Italian Banks

MEDIOBANCA SECURITIES

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The value of time

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The market is not paying for EPS accretion from time-value reversal, for now

In August 2015, the Italian government converted into law the Decree dated 27 June 2015, which incorporated measures aimed at accelerating credit recovery procedures and foreclosures. We find investors in a 'wait-and-see' mood for now, awaiting results that could, however, be a couple of years down the road. This note aims to shed more light on the government's target of shortening of repossessions by three years. We think this target is robust enough to command multiple expansion ahead of the results, expected by 2017/18.

Two accelerating steps: repossessions and bankruptcy procedures

The NPLs reform is moving away from the principle that a company in financial distress can drag down suppliers by continuing to contract obligations that cannot be met. Dealing promptly with corporate crises can clearly better safeguard the economy as well as boost the value of NPLs so to foster a private/secondary market for this asset. The new framework removes regulatory obstacles to debt restructuring, improves the insolvency procedures, encourages extra-judicial workouts, reduces the legal burden, and accelerates collateral foreclosure by reducing the role of the court and by empowering notaries to set the values and to oversee collateral auctions.

Measures to prevent bankruptcy and accelerate bankruptcy procedures

Facilitating debt restructuring, increasing the success rate of interventions and speeding up procedures are the key changes being implemented. An agreement can now be struck with 75% of creditors representing 50% of the debt; *concordato preventivo* can be asked by creditors expressing 10% of claims and foresees assets purchase by third parties (including the bank owning the NPLs); sale procedures are being made faster with priority to extrajudicial sales; auctions dates are fixed at the start of the process; assets are liquidated within two years from the bankruptcy declaration; separation between trustee and judicial commissioner, both subject to penalty of withdrawal, is being achieved; and credit losses deductibility completes the picture.

Measures to accelerate the repossession of collaterals

The new rules – applied to new and old proceedings – foresee: quickened real estate foreclosures (we calculate total admin needs nearly halved to 250 days now); mandatory enforcement for expropriation of assets; single portal for judicial sales; and compulsory (no longer discretionary) use of notaries to carry out collateral sales activities. This should result in streamlined and shortened court proceedings.

Recent assessments from the Bank of Italy, ABI and Cerved suggest 3 years cut

The value on NPLs stems from the maximum recoverable amount (including collateral), discount rate and recovery time. Shorter recovery on the foreclosures would thus reflect in higher NPLs value feeding through the equity of the banks via lower LLPs. Recent analysis from Bank of Italy, ABI and Cerved suggest the time for repossession and credit recoveries could reduce by 30-40%, i.e. by 2/3 years.

We see +0.4pp RoTE and +4% EPS for each year cut; 1x P/E point for the popolari

When considering the vintage of NPLs, we estimate €66bn gross NPLs in our coverage to be affected by the reform, i.e. 45% of total. We see €24bn recovery value from the RE collateral backing such stock of NPLs. Based on our discount rate assumptions, this results in €780m delta value of RE collateral, i.e. time value provisions release, for each year of shorter foreclosure. We conclude with +4% EPS in 2018E, or +0.4% RoTE for each year cut. Excluding UCG (relatively lower weight of Italy and lower collateralised NPLs due to vintage), ISP and Credem (better than average asset quality), we jump to +9% average EPS and +0.7% RoTE for the smaller banks. Highest beneficiaries at the top of our ranking are CREVAL, BPER and MPS, due to the high value of RE collateral and to their relatively low profitability. We reiterate our positive stance on the Italian banks and believe the NPLs decree discussed in this note represents the next valuation catalyst for the sector.

Estimated EPS and RoTE impact from 1 Year Shorter Recovery Time, 2018E

	EPS	ROTE
CVAL	+16%	+1.0%
BPER	+12%	+1.1%
MPS	+10%	+0.8%
BP	+9%	+0.8%
UBI	+8%	+0.6%
BPM	+6%	+0.5%
BPSO	+7%	+0.5%
ISP	+3%	+0.3%
CE	+2%	+0.2%
UCG	+1%	+0.1%
Average	+4%	+0.4%
Avg. ex UCG, ISP & Credem	+9%	+0.7%

Source: Mediobanca Securities

Measures to accelerate credit recovery

The market is not paying for the benefit of time-value reversal for now

In August 2015, the Italian government converted into law the Decree dated 27 June 2015 incorporating measures aimed at accelerating the credit recovery procedures (see our *Bad Bank Thoughts* note, dated 22 June 2015). Our recent marketing suggests that investors are hardly willing to pay today for the future EPS accretion stemming from the time-value reversal, thus preferring to await evidence on accelerating foreclosures, which could, however, be a couple of years down the road. Our discussions with investors suggest that this is also the result of the little visibility so far on how the declared government's target of three years shortening of repossessions will be achieved. This note aims to serve such a purpose and to provide more colour on why we believe the NPLs' reform is robust enough to command a multiple expansion ahead of the results expected by 2017/18.

Shedding light on the NPLs reform: accelerating both repossession and bankruptcy procedures

The NPLs' reform measures are moving away from the principle that a company in financial distress can drag down suppliers by continuing to contract obligations that cannot be met. Dealing promptly with corporate crises can therefore better safeguard the economy as well as boost the value of NPLs, so to foster the development of a private/secondary market for this asset. The new legislative framework addresses some key features including removing regulatory obstacles to debt restructuring, further improving the insolvency framework, encouraging extra-judicial workouts, reducing the legal burden and accelerating collateral foreclosure, and reducing the role of the court by empowering notaries to determine the values and to oversee collateral auctions.

Italy – Breakdown of Non-Performing Loans (Sofferenze) by Segment, June 2015

Segment	% on Total
Public Administration	0%
Financial Institutions	2%
Corporate	71%
Small Business	19%
Households	8%
Total	**€196bn**

Source: Bank of Italy, Mediobanca Securities analysis

Newly-approved measures can be divided into two areas, i.e. measures to accelerate the bankruptcy proceedings and measures to accelerate the repossession of collaterals.

