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Bad loan recovery rates in 2019

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1. Introduction and main conclusions

This note updates to 2019 the estimated bad loan recovery rates already published in the *Notes on Financial Stability and Supervision,* Nos. 7 and 11 of 2017, No. 13 of 2018 and No. 18 of 2019. Moreover, the note illustrates the findings of the yearly survey of NPL sales, conducted by the Bank of Italy starting from 2016. The data, together with some detailed breakdowns that are commented on but not reproduced in this text, are available in digital format.

The analysis reached the following main conclusions.

Reduction in the stock of bad loan positions

- **In 2019, €34 billion of bad loan positions were closed (i.e. derecognized from banks' financial statements).** The amount decreased compared to what was recorded in previous years (€78 billion in 2018, €43 billion in 2017), however the ratio of the value of bad loans closed to the stock outstanding at the end of the previous year was just below the average value recorded in the last two years (35 and 36 per cent respectively). Almost all the main transactions were finalized with recourse to GACS (a state guarantee scheme to securitize bad loans), for an amount of bad loans disposed equal to €13.1 billion.
- The reduction of closed bad loan positions affected both those sold on the market and those closed using standard recovery procedures; however, the amount of closed positions was three times higher than that of newly-classified bad loans (€12 billion). **The lower amount of closed positions reflects the contraction**

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Our thanks go to Paolo Angelini, who read the preliminary versions of this note and provided useful suggestions.

of bad loans outstanding on the banks' balance sheets (between 2016 and 2018, outstanding bad loans decreased from €192 billion to €98 billion), as well as the reduction in their average vintage and therefore in the amount of positions closer to being closed in accordance with the ordinary procedures.

- **The secondary market for non-performing loans other than bad loans (unlikely to pay) continued to grow**: the amount of loans sold on the market was €8.5 billion (€4.3 billion in 2018).
- **For 2020**, despite the outbreak of the pandemic holding back the market for a few months, **the overall amount of non-performing loans sold, estimated at around 30 billion, will be higher than the targets set at the beginning of the year**, benefiting from both extraordinary transactions such as the one realized by Monte dei Paschi di Siena, and the incentive introduced by the 'Cure Italy' decree, which makes it possible to convert part of the admissible DTAs into tax credits in case of sale of impaired loans.

Recovery rates of bad loans closed

- **Compared to 2018, decreases were recorded in the recovery rates of bad loan positions, both those sold on the market** (from 30 to 28 per cent) **and those closed using standard recovery procedures** (from 46 to 44 per cent). For both types of closure the reduction is attributable to a limited number of transactions of a significant amount and to some intermediaries, excluding which the recovery rates would be in line with 2018. The overall recovery rate decreased to 31 per cent (33 per cent in 2018); the gap in recoveries between disposals and ordinary procedures remains high, equal to approximately 16 percentage points.
- **The average recovery rate for bad loans secured by collateral was 35 per cent**, decreasing both for the positions sold (from 36 to 32 per cent) and for those closed using standard recovery procedures (from 52 to 48 per cent). **For the unsecured positions, the average recovery rate was 21 per cent**. In this case too, the reduction occurred both on bad loans sold to third parties (from 19 to 16 per cent) and, albeit to a lesser extent, on those closed using standard recovery procedures (from 36 to 35 per cent).

Disposal prices of non-performing loans

- **The price of the bad loans sold in 2019**, calculated on the basis of the annual survey conducted from 2016 on a very large sample of transactions, **was equal to 23 per cent of the gross book value at the time of the sale, essentially unchanged compared with 2018**, despite a slight reduction in the average vintage (from 5.5 to 4.6 years) of the positions disposed. The price averaged 31 per cent (34 per cent in 2018) for bad loans secured by collateral and 12 per cent for the others (10 per cent in 2018).
- **The disposal price of non-performing loans other than bad loans increased significantly in 2019** both for the positions secured by collateral (to 58 per cent, from 49 per cent of 2018) and for the unsecured positions (to 44 per cent, from 35 per cent of 2018).

