



***FURTHER DEVELOPING
SECONDARY MARKETS FOR
NON-PERFORMING LOANS:
THE ROLE OF SECURITISATION***

NPL Advisory Panel

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Further developing secondary markets for non-performing loans:

The role of securitisation

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Members of the NPL Advisory Panel

Alpine Tremont LLC

AMCO - Asset Management Company S.p.A (AMCO)

ASOCIACIÓN DE USUARIOS FINANCIEROS (ASUFIN)

Associação Portuguesa para a Defesa do Consumidor (DECO)

BANCO BILBAO VIZCAYA ARGENTARIA (BBVA)

BANCO DE SABADELL, S.A. (SABADELL)

Bureau Européen des Unions de Consommateurs (BEUC)

Commerzbank AG

Debitos GmbH

EOS Holding GmbH

Erste Group Bank AG

European Association of Co-operative Banks (EACB)

European Banking Federation (EBF)

European DataWarehouse GmbH (EDW)

Fédération bancaire française (FBF)

Guber Banca S.p.A.

Hoist Finance AB (publ) (HOFI)

Intrum

KPMG EMA (KPMG EMA)

Morgan Stanley (MS)

National Asset Management Agency (NAMA)

NPL Markets Limited

Prometeia SpA (Prometeia)

Raiffeisen Bank International AG (RBI)

UniCredit

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1. INTRODUCTION

The aim of this paper is to examine how securitisation contributes to the development of a mature EU secondary market for non-performing loans (NPLs). In order to provide banks with the right tools to address NPLs, secondary markets for distressed debt offer a good way to offload non-performing assets from their balance sheet. A deep and liquid secondary market for distressed assets across the EU allows banks to reduce their NPLs by selling them to third-party investors.

In the aftermath of the Global Financial Crisis, when several European banks were left with historically high levels of NPLs, a functioning EU secondary market for NPLs did not exist yet. Several of the actions contained in the "Action Plan to Tackle Non-Performing Loans in Europe", adopted by the European Council on 11 July 2017, as well as in follow-up measures, were indeed aimed at fostering the development of secondary markets for NPLs.

As secondary markets for NPLs are becoming more efficient, banks now have more options at their disposal to avoid large build-ups of NPLs on their balance sheets. In turn, this helps banks focus on their lending activities and liberates space in their balance sheets for new lending, thereby supporting future credit supply to the real economy.

By helping banks rapidly dispose of their NPLs, an efficient EU secondary market for NPLs can also reduce financial fragmentation and facilitate capital flows within the single market. From this perspective, a functioning secondary market brings broader financial stability benefits and is one of the building blocks of a well-functioning Capital Markets Union (CMU).

In this context, securitisation would represent an important part of the toolbox to address existing high stocks of NPLs and could contribute towards preventing a future build-up. The importance of the securitisation instrument in dealing with NPLs has been clearly acknowledged, both at national and at European level¹. However, the creation and further development of a proper "NPL securitisation market" seems to pertain to a more mature NPL ecosystem compared to the existing one.

The current document explores the opportunity and the possibility to use the securitization as a tool to address NPLs across the EU. Taking the example of the Member States (MS) that provided government guarantees in connection with NPL securitisations, the paper will explain the concept of NPL securitisation in detail and set out its potential advantages. Section 2 outlines the context and framework, including the relevant regulatory requirements. Section 3 presents an overview of the EU NPL securitisation market and focuses on its development. Section 4 highlights the main lessons learnt so far. Section 5 offers a number of concrete ideas and touches upon potential measures to enable further improvement. Section 6 concludes.

¹ A number of studies and analyses, both from the private and public sector acknowledge that. See, for instance, [John Fell, Claudiu Moldovan and Edward O'Brien: "Resolving non-performing loans: a role for securitisation and other financial structures?", ECB Financial Stability Review, May 2017.](#)

At European level, the regulatory environment has removed some of the constraints to the development of NPL securitisation². Several amendments to the Securitisation Regulation³ and the Capital Requirements Regulation⁴ (CRR) have clarified the regulatory framework for NPL securitisation. The securitisation framework was amended to cater for the specificities of securitisations of non-performing exposures (NPEs), while maintaining high prudential standards. This could enable the broader use of this tool by banks to free their balance sheets from NPLs. Beyond banks, other market participants could benefit from the wider use of securitization, such as: investment banks functioning as the structurer of such securitisations and allocating the tranches; funds investing in the junior tranches; and credit servicers, aligned with investors assuming the risk.

In addition, at national level, NPL securitisation schemes have been applied on a wider scale by some EU countries.

After the EU financial crisis, high NPL levels took on a systemic dimension, when a common NPL secondary market was still missing. Italy and Greece developed the use of transactions through state guarantees programmes (priced on market terms) via securitisations. Such different schemes did not involve State aid and contributed to the reduction of high NPL ratios. More specifically, in Italy the *Garanzia sulla Cartolarizzazione delle Sofferenze* (GACS)⁵ had run for six years until June 2022 and enabled Italian banks to shed substantial volumes of NPLs from their balance sheets. In Greece, meanwhile, the “*Hellenic asset protection scheme*” – or HAPS – enabled Greek banks to divest large numbers of NPLs.

Securitisation on the basis of government guarantee schemes has been instrumental in such markets with high levels of NPLs because it was able to offer a lower average cost of funding (e.g. compared to outright NPL portfolio sale), adequate senior investor protection and legal certainty. In Italy and Greece – both of which registered high levels of NPLs – state-guaranteed securitisation has been instrumental, as the breadth and depth of the NPL market at the time was not adequate to absorb such large numbers of NPLs through NPL market securitisation. In this light, state-guaranteed schemes played an important role in developing these markets and thus promoting financial stability, despite the potential costs to taxpayers of these schemes⁶.

As a whole, the EU NPL securitisation market is arguably still underdeveloped – but it might grow in the future. From this perspective, state guaranteed schemes are not expected to be needed anymore to kick-start the disposal of NPLs. Largely due to their simplicity and lower costs, direct sales have remained the preferred alternative used by banks to dispose of NPLs. However, NPL securitisation is a versatile instrument that

² For further details, see section 2.3.

³ Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.

⁴ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012.

⁵ GACS has facilitated the secondary market for bad loans held by Italian banks, by offering a market-conform public guarantee to the senior, low-risk notes, and thereby increased the creditworthiness of the senior tranches.

⁶ It is to be mentioned that other Member States, such as Croatia and Romania, also show a double-digit percentage decline in NPLs in the period 2015 to 2022 without relying on state guarantee schemes.

has significant potential and could be useful if combined with other measures to tackle NPLs⁷.

Taking a forward-looking perspective, NPL market securitisation could help banks deleverage and successfully manage NPLs, should accelerating inflation and tightening of credit conditions lead to a significant rise in NPLs. NPL securitisation could complement the effective organic workout of loans in distress, while improving the functioning of the NPL secondary market as a whole.

2. NPL SECURITISATION: CONTEXT AND FRAMEWORK

2.1. SCOPE, RATIONALE AND KEY ECONOMIC CONSIDERATIONS

NPL securitisation transactions are an integral part of the development of a secondary market for NPLs, as set out in the Commission's 2020 NPL Action Plan⁸. In addition to outright sales, the securitisation tool is one of the market-based solutions that allows banks to deleverage effectively.

NPL securitisation can be deployed as a balance sheet management instrument, enabling banks to substitute a portion of an NPL portfolio with securitisation notes. In addition, instead of a bank retaining NPL securitisation notes, these can also be sold to third-party investors, thereby effectively removing the underlying credit risk from banks' balance sheets (subject to minimum risk retention requirements).

Generally, NPLs securitisation should pursue the same objective as an outright sale, which is to deconsolidate non-performing assets from the balance sheet by transferring them to a third party, but with some added benefits, such as:

1. Getting access to a wider spectrum of investors who are not necessarily specialised in NPLs.
2. Creating securities with different risk profiles and related pricing (tranching), thus targeting for every tranche the most suitable investors in line with their risk appetite.

The points above provide a number of clear advantages, but they also bring a certain amount of complexity. In particular, setting up the necessary infrastructure to allow this type of transaction entails significant costs and organisational complexities (e.g. legal and IT platforms need to be able to securitise and ensure regulatory compliance and provide the relevant information for the rating, if required)⁹. Another difficulty

⁷ For instance, asset management companies (AMCs) and asset protection schemes (APSS) proved to be successful in helping banks tackle the large amounts of legacy NPL exposures following the global financial crisis and the EU sovereign debt crisis.

⁸ See https://finance.ec.europa.eu/publications/action-plan-tackling-non-performing-loans-npls-aftermath-covid-19-pandemic_en.

⁹ Once the organizational infrastructure to carry out securitisations of NPL notes has been set up, a number of lesser complexities may need to be taken into account, such as:

- i. Since the buyer of the final tranches is an investor, but not necessarily a specialist in terms of NPL management, it is the originator who would need to structure the entire operation, including hiring the servicer, supervising the business plan and managing the rating with the agencies. This can delay the structuring of the operation by a couple of months.
- ii. Once the transaction is structured, there is a significant risk in the placement of the tranches, even for the senior tranche. However, the typical buyers of the junior and mezzanine tranches are still the same specialised investors that usually buy NPL portfolios.

specific to NPL securitisations is that fulfilling the business plan is subject to more uncertainties than in the case of performing loans. This uncertainty lessens when there are multiple market agents who have experience with the underlying and can provide confidence regarding the assumptions behind the original business plan (i.e. a developed market is needed).

Box 1 presents in more detail the different key economic considerations for sellers and purchasers of NPL securitisation notes. The remainder of the section is dedicated to presenting the various types of securitisation, their different aims and the respective frameworks.

Box 1

Key economic considerations behind selling and purchasing NPL securitisations

When buying and selling NPLs through a securitisation structure, there are a number of key elements to consider for both seller and purchaser.

Among the **key economic considerations for the seller**, from a cost perspective, is that it is necessary to balance what are likely to be higher transfer prices¹⁰ from a securitisation (compared to an outright sale) against the costs involved. Furthermore, a seller will need to reach critical volumes for a given transaction and will have to estimate the breakdown of costs (e.g. rating agency, investment bank fee). This will of course depend on the circumstances and the nature of the securitisation operation (state-sponsored vs market-based).

Another consideration pertains to **decisions about retaining or selling the senior risk tranche(s)** and their consequences. For instance, risk weights of retained tranches and the potential impact on derecognition of the loans may affect the seller's decision. Normally an NPL securitisation has the objective of derecognition of the portfolio from both an accounting and regulatory point of view. The accounting derecognition is defined by the IFRS principles, while the regulatory one is defined by the Significant Risk Transfer provision set out in the CRR. The decision on how much to retain from the issued securitisation notes is the result of a careful combination of interests between the amount sold/retained to obtain derecognitions and cost/income considerations.

The seller will also need to **consider investors' demand for senior risk tranches** with and without government guarantees (where available and relevant). In case of state-sponsored securitisations, the guarantee would come at a cost, but can also be used as security and pledged as collateral for repo style transaction. In past cases, the cost of the state guarantee has been linked to a basket of CDS of domestic issuers or the State credit default swap (CDS). It is therefore closely linked to the market/sovereign risk respectively. The cost of the state guarantee may increase over time, according to the expected redemption profile of the guaranteed rated-senior tranche(s), as step-ups and penalties are included, depending on the time of repayment in full of the principal of the

¹⁰ Among other factors, this depends on whether State guarantees are involved, such as in Italy and Greece.

guaranteed senior notes. In the case of guaranteed schemes, the requirements to have the senior tranche(s) rated by a credit rating agency, as well as additional information and structural demands for rated securitisations, should be factored in.

Finally, the seller should also **consider the possible benefit of regulatory capital release**, as regulatory capital requirements would be reduced thanks to the transfer of risk (and would go to zero risk weight if provided with government guarantees), provided that significant risk transfer takes place subject to the conditions set out by the regulatory framework and the competent authority.

In NPL transactions, the seller might be exposed to some **liabilities deriving from the customary representations and warranties** covering the transferred portfolio that are provided in the context of the different types of securitisation transactions. In order to mitigate the effects of the risks of claims based on representations and warranties and to disincentivise indemnity claims, the originator(s) and NPL purchasers may enter into limited repurchase options agreements that are structured in order for the originator to comply with the requirements needed in terms of accounting and prudential derecognition. As limiting the liability in favour of the NPL seller means limiting the rights and potential claims of the buyer / investors, strong limitations in this respect usually have a negative influence on the price which will be offered for the NPL portfolio.