Measures to prevent bankruptcy and accelerate bankruptcy procedures

Intervention in this field aims at facilitating temporary debt restructuring, at increasing the success rate of interventions so to prevent bankruptcy, and at speeding-up the bankruptcy procedures.

- **Debt restructuring** - An agreement can now be struck with 75% of the financial creditors if they represent at least 50% of the debt and after satisfying non-financial creditors. This should prevent some claims from blocking the procedure, which marks a step-change versus before when 25% or less of creditors could block any debt restructuring.
- **Competition in bankruptcy procedures aimed at continuing/selling the activity** *Concordato preventivo* (composition with creditors) can now be submitted by creditors representing at least 10% of the claims, when the debtor's proposal does not provide for the satisfaction of 40% of unsecured claims.
- **Competition in bankruptcy procedures** - In addition to the debtor, offers for the purchase of the assets can now be made by third parties (including the bank owning the

NPLs), provided those are comparable and ameliorative, i.e., preventing assets devaluation.

- **Facilitating access to credit during a corporate crisis** - In accordance with creditors, the court may authorise funding during bankruptcy procedures (*concordato in bianco*) without a professional opinion needed. This should increase the chances of successfully exiting from bankruptcy.
- **Sale of assets/collaterals** – Sale procedures are made faster, giving priority to extrajudicial sales. Dates of the auctions are fixed at the start of the process. In addition, the liquidation of the assets of the bankrupt firm has to be carried out within two years from the date of the bankruptcy declaration (the scheduled timeframe for the liquidation of the assets has to be presented within 180 days from the date of the bankruptcy declaration). No fulfillment of such obligations results in the withdrawal of the mandate of the judicial commissioner.
- **Separation between the bankruptcy trustee and the judicial commissioner** – The roles are made incompatible and both must fulfill their duties within a time limit (penalty of withdrawal).
- **Credit losses deductibility** - Allowing the full deductibility of credit losses in the year in which those are incurred should incentivise banks to sell bad loans. This measure has positive capital implications as it will halt the formation of future DTAs (see our *Bad Bank Thoughts*, dated 22 June 2015).

Overall, we think there is sufficient action to speed up the process, particularly owing to the removal of the so-called holdout problem. To-date dissenting creditors have kept their right to be paid in full so that the objection of a single creditor could delay or block the entire process. Equally, on *concordato* prior to the reform creditors could only approve or reject a debtor's plan without any possibility of influencing the process, whilst now the new rules on composition with creditors should facilitate prompt agreements.

Measures to accelerate the repossession of collaterals

The main changes to the procedural rules governing the foreclosure of collateral so far seek to simplify and reduce the length of court proceedings. The new rules apply to new proceedings and to those already initiated at the time of the entry into force of the reform.

- **Information search on assets to be repossessed** - The law introduces the possibility for creditors to seek information from the managers of databases (revenue, pension, car register), with no need for a Ministry of Justice decree.
- **Use of external professionals** - It is now mandatory for the judge to resort to professional experts (such as notaries, lawyers, accountants) to carry out the activities related to the disposal of the collateral, in order to streamline court proceedings and increase their efficiency. In the previous regime, resorting to experts was discretionary, and there was little recourse to this option, according to the Bank of Italy.
- **Acceleration of foreclosures of real estate assets** - Creditors cannot take more than:
  - 45 days for filing a request to order the sale (90 days in the previous regime);
  - 60 days for filing, prior to the auction sale, the documentation concerning the foreclosed asset (120 days in the previous regime).
  - The court cannot take more than 90 days for conducting the hearing of creditors and other interested parties in view of the auction (120 days in the previous regime).

- The cadastral information has to be filed within 60 days versus the previous 120 days. In addition, the market value replaces the value indicated by multiplying the cadastral value by a coefficient.
- Finally, the legislation foresees an acceleration of the time for the oath of the consultant estimator and of the submission of tenders.

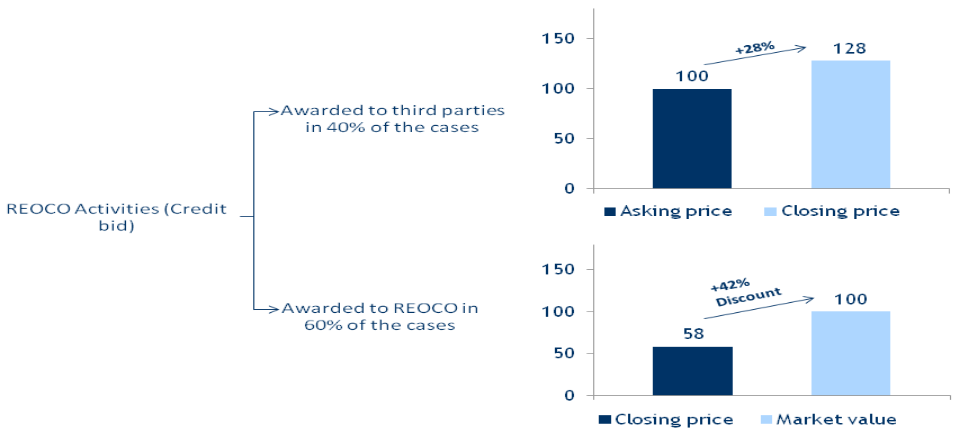
- **Expropriation of assets subject to restrictions** - The law introduces enhanced protection for creditors in cases where assets are placed under a seizure order through the simplified revocation procedure. The institution introduced by the decree enables creditors — where they consider their interests to have been prejudiced by a restriction on usage of any kind — to initiate mandatory enforcement procedures regardless of whether a ruling has been obtained declaring the transfer to be ineffective (the revocation procedure).
- **Judicial sales publicised through the web** - A single portal will allow all interested parties to acquire information related to judicial sales, avoiding the fragmentation related to the publication of notices of sale for each court.

REOCO – Real Estate Owned Company

We believe the new framework is tackling the right issues. The multiple auctions for real estate collaterals, for instance, were a feature of the previous regime. It typically took a third or a fourth auction to assign the collateral with significant delays in the process. In particular, a bid could be accepted at the first auction only if 20% higher than a reference price set by the court. Creditors can now rather offer a price equal to that of the last unsuccessful auction. Moreover, it is now possible for the winning bidder to pay the price in monthly instalments whereas before a lump sum payment for the entire amount was required. REOCO (Real estate owned company) can thus now place bids whenever the value of a real estate asset falls below a certain threshold, so to help support prices and pushing third parties to participate to the auctions.

