The Italian Unlikely to Pay Market

A big opportunity

Contacts

Pier Paolo Masenza
Partner
M: +39 348 2505003
pierpaolo.masenza@it.pwc.com

Stefano Senatore
Senior Manager
M: +39 346 0690033
stefano.senatore@it.pwc.com
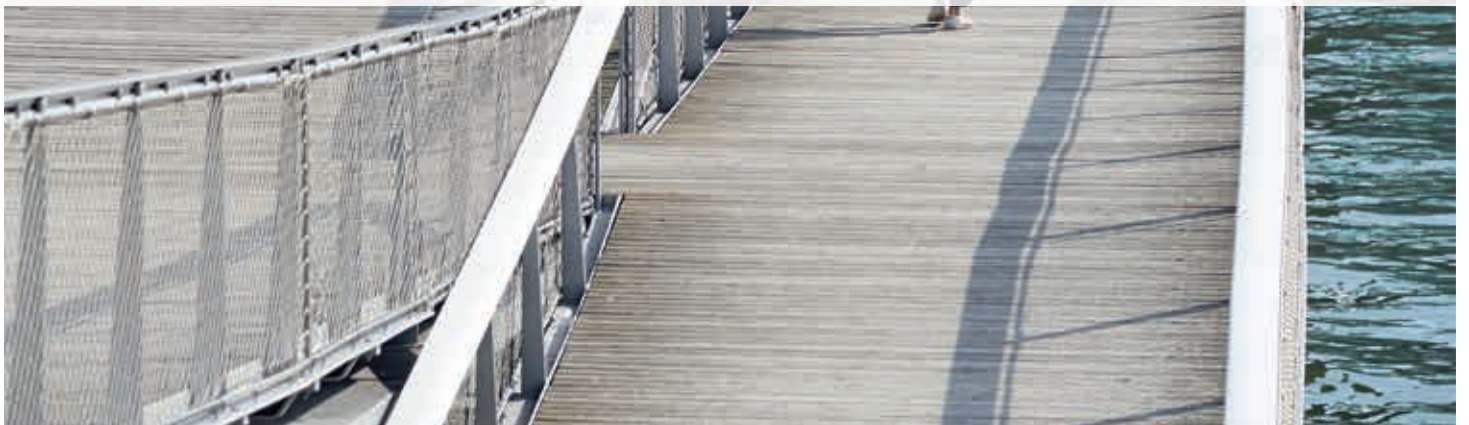
Contributors

Napoleone Del Gallo Di Roccagiovine

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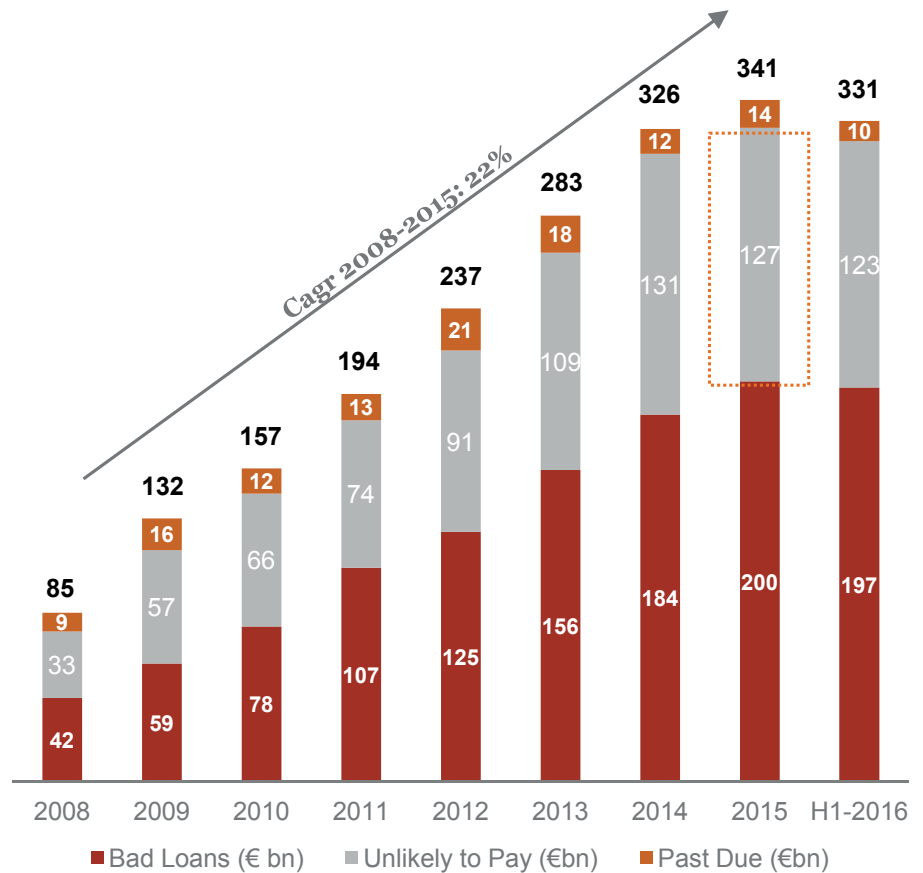# *The Italian Non Performing Exposure market*

Asset Quality

The Italian banking market continues to experience challenges surrounding asset quality with NPE at €331bn at the end of Jun 2016.

After reaching its peak at the end of 2015 at €341bn (Cagr 2008-2015 @22%), the Italian NPE recorded a 3.1% decrease in 1H2016.

The UTP, 37% of total NPE in 1H16, experienced a decreasing trend starting from 2015 and such trend is confirmed in 1H2016. The declining trend of UTP is driven by lower inflows from performing and past due.

	2008	2009	2010	2011	2012	2013	2014	2015	H1-2016
Total	85	132	157	194	237	283	326	341	331
Past Due (€bn)	9	16	12	13	21	18	12	14	10
Unlikely to Pay (€bn)	33	57	66	74	91	109	131	127	123
Bad Loans (€ bn)	42	59	78	107	125	156	184	200	197

Cagr 2008-2015: 22%

Starting from 2018, we expect that a higher portion of performing loans might be at risk to be reclassified as under-performing following the introduction of a different valuation approach (from "ex post" to "forward looking").

The transition to IFRS 9 (from IAS 39) will be critical as banks will be required to accrue provisions based on expected losses and not only upon the occurrence of specific events (e.g. "impairment tests"). Banks will be asked to adopt a "forward looking" approach and as such to anticipate losses at the first signals of deterioration. As a result, specific instruments as well as right structure and skilled people to proactively monitor borrowers' performances will be required.

The Unlikely to Pay segment
An opportunity to make a change

1 Unlikely to Pay distribution among top 20 banks

At the end of June 2016, the UTP exposure amounted to €123bn showing a declining trend vs YE2015 (-3%). 92% of the overall amount is concentrated within the top 20 Banks

UTP among top 20 Italian banks

The overall UTP exposure is highly concentrated within the top 10 Italian banks (81% of the total UTP exposure); when considering the top 20 Italian banks, such percentage reaches 92%.
In 2016, the UTP exposure declining trend, started in 2015 (-3% from YE2014 to YE2015), is confirmed.

However, there have been few exceptions like Banca Popolare di Vicenza and Veneto Banca that recorded a different trend (Vicenza +4.7% and Veneto +6% in June 2016 vs December 2015).

	11.	BPM	2.6
	12.	Credito Valtellinese	2.5
	13.	CA Cariparma	2.3
	14.	BP di Sondrio	1.8
	15.	Iccrea	1.3
	16.	BP di Bari	1.0
	17.	CR di Bolzano	0.6
	18.	Banco di Desio	0.6
	19.	GE Capital	0.5
	20.	CR di Cesena	0.5
		Others	10.0

	UniCredit	Intesa Sanpaolo	MPS	Banco Popolare	UBI	BNL	BPVI	BPER	Veneto Banca	Gruppo Carige	Others	GBV total 31Dec2015	Change June2016-Dec2015	GBV total 30June2016
	26.9	23.0	17.4	10.0	6.2	4.7	4.4	4.0	3.5	3.0	23.7	126.8	(3.8)	123.1
Gross UTP/Gross NPE	32%	36%	37%	48%	46%	36%	50%	35%	47%	45%				
Gross NPE ratio	16%	17%	35%	24%	15%	19%	31%	23%	30%	28%				
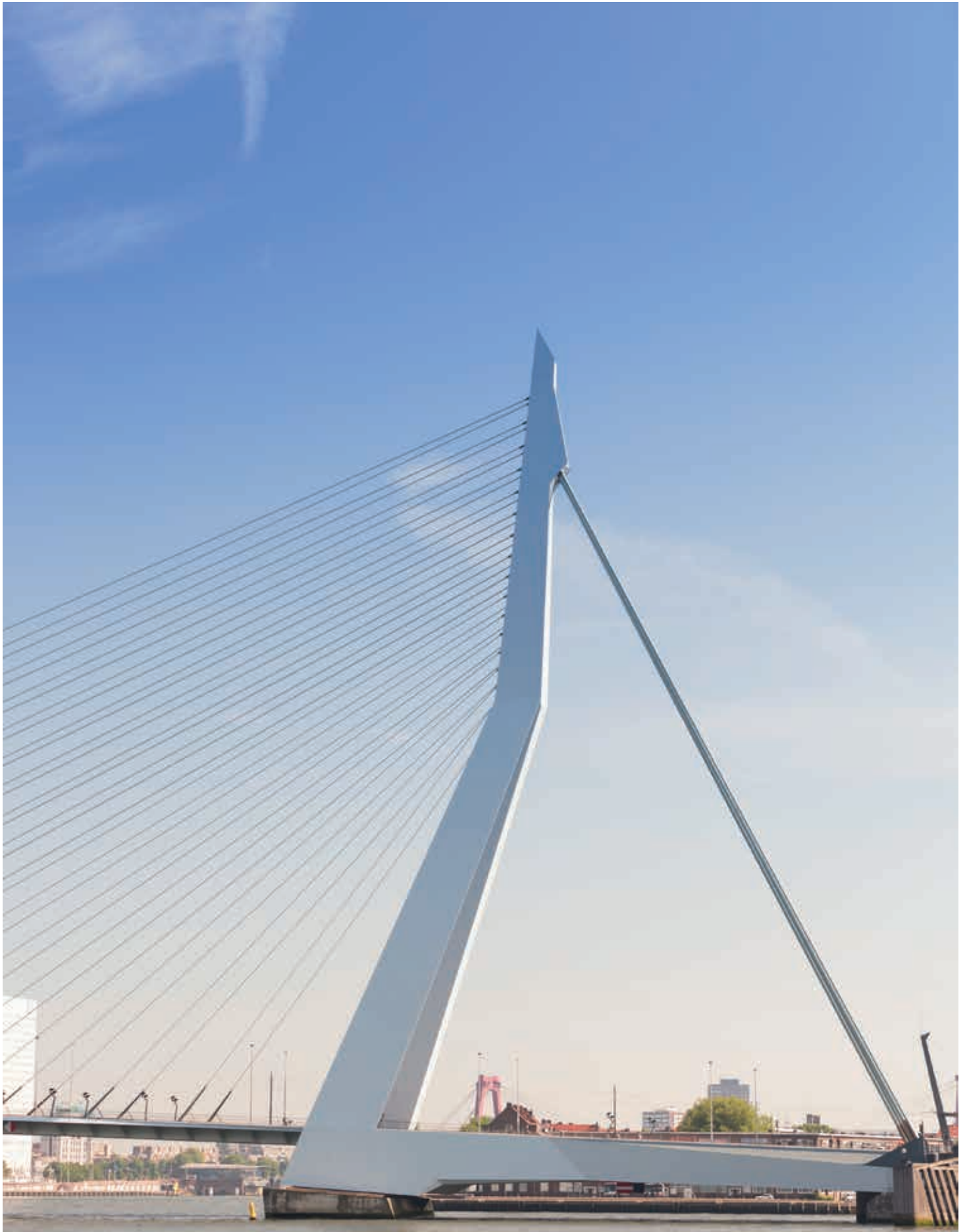
2 Unlikely to Pay inflows and outflows from 2013 to 2015 – Top 20 Italian banks