Among the **key economic considerations for the investor**, it is primarily necessary to understand the structural features of the scheme, including triggers that change the payment waterfall and may affect both the investor and servicer overall lifetime returns (e.g. grace period for underperformance triggers to be activated, cumulative collection triggers and profitability triggers). Normally the market for junior and mezzanine tranches of NPL securitisation targets very specialized investors who often are servicers who will consider the servicing fees as a reason to invest in the securities.

Another key aspect relates to understanding the **importance of the servicer and the initial business plan**. The investor relying totally on the payment of interest and principal needs to assess independently whether the initial business plan can be considered realistic as servicers may be incentivised to inflate their recovery projections in order to win the mandate. Similarly, rating agencies are selected by the seller/arranger and they may overestimate recoveries as well. On the other hand, the requirements set by the regulatory framework for credit rating agencies in the EU provide some safeguards while reputational risk for rating agencies makes them prudent. Servicers also need to keep a prudent stance to preserve, among other things, their reputation.

Finally, the appointment of a purchaser-affiliated servicer would align buy-side interests and indirectly generate additional revenue stream for the purchaser. This only applies to securitisations where the investor takes such a decision.

2.2. TYPES OF NPL SECURITISATION

This section compares the aim and role of NPL securitisation transactions without a public guarantee, which will be referred to as **market securitisations**, with securitisations issued under **government guarantee schemes**. The different types of market securitisations (including sub-participation) are explained and the similarities and differences with government-guaranteed securitisation are explored. The latter have played an important role in Italy (called “*Garanzia sulla Cartolarizzazione delle Sofferenze*” or GACS) and Greece (the “Hellenic asset protection scheme” or HAPS), facilitating the offloading of sizable legacy NPL stocks from banks’ balance sheets. Although these schemes are not expected to be used in the future, their analysis and comparison with market securitisation can still help us to draw important lessons for the further development of the NPL securitisation market.

2.2.1. NPL MARKET SECURITISATION

Traditional NPL securitisations are structured financings whereby an owner sells NPLs (at a discount) to a bankruptcy-remote entity, i.e. a securitisation special purpose vehicle (SSPV) that funds the acquisition of the NPLs by issuing notes, typically referred to as asset backed securities (ABS), to capital markets investors. In order to be considered a securitisation from a European regulatory point of view, credit risk of the securitised exposures needs to be tranching while at least two different tranches of notes need to be issued by the SSPV, i.e. one senior tranche and one junior tranche; noting that structures with a third mezzanine tranche are also common. In addition, payments in the transaction need to be dependent upon the performance of the securitised exposures. The originator and SSPV must also comply with other regulatory requirements set out in the Securitisation Regulation, such as transparency, criteria for the selection and pricing of the assets, no re-securitisation, and the requirement that the originator/servicer retain a certain percentage of risk on a permanent basis. The SSPV will enter into a servicing agreement with a servicer that will manage the workout of the NPLs.

All securitisations entail additional transaction costs compared to an outright sale, but aim to achieve an aggregate higher sales price by tailoring the terms of the notes to investors with different risk-return preferences. The cost of the structure (set-up costs plus annual costs) is clearly an important factor. The more complex and expensive the structure, the higher the chance that overall prices might not exceed the prices that could have been paid in case of an outright sale. The purpose of structuring the securitisation notes in different tranches is to carve out a large senior tranche with reduced credit risk by means of credit enhancement and other structural features. The aim is to place the senior tranche with investors at a much-reduced return target compared to the return targets of investors in an outright sale provided that the return expectations for the mezzanine and junior tranches usually exceed overall return targets of an outright sale due to the higher risk profile of such lower ranking tranches. This makes it possible to widen the investor base for the transaction.

In **primary market securitisations**, the original lender, typically a bank, will sell the NPLs to the SSPV in order to remove them from the balance sheet through

derecognition, to reduce risk-weighted assets, and to reduce the bank's NPL ratio. The seller (acting as the originator in the transaction) will retain all or some (at least 5%) of the senior tranches in addition to the minimum 5% slice of the junior and mezzanine tranches that must be retained according to regulatory risk retention requirements (thereby ensuring that the originator maintains sufficient "skin in the game"). In addition, the risk retention requirement can also be fulfilled by the servicer¹¹, following the entry into force in 2021 of the Capital Markets Recovery Package, which recognised that the servicer's interest in the workout of the NPLs ensures a better alignment with the interests of investors, while the bank originator's preeminent interest is to get rid of the NPLs completely and achieve a clean break.

In **secondary market securitisations**, the investor, who purchased the credit from the original lender, uses securitisation to increase leverage. For example, by selling senior notes to institutional investors while retaining the junior notes. Risk retention rules apply also in this case. Prior to 2018, most NPL transactions were secondary-market securitisations structured as unrated private acquisitions financed by a senior loan, which were then syndicated to a small number of investors who remained in the transaction to maturity.

Secondary market securitisations can be structured at the time of acquisition. The investor, at the time of acquisition or at a later stage, uses the securitisation to obtain leverage to ensure it reaches its internal rate of return.

2.2.2. SUB-PARTICIPATION

Sub-participation provides an intermediate option, offering an alternative between outright sale and full market securitisation. It entails the transfer of NPLs to an SSPV, like full market securitisation, but does not have as many requirements¹².

There are certain operating costs (at least in terms of set-up), yet they are lower when compared to market securitisation.

The credit rights are typically sold to a vehicle that is administered and managed by a specialised servicer. In particular, it is customary that the bank:

- maintains the NPLs in its IT systems;
- continues to generate fees, interest, principal, arrears and expenses for each of the loans;
- collects the money from the original accounts of the debtors;
- reports daily to the servicer on the status of the portfolio: principal and outstanding debt, date of last payment, status (current or not), breakdown of collections for the month, status of collateral and status of legal proceedings;

¹¹ I.e. if the servicer fulfils the necessary requirements.

¹² From a regulatory point of view, sub-participation is considered as traditional securitisation. Article 2(9) of the Securitisation Regulation defines 'traditional securitisation' as a securitisation involving the transfer of the economic interest in the exposures being securitised through the transfer of ownership of those exposures from the originator to an SSPE or through sub-participation by an SSPE, where the securities issued do not represent payment obligations of the originator.

- transfers daily to an external account all collections; and
- complies with a series of regulatory reports (non-delegable services) and legal obligations derived purely from the ownership of the NPL. As the NPLs do not leave the bank's systems, reporting is controlled by internal teams and is homogeneous with the rest of the portfolio.

A dedicated back office of the bank may receive the information regarding the execution of a recovery agreement from the servicer, to enter into its systems to generate the relevant principal and debt reductions based on the agreements made.

Sub-participation can be a simpler starting point for full securitisation, where the additional complexities of tranching, collection analysis, rating and placement of notes or bonds are also combined.¹³ Box 2 explores in more detail the Spanish case where NPL securitisation has mostly taken place through sub-participation.

Box 2

Lessons learnt from non-sponsored securitisations: the Spanish case

Unlike in other EU countries, securitisations in Spain have mostly taken place organically, thanks to the maturity of the local market. In Spain, securitisations have provided an exit route for investors who had bought portfolios in the primary market, i.e. once the portfolio is being worked out and there is continuity in collections. Securitisations have also provided banks with a way of structuring portfolios that could not be sold by direct sale, thereby freeing up capital associated with provisioning requirements resulting from the prudential backstop regulation.

In Spain, most banks have not securitised NPLs with tranches. Rather, the economic interest in portfolios have predominantly been sold via sub-participation, mostly to a single investor. This is mainly due to the fact that the balance between potential price upside (with increased complexity) and the certainty of execution has tipped in favour of the latter. Another key lesson has been the importance of avoiding unnecessary portfolio migrations between the bank and the (investor's) servicer. It was considered preferable that the bank continue performing the primary servicing (i.e. collections and IT). This has forced Spanish banks to modify their processes and open their IT systems, so that relevant management decisions could be taken by the third party.

Typically, Spanish securitisation operations involved the disposal of performing and re-performing mortgage loan portfolios, structured as a sale of mortgage participations (*participaciones hipotecarias* or PHs) and/or mortgage transfer certificates (*certificados de transmisión hipotecaria* or CTHs). These are transferable securities traditionally used in Spanish securitisations. They transfer

¹³ In this context, relevant lessons can be taken away from the experience of the Macondo project (a transaction performed by Banco Santander), where both ways were proposed: sub-participation or full securitisation. While the idea was to opt for full securitisation, it ended up being sold through sub-participation due to the complexity of the whole process in the alternative option.

to the sub-participant the economic interest in the underlying mortgage loans. The transfer of the economic rights of the underlying mortgage loans via PHs and CTHs is exempt from stamp duty tax or registration costs.

Transferring rights in respect of a portfolio involving PHs, CTHs or simply a sub-participation agreement to include all types of loans implies that the originator needs to continue to be the lender of record. Hence, it maintains the relationship with the underlying borrowers and e.g. the right to foreclose. The holder of the PHs and CTHs is entitled to all collections and enforcement revenues of the underlying loans. However, the fact that the seller remains in the structure and maintains a relevant role can be a source of friction (e.g. risk of insolvency of the seller, conflicting servicing strategies, different nature of the underlying exposures, etc.).

2.2.3. NPL SECURITISATION AS PART OF A GOVERNMENT GUARANTEE SCHEME

Government-guaranteed securitisations have played an important role in helping banks dispose of NPLs when there have been historically high levels of NPLs and when an NPL market ecosystem was not developed enough to absorb such high levels. These schemes entailed higher transaction costs, but they minimised potential losses for senior investors when compared to both market securitisations and outright sales. They were therefore more attractive to investors and may have contributed to reducing the bid-ask spread between sellers and investors. The general objectives of such state-supported schemes were to accelerate the deleveraging of NPLs and create liquidity or reduce capital requirements for lenders¹⁴. In this way, they may also have supported the development of NPL securitisations in a given jurisdiction.

In Italy¹⁵ and Greece¹⁶, primary securitisations have been issued under a government guarantee scheme, whereby the government provides a guarantee for the most senior notes, while the junior and mezzanine notes are offered to third-party specialised investors. Secondary-market securitisations are not eligible for government guarantee schemes, which are designed to help banks reduce their NPLs. Both the GACS and the HAPS schemes require the senior tranche to be rated by a recognised rating agency with a minimum rating of BBB - (initially) and later BBB in the case of the GACS, and BB- in case of the HAPS. In the case of GACS, the guarantee comprises a CDS issued by a government entity, which must be remunerated by the SSPV at market levels to avoid potential State aid issues. For HAPS, it is a standard state guarantee that can be activated, e.g. separately for each missed coupon payment, and is again remunerated on market terms to appropriately reflect the risk undertaken by the state.

Whereas market (non-government-guaranteed) securitisations can be structured in any way acceptable to investors and compliant with the Securitisation Regulation, the government guarantee scheme imposes several additional requirements on the transaction structure to obtain the public guarantee on the senior tranche.

¹⁴ That is, banks gain liquidity if they sell senior tranches. Otherwise, the result is limited to equity relief.

¹⁵ At present, Italy has put on hold plans to revive the GACS scheme under revamped terms.

¹⁶ The HAPS scheme expired in October 2022. Greece is reportedly assessing the need for a possible reintroduction of the HAPS scheme.

First, the senior tranche must be rated with a minimum **rating by at least two recognised¹⁷ rating agencies**. The requirement of two ratings applies to all rated structured finance notes following the European regulation of credit rating agencies. Obtaining a rating for NPL portfolios can be a complex and time-consuming process and increases transaction costs. To assign a rating to the senior tranche, rating agencies take into account the cost of the guarantee, but not the protection from the government guarantee. Rating agencies evaluate the servicer's expertise and historical payment performance and scrutinise the servicer's business plan to assess the probability of full repayment in line with the assigned rating.

