



FUND OF PROBLEM LOANS
ACQUISITION. MANAGEMENT. SALE.



THE
EXPERIENCE OF
ITALY IN NPL
REGULATION.
AMCO'S ACTIVITIES

I. Measures for NPL Resolution in Italy

Preconditions for the Rise of NPL Levels

The issue of non-performing loans (NPL) in Italy remains a focal point of EU efforts to address the so-called legacy debt. This issue is closely linked to the slow banking reform, low sector profitability, and fragmentation.

Nevertheless, Italy's experience is of interest because, until 2019, government measures to support the NPL market were carried out without the establishment of a centralized asset management company.

Unlike other eurozone countries, Italy did not experience a credit or real estate boom before the global economic crisis of 2008. Household debt and the quality of the loan portfolio remained moderate.

However, the level of economic growth remained weak throughout Italy's membership in the EU.

After the 2009 recession, the level of NPLs began to rise rapidly. Bank capital was limited (the capital adequacy ratio was 11.7% in 2009), which prevented banks from writing off overdue debt.

In addition, there were limitations in tax legislation and bankruptcy procedures, and long court proceedings further hindered the NPL resolution process carried out by banks.

I. Measures for NPL Resolution in Italy

First Steps in Reducing NPL Share – Legal Measures

At the same time, the measures aimed at resolving non-performing loans (NPL) in Italy were introduced relatively late — in 2015, when the government shortened bankruptcy procedures, which increased the efficiency of debt recovery processes.

In 2016, reforms were carried out in the process of forced debt collection outside of court, along with other measures to enhance the transparency of bankruptcy procedures. Additionally, amendments were made to the Italian securitization law, simplifying the process of selling loans and providing special purpose vehicles (SPVs) with the opportunity to participate in loan restructuring.

By 2016, as a result of increased oversight by regulatory authorities and the establishment of target indicators for reducing NPLs on bank balance sheets, the volume of non-performing loans in the secondary distressed asset market significantly grew. Furthermore, several measures were taken to consolidate or liquidate small banks, which also helped cleanse the aggregate loan portfolio of the system from toxic loans and move them to the secondary NPL market. As in other countries, one of the most pressing issues hindering the development of the distressed asset market in Italy was the valuation of NPLs.

I. Measures for NPL Resolution in Italy

First Steps in Reducing the Share of NPL – Legal Measures

For a long time, there was a significant gap between the asset valuations proposed by investors and those provided by the selling banks. To address this issue, in 2015, the Italian government proposed the creation of a state-supported centralized asset management company. However, this scheme was not approved by the European Commission, as acquiring assets at prices higher than market value could lead to abuse of state aid. In 2016, an alternative NPL resolution scheme was approved — GACS Cartolarizzazione Sofferenze (Garanzia Sofferenze) or "Guaranteeing the Securitization of Non-Performing Loans."

Under this scheme, the Italian Treasury guarantees the senior tranches of bonds issued by the SPVs of the banks selling the non-performing loans. The SPVs, in turn, are created by participants, and their bonds are backed by loans. GACS covers interest and principal payments provided that the securitization meets the following requirements:

- (1) the NPL pools must be sold by the banks to the SPVs at a price not exceeding their net book value;
- (2) the SPV must issue at least two tranches of bonds (senior and junior);
- (3) senior bonds must have an investment-grade rating from at least one ECB-approved external credit agency;

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First Steps in Reducing the Share of NPL – Creation of Atlante

(4) the management of non-performing loans must be carried out by a third party, independent of the selling bank and its group;

(5) payments on junior bonds can only be made after the senior bonds are redeemed;

