

Covid-19: 2020 slowdown in Italian NPL securitisation



Scope
Ratings

Scope expects a 50%-70% reduction in Italian NPL securitisation this year relative to 2019 as banks put deleveraging plans on hold while they await better market conditions. We do not expect an immediate spike in defaults brought about by Covid-19 in 2020, but they will increase from 2021. We estimate EUR 30bn of new NPL inflows out to 2021.

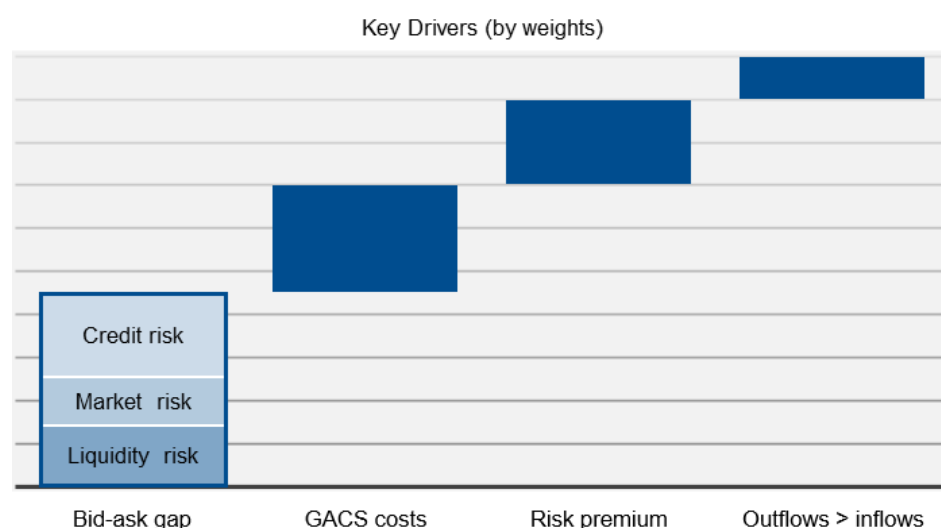
As highlighted in a [recent study](#) we do not expect Italian NPL securitisation to reach the levels of 2018-2019¹. Activity may increase from 2021, however, driven by the expiry of Italy's GACS scheme in May 2021 and facilitated by more favourable market conditions.

An acceleration in activity during 2021 will also be driven by new defaults brought about by Covid-19. Defaults on new corporate financings will be mostly covered by sovereign guarantees so a significant portion of credit risk will be held by sovereigns rather than banks. Under this scenario a proportion of new defaults might not be securitised, potentially going instead into a centralised bad bank.

As shown in Figure 1, a slowdown in securitisation will be driven by an uncertain macroeconomic scenario, widening the bid-ask gap between seller and investor expectations.

Higher risk premiums and increased GACS costs will contribute. Lastly, NPL outflows² will be higher than inflows, lowering the disposable stock. What might incentivise sellers to dispose of NPLs is use of deferred-tax-assets (DTAs) to compensate for any losses incurred in the disposals. However, this option will only benefit sellers to a limited extent.

Figure 1: Key drivers for 2020 slowdown



¹ Please refer to the Appendix for the list of the securitisations rated by Scope.

² Represented by disposals and exposures going back to a performing status.

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1. Securitisation to slow in 2020

We expect that new issuance of Italian NPL securitisation will significantly slow down in 2020. In our baseline scenario, we estimate volumes of EUR 7bn in terms of GBV or EUR 12bn in our more optimistic scenario. The estimate is based on historical information and market data.