GACS transactions are usually **structured around three tranches: senior, mezzanine and junior**. The senior guaranteed notes are usually retained by the bank at face value with a 0% regulatory risk weight while mezzanine and junior notes are sold to non-bank third-party investors, at a discount to par, due to the embedded higher risk¹⁸. It is worth noting that in some transactions under the Greek HAPS scheme, part of the mezzanine and junior notes were distributed as a dividend-in-kind to the equity investors of the bank. This could be related to the fact that the market price may have been considered uncertain or unstable by investors.

The government guarantee schemes require that **at least 50% plus 1 share of the junior (and mezzanine) notes are sold** to private investors at a positive price and that a sufficiently large portion of the junior and mezzanine notes is sold to achieve derecognition of the loans from the seller's balance sheet.

Moreover, the government guarantee schemes impose a **template for the payment waterfall** that governs the SPV. The key features of such payment waterfalls include that the guarantee fee is paid senior to all note payments and the principal of the mezzanine and junior notes is paid only after full redemption of the senior notes¹⁹.

Certain **performance triggers** are introduced to defer interest on the mezzanine notes and to either defer a portion of the fees paid to servicer or even to replace the servicer after persistent underperformance compared to the original business plan. It is important that the note holders have this option to replace the original servicer in case of structural underperformance. This is a further safeguard to ensure that the interests of the investors/guarantor/servicer are aligned. However, when executing such a change, minimal disruption in the credit management should be ensured and there should be a requirement to support the migration process to the new servicer.

For government guarantee schemes, the **appointment of an external and independent servicer** is a key requirement, in order to try to prevent conflicts of interest with the seller and ensure a professional management of the loans. In market

¹⁷ At least one of the credit rating agencies providing the rating needs to be approved by the ECB. Should two ratings be required under the applicable regulation, the second rating can be performed by a rating agency registered pursuant to Regulation 1060/2009.

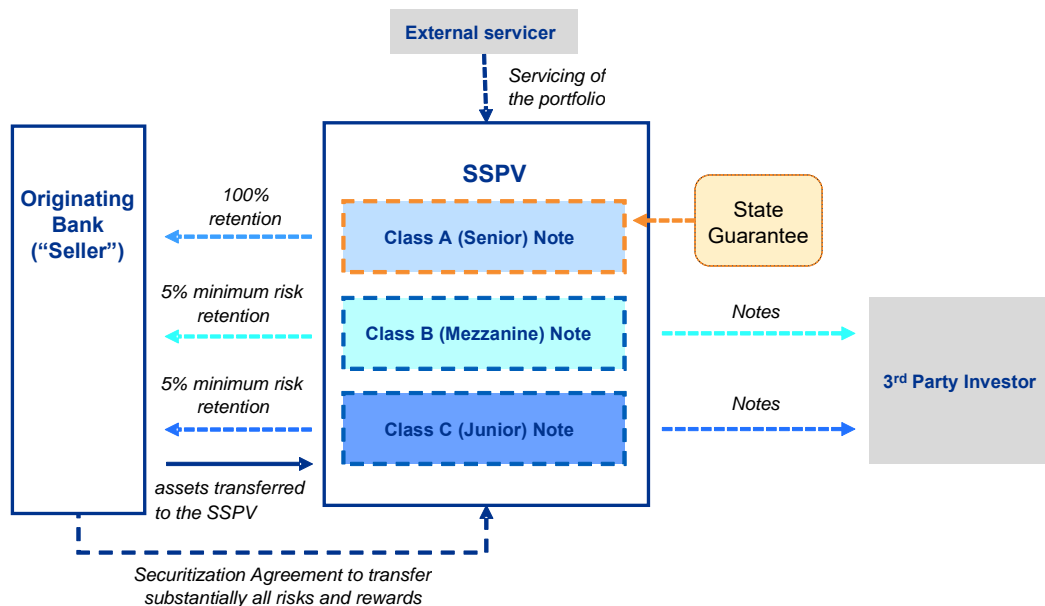
¹⁸ The extent of this discount may also partly depend on the way the originating bank has operationalised and recorded the non-refundable purchase price discount, i.e. the difference between the outstanding balance of the exposures in the underlying pool and the price at which those exposures are sold by the originator to the SSPV, where neither the originator nor the original lender are reimbursed for that difference.

¹⁹ In some limited cases, the waterfall structure has gone even beyond what was envisaged in the template set by the government guarantee scheme, subordinating even the payment of the interest on the mezzanine notes to the repayment of the principal of the senior notes.

securitisations, in cases where a single investor obtains all the mezzanine and junior tranches, this investor usually decides which servicing entity to appoint. In cases where several investors are involved, even in different tranches, the rules are more complex, involving pre-approved lists by name and/or rating. Alternatively, an initial appointment of the servicer can be done by the seller, with a business plan and an alignment of economic interests between the servicer and the portfolio performance, as well as a right given to the investor to change the servicer (or, in the case of the guarantor, to request this change) in case of persistent underperformance.

Figure 1 shows the transaction structure of a typical Government guaranteed transaction with three tranches, while Table 1 summarises the key differences of securitisations with and without government guarantee. More details about the structure of the GACS and HAPS scheme can be found in the annex.

Figure 1: Example of Government guaranteed securitisation structure²⁰



²⁰ Referring to senior tranche: in the example it is fully retained by the originator just for illustrative purpose. This is in fact one of the possibilities and 5% retention requirement is usually applied to the senior as well.

Table 1: Feature comparison of NPL securitisation transactions with and without government guarantee

Structural feature	Government-guaranteed securitisation	Market securitisation
Eligible assets	Italy (GACS) – NPLs only, not unlikely-to-pay loans (UTP) Greece (HAPS) – All NPLs	No restriction on the type of loans. NPL, UTP and re-performing loans have been securitised.
Regulation	Subject to the EU Securitisation Regulation. Most deals are private securitisations.	Subject to the EU Securitisation Regulation and/or national law. Most deals are private securitisations, public transactions are possible.
Rating	Minimum of two ratings required by recognised rating agencies. Required ratings equal to or higher than: <ul style="list-style-type: none"> • BBB for GACS • BB- for HAPS 	Not required, but sometimes sought for better pricing of the senior tranche and lower risk weight if the senior tranche is retained.
Significant risk transfer (SRT)	Required only if the seller is a bank seeking a regulatory capital benefit from the transaction.	Required only if the seller is a bank seeking a regulatory capital benefit from the transaction.
Accounting derecognition of the NPLs	Required	Not required by the regulatory framework.
Risk weight of a retained senior tranche	0% due to the sovereign guarantee.	Depends on portfolio, the rating (if any), and the regulatory regime of the retaining entity.
Guarantee fee	Market terms guarantee fee to comply with EU State Aid rules. Guarantee fee is senior in payment waterfall.	Not applicable
Appointment of an external and independent servicer	Required: the seller, with the help of an arranger, selects the servicer which is then appointed by the SSPV. The servicer proposes the original business plan, i.e. the expected future collection and expense cash flows.	The investors can select the servicer, which can be an affiliated entity of one of the investors. It is also possible that the seller appoints an initial servicer, which may be replaced later on by the investor(s). ²¹
Performance test and triggers	Required, i.e. for the subordination of mezzanine interest rate payments and replacement of the servicer in the case of persistent underperformance.	Freely negotiated, balancing the interests of senior and junior investors. Often the definition of test and triggers mirror those used in government-guaranteed deals, but with different thresholds.

²¹ For instance, this might be the case when the securitisation is done before selecting the junior and mezzanine investors.

2.3. REGULATORY REQUIREMENTS

This section explains the main regulatory requirements arising from the EU Securitisation Regulation, which applies when portfolios are sold in at least two risk tranches.

2.3.1. RISK RETENTION

Risk retention requirement pursuant to Article 6(1) of Regulation (EU) 2017/2402, as amended by Regulation (EU) 2021/557²², obliges the originator or the servicer (or the acquiror who organises the securitisation and carries the risk retention obligation) to maintain a material net economic interest in the securitisation of at least 5%. Depending on the type of securitisation, originator(s) objectives and investor(s) involvement, the originator(s) might decide to subscribe more than the minimum required as per the risk retention requirement. Considering that the main goal of a true sale NPL securitisation is the accounting derecognition of the underlying defaulted portfolio, one approach is the subscription of 100% by the originating bank of the notes, and then the re-sale of 95% of mezzanine and junior tranches. 5% of junior and 5% of mezzanine tranches and effectively 100% of the senior tranche is usually kept for retention purposes.

2.3.2. ADDITIONAL AMENDMENTS INTRODUCED THROUGH THE CAPITAL MARKETS RECOVERY PACKAGE TO FACILITATE NPLS SECURITISATION

The Capital Markets Recovery Package has introduced several amendments to the Securitisation Regulation and to the CRR that have been applicable since March 2012, with a view to facilitate the securitisation of NPLs. The amendments to the Securitisation Regulation introduced three new risk retention and due diligence principles applicable exclusively to NPEs, with the aim of removing the existing regulatory obstacles to NPL securitisation. First, the amendment has allowed the risk retention holder to be the servicer, subject to the servicer satisfying prescribed requirements, taking into account that the servicer usually has a more substantial interest than the original lender in the recovery process and accordingly the interests of the servicer are better aligned with those of the investors in this context. Second, the amendment allowed the risk retention to be determined on the basis of the NPE discounted value and not on the nominal value, to reflect the fact that in case of NPLs, it is the discounted value i.e. net of the price discount at which the underlying exposures are transferred that better reflects the actual risk of loss for investors, than the nominal value. Lastly, recognising that, where an originator has purchased NPLs from a third party before securitising them, the standards applied to the pricing and selection of those NPLs by the originator are of more importance than the credit-granting standards applied at the time of origination (and that such credit-granting standards can also be very difficult to verify), the amendment has replaced this requirement with the duty to apply sound standards in the selection and pricing of the exposures and the obligation on the investors to verify this in the due diligence, in cases where an originator has purchased NPLs from a third party.

²² Regulation (EU) 2021/557 of the European Parliament and of the Council of 31 March 2021 amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 crisis.

The amendments to the CRR introduce a specific and more risk-sensitive capital treatment for positions in the NPL securitisations, addressing disproportionate capital requirements under the SEC-IRBA and SEC-SA capital approaches when applied to the NPL securitisations. As part of these amendments, NPE securitisations benefit from a 100% risk weight for senior tranches of traditional securitisations and a floor of 100% to the risk weight of other tranches of both traditional and on-balance sheet synthetic NPL securitisations that are subject to the general framework for calculation of risk weights. In addition, the amendments to the CRR set out that the expected losses and exposure values in respect of the NPE portfolio shall be calculated net of the non-refundable purchase price discount.

2.3.3. SIGNIFICANT RISK TRANSFER²³

Among NPL securitisations, in the case of banks established in the Banking Union, the SRT process requires a 90-day prior preliminary notification to the competent authority, which is followed by the final notification within 15 days after the closing of the transaction. It also requires that Annex I of the “Public guidance on the recognition of significant credit risk transfer” issued by European Central Bank (ECB) on 24 March 2016²⁴ be complied with.

The Capital Requirements Regulation (CRR) provides for different possible ways for the risk to be considered ‘transferred’. If the transaction complies with one of two available ‘quantitative’ tests, which specify shares of the riskier positions of a securitisation to be transferred to third parties. Concretely, the CRR requires for less than 50% of the risk-weighted exposure amounts of the mezzanine tranche to be retained or, if there is no mezzanine tranche, that less than 20% of the exposure value of the junior tranche should be retained²⁵, in order for SRT to be achieved. The junior tranche is the first loss tranche to bear losses incurred on the securitised exposures providing protection to the higher-ranking tranches. The quantitative tests set a benchmark to assess the ‘significance’ of the risk transfer. Passing the quantitative tests, however, is not sufficient to achieve SRT: the CRR gives discretion to the competent authorities to decide on a case-by-case basis that the capital reduction is not justified by a ‘commensurate’ transfer of credit risk to third parties. As an alternative to the quantitative tests, the CRR allows that permission is granted by the competent authority that significant risk transfer is achieved, irrespective of whether or not the transaction meets the above-mentioned quantitative tests. A detailed analysis of how SRT applies to NPL securitisations can be found in the EBA SRT Report published in November 2020.²⁶

²³ See also Annex 1 for additional detailed notes. In addition, relevant and detailed information can be found in the EBA Report on significant risk transfer in securitisation under articles 244(6) and 245(6) of the capital requirements regulation (EBA/Rep/2020/32) ([link](#)).

