2Worlds S.r.l.

Non-Performing Loans (NPL)

Ratings

Tranche	Rating	Size (EUR m)	Thickness (%)	CE as % of GBV[1]	Coupon	Final maturity
Class A	BBB_{SF}	288.5	88.0	71.2	6m-Euribor + 0.4%	Jan 2037
Class B	B_{SF}	30.2	9.2	68.2	6m-Euribor + 8.0%	Jan 2037
Class J	NR	9.0	2.7	67.3	Variable	Jan 2037

Scope's Structured Finance Ratings constitute an opinion about the relative credit risks and reflect the expected loss associated with the payments contractually promised by an instrument on a particular payment date or by its legal maturity. See Scope's website for the SF Rating Definitions.

[1] Gross book value (GBV) of the securitised portfolio at closing (EUR 1,002m)

Transaction details

Purpose	Risk transfer
Issuer	2Worlds S.r.l.
Originators	Banco di Desio e della Brianza S.p.A. (BDB) and Banca Popolare di Spoleto S.p.A. (BPS)
Special servicer	Cerved Credit Management S.p.A.
Portfolio cut-off date	31 December 2017
Issuance date	25 June 2018
Payment frequency	Semi-annual (January and July)
Lead arranger	Banca IMI S.p.A.

The transaction is a static cash securitisation of an Italian NPL portfolio worth around EUR 1,002m by gross book value. Based on Scope's adjusted pool balance, as further explained below under the Quantitative analysis and key assumptions, the pool comprise both secured (53.2%) and unsecured (46.8%) loans. The loans were extended to companies (73.6%) and individuals (26.4%) and were originated by Banco di Desio e della Brianza S.p.A. and Banca Popolare di Spoleto S.p.A. Secured loans are backed by residential (44.4% of indexed property valuations) and non-residential (55.6%) properties that are highly concentrated in Milan (11%) and Rome (9.2%) and the non-metropolitan areas of the centre (41.5%) and the north (29.7%) of Italy. The issuer acquired the portfolio at the transfer date, 12 June 2018, but is entitled to all portfolio collections received since 31 December 2017 (portfolio cut-off date).

The structure comprises three classes of notes with fully sequential principal amortisation: senior class A, mezzanine class B, and junior class J. The class B interest ranks senior to class A principal at closing but will be subordinated if actual collections are around 15% below the business plan prepared by the servicer. Class J principal and interest are subordinated to the repayment of the senior and mezzanine notes

Rating rationale (summary)

The ratings are mainly driven by recovery amounts and timing from the NPL portfolio, which was acquired by the issuer at a 67.3% discount to the portfolio's gross book value. Recovery and timing assumptions applied in the analysis incorporate Scope's economic outlook for Italy and positive view of the special servicer's capabilities. The ratings are supported by the structural protection provided to the notes, the absence of equity leakage provisions, liquidity protection, and an interest rate hedging agreement.

The ratings also address exposures to the key transaction counterparties: Cerved Credit Management S.p.A. (CCM) as special servicer; Cerved Master Services S.p.A. (CMS) as master servicer; Securitisation Services S.p.A. (Securitisation Services) as back-up servicer, representative of noteholders, and calculation agent; Zenith Service S.p.A. (Zenith Service) as monitoring agent; BNP Paribas Securities Services, Milan Branch (BNP Paribas Securities Services) as account bank, cash manager, and principal paying agent; and Banca IMI S.p.A. (Banca IMI) as interest rate cap provider. In order to assess counterparty risks Scope has taken into account its public rating on BNP Paribas (AA-

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Related Research

General Structured Finance Rating Methodology, August 2017

Methodology for Counterparty Risk in Structured Finance, August 2017

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/S1) the parent company of BNP Paris Securities Services and publicly available ratings on Banca IMI.

Scope applied a specific analysis to recoveries and has differentiated between secured and unsecured exposures. For secured exposures, collections were based mostly on the latest property appraisal values which were stressed to account for liquidity and market value risks; recovery timing assumptions were derived using line-by-line asset information detailing the type of legal proceeding, the court issuing the proceeding, and the stage of the proceeding at the cut-off date. For unsecured exposures, Scope used historical line-by-line market-wide recovery data on defaulted loans between 2000 and 2017 and calibrated recoveries, taking into account that unsecured borrowers were classified as defaulted for an average of 3.2 years as of closing.

Rating drivers and mitigants

Positive rating drivers

Above-average collateralisation. The class A represents only 65.1% of the total assets security value (loan-to-value). This level is at the lower end of loan-to-values in recent peer transactions (65-85%) and remains relatively low after the market-value decline and fire sales discount stresses.