2020(E): EUR 7bn-EUR 12bn of GACS NPL securitisations

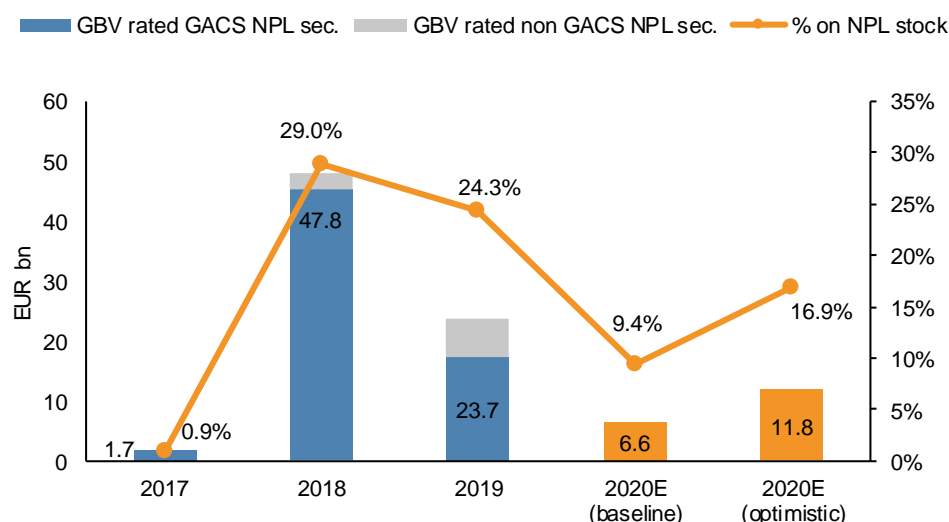
2021 may see increased activity in NPL securitisation

Figure 2 shows that securitisation volumes halved between 2018 and 2019 to EUR 24bn. However, this was in line with the decrease of NPL stocks due to banks' deleveraging activities, so on a relative basis the proportion of annual NPL stock securitised in 2018-2019 was in a consistent 24%-29% range. But we expect a significant reduction in securitisation activity in 2020 to between 9% and 17% of annual stocks.

Overall, we expect that securitisation activity will increase in 2021, especially in the first two quarters, driven by the expiry of the GACS guarantee scheme in May. The speed of recovery of the Italian economy might also contribute to an acceleration in activity.

Defaults are expected to rise from 2021, gradually for households but with a cliff-effect for companies in 2022³. Since company financings granted after the Covid-19 outbreak⁴ will be mostly covered by sovereign guarantees, credit risk will partially migrate from bank balance sheets to government accounts. It is uncertain if new corporate defaults will be securitised. A centralised bad bank might instead be created.

Figure 2: NPL securitisations: past and future trends



Source: Bank of Italy (Banca Dati Statistica or BDS), public data, Scope Ratings

2020-21(E): EUR 30bn of NPL inflows

As shown in **Figure 3**, we forecast NPL inflow⁵ rates to increase by 2021, resulting in inflows of roughly EUR 30bn by 2021. As a net effect (i.e. inflows and outflows), we forecast a decrease in the NPL stock by 2021. We expect that 2020 outflows will be more severe than inflows (i.e. new defaults), the former being driven by deleveraging activities (i.e. portfolio sales) and re-performing flows. This will contribute to slow securitisation activity as disposable stocks will decrease.

The estimate for 2020-21 volumes is based on the historical NPL inflows and outflows, registered after the Italian sovereign crisis. The forecast takes into account government

