual Report	427	S&P - STRONG Aug 2010
Pirelli RE Credit Servicing	8,649	30 Jun 2009 S&P Report	276	S&P - STRONG Apr 2010
Archon Group Italia	2,236	31 Mar 2010 S&P Report	143	S&P - STRONG Sep 2010
Guber	1,700	30 Apr 2010 S&P Report	100	Fitch - CSS2 & RSS2 Nov 2010
FBS	1,485	31 Dec 2009 Report S&P	109	S&P - ABOVE AVERAGE Jun 2010
Jupiter Finance	n.a.	n.a.	21	n.a.
Toscana Finanza	1,033	31 Dec 2009 Annual Report	n.a.	n.a.

Source: PwC analysis based on Annual Reports and Servicer Evaluation Rating report available

6 *Past NPLs transactions and investors interest*

NPLs deals

The introduction of the securitisation law in 1999 (Law 130/99) allowed for the development of a flourish market for NPL transactions with the entrance of international investors.

In the 2005-2007 period, the strong competition on large size transactions and the low expected returns (function of the low interest rates and market liquidity) allowed for a sensitive NPLs price increase.

In 2008, the increase of the interest rates, the liquidity crisis and the insufficient transparency of some sale processes, determined a price gap between sellers and potential buyers with no significant transactions.

In 2009 and 2010, the financial crisis induced different investors to abandon the NPLs market, while other investors, even if virtually active, remained silent with the consequence of no market activity.

In 2011, we observe a renewed interest toward the NPLs market and we envisage a re-opening of the market.

Key Message: The NPLs market is a mature market with a friendly legal framework introduced in 1999 by the securitisation law

Table 6: Main NPLs public transactions closed from 2005

Year	Seller	GBV (€mln)	Asset type	Buyer
2010	Non-Performing Loans Spa	39	Secured	Sagittaria Finance Srl
2010	Cross Factor Spa	4	Consumer loans	Agathos Finance Srl
2009	Cross Factor Spa	7	Consumer loans	Agathos Finance Srl
2008	Banca Pop. Cento	101	Mixed S / U	NPLs Spa
2007	Antonveneta	2,610	Mixed S / U	Pirelli Re e GE
2007	Credito Valtellinese	140	NA	Finanziaria San Giacomo (CreVal)
2006	Unicredit	2,300	Secured	Pirelli Re
2007	BNL - BNPP	1,500	Secured	Pirelli Re
2006	Antonveneta	955	Mixed S / U	GE e ABN Amro
2006	BPVN	195	Secured	Pirelli RE
2006	Unicredit	1,700	Mixed S / U	GE, ABN Amro e Tecnocasa
2006	BPI	925	Mixed S / U	Maya Fin and Teseo Fin (ABN Amro & WestLB)
2006	Banca Pop. Etruria	132	Mixed S / U	Deutsche Bank
2005	Monte Paschi	190	Mixed S / U	Lehman Fund
2005	Centrobanca	107	Secured	Tersicore Finance Srl - WestLB
2005	San Paolo	270	Secured	ABN Amro
2005	BNL - BNPP	290	Secured	Goldman Sachs
2005	BNL e FIM	400	Mixed S / U	Cairol Finance (Intesa SP)
2005	Banca Intesa	9,067	Mixed S / U	Merrill Lynch e Fortress
2005	BNL - BNPP	900	Mixed S / U	Pirelli RE e Morgan Stanley

S= Secured Mortgage Loans; U=Unsecured Loans

Source: PwC summary on public available information

7

Closing remarks

- *With €78 bn of NPLs in the books of the Italian banks, Italy is a sizable market*
- *In terms of asset quality, the Italian lending business is characterized by a good percentage of secured lending. The high saving rate of Italian families and the high propensity for a purchase of a property house (ca. 80%), drive Italian banks to be exposed for a relevant part of their books to families (€493 bn in 2010), mainly acquiring a first lien mortgage.*
- *The Italian real estate market has been less affected than the market of other European countries during the 2008-2009 turmoil period, both in terms of turnover volumes and in terms of price change, confirming the overall stability of the market*
- *Given the concentration of the Italian industry, acquiring NPLs from the first 7 Italian credit institutions give access to a good percentage of the NPLs market and to a good geographical diversification*
- *Despite Italian banks seem not to be in a rush of selling their NPLs, we expect that the increasing stock of NPLs (due in part to the structural lengthy in the legal recovery process), the growth in the lending business, Basel III additional capital requirements and, finally, the increase in revenues will drive them to NPLs sale transactions starting from 2011*
- *The legal framework for NPLs transactions is pretty friendly and based on a robust law introduced in 1999 (the securitisation law)*



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