²⁴ Nonetheless, the information required in such Annex I is designed for performing loan securitisations.

²⁵ Provided that the originator can demonstrate that the exposure value of the junior (i.e. the first loss) tranche exceeds a reasoned estimate of the expected loss on the underlying exposures by a substantial margin.

²⁶ See EBA Report on significant risk transfer (EBA/Rep/2020/32).

2.3.4. SUPERVISORY NOTIFICATIONS

Detailed disclosures under the Securitisation Regulation need to be considered.

The originator must demonstrate that sound standards have been applied in the selection and pricing of the securitised non-performing exposures. In addition, the sell-side must disclose detailed information on each securitised exposure. Supervisory notifications for NPL securitisations follow the same procedures and data requests as other securitisations:

- **SRT notification:** This is a notification that the originator of a securitisation must make to the relevant competent authority to demonstrate that it has transferred a significant portion of the credit risk associated with the securitised assets to investors in the securitisation. The SRT notification includes information on the securitised assets, the structural features of the transaction, and the parties involved. The notification must demonstrate that the originator has applied sound standards in the selection and pricing of the securitised non-performing exposures. The competent authority will then assess whether the SRT notification is valid and whether the securitisation meets the requirements for regulatory capital relief and other supervisory considerations.
- **COREP detailed data in C14 table:** This is a regulatory requirement under the Capital Requirements Directive, where C14 refers to a specific table within the COREP framework that relates to the disclosure of information on securitisation exposures²⁷. The information required to be disclosed in the C14 table includes details of the credit institutions' exposure to securitisation transactions, including information on the underlying assets, the structure of the transaction and the level of risk associated with the transaction. The requirement to report detailed data in the C14 table is a key element of the Securitisation Regulation, and aims to enhance the quality and comparability of data available to regulators and supervisors, thereby improving their ability to assess the risks associated with securitisation transactions.

2.3.5. INVESTOR DUE DILIGENCE:

Due diligence is required under the Securitisation Regulation. In the case of NPL securitisations, investors perform an in-depth analysis of the business plan and of the underlying exposures²⁸. They focus on the assumptions made by themselves, external consultants or the servicer for the estimation of the business plan. They typically would require details on the methodological approach applied to define the recoveries

²⁷ Commission Implementing Regulation (EU) 2021/451 of 17 December 2020 laying down implementing technical standards (ITS) for the application of Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to supervisory reporting of institutions and repealing Implementing Regulation (EU) No 680/2014.

²⁸ Documented due diligence would normally also be carried out by credit purchasers, even if it is not formally required by the NPL Directive unless the Credit Purchaser is a regulated entity. Given that credit purchasers should not be subject to additional regulatory requirements by national authorities when implementing the NPL Directive itself, due diligence will mostly be conducted as a measure to safeguard the credit purchasers' commercial interest and not to fulfill a formal requirement.

statistically. Therefore, the focus is put on recovery rates for secured and unsecured assets, recovery times, etc.

The main special feature of investor due diligence in securitisations is that potential investor(s) and servicer(s) must review all the documents available (contracts, real estate valuations, financial statements, etc.) relating to a significant number of borrowers. This depends on the amount in underlying assets and to what extent they could be treated as similar in nature (enabling the application of statistical methods).

It is also common for investors in NPL securitisations to require ad-hoc analyses on the larger positions in the NPL portfolio. In cases where an analytical approach (instead of a statistical one) has been followed, on an asset-by-asset basis, investors often ask for details about the methodology used to perform it.

The key risk for investors concerns NPLs' collateral valuations and collection processes. For secured NPLs, there is therefore normally a significant focus on how recent the valuations are and how they were carried out. In certain markets, relevant benchmarks are available, i.e. portfolios older than the selected one, but of a similar nature and considered likely to have a similar collection performance. When admissible, taking into account confidentiality restrictions, the analyses of such benchmarks' recoveries are often made available to e.g. investors and rating agencies. Such benchmarks are available especially in mature markets, where both investors and servicers usually have their own benchmarks.

2.3.6. LOAN-LEVEL DISCLOSURES:

Because the lack of transparency of structured financial instruments was considered to be one of the drivers of the great financial crisis of 2008-2009, the ECB established a regime of standardised loan-level disclosures for its collateral framework. Issuers of publicly traded securitisations had to submit detailed information on the underlying pool of loans in standardised templates to a central data repository or 'data hub', thereby enabling investors to carry out their due diligence and benchmarking.

The notification to the ECB is a requirement that applies to securitisation transactions where the originator, sponsor or SSPV is established in the euro area and where the securities issued are retained on the balance sheet of a credit institution subject to the ECB's supervision. The notification must include information on the securitised assets, the underlying risks, the securities issued and the structure of the transaction. The new notification requirement was introduced by the ECB to enhance its oversight of the securitisation market and to improve the quality of data available to supervisors²⁹. The information provided in the notification helps the ECB to identify potential risks and vulnerabilities in the securitisation market and to assess the impact of securitisation on the credit institutions' balance sheets. For NPL securitisations, the notification to the ECB is particularly important because it provides the ECB with information about the quality of the assets that are being securitised, the structure of the transaction and the associated risks. This helps the ECB to ensure that credit institutions subject to its supervision are properly managing their NPL portfolios and that they are not taking excessive risks.

²⁹ [ECB - Guide on the notification of securitization transactions.](#)

The EU's Securitisation Regulation (EU) 2017/2402 tasked ESMA with the design of the regulatory technical standards that provided participants of the securitisation market with detailed instructions on the loan-level reporting templates and on the information that should be made available for state-sponsored and for market securitisations. The templates provided by ESMA cover different asset classes of performing loans (e.g., residential mortgages, auto loans or SME loans) with an add-on template for NPLs. To comply with the Securitisation Regulation the issuer of an NPL securitisation has to populate and make available the reporting template for the respective asset class as well as the add-on template (i.e. two distinct reporting templates with information on the underlying exposures) to investors, to supervisors and, upon request, to potential investors.

Under the Securitisation Regulation, the originator, sponsor or SSPV of a public securitisation is required to report to ESMA certain information related to the securitisation³⁰. This information includes the type of securitisation, the underlying assets, the securities issued, the rating assigned to the securities, the underlying risks, and the characteristics of the SSPV³¹. In the case of NPL securitisations, the notification to ESMA is particularly important because it provides transparency about the securitised assets and the risks associated with them. It is important for investors to receive relevant reporting and have transparency, as it helps them to make informed decisions about whether to invest in the securitisation. It is also important for supervisors, as it helps them to monitor the securitisation market and identify potential risks. When the securitisation is public, this information is made available via securitisation repositories. Securitisation repositories are authorised and supervised by ESMA and are accessible to competent authorities and market participants.

A common challenge has been data quality. ESMA, in cooperation with the securitisation repositories, has defined hundreds of data validation rules to establish a minimum level of data accuracy, correctness and consistency. This enables investors and supervisors to use benchmarks and improve their risk assessment. The validation rules, however, only apply in practice for transactions that are required to report to the securitisation repositories.

As detailed further in Section 3, the market for European NPL portfolio sales has seen completed deals with an average annual gross book value of about EUR 100 billion per year in the 2015-2022 period. The investor base in this market is quite concentrated, as it requires a very high level of expertise. For direct sales, investors generally ask for ad-hoc data that can vary from deal-to-deal depending on the portfolio asset class. On the other hand, private NPL securitisations and UTP securitisations are more reliant on the type of loan-level information that is already available from the selling banks and often exceeds the amount of information that is being provided in the ESMA reporting templates. Investors, through their due diligence teams and the due diligence activity, then try to fill the information gaps by asking for further information from the selling banks or relying on third-party sources. From this perspective, the adoption by the Commission of the EBA draft Implementing Technical Standards (ITS) on data

³⁰ For private securitisations, which are not offered to the public or admitted to trading on a regulated market, the notification to ESMA is voluntary. The originator, sponsor, or SPV may choose to provide information to ESMA using the same standardised notification template as for public securitisations.

³¹ Regulation (EU) 2017/2402, Article 7.

templates for the provision of information to buyers is expected to foster consistency and transparency in the loan-data disclosure domain and further benefit the development of the market³².

In the Italian GACS securitisation market, thanks to the big volume, loan-level data tapes – on top of the ESMA templates – used for the initial due diligence carried out by the various market participants were standardised across different originators and servicers as they were based on the requirements of rating agencies.

3. EVIDENCE FROM EXISTING NPL SECURITISATION SCHEMES

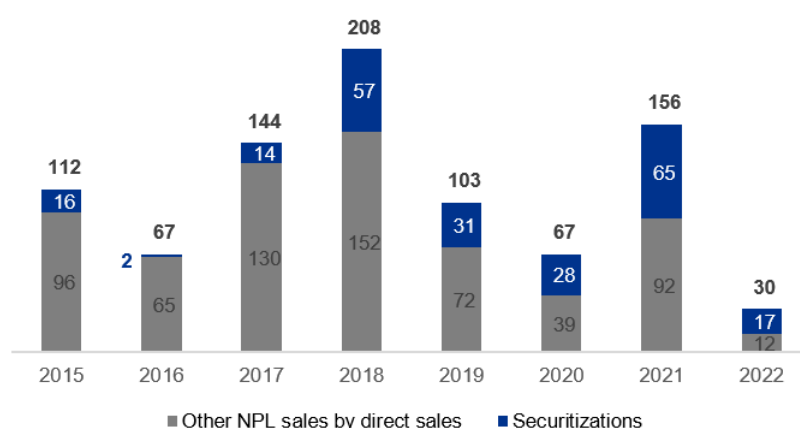
3.1. OVERVIEW OF THE SIZE, STRUCTURE AND TRENDS OF THE NPL SECURITISATION MARKET

Since 2015, the NPL market has seen a significant number of transactions that contributed to bringing down NPL levels in almost all Member States. As shown in Figure 2, direct sales have remained the preferred alternative used by banks to dispose of NPL sales since 2015.

Nonetheless the volume of EU NPL securitisation transactions has been sizeable and played an important role in helping banks disposing of their NPL portfolios, in particular in the period 2018-2022. In terms of volume, in the EU NPL transactions totalled about EUR 790 billion for the period 2015-2022. NPL securitisation deals amounted to about EUR 205 billion in the same period (that is about a quarter of the total amount of NPL transaction volume).

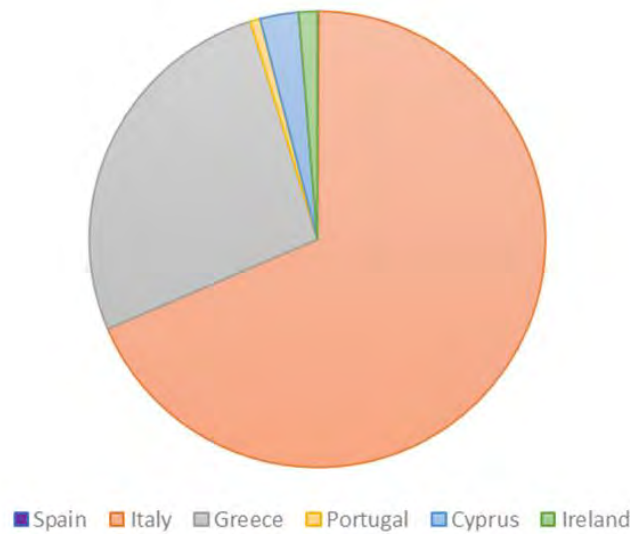
In terms of number of transactions and issuance volume, the European NPL securitisation market has been dominated by securitisation schemes in Italy and Greece. As shown in figure 3, total NPL securitisation transactions in Italy and Greece dwarf the rest of the EU with a share of about 95%.