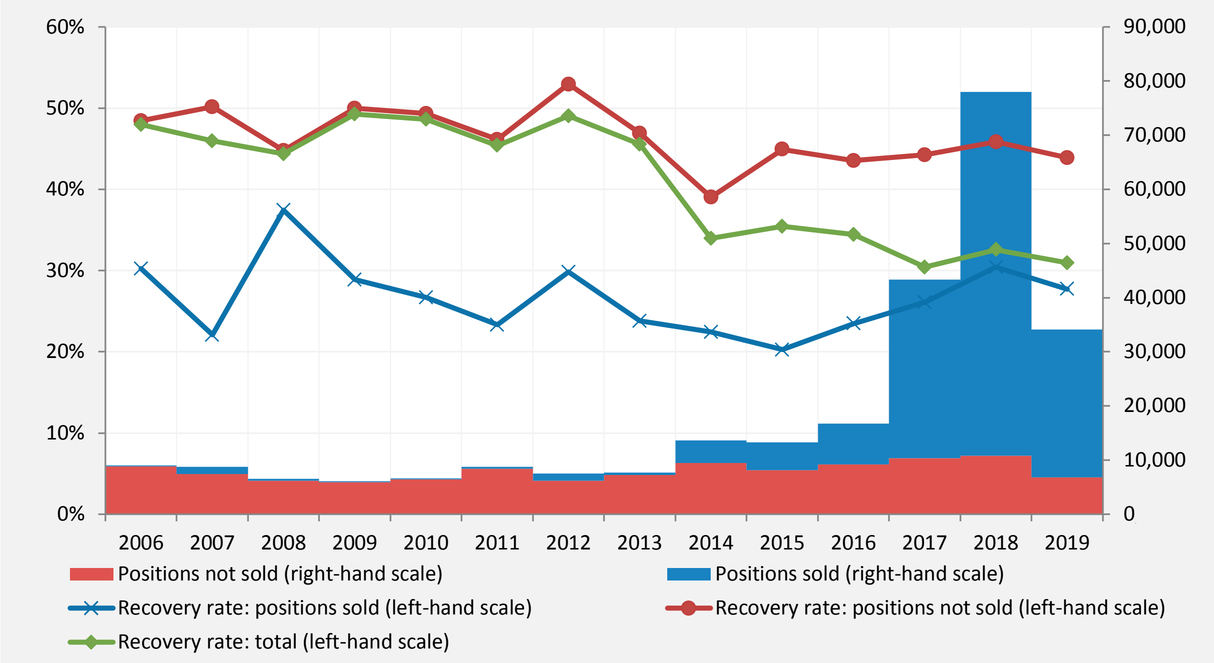
In 2019, the total amount of closed bad loans fell considerably mainly owing to sales on the market

2. Bad loan recovery rates[1]

In 2019, the total amount of closed bad loan positions decreased significantly compared with the previous year (from €78 billion to €34 billion). The decrease was recorded both for sales on the market (from €67 billion to €27 billion) and for positions closed using the standard recovery procedures (from €11 billion to €7 billion).[2]

The share of sold positions on total closed bad loans decreased slightly, but is still significant (from 86 to 80 per cent; Figure 1 and Table 1; Table A1 in the Digital Appendix).

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



Source: Based on Central Credit Register data.

As in previous years, recourse to securitisations through GACS (a state guarantee scheme to securitize bad loans) for larger transactions continued in 2019. In addition, there was a reduction in the average amount of closed bad loans (from €177,000 to €121,000), which mainly concerned bad loans sold on the market, in particular exposures towards firms and those backed by collateral; this trend reflects the decrease

[1] The yearly values of closed bad loans shown in the tables may not correspond to the 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.