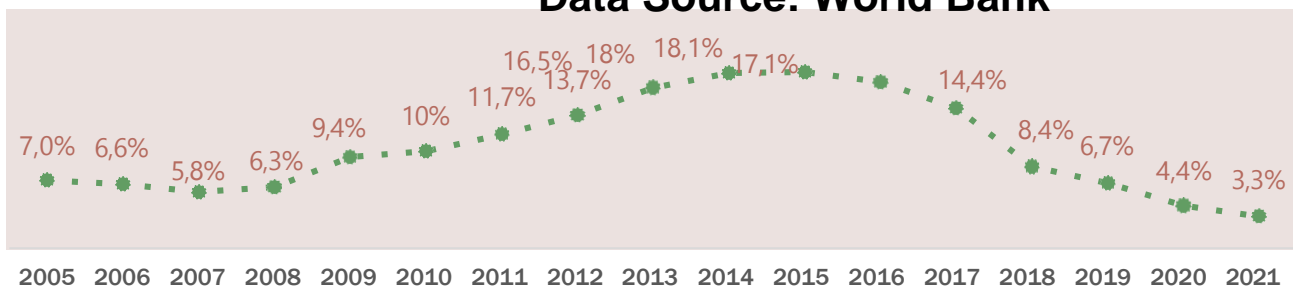
(6) the majority of junior bonds must be sold to external investors.

In addition to GACS, some Italian banks joined forces to create a closed fund, Atlante which was invested in by Italian banks, insurance companies, and investment

funds, and managed by the independent management company Quaestio Capital Management. The fund's goal was to support undercapitalized banks on one hand, and to purchase junior tranches of non-performing loan securitizations on the other.

As a result of these measures, by mid-2018, the share of overdue loans in Italy had decreased to less than 10% from its peak value of 18%. By the end of 2022, the share of NPLs in the country's banking sector loan portfolio stood at approximately 3%.

Dynamics of NPL Levels in the Loan Portfolio of the Italian Banking Sector Data Source: World Bank



II. Creation of AMCO

Early Stages and Development of SGA's Activities

Despite the use of a wide range of mechanisms, including the implementation of the GACS scheme, the Italian government ultimately decided to employ another tool for NPL (Non-Performing Loans) resolution – a centralized asset management company.

The company AMCO (or Asset Management Company) was founded as a result of the reorganization of Società per la gestione di attività (SGA), which was established back in 1989 to rehabilitate Banco di Napoli by acquiring the bank's troubled loans.

In 1997, SGA was granted the status of a "financial intermediary," which, according to Italian banking law, allowed it to conduct lending activities. From 1997 to 2002, SGA carried out

transactions to acquire NPLs from Banco di Napoli and other companies within the Banco di Napoli banking group, as well as shares of companies such as Graal S.r.l., which provides leasing services.

In 2014, Banco di Napoli engaged SGA as a direct servicing agent for the entire credit portfolio, amounting to approximately 3 billion euros.

A turning point in SGA's activities came in 2016-2017, when a crisis began at the world's oldest bank, Monte dei Paschi di Siena, as well as at Banca Popolare di Vicenza and Veneto Banca (the so-called "Banche Venete").

At the initial stage, the Italian government explored the possibility of involving the Atlante fund to resolve the crisis in the Banche Venete.

II. Creation of AMCO

Transformation of SGA into a State Asset Management Company – AMCO

Thus, Atlante acquired shares in the Banche Venete in 2016, while its "twin fund," Atlante II (later renamed the Italian Recovery Fund – IRF), was intended to acquire the banks' distressed portfolio in market conditions, in accordance with EU restrictions on state aid.

Additionally, the Italian government laid the groundwork for the transformation of SGA into a state-owned asset management company with a macroeconomic mission.

In 2016, a decree was signed that mandated the transfer of all of SGA's shares to the Ministry of Economy and Finance of Italy.

Moreover, the organization's functions and corporate objectives were expanded to

include the acquisition and management of distressed financial assets within the system.

Since Atlante was insufficient to prevent the crisis in Banche Venete, in June 2017, the Italian government, together with the European Commission, developed a new resolution scheme for the two banks.

As a result, Banche Venete underwent forced liquidation, and the assets and liabilities of the banks (excluding the toxic portfolio) were acquired by Intesa Sanpaolo with the support of the European Commission.

Meanwhile, the distressed assets of the two banks, with a total balance sheet value of 18.3 billion euros, were transferred to the management of SGA.