In 2015, about 56% of the UTP remained UTP while 22% turned to bad loans with the remainder either collected or back to performing

Outflows and Inflows

In 2015, total outflows of the top 20 Italian banks decreased from €60.9bn to €50.8bn primarily driven by lower outflows to bad loans (33% in 2014 vs. 22% in 2015).

2015 inflows decreased by €22m driven by lower inflow from performing exposures (36% in 2014 vs. 22% in 2015)

as well as by lower inflows from non performing (23% in 2014 vs. 13% in 2015).

UTP remained UTP during 2015 amounted to €65bn i.e. 56%. As highlighted below, in 2014, such percentage was significantly lower.
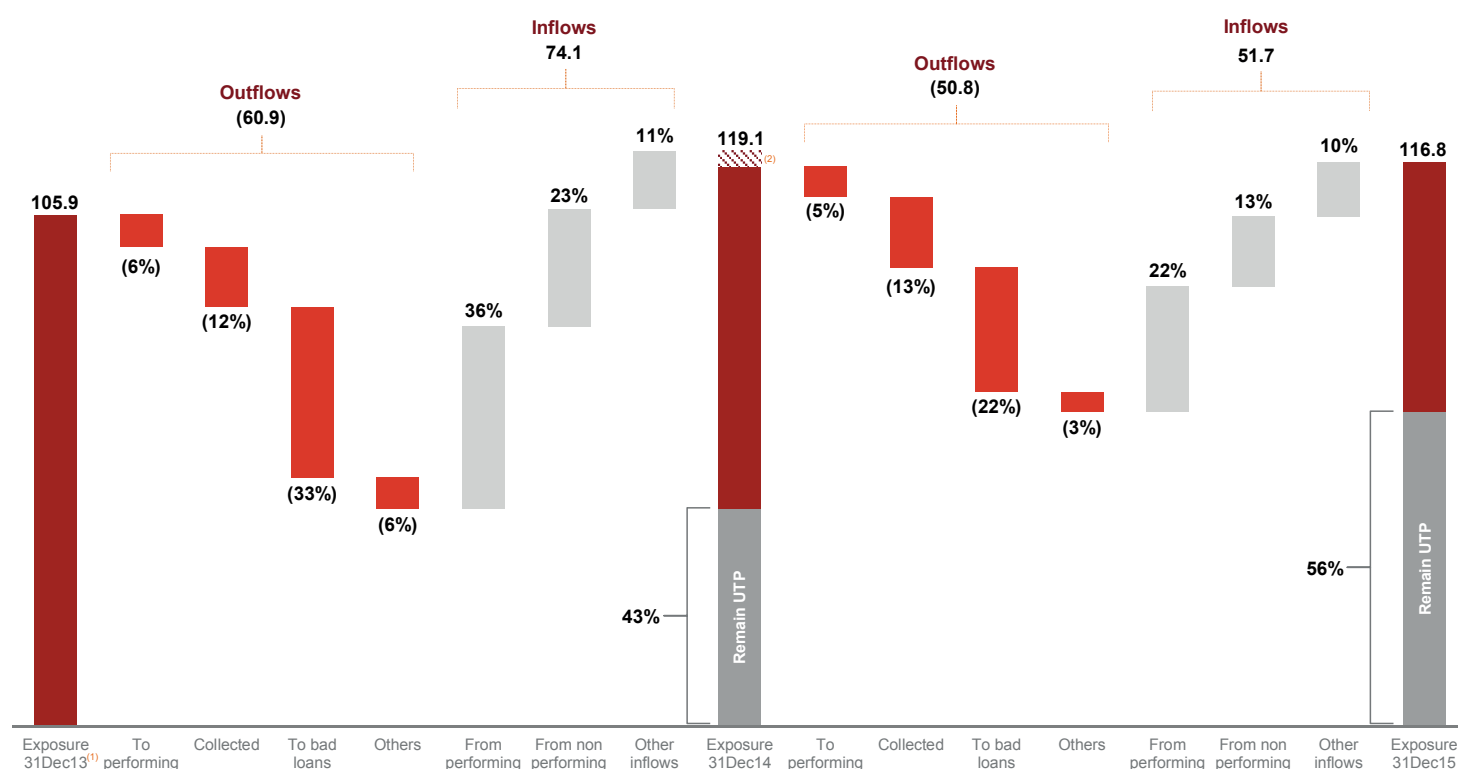
(1) Calculated as sum of "incagli" (including "incagli oggettivi") and restructured exposures
(2) €3.3bn reconciliation gap due to change in definitions

Outflows and inflows | Unicredit

Outflows (17.3)

Inflows 15.0

29.1	(5%)	(20%)	(27%)	(7%)	18%	16%	17%	**26.9**
Exposure 31Dec14	To performing	Collected	To bad loans	Others	From performing	From non performing	Other inflows	Exposure 31Dec15
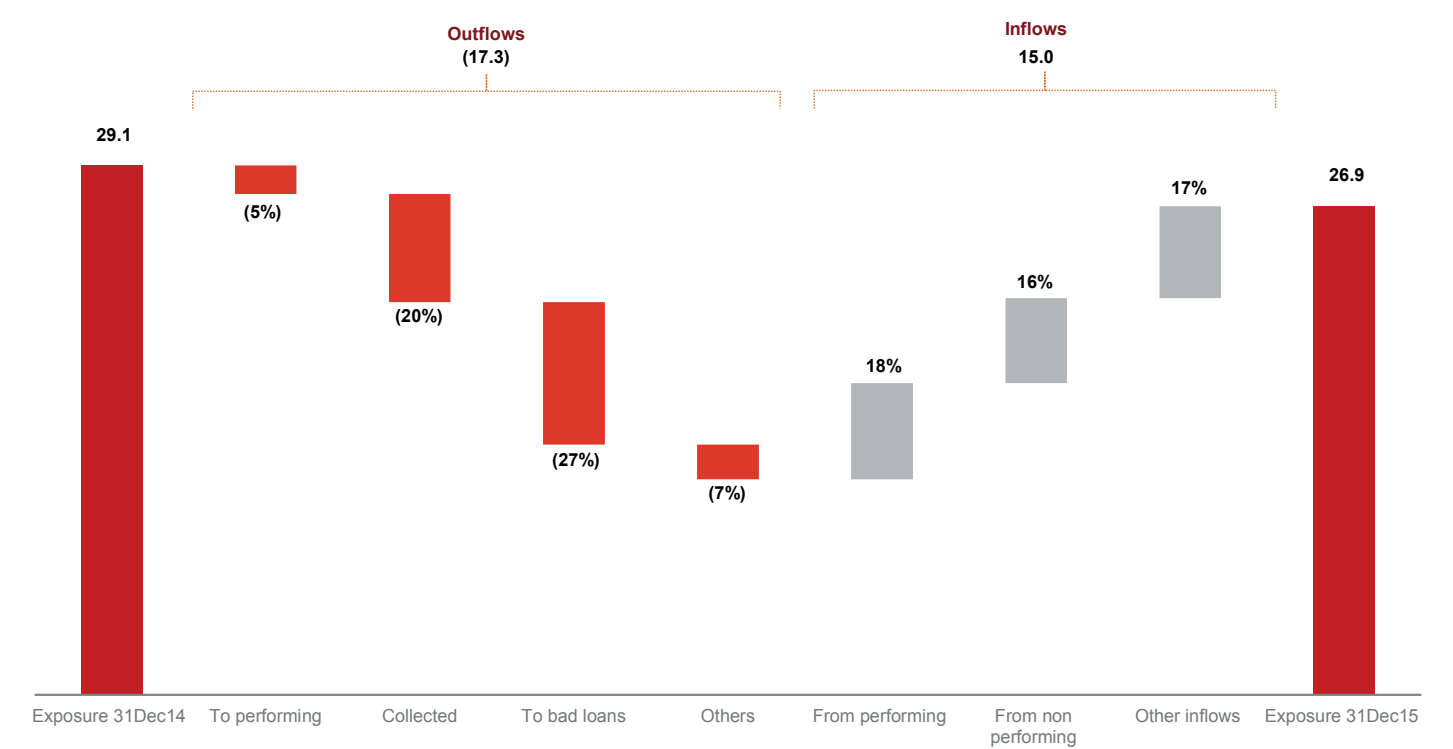
Outflows and inflows | Intesa Sanpaolo