- As shown below, according to Cerved, in 40% of the cases this process leads to the asset being awarded to third parties at prices 28% higher than the asking price.
- In the remaining 60% of the cases, REOCO wins the auction at a price 40% lower than market value, which in turn allows to sell the property in the market and extract value from the NPL.

REOCO Activities



Source: Mediobanca Securities, CERVED

Credit recovery could be accelerated by 2/3 yrs

The reform is tackling the main issues . . .

Overall, the reform aims at improving the legal framework for early intervention in cases of financial distress, promoting early action in case of crisis, making restructuring more likely and possibly preventing insolvency and the start of the bankruptcy legal process. It should also better provide protection to creditors in case of borrowers' difficulties as foreclosure procedures are expected to become more rapid, with forced sales improved by extra-judicial and more market-oriented mechanisms. In addition, we see the protection for creditors in cases where assets are placed under seizure order through the simplified revocation procedure as particularly relevant.

. . . even though some doubts remain on the courts' role remaining central to the process

Admittedly at this current early stage, it is not possible to quantify precisely the practical effects of the newly-introduced legislative changes. Despite the fact that new law tries to reduce the use of judicial procedures, courts will indeed continue to play an important role, and we understand the market's uncertainty on the courts being able to speed up the procedures as foreseen by the new legislation.

Recent assessments from the Bank of Italy, ABI and Cerved suggest 3 years cut to be plausible

A preliminary assessment was provided over the last two weeks by the Bank of Italy and by the Italian banking Association (ABI) via a survey conducted in collaboration with the credit information provider Cerved.

- According to the Bank of Italy, the average time from declaration of insolvency to the distribution of proceedings normally lasting more than six years could reduce by three years in a favourable scenario and by two years in a less favourable scenario.

Bank of Italy – Preliminary Assessment of the Benefits of New Bankruptcy Law

	Average Time from Declaration of Insolvency to Distribution of Proceedings	Acceleration in Credit Recovery
Current Regime	> 6 Years	
New Regime - Favorable Scenario	c.3 Years	c. 3 Years
New Regime - Less Favorable Scenario	c.4/5 Years	c. 2 Years

Source: Bank of Italy (The changes of the Italian insolvency and foreclosure regulation adopted in 2015, November 2015)

- According to the survey conducted by ABI-Cerved with a number of banks and investors, the bankruptcy procedures could be reduced by c.30%. As the average length of time of the overall bankruptcy procedure is about seven years, reducing it by c.30% would mean anticipating the recovery of the credit to 4/5 years.

Cerved / ABI Survey – Preliminary Assessment of the Benefits of New Bankruptcy Law

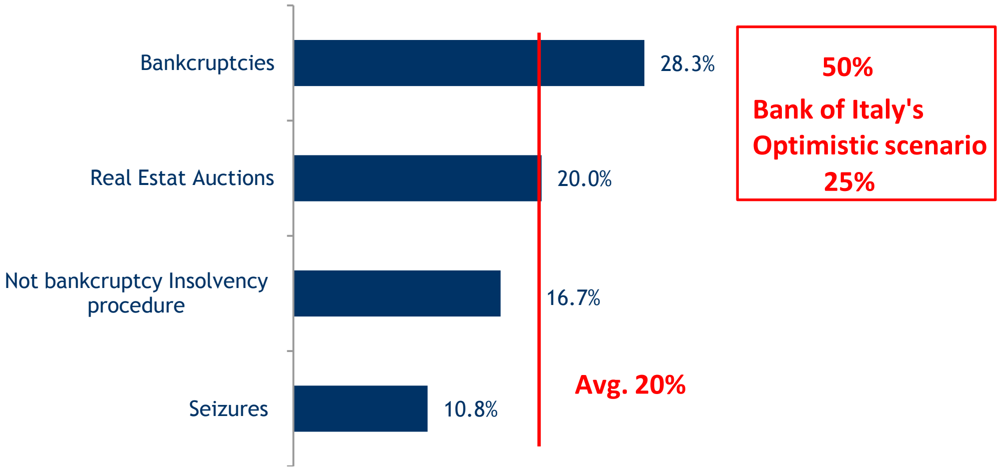
	Reduction in Procedural Time
Repossession of Collaterals	-11%
Debt Restructuring	-17%
Real Estate Auctions	-20%
Bankruptcy	-28%

Source: Cerved (Rapporto PMI 2015)

Bank of Italy versus Cerved shows upside

There is still not a clear view on how timing will be reduced. As shown below, Cerved's scenario suggests an average 25% cut in the timeline of different procedures. This is broadly in line with the Bank of Italy expectations, although a blue-sky scenario from the BoI could lead to a 50% time cut.

Timeline reduction foreseen on procedures



Source: Mediobanca Securities, CERVED vs Bank of Italy

Foreclosure - Insolvency procedures and timeline for non-performing credit extinctions

The volume of non-performing credit that exits the banks' balance sheets is highly dependent on the foreclosure and insolvency procedures, and thus on how quickly the banks can recover the credit. A large part of the NPLs stock is highly dependent on foreclosure procedures. According to Cerved, €119bn belong to companies with loans above €500k, thus above the bankruptcy law threshold. As such, based on Cerved's estimates, the timeline of real estate foreclosures' weight on the overall timeline of credit recovery for €51bn whereas chattel foreclosures for €11bn and seizure of '*V stipendio*', fifth of salary €12bn.