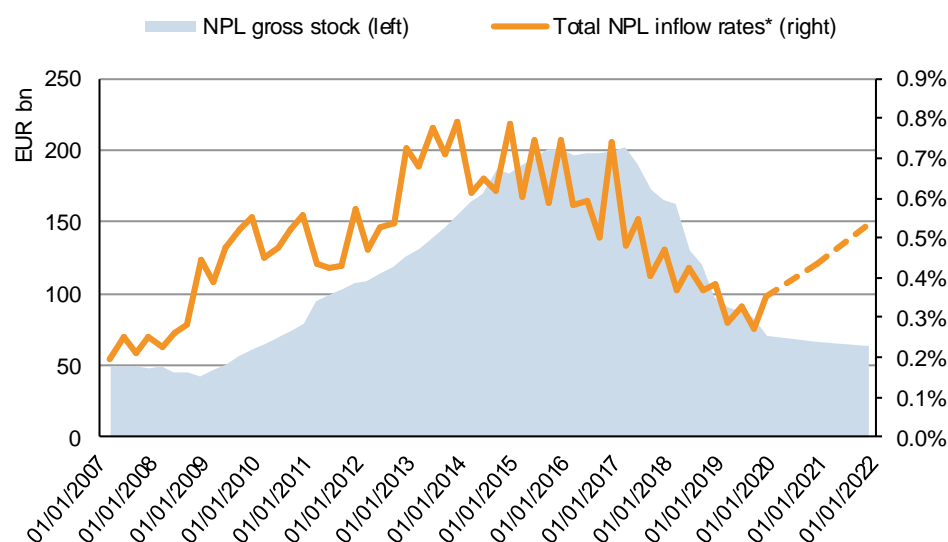
³ Please refer to the [article](#) recently published by Scope, on default expectations.

⁴ Based on the Italian decree "Decreto di Liquidità" n.23, 8 April 2020.

⁵ NPL inflows refer to exposures migrating to non-performing status.

aid, which will contribute to a delay in the increase of inflows. As highlighted in our recent [report](#), we expect that new defaults will significantly rise from 2021.

Figure 3: NPL stock and inflows: past and future trends



*Total refers to all borrowers except financial monetary institutions. NPL inflows are computed as new NPL inflows over performing stock at inception, with a quarterly basis.

Source: Bank of Italy (Banca Dati Statistica or BDS), Scope Ratings

2. 2020 slowdown: key drivers

We summarise below the main drivers for the slowdown in securitisation issuance, along with the incentives introduced by DTAs. As mentioned in Section 1, the imbalance between the reduction in NPL stocks and new inflows will contribute to a slow-down in securitisation activity.

Due to increased liquidity risk, we expect investors to require robust cash reserves, aligned with the upper-bound of historical liquidity levels (i.e., 4%-5% of Class A).

✓ Driver: wider bid-ask gap on NPL portfolios

Portfolio disposal prices are expected to fall as investors take more conservative views on their projections for recoveries. The suspension of legal proceedings will lengthen the typical time of recovery assumptions applied by investors⁶. More back-loaded cash-flows will lower investors' returns (IRR⁷) so in order to keep IRRs unchanged, sale prices of NPLs will have to decrease. Lower expected recoveries stemming from secured and unsecured exposures will also contribute to lower NPL prices. Uncertainty around Italy's speed of recovery penalises projections that are less 'through the cycle'.

As a result, the bid-ask gap between banks and investors is expected to widen, causing a higher impact on bank balance sheets. Banks will either postpone their disposal plans or sell smaller portfolios to minimise losses on their P&Ls.

Wider bid-ask gap

⁶ Covid-19 outbreak is expected to delay all legal proceedings (please refer to [Scope commentary](#)).

⁷ Internal rate of return.

Higher risk-premium

✓ Driver: higher risk-premium for note placements

Mezzanine and junior notes might be sold to investors at higher discounts than before. If investors foresee increased risk to Italy's economy, they will incorporate higher risk-premiums into their pricing. This could impact both primary and secondary markets, where only the most opportunistic investors might acquire riskier notes.

