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From Non-Performing Loans to “Unlikely to Pay:” The Next Frontier

by TMA Europe

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From NON Performing Loans to „Unlikely to Pay“: The Next Frontier

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NPL's in Germany:

- NPL's overall are still at a low level – NPL market remains subdued
- NPL definition as non payment in 90 days (EBA) have existed since many years
- The focus is to restructure the (corporate) loans: operational plus debt restructuring in an early phase to tackle the NPL volume
- Banks remain reluctant to sell to market prices accompanied with haircuts



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Titel der Präsentation bei Einfügen/Kopf-und Fußzeile ändern und dann für alle übernehmen

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The Italian NPL market

What's next...?!



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Foreword & Content

The Italian market for Non Performing Exposures (“NPE”) over the year 2017 and the first months of 2018 met expectations in terms of vitality and fervor. With regard to Bad Loans, volumes lie at €165 billion (GBV) and €64 billion (NBV) as at December 2017. Their massive reduction, occurred from December 2016 to December 2017 (less 18% in terms of GBV and less 26% in terms of NBV), has been driven mainly by a few mega deals of loans derecognition (€17.7 billion disposed by Unicredit through Project Fino, €16.8 billion disposed by Banca Popolare di Vicenza and Veneto Banca through their bailout). Eventually the NPL disposals in 2017 reached a volume of €64 billion.

The reduction trend even continued over the first quarter of 2018 featuring further mega deals such as the disposal of €24 billion of Bad loans sold by MPS through securitisation and the disposal of €10.8 billion of Bad Loans sold by Intesa Sanpaolo in the context of the sale of their NPL platform to Intrum.

Alongside the circa €37 billion of transactions already closed in 2018 from 1st January, we foresee a pipeline for further NPE transactions to be announced in the year equal to circa €28 billion, including several securitisation operations under GACS (supported by the Italian Government guarantee on the senior notes) and the disposals of some Unlikely to Pay (“UtP”) portfolios. These announced transactions will even fuel the NPL secondary market. UtP exposures reached €94 billion of GBV as at December 2017 (vs. €117 billion one year before) definitively surpassing the level of Bad Loans in terms of NBV (€66 billion vs €64 billion respectively). Italian banks are still pondering over how to best structure the management of their UtP (internally by their specialised departments or externally by specialised servicers), and effectively implement disposal plans of their UtP exposures (sales of UtP, net of the disposals associated to several bailouts, were limited in terms of numbers of transactions and in EUR volumes in 2017).

The first months of 2018 also witnessed a significant increase in the NPE provisions within the Italian banks led by the application of IFRS9 for the first time. The adoption of the international accounting principle led the average NPE provision of the top ten Italian banks as at March 2018 to 59% from 54% as at December 2017 (in particular Bad Loans’ provision achieved 66% from 61% and the Unlikely to Pay’s provision reached 38% from 35%).

Over the last eighteen months, the real trendsetter of the NPL market was the consolidation path of the servicing arena through the acquisition of several workout platforms by big players.

The transactions included either the captive units of some Italian banks (e.g. the platform of MPS, Carige and Intesa Sanpaolo acquired respectively by Cerved/Quaestio, Credito Fondiario and Intrum) and some independent players (e.g. CAF, Phoenix Asset Management, Parr Credit, FBS acquired respectively by Intrum, Anacap/Pimco, Arrow and Banca IFIS). We believe that new players could enter the market in 2018 for further platform disposals, mainly driven by the future opportunities of the servicing market such as i) the forecasted rise in the volumes of Bad Loans outsourced by the Italian banks to external servicers, ii) the management of the Unlikely to Pay exposures which actually represent the next frontier of NPE servicing.

In the context of consolidation, a leading role could be held by the “challenger banks”. These players, leveraging their banking license, their in-house workout management expertise and restructuring capabilities, could offer a wide range of services in the market either in the consolidated field on Bad Loans’ collection and in pioneering the field of Unlikely to Pay loans’ management. We believe that the challenger banks could represent the evolution of the traditional banking business model. Through i) new lending to UtP, sub-performing and subprime borrowers, ii) specialty finance and iii) expertise in restructuring measures, the challenger banks could massively affect the dynamics of these portions of NPE portfolios that at least up until now did not result in significant positive outcome within the Italian banking system.

The maneuvers we see in the market even reflect the requests of the Regulators addressed to the Italian banks. These recommendations aim, on the one hand, at redefining their NPE strategies to reduce the NPE ratios and on the other hand, at reshaping their operating model to progress towards a further industrialization of the overall loans management. Regulatory pressure on the Italian banks aimed at reducing their NPE ratio is focusing even on UtP that always more frequently are under investigation in the course of the audit of the Regulators. ECB guidelines, whose application will be extended in Italy to the Less Significant banks, the calendar provisioning (within the ECB Addendum) and the aforementioned first time adoption of IFRS9, will continue to drive the strategic decisions of the Italian banks in the near future.

Despite the political turmoil currently perceived by the market, in light of all the movements occurred over the last year, we believe that the Italian NPE market is still rich with interesting opportunities and new potential and innovative initiatives. Thus we wonder what’s next...?!

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The terms of NPL (“Non Performing Loans”) and NPE (“Non Performing Exposures”) are used interchangeably within this study. This recommendation was even explained in the “Guidance to banks on non-performing loans (March 2017)” released by ECB – Banking Supervision*

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* “Guidance to banks on non-performing loans (March 2017)” by ECB, par. 1.2, pag.6 “Scope of this Guidance” and par. 5.1, pag. 47 “Purpose and Overview”



Macroeconomic Scenario



Key Message: Following the 2017 positive trend, the European economic performance is expected to be shown robust also in 2018, with inflation set to remain stable. During 2018, total investments should continue growing, since they could still benefit from supportive financing conditions, a stronger business sentiment and higher corporate profitability.



During the first half of 2017, the pace of the European economic growth surpassed expectations, thanks to resilient private consumption and moderate improvements in the labour market. During the following months, a strong consumer and business sentiment has suggested that this robust economic performance should prolong to the near-term.

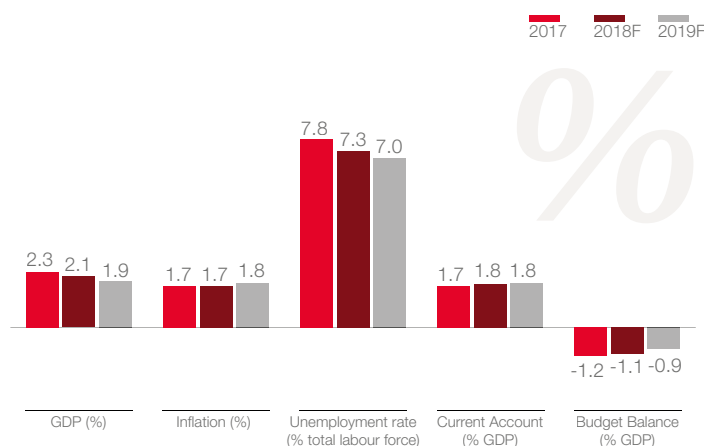
After peaking 2.3% in 2017, EU GDP growth is set to moderate slightly to 2.1% in 2018 and to 1.9% in 2019 (projections for 2019, given the ongoing withdrawal of the UK from the EU, are based on a purely technical assumption of status quo in terms of trading relations between the country and the other EU27).

Italian GDP is forecast to decrease to 1.3% in 2018 and then reach 1.0% in 2019. Export growth is predicted to lose some strength due to the appreciation of the Euro, while public and private consumption are projected to decelerate.

During 2017, European inflation oscillated between 1.3% and 2.0%, mainly driven by the impact of energy base effects. In 2018, inflation is projected to remain quite stable (1.7%), peaking 1.8% in 2019.

Since the renewed fiscal incentives included in the 2018 budget are expected to further empower growth in the labour market, the Italian unemployment rate is projected to gradually decline: the rate is forecasted to reduce to 10.9% in 2018 and 10.5% in 2019.

Chart 1: EU main economic drivers



Source: PwC analysis on European Economic Forecast Autumn 2017.
Unemployment rate as a % of total labour force, current account balance and budget balance as a % of GDP.

Chart 2: Italian main economic drivers



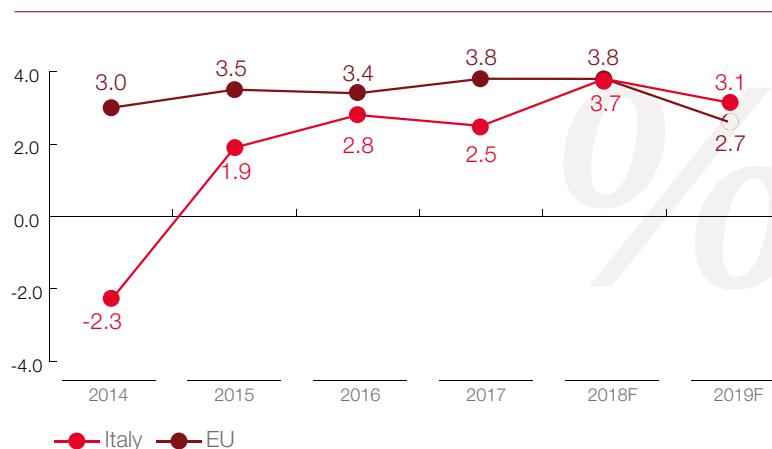
Source: PwC analysis on European Economic Forecast Autumn 2017.
Unemployment rate as a % of total labour force, current account balance and budget balance as a % of GDP.

The EU current account surplus is set to exhibit a stable trend (1.8% for both 2018 and 2019): in fact, notwithstanding robust import growth, net trade should contribute only marginally to growth over the next 2 years. In Italy the surplus is forecasted to reach 2.5% in 2018 and 2.3% in 2019.

In the first half of 2017, higher demand expectations, supportive financing conditions, lower uncertainty, strong business sentiment and increasing corporate profitability contributed to a positive setting for corporate investment. Investments are forecast to go on growing at this robust pace, before slowing down in 2019.

The improved outlook for nominal GDP growth and low interest rate levels generate favourable snowball effects in the public sector deleveraging process, with Government Gross Debt Ratios projected to follow a downward trend in almost all Member States (for example, for Italy, this Ratio is set to be 130.8% in 2018 and 130.0% in 2019).

Chart 3: Total investments volume trend

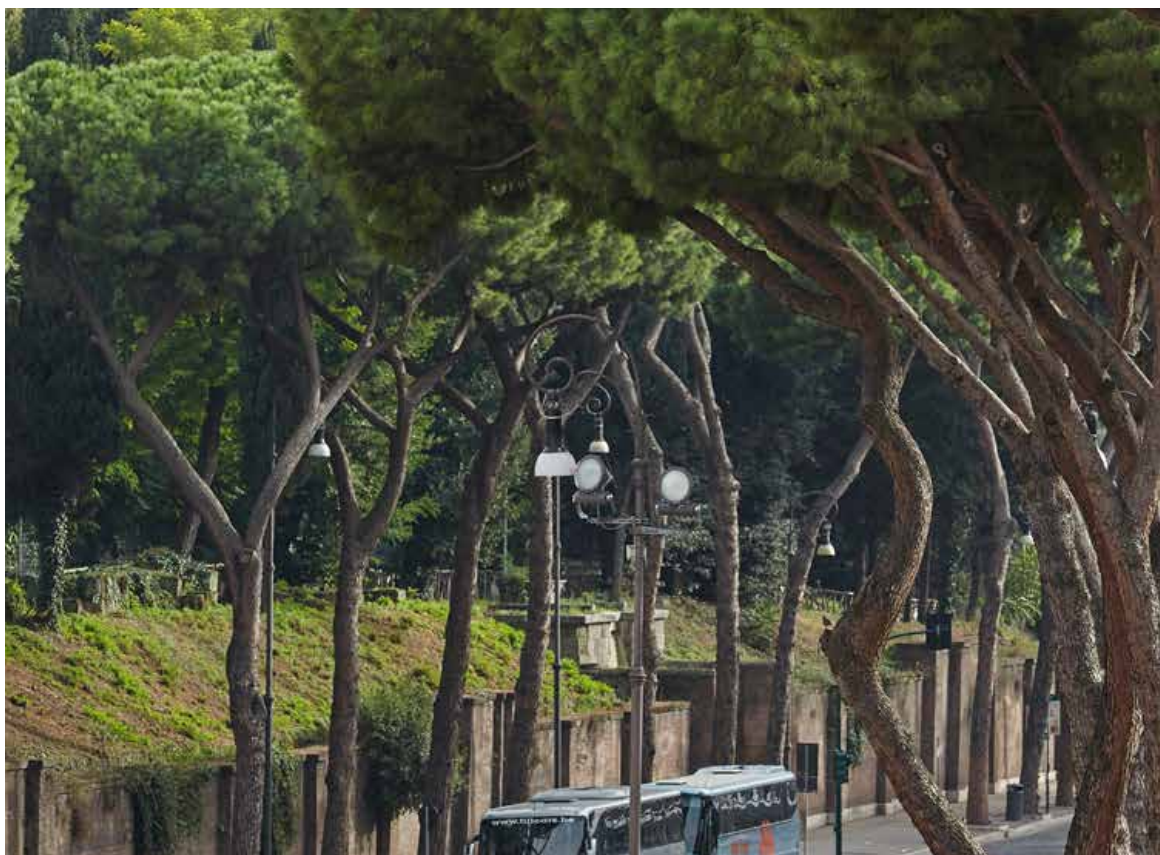


Source: PwC analysis on European Economic Forecast Autumn 2017.

Table 1: Government Gross Debt Ratio per country

Government Gross Debt Ratio (% GDP)	2014	2015	2016	2017	2018F	2019F	Trend 2018-2019F
Italy	131.8	131.5	132.0	132.1	130.8	130.0	▼
EU	88.2	86.1	84.8	83.5	81.6	79.8	▼
Spain	100.4	99.4	99.0	98.4	96.9	95.5	▼
France	95.0	95.8	96.5	96.9	96.9	96.9	=
UK	87.4	88.2	88.3	86.6	85.3	84.2	▼
Germany	74.6	70.9	68.1	64.8	61.2	57.9	▼

Source: PwC analysis on European Economic Forecast Autumn 2017.



Italian Real Estate Market



Key Message: In 2017, the Italian Real Estate market registered a 2.1% growth compared to 2016, mainly driven by transactions related to residential assets. Investments in Real Estate reached €11.1 billion in 2017, with offices continuing to represent the major asset class for investment.



Volume of Real Estate transactions in 2017

In 2017, the Italian real estate market has been continuing on its positive trend, driven mainly by sales of residential and industrial properties.

The most significant percentage growth, compared to the previous year, was recorded in the industrial building sector (+6.7%). See **Table 2**.

Residential sales in 2017 have increased throughout each region of Italy with respect to 2016. The North showed the greatest positive results, with a 3.4% increase over 2016, followed by the Centre and South with +1.9% and +1.4%, respectively. See **Table 3**.

During 2017, non residential asset classes showed a slight decrease, accounting for 2.5% compared to 2016. While continuing to account for a small proportion of the total, the industrial segment is the sector registering the highest growth rate, at 6.7%. See **Table 4**.

Appurtenances (which include garages, basements and parking spots) and other sectors are showing a strong decrease, due to provisional data.

Table 2: Italian NTN¹ comparison by sector

Asset type	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	2016	2017	Delta (%) 2016-2017
Residential	115,194	143,298	123,476	146,896	121,972	145,527	122,373	152,608	528,865	542,480	2.6%
Office	2,025	2,413	2,510	3,000	2,362	2,486	2,584	2,922	9,946	10,354	4.1%
Retail	6,776	7,598	7,188	9,024	6,215	7,176	6,340	8,384	30,586	28,115	-8.1%
Industrial	2,121	2,897	2,565	3,704	2,329	2,996	2,894	3,818	11,287	12,038	6.7%
Total	126,116	156,206	135,738	162,624	132,878	158,186	134,191	167,732	580,684	592,987	2.1%
Appurtenances ²	87,554	110,015	94,007	119,427	85,291	101,566	85,386	111,646	411,003	383,889	-6.6%
Other ³	10,792	13,400	12,726	15,660	12,663	14,464	12,661	16,963	52,578	56,751	7.9%

Source: PwC publication "Real Estate Market Overview – Italy 2017".

1. NTN is the number of standardized real estate units sold, taking into account the share of the property transferred.

2. Appurtenances comprehend properties such as basements, garages or parking spots.

3. The sector "Other" includes hospitals, clinics, barracks, telephone exchanges and fire stations.

Table 3: Residential NTN by geographic area

Area	Region	Year 2015	Year 2016	Year 2017	Delta (%) 2015-2016	Delta (%) 2016-2017
North	Provinces	72,648	89,901	93,060	23.7%	3.5%
	No Provinces	157,819	192,015	198,394	21.7%	3.3%
	Total	230,467	281,916	291,454	22.3%	3.4%
Center	Provinces	45,425	51,577	53,027	13.5%	2.8%
	No Provinces	49,041	58,159	58,805	18.6%	1.1%
	Total	94,466	109,736	111,832	16.2%	1.9%
South	Provinces	33,931	38,921	40,385	14.7%	3.8%
	No Provinces	85,771	98,292	98,809	14.6%	0.5%
	Total	119,703	137,214	139,194	14.6%	1.4%
Italy	Provinces	152,004	180,400	186,472	18.7%	3.4%
	No Provinces	292,632	348,465	356,008	19.1%	2.2%
	Total	444,636	528,865	542,480	18.9%	2.6%

Source: PwC publication "Real Estate Market Overview – Italy 2017".

Table 4: Non residential NTN by geographic area

NTN YE 2017 Office	Q1 2017	Q2 2017	Q3 2017	Q4 2017	2016	2017	Delta (%) 2016-2017
North	1,385	1,455	1,528	1,777	6,096	6,145	0.8%
Center	573	527	541	586	1,969	2,227	13.1%
South	404	504	515	559	1,881	1,982	5.3%
					9,946	10,354	4.1%

NTN YE 2017 Retail	Q1 2017	Q2 2017	Q3 2017	Q4 2017	2016	2017	Delta (%) 2016-2017
North	2,843	3,400	3,081	4,052	15,003	13,376	(10.8%)
Center	1,434	1,629	1,485	2,002	6,822	6,550	(4.0%)
South	1,938	2,147	1,774	2,330	8,761	8,189	(6.5%)
					30,586	28,115	(8.1%)

NTN YE 2017 Industrial	Q1 2017	Q2 2017	Q3 2017	Q4 2017	2016	2017	Delta (%) 2016-2017
North	1,536	1,997	1,919	2,620	7,344	8,072	9.9%
Center	381	501	424	622	1,871	1,928	3.1%
South	412	498	550	577	2,073	2,037	(1.7%)
					11,287	12,038	6.7%

Source: PwC publication "Real Estate Market Overview – Italy 2017".

