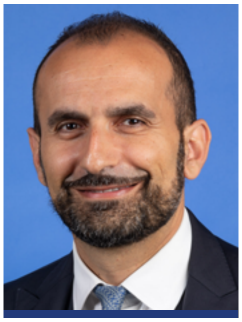
New frontiers?

Given the success of both GACS and HAPS in facilitating the development of a market for non-performing loans, and consequently bank deleveraging, could similar government-backed measures emerge in other European jurisdictions? **Vincent Nadeau** examines the prospects for the introduction of further national guarantee schemes.

Italy and Greece appear to have embraced the most efficient model for de-risking their banks via the GACS and HAPS schemes respectively. With the overhang of troubled assets expected to rise post-Covid and new regulatory rules coming into effect for NPLs, the case for introducing securitisation guarantee schemes in other countries seems to be gaining momentum.

"GACS and HAPS have been game-changers for the NPL securitisation market. In my view, in the next five years, securitisation will be the most relevant tool by which both banks and investors will dispose of their NPL stock. Securitisation allows you to lower the capital structure and it is evident by the current way of the market that such transactions will not be solely confined to Italy or Greece," suggests Dario Maria Spoto, partner at KPMG.

Structurally and conceptually, the gap between bid and offer prices has historically complicated attempts by banks to dispose of their non-performing loans. However, the Italian Garanzia Cartolarizzazione Sofferenze (GACS) and Greek Hellenic Asset Protection Scheme (HAPS) adopted a direct approach towards the active resolution of NPLs, through specific programmes providing a state guarantee on senior notes in bad loan securitisations. Such government guarantees



Dario Maria Spoto, KPMG

enable the underlying NPLs to be priced higher and thus bridge the difference between the asking price and the price that potential buyers would be willing to pay.

First introduced in February 2016 and extended several times before its original expiration date of March 2019, the success of GACS in allowing the development of a market for bank NPLs saw the Italian government extending it for another 24 months, until March 2021, and again this year until mid-2022. In October 2019, the Greek government – with the agreement of the European Commission – introduced the HAPS rules, which aim to reduce the NPL stock from Greek systemic banks in a similar manner to those already used in Italy through GACS. HAPS has also been prolonged for a further 18 months, until October 2022.

Both schemes require the senior tranche of a securitisation to be rated by at least one External Credit Assessment Institution (ECAI) approved by the ECB. To be eligible for the government guarantee, the senior tranche should receive a rating equal to or higher than a predetermined target (triple-B for GACS; double-B minus for HAPS).

Spoto notes that the main difference between the two schemes is in fact linked to this minimum rating. "Naturally, we also do have to take into account that we are dealing with two completely different macroeconomic settings and, thus, different sovereign ratings. But the obvious difference is in the target rating."

There are further differences, particularly as the schemes have also evolved and been modified from time to time. For instance, there are differences in the mezzanine interest deferral trigger.

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GACS makes the full deferral of mezzanine interest compulsory if the net cumulative collection ratio is below 90%. HAPS requires the deferral of at least 20% of mezzanine interest if the net cumulative collection ratio is below 80% or if the servicer is replaced.

Under HAPS, upon enforcement of the guarantee, the servicer can be replaced if the net cumulative collection ratio for two consecutive payments is below 70%. Under GACS, upon enforcement of the guarantee, the servicer must be replaced if the ratio has been below 100% for two consecutive payments.

But perhaps what best defines both schemes, and particularly in the case of Italy – being a more mature market and having been operating for longer – is their successful outcome. Industry participants unanimously agree that both programmes are delivering on what they were originally designed to do. Moreover, they highlight the benefits of securitisation as a tool to help reduce the informational asymmetries between banks and investors across the NPL market.

"Prior to the introduction of the GACS and HAPS programmes, there was naturally an NPL market in both jurisdictions, but more related to direct NPL sales. However, the distance or gap between investors and banks was too large and those schemes were introduced within this specific

Sally Onions, Allen & Overy

context," notes Rossella Ghidoni, director, structured finance at Scope.

She adds: "There was a high stock of NPLs which could not have been sold easily, or on a massive scale. National schemes incentivised banks to perform those securitisations. In Italy, for example, over €90bn of securitisations have been closed, which is huge."

Timur Peters, ceo of Debitos, states: "My impression is that [GACS and HAPS] will be renewed for a while. This securitisation scheme is a success story; clearly a preferred option over having bad banks as a business plan. In the last eight months in Greece, we have seen the same flurry or patterns originally experienced in Italy."

Meanwhile, the economic pain caused by the coronavirus pandemic has brought a renewed focus on how government guarantee schemes can provide valuable and effective solutions during an unpredictable context – especially one in which non-performing exposures are on the rise. Indeed, a backlog of debt and defaults is anticipated to materialise over the next couple of years, following the withdrawal of governmental coronavirus support measures.

"In Italy, GACS has been extremely relevant and in 2018-2020 accounts for 70%-80% of all transactions. Banks are still active servicers on such transactions," observes Paolo Pellegrini, director general at Cerved Credit Management.

He adds: "But the typology of a new wave of Covid assets will be significantly different – mainly fresh NPEs still in the unlikely-to-pay classification – and will require new instruments, while it is unclear if GACS will be fully applicable in this new context. At the same time, the Covid crisis also means that no-one can ignore the NPL ratio."

"THIS SECURITISATION SCHEME IS A SUCCESS STORY; CLEARLY A PREFERRED OPTION OVER HAVING BAD BANKS AS A BUSINESS PLAN"

Prior to the pandemic, Spoto says he was convinced that such schemes would not be replicated in other jurisdictions. "However, if we now combine a more capitalised banking system with the new regulatory rules affecting NPLs, it pushes the case for the need of securitisation guarantee schemes."

He adds: "My view is that southern countries – such as Spain or even Portugal – could be likely candidates. France has a huge stock of NPLs, but the ratio is more comfortable than in the jurisdictions I have just cited. However, if Spain and Portugal start introducing measures to assist banks through similar schemes – even for sub-performing loans – we could witness a domino effect."

But Sally Onions, partner at Allen & Overy, says it is unclear whether there is a particular need to replicate such schemes in more established NPL markets, where NPL sales have continued throughout the pandemic. "Following Covid, there has been much said about an 'NPL cliff'. That remains to be seen. However, what I feel we will see is more jurisdictions being involved in NPL sales, with more diverse types of underlying assets."

Conceptually, NPL securitisation continues to mean different things to different market participants, according to Reed Smith partner Iain Balkwill. This seems particularly evident in the context of banks disposing of their non-performing loans.

He concludes: "Ultimately, for this technology to really prosper, you need to make sure the ecosystem and structures are all in place – such as rating agencies, legal framework and all the counterparties having the requisite expertise required to structure and effectively execute on these deals – which can explain why Greece took a little longer to get up and running with HAPS."

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