Higher GACS costs

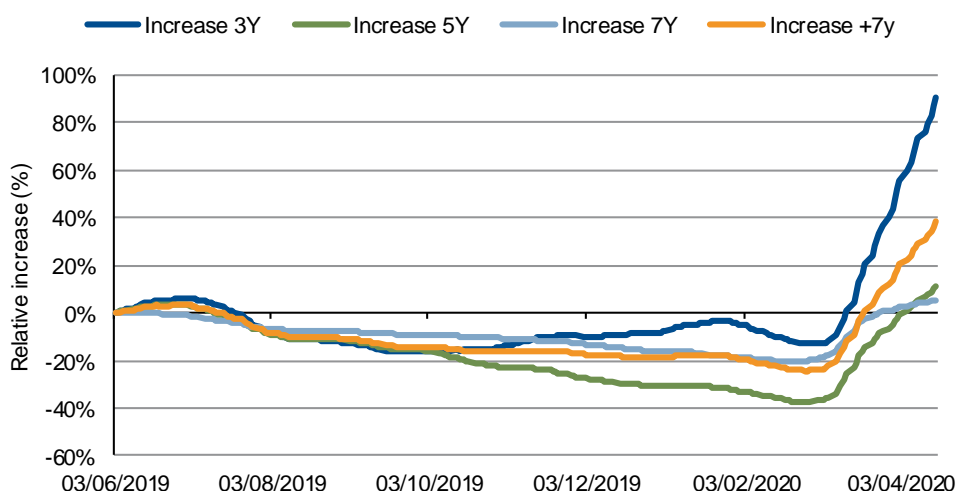
✓ Driver: higher GACS costs

Due to the uncertain macroeconomic scenario, sovereign credit-default-swap (CDS) spreads have seen a significant increase⁸ in the last three months (+186% +121%, +108% for 3/5/7-year tenors).

As a result of Covid-19, GACS guarantees are more expensive than last year.

Figure 4 shows the relevant increase⁹ of GACS costs for senior notes with BBB ratings. Credit risk has increased more for short-term tenors, reflecting increasing concern in the next few years. GACS costs for years one to three increased by 91% with respect to May 2019 levels, the highest increase among all tenors.

Figure 4: GACS costs for BBB ratings (relative increase)



Source: Market data, Scope Ratings

GACS costs are computed based on a two-month reference period, used to calculate historical CDS averages. In times of crisis, a two-month reference period does not mitigate the effect of short-term peaks. This explains the significant increase of GACS costs triggered by Covid-19 outbreak.

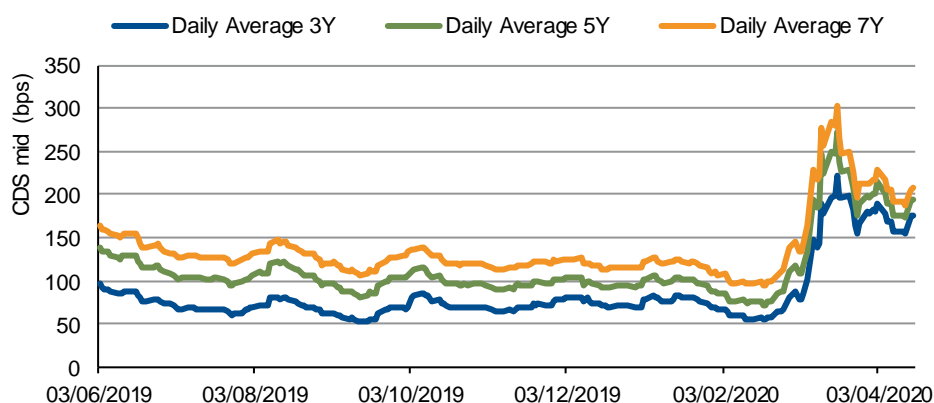
Daily averages of CDS values for the BBB basket¹⁰ (used to compute GACS costs), sharply increased between March and April, as shown in Figure 5.

⁸ Increase measured between 2020 peak and January levels.

⁹ Costs are computed from May-19 values, the date on which the European Commission approved the extension of the GACS scheme.

¹⁰ I.e., daily average of CDS values for the entities within the BBB basket or paniere, as per GACS formula.