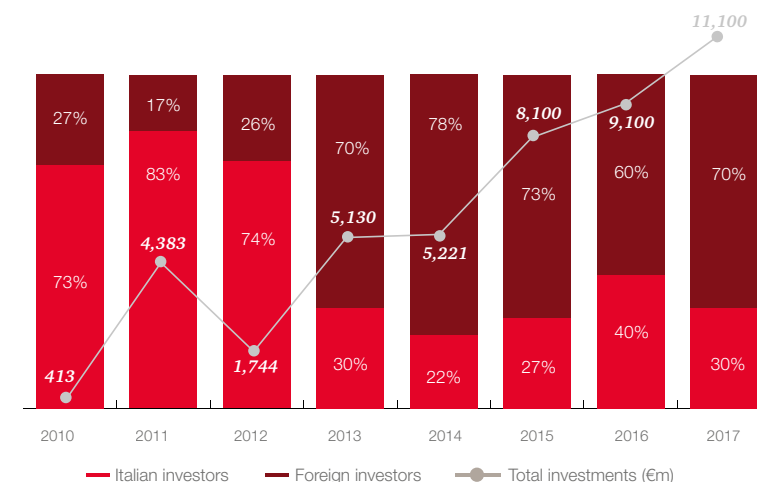
Investments in the non residential Real Estate market

In 2017, the Italian commercial real estate market recorded a transaction volume of €11.1 billion, 22% more compared to 2016, confirming the increasing investor confidence and demand for Italian real estate. The investment recovery has started in 2013 reaching the highest point in 2017, the best year ever for Italian real estate investment since the record level of €10 billion in 2007.

The strong growth was driven by the Office sector, €3.9 billion invested, which represent 35% of the total volumes of transactions. However, there is a reduction in the Office sector relative share on total (44% in 2016), in favor of other types of investments such as the Industrial, Hotel and "Other" ones. The Retail sector registered an increase by 6% over the same period. Industrial estates (+255) is growing fast, but the lack of supply across the country obliges the investors to widen their areas of interest and to concentrate on value added operations.

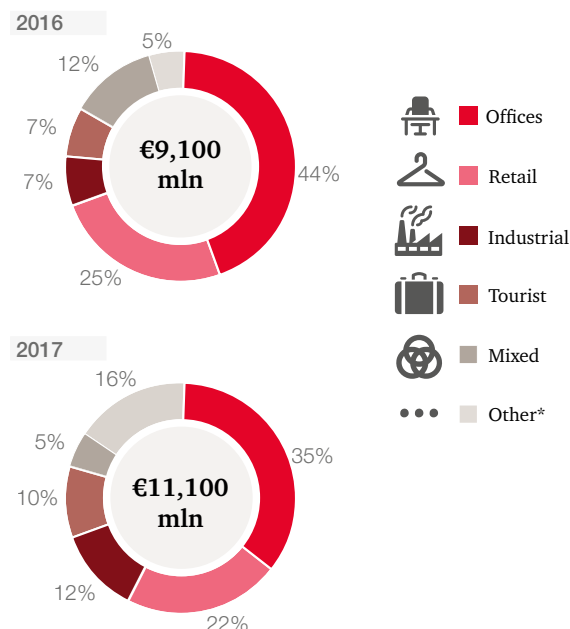
Milan and Rome still represent key markets for investments, accounting for 32% and 11% of the total investment volume in 2017, respectively. However, some investors have adapted their strategies to the dynamic market and started to consider secondary locations as well.

Chart 4: Investments in the non residential Real Estate industry - Investor type



Source: PwC publication "Real Estate Market Overview – Italy 2017".

Chart 5: Investments in the non residential Real Estate industry – Asset type



Source: PwC publication "Real Estate Market Overview – Italy 2017".

**Other* includes banks, public administration and sovereign funds.



***Constant waves of
regulatory evolutions
are putting the
financial industry
players under
pressure***



The regulatory framework is on an ongoing evolution which keeps shaping and influencing the entire financial industry. It no longer concerns only significant institutions and banks: the scope is extended to include the less significant institutions as well financial intermediaries and credit servicers and purchasers.

Most importantly, each wave of regulatory reforms affects the industry in a dynamic way, meaning that besides any one-off impact the true impact has a forward looking dimension leading towards an adoption of comprehensive strategies and measures in an innovative and structured manner.

A *Calendar Provisioning (ECB Addendum) vs European Commission Proposal*

Timely NPL provisioning and write-offs continue to be a matter of constant elaboration and a critical element in the shaping of the institutions' strategy and operating plan. Following the initial draft of the Addendum to the ECB NPL Guidelines (the final addendum was published on 15th March 2018) the European Commission also published a consultation on the regulation of the minimum NPE Coverage on the 14th March 2018.

While the Addendum of the ECB is a Pillar 2 requirement and applicable to all significant banks supervised by the ECB, the European Commission proposal is a Pillar 1 requirement, therefore binding, and is applicable to all banks based on the update of the Capital Requirement Regulation (CRR).

Ongoing regulatory pressures

- A** Calendar Provisioning (ECB Addendum) & EU Commission Proposal
- B** Guidelines for Less Significant Institutions
- C** IFRS 9 First Time Adoption
- D** Credit Servicers Directive Proposal

B *Guidelines on NPL Management for the Less Significant Institutions*

The Bank of Italy, published in January 2018, the final version of the NPL Guidelines addressed to the Less Significant Institutions. The final version of the Guidelines is mostly* in line with the consultation published on September 2017, providing clear indications to banks on issues concerning strategy, governance and rules of conduct (as evidenced on PwC NPL Report Dec. 17 - Ready for the Breakthrough).



Key potential impacts of the Addendum



Increased capital / P&L charges for the banks, taking into consideration an impairment equal to 100% of the residual amount of the loan.



Increase in the number of disposal operations aimed at reducing total impairment levels as well as the level of sustainable losses.



Acceleration of the recovery activity with the objective to reduce the impairment levels.



Potential reduction in price expectations deriving from the combination of: increase in the number of disposal operations and increase of the negotiating power of the potential NPL buyers.

* Indicatively in the final version statistical methods for the valuation of real estate collateral can be used for Gross exposures under €300k instead of €150k when in consultation.

C *IFRS 9 Adoption*

As of 1st January 2018, IFRS 9 substitutes IAS 39, adding further pressure on the banks. The loan provisioning policy is being continuously challenged.



Potential impacts of the IFRS 9 First Time Adoption

- Capital impact
- Strategic impact
- Business processes impact

The transitory regime of the IFRS 9 adoption, which foresees a capital absorption (within a five year period from 2018 to 2022) of the losses deriving from the implementation of the IFRS 9 instead of a P&L impact, will be also applicable to the financial intermediaries (ex. Art. 106 TUB) as of the end of the financial year 2018 or throughout the year as published by Bank of Italy (Bank of Italy communication 09/04/2018).

D *Directive on credit servicers and credit purchasers*

Following the 2017 “Action Plan to tackle NPL in Europe”, the EU Commission issued a proposal for a directive with the aim to harmonize requirements and create a single market for credit servicers and credit purchasers. Outsourcing the servicing of a part of the NPL portfolio to a specialized credit servicer or selling the credit agreement to an adequate purchaser may lower the cost of entry for potential loan purchasers by increasing the accessibility and reducing the costs of credit servicing. The key elements of the directive can be evidenced on the table on the right. The proposal applies to purchasers and servicers of credit originally issued by a credit institution irrespective of the borrower type.



Key elements of the directive proposal

- **Requirements for credit servicers authorization:**
 - EU citizen or legal person; in case of legal person: reputation, police records and insolvency/bankruptcy situation;
 - appropriate governance arrangements and internal control mechanisms;
 - appropriate policy for the treatment of borrowers;
 - complaints recording and handling procedures.
- **Obligation for a public register set-up**
- **Contractual relationship between credit servicer and creditor.** Written agreement outlining:
 - a detailed description of the services;
 - remuneration level and calculation;
 - extend of representation;
 - an undertaking by the parties to law compliance.
- **Rules for outsourcing.**
- **Provision of cross-border services.**
- **Data Templates:** EBA shall develop data standards for the use of credit institutions.
- **Penalties.**
- **Supervision:** At least yearly with the extend based on the size, nature, scale and complexity of the credit servicer.



Key Potential impacts of the IFRS 9 FTA

Capital impact*

- **ECB:** According to a study performed by the ECB a 40bps impact is estimated for the significant banks while a 59bps impact on the CET1 Ratio for the less significant institutions.
- **Bank of Italy:** As it concerns the Italian banks the equivalent CET 1 impact is estimated to be equal to 37 bps for the significant institutions, while for the less significant institutions equal to 47 bps.

Strategic impact

- **Client selection:** Exposures will be more vulnerable to deteriorating status migration.
- **Collateral Management:** The presence of high quality collaterals can mitigate the effects of a Stage migration.
- **Duration:** The probability of default of the exposures is potentially greater with the increase of the duration of the same exposure.

Business processes impact

- **Origination:** necessity to adopt a forward looking view on loan origination.
- **Decision making powers.**
- **Pricing Risk – Adjusted models:** will need to be adjusted to consider the increased cost of risk.
- **Credit monitoring:** increased importance of EWIs.
- **People Management:** increased responsibility will fall on the retail network.

*Source: ECB press release 24/11/2017; Bank of Italy financial stability Report November 2017.





Challenger Banks value proposition



Key Message: banking and financial services are undergoing a radical transformation. The so-called challenger banks are spreading across the market, thanks to their slim structure that allows them to focus on niche segments not covered by the traditional banking market.



Overview

The banking credit crunch that hit the Italian market over the last years generated an amplified effect in terms of lack of credit facilities on the SME segment, which represent 95% of Italian enterprises. In spite of the economic recovery, banks continue to curb financing.

The traditional banks seem to be unsuited to revive the situation as:

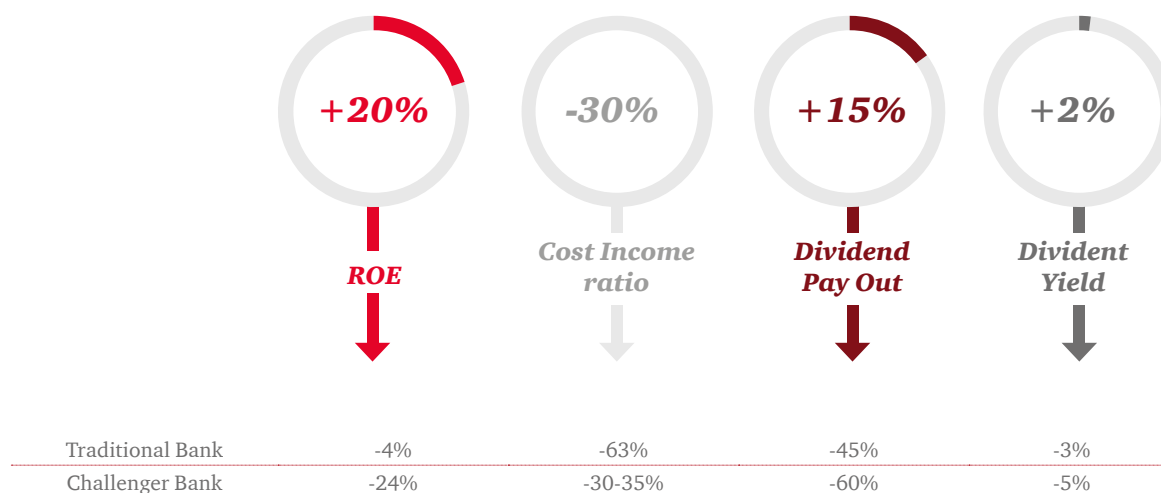
- traditional credit processes are no more suitable for SME's firm as the typical credit deals are not profitable for the bank;
- credit origination is still based on traditional channels: no digital experience for SME's;
- the traditional banking system is unable to provide an efficient exploitation of credit enhancement opportunities;
- SME is tracked as "high risk profile counterpart" for traditional banks.

Both the obsolescence of Traditional Banks' credit processes and SME's high risk profile give rise to the need for alternative finance players (challenger banks / specialized lenders), able to focus on specific market segments rather than the entire retail banking value chain.

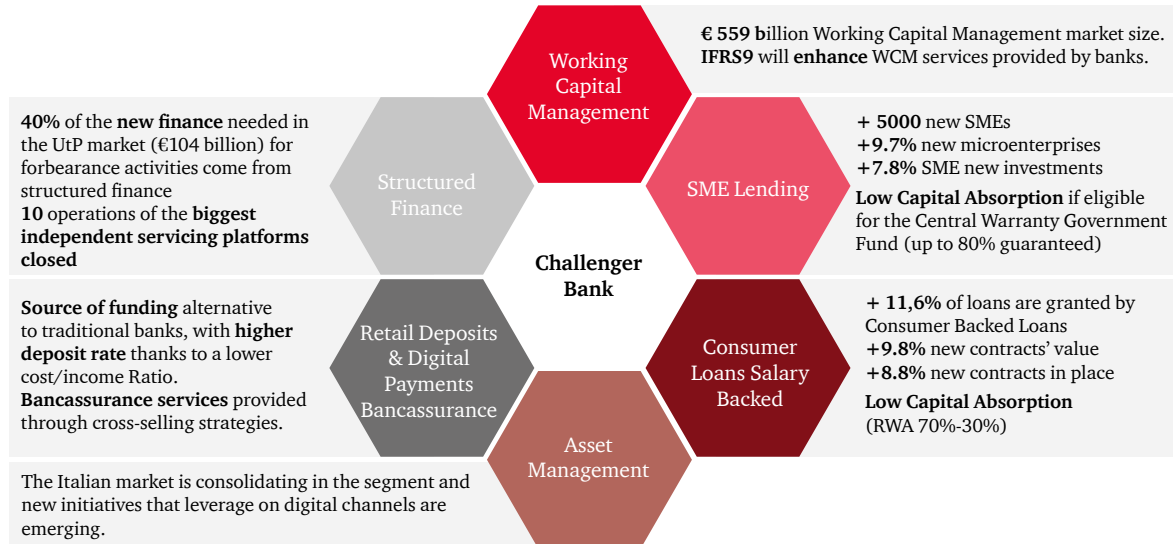
The goal of challenger banks is to disrupt the traditional banking system with innovative models, mostly based on "state of the art" technology, and to obtain profits in niche segments, without pursuing a "generalist" approach. In particular the suggested model leverages on:

- sectors not covered comprehensively by traditional banks;
- business model for all economic cycles (during the crisis NPL sector boomed and some players setup new niche business lines);
- highly scalable business (through digital channels avoided physical network constraints);
- low risk assets: if risk is mitigated via creditor/debtor selectivity or Public Government warranty.

Chart 6: Some attractive aspects of challenger banks

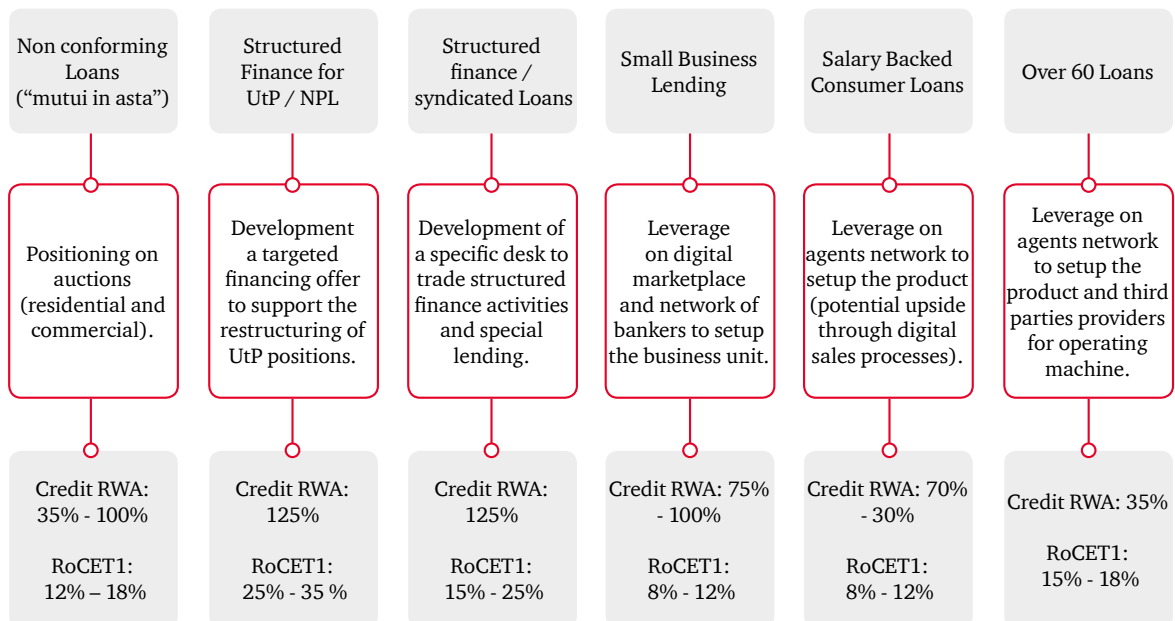


The details of the target segments where to focus the Value Proposition:



Sources: Report Cervel PMI 2017; NPL Report July 2017; CRIF; Assofin Consumer Loans data 9M17; The Italian Insurance Market 2016 figures + 3M17 overview PwC; Il Giornale 2017; Osservatori.net 2017

The potential return and capital absorption of the vertical segments:



Key Success Factors

Even if the potentiality of the Challenger Banks sector in Italy is huge due to its low level of maturity – as perfectly understood by some foreign Private Equity Funds and National Entrepreneurial initiatives –, the setup of the right business model (commercial and operational) it's not easy, considering the relatively easy way to collect retail funds and the difficulty in selecting the right counterpart to finance (SME, NPL / UtP, Public Government Factoring etc.).

Main Key Success factors that an investor must consider during the setup of the initiative:

- define the target Value Proposition of the Challenger Bank: focus on few solid initiatives and avoid a wide spread catalogue of banking services;
- select the right team: the initiative is highly based on industrial rationales and the right skills in place together with the right experience can guarantee a successful execution of the plan;
- develop a capability of “Fast Prototyping”: the whole operating structure of the player must be able to quickly evaluate opportunities, implement products and value propositions for the customers, beat the competition on time-to-market (for example “time-to-yes” less than a day in SME lending activities);
- focus on scalability: build an operating model that is easily scable based on the success of the initiatives (leverage on cloud technologies and Business Process Outsourcing);
- extensive use of innovative technology: invest in innovation where the benefits are tangible (for example, on the Customers Front End to speed up the commercial offering or Robotics to obtain a “best in class” cost/ income Ratio) and select the core components that guarantee the full regulatory compliance at “almost zero” implementation cost for the player.



