

# How to liquidate NPLs in a “gloomy” economy

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## 1. The Securitization Market Crisis

Until July 2008 securitization was the most efficient means to liquidate an NPL portfolio. The deep financial crisis, which since September 2008 affected the global financial markets, has seen interest decline in the securitization market as well.

Nowadays, those managing NPLs are looking for different exits. An option which has been proved successful is the proposal of a so-called insolvent composition provided by Italian insolvency laws. This alternative exit implies that the claim is owned against an insolvency procedure and that the creditor is willing to purchase all the assets of this insolvency procedure and to manage their liquidation. If the deal is properly planned in advance a creditor will obtain the payment of its claim and it may obtain a further benefit resulting from the difference between the expected higher value of the liquidation of the assets (as planned by the creditor) and the lower price offered to the procedure in order to purchase all these assets.

## 2. The insolvent composition with creditors

NPL portfolios may include claims secured by mortgages. These claims and the relevant insolvency procedures date back a long period. In addition to the cash not allocated yet, the insolvency procedure might have illiquid assets such as real estate assets (securing the relevant NPL), claims (including tax claims of relevant amount) or proceedings (including those of a relevant value against top-tier subjects as the defendant banks in claw-back actions).

The insolvent composition is a procedure whereby a creditor (or a third party) proposes to creditors of an insolvency procedure (bankruptcy procedure or extraordinary administration) the purchase of the assets of the same insolvency procedure for a consideration -generally cash- to be distributed to creditors according to the ranking of their claims.

The owner of an NPL who wants to liquidate its claim by means of an insolvent composition with creditors needs to assess the -illiquid- assets owned by the insolvency procedure in order to identify their possible liquidation value which, deducted of the expected profit and of the NPL's value, constitutes the amount to offer to the creditors of the procedure.

Therefore it is crucial to assess the liquidation value -and ultimately the liquidation process- of the main illiquid assets belonging to the insolvent procedure. If the claim is secured by mortgage on an asset which has not been sold yet, the owner of the relevant NPL will have to identify a liquidation process for such asset (for instance, identify a potential purchaser). If one of the illiquid assets of the insolvency procedure is a tax claim, the potential purchaser may decide either to hold such claims until paid out or to assign it to someone who is interested in purchasing it.

After the above due diligence, the owner of an NPL may file an insolvent composition proposal. Even if the insolvent composition proposal has to be secured (generally, by means of a first demand bank guarantee), the proponent does not have to pay until the proposal is definitively approved (i.e. not subject to appeal) by

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For any further clarifications or research please contact:

#### Rome

Antonio Auricchio  
Tel. +39 06 478751  
aauricchio@gop.it

Gabriella Covino  
Tel. +39 06 478751  
gcovino@gop.it

Silvio Tersilla  
Tel. +39 06 478751  
stersilla@gop.it

Saverio Schiavone  
Tel. +39 06 478751  
sschiavone@gop.it

#### Milan

Alessandro Giuliani  
Tel. +39 02 763741  
agiuliani@gop.it

Matteo Bragantini  
Tel. +39 02 763741  
mbragantini@gop.it

Giovanni Marsili  
Tel. +39 02 763741  
gmarsili@gop.it

#### Turin

Alessandra Gioveti  
Tel. +39 011 5660277  
agioveti@gop.it

Rome

Milan

Bologna

Padua

Turin

London

Brussels

New York

www.gop.it

the creditors and by the Court. Furthermore, the value of the guarantee is to be considered net of the cash available of the procedure. There might be cases where the value of the bank guarantee can be further deducted.

The real counterparty of the insolvent composition proposal is the trustee (or the commissioner in the extraordinary administration) or the creditor's committee (or the surveillance committee in the extraordinary administration). In the bankruptcy procedure, the creditors' committee has a veto right on the insolvent composition proposal. In the extraordinary administration, the insolvent composition proposal is authorized by the Ministry of Industry and Trade, upon advice of the extraordinary commissioner and of the surveillance committee. Regardless of the veto right, it is common practice for the above authorities to generally decide unanimously on the admission of the insolvent composition proposal.

### 3. Some procedural issues

In case of a bankruptcy procedure, if the proposal is admitted to the vote of creditors, their consent can be expressed or implied (the principle of 'silence is consent' applies). The insolvent composition is approved with the positive vote of the majority of the value of the unsecured claims. Furthermore, if the insolvent composition proposal provides for classes of creditors, the proposal is approved if such majority is reached in the major number of classes. In such case, if a creditor in a dissenting class challenges the convenience of the proposal then the Court may apply the "cram down" mechanism and it can issue a decree approving the insolvent composition if it deems that the claim is satisfied by the insolvent composition in a measure not lower with respect to other possible options. In case of extraordinary administration creditors do not vote whilst they are entitled to challenge the proposal.

In case of a bankruptcy procedure only the creditor who has voted against the proposal for insolvent composition (or in case of extraordinary administration, the creditor who has challenged the proposal) can challenge it before the Court. The Court can disregard the challenge and approve the proposal. Such approval can then be further challenged before the Court of Appeal by the creditor having failed its original challenge. If all creditors have voted in favour of the proposal, the Court finally approves the composition.

### 4. Conclusions

In light of the gloomy securitisation market, the transfer of the claim on a single claim basis or in block is the typical way to liquidate an NPL portfolio. However, in certain circumstances, even if more labour intensive, the proposal of an insolvent composition may represent a faster liquidation and a further source of income since a creditor can obtain the extra value resulting from the difference between the expected liquidation value and the amount paid to creditors.

In any event a careful due diligence is advisable since the value of an NPL depends not only on its security but also on the possible outcome of the insolvent composition.