Figure 5: Daily averages of CDS values for BBB basket



Source: Market data, Scope Ratings

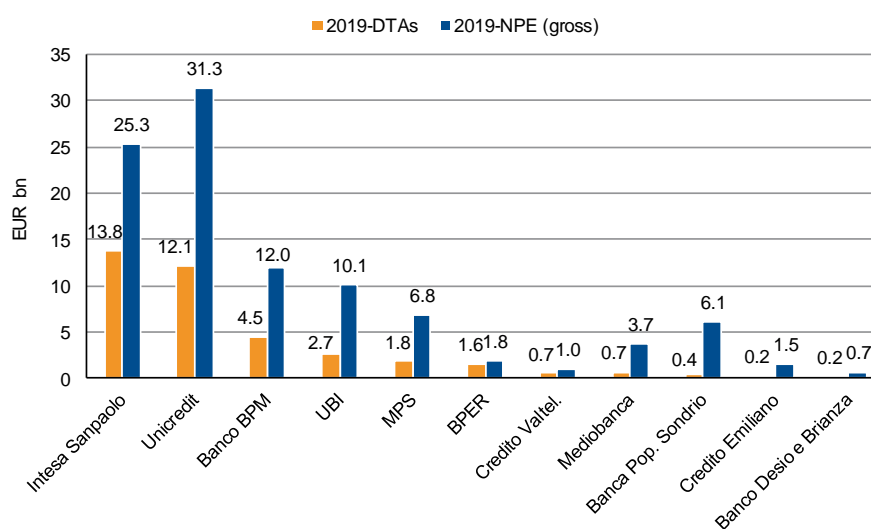
✓ Incentive: DTA measures as incentives for NPL disposals

As envisaged in Decree nb.18 of 17 March 2020 (Decreto Cura Italia), banks can convert certain types of DTAs into tax credits and leverage them to compensate for the impact of NPL¹¹ disposals on their capital ratios. Even though the aim of this measure is to incentivise bank disposals, its application is relatively limited. In fact: i) the incentive is valid only for 2020 disposals, ii) only certain DTAs are eligible (fiscal losses or perdite fiscali and ACE¹² surplus), iii) tax credits can be leveraged up to EUR 110m¹³ for a maximum portfolio amount of EUR 2bn GBV. Banks will also have to pay 150bp¹⁴ p.a., to benefit from the option.

DTA incentive

Figure 6 shows the amount of DTAs and NPEs held by Banks, while Figure 7 shows banks' positioning in terms of NPE and DTA relative values.

Figure 6: Top 11 Bank NPE and DTA stocks (2019)*



* NPE figures for Banco di Desio e della Brianza SpA refer to the third quarter of 2019. DTA figures refer to the total amount of Bank's DTA (i.e., they include non-convertible DTAs). NPE figures include bad loans, unlikely to pay and past due exposures.

Source: public data, Scope Ratings

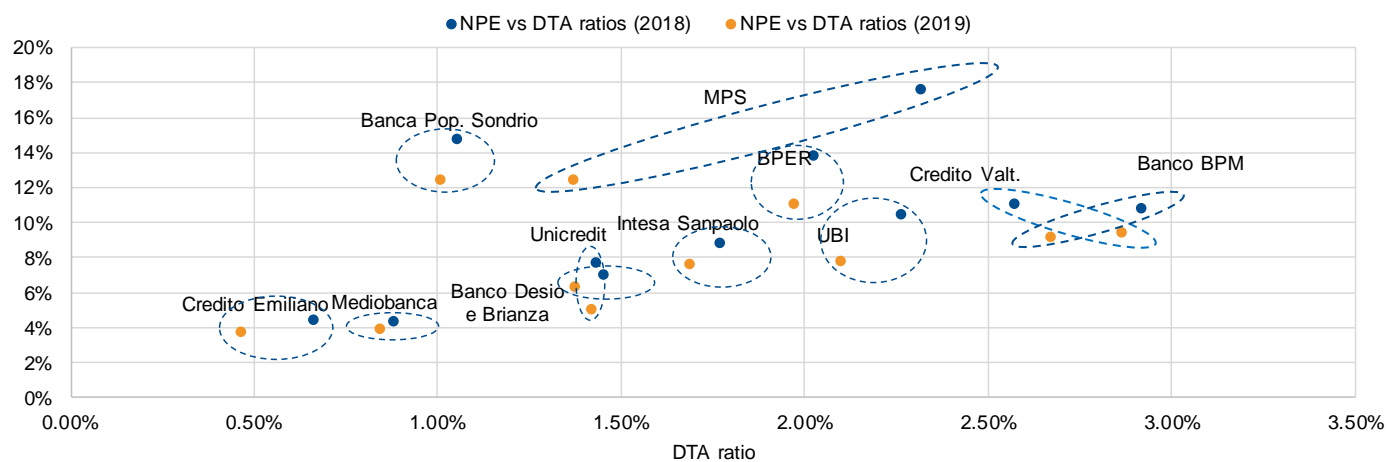
¹¹ The Decree applies to the disposal of borrowers with past-due payments of at least 90 days.