[2] The amount of positions closed through ordinary procedures depends on various factors including the amount of the outstanding loans, their composition (i.e. a position with a higher average vintage is generally closer to being closed in accordance with the ordinary procedures), the quantity and quality of internal and external structures used by intermediaries for the management of positions, as well as incentive mechanisms for the recovery performance of these structures. The latter can be oriented towards a greater speed in closing positions (especially if there is high stock to be disposed of) or to maximizing recoveries, which sometimes takes longer and can therefore be more easily pursued when stocks settle at low levels.

in the value of the most significant transactions, which in the previous two years had contributed to considerably increasing the total amount of bad loans sold.

The reduction in the amount of closed bad loans affected all positions, regardless of the presence of collateral and of the economic sector of the debtor. Nonetheless, there has been a change in the percentage composition by type of closed position, with a higher share of positions secured by collateral:[3] their weight on the total reached 73 per cent in 2019, compared with 68 per cent in 2018 and 53 per cent in 2017 (Table A1).[4] With regard to the distinction between firms and households, in 2019 the share of closed bad loans to households increased (32 per cent and 17 per cent in 2018; Table A4), and it was almost entirely due to the bad loans sold on the market and secured by collateral, which accounted for 76 per cent of closed bad loans to households (Table A5 and Table A9).

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 of closure	TOTAL			of which: positions that were not sold			of which: positions sold to third parties		
	Recovery rate (%)	Positions closed		Recovery rate (%)	Positions closed		Recovery rate (%)	Positions closed	
		Amount (€/mln)	Number		Amount (€/mln)	Number		Amount (€/mln)	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
2017	30.4	43,360	370,741	44.3	10,349	110,205	26.1	33,011	260,536
2018	32.6	78,017	441,621	45.9	10,794	92,919	30.4	67,223	348,702
2019	31.0	34,123	281,630	43.9	6,849	62,203	27.7	27,275	219,427
Total		**260,093**	**3,050,304**		**111,463**	**1,770,487**		**148,631**	**1,279,817**
Average	**35.7**	**18,578**	**217,879**	**46.1**	**7,962**	**126,463**	**27.9**	**10,616**	**91,416**

Source: Based on Central Credit Register data.

3 Loans secured by collateral are secured – in full or in part – by the following forms of collateral recorded by the Central Credit Register: pledges, mortgages and liens. Other loans include those secured by personal guarantees or those without guarantees.

4 The increase compared with 2018 mainly concerned bad loans that were not sold (from 8 to 14 per cent), while the share of bad loans closed through sales on the market remained almost unchanged (at 59 per cent).

The recovery rate decreased both for the positions sold on the market and for those closed using standard recovery procedures

In 2019, the recovery rate for positions sold to third parties decreased by more than two percentage points compared with the previous year (from 30 to 28 per cent). The reduction, related both to the component secured by collateral (from 36 to 32 per cent) and to the unsecured component (from 19 to 16 per cent), is almost entirely explained by the sharp drop in the recovery rate recorded in the household segment (from 41 to 27 per cent; Table A9) and it was also affected by some large-amount disposals which recorded recovery rates much lower than the average. In particular, there is one disposal transaction of secured exposures to households, net of which the recovery rate would have been just below that observed in 2018.

On the basis of the aforementioned yearly survey on NPL sales conducted by the Bank of Italy on a representative sample of Italian banks, in 2019 the price, expressed as a percentage of the gross book value at the time of sale, remained unchanged compared with 2018, at 23 per cent (see the box 'The prices of bad loan sales in 2019'),[5] despite a reduction in the average vintage of the positions sold (from 5.5 to 4.6 years).

The recovery rate for positions closed using standard recovery procedures decreased from 46 to 44 per cent, especially in the component secured by collateral (from 52 to 48 per cent), and owing to the dynamics attributable to a limited number of intermediaries. The gap between the recovery rates recorded, respectively, on positions closed using standard procedures and positions sold, remained stable compared with the previous year, and equal to 16 percentage points.

As highlighted in previous analyses,[6] in 2019 recovery rates continued to differ significantly from bank to bank, consequently affecting the trend of the values observed at aggregate level. The observed heterogeneity also confirms that many intermediaries should strengthen their NPL management and recovery processes.

