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Bad loan recovery rates in 2016

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1. Introduction and main conclusions

This note updates the bad loan recovery rates estimated in *Notes on Financial Stability and Supervision*, No. 7, and provides a comparative analysis of the characteristics of closed bad loan positions relative to stocks outstanding at the end of 2016.[1)] The data, along with some detailed breakdowns that are commented on but not reported in this text, are available in digital format.

Our analysis reached the following main conclusions.

In 2016 the overall amount of closed positions reached its highest level since 2006 (€17 billion, compared with €13 billion in 2015), mainly owing to the increase in sales on the secondary market. This value is still lower than that of newly classified bad loans, but the difference has more than halved over the last three years. The number of positions closed exceeded that of positions opened.

In 2016 the average recovery rate came to 34 per cent (35 per cent in 2015 and 34 per cent in 2014). The slight decline reflected the significant increase in the share of positions sold, whose recovery rates remain far below those obtained using standard recovery procedures. Nonetheless, the average recovery rate for positions sold on the market did increase (23 per cent compared with 20 per cent in 2015).

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1) F. Ciocchetta, F.M. Conti, R. De Luca, I. Guida, A. Rendina, G. Santini, 'Bad loan recovery rates', Banca d'Italia, *Notes on Financial Stability and Supervision*, No. 7, January 2017.

The speed of disposal of bad loans is still rising gradually. The share of positions closed within one year of being classified as a bad loan, which had fallen to a low of 20 per cent in 2012, rose to 38 per cent for the positions opened in 2015. As for the amounts involved, the ratio between the amount of bad loans closed each year and the stock outstanding at the start of the period, which had reached a low of 6 per cent in 2013, was consistently above 8 per cent in the last three years, reaching over 9 per cent in 2016.

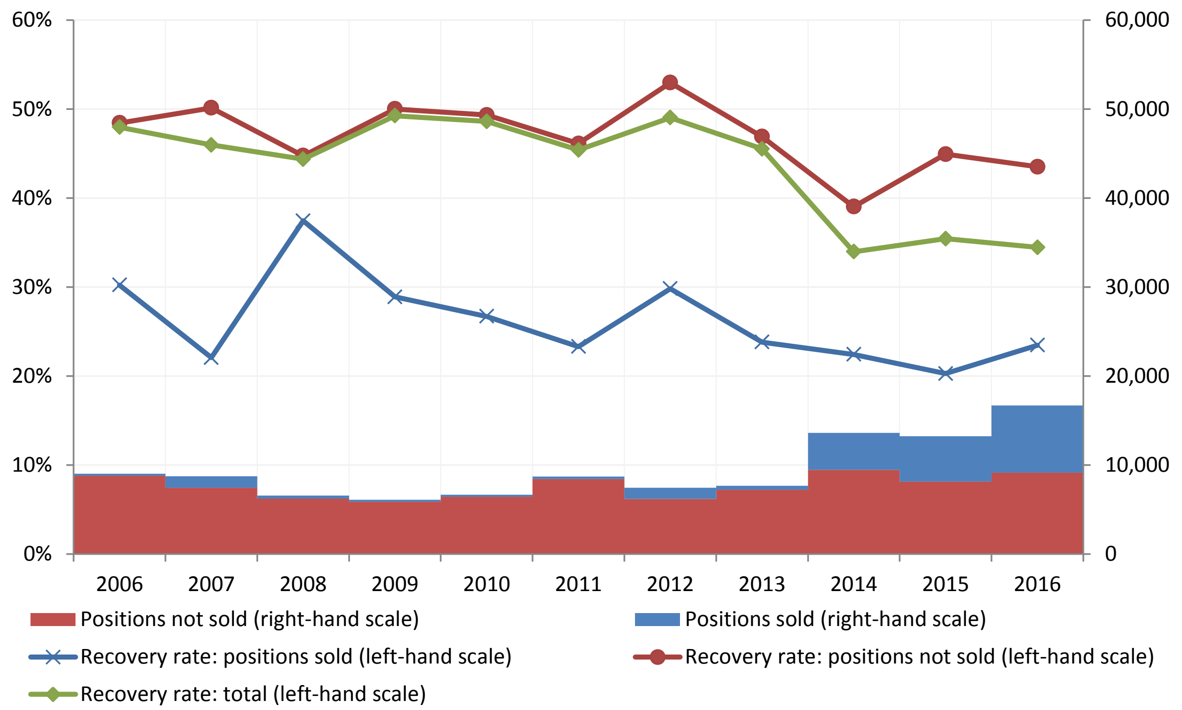
The recovery rates observed recently do not appear to overestimate potential recoveries in the next few years. In fact, the age of the positions closed during the period 2006-16, for which the recovery rates have been calculated, is much higher than the average vintage of the stock of positions outstanding at the end of 2016. These closed positions also show a smaller percentage of positions secured by collateral. Their composition by counterparty sector (households, firms) and geographical distribution (north, centre, south) appears very similar to that of the outstanding.