Figure 2 – EU NPL market by volume (EUR bn)



³² Commission Implementing Regulation (EU) 2023/2083 of 26 September 2023 laying down implementing technical standards for the application of Article 16(1) of Directive (EU) 2021/2167 of the European Parliament and of the Council with regard to the templates to be used by credit institutions for the provision to buyers of information on their credit exposures in the banking book (Text with EEA relevance): [EUR-Lex - 32023R2083 - EN - EUR-Lex \(europa.eu\)](https://eur-lex.europa.eu/eli/reg/2023/2083/20230926/eng)

Figure 3: Geographical distribution of NPL securitisations between 2015 and 2022

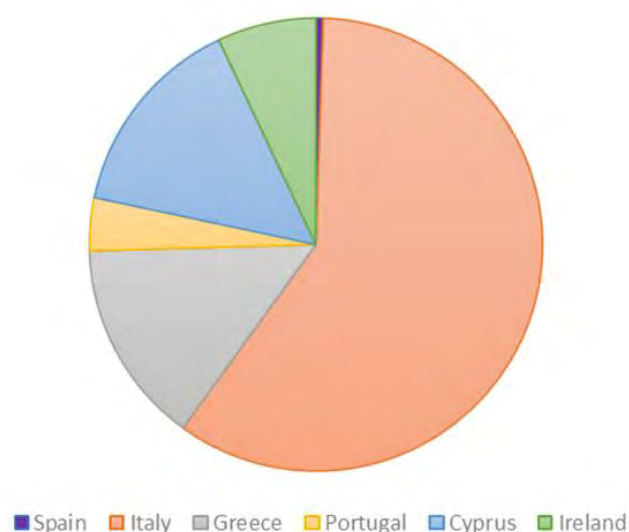


Note: Share of total volume (€ bn) of NPL securitisation transactions (including both Government-guaranteed and market-based schemes). Source: KPMG elaborations

However, it is important to clarify that the majority of securitisation schemes in Italy and Greece were government-guaranteed securitisations, whose schemes amounted for the 2015-2022 period to about EUR 119 and 49 billion, respectively (corresponding to about 84% and 90% of total NPL securitisations that took place in Italy and Greece). Together, the two state-guaranteed schemes amount to about 80% of total NPL securitisation transactions in the EU. Therefore, the total volume of NPL market securitisation schemes for the EU amounted to about EUR 39 billion, until end-2022.

Considering the geographical distribution of market transactions, it can be seen – as shown in figure 4 – that the majority of the volume of transactions in the market is still located in Italy and Greece, but transactions are more evenly distributed in other countries too, highlighting how the market for NPL securitisations is developing.

Figure 4: Geographical distribution of NPL market securitisations between 2015 and 2022



Note: Share of total volume (€ bn) of NPL securitisation transactions (market-based schemes only). Source: KPMG elaborations

Some of the European NPL securitisations are private securitisations, which means that their ongoing standardised investor disclosures are not submitted to and published by a securitisation repository. More recently, on the back of supervisory efforts to accelerate the pace of NPL reduction, the NPL securitisation market has seen more rated transactions – particularly in Greece, Spain, Ireland, Italy, Cyprus, and Portugal – that are being structured as multi-tranche transactions and, where available, driven by government guarantee schemes.

3.2. OVERVIEW OF GOVERNMENT GUARANTEED SCHEMES

As explained above, government guaranteed schemes are not expected to be introduced in the future, when any NPL disposal should be primarily dealt with through market solutions. Nonetheless, given the significant role they played in Italy and Greece, it is important to provide a closer overview of these schemes, as this analysis may helpfully feed into the discussion of how to further develop NPL market securitisation.

3.2.1. ITALIAN MARKET OVERVIEW

Since 2016, when the GACS scheme was introduced in the Italian NPL market, the banks have made extensive use of this type of guarantee. In fact, from 2015 to the end of 2022, EUR 119 billion of NPLs were deconsolidated making use of the GACS scheme for a total of 42 securitisation transactions³³.

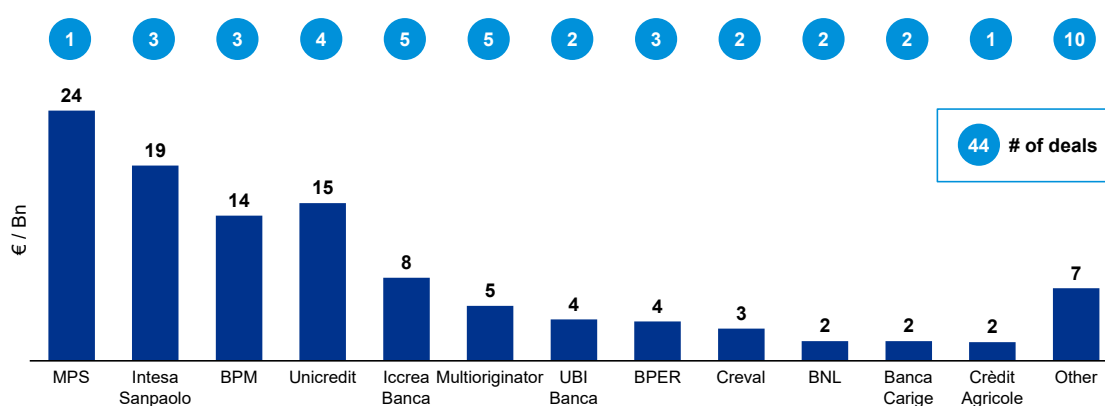
The securitisations are characterized by a large number of impaired exposures (only bad loans) and highly heterogeneous portfolios. Secured exposures represent 60% of

³³ Source: KPMG and Debtwire. To be noted that other estimates, (e.g. by PwC or Banca Ifis) indicate slightly lower numbers for the total volume and number of transactions.

the total gross book value (GBV). However, the composition has not been stable over time, leading to fluctuations in the transfer price, as happened in 2021: the secured component of the portfolios transferred through GACS in 2021 corresponded to only 51%, resulting in a substantial decrease in the price.

Exposures to corporates amount to 75% of total GBV and the remaining part corresponds to household exposures. The biggest GACS deal closed so far in terms of GBV has been the ‘Siena NPL 2018’ worth EUR 24 billion by Banca Monte dei Paschi di Siena (MPS) in 2018. As an example, figure 5 shows the breakdown of GACS securitisations by originating bank for the period 2016-2021.

Figure 5: GACS deals breakdown by originators from 2016 to 2021 (EUR billion)



Source: KPMG elaborations

GACS has been one of the main incentives for reducing the stock of NPLs since 2016, when Italian banks had to carry out massive sales of NPLs. European Banking Authority (EBA) Guidelines define “high NPL ratio banks” as all institutions bearing an NPL ratio higher than 5%, implicitly setting a target threshold for the banks to proactively reduce their stock of NPLs. According to Banca d’Italia calculations, in 2015, the NPL ratio was around 16.5% across the entire Italian banking sector.

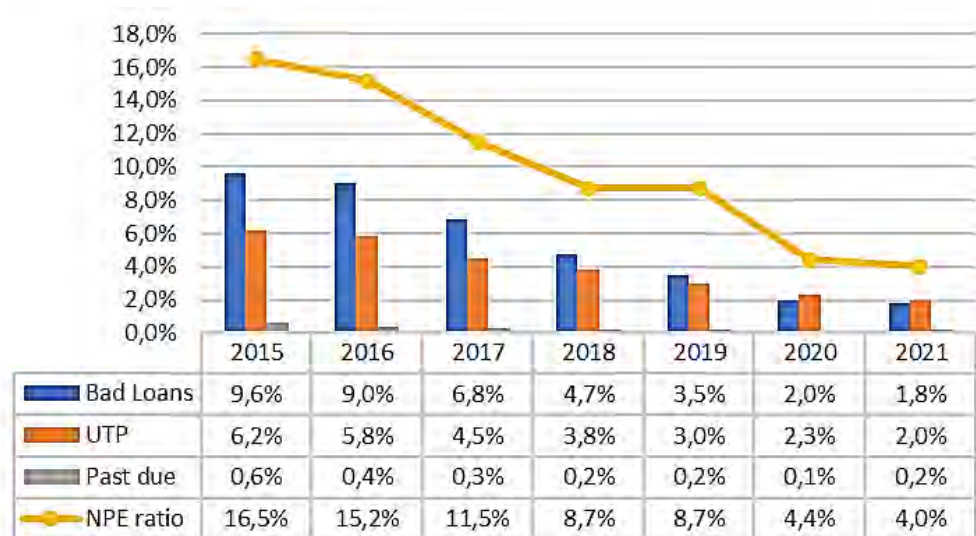
Supervisory monitoring played a significant role in the context of the Italian GACS initiative and was instrumental in maintaining the integrity and effectiveness of the initiative. As part of the scheme, the supervisory authorities, particularly the Bank of Italy and the ECB, played a crucial part in monitoring the implementation and progress of the scheme. This ensured that banks adhered to regulatory standards, mitigated potential risks, and provided transparency for investors and the broader market. By closely overseeing the implementation and progress of the GACS scheme, supervisory authorities contributed to the successful reduction of NPLs in Italy and the stabilisation of the banking sector.

The use of GACS allowed the derecognition of NPLs, implying a gradual decrease in the NPL ratio bringing it down to and below the threshold level of 5% after 2020. For banks, the GACS scheme has been one of the most effective and competitive ways of supporting their deleveraging plan because it may have helped a maximisation of the

disposal price. The higher transfer price results from a lower blended return required by investors and the review by independent rating agencies. The higher transfer price minimises the impact on the bank's profit and loss while achieving full accounting and prudential derecognition.

Italian banks divide their stock of NPL into Past Due, UTP and Bad Loans³⁴. The GACS scheme allowed for a decisive reduction of bad loans. As a result of these massive disposals, the stock of UTPs has started to exceed Bad Loans from 2021 (breakdown provided in Figure 6).

Figure 6: NPL ratio of Italian banks



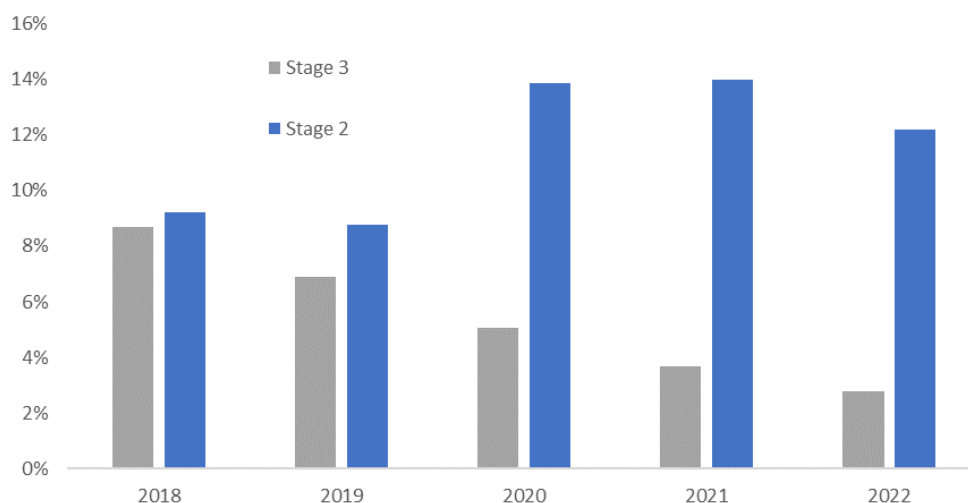
Source: Banca d'Italia, Note di stabilità finanziaria e vigilanza N. 28, March 2022

A similar picture can be drawn under the IFRS9 perspective and the allocation of financial instruments subject to expected credit loss (ECL) requirements in three different stages (stages 1, 2 and 3), according to their credit risk level. This perspective therefore follows a forward-looking view provided by the expected credit loss model. Those financial assets that have experienced a significant increase in credit risk are assigned to stage 2 and those that are credit impaired are assigned to stage 3. Figure 7 shows the level of stage 2 and stage 3 assets for the Italian banking sector³⁵. While the share of Stage 3 assets has gone down, consistently with the decrease of the NPL ratio, the share of Stage 2 assets marked a moderate increase since 2020, in line with the more uncertain economic outlook that brought an increase in expected credit losses.

³⁴ [Banca d'Italia - Non-performing loans \(NPLs\) in Italy's banking system](#)

³⁵ The definition of Stage 3 assets is similar, but different from the EBA's NPL definition, as the 90 days past-due criterion does not necessarily mean stage 3 classification. For further reference, see the [EBA Report on NPLs](#).