Foreclosure - Insolvency procedures and bad debt extinction timeline

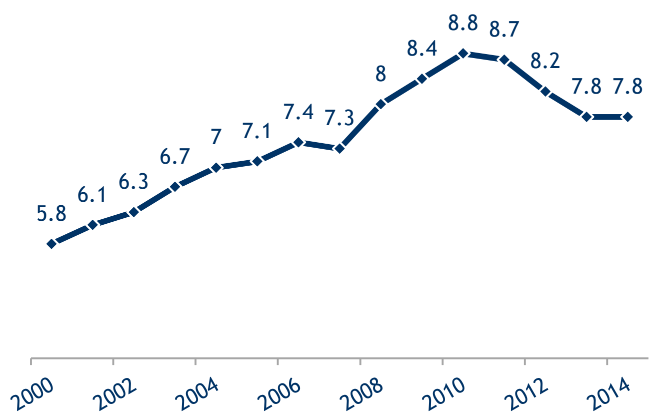
	Duration (years)
Insolvency Proceedings	
Lag between credit become non-performing and insolvency procedure	1.0
Average duration of bankruptcies	7.8
Lag between bankruptcy case is closed and extinction of non-performing credit from bank's balance sheet	0.5
Real Estate Foreclosures	
Administrative time required for the auction to start	2.9
Auction average duration	2.1
Timeline to cash-in post repossession	1.0
Chattel Foreclosures	
Foreclosure procedure	2.0
Timeline to cash in post repossession	2.0
Seizure of '*V Stipendio*' fifth of salary	
Foreclosure procedure	2.0
Timeline credit recovery	4.2

Source: Mediobanca Securities, CERVED estimates

Average duration of bankruptcy procedures stands at 7.8 years . . .

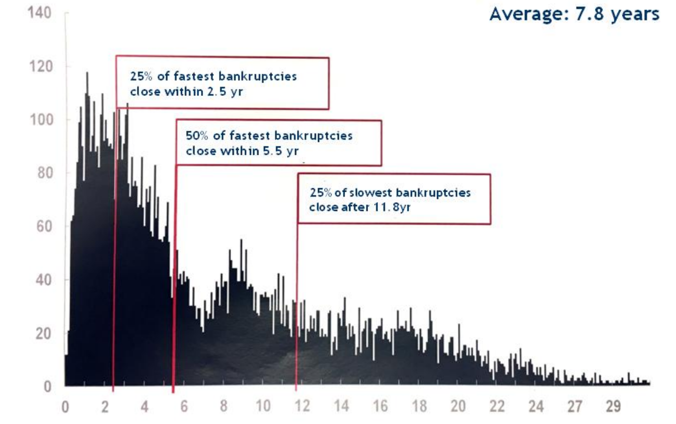
The peak in the length of bankruptcy procedures was reached in 2010 at 8.8 years. As shown above and in the lhs chart below, now it is running at 7.8 years. However, we must flag a tail of few cases taking up to 15 years. In general, data suggest (rhs chart below) that 25% of the procedures are closed within 2.5 years, 50% within 5.5 years and 75% within 12 years. So the remaining 25% cases take more than 12 years.

Average duration of bankruptcy procedures - Years



Source: Mediobanca Securities estimates on Cerved data

Distribution of bankruptcies by duration (number of cases, bankruptcies closed in 2014)



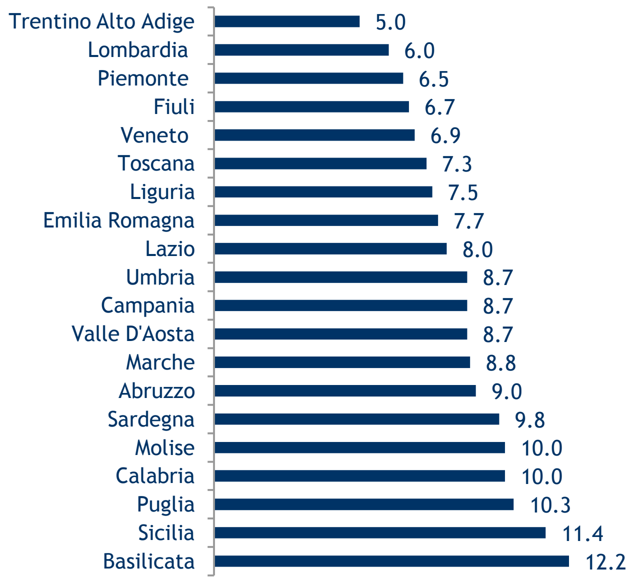
Source: Mediobanca Securities estimates on Cerved data

. . . depending on geography

The above dispersion of length for bankruptcy procedures is mainly a function of the different speeds among provinces:

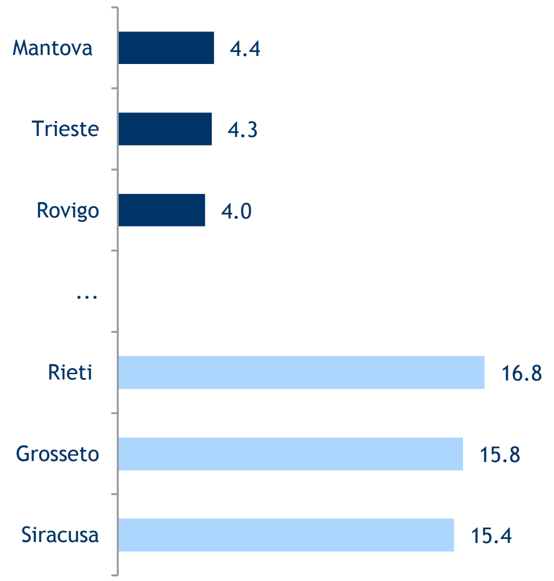
- In 25% of the provinces it takes 6.4 years;
- In 50% of the provinces it takes 7.6 years;
- In 25% of the provinces it takes more than 10 years;
- Outliers are the province of Rovigo with 4 years and Rieti at the other end with 16.8 years.

Average duration of bankruptcy procedures, by region - Years (2014)



Source: Mediobanca Securities estimates on Cerved data

Duration of closed bankruptcy procedures by province. years; longest and shortest - 2014



Source: Mediobanca Securities estimates on Cerved data

The decree to rescue four local banks

The new decree confirms the government commitment to fixing the banking sector . . .