2. Bad loan recovery rates [2)]

In 2016 the recovery rate was 34 per cent

In 2016 the bad loan recovery rate was 34 per cent (Figure 1), virtually unchanged from the preceding two years and below the average for the period 2006-16.

Figure 1 – Bad loan recovery rate and value by year and type of closure
(per cent and amounts in millions)



Source: Based on Central Credit Register data.

2) The amounts of bad loans shown in the tables may not correspond to figures reported in other Bank of Italy publications, as explained in the Methodological Appendix to 'Bad loan recovery rates', Banca d'Italia, *Notes on Financial Stability and Supervision*, No. 7, January 2017.

In 2016 the overall amount of bad loans closed peaks for the period under consideration

In 2016 the overall amount of closed positions was at its highest since 2006 (€17 billion). The value of positions closed following standard recovery procedures exceeded the figure reported for 2015 by about €1 billion and was much higher than the period average (Table 1). The increase was more robust for loans sold on the market (€8 billion, equal to 45 per cent of the total, compared with an average of 20 per cent for 2006-16; Table A1 in the Digital Appendix), whose recovery rates continue to be lower than those for positions closed following standard procedures. If the share of positions sold on the market in 2016 had remained similar to that for 2015, the average recovery rate in 2016 would have been 36 per cent.

Table 1 – Recovery rate by type of closure: standard procedures or sales on the market
(number of positions, millions of euros and per cent)

Year	TOTAL			of which: positions that were not sold			of which: positions sold to third parties		
	Recovery rate (%)	Positions closed: Amount (€/mln)	Positions closed: Number	Recovery rate (%)	Positions closed: Amount (€/mln)	Positions closed: Number	Recovery rate (%)	Positions closed: Amount (€/mln)	Positions closed: Number
2006	48.0	9,039	198,588	48.4	8,803	183,345	30.2	236	15,243
2007	46.0	8,742	161,209	50.1	7,443	135,983	22.1	1,299	25,226
2008	44.4	6,580	123,615	44.8	6,225	110,509	37.4	355	13,106
2009	49.3	6,109	133,976	50.0	5,893	117,707	28.9	216	16,269
2010	48.6	6,667	128,168	49.3	6,454	108,591	26.7	213	19,577
2011	45.4	8,718	145,538	46.1	8,442	127,922	23.3	276	17,616
2012	49.0	7,472	128,653	53.0	6,207	102,510	29.8	1,266	26,143
2013	45.5	7,683	112,331	46.9	7,229	96,714	23.8	454	15,617
2014	34.0	13,613	287,685	39.0	9,463	241,056	22.4	4,150	46,629
2015	35.4	13,258	257,965	44.9	8,157	180,898	20.3	5,101	77,067
2016	34.5	16,712	278,584	43.5	9,155	99,925	23.5	7,557	178,659
Total		**104,593**	**1,956,312**		**83,471**	**1,505,160**		**21,123**	**451,152**
Average	**41.8**	**9,508**	**177,847**	**46.5**	**7,588**	**136,833**	**23.2**	**1,920**	**41,014**

Source: Based on Central Credit Register data.

The recovery rate for positions sold on the market is rising

Once again in 2016 the recovery rate for positions sold to third parties was considerably below the average rate for positions closed through standard procedures (23 per cent, compared with 43 per cent). However, it did increase by 3 percentage points compared with 2015, benefiting above all from the increase in recoveries of loans secured by collateral (from 30 per cent to 37 per cent).