THE PRICES OF BAD LOAN SALES IN 2019

In order to collect information on the sale prices of bad loans, since 2016 the Bank of Italy has conducted an annual survey of a representative sample of banks. In the last survey, the participating banks together accounted for around 90 per cent of the gross book value of NPLs in the Italian banking system at the end of 2018.

In 2019 the average price of the bad loans sold was 23 per cent of the gross book value at the time of sale, largely unchanged from 2018, even though this was ascribable to a reduction in the price of bad loans secured by collateral (from 34 to 31 per cent) and an increase in the price of the unsecured positions (from 10 to 12 per cent; Table A).

The average vintage of bad loans sold was slightly less than 5 years (4.6 years), decreasing compared with 2018 (5.5 years), especially for the unsecured positions.

5 The recovery rate for positions sold on the market differ from sale prices, because recovery rates (which are higher) also take account of the cash flows ('partial' recoveries) collected in the period prior to the closure of the position. The information available in the Central Credit Register does not allow us to distinguish between the recoveries made during the life of the loan and the actual sale price. Overall, the indications arising from this survey are in line with the results obtained through the Central Credit Register data.

6 F. Ciocchetta, F.M. Conti et. al., 'Bad loan recovery rates', Banca d'Italia, *Notes on Financial Stability and Supervision*, No. 7, 2017.

Table A – The sale prices of bad loans by type of guarantee
(per cent)

	Total	Positions secured by collateral	Unsecured positions
2016	**14.9**	30.5	9.1
2017	**16.5** (*)	26.2 (*)	9.9 (*)
2018	**23.1**	33.8	10.0
2019	**23.3**	31.2	11.8

(*) Net of the FINO operation concluded by UniCredit, the average prices of positions secured by collateral and of unsecured positions were equal to 33 and 9 per cent of the gross book value, respectively; the overall average price was 20.4 per cent.

As in previous years, the sale price decreases as the average vintage of the positions rises: for loans with a vintage of more than 5 years, which in 2019 accounted for around 19 per cent of the total value of the positions closed, the price averaged 18 per cent, while it was 26 per cent for those with a vintage of between 3 and 5 years, which represented 68 per cent of the bad loans disposed (Table B).

The phenomenon of the price decreasing as the vintage of classification as a bad loan increases is more marked when positions secured by collateral and unsecured positions are observed separately. In particular, in the case of sales of bad loans backed by collateral, the price decreases constantly as the average vintage increases, while for unsecured bad loans the difference in prices by vintage is narrower.

Table B – Sale prices between 2017 and 2019 for secured and unsecured positions by vintage
(per cent)

	Total positions			Positions secured by collateral			Unsecured positions		
Vintage (years)	**0-2 years**	**3-5 years**	**>5 years**	**0-2 years**	**3-5 years**	**>5 years**	**0-2 years**	**3-5 years**	**>5 years**
2017	32.3	16.1	11.3	61.1(*)	24.8	21.9	17.6	9.8	6.8
2018	29.6	26.4	19.5	35.9	33.9	33.5	17.9	14.0	7.5
2019	17.0(**)	26.0	17.7	36.3	32.3	25.1	12.4	12.9	8.9

(*) The higher price recorded in 2017 for positions with a vintage of 0-2 years was due to the disposal of some prestigious immovable properties.
(**) For disposals with a vintage of less than 2 years, the price reduction is attributable to the different composition of the portfolios sold, with a greater weight of the exposures not backed by collateral.

Starting from 2017, a growth in transactions involving non-performing loans other than bad loans was observed. This category of loans presents a high level of heterogeneity; to deal with it, banks have envisaged strategies that are sometimes different from those defined for bad loans, including not only the sale, but also the signing of partnership agreements with external servicers or the involvement of specialized funds. Differently from the bad loan market, the sales of other impaired loans are concentrated in a smaller number of banks, also owing to their greater complexity and the fact that there is less experience on this type of transactions. In 2019, the amount of non-performing loans other than bad loans sold on the market was €8.5 billion (€4.3 billion in 2018) and the sale price was 53 per cent, up by nine percentage points compared with what achieved in 2018. Both the specificities of some large-amount transactions and the greater knowledge of the market by buyers and banks contributed to the price increase. The average vintage of these positions was 4 years, in line with that of previous years. The presence of collateral, compared to the bad loan disposals, had a more limited impact on the price, which was approximately 14 percentage points higher than that of unsecured exposures.