Italian NPL Market



Key Message: NPL volumes in the Italian market recorded a massive decrease over the last year. The NPL stock, starting from a volume of €324 billion (GBV) at the end of 2016, declined reaching €264 billion at the end of 2017. All the categories, Bad Loans, UtP and Past Due illustrate this positive trend.

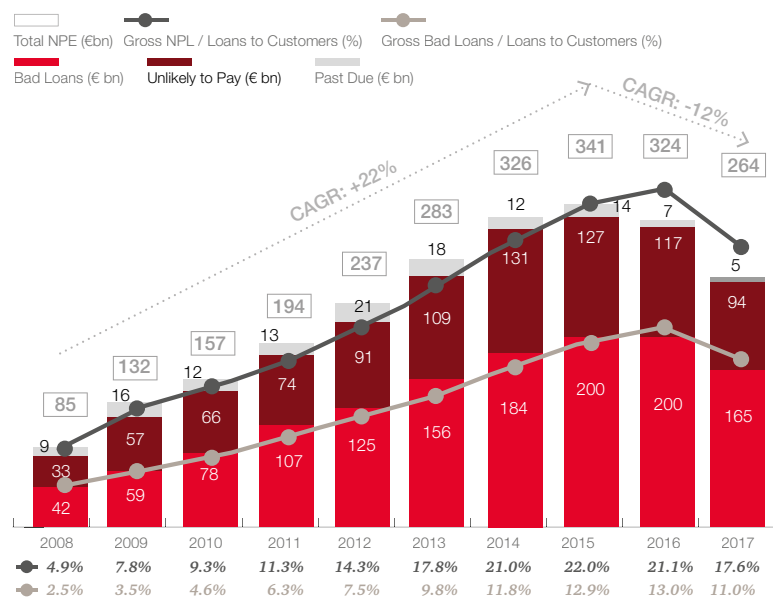
Asset quality

Chart 7 illustrates the reduction in the NPL stock. After reaching its maximum at YE 2015 (€341 billion of GBV), the stock consistently reduced over the last two years, reaching €264 billion at YE 2017.

At the end of 2017 Gross Bad Loans decreased to €165 billion, reducing by €35 billion over the last year. Unlikely to Pay and Past Due showed the same declining trend standing at €94 billion (from €117 billion at YE-2016) and €5 billion (from €7 billion at YE-2016).

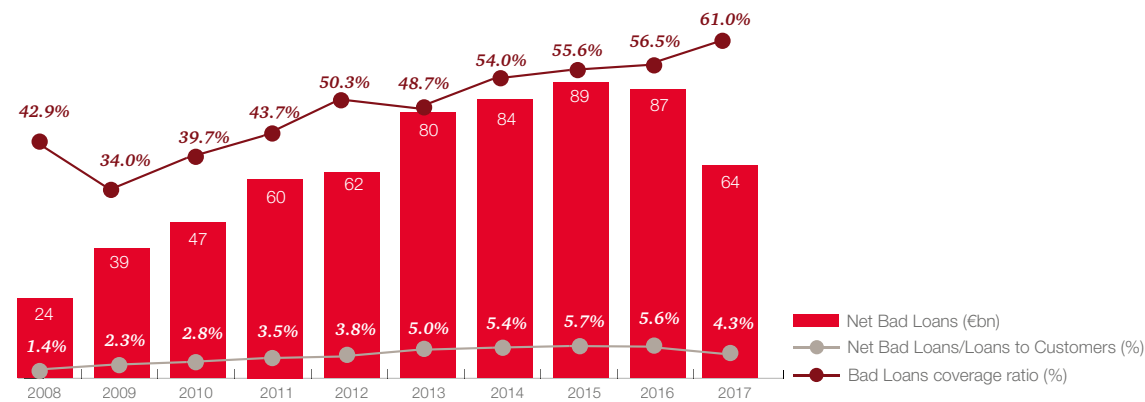
Chart 8 demonstrates that the net Bad Loans amount followed the same positive trend that invested the Italian NPL market of the last two years. Their net amount reached €64 billion at YE 2017 (€87 billion at YE-2016). The Bad Loans' Net NPL Ratio declined to 4.3% (5.6% at YE-2016).

Chart 7: Gross NPE and Bad Loans trend



Source: PwC analysis data of Bollettino Statistico di Banca d'Italia and ABI Monthly Outlook
Data referred to the Italian Banking system only (excluded Cassa Depositi e Prestiti).

Chart 8: Net Bad Loans Trend

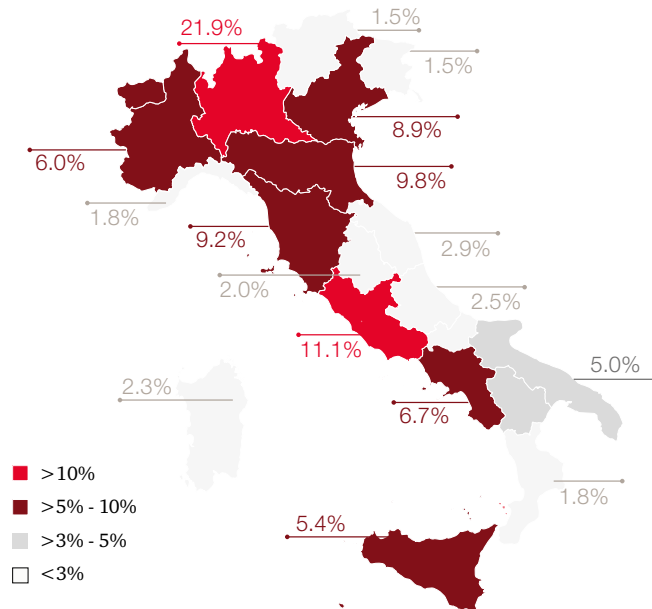


Source: PwC analysis data of ABI Monthly Outlook.
Data referred to the Italian Banking system only (excluded Cassa Depositi e Prestiti).

Looking at the Bad Loans stock composition:

- the breakdown of Gross Bad Loans shows that Lombardy and Lazio regions have the highest concentration of stock with 21.9% and 11.1%;
- at the same time, these two regions have a Gross Bad Loans Ratio equal to, respectively, 10.5% and 12.0%;
- the northern regions have a lower Gross Bad Loans Ratios compared to the ones in the Centre and South of the Country;
- the percentage of secured Bad Loans is increasing from the 48% of 2016 to the 50% of YE-2017;
- at the end of 2017, the "Corporate & SME" sector continues to represent the greatest share of Gross Bad Loans, standing at 66% and followed by the "Consumer" sector (24%).

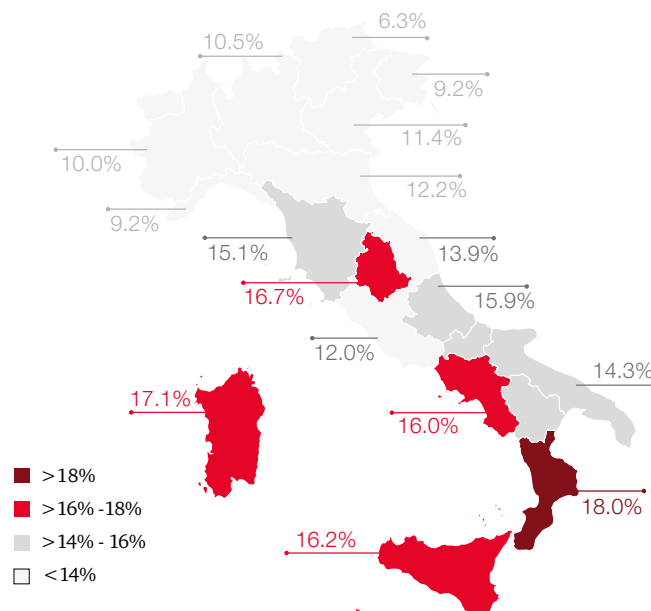
Chart 9a: Breakdown of Gross Bad Loans by region* (YE 2017)



Source: PwC analysis on data of "Bollettino Statistico" of Bank of Italy.

* Unique percentage for 1) Valle d'Aosta and Piemonte, 2) Abruzzo and Molise, 3) Puglia and Basilicata.

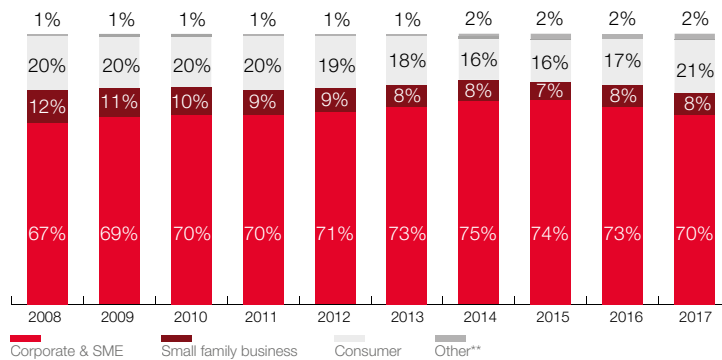
Chart 9b: Breakdown of Gross Bad Loans Ratio by region* (YE 2017)



Source: PwC analysis on data of "Bollettino Statistico" of Bank of Italy.

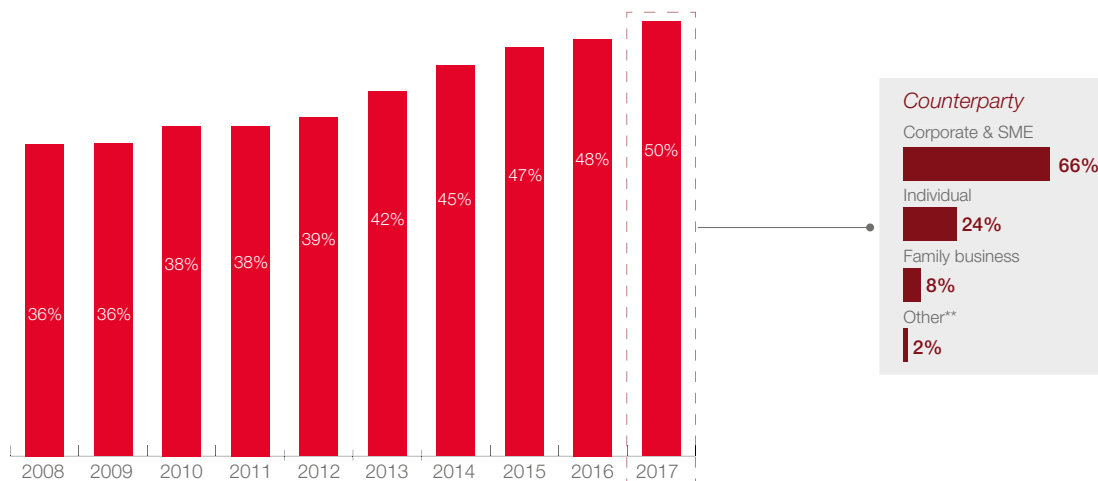
* Unique percentage for 1) Valle d'Aosta and Piemonte, 2) Abruzzo and Molise, 3) Puglia and Basilicata.

Chart 10: Breakdown of Gross Bad Loans by counterparty (YE 2017)



Source: PwC analysis on data of "Bollettino Statistico" of Bank of Italy.
 "Other" includes PA and financial institutions.

Chart 11: Secured Gross Bad Loans trend (% on total Bad Loans)

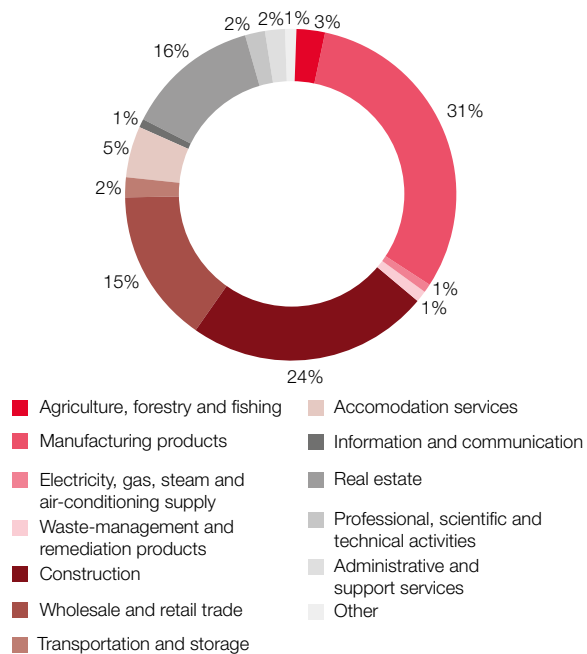


Source: PwC analysis on data of "Bollettino Statistico" of Bank of Italy.
 ** "Other" includes PA and financial institutions.

The breakdown of Gross Bad Loans by economic macrosector (**Chart 12**) shows that Real Estate, Constructions and Manufacture account for over 71% of the Italian NPL market.

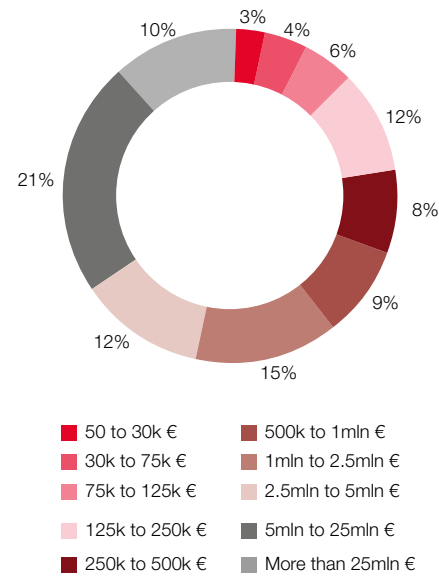
On the other side, the Breakdown of Gross Bad Loans by ticket size (**Chart 13**) illustrates that the 31% of the NPL Italian market is represented by exposures with a value of more than €5 million.

Chart 12: Breakdown of Gross Bad Loans by macrosector



Source: PwC analysis on data of "Bollettino Statistico" of Bank of Italy.

Chart 13: Breakdown of Gross Bad Loans by ticket size



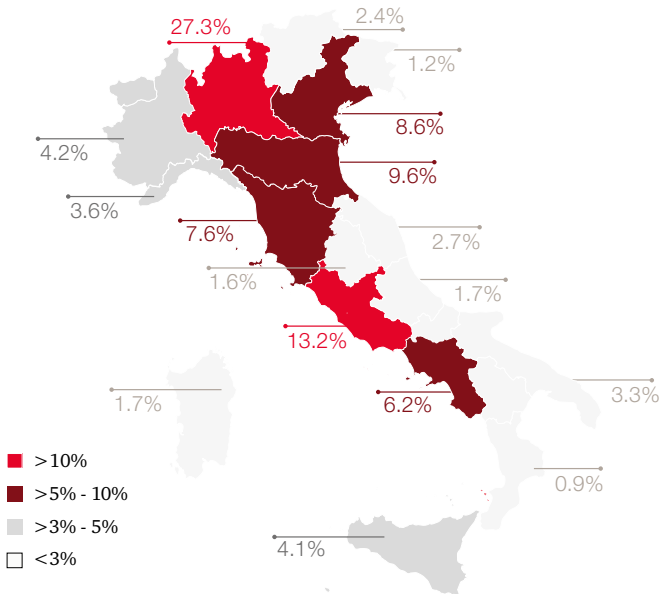
Source: PwC analysis on data of "Bollettino Statistico" of Bank of Italy.

Focus: UtP

The UtP stock composition at YE-2017 shows that:

- the UtP breakdown by region highlights the highest UtP levels in Lombardy (27.3%) and Lazio (13.2%), with a UtP Ratio equal, respectively, to 7.4% and 8.0%;
- Friuli Venezia Giulia, Trentino Alto Adige, Umbria, Marche, Abruzzo and Molise, Calabria and Sardegna each own a percentage of UtP lower than 3%.

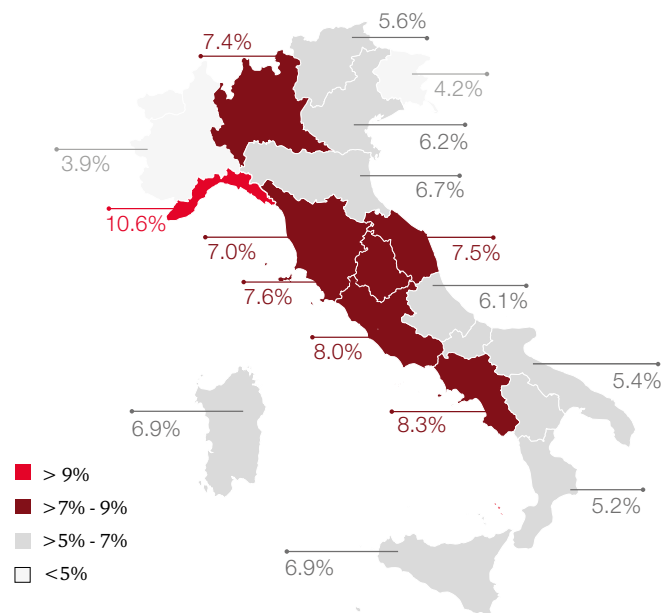
Chart 14a: Breakdown of UtP by region* (YE 2017)



Source: PwC analysis on data of "Bollettino Statistico" of Bank of Italy.

* Unique percentage for 1) Valle d'Aosta and Piemonte, 2) Abruzzo and Molise, 3) Puglia and Basilicata.

Chart 14b: Breakdown of UtP Ratio by region* (YE 2017)



Source: PwC analysis on data of "Bollettino Statistico" of Bank of Italy.

* Unique percentage for 1) Valle d'Aosta and Piemonte, 2) Abruzzo and Molise, 3) Puglia and Basilicata.



Key Message: At the end of 2017 data on firms' closures confirmed the dropping trend emerged in the previous quarters: the most remarkable reduction pertains to bankruptcies, which stand now back to the levels recorded during the early 2000s.

During 2017, 93,000 Italian companies started an insolvency procedure, highlighting a 5% drop with respect to the previous year, a result which is quite distant from the negative peak recorded in 2013 (that scored an overall amount of 109,000 procedures) (**Chart 15**).

Data on the number of bankruptcies shows that the improvement observed in the first half of 2017 has strengthened: in fact, as for YE-2017, 12,009 Italian firms went bankrupt (a 11.3% reduction with respect to 2016) and, in particular, in the last quarter of the year, they are estimated to amount to 3,242 (-4.8% if compared to the same period of 2016). The decrease involves all firms' legal status, especially companies other than share capital companies and partnerships (-14.4% with respect to the previous year) (**Chart 16**). Moreover, this downturn is shared among all Italian regions (firstly Piemonte, Liguria and Lombardy) and all economic sectors, with a particularly positive tendency for the industrial ones and that of construction.