¹² ACE stands for "Aiuto per la crescita economica/Support for the economic growth", it refers to a tax relief regime.

¹³ Convertible DTAs are capped at 20% of a portfolio's notional (gross-book-value). Single disposals cannot exceed EUR 2bn of notional. As a result of both caps, and considering the IRES component, convertible DTAs eligible for the Decree cannot exceed EUR 110m.

¹⁴ On the difference (if positive) between anticipated and paid taxes.

Figure 7: Top 11 Banks - NPE versus DTA % (2018-2019)*



*DTA ratio measures DTAs over Total Assets, NPE ratio measures NPE over total loans. DTA figures refer to the total amount of Bank's DTA (i.e., they include non-convertible DTAs). NPE figures include bad loans, unlikely to pay and past due exposures.

Source: public data, Scope Ratings

I. Appendix –NPL securitisations rated by Scope

Deal name/Link to Rating report	Issuance	Seller	Servicer (master and special)	GBV (million)	Scope rating Class A	Scope rating Class B	Coupon A/B	GACS (Y/N)
Elrond NPL 2017 Srl	Jul-17	Credito Valtellinese SpA, Credito Siciliano SpA	Cerved Credit Management SpA, Cerved Master Services SpA	1,422	BBB-	B+	6mE+0.5%/6mE+6%	Y
Bari NPL 2017 Srl	Dec-17	Banca Popolare di Bari Scpa, Cassa di Risparmio di Orvieto SpA	Prelios Credit Servicing SpA	345	BBB	B+	6mE+0.3%/6mE+6%	Y
GBV of GACS eligible securitisations rated by Scope 2017 (EUR million)				1,767				
Siena NPL 2018 Srl	May-18	Monte dei Paschi di Siena SpA, MPS Capital Services Banca per le Imprese SpA, MPS Leasing & Factoring SpA	Juliet SpA, Italfondario SpA, Credito Fondiario SpA, Prelios Credit Servicing SpA	24,070	BBB+	Not Rated	3mE+1.5%/3mE+8%	Y
Aragorn NPL 2018 Srl	Jun-18	Credito Valtellinese SpA, Credito Siciliano SpA	Credito Fondiario SpA, Cerved Credit Management SpA	1,671	BBB-	B	6mE+0.5%/6mE+7%	Y
Red Sea SPV Srl	Jun-18	Banco BPM SpA and Banca Popolare di Milano SpA	Prelios Credit Servicing SpA	5,097	BBB	Not Rated	6mE+0.6%/6mE+6%	Y
4Mori Sardegna Srl	Jun-18	Banco di Sardegna SpA	Prelios Credit Servicing SpA	1,045	A-	BB-	6mE+0.9%/6mE+8%	Y
2Worlds Srl	Jun-18	Banco di Desio e della Brianza SpA, Banca Popolare di Spoleto SpA	Cerved Credit Management SpA, Cerved Master Services SpA	1,002	BBB	B	6mE+0.4%/6mE+8%	Y
BCC NPLS 2018 srl	Jul-18	21 co-operative banks co-ordinated by Iccrea SpA and two banks belonging to ICCREA Banca SpA	Prelios Credit Servicing SpA	1,046	BBB-	B+	6mE+0.4%/6mE+6%	Y
Juno 1 Srl	Jul-18	Banca Nazionale del Lavoro SpA	Prelios Credit Servicing SpA	957	BBB+	Not Rated	6mE+0.6%/6mE+8%	Y
Maggese Srl	Jul-18	Cassa di Risparmio di Asti SpA, Cassa di Risparmio di Biella e Vercelli-Biverbanca SpA	Prelios Credit Servicing SpA	697	BBB	Not Rated	6mE+0.5%/6mE+6%	Y
Maior SPV Srl	Aug-18	Unione di Banche Italiane SpA and IW Bank SpA	Prelios Credit Servicing SpA	2,749	BBB	Not Rated	6mE+0.5%/6mE+6%	Y
IBLA Srl	Sep-18	Banca Agricola Popolare di Ragusa Scpa	Italfondario SpA	349	BBB	B	6mE+0.6%/6mE+8%	Y
AQUI SPV Srl	Nov-18	BPER Banca SpA, Cassa di Risparmio di Saluzzo SpA and Cassa di Risparmio di Bra SpA	Prelios Credit Servicing SpA	2,082	BBB-	Not Rated	6mE+0.5%/6mE+7%	Y
POP NPLS 2018 Srl	Nov-18	17 banks	Cerved Credit Management SpA, Cerved Master Services SpA	1,578	BBB	B	6mE+0.3%/6mE+6%	Y
Riviera NPL Srl	Dec-18	Banca Carige SpA and Banca del Monte di Lucca SpA	Italfondario SpA, Credito Fondiario SpA	964	BBB-	B+	6mE+0.65%/6mE+7%	Y
BCC NPLS 2018-2 Srl	Dec-18	73 co-operative banks	Italfondario SpA	2,004	BBB	B+	6mE+0.3%/6mE+6%	Y
Belvedere SPV Srl	18-Dec	Gemini SPV Srl, Sirius SPV Srl, Antares SPV Srl, 1702 SPV Srl, Adige SPV Srl	Bayview Italia S.r.l. , Prelios Credit Servicing S.p.A.	2,541	BBB	Not Rated	6mE+3.25%/6%	N
GBV of GACS eligible securitisations rated by Scope 2018 (EUR million)				45,311				