The recovery rates for bad loans secured by collateral remain significantly higher than those for the other positions

2.1 Positions secured by collateral versus other positions. – The average recovery rate for bad loans secured by collateral declined to 35 per cent (38 per cent in 2018; Table A3), owing to the joint effect of the recovery rate reduction both on the component sold on the market (32 per cent in 2019, from 36 per cent in 2018; Table A2) and on the positions closed using standard recovery procedures (48 per cent in 2019, from 52 per cent in 2018).

For the unsecured positions, the reduction of recovery rates (to 21 per cent) was instead slightly lower and equal to about one percentage point (Table A3), mainly owing to the reduction recorded for positions sold on the market (from 19 to 16 per cent; Table A2).

2.2 Loans to firms and households. – In 2019, the recovery rate of bad loans to non-financial firms increased slightly to 32 per cent (30 per cent in 2018), exclusively owing to the higher share of closures through ordinary procedures compared with sales on the market; in fact, recovery rates decreased slightly both on the positions sold on the market and on those subject to ordinary closure. On the other hand, the recovery rate of positions with households decreased significantly (from 43 to 30 per cent), affected by the significant decline that characterized recovery rates on positions sold on the market, largely attributable to a single transaction of significant amount.

The recovery rates for bad loans closed using standard recovery procedures decrease as the vintage increases

2.3 Recovery rate by vintage of bad loans. – In line with what has already been highlighted for the sale prices, the fact that the recovery rate decreases as the average vintage of classification as a bad loan rises holds true even for positions closed using standard recovery procedures (Table 2).[7] This phenomenon is more marked for positions secured by collateral.

The trend highlighted for 2018 is also confirmed for 2019. In particular, the average recovery rate of positions closed using standard recovery procedures, secured by collateral and with a vintage of classification as a bad loan of up to 2 years, was 22 percentage points higher than the recovery rate recorded for positions with a vintage of over 5 years (respectively 61 and 39 per cent). In the case of unsecured positions, the gap on recovery rates based on the vintage reached 18 percentage points (47 against 28 per cent).

In 2019, the share of positions closed using standard recovery procedures with a vintage of more than 5 years (secured by collateral or not) remained particularly high and equal to 47 per cent; the remaining share was fairly evenly distributed between the clusters with lower vintages (0-2 years and 3-5 years). A comparison between the different years analysed shows that the distribution of the value of positions closed by vintage and the respective recovery rates are relatively stable (Table 2).

[7] This phenomenon also reflects the impact of the discounting of the amounts recovered. In this regard, it can be observed that the tables do not represent real recovery curves as a function of the vintage of the position. The Central Credit Register, in fact, provides information about how much, on average, is recovered on positions closed after a certain number of years, but not the timeline of the recoveries. It is worth recalling that the recovery rates by vintage cluster are, in any event, comparable because they are all discounted.

Table 2 - Recovery rate for positions not sold by vintage of classification as a bad loan and by type of guarantee
(millions of euros and per cent)

Year of closure	Vintage[1]	Positions secured by collateral		Unsecured positions	
		Amount (€/mln)	Recovery rate (%)	Amount (€/mln)	Recovery rate (%)
2019	0-2 years	996	61.2	648	46.6
	3-5 years	1,506	52.6	512	33.3
	>5 years	2,174	38.8	1,014	28.4
	Total	**4,675**	**48.0**	**2,173**	**35.0**
2018	0-2 years	1,625	63.5	1,071	44.8
	3-5 years	1,963	57.9	974	40.4
	>5 years	2,844	42.4	2,317	30.3
	Total	**6,432**	**52.4**	**4,363**	**36.1**
2017	0-2 years	1,529	68.5	1,196	40.6
	3-5 years	1,546	59.3	1,108	31.7
	>5 years	2,760	44.2	2,210	25.4
	Total	**5,834**	**54.6**	**4,515**	**31.0**
2016	0-2 years	1,375	68.9	1,144	45.4
	3-5 years	1,271	54.5	1,044	34.6
	>5 years	2,193	43.5	2,127	24.0
	Total	**4,840**	**53.6**	**4,315**	**32.2**