III. AMCO's Activities

Transformation of SGA into a State Asset Management Company – AMCO

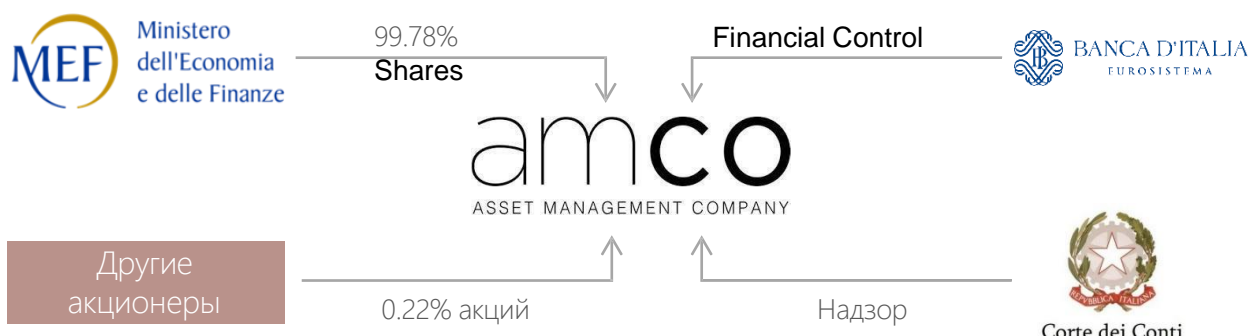
The purchase price of the portfolio was determined based on its balance sheet value, but was subject to adjustment according to the level of actual recoveries and the costs incurred by the company during asset management. Additionally, SGA did not make an immediate payment for the portfolio, but agreed to make payments in stages as recoveries were made.

During the acquisition of the Banche Venete portfolios, there was a change in the management of SGA, as well as a significant strengthening of its governance and organizational structure.

In 2019, the company changed its name to the English version – AMCO, and launched a new strategic plan aimed, among other things, at increasing average recovery rates and integrating new business initiatives.

Thus, the company transformed into a key player in Italy's distressed asset market, with its activities no longer limited to rehabilitating individual banks.

By the end of 2019, the total assets under AMCO's management exceeded 23 billion euros.



III. AMCO's Activities

Types of Transactions and Asset Management

AMCO's most recent transactions can be broadly grouped into the following strategic areas, in which the company acts both as an asset manager and as an investor in equity capital:

“Traditional” direct purchase of distressed assets from banks;

Securitization – AMCO invests in a series of bonds secured by non-performing loans, for example, from Banca Popolare di Bari and Banca del Fucino;

Investment in credit funds – in 2019, AMCO participated in the creation of a multi-originator platform for the long-term management of various toxic assets of Italian banks.

AMCO’s approach to asset management does not differ from that of other asset management companies (AMCs).

Thus, the loans purchased by the company are divided into “viable” assets, which can generate cash flows in the future, and “hopeless” loans, which have no recovery prospects.

For the first category of loans, AMCO takes measures aimed at restoring the borrowers' activities, including by providing additional financing.

For “hopeless” loans, AMCO carries out debt collection activities.

IV. Current Status of AMCO's Activities

By the end of 2022, the total volume of assets under AMCO's management amounted to 36.4 billion euros.

The majority of the loans (78%) are from the corporate sector.

At the same time, only 52% of the loans in the overall portfolio are secured by collateral.

A quarter of AMCO's assets are managed by trustees.

Although AMCO's charter also allows it to dispose of assets, judging by the latest reports, the company has not yet initiated this process.

As of 2022, through its recovery and collection efforts, AMCO generated cash flows amounting to 1.5 billion euros.

Currently, AMCO holds one of the leading positions in the distressed asset market in Italy, with a competitive advantage due to government support.

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JSC "Non-Performing Loans Fund"

Sources:

AMCO's annual reports, amco.it
Non-performing Loans – New Risks and Policies? Economic Governance Support Unit Study, 2021