Outflows (10.0)

Inflows 9.5

23.4	(7%)	(10%)	(22%)	(4%)	17%	16%	7%	**23.0**
Exposure 31Dec14	To performing	Collected	To bad loans	Others	From performing	From non performing	Other inflows	Exposure 31Dec15
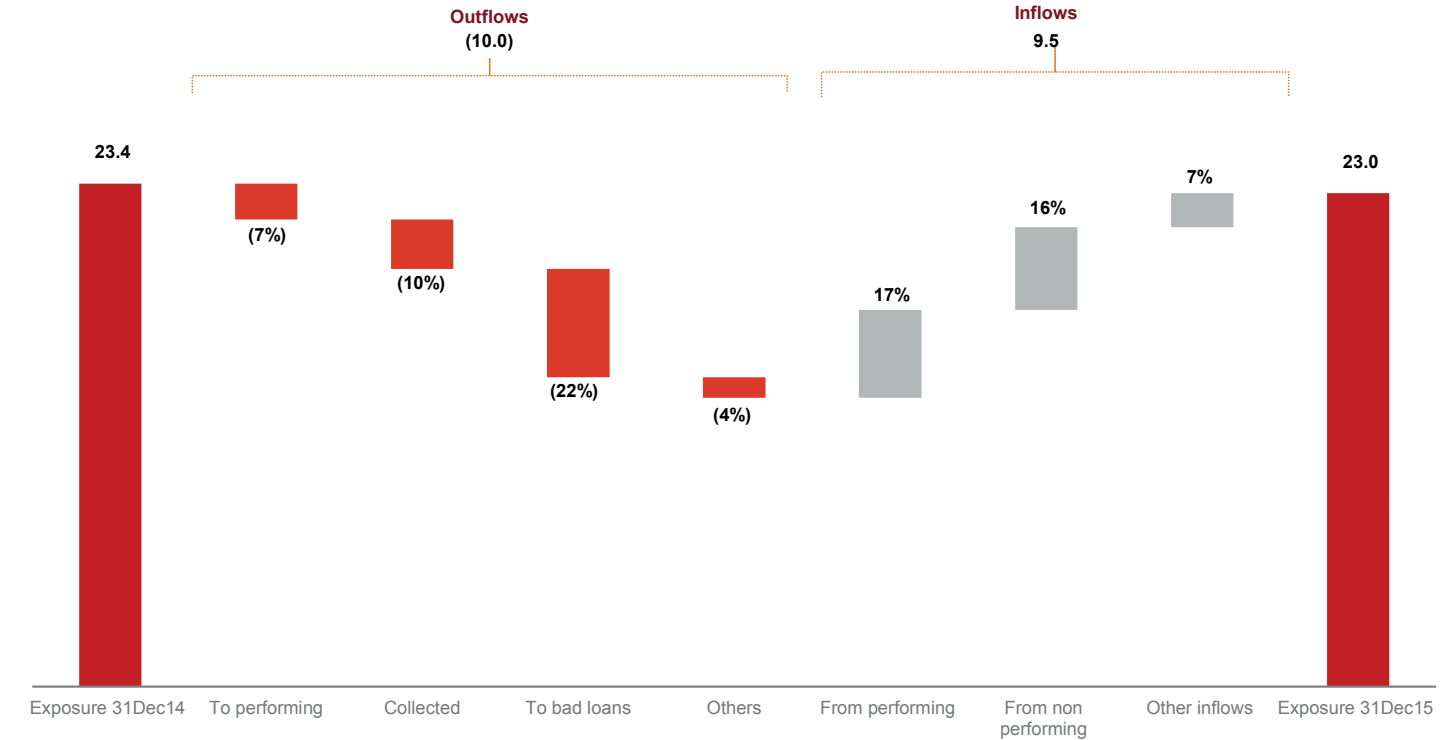
Outflows and inflows | MPS

	Outflows (6.0)				Inflows 6.2			
17.2	(5%)	(7%)	(21%)	(2%)	19%	10%	7%	17.4
Exposure 31Dec14	To performing	Collected	To bad loans	Others	From performing	From non performing	Other inflows	Exposure 31Dec15
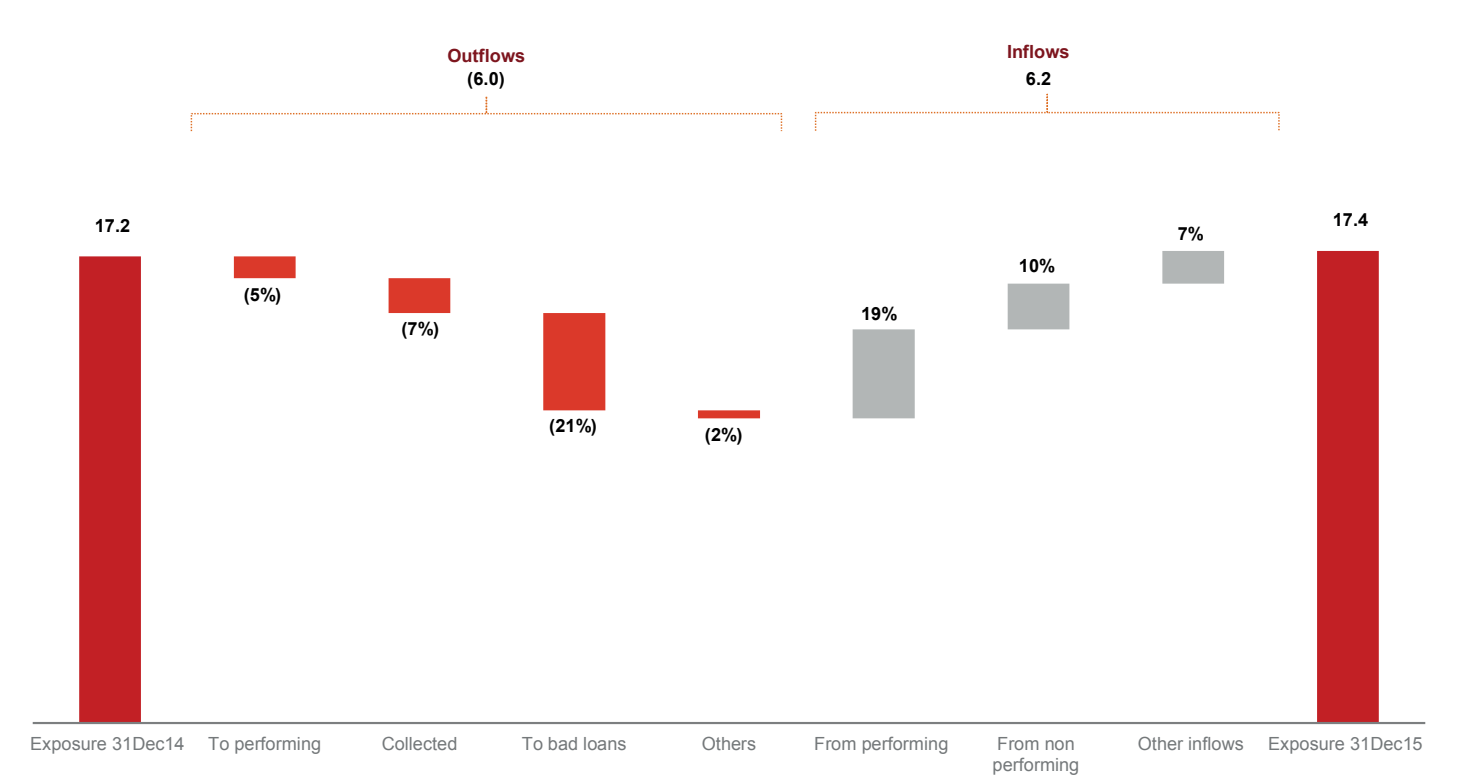
Outflows and inflows | Banco Popolare