The Italian Government approved over the weekend a decree to rescue four local banks on the brink of bankruptcy (Cassa Risparmio di Ferrara, Banca Marche, Banca Popolare Etruria e Lazio, Cassa Risparmio di Chieti). The intervention entails that the National Resolution Fund will fund €3.6bn for the rescue of the above mentioned banks: €1.7bn to cover the losses, €1.8bn for the recapitalization and €0.14bn for the creation of bad banks to spin-off the non-performing exposures. According to press, UCG, ISP and UBI will provide the credit lines to the fund, but the entire Italian banking system will contribute to the Fund. So far, only ISP disclosed the P&L impact due to the extraordinary contribution to the fund, i.e. €380m pre tax corresponding to c.4x the contribution due in 2015.

. . . and could cost one off 11% of EPS and 8bps of CET1

We estimate the impact on EPS and on CET1 ratio of the additional contribution to the Single Resolution Fund (SRF) on the back of the press release issued by ISP.

- We multiply by four the 2015 contribution when reported (UBI, BP, BPER, MPS, CREDEM).
- At UCG, we estimate €80m provisions in 9M2015, i.e. 50% of the contribution to the SRF (€160m pertaining to Italy, Germany and Austria). We allocate 50% of the SFR provisions to Italy, as the direct funding in Italy accounts for c.50% of the direct funding in the three countries.
- As BPM and CREVAL disclose only the total amount, we apply a percentage representing the weight of the SFR on the total contribution to SFR and to the Deposit Guarantee Scheme (DGS) at domestic peers.
- As BPSO did not publish the amount of its contribution to the SRF, we estimate it in the region of €9m, equal to 3bps of customer deposits (the average of the banks that disclosed the amount allocated to the SRF).

We estimate the impact on 2015E EPS would hover over 10% on average, while the hit on CET1 ratio would be in the region of 10bps on average, quite uniform across banks. The burden of the additional contribution to the SRF should represent - on average - 24% of DPS, accounting for 85% of dividends at UBI, 65% at BPER and 60% at BPSO. In our view, the hit on capital could be balanced by the capital gain from the disposal of ICBPI at UBI, BP, BPER, BPM, and CREVAL.

Italian Banks – Estimated or Reported contribution to Single Resolution Fund SRF, 2015E

€m	ISP	UCG	UBI	BP	MPS	BPER	BPM	BPSO	CREVAL	CREDEM	Avg.(ex BPSO)
Single Resolution Fund (SRF)	95	80	23	23	40	11	8	8	4	5	288
Deposit Guarantee Scheme	43		11	12	15	9	4		2	5	
Total	138		34	35	55	19	12		6	10	
SRF as % of the Total	69%		67%	66%	73%	55%				53%	64%
SRF as % of Deposits	0.04%	0.02%	0.04%	0.04%	0.04%	0.03%	0.03%	0.03%	0.02%	0.03%	0.03%

Source: Company data, Mediobanca Securities estimates

Italian Banks – Estimated Impact on CET1, DPS and EPS from Additional Contribution to the SRF, 2015E

€m	ISP	UCG	UBI	BP	MPS	BPER	BPM	POPSO	CREVAL	CREDEM	Total
Estimated Add. Contribution - Pre tax	380	320	91	92	160	42	32	31	16	20	1,185
Estimated Add. Contribution - Post Tax	255	214	61	62	107	28	21	21	11	14	794
As Percent of RWA - 2015E	**0.09%**	**0.05%**	**0.11%**	**0.13%**	**0.14%**	**0.07%**	**0.06%**	**0.09%**	**0.07%**	**0.08%**	**0.08%**
As Percent of DPS - 2015E	**11%**	**29%**	**85%**	**0%**	**0%**	**65%**	**22%**	**60%**	**0%**	**23%**	**24%**
As Percent of EPS - 2015E	**8%**	**9%**	**27%**	**18%**	**165%**	**23%**	**9%**	**13%**	**17%**	**7%**	**11%**

Source: Mediobanca Securities estimates

Disclosed Capital Gain from ICBPI disposal and impact on CET1 ratio

€m	UBI	BP	BPER	BPM	CREVAL
After-Tax Capital Gain (€m)	70	140-160	149-162	64-70	217-247
Impact on CET1 Ratio (bps)	11	65-70	40	19-21	165-183

Source: Company data, Mediobanca Securities

Each year of shortening is worth +4% EPS

NPL value driven by maximum recoverable amount (collateral), discount rate and recovery time

A loan is accounted for in the banks' balance sheets at its presumed realisable value, which equates to the present value of the estimated future cash flows associated with the receivable, discounted at the original effective interest rate for assets recognised at amortised cost (such as loans and receivables). The variables in the estimate of the value of receivables subject to analytical valuation under IAS are therefore the Maximum Recoverable Amount (which incorporates the value of collaterals if any), the Discount Rate and the Recovery Time.

Recovery rate on a NPL investment

The net present value of a NPL portfolio is therefore dependent upon the cash flows originated for that same portfolio. The value increases as the recovery rate increases. Moreover, the value increases when the share of the stock is liquidated, as it is implied that the length of time for recovery decreases, as the cash flows are distributed in a shorter period of time and decreases when the discount rate increases reducing the present value of the cash flows.

Four main key variables affect the recovery rate: guaranteed vs non-guaranteed, loan size, borrower, and vintage. The 18 clusters grid below best summarises the impact on the recovery value of the previous three variables. We differentiate between guaranteed and not guaranteed, and between credit amount for the three key categories of borrowers: non-financial companies, SMEs and households.

- Based on most recent Cerved analysis, it can be seen that the recovery rate ranges between 41% and 76% for guaranteed exposures. Smaller tickets in each sub-category benefit from higher recovery rates.
- The recovery rate for non-guaranteed exposures ranges between 5% and 16%.