The recovery rates rise for bad loans secured by collateral and fall for other positions

2.1 Positions secured by collateral vs other positions[3)] – The average recovery rate for bad loans secured by collateral rose by around 2 percentage points to 47 per cent. There was an improvement in the recovery of both positions closed following standard procedures and in those sold to third parties (Table A2). The recovery rate of unsecured positions instead declined, by almost 6 percentage points, to 23 per cent (Table A3).

The recovery rates for loans to firms are lower than those for loans to households, but the gap continues to narrow

2.2 Loans to firms and households. – In 2016 the recovery rates for bad loans to non-financial firms was 34 per cent, below the rates reported for those to households (38 per cent; Tables A4, A5 and A6). The narrowing of the gap, a trend already noted in 2014-15, continued, largely owing to a change in the composition of positions closed for the two counterparties.[4)]

2.3 Recovery rates by age of bad loans. – The updated results confirm that, on average, the longer bad loans remain on banks' balance sheets, the lower their recovery rate (Tables A7 and A8). This is due in part to the discounting of the amounts recovered.[5)]

3. Closed bad loans: recovery times, volume and characteristics

In 2016, for the first time since 2006, the number of closed positions exceeds that of open positions

In 2016 the number of closed positions rose further, to about 279,000, compared with an average of 178,000 in the period 2006-16 (Table 1), and exceeded that of open positions (273,000). As to the amounts involved, the positive differential between the value of newly classified bad loans and the bad loans closed has more than halved in the last three years, equalling €10 billion in 2016 (Table 2). Similar indications also emerge from variations in the share of bad loans closed in each year, calculated as the ratio of the value of the positions closed to total outstanding positions at the start of the period. This share, which declined gradually to 6 per cent in 2013, in the last three years has remained consistently above 8 per cent, reaching 9 per cent in 2016, despite the fact that in the period considered the stock of bad loans continued to grow.

3) Loans secured by collateral are those secured, in whole or in part, by the following classes of collateral reported in the Central Credit Register: pledges, mortgages and liens. Unsecured positions include those secured by personal guarantees and fully unsecured loans.

4) With respect to firms, this refers to the perceptible increase in the number of closed positions secured by collateral, whose share of the total was, on average for the last three years, similar to that recorded for loans to households, while in the previous period it had been about 8 percentage points lower.

5) The tables do not show the real recovery curves. The data in the Central Credit Register can be used to determine how much is recovered on average for positions closed after a certain number of years, but not the temporal distribution of the recoveries. Nonetheless, given that they are discounted, the recovery rates of the various age classes can still be compared.

Table 2 – Number and amount of closed and open bad loan positions
(annual data; number of positions, amounts in millions of euros; per cent)

Year	**Positions closed** (by year of closure)		**New positions** (by year of classification)		**Positions outstanding at the end of the previous year**		**Positions closed/positions outstanding at the end of the previous year**	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
2006	198,588	9,039	196,212	10,482	580,568	46,922	34.2%	19.3%
2007	161,209	8,742	202,515	8,649	578,192	48,365	27.9%	18.1%
2008	123,615	6,580	185,319	12,593	619,498	48,273	20.0%	13.6%
2009	133,976	6,109	240,441	21,668	681,202	54,285	19.7%	11.3%
2010	128,168	6,667	257,067	22,096	787,667	69,844	16.3%	9.5%
2011	145,538	8,718	228,639	24,531	916,566	85,273	15.9%	10.2%
2012	128,653	7,472	246,428	25,029	999,667	101,086	12.9%	7.4%
2013	112,331	7,683	229,739	31,831	1,117,442	118,642	10.1%	6.5%
2014	287,685	13,613	283,987	34,322	1,234,850	142,789	23.3%	9.5%
2015	257,965	13,258	307,554	31,146	1,231,152	163,499	21.0%	8.1%
2016	278,584	16,712	273,338	27,019	1,280,741	181,387	21.8%	9.2%
Total	**1,956,312**	**104,593**	**2,651,239**	**249,366**				
Average	**177,847**	**9,508**	**241,022**	**22,670**	**911,595**	**96,397**	**20.3%**	**11.2%**

Source: Based on Central Credit Register data.