	Outflows (3.7)				Inflows 2.9			
10.8	(7%)	(11%)	(15%)	(2%)	17%	2%	8%	10.0
Exposure 31Dec14	To performing	Collected	To bad loans	Others	From performing	From non performing	Other inflows	Exposure 31Dec15
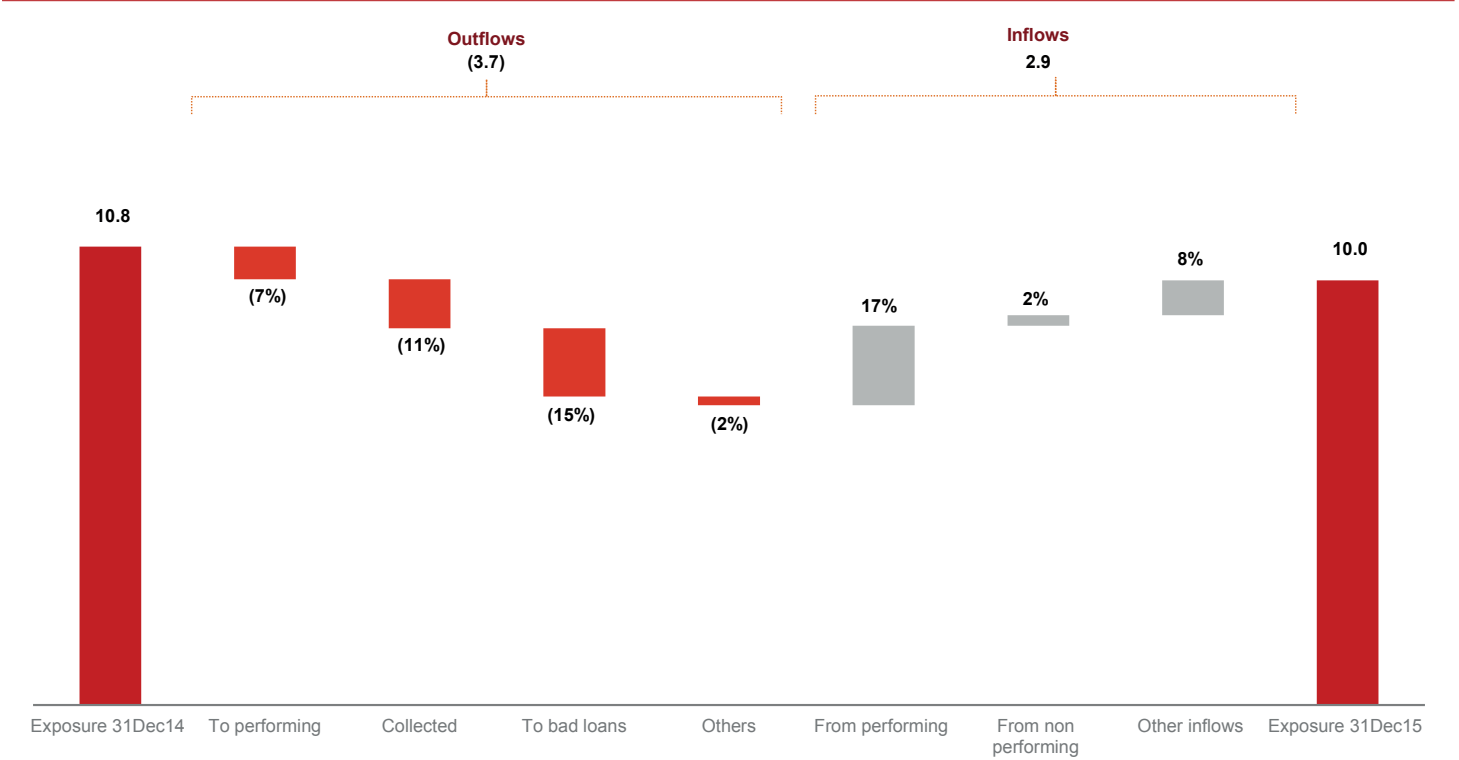
Outflows and inflows | UBI

Outflows
(2.3)

Inflows
2.6

5.9	(3%)	(10%)	(21%)	(4%)	24%	13%	6%	6.2

Exposure 31Dec14 | To performing | Collected | To bad loans | Others | From performing | From non performing | Other inflows | Exposure 31Dec15
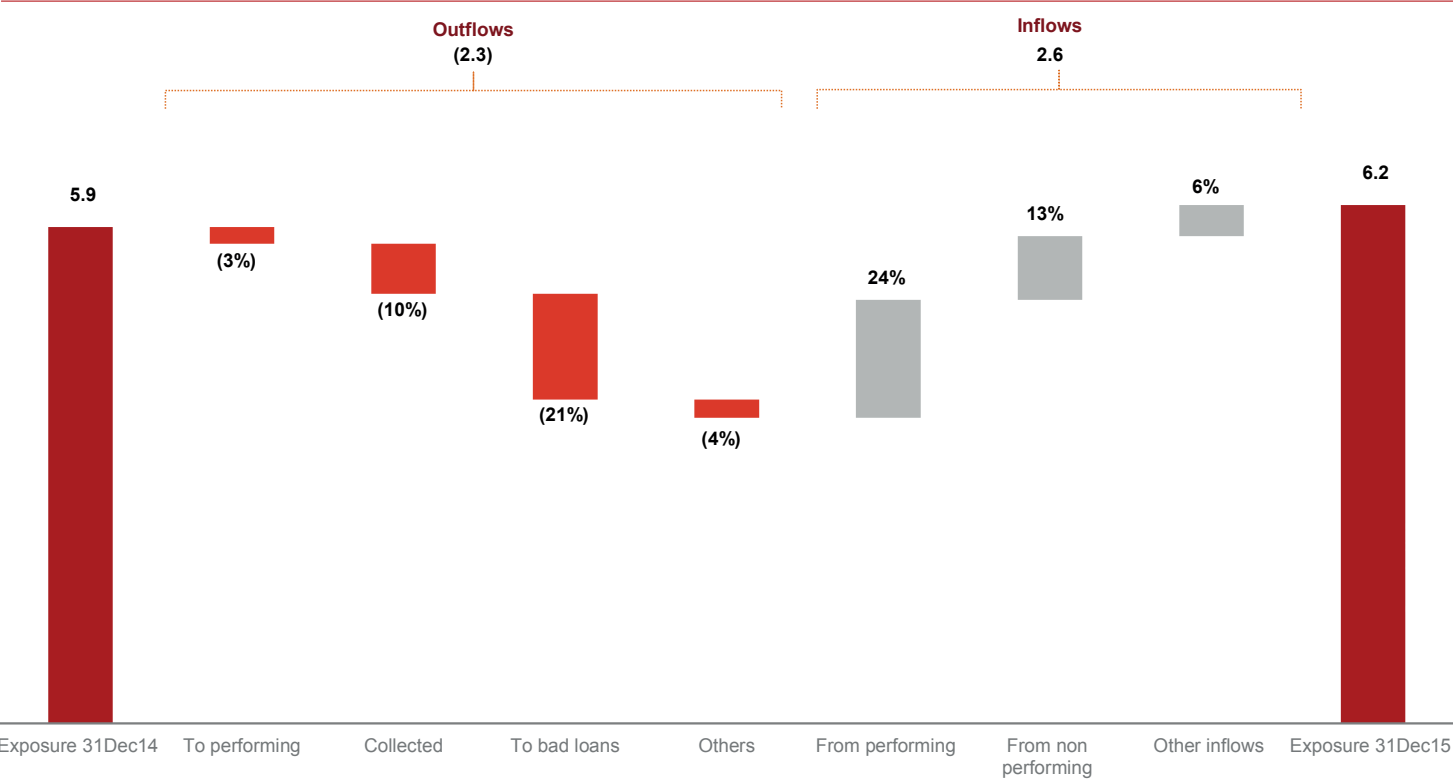
Outflows and inflows | BNL

Outflows
(2.0)

Inflows
2.2

4.5	(4%)	(5%)	(34%)	(2%)	26%	20%	2%	4.7

Exposure 31Dec14 | To performing | Collected | To bad loans | Others | From performing | From non performing | Other inflows | Exposure 31Dec15
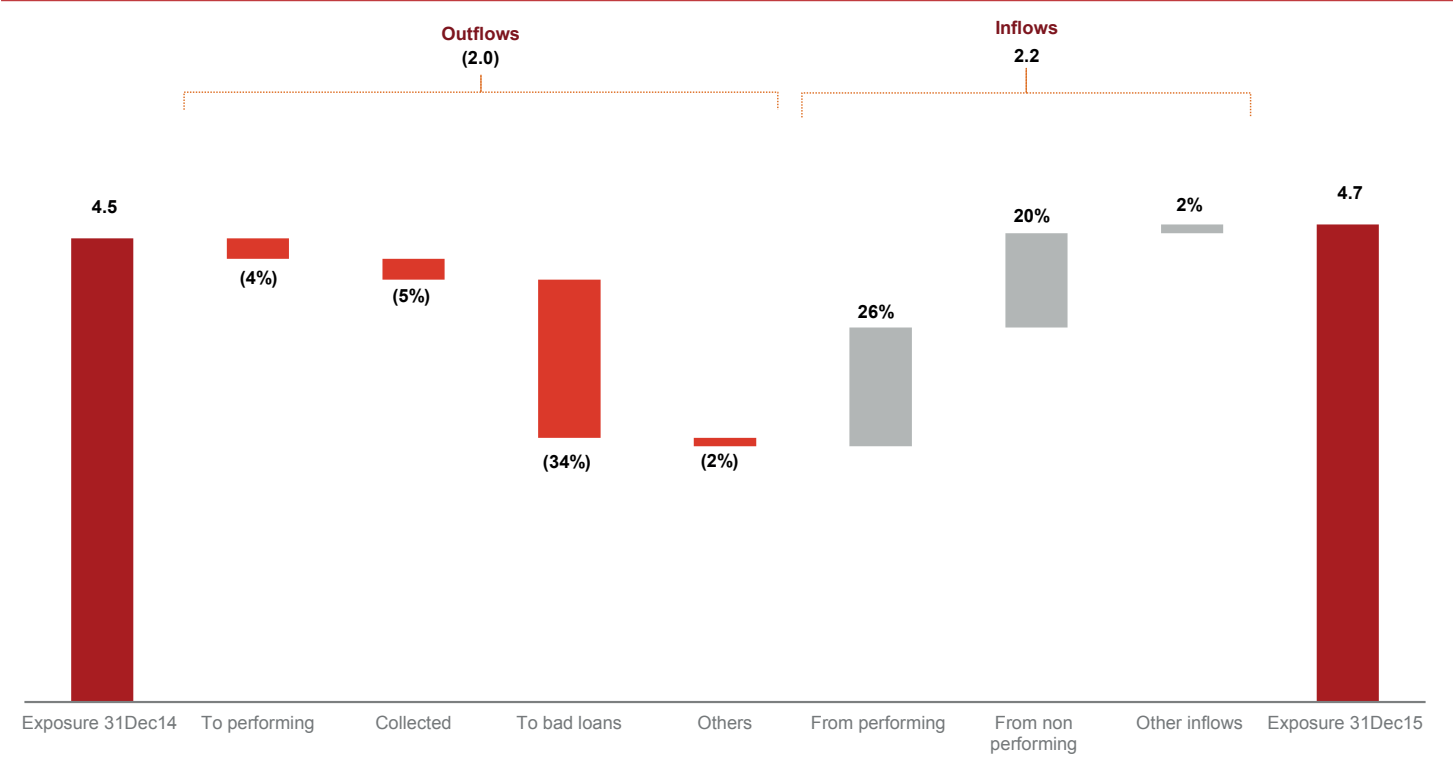
Outflows and inflows | Banca Popolare di Vicenza

