Irish reforms point way for Italian NPLs

ITALY AND its mountain of bad debt are firmly in focus for the European banking system, with observers hoping the country can look to other European nations, particularly Ireland, for a solution to its non-performing loans dilemma.

Italy's banks have the highest number of NPLs in Europe.

The stock of NPLs is equivalent to 19% of the country's GDP, according to a Rabobank research note, and while some progress has been made in reducing the exposure of banks — for instance, through the resolution of Banca Monte dei Paschi di Siena — there are still a number of Italian banks that could struggle to keep up with the European Union's Bank Recovery and Resolution Directive.

"We don't expect a banking crisis in Italy imminently, but there certainly remain a large number of banks that are very sensitive to any possible shocks," wrote Rabobank.

"We believe creditors of larger banks in Italy could face the full force of the BRRD if they are deemed to be 'failing or likely to fail' by the regulator at any point in the coming months but we expect smaller banks will likely be resolved under national insolvency laws."

Bank of Italy figures show that as of March 2017, the total number of Italian NPLs had declined, but the number of loans classified as "sofferenze" or "very bad" actually increased during that period, comprising approximately 60% of the Italian NPL stock.

Following the global financial crisis, Ireland was faced with similar problems. However, unlike Italy, the country moved quickly to reform its legal processes for resolving NPLs, aiding in the disposal process and unburdening its banking system.

"Ireland is an example where significant reform was undertaken in a relatively short space of time," Conor Houlihan, partner and head of banking and capital markets at law firm Dillon Eustace, told *GlobalCapital*. "We acted for the purchaser on one of the first major Irish NPL sales, the so-called "Project Kildare" portfolio, in 2012, and since then there has been significant legal reform – for example, the updating of our personal insolvency laws and the introduction of a new statutory framework for credit servicing."

> **"Creditors of larger banks in Italy could face the full force of the BRRD"**

Due to the complexity of the Italian legal system, and the years-long process for resolving distressed assets, there has been little appetite from loan investors to date.

Sources in Italy said that the resolution time is the greatest barrier to entry for investors looking to buy Italian NPLs, and has led to a wide disparity between the price at which buyers are willing to pay and banks are willing to sell. As a high proportion of Italian NPLs are unlikely ever to perform again, reducing the resolution time is critical to attract more buyers to the market.

"Reducing the timeframe to work out NPLs is a key element in creating the right environment where deals can be done and pricing is at a level that meets sellers' expectations as well as buyers' return requirements," Houlihan added, pointing to Ireland as an example.

Ireland had a unique advantage compared with the Italian banks, however. Most Irish NPLs were backed by real estate, while Italian NPL portfolios are a mix of residential and commercial mortgages, business loans and other credits. Each asset type has a different resolution process, a further impediment to investment.

"There are tried-and-tested methods of realising real estate collateral in Ireland, which buyers, and their funders, are now largely comfortable with," said Houlihan. "Consensual resolution and [discounted payoffs] have also helped both debtors and NPL buyers to work through assets relatively quickly.

"Of course, sales of real estate NPLs and the work-out of these assets in Ireland have also been helped by the relatively buoyant Irish real estate market that currently prevails."

If Italy's banks are to shed their NPL exposures, similar reforms will likely be needed.

The country has made some progress, but government guarantees and selling securitized NPL exposures to the Atlante fund are not long-term solutions.

There is also the danger that short-term approaches ignore the need for true reforms to expedite the resolution process.

"I worry that all this state aid and kicking the can down the road through Atlante and GACs (the government guarantee scheme) is going to take focus off the vital reform that Italy needs to resolve this," an ABS analyst said.

Investors seem to agree, and although Italy can continue to aid its banks through various forms of state aid, the long-term goal should be to sell the exposures to investors such as private equity funds, as Ireland did in the years following the crisis. ■