The drop in the number of not-bankruptcy procedures, started 3 years ago, is still continuing. The amount of insolvency procedures started in 2017 (and different from bankrupt) registered a reduction, compared to 2016, mostly concentrated within the construction sector, then followed by industrial firms and services companies (**Chart 17**).

Following the decreasing trend observed during the first half of the year, at the end of 2017 79,587 Italian firms overall started a voluntary liquidation procedure, highlighting a 4% drop with respect the same period of 2016. The decrease mostly pertains to partnerships (-11.3%), which have reached the bottom level since 2001 (**Chart 18**).

Chart 15: Insolvency procedures

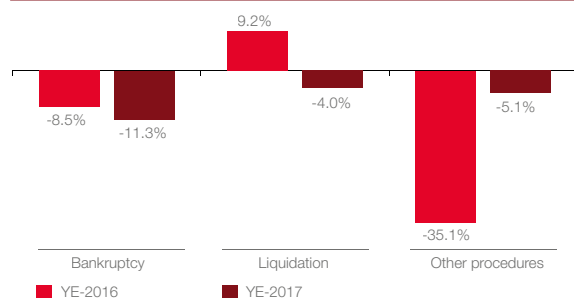


Chart 16: Bankruptcies by type of company

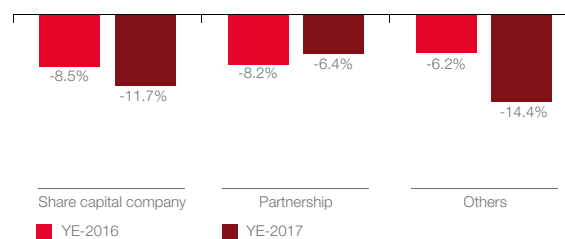


Chart 17: Non-bankruptcy procedures

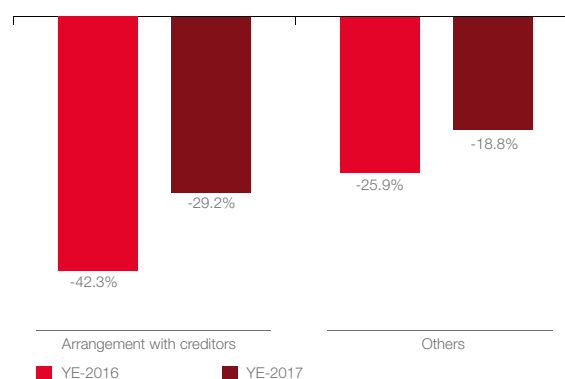
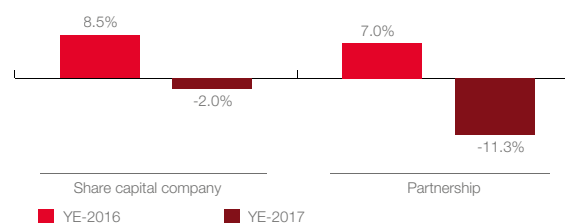


Chart 18: Liquidations by type of company



Source: Osservatorio su fallimenti, procedure e chiusure di imprese, Cerved.



Italian Banks’ Overview

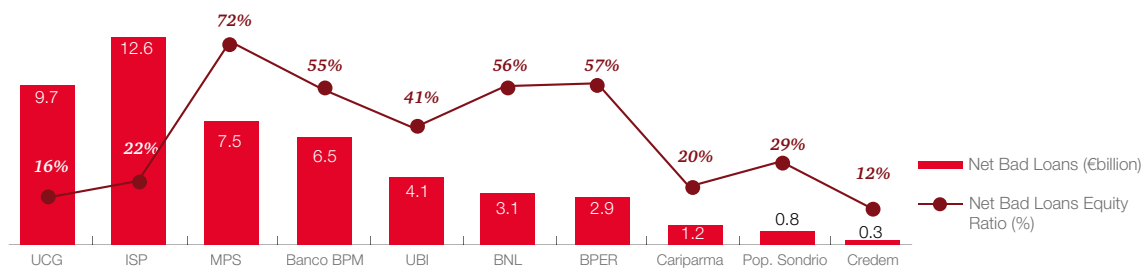


Key Message: For the Italian banking industry, 2017 was a turnaround year, in terms of net aggregated earnings, capital strengthening and mergers. Along with these results, the improvements in credit quality have been significant: indeed Italian banks overall reduced the stock of their Gross Non Performing Exposures and 2018 is expected to be characterised by the same deleveraging attitude as well.

Recent Events

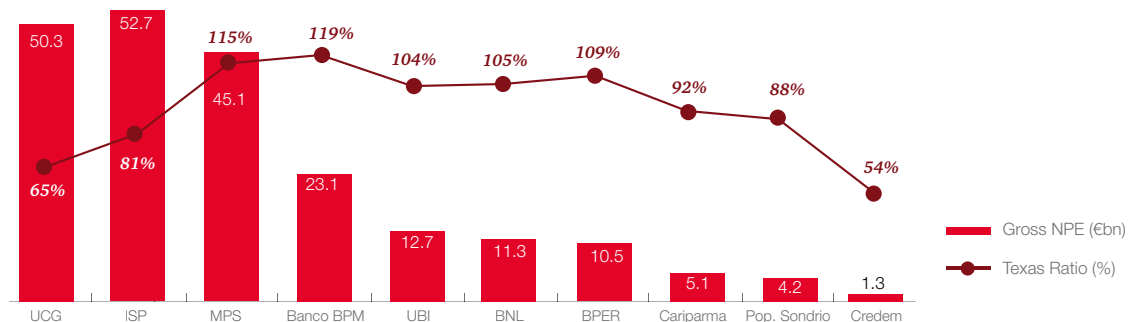
- During the last quarter of 2017, Banca Carige closed the disposal of a €1,2 billion mixed secured - unsecured portfolio of Bad Loans with Credito Fondiario, Davidson Kempner acquired a €320 million Bad Loans portfolio from Banca Popolare di Bari and Cassa Centrale Banca closed with Seer Capital Management and Locam S.p.A. the sale of a mixed secured – unsecured portfolio of Bad Loans for a total value of €885 million.
- In October 2017, the ECB issued an Addendum to its guidance to banks on exposures included in the Non Performing category after January 1st, 2018: European banks will be required to automatically depreciate these loans for the 100% of their book value, after 2 years if unsecured, after 7 years if secured. If confirmed, this measure could eventually produce a stiffening effect on the NPL disposal policies of many Italian banks.
- Following some other significant events occurred in 2017, like the struggles of Carismi, Carim and CariCesena, those of Veneto Banca and Popolare di Vicenza, of MPS, Carige and Creval, and like Unicredit €13 billion capital increase, for the Italian banking system year 2018 promises to be as rich of changes and occurrences as the previous one.

Chart 19: Net Bad Loans and Equity for the Top 10 Italian Banks



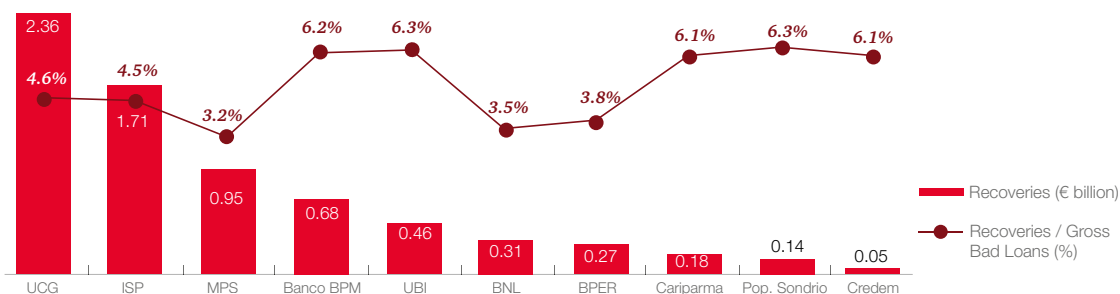
Source: Financial Statements as of YE-2017. Data affected by different write-off policies.

Chart 20: Gross NPE and Texas Ratio for the Top 10 Italian Banks

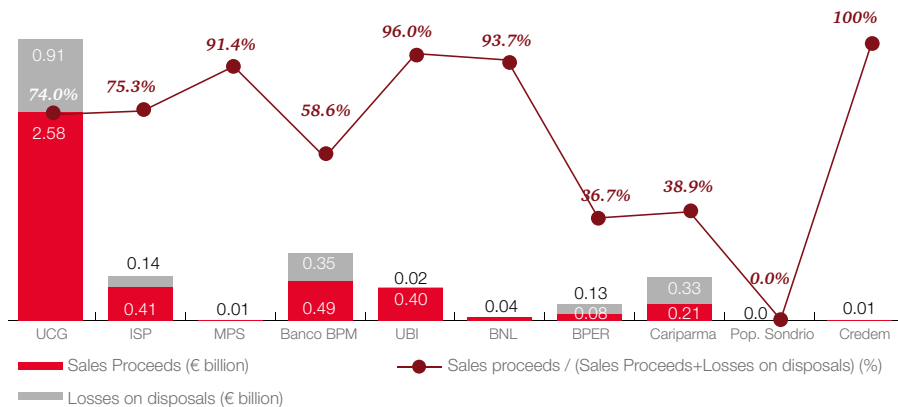


Source: Financial Statements as of YE-2017. Data affected by different write-off policies.

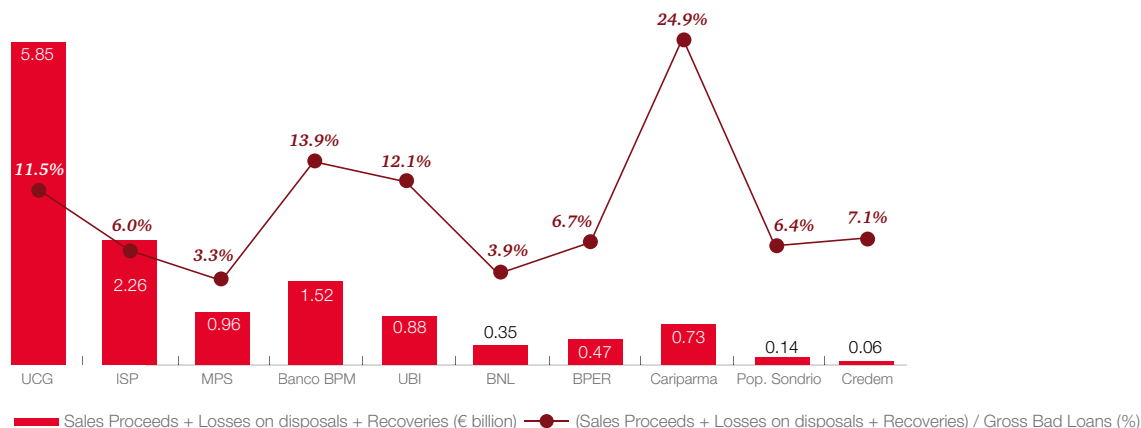
* Texas Ratio defined as the Ratio between total Gross NPE and the sum of CET1 and provisions.

Chart 21: Recoveries / Gross Bad Loans for the Top 10 Italian Banks


Source: Financial Statements as of YE-2017. Data affected by different write-off policies

Chart 22: Sales Proceeds / (Sales Proceeds + Losses on disposals) for the Top 10 Italian Banks


Source: Financial Statements as of YE-2017. Data affected by different write-off policies.

Chart 23: (Sales Proceeds + Losses on disposals + Recoveries) / Gross Bad Loans for the Top 10 Italian Banks


Source: Financial Statements as of YE-2017. Data affected by different write-off policies.

Chart 24 focuses the Gross NPL Ratio and the NPL Coverage Ratio for the Top 10 Italian banks. As shown, the average for the two Ratios is respectively 16.0% and 49.4%. The differences comparing the different banks are clear. On one side, MPS shows the highest Gross NPL Ratio with 37.3% while, on the other side, Credem stands at the lower extreme of 5.2%. Considering the NPL Coverage Ratio, MPS again shows the highest value (67.2%) and UBI the lowest (35.4%). The Coverage Ratio is not directly comparable as it is influenced by several factors different from every bank: policies on write-offs, level of collateralization of the loans, vintage of the portfolio.

The same analysis is reproduced considering the Gross Bad Loans Ratio and the Bad Loans Coverage Ratio (**Chart 25**). Also in this case there are significant differences comparing the Top 10 banks. MPS reaches the peak with a Gross Bad Loans Ratio of 27.0% and Credem represents the lowest (3.2%) the top 10 average stands at 10.3%. The relative Coverage Ratio indicates two opposite peaks: 77.2% with MPS and 44.8% with UBI (the average stands at (61.1%).

Chart 24: Top 10 Italian Banks – NPE Peer Analysis as of YE-2017

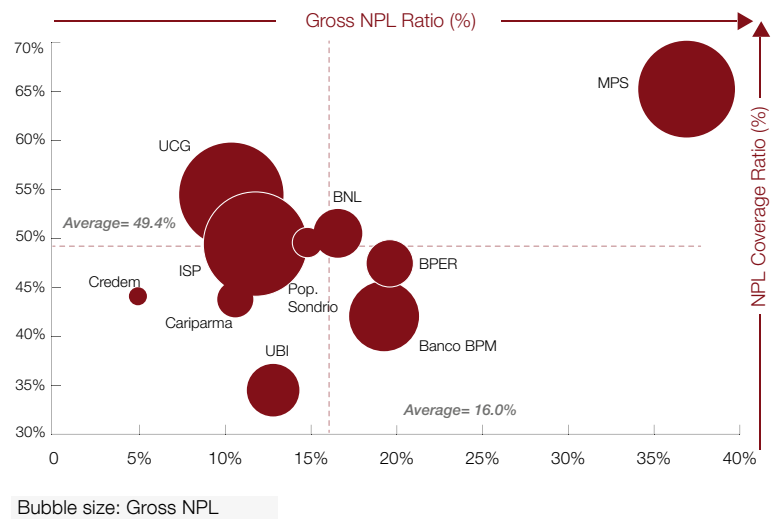


Chart 25: Top 10 Italian Banks – Bad Loans Peer Analysis as of YE-2017

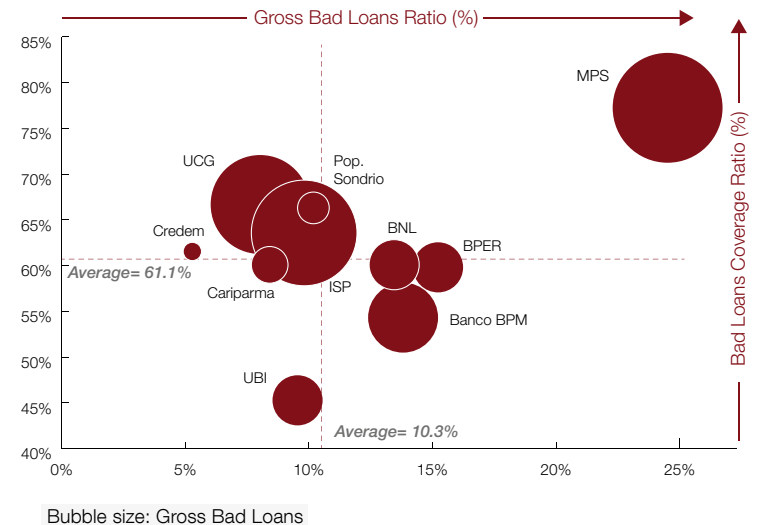
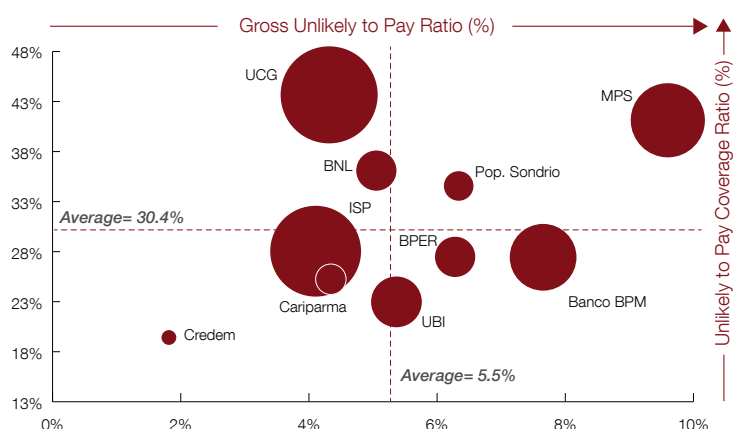


Chart 26 provides a snapshot for the Unlikely to Pay Ratio and its Coverage Ratio. The average for the first Ratio is 5.5% while for the second is 30.4%. The Gross Unlikely to Pay Ratio shows its highest value with MPS (9.5%) and the lowest with Credem (1.8%), whereas the average stands at 5.5%. The Unlikely to Pay Coverage Ratio is on average 30.4%: UCG stands at the top with 43.2%, Credem at the bottom with 19.4%.

Chart 26: Top 10 Italian Banks – Unlikely to Pay Peer Analysis as of YE-2017

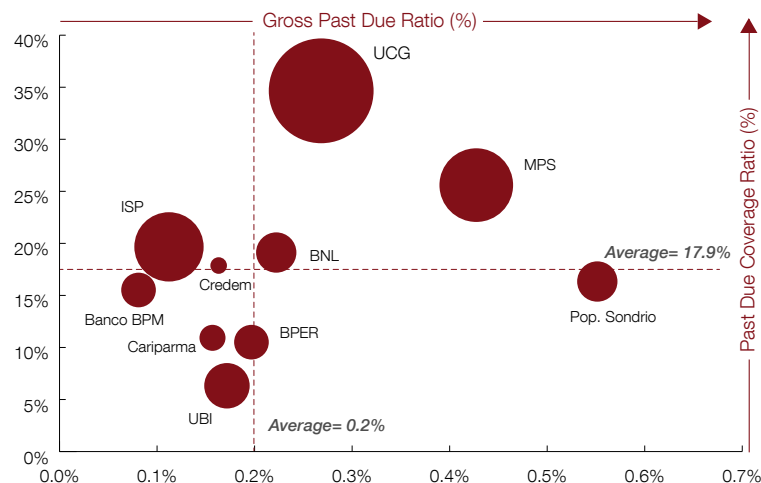


Bubble size: Gross Unlikely to Pay

Source Financial statements as of YE-2017. Data affected by different write-off policies.

Chart 27 illustrates the Past Due Ratio and the Coverage for the banks analyzed. Banca Popolare di Sondrio records the highest Gross Past Due Ratio (0.6%) while ISP and Banco BPM the lowest (0.1%). The average stands at 0.2%. The relative Coverage Ratio indicates two peaks: on one side, UCG with 37.1%, on the other side, UBI with 6.4% (the average is 17.9%).