Average recovery rate on a NPL investment

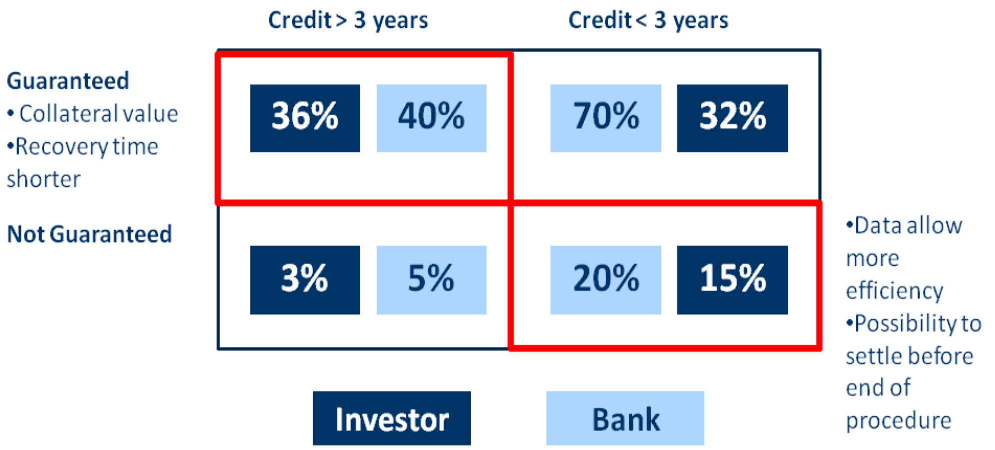
	Credit amount	Guaranteed	Non guaranteed
Non-Financial Companies	<125k	71%	16%
	From 125k to <500k	59%	14%
	>=500k	41%	9%
Small companies (<5 employees)	<125k	67%	14%
	From 125k to <500k	63%	10%
	>=500k	47%	5%
Households	<125k	76%	14%
	From 125k to <500k	72%	10%
	>=500k	54%	5%

Source: Mediobanca Securities, CERVED

Simulating the value of a €100 portfolio, by procedure, foreclosure and guarantee

One of the most relevant variables for the value of the NPLs is the tenure of the credit, as the older it is the more it is implied that the insolvency procedure or foreclosure is ahead of time. Indeed, the negative discount rate applied by the investor decreases.

Net present value of €100 of NPLs based on tenure and guarantee



Source: Mediobanca Securities, CERVED

The table below shows the different values of portfolios of different credits and different recovery rates.

Value of a €100 portfolio, by procedure, foreclosure and guarantee

	Discount rate @ 10%	Discount rate @ 15%
NFC - Real estate foreclosures and guarantee	30.4%	26.8%
NFC - Insolvency procedure and guarantee	23.1%	19.4%
NFC - Insolvency procedure and no guarantee	5.2%	4.4%
NFC - Chattel foreclosures and no guarantee	11.5%	10.5%
Total Non-Financial Companies (NFC)	17.8%	15.3%
SB - Real estate foreclosures and guarantee	41.7%	36.7%
SB - Insolvency procedure and guarantee	26.9%	2.3%
SB - Insolvency procedure and no guarantee	3.0%	2.5%
SB - Chattel foreclosures and no guarantee	9.0%	8.2%
Total Small Businesses (SB)	29.9%	26.5%
H - Real estate foreclosures and guarantee	48.4%	42.6%
H- seizure 'V stipendio', fifth of salary	6.6%	0.1%
Total Households (H)	42.5%	37.4%

Source: Mediobanca Securities, CERVED

Our model applies to 45% of the stock of NPLs

Looking at 2018 earnings

In order to gauge the magnitude on the profitability of Italian banks from the improved credit recovery procedures, we look at 2018E earnings, as we believe that any release of time value provisions would be feasible only when the changes in legislation will prove successful in practice. We assume two-to-three years as a reasonable test-period, and estimate the portion of the loan loss allowance related to NPLs that could be released if the value of the collateral securing the NPL increases on the back of a reduction in the discount period.

Taking into account only NPLs . . .

We assume that only the work-out of NPLs (i.e. insolvencies, regardless whether ascertained in a judicial court) would benefit from the shortening of the recovery period. In other words, we assume that loans in temporary financial distress (such as Unlikely-to-Pay Loans) will not be affected by the reform. We regard this as a reasonable but conservative assumption as the reform primarily aims at preventing financial distress from degenerating into insolvency by facilitating debt restructuring and extra-judicial agreements.

. . . and only for the component generated in Italy

We apply our methodology only to NPLs generated in Italy. This means the newly-approved legislation should affect c.75% of UCG's NPLs and c.85%/90% of ISP's ones.

Vintage matters

The whole stock of NPLs will not benefit from the accelerated credit recovery procedures, as the oldest ones are supposed to have already arrived at the end of the work-out process and should therefore not benefit from the newly-approved procedures. As a result, our base case scenario is for 45% of the NPL stock to benefit from the shortening of the recovery period. Such a level ranges from c.28% at UCG to c.77% at BPSO, depending on the NPLs vintage (the higher the amount of recent NPLs, the higher the ratio).

Our exercise applies to 25% of gross deteriorated loans, i.e. 45% of gross NPLs . . .

As a result of the above, we calculate the stock of NPLs affected by the legislative changes accounting for 100% of the delta stock in Gross NPLs since 2010 (we assume that NPLs dated 2008-2009 are unlikely to be affected, being too old). In general, we conclude the new law could affect c.26% of the stock of Gross Deteriorated Loans, i.e. 45% of the stock of Gross NPLs as at 2014 as shown below.

Italian Banks – Estimated Stock of NPLs Affected by Legislative Change as % of Deteriorated Loans

	UCG	ISP	MPS	BP	UBI	BPER	BPM	BPSO	CREDEM	CREVAL	AVG
'- as % of Total Det. Loans	17%	30%	30%	26%	29%	38%	39%	34%	33%	31%	**26%**
'- as % of NPLs	28%	50%	56%	53%	58%	64%	75%	77%	55%	63%	**45%**

Source: Mediobanca Securities estimates

. . . and only to real estate collateral, i.e. 72% of total collateral value . . .

We take into account the value of real estate collateral securing deteriorated loans as reported in the 2014 annual reports. We allocate such value to the stock of NPLs estimated to be affected by the law changes by multiplying such value by the weight of the estimated stock of NPLs affected by the law changes on total deteriorated loans.