Outflows
(1.1)

Inflows
2.8

2.7	(1%)	(7%)	(32%)	(1%)	85%	18%	2%	4.4
Exposure 31Dec14	To performing	Collected	To bad loans	Others	From performing	From non performing	Other inflows	Exposure 31Dec15
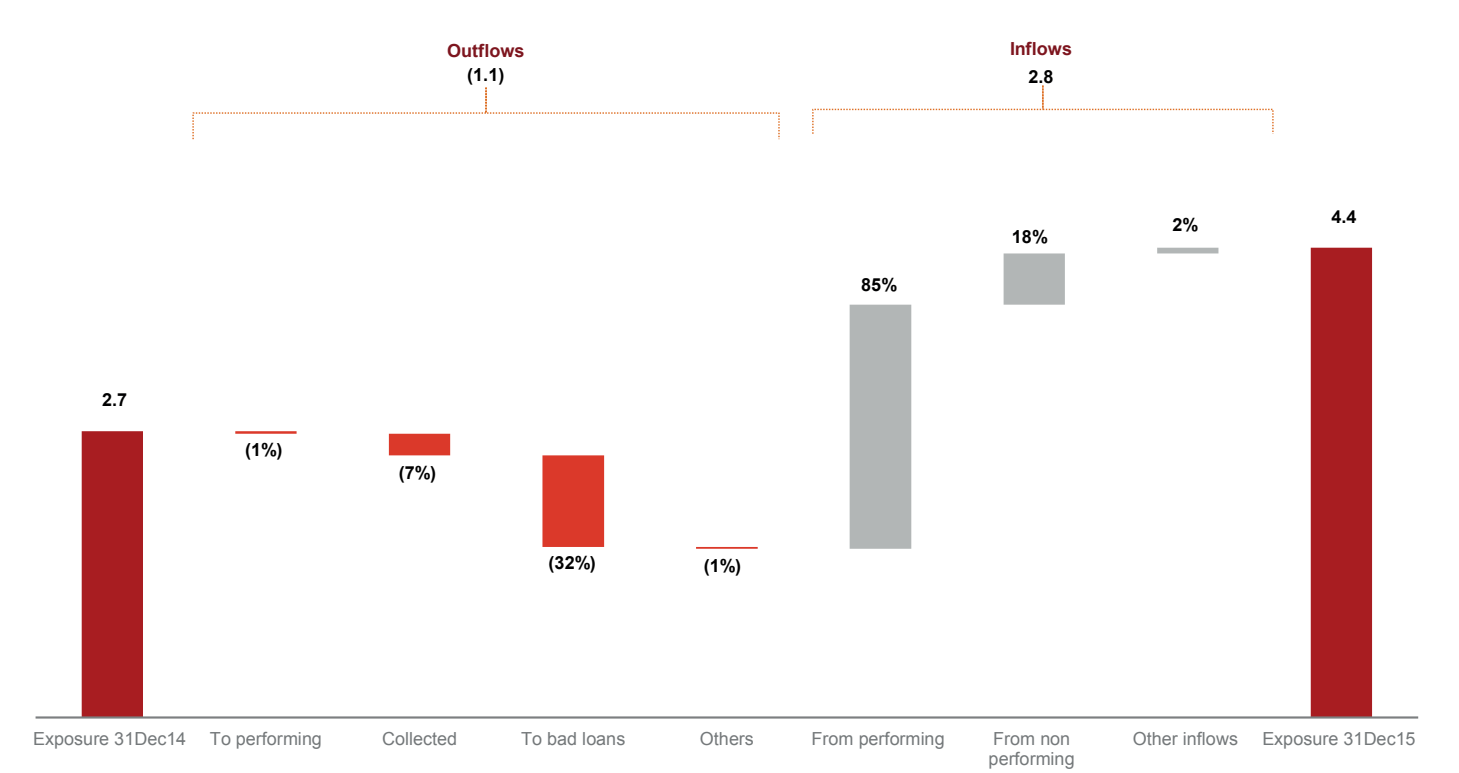
Outflows and inflows | BPER

Outflows
(2.1)

Inflows
1.8

4.3	(6%)	(25%)	(19%)	(1%)	27%	3%	13%	4.0
Exposure 31Dec14	To performing	Collected	To bad loans	Others	From performing	From non performing	Other inflows	Exposure 31Dec15
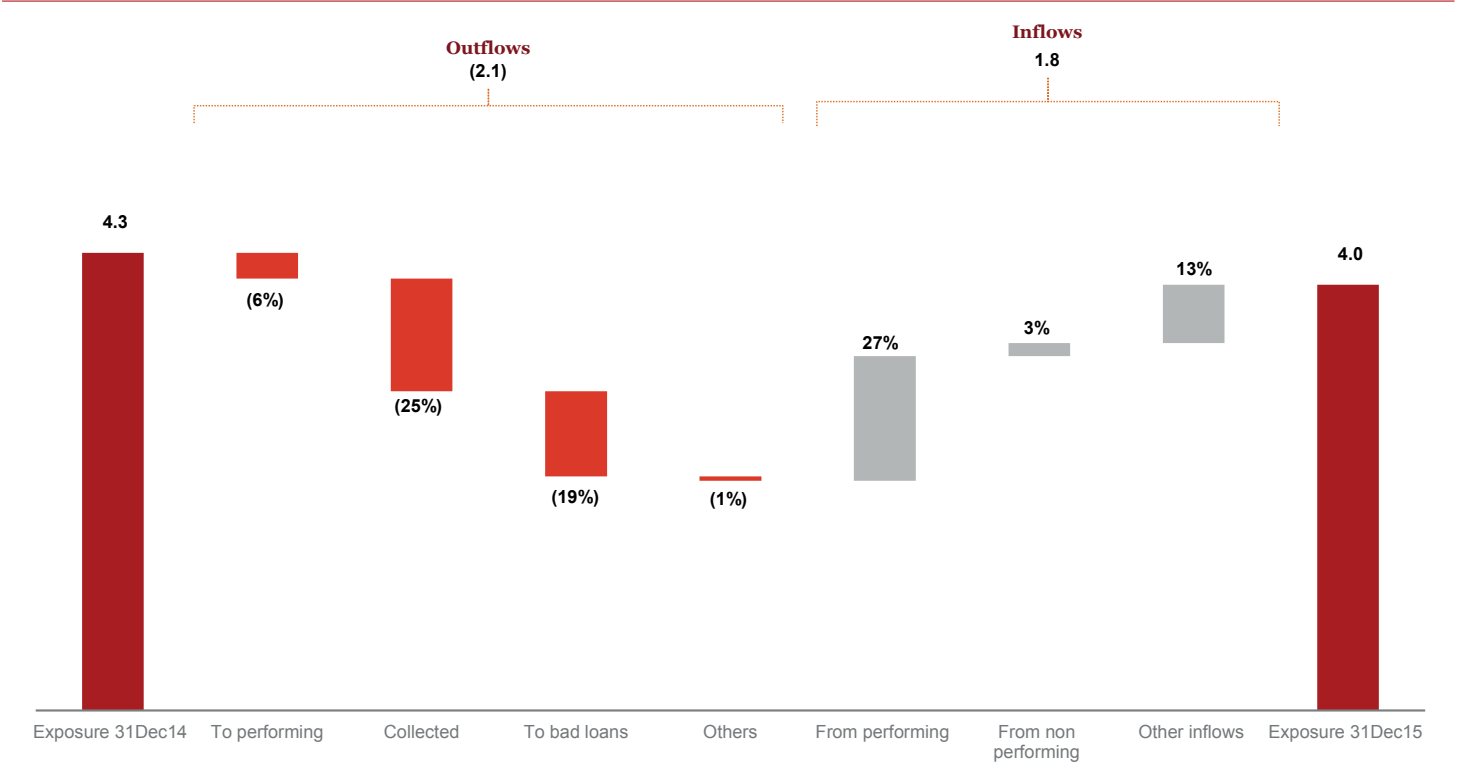
Outflows and inflows | Veneto Banca

Outflows
(0.7)