Chart 27: Top 10 Italian Banks – Past Due Peer Analysis as of YE-2017

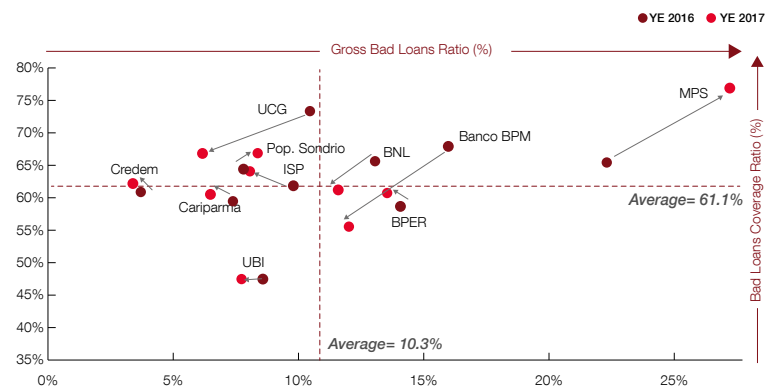


Bubble size: Gross Past Due

Source Financial statements as of YE-2017. Data affected by different write-off policies.

Chart 28 analyzes the movements in the Gross Bad Loans Ratio and the Bad Loans Coverage Ratio between 2016 and 2017. At YE-2017 the average Bad Loans Ratio reaches 10.3%, whereas the Coverage Ratio stands at 61.1%. The snapshot indicates that most of the top 10 Italian Banks have improved their Gross Bad Loans Ratio during 2017.

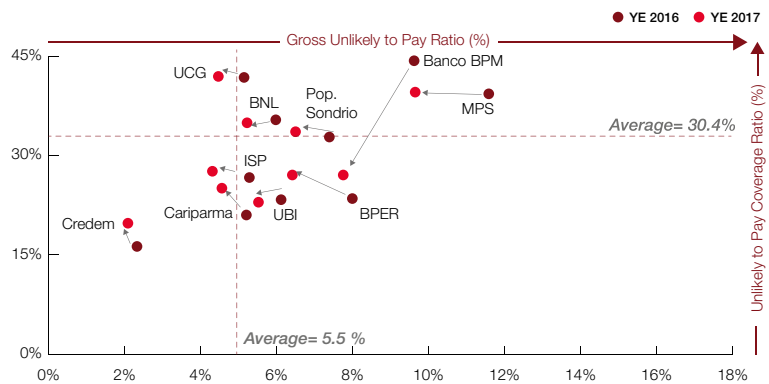
Chart 28: Top Italian Banks – Bad Loans movements (YE-2016 vs YE-2017)



Source: Financial Statements as of YE-2017. Data affected by different write-off policies.

Chart 29 shows that, all the banks analyzed experienced a decrease in the Unlikely to Pay NPL Ratio. At YE-2017 the average Unlikely to Pay NPL Ratio stands at 5.5%, while the Unlikely to Pay Coverage Ratio is 30.4%. The Unlikely to Pay Coverage Ratio decreased for Banco BPM (40.2%), UBI (1.5%) and BNL (1.2%).

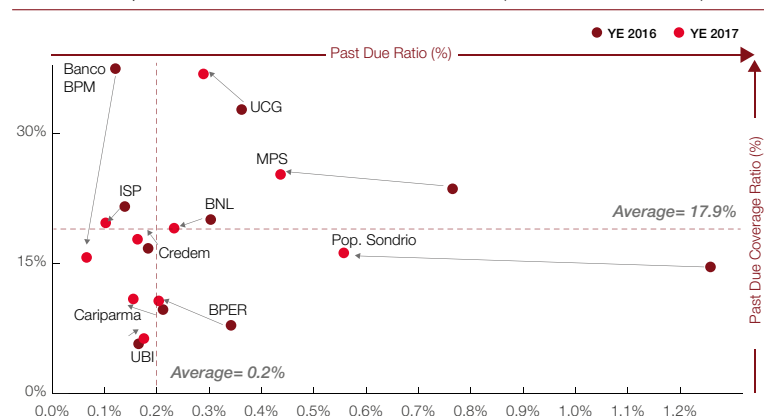
Chart 29: Top Italian Banks – Unlikely to Pay movements (YE-2016 vs YE-2017)



Source: Financial Statements as of YE-2017. Data affected by different write-off policies.

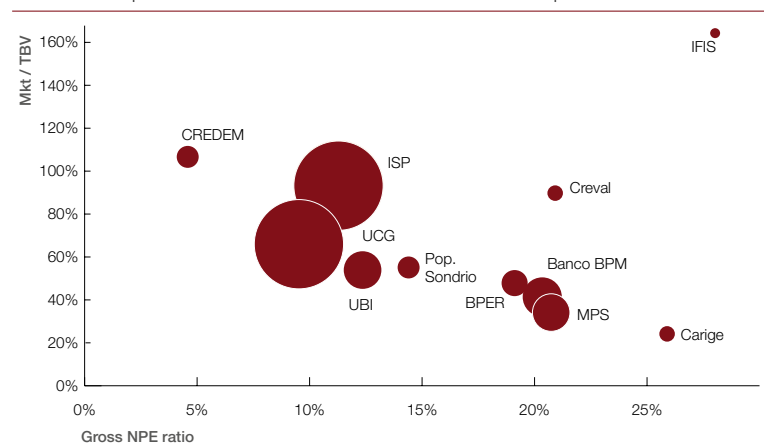
Chart 30 illustrates the movements in the Past Due Ratio and Past Due Coverage Ratio. At YE-2017, the average Past Due Ratio stands at 0.2%, whereas the Past Due Coverage Ratio is 17.9%. In 2017 all the banks, except for UBI, experienced a decrease in their Past due Ratio (the average decrease is 38.3%). The average decrease of the Past Due Coverage Ratio is instead of 5.4%.

Chart 30: Top Italian Banks – Past Due movements (YE 2016 vs YE 2017)



Source: Financial Statements as of YE-2017. Data affected by different write-off policies.

Chart 31: Top Italian Banks – Relation between MarketCap/TBV and NPL Ratio



Source: Financial Statements as of YE-2017.



Focus on UtP Italian market



Key Message: At the end of FY 2017, the total Italian UtP exposure amounted to €94 billion, the 80% of which is concentrated within the top 10 banks. Despite the declining trend, the UtP magnitude is still huge.

Our view

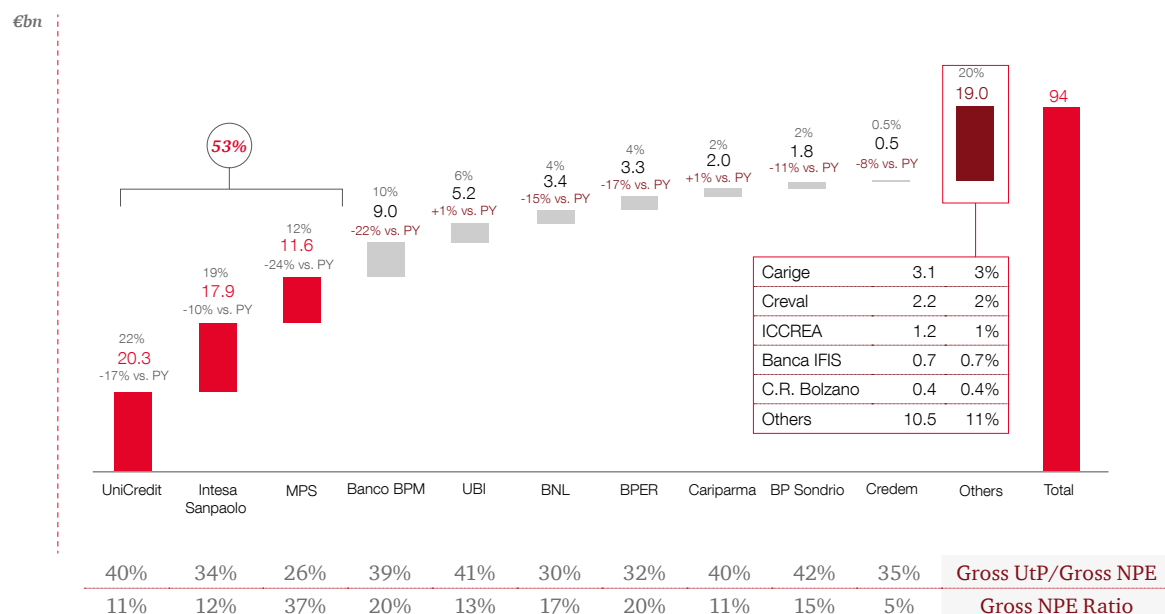
UtP is a major issue for the Italian banking system for several reasons. The NPE figures at the end of 2017 still show a huge amount of UtP (€94 billion of GBV), of which 80% is concentrated within the top 10 banks.

The recent requirements mandated by the European Regulators (the ECB guidelines, the calendar provisioning, within the ECB Addendum, and the application of IFRS9 from 1 January 2018) will undoubtedly drive the Italian banks' management of the current stock, next wave of NPE and the UtP deleveraging plans as well.

Capital requirements and short/medium-term plans of reducing their NPE Ratio could lead to massive UtP sale opportunities (single names and/or small portfolios).

Industrial capabilities' self-assessment along with identification of potential upside coming from the proper restructuring of the UtP could even lead the banks to internal management or external management (through specialised servicers) of the UtP.

UtP distribution (€ billion) - Top 10 Italian banks



Source: PwC analysis of banks' financial statements as at 31/12/17. The list of Top 10 Italian banks is based on the Gross Book Value of Total Exposure as at 31/12/16 (source: ABI). ICCREA exposure as at 30/06/17.

UtP Coverage Ratios vs. Gross UtP Ratios

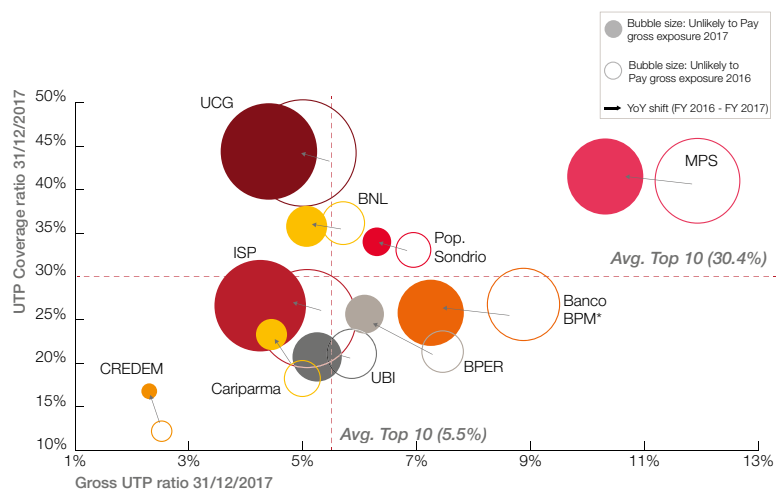
Top 10 Italian Banks featured generally higher provisions of UtP in 2017 vs 2016, resulting in higher Coverage Ratios (avg. 30.4% in 2017). In particular UniCredit and Intesa Sanpaolo, both below the average Gross UtP Ratio (4.3% and 4.1% respectively), increased their UtP provisions reaching UtP Coverage equal to 43.2% (UniCredit) and 27.9% (Intesa Sanpaolo) at the end of 2017.

MPS, third bank in terms of UtP exposures, showed Gross UtP Ratio (9.5%) lower than in 2016 (11.5%) with an average UtP Coverage of 40.6% in 2017 compared to 40.3% in 2016. The former is due to the recognition of Bad Loans previously classified as UtP. Ratios of Banco BPM* showed a reduction of the Gross UtP Ratio (7.6% in 2017 vs 9.5% in 2016) as well as UtP Coverage (27.3% in 2017 vs 28.0% in 2016). Likewise, UBI dropped its Gross UtP Ratio from 5.9% to 5.3% and UtP Coverage from 23.3% to 22.9%.



Key Message: The UtP average Coverage Ratio of the Top 10 Italian banks reached 30.4% (29.1% in 2016) while their Ratio on total loans declined from 6.5% to 5.5%. The Italian banks are on the right path but further efforts are required.

Chart 32: Top 10 Italian banks



*Ratios of Banco BPM as at 31/12/16 were calculated as sum of the figures of Banco Popolare and BPM (merged together in Banco BPM from 1/01/2017).

Inflows and outflows

In 2017, total outflows of the Top 10 Italian banks remained stable at around €44 billion, despite lower outflows to Bad Loans: 21% in 2016 vs 16% in 2017.

The inflows in 2017 decreased from €33 billion to €30 billion, mainly due to the lower inflows from performing and Past Due exposures.

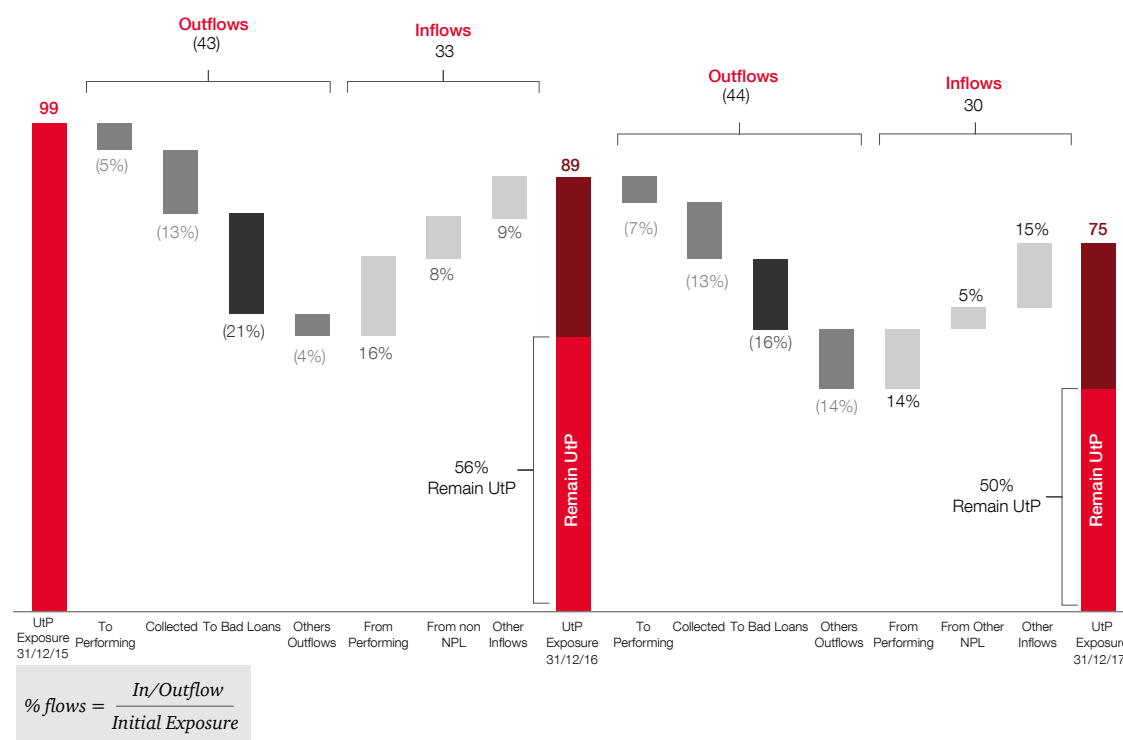
In particular, UtP gauged a firm decline of inflows from performing loans over the last 2-year period: 16% in 2016 vs 14% in 2017.

UtP which remained UtP during 2017 amounted to €44.5 billion (i.e. 50% out of €89 billion), indicating how the main issue for the Italian UtP lies mainly in their massive stock and a management not yet able to target deleverage solutions.



Key Message: At the end of 2017, despite the decreased outflows to Bad Loans (-5%) and inflows from performing (-2%) compared to 2016, 50% of UtP remained as such. The UtP issue for 2018 still lies in the management of their massive stock.

Chart 33: Unlikely to Pay inflows and outflows from 2015 to 2017 - Top 10 banks FY17 (€ billion)



Source: PwC analysis of banks' financial statements as at 31/12/17 and 31/12/16.

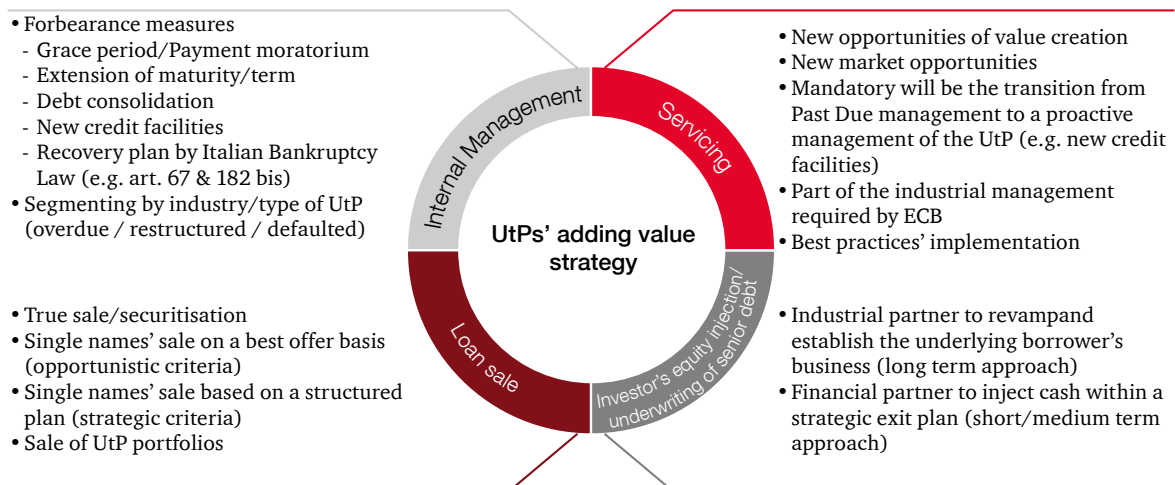
Our view on the available strategies for UtP

The strategic options identified through the on going due diligence carried out by the bank on the borrower's case could result in the return of the loan to the performing category through the implementation of internal forbearance measures or via the sale of the loan or by the classification of the exposure as Bad Loans (thus requiring the prompt liquidation of the borrower's asset through judicial procedures).

Sale of UtP could even be executed through portfolios transactions which require preliminary strategic segmentation to maximize loans' value for the banks. Alternatively, banks may decide to outsource the management on NPE (such as UtP) to a specialised credit servicer.



Key Message: Following improved proactive management, banks could identify the most effective and efficient solutions to deleverage their UtP (e.g. return to performing, collection) among several strategic options. Solely a proactive management of UtP could lead to the right "tailor made" strategic solution.