The speed of reduction is improving

The speed of bad loan closure continued to increase, as it has since 2013. For example, the share of positions closed within one year from the classification as bad loans, which had fallen to a low of 20 per cent in 2012, rose to 38 per cent for the positions opened in 2015, the most recent year for which the closure rate at one year can be measured (Table 3). The improvement reflects the growth in sales on the market, attributable in part to banks having adopted more active bad loan management policies; though difficult to quantify, changes to the legislation on NPLs introduced from 2015 onwards have also had an effect.[6)]

6) See M. Marcucci, A. Pischedda and V. Profeta, The changes of the Italian insolvency and foreclosure regulation adopted in 2015, Banca d'Italia, *Notes on Financial Stability and Supervision*, No. 2, 2015, and E. Brodi, S. Giacomelli, I. Guida, M. Marcucci, A. Pischedda, V. Profeta and G. Santini, New measures for speeding up credit recovery: an initial analysis of Decree Law 59/2016, Banca d'Italia, *Notes on Financial Stability and Supervision*, No. 4, 2016. For a discussion of the reforms of the tax treatment of loan losses, see De Vincenzo and G. Ricotti, The use of tax law from a macroprudential perspective, Banca d'Italia, *Notes on Financial Stability and Supervision*, No. 1, 2014. For the changes introduced by Law 130/99, see Albamonte, Recent changes to Law 130/1999 on securitization of loans, Banca d'Italia, *Notes on Financial Stability and Supervision*, No. 10, 2016.

Table 3 – Share of positions closed within 1 - 6 years of being classified as a bad loan
(per cent)

Year of classification	within 1 year	within 2 years	within 3 years	within 4 years	within 5 years	within 6 years
2006	47	59	66	71	73	76
2007	41	53	58	65	66	69
2008	32	39	49	54	56	60
2009	30	41	50	56	65	72
2010	24	34	40	54	62	65
2011	24	39	48	56	60	
2012	20	34	43	47		
2013	21	38	42			
2014	26	32				
2015	38					

Source: Based on Central Credit Register data.

4. Is the composition of closed bad loans comparable to that of outstanding positions?

The analysis of recovery rates is based on the universe of bad loan exposures closed from 2006-16 (around 2 million of positions, for a total amount of about €105 billion). The number of outstanding positions at the end of 2016 exceeded 1 million, for a total value of €190 billion.

The composition of closed positions was compared to that of outstanding stock to assess whether they differ. Significant differences could indicate that the recovery rates discussed in this note are not representative. Four characteristics were taken into account: age, presence of collateral, sector (households or firms) and geographical distribution (north, centre and south).

Bad loans less than 2 years old represented, on average, 16 per cent of the exposures closed during 2006-16, while those aged over 5 years made up 57 per cent. The outstanding stock at the end of 2016 contains a higher ratio of newer positions: those less than 2 years old represent 43 per cent of the total, while those more than 5 years old amount to 33 per cent (Table A9).

The share of positions secured by collateral averaged 40 per cent of the overall closed positions, 9 percentage points lower than that of the stock outstanding at the end of 2016 (49 per cent; Table A10). The gradual increase in the share of secured positions suggests that, over the period, banks adopted more conservative lending policies.

The share of closed bad loan exposures to firms represented 76 per cent of all closed positions on average. These exposures made up 85 per cent of the stock outstanding at the end of 2016 (Table A11).

The geographical distribution of bad loans closed is virtually the same as that observed for bad loans outstanding at 2016. The share of bad loans closed that were made to residents of Northern Italy is equal to 47 per cent, 25 per cent in Central Italy and 27 per cent in Southern Italy. The shares of bad loans outstanding at year-end came to 52 per cent in the North, 24 per cent in the Centre and 22 per cent in the South (Table A12).

In conclusion, the age of bad loans closed is much greater relative to the stock of outstanding bad loans, fewer of them as a percentage are secured by collateral, a slightly higher percentage of them are loans to firms, but the geographical distribution is largely similar. Therefore, no factors support the assumption that the recovery rates for closed positions overestimate the recoveries that can be made in the next few years.