Location. The portfolio is concentrated in the metropolitan areas of Milan, Rome and other northern and central Italian regions. These regions benefit from the most dynamic economic conditions in the country and, in general, the most efficient tribunals.

Liquidity protection. A cash reserve representing 4.05% of the total outstanding balance of class A and class B notes, protects the liquidity of senior noteholders, covering senior expenses and interest on class A notes for about four payment dates as of closing.

High share of foreclosures. Around 67.4% of the portfolio's first-lien secured gross book value corresponds to borrowers under a foreclosure. Compared with bankruptcies, foreclosures typically result in higher recoveries and are more quickly resolved.

Real estate recovery. Scope expects a gradual recovery of Italian real estate prices, notwithstanding weak medium-term economic growth potential. The cyclical recovery from the current trough will be driven by moderate private-sector indebtedness and improving property affordability.

Negative rating drivers and mitigants

Seasoned unsecured portfolio. The weighted average time since default is approximately 3.2 years for the unsecured portion. Most unsecured recoveries are realised in the first years after a default according to historical data.

Collateral liquidity risk. Scope's assumptions on fire sales constitute the primary source of portfolio performance stresses.

Collateral appraisal values. NPL collateral appraisals are more uncertain than standard appraisals because repossessed assets are more likely to deteriorate in value.

Pool audit. The findings of the pool audit showed a level of errors which is higher than what is normally seen in peer transactions. This is partially mitigated by (i) the fact that the special servicer has committed to undertake a check of all loans against the reps and warranties and report then any discrepancies within 24 months after issuance and (ii) the sellers have increased the limit for indemnifications for loans that breach reps and warranties.

Upside rating-change drivers

Legal costs. Scope has factored in the legal expenses for collections as detailed in the servicer's business plan. A decrease in legal expenses could positively affect the ratings.

Servicer outperformance regarding recovery timing. Consistent servicer outperformance in terms of recovery timing could positively impact the ratings. Portfolio collections will be completed over a weighted average period of 4.0 years (3.6 years when considering collections already received), according to the servicer's business plan. This is about 22 months faster than the recovery timing vector applied by Scope in its analysis (Scope expects recent legal reforms to have a positive impact on court performance and has applied a limited stress on recovery timing assumptions).

Downside rating-change drivers

Fragile economic growth. The trajectory of Italy's public debt is of concern given its weak medium-term growth potential of 0.75% alongside the new government's plans to reverse reforms, raise spending and cut taxes.

Interest rate cap. An interest rate cap, with an increasing strike schedule which ranges from 0.3% as of closing to 1.25% from January 2025, partly mitigates the risk of increased liabilities on the notes in the event of a rise in Euribor. Delayed recoveries beyond Scope's stressed recovery timing vector would increase the mismatch between the swap notional and the outstanding principal of the rated notes.

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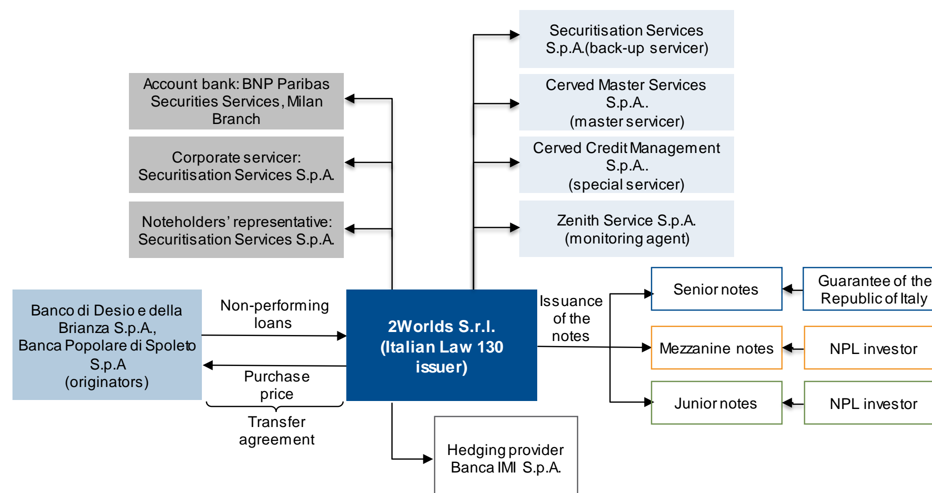
1. Transaction summary

The transaction structure comprises three tranches of sequential principal-amortising notes, an amortising liquidity reserve equal to 4.05% of the outstanding class A and class B notes, and an interest rate cap agreement.