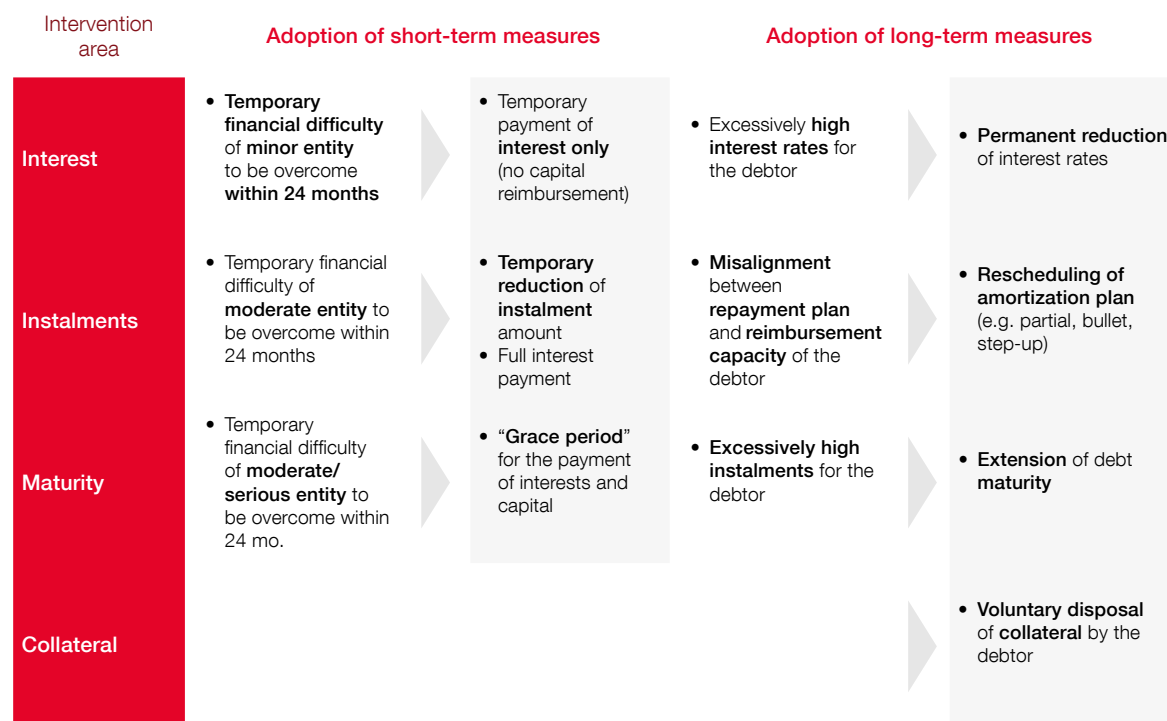
Forbearance as a relevant measure for the proactive management of UtP

The ECB guidance emphasizes that the main objective of forbearance measures is to allow debtors to exit their non-performing status or to prevent performing borrowers from reaching a non-performing status. Therefore, the guidance actively addresses the theme, by guiding banks in the identification of the optimal balance of forbearance measures aimed at granting the exit from short- and long-term difficulty status of the debtor. In particular, on the basis of the type of difficulty of the debtor, either short- or long-term forbearance measures (or a combination of the two) maximizing recoveries shall be identified, by granting, simultaneously, the sustainability of the adopted measures (e.g. debt service capacity).



Key Message: Italian banks should improve their loans' restructuring procedures throughout an appropriate and more effective "case by case" analysis of the financial difficulty of the borrower.

Main forbearance measures⁽¹⁾ – Application examples



= financial situation of the debtor = applicable forbearance measure

(1) In addition to debt forgiveness and/or arrears capitalisation options.



In particular cases it is possible to adopt **new credit facilities** or **debt consolidation** measures

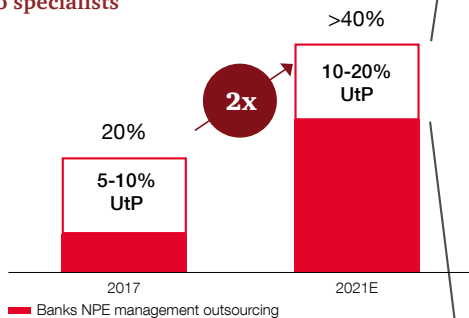
Servicing of UtP as a new market opportunity

Outsourcing the UtP is the next frontier of NPE servicing. The specialized servicers must migrate from a traditional management of overdue UtP exposures to a proactive management of UtP, thus entailing new lending and restructuring measures as strategic management options.

The UtP servicing could increase significantly over the next four years along with the volumes of NPE outsourced by banks and investors to external specialised servicers.

Conditions to be satisfied by the Servicers for the management of UtP

% of NPE stock outsourced to specialists



New lending – Through the on going management of the existing loan contracts, servicers must secure: 1) new injection of cash (debt and/or equity) into the UtP borrowers' capital structure, directly (e.g. challenger banks) or indirectly (through third party investors) and 2) support in defining restructuring plans.



Management – Servicers must carry on a proactive management of the UtP borrowers on a daily basis. Essential is the relationship established with the borrowers and the knowledge of their local market.



IT Platform – Servicers must migrate the UtPs management on advanced IT platform aiming at promptly managing the relevant information about the borrowers.



Strategies – Servicers must identify the proper management strategy of the UtP borrowers through the continuous assessment of their performance, early warning indicators, KPI.



Key Message: In 2017 UtP transactions, excluding the ones realised in context of banks' bailouts, have been limited in terms of amount and volumes. We believe that the market of UtP transactions is starting in 2018.

Market transactions of UtP portfolios and single names in 2017

	Seller	Buyer	€ million
Banks' bailouts	Veneto Banca, Banca Popolare di Vicenza	SGA	9,000
	Banca Marche, Etruria, Chieti	Quaestio Capital SGR + Credito Fondiario	2,200 ⁽¹⁾
	CRC – Carim – Carismi	Quaestio Capital SGR (mezzanine) + FIDT (junior)	2,800 ⁽¹⁾
	Carife	Quaestio Capital SGR + Credito Fondiario	376 ⁽¹⁾
Other transactions	CreVal	Credito Fondiario	104
	CRC – Carim – Carismi	Algebris Investments	286
	CreVal	Algebris Investments	245 ⁽²⁾
	Commerzbank	Fortress Inv. Group	234 ⁽¹⁾
	CreVal	Cerberus	105
	Hypo Alpe Adria Bank S.p.A.	Bain Capital Credit	750 ⁽¹⁾
	UniCredit S.p.A.	Stinger SPV Srl	35
	CreVal	Hoist Finance	24
	UniCredit S.p.A.	DeVar Claims SPV Srl	n.a.

⁽¹⁾ Mixed portfolio of UtP and Bad Loans.

⁽²⁾ Transaction closed in Q1 2018.

Investor's equity injection/underwriting of senior debt

The UtP market features structured transactions where specialized investors (distressed and turnaround) inject new equity or debt in distressed companies within a strategic exit plan in the short-medium run (speculative view) or in the long run (industrial view).

Specialized players are introducing new solutions for the banks to inject new finance in their borrowers and to reduce their NPE Ratios.

<i>Deal Structure</i>	<i>Type of investor</i>	<i>Derecognition for the bank</i>
Buyout of single-named UtP aimed at revamping the business throughout debt consolidation and proactive management of target company	Private Equity Funds (distressed value investing in equity)	Banks can derecognise the loan through a true sale
Synthetic securitisation of non-performing exposures, potentially secured by GACS	Acquirers of asset-backed securities (including the banks originators underwriting the SPV notes) along with investors with different risk profile	Banks cannot derecognize the loan if they hold the credit risk through the junior notes of the SPV
Acquisition of target company with debtor-in-possession (DIP) financing to realise new investments. Often the investment vehicle / fund is participated in selling banks	Private Debt Funds investing in distressed companies	Banks can derecognise the loan and replace it with shares of the investment vehicle/ fund
Creation of an all-equity SPV, fully provided with cash; merger of the SPV with target bank; use of SPV's raised cash to underwrite senior debt/ equity of distressed companies with the purpose of business recovery	SPAC (Special Purpose Acquisition Company)	Banks can derecognise the loan through a true sale



The Servicing Market



Executive Summary

The NPL servicing industry continues its positive growth through the beginning of 2018 with newcomers joining the market. We expect more than €100 billion of disposals for the period 2018-2021 driven by the increasing banks' NPL platforms sales. Increasing market and regulatory pressure will also push banking groups to consider possible strategic partnerships with NPL specialists.



Key recent dynamics

The NPL servicing industry continues its positive growth through the beginning of 2018 based on outsourcing of recovery activities by Banks and continuous increase of Banks' portfolio disposals to investors. Market, competitive and regulatory dynamics that characterized 2017 and first half of 2018 have driven the evolution of the servicing industry:

- newcomers are joining the industry with big international investors entering the market. We have observed the consolidation of big international players' presence: first of all Intrum/Lindorff, acquiring CAF at the end of 2017 and the NPL platform of Intesa Sanpaolo in April 2018, which will become the second operator by volumes in the Italian market after doBank; furthermore we should mention the partnership of Anacap with Pimco for the acquisition of Phoenix;
- strategic outsourcing of NPL banking platforms is driving the growth of specialized NPL servicers. Following Creval, MPS, Bari, Carige and Intesa Sanpaolo deals, other banking groups may consider partnerships for their NPL platforms with the main market participants;
- strong evolution in business models reflected in new market participants such as SGA and Spaxs. SGA, the former "bad bank" of Banco di Napoli, owned by the Italian government is conceived as debt purchaser but will also be involved in the credit management and collection activities, while Spaxs is an innovative initiative that aims to enter the market acquiring a set of companies to participate actively in the UtP market providing financing for restructuring SMEs;
- regulation is shaping the market field: Calendar Provisioning, IFRS9 and the EBA consultation Guidelines on how to manage NPL -which specifies a 5% threshold on NPL Ratio above which banks will be classified as "High NPL banks"- is pushing NPL disposals.

Our outlook for 2018 / 2019

In our outlook for the following 12 months we see an additional increase of the share of the market managed by NPL specialists in particular connected to the shift of Bad Loans ownership from Banks to specialized investors. We expect more than €100 billion of disposals for the period 2018-2021 to be driven by the increasing banks' NPL platforms sales.

We expect the following dynamics to characterize sector growth:

- the proactive management of Banks' UtP portfolios promoted by the ECB Guidelines, will increase the disposal of these portfolios attracting a wider investor base with subsequent outsourcing of servicing activities;

- evolution of the business and regulatory model of NPL servicers, mainly driven by UtPs that require different skills and capabilities more similar to traditional banking activities;
- value creation with strategic carve-out opportunities of NPL banking platforms: increasing market and regulatory pressure will push banking groups to consider possible strategic partnerships with NPL specialists;
- a second wave of consolidation will be driven on one hand by the new directive of the European Parliament on credit servicers that aims to harmonize the European market facilitating cross-border scale-up activities, while on the other hand by the pressure on margins that will increase competitive pressures on DCAs;
- decreasing market space for smaller independent NPL servicers, vertical integration between investors and servicers and carve-out of NPL platforms are likely to have a downward impact on managed volumes of players not involved in these deals.

Is carve-out the best alternative?

The sale or outsourcing of NPL banking platforms appear to be on the headlines of Banks' strategic initiatives. Following Creval, MPS, Bari, Carige and Intesa Sanpaolo deals, market rumours are emerging around possible further carve-out initiatives of Italian banking players.

We consider it crucial to identify value creation drivers based on efficiency (recovery rates) and effectiveness (cost) improvements.

In our view, three fundamental ingredients characterize a successful platform carve-out transaction, each of them should be based on few strategic drivers:

1. deal features: transaction structure, perimeter (stock, forward flows) and Strategic Governance Model (including delegation of authorities) are crucial for the success of the deal negotiation phase;
2. operating model: the definition of to-be IT platform and transition model and of important operating functions is the necessary element for the launch of platform' operations;
3. reporting and control model: data quality and KPI & SLA establishment is decisive to maximize value extraction, in the short and/or medium-long term, from workout units.

Table 5: Main transactions in the servicing sector

2013						
Italfondario Acquisition of a minority stake in BCC Gestione crediti from ICCREA	Cerved Acquisition of Tarida, specialized in consumer finance collections with 1.9bn AuM and 250k tickets					
2014						
Hoist Finance Acquisition of 100% of TRC from private shareholders. Specialized in consumer finance	Banca Sistema Acquisition of 2 servicing platform Candia & Sting from private share and merger (CS Union)	Cerved Acquisition of 80% of Recus. Specialized in collection for telcos and utilities				
2015						
Fortress Acquisition of UniCredit captive servicing platform (UCCMB)	Lonestar Acquisition of CAF a servicing platform with €7 bn AuM from private shareholders	Cerved Acquisition of 100% of Fin. San Giacomo part of Credito Valtellinese group				
2016						
Cerved + BHW Bausparkasse Long-term industrial partnership for the management of 230 €m of NPL originated by the Italian branch of BHW Bausparkassen AG	Axactor Acquisition of CS Union from Banca Sistema	Lindorff Acquisition of CrossFactor, a small factoring and credit servicing platform	Arrow Acquisition of 100% of Zenith Service, a master servicing platform	Kruk Acquisition of 100% of Credit Base	doBank Acquisition of 100% of Italfondario	Dea Capital Acquisition of 66,3% of SPC Credit Management
2017						
Kkr Acquisition of Sistemica	Lindorff Acquisition of Gextra, a small ticket player from doBank	Bain Capital Acquisition of 100% of HARIT, servicing platform specialized in secured loans	Varde Acquisition of 33% of Guber	Cerved + BHW Bausparkasse Long-term industrial partnership extension for the management of a portfolio of loans of 1.5 €bn originated by the Italian branch of BHW Bausparkassen AG	Davidson Kempner Acquisition of 44.9% of Prelios and launch of a mandatory tender offer	Cerved + Quaestio Acquisition of the credit servicing platform (a.k.a. “Juliet”) of MPS
Cerved Acquisition of a NPL platform of Banca Popolare di Bari	Intrum/ Lindorff Acquisition of 100% of CAF	Credito Fondiario Acquisition of NPL servicing platform of Carige				
H1 2018						
Arrow Acquisition of 100% of Parr Credit and Europa Investimenti	IBL Banca + Europa Factor Joint venture for the creation of the new Servicer Credit Factor: 106 vehicle (subject to Bankit authorization)	Anacap + Pimco Acquisition of a majority stake in Phoenix Asset Management	Intesa + Lindorff / Intrum Joint venture for the NPL platform of Intesa Sanpaolo	Kruk Acquisition of 51% of Agecredit	Banca IFIS Acquisition of 90% of FBS (Subject to the approval of the regulator)	

Table 6: Overview of main servicers (data at 31/12/2017) – Ranking by Revenues

Company	Bank of Italy Surveillance	Revenues (€ million)	Special Servicing		Servicing Performing AuM (€ billion)	Master Servicing AuM (€ billion) ¹¹	Ebitda (€ million)
			Total Bad Loans ¹ AuM (€ billion)	Other NPL AuM ² (€ billion)			
doBank ³	Bank	213.0	74.3	1.5	0.9	44.9	70.1
Cerved Credit Management	106	94.8	34.9	1.4	9.5		27.6
MBCredit Solutions	106	70.3 ¹²	5.5	-	-		28.7 ¹²
Credito Fondiario	Bank	41.6	6.3 ⁴	1.3 ⁴	1.4 ⁴	42.5 ⁴	n.a.
Fire	115	40.3	3.2	4.0	9.0		1.1
Advancing Trade	106/115	35.0	3.1	0.9	1.0		10.0 ⁵
Guber	Bank	30.9	7.9	-	-		n.a.
Cribis Credit Management	115	25.2	2.1	12.9	7.6		n.a.
CAF (Intrum Italy)	115	22.7	8.2	-	0.2		8.9
Serfin	115	22.0	0.5	0.3	0.7		n.a.
Hoist Italia	115	21.3	6.8	-	-		n.a.
Securitisation Services	106	20.7	0.6	1.0	2.5	37.4	11.4
FBS	106	20.4	8.0	-	-		10.1
Sistemla	115	20.3	6.5	-	-		5.5
Europa Factor	106/115	20.1	2.6	-	0.5		2.5
Parr Credit (Arrow Group)	115	17.6	0.5	0.4	-		1.0
Gruppo Frascino ⁷	115	15.0	2.1	-	0.2		4.8
Officine CST	115	14.6	1.7	-	1.4		5.4
Bcc Gestione Crediti	115	14.4	4.0	-	-		3.8
Prelios Credit Servicing	106	13.5	4.6	-	-	6.4	0.5
Aquileia Capital	106/115	13.5	1.3	0.2	-		n.a.
Frontis NPL	115	12.4	2.5	0.3	-		9.8
Fides	115	12.0	1.1	0.2	0.2		n.a.
Axactor Italy	106	9.2	1.0	0.3	-		n.a.
AZ Holding	115	8.5	1.9	-	-		n.a.
CSS	115	7.5	2.2	0.4	-		0.6
Finint Revalue	115	6.9	2.8	0.6	-		n.a.
SiCollection	115	6.4	1.0	-	-		0.7
Phoenix Asset Management	115	6.0	8.9	-	-		2.9
Link Financial	115	4.6	2.2	0.1	-		n.a.
Aurora RE	115	4.2	0.2	0.7	0.2		n.a.
Centotrenta Servicing	106	4.2	-	-	-	8.1	1.1
Gextra (Intrum Italy)	115	3.6	0.5	0.1	-		0.3
Certa Credita	115	2.9	0.2	-	0.1		0.5 ⁹
Blue Factor	106	2.0	1.6	-	-		0.7
Bayview Italia	115	~ ¹⁰	3.6	-	-		n.a.
Zenith Service (Arrow Group)	106	~ ¹⁰	-	0.8	8.4	25.6	n.a.

Source: PwC analysis on data provided by Servicers as of 31/12/2017; data have been directly provided by Servicers and have not been verified by PwC. Servicers present highly heterogeneous organizational, industrial and operating structures. Comparing the information presented above requires a correct analysis and understanding of the competitive landscape and servicers business model.

1 Includes both owned and third parties portfolios.

2 Includes Unlikely to Pay + Past Due more than 90 days.

3 doBank group figures include Italfondario.