Inflows
1.8

Exposure 31Dec14	To performing	Collected	To bad loans	Others	From performing	From non performing	Other inflows	Exposure 31Dec15
2.4	(3%)	(9%)	(13%)	(3%)	68%	10%		3.5
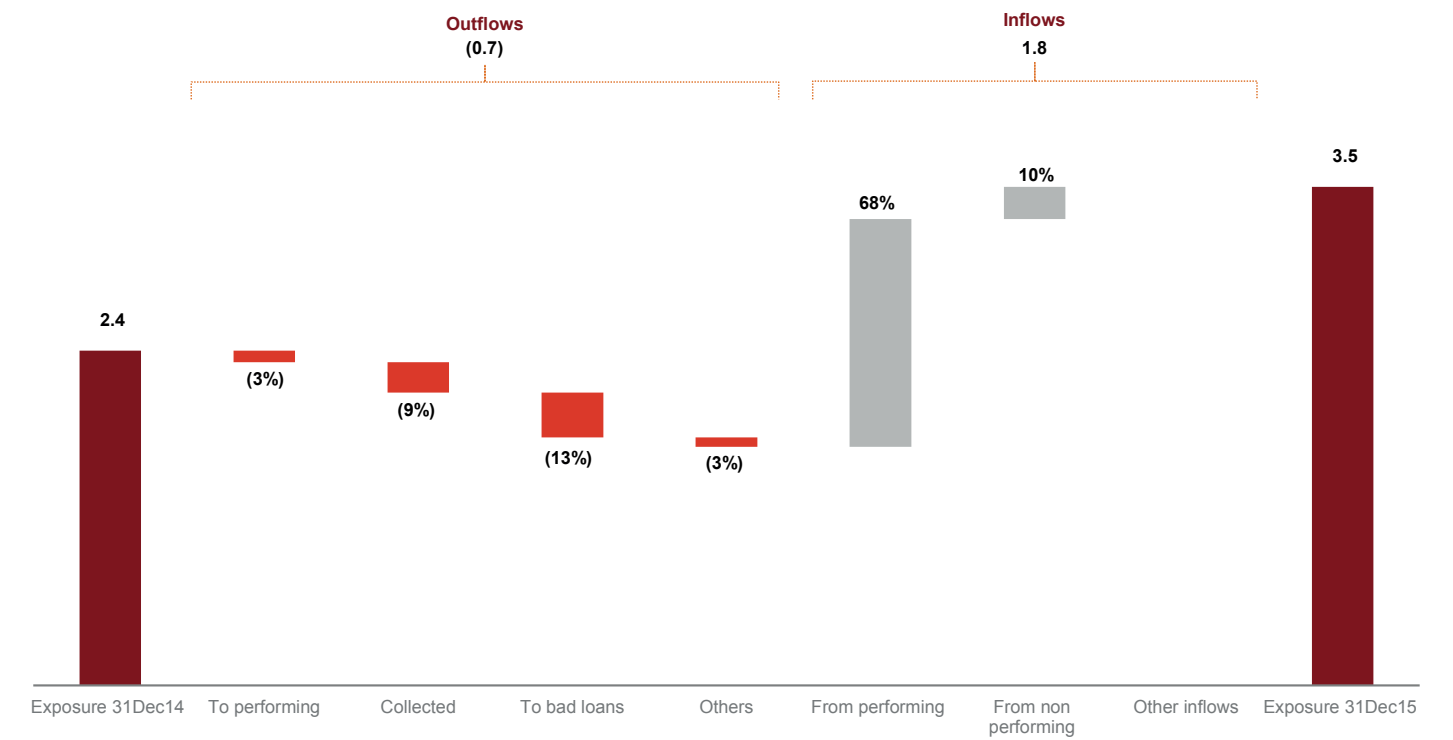
Outflows and inflows | Carige

Outflows
(1.0)

Inflows
0.8

Exposure 31Dec14	To performing	Collected	To bad loans	Others	From performing	From non performing	Other inflows	Exposure 31Dec15
3.2	(4%)	(11%)	(12%)	(3%)	12%	2%	10%	3.0
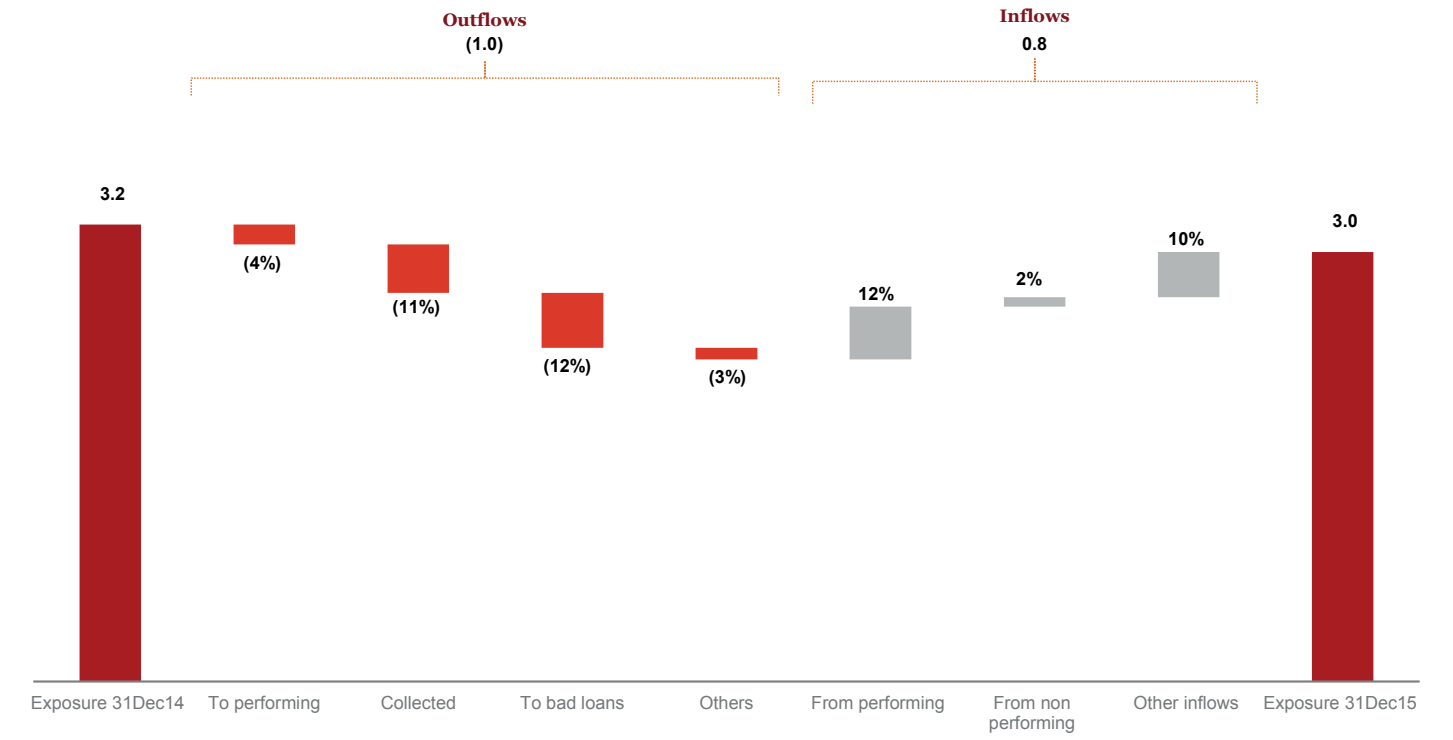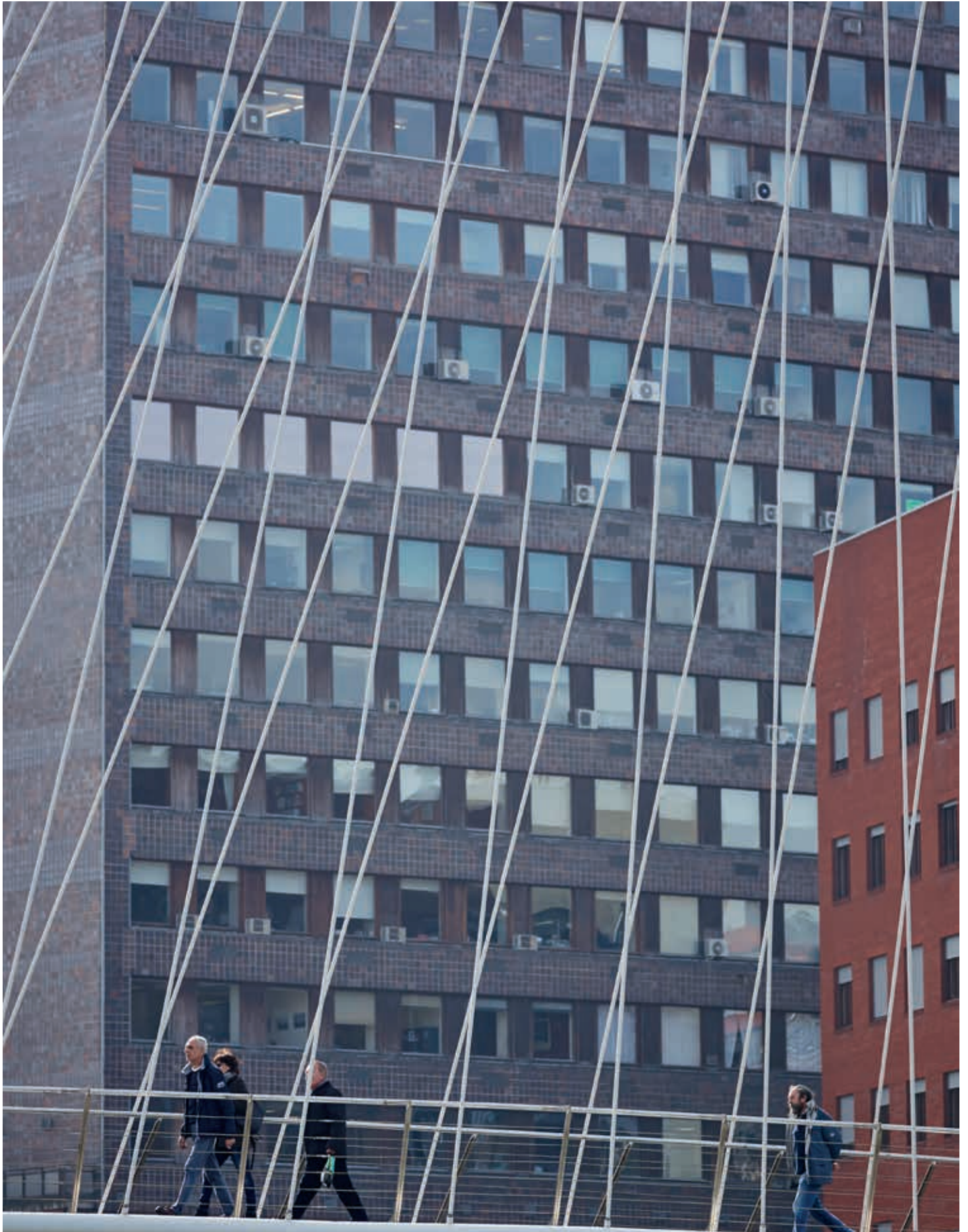
3 Unlikely to Pay coverage ratio - Top 20 Italian banks

General need to increase UTP coverage ratio. The top 20 Italian banks average coverage ratio was at 27.6% in 2015. Banks with high proportion of UTP over total NPE might need to implement a more proactive management

UTP Coverage ratios vs. Gross UTP ratios

At the end of 2015, both UniCredit and Intesa Sanpaolo showed a reassuring below average Gross UTP ratio (5.2% and 6% respectively), despite a different UTP coverage ratio (34% for UniCredit and 25% for Intesa Sanpaolo).