Figure 1: Transaction diagram:



Sources: Transaction documents and Scope Ratings.

Figure 2 shows the main characteristics of the preliminary portfolio analysed by Scope as of the 31 December 2017 cut-off date.

Scope has adjusted the pool's gross book value based on information regarding closed positions, collections and sold properties. Specifically, the analysis has excluded portfolio loans that the agency has assumed to be closed; based on collections already received and cash in court to be received. Collateral connected with these positions has also been removed. Overall, Scope's adjustments have reduced the pool to EUR 968m in GBV by deducting the cash already collected and cash in court (where the latter is assumed to be received with a one-year delay). All stratifications below include these adjustments.

Figure 2: Key portfolio stratifications

Data summary as of pool cut-off date 31 December 2017

		Scope-adjusted pool		
	Unadjusted pool	All	Secured	Unsecured
Number of loans	13,572	13,234	4,471	8,763
Number of borrowers	4,006	3,956		
Gross book value (EUR m)	1,002	968	514	454
% of gross book value	100%	100%	53.1%	46.9%
Weighted average seasoning (years)		2.7	2.3	3.2
Sum of collateral appraisal values (EUR m)			791	
Borrower type				
Corporate	72.9%	73.6%	65.2%	83.3%
Individual	27.1%	26.4%	34.8%	16.7%
Primary legal procedure				
Bankrupt borrower		70.7%	21.5%	37.9%
Non-bankrupt borrower		29.3%	67.4%	47.0%
Not started or unknown		0.0%	11.1%	15.1%
Stage of procedure (secured loans)				
Initial			69.5%	
Court-appointed valuation (CTU)			7.1%	
Auction			21.4%	
Distribution			2.0%	
Collateral location (% of appraisal values)				
North	44.5%		43.5%	
Centre	53.9%		51.3%	
South and islands	1.6%		5.2%	
Borrower concentration (% of GBV)				
Top 10	5.8%	3.6%		
Top 100	23.3%	18.1%		
Property type (% of GBV)				
Residential	41.1%		44.4%	
Non-residential	58.9%		55.6%	

Sources: Data tape from BDB and BDS; calculations and/or assumptions by Scope Ratings

2. Economic environment

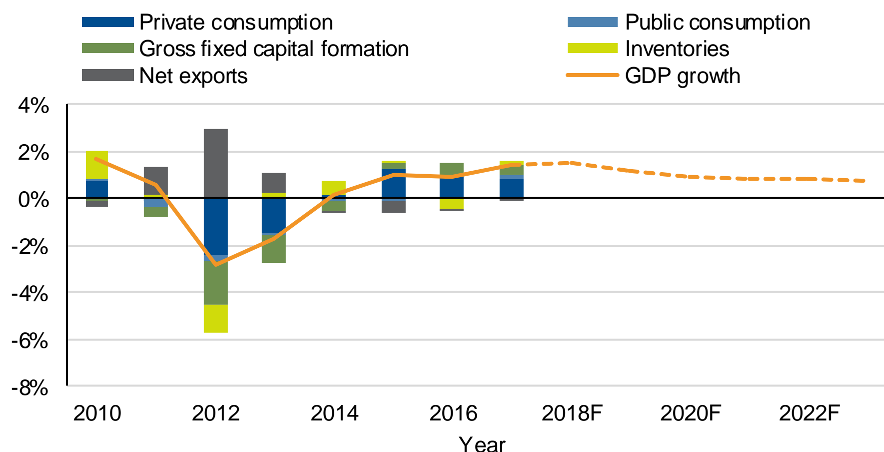
Gradual property price recovery despite economic challenges

The portfolio recovery amount and timing assumptions reflect Scope's expectation of a gradual recovery of Italian real estate prices and progress in delivering structural reforms, notwithstanding the weak medium-term economic growth potential. The cyclical recovery from the current trough is driven by moderate private-sector indebtedness and improving property affordability.

Large and diversified economy

Scope's sovereign rating on Italy (A-/Negative) is underpinned by a large and diversified economy and a cyclical rebound against the backdrop of long-term economic challenges. The Negative Outlook reflects Scope's concerns over Italy's public-debt trajectory given the weak medium-term growth potential of 0.75% alongside the new government's plans to reverse reforms, raise spending and cut taxes.