Italian Banks - Value of Collaterals Securing Deteriorated Exposures, 2014

€bn	UCG	ISP	MPS	BP	UBI	BPER	BPM	BPSO	CREDEM	CREVAL	TOTAL
Value of Real Estate Collaterals	49.6	53.1	36.3	20.0	15.2	13.6	7.0	4.9	1.7	6.8	208.2
Value of Securities Collaterals	0.4	0.9	0.5	0.4	0.1	0.1	0.0	0.0	0.0	0.1	2.4
Value of Other Real Collaterals	7.0	1.8	0.4	0.6	0.0	0.2	0.0	0.0	0.0	0.0	10.3
Value of Personal Guarantees	7.0	6.6	21.1	15.8	11.1	1.3	0.4	2.1	0.8	0.4	66.7
Total	**64.0**	**62.4**	**58.3**	**36.7**	**26.4**	**15.2**	**7.4**	**7.1**	**2.6**	**7.3**	**287.5**
Real Estate - % of Total	**77%**	**85%**	**62%**	**55%**	**57%**	**89%**	**94%**	**69%**	**65%**	**93%**	**72%**
Securities - % of Total	1%	1%	1%	1%	0%	1%	0%	0%	1%	1%	1%
Other Real Guarantees - % of Total	11%	3%	1%	2%	0%	2%	1%	0%	2%	1%	4%
Personal Guarantees - % of Total	11%	11%	36%	43%	42%	8%	5%	30%	32%	6%	23%

Source: Company Data, Mediobanca Securities analysis

. . . discounted for time value and for cost of repossession . . .

The fair value of real estate collaterals reported in the annual report does not account for the depletion of the value that the collateral would incur in the lengthy auction process. Thus, we assume the NPL coverage as a proxy to estimate the devaluation of the collateral (i.e. the value that would be lost in the auction and judicial process). We assume this includes the deterioration of the value collateral due to time, physical damage, and the various costs related to the repossession of the collateral itself.

. . . based on coverage ratios . . .

We estimate the recovery value of collateral as the value of real estate collateral securing NPLs complementary to the NPL coverage ratio. As an example, we reduce the fair value of real estate collateral at ISP to 37% of the value reported in 2014, given 63% NPL coverage ratio. We capitalise the recovery value of collateral by one year to account for the acceleration in the credit recovery procedures.

. . . and on discount rate

We estimate the discount rate based on:

- the average rate on customer loans for every year in the period 2012-2017E;
- the gross NPLs in 2015-2017E, i.e. the annual NPL formation in the 2012-2017E period;
- and the weights assigned to the average rate of customer loans in each year corresponding to the share of annual NPL formation on the aggregate NPL accumulation in 2012-2017E.

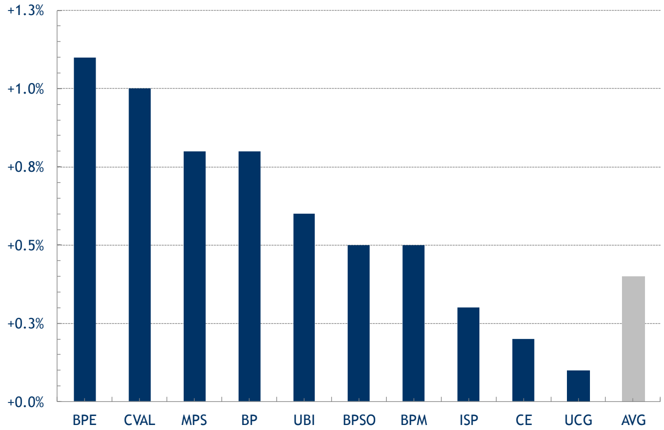
+4% EPS for each year of shortening – Creval, BPER, MPS double-digit

We estimate the impact of shortening the credit recovery procedure by one year as the difference between the *capitalised recovery value* and the *recovery value* of collaterals in 2014. We assume this amount is a good proxy for the release of provisions related to the time value of collateral.

The impact on 2018E EPS is shown below, after taxing the estimated release of provisions by 33%:

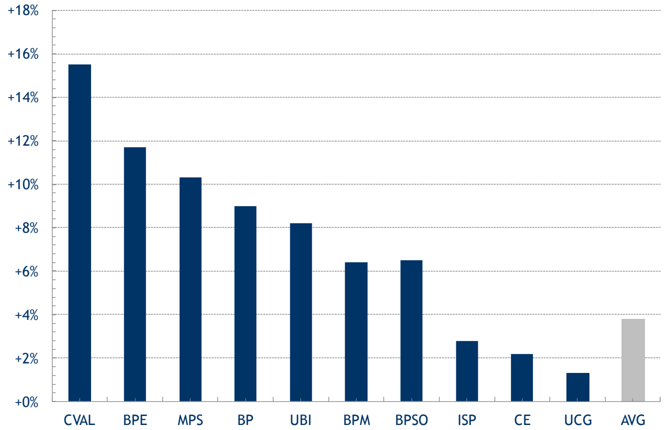
- The weighted average impact hovers over +4% of 2018E earnings due to the very low impact for UCG (+1% of 2018E EPS) as a result of relatively small amount of real estate collaterals and to c.25% of NPLs stock generated outside of Italy;
- Aside from UCG, the lowest beneficiaries appear to be ISP and CREDEM, the former due to the relatively lower weight of Italy at the group level, the latter due to better-than-average asset quality;
- Highest beneficiaries are CREVAL and BPER, due to the high initial value of real estate collateral and relatively low profitability (CREVAL).