MPS, third group in terms of UTP exposures, showed above average Gross UTP ratio (13%) with an average UTP coverage ratio at 29%.
Veneto Banca, Carige, Banca Popolare di Vicenza show below average coverage ratios and above 12% gross UTP ratios.

NPE breakdown by bank

	UniCredit	Intesa Sanpaolo	MPS	Banco Popolare	UBI	BNL	BPVI	BPER	Veneto Banca	Gruppo CARIGE
Past due	3%	2%	6%	1%	2%	2%	2%	2%	7%	4%
Unlikely to pay	32%	36%	37%	48%	46%	36%	50%	35%	47%	44%
Bad loans	64%	62%	57%	50%	52%	62%	49%	62%	46%	51%

	BPM	Credito Valtellinese	CA Cariparma	BP di Sondrio	ICCREA	BP di Bari	CR di Bolzano	Banco di Desio	GE Capital	CR di Cesena
Past due	2%	6%	2%	11%	3%	9%	2%	4%	12%	3%
Unlikely to pay	44%	44%	45%	43%	52%	32%	42%	38%	41%	36%
Bad loans	54%	50%	53%	45%	44%	59%	56%	58%	47%	61%

Legend: ■ Bad loans ■ Unlikely to pay ■ Past due

Bubble size: Unlikely to Pay gross exposure

4   *Our view*

UTP need to be moved out of their hybrid condition. Different options might be available and vary case by case

The unlikelihood judgement

The exposures are classified as Unlikely to Pay in light of the unlikelihood that relevant debtors will fulfil their credit obligations.

The unlikelihood judgement is made by the Bank based on a varied spectrum of signals and issues.

The range of signals and issues may be very wide and differs case by case but a common feature is that each of them is recoverable and / or is manageable if tackled properly and timely. Time is of essence.

What should banks do?

1 Perform budget/BP analysis and ad hoc reclassifications

2 Regularly monitor the Central Credit Register to be informed on the total exposure to the system and relevant movements

3 Use early warning indicators: from internal (companies and individuals) and external sources

4 Produce and regularly update an overall rating on borrowers' overall risk based upon info gathered from several sources

Market risks
(external variables such as those regarding the environment where the borrowers operate)

Operational risks
(risks concerning the operational structure of the borrowers)

Financial risks
(financial soundness of the borrowers and / or relevant customers and / or suppliers)

5 NPE operating model: dedicated workout units, standard procedures for classification and segmentation

There are several options to move the UTP out of their hybrid condition

Collection

Forbearance measures
(12 months from allowance)

Performing

Bad loans

UTP

Equity / Senior debt solutions

Sale
(Several factors impacting such pattern e.g. alive counterparty, NBV, P&L immediate impact)

⌐ ¬ Activities
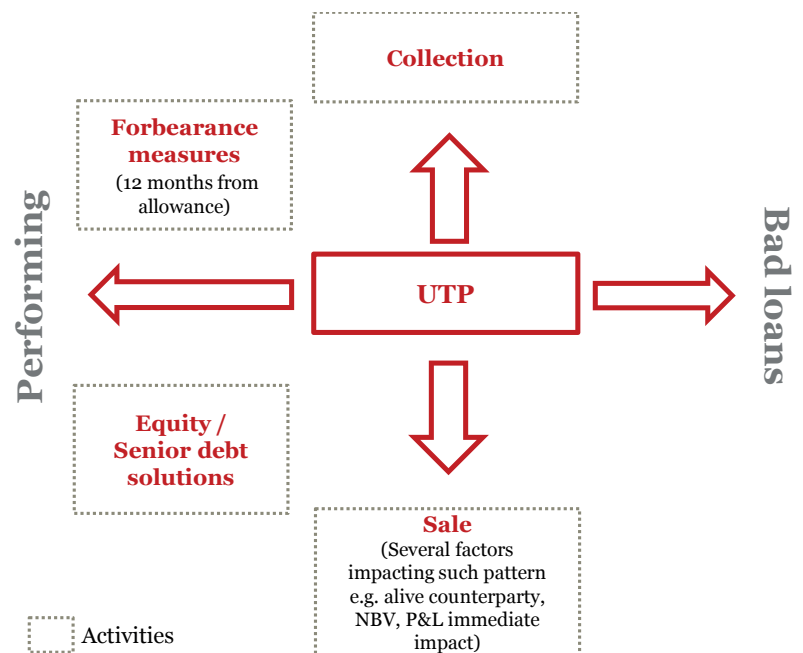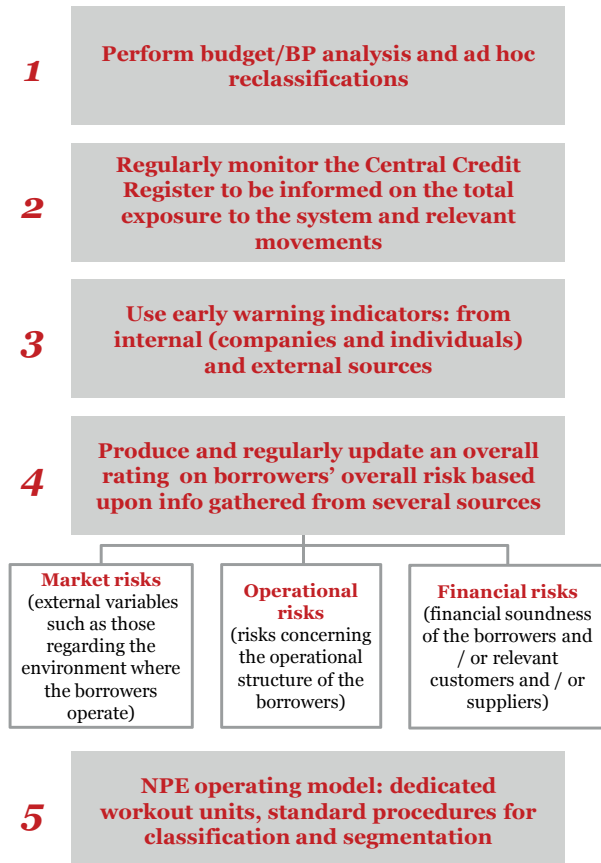
5 Non Performing Exposures classifications

How to define and what to include within the "Unlikely to Pay" category

Non-Performing Exposures

The commonly used term non-performing loans ("NPL") is based on different definitions across Europe.
To overcome problems, EBA has issued a common definition of Non-Performing Exposures ("NPE") which is used for supervisory reporting purposes.

In Italy, banks are also required to distinguish among different classes of NPE: (i) Bad Loans, (ii) Unlikely to Pay and (iii) Past-Due; the sum of these 3 categories corresponds to the Non-Performing Exposures referred to in the EBA ITS.

