# A Strategy for Developing a Market for Nonperforming Loans in Italy

# Based on IMF Working Paper

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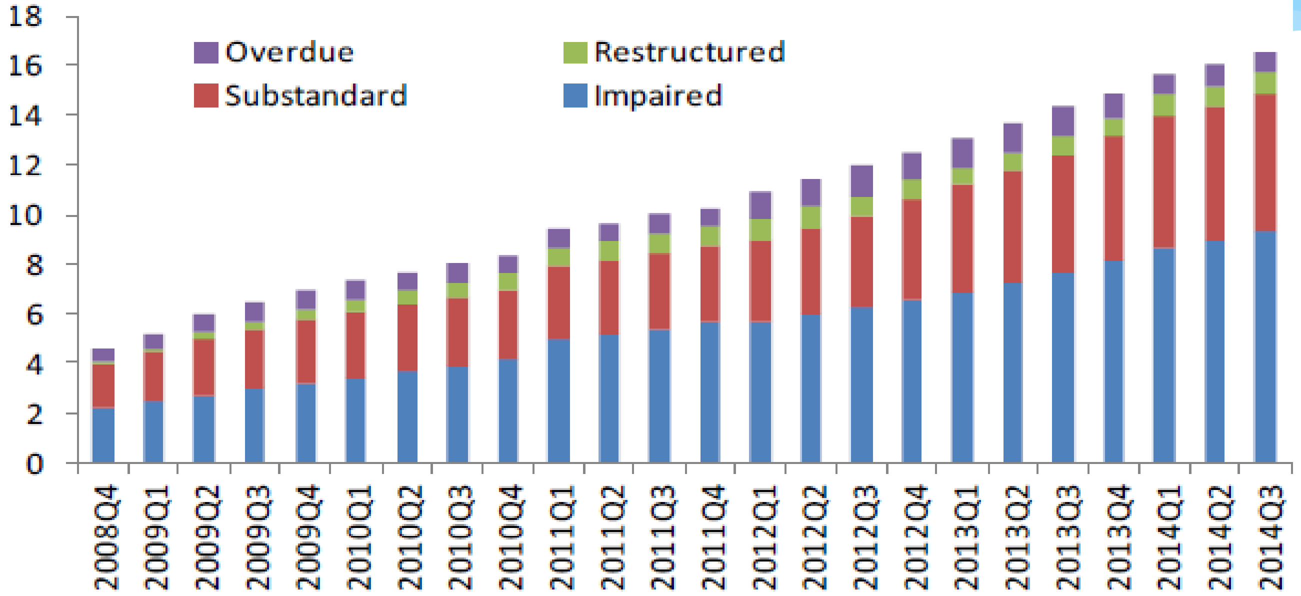
|---|---|
| 1 | NPLs in Italy: General Outlook |
| 2 | A Strategy for Developing a Market for NPLs in Italy |

# Since 2008, NPLs have reached systemic levels in Italy…

## Italy: Non-performing Loans




Source: Bank of Italy and IMF Staff Estimates
Notes: In percent of total loans.

# …both Corporate and Retail NPLs

## Euro Area: Gross Nonperforming Exposure (NPE) Ratios by Sector

*(asset-weighted average; in percent of total assets, 2014)*

| | Total | Corporate | Retail | Total *(in percent of GDP)* |
|---|---|---|---|---|
| Cyprus | 39.4 | 46.3 | 29.6 | 48.0 |
| Ireland | 32.2 | 50.2 | 21.7 | 40.9 |
| Greece | 25.3 | 23.2 | 26.9 | 25.4 |
| Slovenia | 20.2 | 29.9 | 11.1 | 14.6 |
| Italy | 17.6 | 21.0 | 13.7 | 12.0 |
| Spain | 12.2 | 18.8 | 6.8 | 9.1 |
| Latvia | 9.7 | 7.3 | 12.1 | 3.7 |
| Lithuania | 8.9 | 9.7 | 8.1 | 3.2 |
| Portugal | 7.9 | 11.1 | 5.7 | 7.3 |
| Malta | 6.3 | 8.8 | 4.7 | 3.0 |
| Luxembourg | 5.0 | 5.3 | 3.1 | 7.0 |
| Slovak Republic | 5.0 | 6.0 | 4.3 | 4.4 |
| Austria | 4.6 | 5.0 | 4.0 | 2.0 |
| Denmark | 4.0 | 5.5 | 1.9 | 1.6 |
| Netherlands | 3.7 | 7.7 | 1.8 | 5.5 |
| Belgium | 3.4 | 5.1 | 2.4 | 2.3 |
| France | 3.2 | 2.9 | 3.4 | 2.7 |
| Estonia | 2.5 | 2.3 | 2.6 | 1.4 |
| Finland | 1.7 | 1.8 | 1.6 | 0.9 |

Sources: EBA, ECB Comprehensive Assessment; SNL, European Central Bank 2014 Comprehensive Assessment database; and IMF staff calculations.