Italian Banks - Estimated Rote Uplift From 1Yr Shortening of Foreclosure Procedures, 2018E



Source: Mediobanca Securities estimates

Italian Banks - Estimated EPS Uplift From 1Yr Shortening of Foreclosure Procedures, 2018E



Source: Mediobanca Securities estimates

MEDIOBANCA SECURITIES

Italian Banks - Estimated EPS Impact From 1 Year Shorter Recovery Time, 2018E

€bn (banks ranked by total assets)	UCG	ISP	MPS	BP	UBI	BPER	BPM	BPSO	CREDEM	CREVAL	TOT
STEP 1 - Estimated Amount of NPLs affected by Law Change											
Total Gross Deteriorated Loans (A)	84.4	63.2	45.3	21.7	13.1	11.0	5.9	3.6	1.3	5.1	254.5
Consolidated Gross NPL (B)	52.1	38.2	24.3	10.5	6.6	6.5	3.1	1.6	0.8	2.5	146.3
Consolidated Gross NPL - Italy as % of Total (C)	76%	87%	100%	100%	100%	100%	100%	99%	100%	100%	88%
Consolidated Gross NPL - Italy (D = B * C)	39.6	33.3	24.3	10.5	6.6	6.5	3.1	1.6	0.8	2.5	128.8
Estimated % of Gross NPL Affected by Law Change (E)	37%	57%	56%	53%	58%	64%	75%	78%	55%	63%	45%
Estimated Gross NPL Affected by Law Change (F = E * D)	**14.6**	**19.0**	**13.7**	**5.6**	**3.8**	**4.2**	**2.3**	**1.2**	**0.4**	**1.6**	**66.4**
NPL Affected by Law Change as % of Total Gross Det. Loans (G = F / A)	**17%**	**30%**	**30%**	**26%**	**29%**	**38%**	**39%**	**34%**	**33%**	**31%**	**26%**
NPL Affected by Law Change as % of Gross NPLs	**28%**	**50%**	**56%**	**53%**	**58%**	**64%**	**75%**	**77%**	**55%**	**63%**	**45%**
STEP 2 - Estimated Value of RE Collaterals Securing NPLS Affected by Law Change											
Real Estate Collaterals Fully Securing Deteriorated Loans (H)	47.1	52.5	35.9	19.2	15.1	13.2	6.7	4.9	1.6	6.7	203.0
Real Estate Collaterals Partially Securing Deteriorated Loans (I)	2.5	0.7	0.4	0.9	0.0	0.4	0.3	0.0	0.1	0.0	5.2
Total Real Estate Collaterals Securing Deteriorated Loans (J = H+ I)	49.6	53.1	36.3	20.0	15.2	13.6	7.0	4.9	1.7	6.8	208.2
Real Estate Collaterals Allocated to NPLs Affected by Law Change (K = J * G)	8.6	16.0	11.0	5.2	4.4	5.1	2.7	1.7	0.5	2.1	57.3
NPL Write-downs (L)	32.4	24.0	15.9	4.5	2.6	3.7	1.7	1.0	0.5	1.4	87.6
NPL Coverage Ratio (M = L / B)	62%	63%	65%	43%	39%	57%	56%	61%	59%	56%	60%
Recovery Value of RE Collaterals Securing NPLs Affected by Law Changes (N = (K * (1-M))	**3.3**	**5.9**	**3.9**	**3.0**	**2.7**	**2.2**	**1.2**	**0.6**	**0.2**	**0.9**	**23.9**
STEP 3 - Estimated Δ+ Value of RE Collaterals Securing NPLs Affected by Law Change											
Estimated Discount Rate (O)	3.50%	3.40%	3.40%	2.90%	2.80%	3.60%	3.10%	3.40%	2.70%	3.50%	0.00%
Capit. Recovery Value of RE Collaterals Allocated to NPLs Affected by Law Change (P = (N *(1+O)^1))	**3.4**	**6.1**	**4.0**	**3.0**	**2.8**	**2.3**	**1.2**	**0.7**	**0.2**	**1.0**	**24.6**
Δ+ Value of RE Collaterals Securing NPLs Affected by Law Change - 1Y Shorter Foreclosure (Q = P - N)	0.12	0.20	0.13	0.09	0.08	0.08	0.04	0.02	0.01	0.03	0.78
STEP 4 - Estimated P&L Impact from Δ+ Value of RE Collaterals Securing NPLs Affected by Law Change											
Δ- Provisions from Δ+ Value of RE Collaterals Securing NPLs Affected by Law Change (R, R = Q)	**0.12**	**0.20**	**0.13**	**0.09**	**0.08**	**0.08**	**0.04**	**0.02**	**0.01**	**0.03**	**0.78**
Italy's Corporate Tax Rate (S)	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%
Estimated Post-Tax Impact (T = R * (1 - S))	0.08	0.14	0.09	0.06	0.05	0.06	0.03	0.02	0.01	0.02	0.52
Estimated Adj. Net Profit - 2018E (U)	5.7	4.8	0.83	0.61	0.61	0.47	0.39	0.23	0.23	0.13	14.0
Estimated EPS Impact - 2018E (V = T / U)	**+1%**	**+3%**	**+10%**	**+9%**	**+8%**	**+12%**	**+6%**	**+7%**	**+2%**	**+16%**	**+4%**

Source: Mediobanca Securities estimates

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Proportion of all recommendations relating to the last quarter			
Outperform	Neutral	Underperform	Not Rated
50.40%	38.01%	9.97%	1.62%

Proportion of issuers to which Mediobanca S.p.A. has supplied material investment banking services relating to the last quarter:			
Outperform	Neutral	Underperform	Not Rated
10.77%	9.26%	7.69%	25.00%

The current stock ratings system has been used since 1 July 2013. Before then, Mediobanca S.p.A. used a different system, based on the following ratings: outperform, neutral, underperform, under review, not rated. For additional details about the old ratings system, please access research reports dated before 1 July 2013 from the restricted part of the “MB Securities” section of the Mediobanca S.p.A. website at www.mediobanca.com.

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INITIAL COVERAGE

Banca Monte Paschi Siena initial coverage as of 12/02/2004.Banca Pop. Milano initial coverage as of 05/03/2003.Banca Popolare di Sondrio initial coverage as of 26/04/2015.Banco Popolare initial coverage as of 25/07/2007.BP Emilia Romagna initial coverage as of 06/06/2012.Credem initial coverage as of 21/03/2003.Creval initial coverage as of 18/12/2007.Intesa Sanpaolo initial coverage as of 16/04/2007.UBI Banca initial coverage as of 16/04/2007.Unicredit initial coverage as of 30/06/2003.

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