Figure 7: Stage 2 and Stage 3 assets for Italian banks (percentage of total loans)

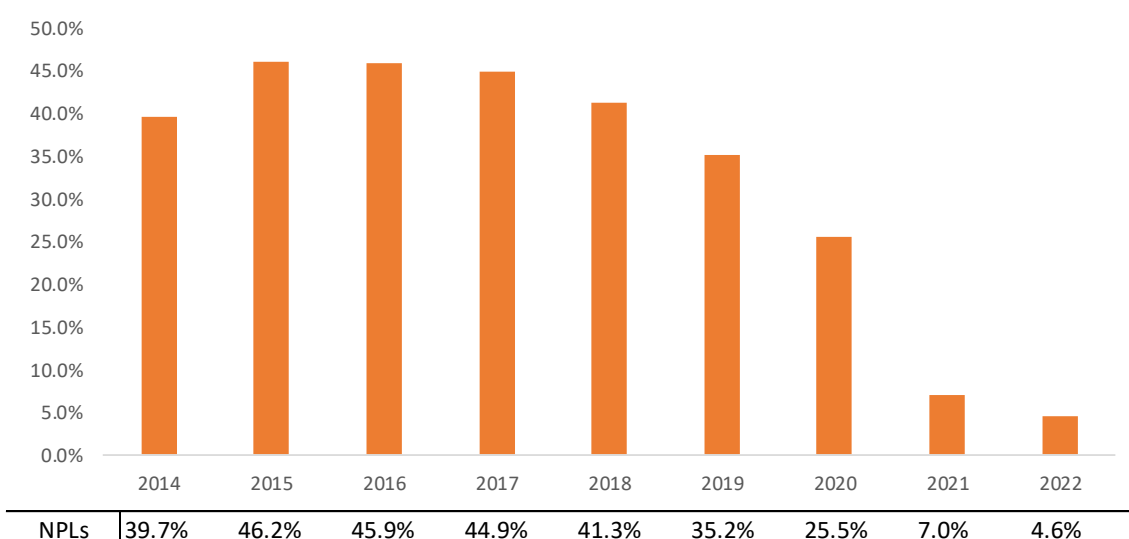


Source: EBA, Risk Dashboard, March 2023

3.2.2. GREEK MARKET OVERVIEW

The HAPS is said to have been the main driver behind the drastic reduction of legacy non-performing loans by Greek banks, with the sector’s NPL ratio falling to 4.6% of total loans at the end of 2022, compared to 25.5% in 2020 and 46.2% at the end of 2015³⁶. While the stock of NPLs has been taken off the banks’ balance sheets, it continues to be a burden for the local economy and needs to be actively managed by specialised servicers and credit management companies instead of the banks’ internal workout units.

Figure 8: NPL ratio of Greek banks

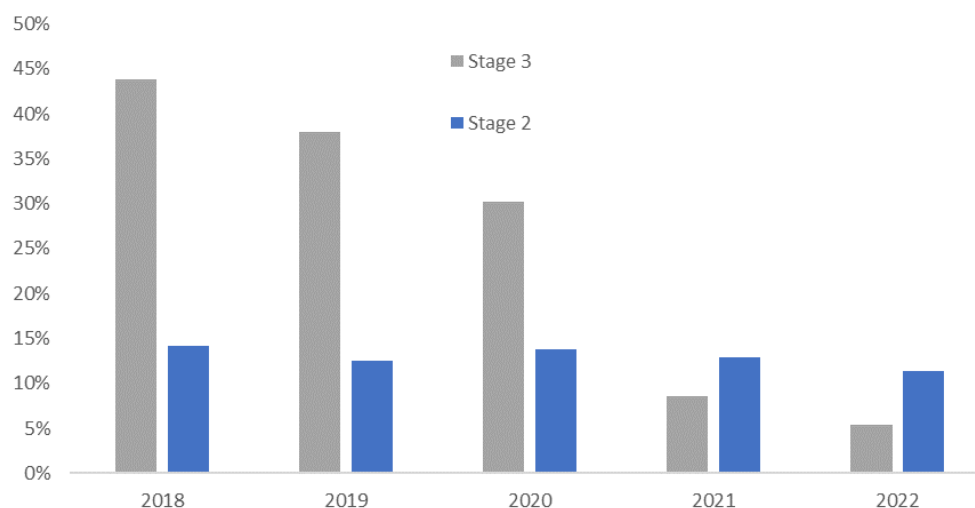


Source: EBA, Risk Dashboard, March 2023

³⁶ Source: EBA – Risk Dashboard data Q1 2023.

The total GBV volume of EUR 50 billion in Greece amounts to around half of the total GBV securitised in Italy under the GACS. Similar to Italy, the NPL dynamics are closely tracked by the ECL dynamics of Stage 3 assets (as shown in Figure 9). The share of Stage 3 assets has steadily decreased consistently with the decrease of the NPL ratio. The share of Stage 2 assets in Greece has instead remained broadly stable or slightly decreased over the period under review.

Figure 9: Stage 2 and Stage 3 assets for Greek banks (percentage of total loans)



Source: EBA, Risk Dashboard, March 2023

4. EVIDENCE ON THE PERFORMANCE OF NPL SECURITISATION SCHEMES

This section takes stock of the available evidence of the performance of NPL securitisation schemes (both market-based and state-guaranteed) *vis-à-vis* their intended objectives, as specified in Section 1, and assesses some of their benefits and costs.

4.1. BENEFITS IN TERMS OF NPL DELEVERAGING AND DEVELOPMENT OF NPL ECOSYSTEM

NPL securitisation schemes have likely contributed significantly to helping banks offload NPLs from their balance sheets. As the development of EU average NPL ratios shows, NPLs have come down significantly from the historically high levels they reached after the global financial crisis and the sovereign debt crisis. In this light, it is also important to point out the role played by government guaranteed schemes in Italy and Greece. These two schemes have helped make it possible to manage and reduce the problem of high NPLs, which in those two countries had taken on a systemic dimension. Still, other Member States, such as Croatia and Romania, also show a double-digit percentage decline in NPLs in the period 2015 to 2022 without having turned to state-guaranteed schemes.

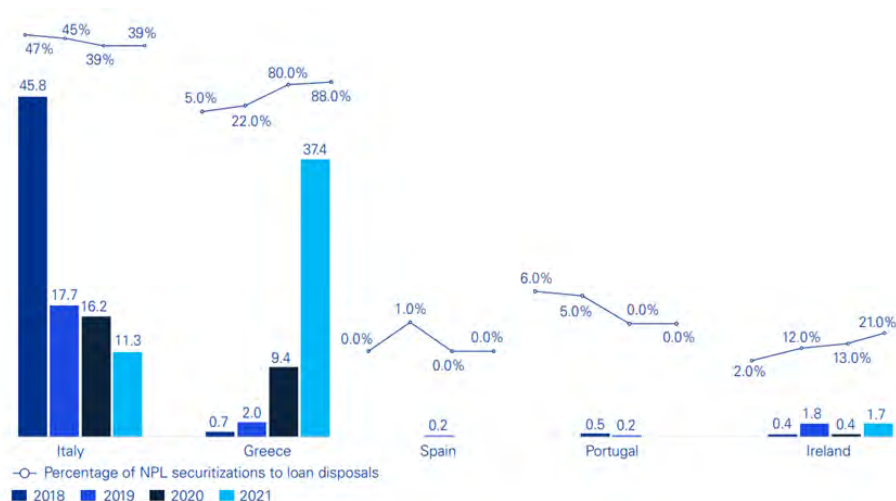
In ordinary situations, market operators (investors, servicers and banks) should be able to resolve delinquencies without public intervention. This requires the development of a specialized market in order to have the appropriate infrastructure, including knowledgeable servicers and a functioning judicial system. Such a specialized market is still growing and was arguably not mature enough in all markets in the aftermath of the crisis.

State-sponsored securitisation schemes helped Italy and Greece develop an ecosystem, including securitisation activity, valuation and advisory services, as well as credit servicing. At the same time, it provided opportunities for international investors in local distressed markets.

The delays in courts proceedings caused by COVID-19 certainly had a negative impact on securitisation performance in the main markets. Collection ratios from judicial recovery activities are to some extent increasing, with ongoing recovery from the pandemic anticipated, but new NPL flows are also expected.

Participation in NPL securitisation is expected to grow due to recent activity in Italy and Greece. Spain, Portugal and Ireland have previously registered securitisation transactions, but activity has been muted in recent years. However, this is expected to change as securitisation structures gain traction with NPL volumes increasing in the short to medium term. For instance, estimates for 2023 and 2024 by several analysts hint that the market will continue to process significant volumes of NPLs, despite the lower numbers compared to a few years ago.

Figure 10: NPL securitisations in Europe (EUR bn, #)



Source: KPMG

4.2. PERFORMANCE OF NPL SECURITISATION SCHEMES

The assessment of the performance of NPL securitisation schemes (whether market-based or state-guaranteed) is an important exercise to determine whether improvements in the current practices are feasible and/or to highlight possible

shortcomings in past practices. However, this is a difficult exercise. Most of the schemes are currently ongoing, therefore any assessment of the performance can only be provisional and the overall performance can only be estimated by making several assumptions about the future path of repayments of the underlying loans. Furthermore, while a provisional assessment of the performance of the schemes with respect to their initial plans is still possible, a cross-sectoral assessment of performance is nonetheless difficult to perform, given the lack of a track history of concluded schemes.

The possibility of government guarantees being ultimately called, entails a potential cost to public finances. Such costs could turn into a net cost for public finances if such losses exceeded the guaranteed premium earned by the state on its scheme, although this is not the baseline scenario in the medium and longer term. That being said, a comprehensive assessment would also need to factor in indirect benefits in terms of taxation and overall economic impact of the scheme.

According to some analysts³⁷, several NPL securitisation schemes under the GACS scheme have been underperforming, when compared to both the servicers' initial expectations and some common assessment metrics (e.g. like the Net Present Value Profitability Ratios (NPVPRs)). For instance, the NPL Performance Index (NPI), compiled by Scope Ratings on the basis of 26 transactions, tracks the ratio between transactions' aggregated cumulative proceeds and net forecasts in original cumulative business plans. The index has been declining since it was established, although it has shown only a moderate decrease of less than 10% in the last two years. On the other hand, other estimates show a more nuanced picture, with the profitability of closing positions exceeding the servicers' expectations and initial business plans in about half of the schemes, and confidential data pointing to average collection ratio above parity across GACS transactions.

This potentially contradictory performance picture can be explained by several concurring factors. First, the performance is necessarily dependent on the broader macroeconomic cycle and outlook. Downside risks in the medium term, including tightening financing conditions, inflationary pressures, and geopolitical risk, have weighed on the economic outlook and on borrowers' affordability and liquidity, compromising collections. The Covid-19 crisis also had an impact, as it seems that part of the underperformance has been driven by the backlog of judicial proceedings, which built up because of the Covid crisis. Extra-judicial agreements and note sales have helped collection inflows, although the latter have been materially delayed due to the increased discounts demanded by investors due to the changing macroeconomic scenario. Other potential drivers of under-performance are difficult servicer onboarding processes delaying servicers' activities; the deteriorating affordability and liquidity among highly indebted companies; and the risks related to real-estate market and/or optimistic property appraisals. This may help explain part of the underperformance that has been recorded, which may not be a structural feature. Another potential explanation could be that these transactions have been overpriced. Although these transactions have been rated by one (or more) rating agency under severe stress scenarios, with hindsight the investment grade ratings that were granted to some transactions may be difficult to justify.

³⁷ See NPL Markets (2023) – Italian NPL ABS Cash Flow Projections

As transactions age, the risk of servicers closing more profitable positions earlier and less-profitable positions later might further squeeze profitability along the life of the scheme. Some estimates show that the expected number of years it will take for transactions to amortise has gradually been increasing over time. However, this may not necessarily mean that collections will not ultimately be successful.

Furthermore, the development of a deeper and more mature market is helping servicers refine the development of business plans. For example, recent transactions typically have more conservative business plans reflecting post-pandemic assumptions. While this makes performance metrics not directly comparable with pre-pandemic transactions, the performance of schemes with more conservative business plans can be expected to be subject to fewer downturns. From this perspective, frequent updates of the initial business plans may contribute to a more accurate market pricing of the securitised notes and ensure better transparency for investors.