Note: Red = top 25 percent of distribution; green = bottom 10 percent of distribution; and light green, yellow, and light red = remainder of the distribution. NPEs restricted to local exposures only. For non–euro area countries, Figure 2b presents NPLs, as the NPE data are not consistently available for countries that were not included in the ECB's Comprehensive Assessment.

# Loan losses have depressed banks' profitability, hindering Italy's recovery

## Reducing NPLs is critical for economic recovery

### Problems

- New lending is held back by weak bank balance sheets
  - Higher risk-weights on NPLs tie-up capital
  - Higher funding costs and lower profitability raise vulnerability to shocks
- Debt overhang negatively affects corporate investment
- The prolonged recession led to higher default risk for firms and banks

### Objectives

- Improve credit supply to support investment
- Reduce corporate debt overhang and allow viable firms to restructure
- Enhance bank lending channel → monetary transmission
- Strengthen bank profitability

# Reasons behind the slow pace of NPLs Resolution

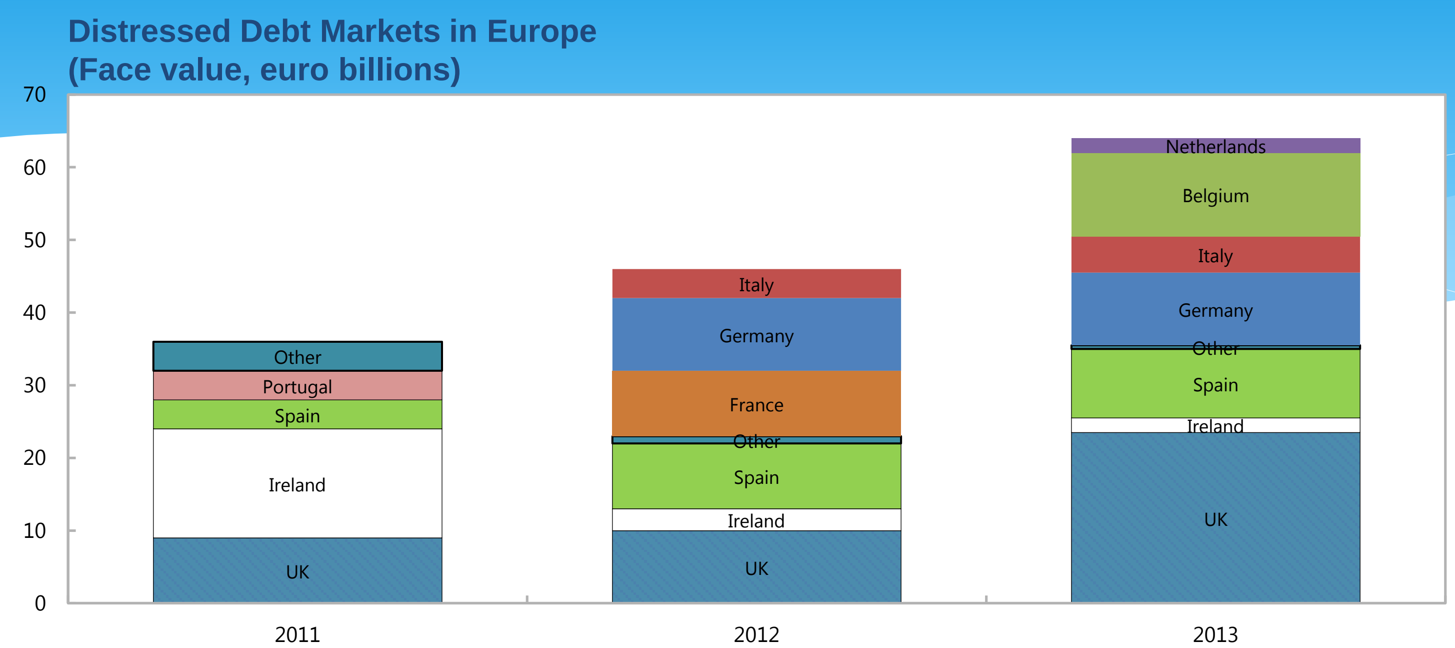
**Supply factors: Limited Incentives for Banks to Sell and Write Off**

- Low provisions and capital buffers
- Heavy reliance on collateral and close relationships with borrowers
- Tax disincentives to provisioning and write-offs
- Accounting regime favorable to holding NPLs

**Demand Factors: High Cost and Limited Options for Restructuring**

- A small investor base with limited risk capital
- A lengthy and inefficient judicial process