4 AuM at 31/05/2018.

5 EBITDA Adjusted.

6 Debt purchasing activities are conducted via Special Purpose Vehicles.

	Main activities				Rating
	NPL servicing	Debt Collection	Debt purchasing	Master servicing	
	✓			✓	✓
	✓	✓			✓
	✓	✓	✓		
	✓		✓	✓	✓
	✓	✓	✓		✓
	✓	✓	✓		
	✓		✓		✓
		✓			
	✓				✓
		✓			
	✓	✓	✓ ⁸		
	✓	✓		✓	✓
	✓		✓		✓
	✓				
	✓	✓	✓		
		✓			
	✓		✓		✓
	✓ ⁹				
	✓		✓		
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				✓	✓
		✓			
		✓			
	✓		✓		
	✓				
	✓			✓	✓

7 Includes Credit Network Finance and Z1s.

8 Officine CST is specialised mainly in PA credit servicing.

9 EBITDA refers to 2016.

10 2017 data have not been provided by Servicers, at 31/12/2016 revenues were equal to: Zenith Service 12€m; Not available data for Bayview.

11 Master Servicing services can be qualified in order to provide an advanced KPIs monitoring activity, which uses powerful algorithms, performance trend analysis and the best recovery strategies ("Special Servicing Oversight").

12 Revenues and EBITDA normalized at 31/12/2017.

Note: Double counting may arise when adding NPL AuM as some servicers outsource part of their portfolios to others due to capacity and/or specialization issues.

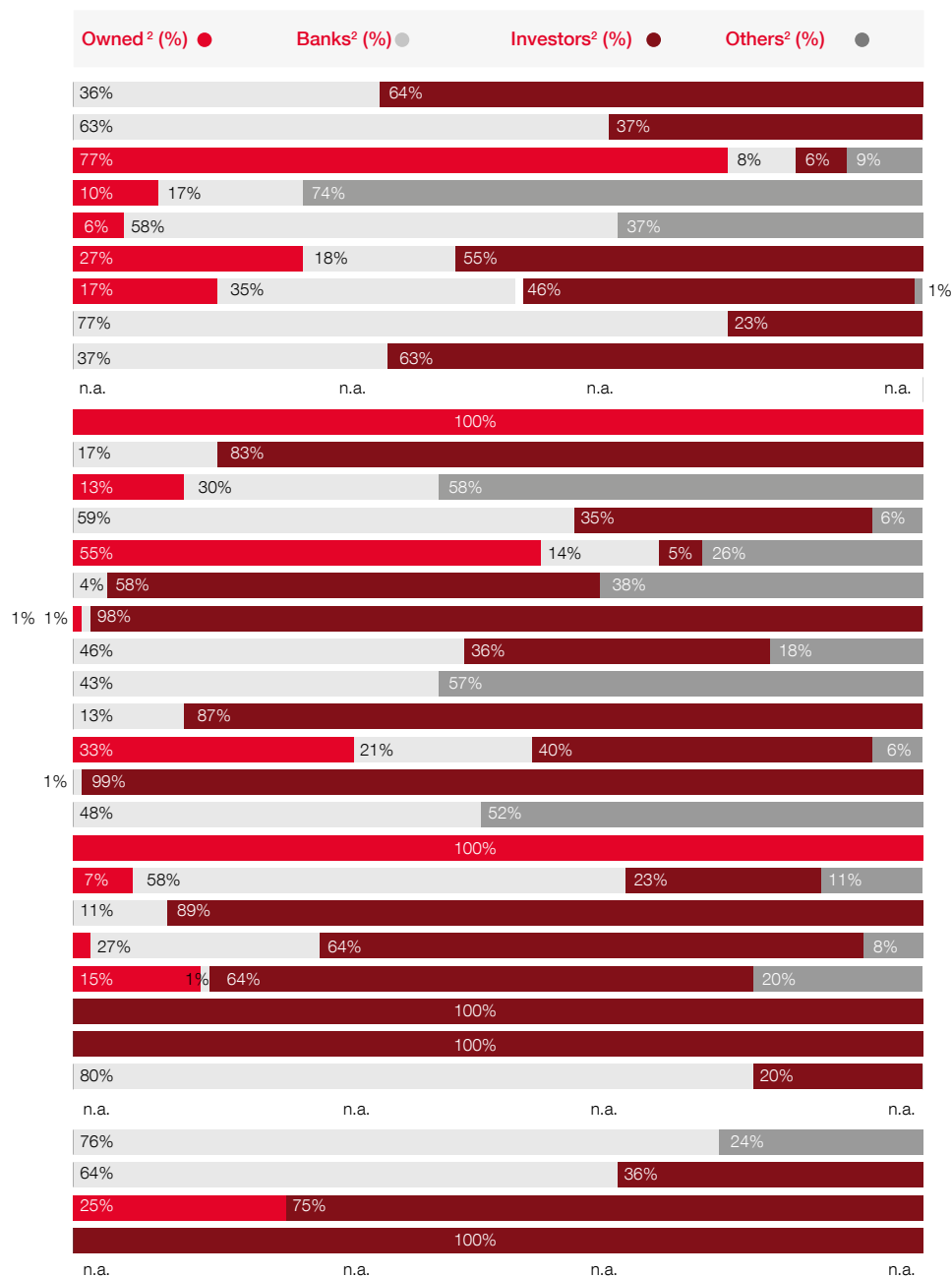
Table 7: Breakdown of servicers' Total Bad Loans AuM¹ (data at 31/12/2017) – Ranking by Revenues

Company	Revenues YE 2017 (€ million)	Total Bad Loans AuM (€ billion) ¹	Average Ticket (€k)	Secured ² (%) ●	Unsecured ² (%) ●
doBank ³	213.0	74.3	115	79%	21%
Cerved Credit Management	94.8	34.9	88	49%	51%
MBCredit Solutions	70.3 ⁷	5.5	3	97%	
Credito Fondiario	41.6	6.3 ⁴	38 ⁴	55%	45%
Fire	40.3	3.2	5	11%	89%
Advancing Trade	35.0	3.1	6	100%	
Guber	30.9	7.9	63	17%	83%
Cribis CM	25.2	2.1	18	62%	38%
CAF (Intrum Italy)	22.7	8.2	31	34%	66%
Serfin	22.0	0.5	1	100%	
Hoist Italia	21.3	6.8	10	99%	
Securitisation Services	20.7	0.6	13	18%	82%
FBS	20.4	8.0	32	23%	77%
Sistemia	20.3	6.5	22	76%	24%
Europa Factor	20.1	2.6	1	14%	86%
Parr Credit (Arrow Group)	17.6	0.5	2	100%	
Gruppo Frascino ⁵	15.0	2.1	14	10%	90%
Officine CST	14.6	1.7	13	52%	48%
Bcc Gestione Crediti	14.4	4.0	124	71%	29%
Prelios Credit Servicing	13.5	4.6	310	57%	43%
Aquileia Capital	13.5	1.3	330	86%	14%
Frontis NPL	12.4	2.5	1,089	92%	8%
Fides	12.0	1.1	6	100%	
Axactor Italy	9.2	1.0	7	99%	
AZ Holding	8.5	1.9	7	5%	95%
CSS	7.5	2.2	6	100%	
Finint Revalue	6.9	2.8	11	81%	19%
SiCollection	6.4	1.0	6	99%	
Phoenix Asset Management	6.0	8.9	344	35%	65%
Link Financial	4.6	2.2	6	12%	88%
Aurora RE	4.2	0.2	25,620	100%	
Centotrenta Servicing	4.2	-	5	n.a.	n.a.
Gextra (Intrum Italy)	3.6	0.5	7	5%	95%
Certa Credita	2.9	0.2	6	100%	
Blue Factor	2.0	1.6	8	100%	
Bayview Italia	- ⁶	3.6	59	43%	57%
Zenith Service (Arrow Group)	- ⁶	-	10	n.a.	n.a.

Source: PwC analysis on data provided by Servicers as of 31/12/2017; data have been directly provided by Servicers and have not been verified by PwC. Servicers present highly heterogeneous organizational, industrial and operating structures. Comparing the information presented above requires a correct analysis and understanding of the competitive landscape and servicers business model.

¹ Includes both owned and third parties portfolios.

² Percentages are based on total NPL portfolio: breakdown for Master and Special servicing activities have not been provided.



3 doBank group figures include Italfondario – Secured AuM: 30% if referred only to “first lien” secured Bad loans.

4 AuM at 31/05/2018.

5 Includes Credit Network Finance and Z1s.

6 2017 data have not been provided by Servicers, at 31/12/2016 revenues were equal to: Zenith Service 12€m; Not available data for Bayview.

7 Revenues normalized at 31/12/2017.

Table 8: Geographical NPL breakdown (data at 31/12/2017) – Ranking by Revenues

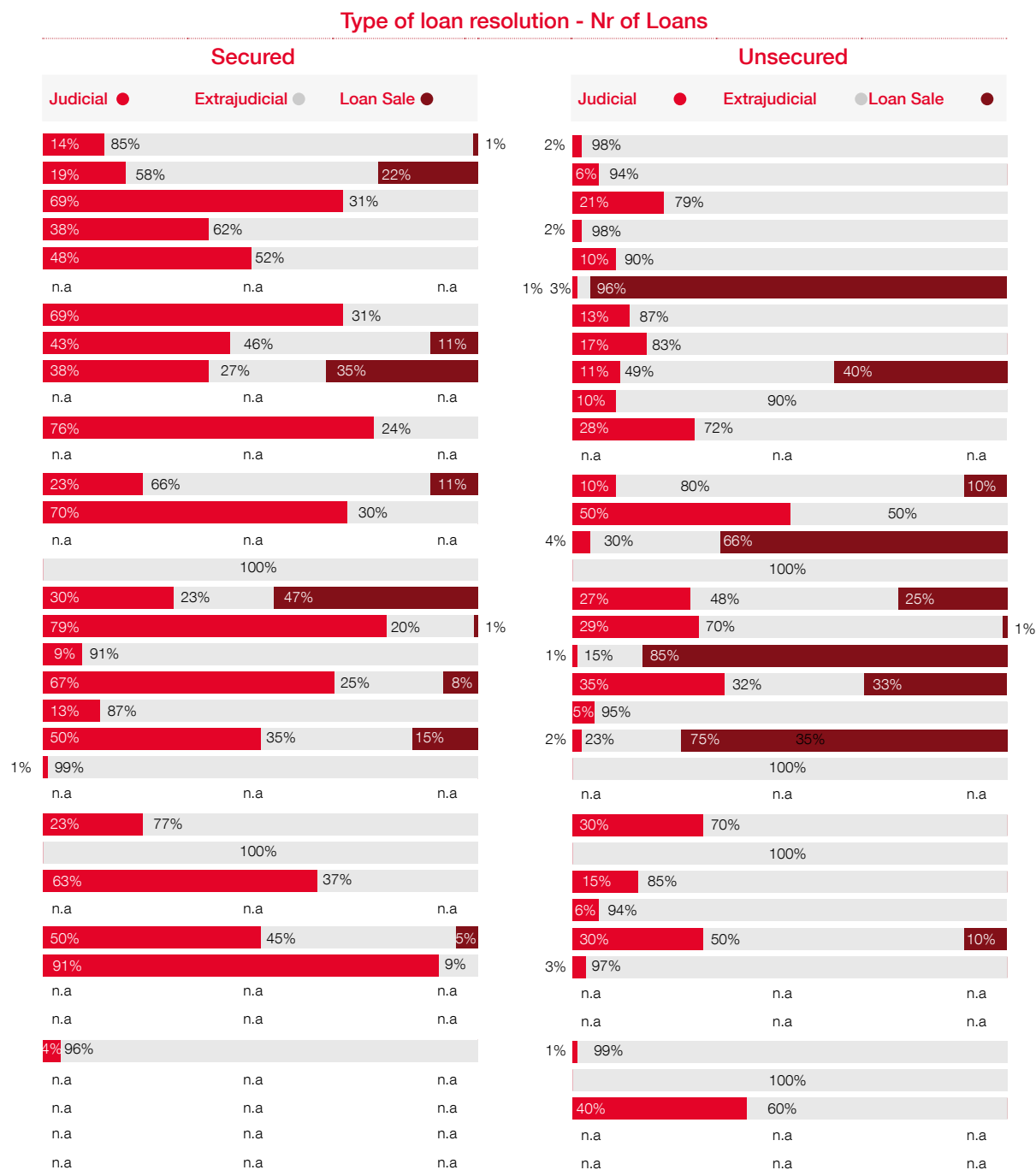
In term of AuM					
Company	Revenues YE 2017 (€m)	Total Bad Loans AuM (€ billion) ¹	North ² ●	Centre ³ ●	South - Islands ⁴ ●
doBank ⁵	213.0	74.3	45%	23%	32%
Cerved Credit Management	94.8	34.9	35%	23%	42%
MBCredit Solutions	70.3 ¹⁰	5.5	39%	23%	38%
Credito Fondiario	41.6	6.3 ⁶	53% ⁷	33%	15%
Fire	40.3	3.2	34%	22%	44%
Advancing Trade	35.0	3.1	36%	16%	48%
Guber	30.9	7.9	42%	40%	18%
Cribis Credit Management	25.2	2.1	47%	25%	28%
CAF (Intrum Italy)	22.7	8.2	49%	31%	20%
Serfin	22.0	0.5	30%	50%	20%
Hoist Italia	21.3	6.8	47%	19%	33%
Securitisation Services	20.7	0.6	40%	27%	33%
FBS	20.4	8.0	27%	38%	36%
Sistemica	20.3	6.5	48%	35%	17%
Europa Factor	20.1	2.6	28%	26%	46%
Parr Credit (Arrow Group)	17.6	0.5	37%	25%	38%
Gruppo Frascino ⁸	15.0	2.1	38%	24%	38%
Officine CST	14.6	1.7	35%	21%	43%
Bcc Gestione Crediti	14.4	4.0	52%	22%	26%
Prelios Credit Servicing	13.5	4.6	25%	22%	53%
Aquileia Capital	13.5	1.3	99%		
Frontis NPL	12.4	2.5	63%	26%	10%
Fides	12.0	1.1	14%	14%	72%
Axactor Italy	9.2	1.0	n.a.	n.a.	n.a.
AZ Holding	8.5	1.9	33%	34%	33%
CSS	7.5	2.2	51%	17%	32%
Finint Revalue	6.9	2.8	33%	42%	25%
SiCollection	6.4	1.0	41%	16%	43%
Phoenix Asset Management	6.0	8.9	21%	59%	21%
Link Financial	4.6	2.2	21%	36%	43%
Aurora RE	4.2	0.2	48%	46%	6%
Centotrenta Servicing	4.2	-	44%	31%	25%
Gextra (Intrum Italy)	3.6	0.5	44%	23%	34%
Certa Credita	2.9	0.2	28%	17%	55%
Blue Factor	2.0	1.6	33%	31%	36%
Bayview Italia	-. ⁹	3.6	53%	28%	19%
Zenith Service (Arrow Group)	-. ⁹	-	54%	20%	27%

Source: PwC analysis on data provided by Servicers as of 31/12/2017; data have been directly provided by Servicers and have not been verified by PwC; Servicers present highly heterogeneous organizational, industrial and operating structures. Comparing the information presented above requires a correct analysis and understanding of the competitive landscape and servicers business model.

¹ Includes both owned and third parties portfolios.

² Includes: Piemonte, Valle d'Aosta, Lombardia, Veneto, Trentino Alto Adige, Friuli Venezia Giulia, Liguria, Emilia Romagna.

³ Includes: Toscana, Umbria, Marche, Lazio.

Table 9: Breakdown of servicers' Total Bad Loans AuM¹ (data at 31/12/2017) – Ranking by Revenues

4 Includes: Abruzzo, Molise, Campania, Puglia, Basilicata, Calabria, Sicilia, Sardegna.

5 doBank group figures include Italfondario

6 AuM at 31/05/2018.

7 North includes n.a.

8 Includes Credit Network Finance and Z1s.

9 2017 data have not been provided by Servicers, at 31/12/2016 revenues were equal to: Zenith Service 12€m; Not available data for Bayview.

10 Revenues normalized at 31/12/2017.



Recent market activity and outlook



Key Message: The Italian banking sector is demonstrating higher willingness to actively manage the amount of Non Performing Loans present on banks' balance sheets and to promote credit recovery. The latest NPL disposals and the recent regulatory changes confirm that the general attitude tends to reduce the weight of Italian deteriorated loans and to restore higher performance levels for Italian banks. Transaction volumes in 2018 are expected to peak €70 billion.

Compared to what has been done in previous years, Italian banks are now carrying out larger NPL sales and write-downs, looking for buyers for their deteriorated loans and managing NPL portfolios in a more proactive way.

For example, among the most relevant and recent events which have characterized the Italian NPL market, the last two quarters of 2017 registered the disposals of the €1.2 billion Bad Loans portfolio of Banca Carige, the €320 million one of Banca Popolare di Bari and the €885 million one of Cassa Centrale Banca.

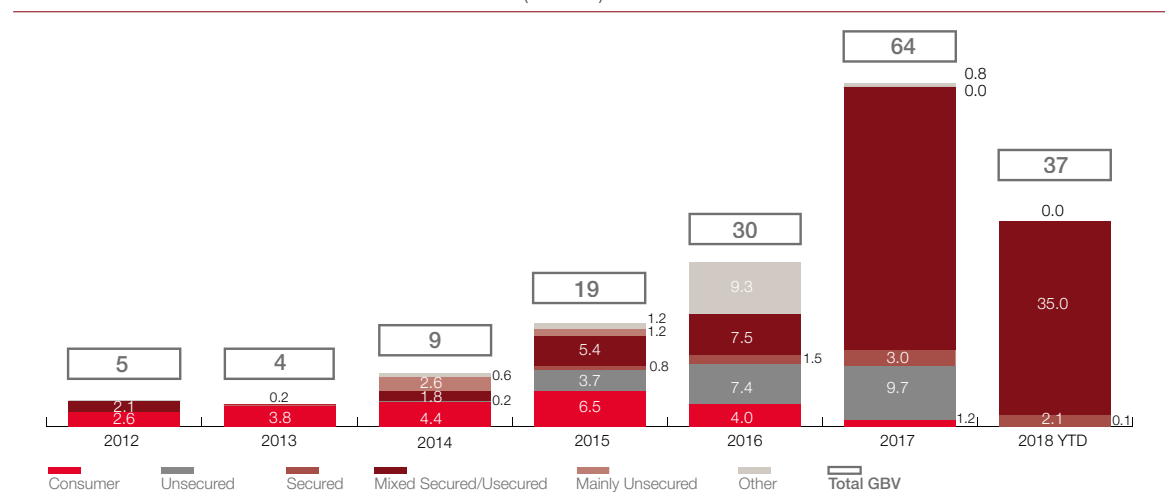
The new accounting rules set out by the IFRS 9, which replaces IAS 39 for the recognition of financial instruments and has come into force from January 1st, 2018, will require Italian banks to consider expected losses on their loan books as well as realized losses. The migration from the old approach will therefore produce substantial effects on banks' balance sheets, in particular with reference to the First Time Adoption (FTA) fiscal year.