Source: Based on Central Credit Register data.
(1) The distribution of the closed positions by vintage cluster is determined by rounding the values of the recovery time (time taken to close the position) to the nearest integer year, e.g. the '3-5 years' cluster includes all the positions whose recovery time was between 2.5 and 5.5 years.

3. Closed bad loan positions: amounts and times to recovery

In 2019, the reduction of positions newly classified as bad loans continued

In 2019, the number of positions closed[8] decreased significantly compared with 2018, to around 282,000, but remained well above the annual average of around 213,000 for the period 2006-2018 (Table 3). The amount of positions that were newly classified as bad loans was equal to about one third of those closed and the related value reached its minimum level since 2009 (€12 billion).[9]

With regard to the trend in the share of positions that are closed each year, calculated as the ratio of the value of positions closed to the total outstanding at the beginning of the period, this reached 35 per cent in 2019 (Table 3). The value is lower than that recorded in 2018 (50 per cent), but remains higher than the average for the two-year period 2016-2017 (16 per cent).

[8] The number of positions is calculated as the number of debtors at banking group level, which are no longer reported to the Central Credit Register after the closing of the position. Consequently, this number does not represent the number of credit lines open or closed during the period.

[9] It should be remembered that only reports from individual banks and from banking and financial institutions belonging to banking groups participating in the Central Credit Register are used in this note. Foreign bank subsidiaries, financial companies and banks specialized in leasing or in recovery activities are not included, together with those under resolution or in comparable situations.

Table 3 - Number and amount of closed and outstanding bad loan positions
(annual data; numbers, amounts in millions of euros and 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/ 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%
2017	370,741	43,360	254,228	23,495	1,275,495	191,694	29.1%	22.6%
2018	441,621	78,017	238,709	19,004	874,140 (1)	157,721 (1)	50.5%	49.5%
2019	281,630	34,123	177,628	12,459	630,490	98,052	44.7%	34.8%
Total	**3,050,304**	**260,093**	**3,321,804**	**304,324**				
Average	**217,879**	**18,578**	**237,272**	**21,737**	**914,834**	**107,702**	**24.8%**	**16.4%**

Source: Based on Central Credit Register data.
(1) 2018 data are partly impacted by the transfer of bad loans to publicly owned companies.

The length of time taken to dispose of bad loans continues to improve

The improvements observed since 2015 in the time taken to dispose of bad loans are continuing, mainly due to the increase of sales in the market. In particular, for the positions classified as bad loans in 2013, the number of positions closed within six years was equal to 86 per cent of the total, the highest value recorded in the survey period. The number of positions closed within two years (positions classified as bad loans in 2017) was 59 per cent, lower than the level recorded in the previous year, but in line with that of two years earlier (Table 4).

Table 4 - Share of positions closed within 1, 2 … 6 years of classification as a bad loan
(per cent; by number of positions)

Year of classification	within 1 year[1]	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	76
2012	20	34	43	47	66	79
2013	21	38	42	64	80	86
2014	26	32	65	79	84	
2015	38	58	74	77		
2016	38	67	72			
2017	47	59				
2018	34					

Source: Based on Central Credit Register data.
(1) The distribution of the positions closed within 1, 2 … 6 years of classification as a bad loan by vintage cluster is calculated by converting the recovery time needed to close the position into the nearest integer year (e.g. the cluster 'within 1 year' includes all the positions that have been closed within 1.5 years of classification as a bad loan; the cluster 'within 2 years' includes all the positions that have been closed within 2.5 years of classification as a bad loan).