The potential risk for public finances may be more substantial for Greece where the amount in outstanding guarantees is larger (as a percentage of GDP) than for Italy (consistently with the higher level of NPLs as a share of total loans documented in Greece). However, so far, in Greece there have been no downgrades of credit ratings of guaranteed senior tranches (as a comparison, there have been downgrades in the GACS scheme). Servicers are taking targeted action to gradually mitigate divergences from original business plans, taking advantage of the gradual re-start of the debt enforcement process which began in April 2021, as well as sales of loan portfolios on the NPL secondary market, potentially also involving a growing portion of reperforming loans. However, there may also be the risk that such sales come at the potential cost of a worse performance in the future, without necessarily resulting in the effective workout of the sold loans.

These costs also need to be put into context. The government-guaranteed schemes were put in place when a proper market for NPL securitisations still did not exist. Consequently, the market would have struggled to absorb the number of NPLs that were deconsolidated from banks' balance sheets through the two schemes.

Moreover, when assessing the future performance of such schemes, it is essential to take into account future remaining collections as well as all benefits, both direct inflows from guarantee fees and broader economic benefits including the indirect impact on tax collection.

In order to minimise the potential risks for taxpayers, the usefulness of the schemes should be assessed carefully to ensure that it is in the public interest. In particular, it will be important to understand whether there were any design flaws that may have resulted in some inefficiencies in the scheme.

At the moment, while it is difficult to model a counterfactual, the indirect benefits to the respective financial systems that the GACS and HAPS have brought are significant, both in terms of faster offload of NPLs and stronger bank balance sheets and of strengthened financial stability in the longer term.

5. LESSONS LEARNT AND POSSIBLE IMPROVEMENT

5.1. AVENUES TO STRENGTHEN THE STRUCTURE OF NPL SECURITISATION

Although the experience is still limited, there are several initial lessons that can be drawn from the market as a whole to help it mature further.

For instance, some views highlight that some of the state-guaranteed transactions may have been overpriced. According to this view, the government schemes may have helped banks dispose of NPL portfolios that would have been difficult to dispose of at such prices in other ways. In this sense, the schemes may have crowded out market securitisation or outright sales at actual market prices. On the other hand, it is important to consider that transactions at lower prices may not have taken place at all. Furthermore, the lack of a mature market may have contributed towards making the pricing of these schemes more difficult. While some authors, i.e. ECB researchers Boudiaf and Miranda (2022), find that Italian GACS transactions have been an expensive means of balance sheet relief for Italian banks studying significant risk transfer notifications available to the ECB, other analyses point to net economic benefits from the schemes, including from the point of view of taxpayers.

Another aspect related to pricing is the rating grade applied to NPL securitisation schemes. The pricing of state-guaranteed schemes may have benefited from investment grade ratings. With hindsight, some NPL transactions have shown a certain degree of rating instability that may hinder price discovery. From this perspective, further investigation of the adequacy of this framework and its incentive structure may be warranted. If rating bias should emerge, a potential remedial action could be **rating agency rotation**. Lastly, the common practice of selling the mezzanine and junior tranches at a steep discount may indicate that the market-implied expected loss of the senior tranche may not be as low as their rating suggests. Preventing the sale of mezzanine and junior tranches at a steep discount might also help better align incentives.

In addition, even if the market is further developing, predicting NPL cash flows – for the seller, investor and servicer – can still be challenging and prone to uncertainties. In certain cases, this has been exacerbated by a lack of correct, up-to-date, detailed and standardised NPL transaction and performance data (which may no longer be the case, as the loan-level reporting is now required by the Securitisation Regulation), as well as the granular information on the underlying loans, the relevant debtors (in anonymised format) and collaterals. The lack of transparency increases risk, which causes illiquidity and makes it harder for purchasers and sellers to determine fair market value. Even with performance data, risks remain, as history does not necessarily repeat itself and not every portfolio performs the same over time. From this perspective, **more timely and frequent updates of the original business plans** may further increase transparency and price discovery and thus further improve the liquidity of the market.

Improving transparency can make pricing more predictable, but other improvements may be necessary, as the experience from NPL securitisations in Italy and Greece demonstrates. First, transferring the servicing to large professional servicing companies does not guarantee performance in line with the projections of such servicers and a root cause analysis should be considered to understand the underlying reasons for this.

In general, investors should not rely solely on the projections of a party that might be keen to either continue or be awarded the servicing. There are a number of safeguards (they were, for instance, already in place in GACS and HAPS schemes) to ensure alignment of interests between mezzanine and junior note buyers/servicer/guarantor, such as the **possibility to defer payment of mezzanine interest and/or servicer fees** as well as the **possibility to substitute the servicer at the demand of the investors** or, where applicable, the guarantor in case of underperformance. Incentive servicing fee structures and other measures to ensure alignment, such as risk retention, can therefore help to overcome potential conflicts of interest between servicer and investors. In any case, incentives and (potentially ‘aggressive’) business plans should always be balanced against an ethical approach towards debtors.³⁸

5.2. HOW TO BEST SUPPORT DEBTORS

There are a number of common approaches that have a material impact on debtors and, if properly managed, could bring more value to the debtors, the banks/servicers and ultimately the market and society overall. The goal of sustaining a corporate position is based on the ability to preserve, as much as possible, the debtor’s enterprise as a going concern. Out-of-court solutions are one of the preferred choices for viable businesses (going concern)³⁹. Acting upstream, with more specialised management once the borrower starts to have financial stress, could deliver highly beneficial results. This also requires a faster and more personalised decision-making process: debtors who intend to restructure their debt require fast responses. Diagnostic systems, tailor-made for each segment, need to be in place, along with precise decisional processes and efficient execution abilities. This also holds true for credit servicers appointed on large NPL securitisations. This goal can be reached through adequate access to relevant information and adequate resources in terms of case managers. However, when it comes to SMEs, different approaches can be applied depending on the size of the company and, particularly for micro firms, pre-packaged restructuring solutions, provided through a system-wide electronic platform, could offer a way forward. Such system-wide out-of-court workout platforms can also be a more efficient way to deal with cases where the debtor has debts to multiple creditors that may involve the state and could allow the overall process to be accelerated, e.g. through automated voting procedures for creditors and electronic exchange of documents and data between the debtor, his/her creditors and public databases.

The bigger the transactions, the larger the risk of too many debtors being handled by the largest servicers. While some may consider this critical, having a holistic view of the various exposures of a specific borrower makes the process more efficient and paves the way for a faster decision process, and local laws normally require multiple creditors to seek common acceptable solutions. In this sense, it would be worthwhile to define:

³⁸ In addition, the impacts of the COVID-19 pandemic and the energy crises have made it clear how servicers and investors should consider adequate buffers in the development of the Business Plan in line with historical performance (as analysed by the rating agencies).

³⁹ Out-of-court solutions can also be applied to retail debtors.

- Rules for the servicers to grant acceptable quality standards⁴⁰ in terms of the manner and speed that debtors are handled, possibly in the form of a Code of Conduct for bilateral restructurings. Similar examples already exist in the banking sector, where banks are obliged to respond to customer complaints within 60 days.⁴¹ As a general principle, any transaction sold to an SSPV should not dilute the existing borrower's protection. In addition to already existing legislation, the NPL Directive – which should be transposed in national legislation by the end of 2023 – further ensures that no dilution of borrowers' rights take place.
- Provided that necessary, updated and timely information on its overall financial situation has been provided by the debtor to the servicer, servicers might be required to provide a reason for refusing a debtor restructuring proposal. In case the debtor's restructuring proposal is considered insufficient, the investors can consider if and under which circumstances they want to oblige the servicer to make a counteroffer to show willingness to reach an out-of-court settlement or appropriately justify towards the investors why the debtor is considered to be non-viable or any other reason for refusing to enter into a restructuring agreement (e.g. if strategic default is suspected given the overall financial situation and wealth of the debtor). Taking into account that neither SSPVs nor NPL servicers are credit institutions, the options to facilitate restructurings are, however, limited.
- Rules for the debtors and for the servicers to safeguard both parties' rights of receiving answers within acceptable timeframes (and in knowing the economic value of a potential restructured position). This should include a maximum duration for the conclusion (successful or not) of the overall restructuring procedure that would avoid the risk of abuse by either creditors or debtors.
- Reference key performance indicators (KPIs) are normally part of the servicing contract to help measure the performance of the servicer, but different approaches are needed for different categories of claims. It should be made clear who is responsible for checking whether these KPIs are respected over time (e.g. the sponsor, the rating agency, etc.).

5.3. ENHANCING DATA COLLECTION AND DATA DISCLOSURE

As a first line of defence, banks should closely monitor asset quality deterioration and continue to actively manage the NPLs on their balance sheets. Banks recognise the importance of collecting detailed workout data and can use their experience with the data demands of NPL portfolio sales to improve their internal data collection. Such granular loan and collateral level data can then be used to monitor recoveries, improve valuation models and optimise the bank's workout processes. The improvements in NPL data and technology will help banks to meet the new standardised data requirements

⁴⁰ In this respect, it is usually part of the vendors due diligence request that only servicers with high standards will be allowed to be part of their panels. Including for reputational reasons, the originator pays attention that no low-quality standard is used in their debt recovery processes (including sale).

⁴¹ To be noted that Art. 24 of the EU Directive on credit servicers and credit purchasers requires effective and transparent customer complaint procedures, free of charge, with recording obligations on the measures taken. Authorities shall also establish and publish complaints procedures for borrowers in relation to credit servicers, credit purchasers and credit service providers.

for NPL transactions that will become applicable at the end of 2023 as part of the implementation of the Directive on credit servicers and credit purchasers, which includes the mandatory use of the data templates from the EBA.

In addition, all NPL public securitisations issued after 2019 must provide regulatory investor disclosures using detailed standardised templates defined by ESMA. Investors and potential investors have the right to receive such disclosures under the Securitisation Regulation, but as nearly all NPL securitisations are private securitisations, such disclosure reports are not accessible to external parties.

Differences also exist in the level of disclosures pertaining to performance aspects not covered by the Securitisation Regulation, such as the level of detail provided by the servicer on forward-looking business plans and the frequency with which such business plans are updated. It is important that such data are restricted to interested parties only (investor or potential investor, guarantor, servicer and relevant authority).

The absence of coherent data disclosures to national securitisation repositories for all private NPL securitisations may hinder the transparency of the market. Ensuring such data is available to relevant stakeholders would provide banks and investors with useful benchmark data to help improve the pricing and risk assessments of NPLs. It is possible that the added costs linked to the additional data disclosure would be limited where the disclosures already exist. However, the impact of further market transparency on competition and the need for confidentiality would need to be further assessed.

For data sharing, it would be essential to anonymise the data before transfer. The feasibility of such anonymisation of personal data would also need to be considered closely. Furthermore, the impact of data-sharing would need to be reviewed from a competition law perspective: The disclosure or exchange of competitively sensitive information amongst competitors (such as pricing, margin, costs) would raise antitrust concerns as under basic antitrust rules each market participant must determine its commercial strategy independently and autonomously.

As mentioned above, the adoption and entry into force of the Implementing Technical Standards (ITS) on NPL transaction data templates is already expected to foster consistency and transparency in the loan-data disclosure domain. Building on this, it could be worth considering the centralisation and further dissemination of NPL transaction data, already complying with the ITS templates. Such an additional step could improve market transparency further and thus attract new investors and increase the efficiency of the EU NPL market across national borders. However, mandating the disclosure of NPL transaction data might also alter existing incentives for investing in the acquisition of NPLs, the impact of which would need to be carefully assessed. It should also be noted that information asymmetries with regards to cross-border data will remain as long as national laws related to processing credit claims remain non-harmonised within the EU.

The considerations above may also be relevant in the context of the possible creation of a central EU data hub, a data repository to collect all transaction data for European NPL transactions, which was proposed in the European Commission's 2020 Action Plan.

NPL resolutions of all transaction types could be supported by general improvements that strengthen the frameworks for debt collection, enforcement, (pre-)insolvency and recoveries. Also, more disclosure of judicial efficiency indicators, such as the relative use, time to resolution, procedural costs and success rates of judicial insolvency and enforcement procedures, would support resolution. Public central credit registers could contribute to more transparency by providing more and better anonymised disclosures on the cure, forbearance, restructuring and general workout outcomes.