Moreover, the ECB Addendum to its guidelines to banks on Non Performing Exposures (which requires write-downs on NPL for 100% of their book value, to be realized in 7 years from their transition to the non performing state for secured loans, 2 years for unsecured ones) could make it less convenient for Italian banks to extend the permanence of NPL on their balance sheets and this is likely to reinforce the power of their NPL disposal policies.

Table 10: Closed NPL transactions in 2018 YTD

Date	Seller	Volume 2018 (€ million)	Performing/Non Performing	Macro asset class	Buyer
2018 Q2	UniCredit S.p.A.	140	Non Performing	Unsecured	MBCredit Solutions S.p.A.
2018 Q2	Alba Leasing	100	Bad Loans	Secured	Bain Capital
2018 Q2	Banca MPS S.p.A.	24,100	Bad Loans	Mixed secured/unsecured	Quaestio Capital SGR S.p.A.
2018 Q2	Findomestic Banca S.p.A.	35	Non Performing	Unsecured	Banca IFIS S.p.A.
2018 Q2	Banca IFIS S.p.A.	40	Non Performing	Unsecured	Pinkerton SPV Srl
2018 Q2	Sicilcassa S.p.A.	1,700	Non Performing	Secured	MB Finance S.r.l.
2018 Q2	Intesa San Paolo	10,800	Non Performing	Mixed secured/unsecured	Intrum
2018 Q2	UniCredit S.p.A.	38	Non Performing	Secured	Due Securitisation SPV S.r.l.
2018 Q2	Agos Ducato S.p.A.	30	Non Performing	Unsecured	Hoist Finance
2018 Q2	Creval	245	Bad Loans & UtP	Secured	Algebris Investments
2018 Q1	Confidential	55	Non Performing	Secured	IDea NPLs
2018 Q1	TI SPV S.r.l.	38	Non Performing	Mixed secured/unsecured	At NPL's S.p.A.
2018 Q1	Banca Valsabbina Scpa	15	Non Performing	Mixed secured/unsecured	Sole SPV S.r.l.
2018 Q1	Banca Popolare di Bari	82	Consumer Loans	Consumer	VIVIBanca

Chart 34: NPL transactions trend in the Italian market (€ billion)



Source: PwC market analysis.

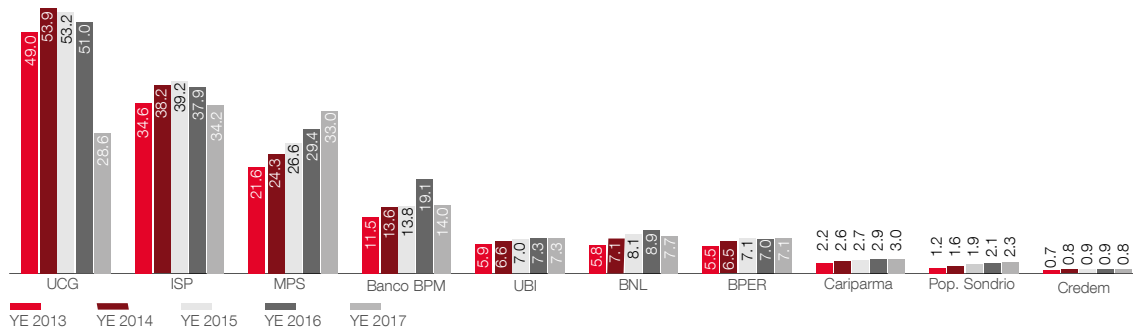
As displayed in **Chart 34**, the first five months of 2018 feature €37.4 billion of closed transactions, including the €24.1 billion Bad Loan securitization completed by Monte dei Paschi di Siena Group and the €10.8 billion sale of Non Performing Loans (both secured and unsecured) by Intesa San Paolo to Intrum.

More NPL transactions are expected for the remaining part of the year (the main ongoing disposal operations announced for 2018 are displayed in the table below): the efforts to reduce the NPL burden and to accelerate the recovery are a 2018 strategic priority for Italian banks.

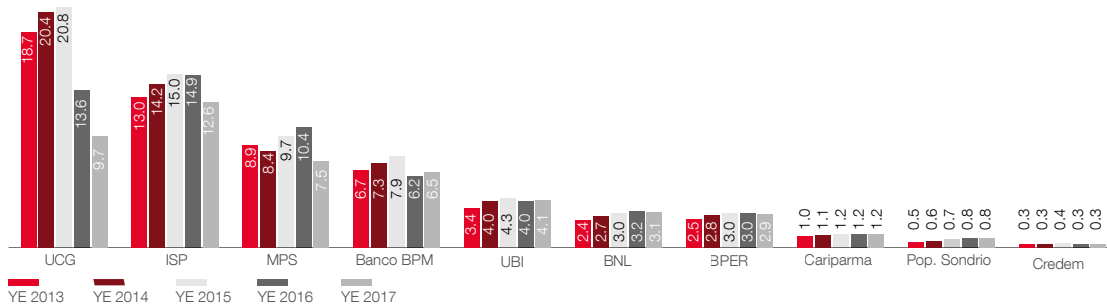
Table 11: Announced NPL transactions for 2018

Seller	Volume (€ million)	Portfolio type	Macro asset class	Project name
UBI Banca	3,000 / 4,000	NPL securitisation	Mainly secured	-
Multioriginator	1,700	NPL securitisation	Mainly secured	Project Multioriginator
ICCREA	1,000	NPL securitisation	Mainly secured	-
Creval	1,600	NPL securitisation	Mainly secured	-
Banco Desio	1,110	NPL securitisation	Mainly secured	-
Credit Agricole	6,000	Bad Loans	Unsecured	Project Poppy
Banco BPM	5,100	NPL securitisation	Mainly secured	Project Exodus
Banca di Sassari	1,100	NPL securitisation	Mainly secured	Project Banca di Sassari
BPER	2,900	NPL securitisation	Mainly secured	Project BPER
Gruppo Delta	2,200	Bad loans	Unsecured	Project Arcade
Cariparma	435	UtP	Secured	Project Valery
Carige	1,400	UtP	Secured	Project Isabella
Carige	500	UtP	Secured	Project Carige

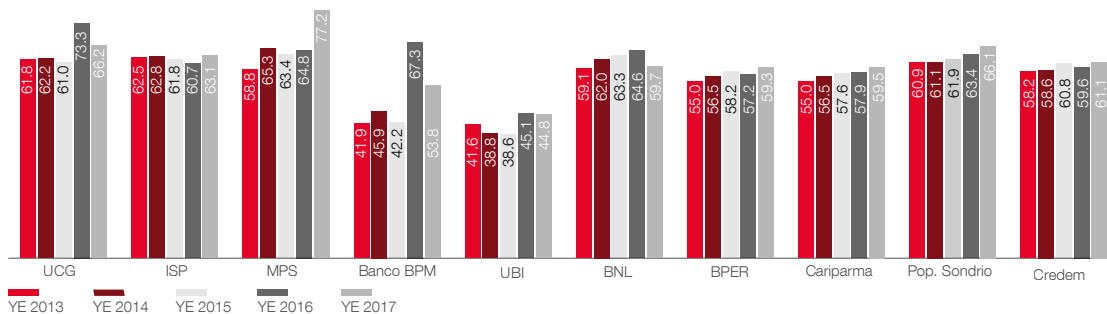
Gross Bad Loans volume (€ billion)



Net Bad Loans volume (€ billion)

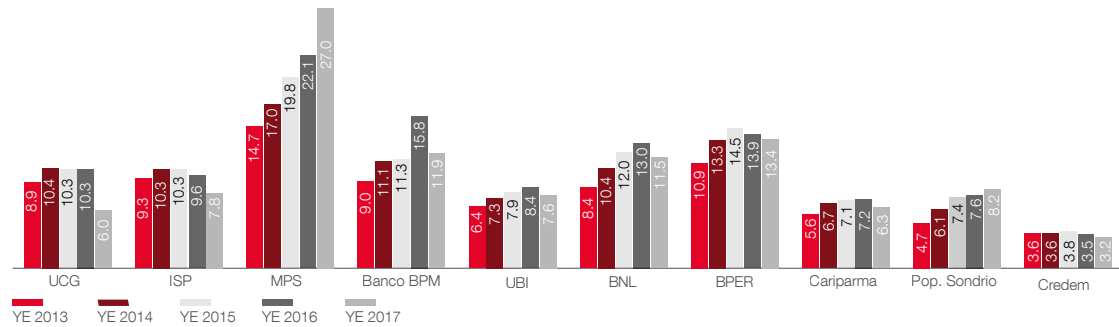


Bad Loans Coverage Ratio (%)

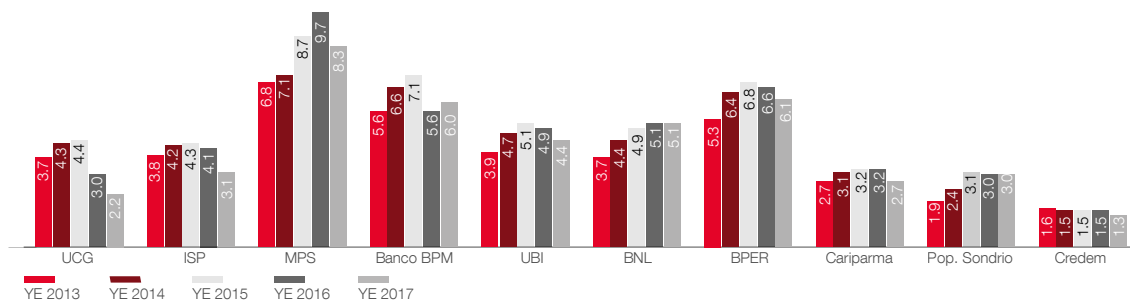


Source: Financial Statements as of YE-2017, YE-2016, YE-2015, YE-2014, YE-2013.

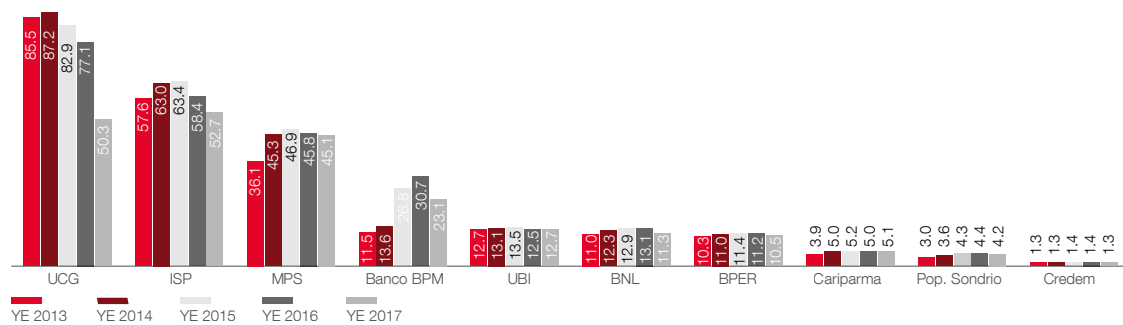
Gross Bad Loans Ratio (%)



Net Bad Loans Ratio (%)

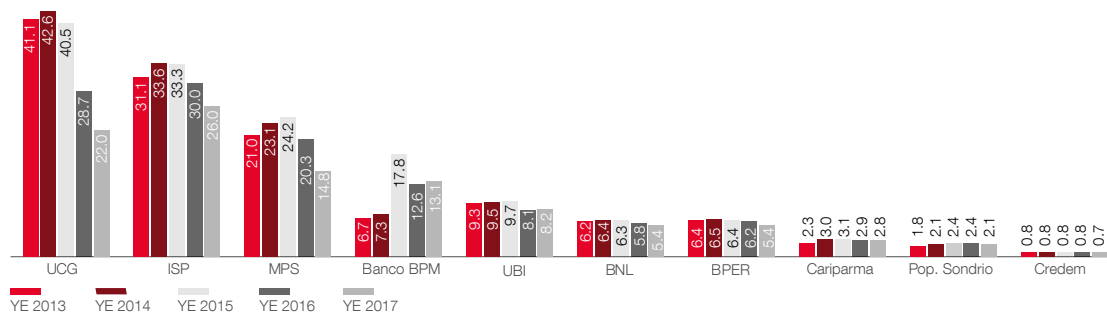


Gross NPE volume (€ billion)

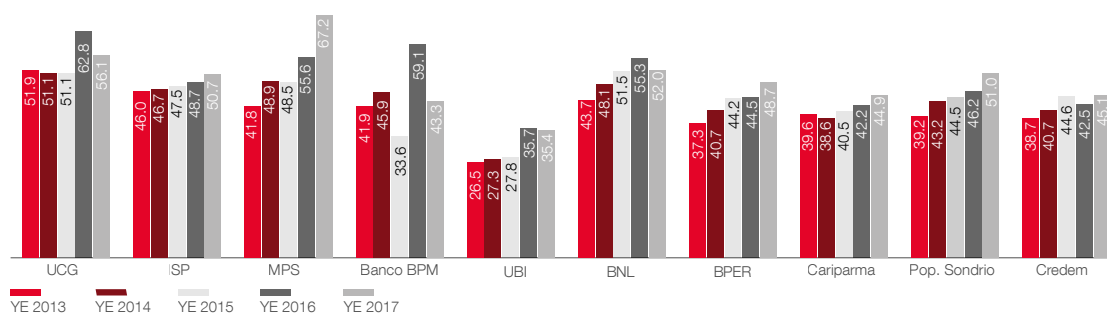


Source: Financial Statements as of YE-2017, YE-2016, YE-2015, YE-2014, YE-2013.

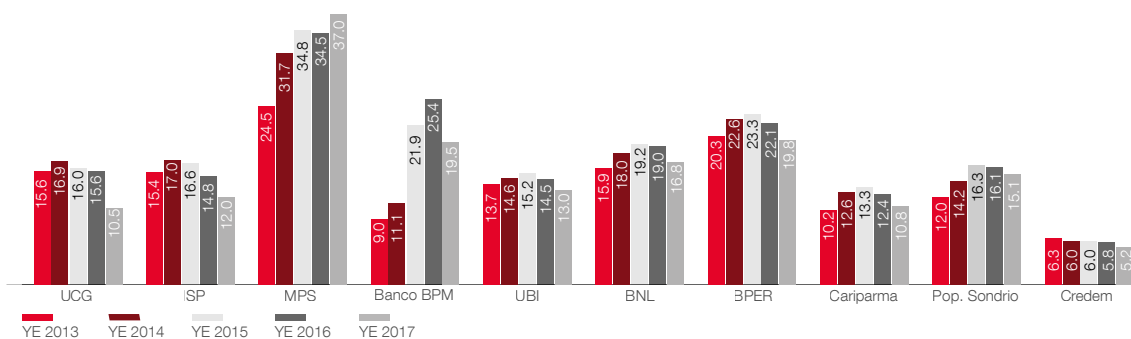
Net NPE volume (€ billion)



NPE Coverage Ratio (%)

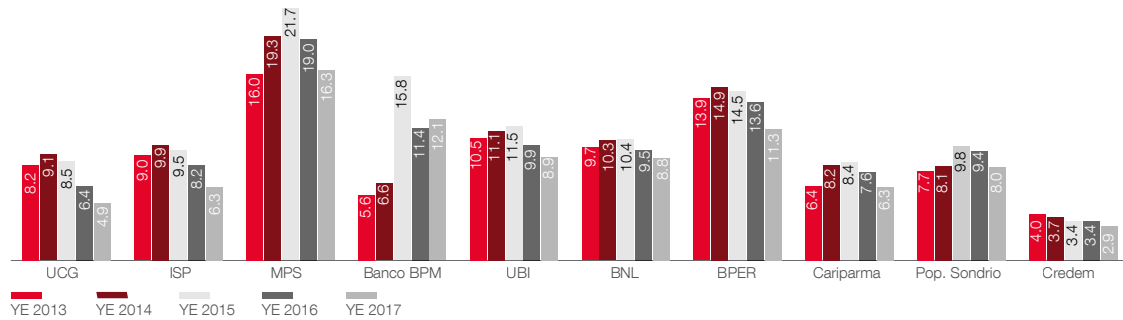


Gross NPE Ratio (%)

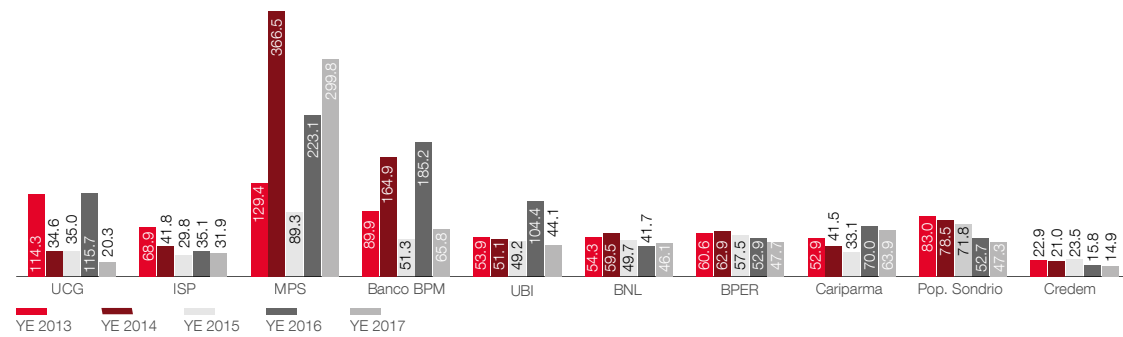


Source: Financial Statements as of YE-2017, YE-2016, YE-2015, YE-2014, YE-2013.

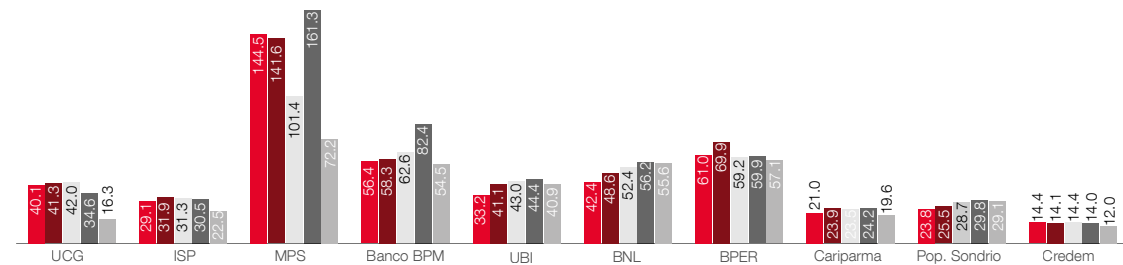
Net NPE Ratio (%)



Yearly Loan Loss Provision/Net Interest Margin (%)



Net Bad Loans/Equity (%)



Source: Financial Statements as of YE-2017, YE-2016, YE-2015, YE-2014, YE-2013.

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