GBV of securitisations rated by Scope 2018 (EUR million)				47,852				
Leviticus SPV Srl	Feb-19	Banco BPM SpA	Credito Fondiario SpA	7,385	BBB	Not Rated	6mE+0.6%/6mE+8%	Y
Juno 2 Srl	Feb-19	Banca Nazionale del Lavoro SpA	Prelios Credit Servicing SpA	968	BBB+	Not Rated	6mE+0.6%/6mE+8%	Y
Prisma SPV Srl	Oct-19	Unicredit SpA	Italfondario SpA, doValue SpA	6,057	BBB+	B-	6mE+1.5%/6mE+9%	Y
Marathon SPV Srl	Dec-19	Marte SPV Srl, Pinzolo SPV Srl	Hoist Italia Srl, Securitisation Services SpA	5,027	BBB+	BB	1.8%/8%	N
Iseo SPV Srl	Dec-19	UBI Banca SpA	Italfondario SpA, doValue SpA	858	BBB	Not Rated	6mE+0.5%	Y
Futura 2019 Srl	Dec-19	Futura SPV Srl	Guber Banca SpA	1,256	BBB	Not Rated	6mE+0.3%	N
BCC NPLs 2019 Srl	Dec-19	68 banks	Italfondario SpA, doValue SpA	1,324	BBB+	B-	6mE+0.3%/6mE+6.5%	Y
POP NPLs 2019 Srl	Dec-19	12 banks	Prelios Credit Servicing SpA, Fire SpA	826.7	BBB	CCC	6mE+0.3%/6mE+9.5%	Y
GBV of GACS-eligible securitisations rated by Scope 2019 (EUR million)				17,419				
GBV of securitisations rated by Scope 2019 (EUR million)				23,702				
Total GBV of securitisations rated by Scope (EUR million)				73,321				

Source: Scope Ratings public data



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