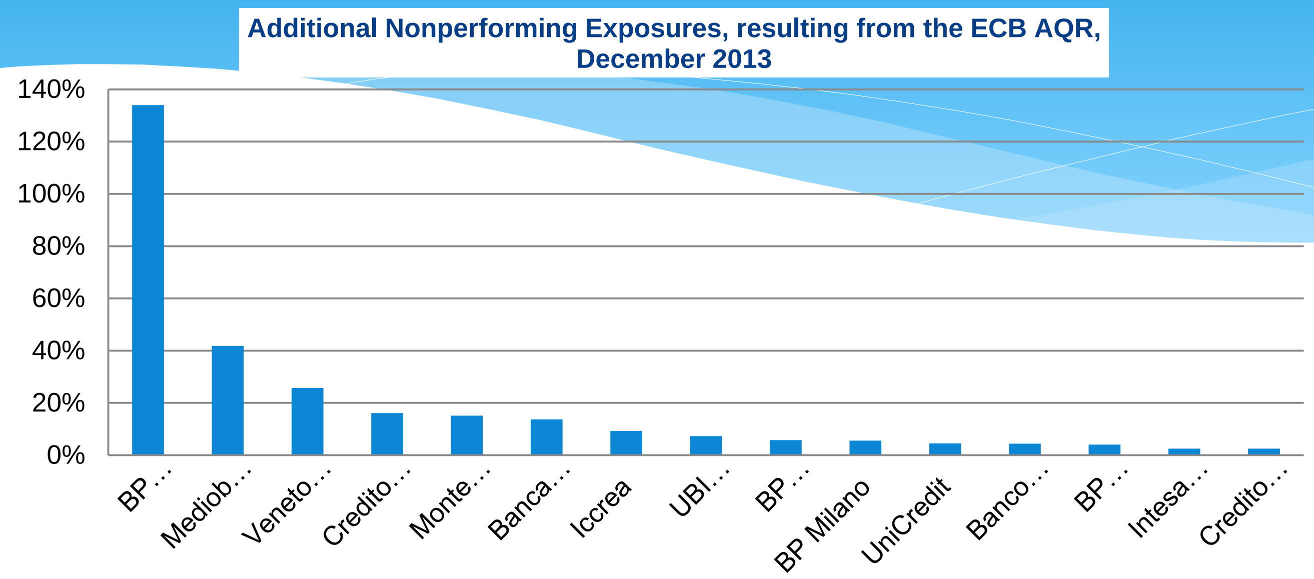
# State of the Distressed Debt Market




Source: PwC.

- Despite the build-up in NPLs, a market for restructuring distressed debt in Italy has yet to pick up after the global financial crisis
- Initiatives to set up private AMCs and restructuring vehicles are only slowly emerging
- Tax disincentives to provisioning and write-offs
- The distressed debt market in Europe is small but has also shown signs of picking up

# Supervisory policies to speed up NPL resolution and debt restructuring




- Any remaining uncertainty about Italian banks’ asset quality needs to be resolved
- Regulatory and supervisory action is be required to increase the ability of the banks to deal with NPLs. Strong disincentives for keeping bad debt on balance sheets would foster NPL clean up
- ECB sees the persistence of bad loans as one of the main challenges for banks and supervision
- ECB is tackling NPL resolution through the establishment of an ad-hoc working group and strong engagement with national competent authorities and banks through Pillar 2

# Removal of tax and other impediments; Legal reforms to to promote both court-led and out-of-court restructuring

- Removing tax impediments to timely provisioning
- Public agencies with claims on defaulted borrowers should participate in debt restructuring agreement and face similar treatment with other creditors
- Strong disincentives for keeping bad debt on balance sheets to foster NPL clean up
- Strengthening insolvency regime and improving the efficiency of the court system
- More extensive use of out-of-court restructuring
- Use of debt-equity swaps

The following **government initiatives** (June 2015) should facilitate the development of a market for NPLs in Italy:

- Full tax deductibility of loan loss provision in 1 year compared to the current 5 years
- Reform of the bankruptcy law which should speed up the write-off

# Develop further NPL AMCs/Corporate Restructuring Vehicles

- NPL asset management companies (AMCs) would help support the distressed debt market in Italy. AMCs can help to close the NPL pricing gap by allowing banks to invest in AMCs and retain some of the upside returns from restructuring in a way that does not conflict with accounting rules
- Similar to AMCs, corporate restructuring vehicles (CRVs) are another instrument that go one step further and rehabilitate distressed companies
- Building on efforts to promote high-quality securitization (HQS), the Italian NPL-ABS market could provide another channel for offloading distressed assets

# Thank you!