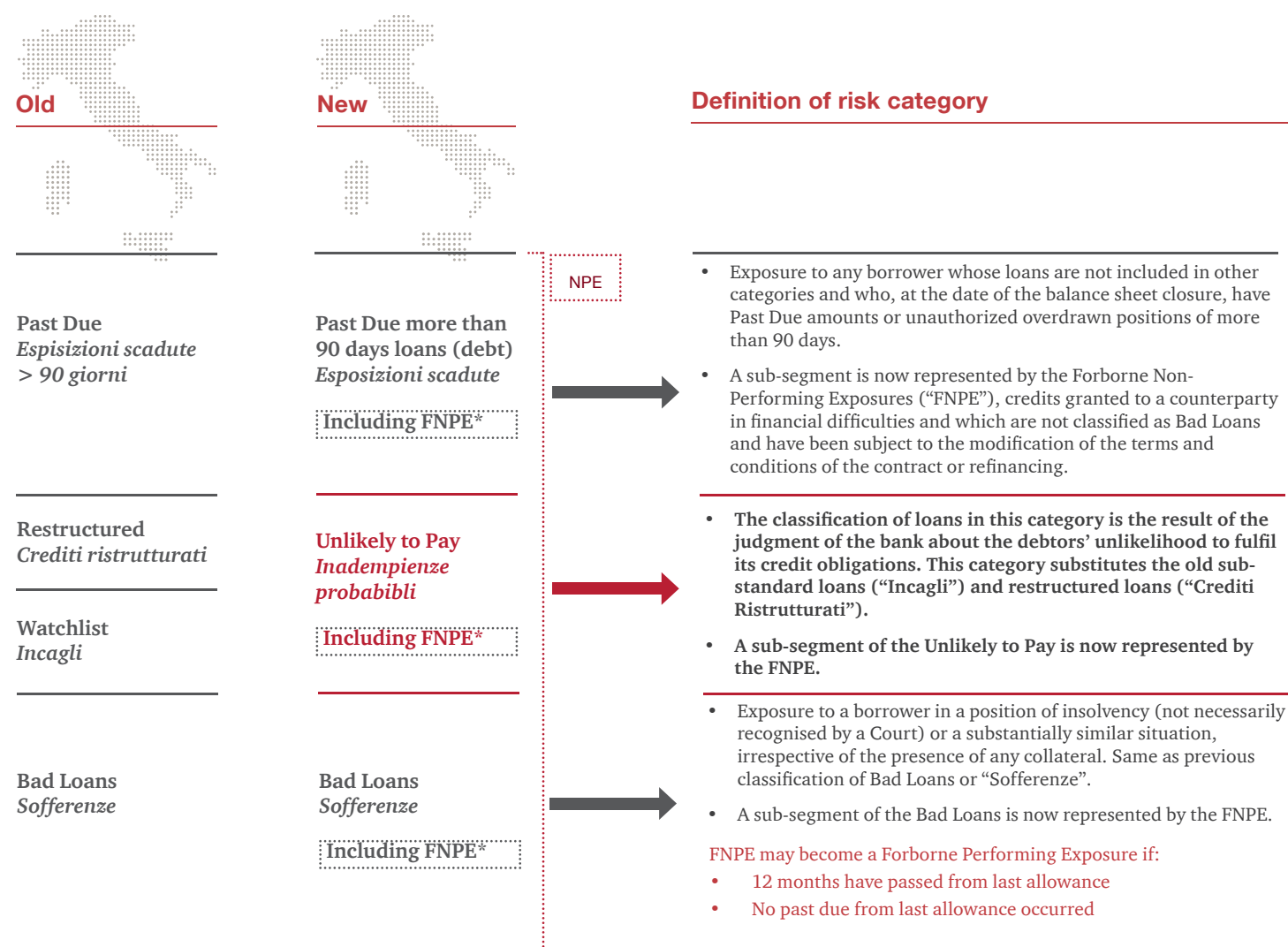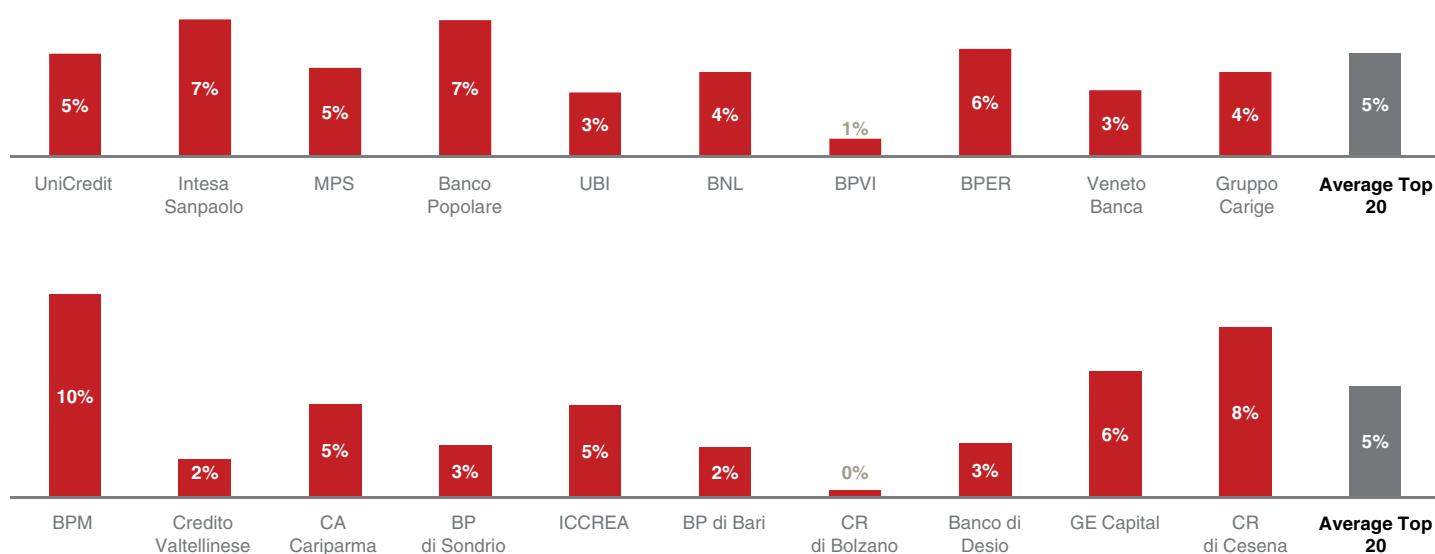| Old	New	Definition of risk category
Past Due *Espisizioni scadute > 90 giorni*	**Past Due more than 90 days loans (debt)** *Esposizioni scadute* Including FNPE* — **NPE**	• Exposure to any borrower whose loans are not included in other categories and who, at the date of the balance sheet closure, have Past Due amounts or unauthorized overdrawn positions of more than 90 days. • A sub-segment is now represented by the Forborne Non-Performing Exposures ("FNPE"), credits granted to a counterparty in financial difficulties and which are not classified as Bad Loans and have been subject to the modification of the terms and conditions of the contract or refinancing.
Restructured *Crediti ristrutturati* **Watchlist** *Incagli*	**Unlikely to Pay** *Inadempienze probabibli* Including FNPE*	• **The classification of loans in this category is the result of the judgment of the bank about the debtors' unlikelihood to fulfil its credit obligations. This category substitutes the old sub-standard loans ("Incagli") and restructured loans ("Crediti Ristrutturati").** • **A sub-segment of the Unlikely to Pay is now represented by the FNPE.**
Bad Loans *Sofferenze*	**Bad Loans** *Sofferenze* Including FNPE*	• Exposure to a borrower in a position of insolvency (not necessarily recognised by a Court) or a substantially similar situation, irrespective of the presence of any collateral. Same as previous classification of Bad Loans or "Sofferenze". • A sub-segment of the Bad Loans is now represented by the FNPE. FNPE may become a Forborne Performing Exposure if: • 12 months have passed from last allowance • No past due from last allowance occurred

*FNPE: Forborne Non-Performing Exposures
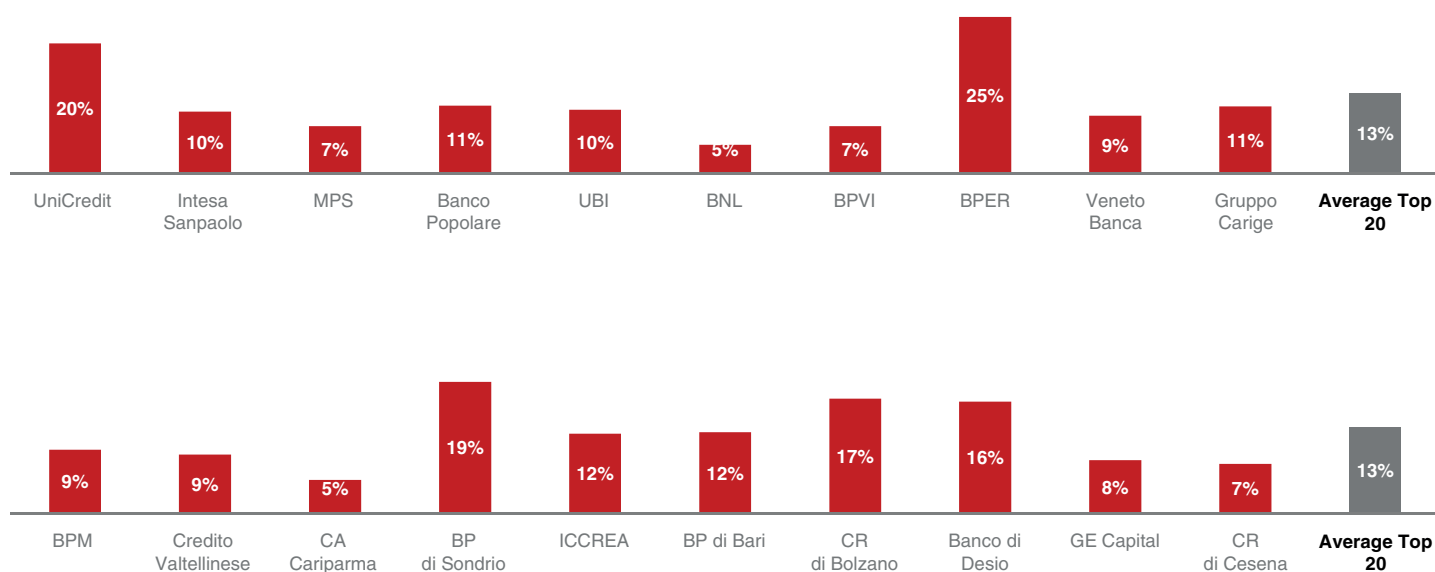Source: EBA, EBA/ITS/2013/03/rev1 24/7/2014

6   *Outflows - Top 20 Italian banks*

The average collection rate does not represent a significant indicator to read the Italian system as it changes significantly from bank to bank

From UTP to Performing in 2015

UniCredit	Intesa Sanpaolo	MPS	Banco Popolare	UBI	BNL	BPVI	BPER	Veneto Banca	Gruppo Carige	**Average Top 20**
5%	7%	5%	7%	3%	4%	1%	6%	3%	4%	5%

BPM	Credito Valtellinese	CA Cariparma	BP di Sondrio	ICCREA	BP di Bari	CR di Bolzano	Banco di Desio	GE Capital	CR di Cesena	**Average Top 20**
10%	2%	5%	3%	5%	2%	0%	3%	6%	8%	5%

From UTP to Collected in 2015

UniCredit	Intesa Sanpaolo	MPS	Banco Popolare	UBI	BNL	BPVI	BPER	Veneto Banca	Gruppo Carige	**Average Top 20**
20%	10%	7%	11%	10%	5%	7%	25%	9%	11%	13%

BPM	Credito Valtellinese	CA Cariparma	BP di Sondrio	ICCREA	BP di Bari	CR di Bolzano	Banco di Desio	GE Capital	CR di Cesena	**Average Top 20**
9%	9%	5%	19%	12%	12%	17%	16%	8%	7%	13%

From UTP to Bad Loans in 2015

UniCredit	Intesa Sanpaolo	MPS	Banco Popolare	UBI	BNL	BPVI	BPER	Veneto Banca	Gruppo Carige	**Average Top 20**
27%	22%	21%	15%	21%	34%	32%	19%	13%	12%	22%

BPM	Credito Valtellinese	CA Cariparma	BP di Sondrio	ICCREA	BP di Bari	CR di Bolzano	Banco di Desio	GE Capital	CR di Cesena	**Average Top 20**
20%	19%	18%	24%	12%	17%	20%	33%	12%	63%	22%

Remained UTP in 2015

UniCredit	Intesa Sanpaolo	MPS	Banco Popolare	UBI	BNL	BPVI	BPER	Veneto Banca	Gruppo Carige	**Average Top 20**
41%	57%	65%	65%	62%	55%	59%	50%	71%	70%	56%

BPM	Credito Valtellinese	CA Cariparma	BP di Sondrio	ICCREA	BP di Bari	CR di Bolzano	Banco di Desio	GE Capital	CR di Cesena	**Average Top 20**
58%	71%	72%	54%	70%	68%	63%	48%	71%	21%	56%

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