6. CONCLUSION

The substantial reduction of European banks' NPL ratios since the end of the sovereign debt crisis in 2014 was achieved in part through the sale and securitisation of NPLs. But other factors played a role as well, including outright NPL sales, improvements to the internal management of NPLs, proactive supervisory action, and reforms of insolvency frameworks in various Member States. The removal of legacy assets that originated from the global financial crisis and sovereign debt crisis has largely been completed, although a significant part of this non-performing debt remains in the hands of credit purchasers/servicers. The focus from governments and supervisors is now shifting to a potential new flow of additional NPLs (caused, at least in part, by the phase-out of COVID-19 public support measures, the dramatic rise in energy prices and inflation in the course of 2022, the subsequent increase in interest rates and other global uncertainties). The current economic headwinds justify renewed attention being given to making the NPL market more efficient.

The development of a deep and liquid secondary market for distressed assets in the EU is crucial to help banks reduce their NPLs by selling them to third-party investors. NPL securitisation can be one important part of the toolbox to encourage the further development of secondary markets for NPLs, enabling banks to substitute NPLs with securitised notes and sell them to third-party investors, effectively removing the underlying credit risk from banks' balance sheets. By widening the range of potential investors, NPL securitisation can help banks to deleverage, support the broader economy, and enable the efficient allocation of capital.

The securitisation of NPLs has proven to be an effective way to reduce NPL ratios. Regulatory requirements for NPL securitisation transactions are extensive and stringent, including transparency, criteria for selecting and pricing assets, and risk retention. Government-guaranteed securitisations have been instrumental in Italy and Greece in reducing the historically high level of NPLs. The Italian Government's GACS initiative has been one of the most effective and competitive ways for banks to support their deleveraging plans by allowing for the maximisation of disposal prices. At the same time, such types of government guaranteed schemes should no longer be necessary to deal with ordinary levels of NPLs, in particular since those schemes have helped develop the necessary ecosystems for dealing with NPLs.

The securitisation of NPLs should help banks deleverage their NPL portfolios, by providing access to a wider spectrum of investors and distributing every tranche to the most suitable investors in line with their risk appetite.

This paper presented the main features of NPL securitisation, some preliminary lessons learnt and potential areas for improvement. It highlights a number of practices that could have a positive impact on debtors, banks, credit purchasers, credit servicers, the market, and society overall. This includes, when applicable, preserving the debtor's enterprise as a going concern, aligning incentives for banks, guarantors, credit servicers and investors, as well as more regular updates of business plans, particularly on performance aspects. Better data collection and the standardisation of regulatory disclosures could also enhance transparency and help develop efficient markets.

With the regulatory environment improving, and against the background of uncertainties linked to the deteriorating credit conditions and volatile macro-financial

environment, market NPL securitisation could play a useful role in tackling the challenges of potentially rising NPL levels in the coming years. The concept of securitisation has improved in reputation, and NPL securitisation certainly looks set to pick up in the EU, and play an important complementary role in improving the functioning of the NPL secondary market as a whole.

ANNEX

THE ITALIAN GACS

The GACS initiative is an Italian Government scheme that stands for “*Garanzia sulla Cartolarizzazione delle Sofferenze*” (‘Guarantee on the securitisation of bad loans’) and was introduced in February 2016 and expired on 14 June 2022. Discussions regarding a potential revival of the initiative are currently on hold.

The scheme, which is voluntary, sets out the framework under which the Italian State may issue a guarantee to secure the payment obligations of the relevant SSPV, with respect to both principal and interest, towards the holders of the senior notes of the securitisation until maturity. The beneficiary of the guarantee was the investor on the senior notes of a rated securitisation transaction with an underlying portfolio of NPLs that are characterized as bad loans.

The framework required:

- Originating bank to be registered in Italy;
- Underlying portfolio classified as NPLs (bad loans only, no UTP and no past due loans);
- Guarantee to be provided on the senior note of the transaction;
- Price of the guarantee at market price. The calculation methodology is clarified by law and the guarantee fee increases over time;
- Senior note to be rated by 2 rating agencies and with a rating at least at BBB level⁴². Rating cannot be withdrawn until the senior note is fully repaid;
- An independent servicer to be appointed for the portfolio;
- Derecognition of the portfolio by the originator at group level;
- The guarantee to cover interest and principal of the senior note and to be unconditional, irrevocable and on first request; and
- The principal of the riskiest tranches (i.e. junior and mezzanine) not to be repaid until the senior guaranteed tranche has been fully repaid.

The enforcement procedure of the GACS considers the following steps:

- Within 9 months from the maturity of the note, upon failure by the SSPV to pay (in whole or in part) amounts due under the senior notes (principal and interest), the noteholder of the guaranteed senior note may enforce the guarantee payment;
- The noteholder can submit a payment request to the SSPV (through the representative of the noteholders);
- Should no payment be made by the SSPV, the holders of the senior notes may enforce the GACS;
- The State will comply with its payment obligations under the GACS within 30 days from the date of receipt of the payment request; and

⁴² The original GACS scheme envisaged a BBB- minimum rating for the senior tranche.

- Payments of the guaranteed fees rank senior and are included in the payment waterfall. Flows generated by the guarantee fees are added to the available fund for the issuance of the GACS guarantees.

The cost of the guarantee is at fair value, i.e., it includes a remuneration in line with that of the market for the risks assumed by the State. The market reference is given by reference to three CDS baskets based on CDS to individual companies (both Banks and Corporate) broken down by rating. The guarantee is granted against an annual fee determined at market conditions based on the following method, according to the latest prolongation of the scheme⁴³:

1. The mid-price of each CDS included in the basket is determined
2. The simple average of the prices of the individual CDS is determined
3. The annual fee is calculated on the residual value of the senior Notes at the beginning of the interest payment period and is equal to:
 - a. for the first three years at the average of the prices of the single three-year CDS,
 - b. for the next two years at the average of the prices of the individual five-year CDS,
 - c. for the years following at the average of the prices of the single seven-year CDS.
4. The cost of the guarantee must be increased by an additional component equal to:
 - a. 2.67 times the difference between the average in point 3b and 3a for the fourth and fifth year, if the senior notes have not been fully repaid by the end of the third year.
 - b. 8.81 times the difference between the average at 3c and 3b for the sixth and seventh years, if not all the senior notes have been repaid by the fifth year.

To ensure greater stability of the operation and greater security for investors, the legislator has established two fundamental obligations:

1. The first concerns the management of assets: an external and independent servicer must be appointed for this type of operation (different from the originating bank and not belonging to its own banking group). This avoids the conflict of interest that could arise if the bank itself manages the assets.
2. The second concerns the rating: each senior note must be evaluated by two rating agencies that assign an independent rating, which cannot be lower than BBB. In this way, the operation receives an external and independent judgment.

Table A.1 shows an overview of the ratings that have been assigned to the GACS securitisations with a GBV greater than EUR 2 billion that have been carried out from 2016 to today.

⁴³ See State Aid SA.62880 (2021/N) - Fourth prolongation of the Italian guarantee scheme for the securitisation of non-performing loans.

Table A.1: Overview of ratings assigned to large GACS securitisations (> EUR 2 billion GBV)

SPV	Main banks involved	Servicer	Issuing Date	GBV EUR / billion	Rating
FINO 1 Securitisation S.r.l	Unicredit	doValue	Nov 17	5.4	CLASS A--> Moody's: A2 sf; DBRS: BBB (high) sf CLASS B--> Moody's: Ba3 sf; DBRS: BB (high) sf CLASS C--> Moody's: B1 sf; DBRS: BB sf
Siena NPL 2018 S.r.l	Banca Monte dei Paschi di Siena	Cerved, Prelios, doValue, Credito Fondiario	Jan 18	24.6	CLASS A--> Moody's: A3 sf; Scope: BBB+ sf
Red Sea SPV S.r.l	Banco BPM	Prelios	Jul 18	5.1	CLASS A--> Scope: BBB sf; Moody's: Baa2 sf
Maior SPV S.r.l	UBI	Prelios	Aug 18	2.7	SENIOR--> Scope: BBB sf; DBRS: BBB (low) sf
Aqui SPV S.r.l	BPER	Prelios	Nov 18	2.1	CLASS A--> Scope: BBB- sf; Moody's: Baa3 sf
Leviticus SPV S.r.l.	Banco BPM	Credito Fondiario	Feb 19	7.4	CLASS A--> Scope: BBB sf; DBRS: BB sf
Prisma SPV S.r.l	Unicredit	doValue	Oct 19	6.1	SENIOR--> Moody's: Baa1 sf; Scope BBB+ sf MEZZANINE--> Moody's: B3 sf; Scope B- sf
BCC NPLs 2020 S.r.l	ICCREA	doValue	Nov 20	2.3	CLASS A--> Scope: BBB sf; Moody's: Baa2 sf CLASS b--> Scope: CC sf; Moody's: Caa2 sf
Yoda SPV S.r.l.	Intesa Sanpaolo	Intrum	Dec 20	6.0	CLASS A--> Scope: BBB sf; Moody's: Baa2 sf
Olympia SPV S.r.l.	Unicredit	Italfondiario, doValue	Nov 21	2.2	CLASS A--> Scope: BBB sf; Moody's: Baa2 sf
Grogu SPV S.r.l.	Intesa Sanpaolo/ BPER	Intrum, Prelios	Dec 21	3.1	CLASS A--> Scope: BBB+ sf; Moody's: Baa1 sf

Source: Banca d'Italia

THE GREEK HAPS

The Hellenic Asset Protection Scheme (HAPS, also known as ‘Hercules’) was implemented by the Greek Ministry of Finance, designed to assist banks in securitising NPLs and moving them out of their balance sheets. The HAPS has been a key tool in deleveraging NPLs in Greece, making such troubled assets more marketable, potentially increasing investors’ demand and related prices for selling banks.

The HAPS scheme was launched in October 2019, and extended in April 2021 under the “Hercules II” programme, which ran for 18 months, until October 2022. The scheme has been used by the country’s largest banks and has contributed to reducing information asymmetries between banks and investors in the NPL market while achieving the goal for which it was originally designed. Before the creation of this scheme, an NPL market related to direct sales existed in the country, but in smaller volumes. The HAPS scheme was based on the previous model of the Italian GACS and shared the aim of supporting local banks in deleveraging to obtain market stability for the banking sector and the broader economy. The scheme is very similar to the Italian model, only covering the senior notes, and with minimum rating requirements. This rating must be provided by an External Credit Assessment Institution, a regulated rating agency recognised by the ECB. When two ratings are assigned to the senior notes, the second rating can be performed by a rating agency registered pursuant to Regulation 1060/20098. For the purpose of the remuneration of the guarantee, only the lower of the two ratings is considered.

Furthermore, for the scheme to be effective, the bank must sell at least 50% plus one share of the junior tranche and an amount of the mezzanine notes that can allow for derecognition, as described above. The scheme provides for the creation of a liquidity line between the cash flows of the underlying assets and the obligatory coupon payments to senior note holders. The notional amount of the liquidity line is proportional to the notional amount of the outstanding senior tranche and sized to attain the minimum level of rating.

Similar to GACS, albeit with different trigger values, the scheme introduces safeguards to align the interests of the note holders, the guarantor and the servicer, such as the possibility of deferral of both servicing fees and mezzanine note interest for material underperformance (20% or more) relative to the business plan, as well as the possibility of replacement of the servicer under specific conditions (guarantee is called and there is material underperformance above 30%).

Key differences between HAPS and GACS are the required rating levels, BB- in HAPS and BBB in GACS⁴⁴. In addition, the way the guarantee fee is calculated to ensure that the government is receiving a market-conform compensation differs. In Greece, the fee is calculated with reference to the CDS of the Greek government and does not use a basket of corporate CDS, as in Italy, due to the lack of a sufficiently liquid basket of domestic corporate CDS⁴⁵. Moreover, while the Italian GACS scheme does not cover exposures classified as UTP, HAPS does provide for the inclusion of these kinds of exposures.

⁴⁴ The Greek government, unlike Italy, did not have an investment-grade rating, which was a factor in designing the specific criteria.

⁴⁵ See State Aid SA.53519 and State Aid SA.62242(2021/N) for further details.