Figure 3: Percentage-point contribution to real GDP growth



Sources: IMF; national statistical accounts; calculations by Scope Ratings

Moderate private-debt levels

The IMF, in its April 2018 World Economic Outlook (WEO), revised Italy's 2018 growth forecast to 1.5% from 1.1% and raised its 2019 expectations to 1.1% from 0.9%. Italy's manufacturing sector – the second largest in the euro area after Germany's – has helped to generate current-account surpluses since 2013 (2.8% of GDP in 2017). Unlike many advanced economies, Italy did not experience a credit-driven boom-bust cycle before the 2008 crisis. Domestic non-financial private debt stands at a comparatively moderate 156% of GDP as of Q3 2017, comparing favourably against euro area peers.

Weak long-term growth prospects

While the cyclical rebound exceeded expectations, long-term growth prospects remain weak. The IMF's medium-term forecast[1] remained at 0.8% in the April 2018 WEO. Italy's production capacity fell in the aftermath of the global financial crisis. As of February 2018, industrial production volumes stood at 81% of early 2008 levels. This comes in contrast to the full recovery in Germany's industrial production post-crisis.

The drop in industrial production capacity is a reflection of the vulnerabilities within Italy's production infrastructure. More than 90% of manufacturing output is generated by micro-firms concentrated in industrial districts. While these firms are competitive in their global niche markets (luxury clothing, household goods, food processing, mechanical products, and motor vehicles), they remain susceptible to market shocks. Their financing capacities are limited and were hit hard during the euro crisis.

Unemployment continues to gradually drift downward from its 2014 peak (13% in November) and was 10.9% as of February 2018. Wage growth has picked up 1.0% YoY as of March 2018. However, inflation remains tepid at only 0.5% YoY in April 2018.

Political and banking system challenges

At the same time, political uncertainties following the March 2018 general elections, as well as ongoing challenges in the banking sector, may weigh on the economic rebound. Italian banks' lending to residents rose 1.9% YoY in February 2018, a modest growth after the previous years of contraction.

3. Portfolio analysis

Scope's assumptions reflect significant recovery timing stresses

Figure 4 compares Scope's lifetime gross collections and recovery timing assumptions for the entire portfolio against those of the special servicer's statistical business plan. Scope has applied rating-conditional recovery rates (i.e. lower recoveries as the instrument's target rating increases). These assumptions result from the blending of

[1] Referring to the IMF's April 2018 WEO's forecast for 2023 growth.

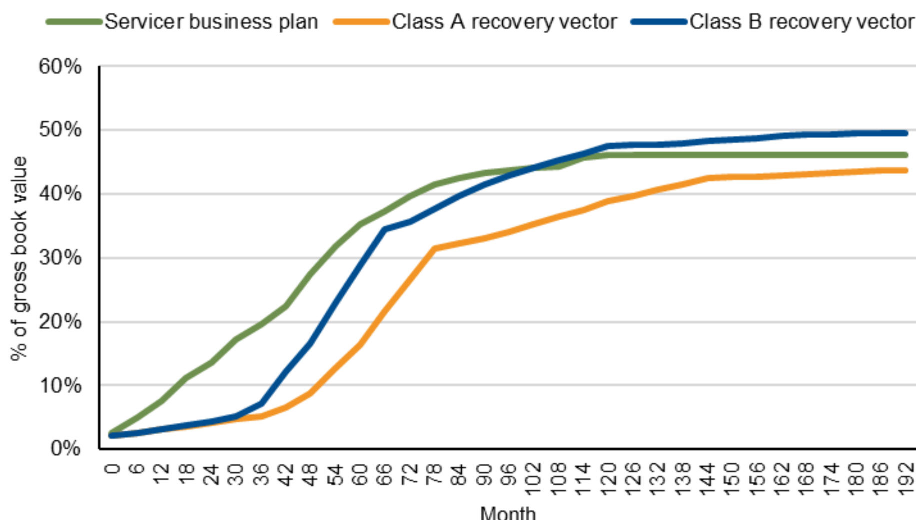
secured and unsecured recovery expectations. Scope has applied a specific analytical framework to project recoveries and differentiated between secured and unsecured segments. The set of assumptions applicable to both classes of notes reflect a significant stress on cash-flow timing, particularly over the first five to six years of the transaction.

Rating-conditional recovery assumptions

For the analysis of the class A notes, Scope has assumed a blended gross recovery rate of 41.4% over a weighted average life of 6.4 years. By portfolio segment, Scope has assumed gross recovery rates of 65.5% and 14.0% for the secured and unsecured portfolios, respectively.

For the analysis of the class B notes, Scope has assumed a blended gross recovery rate of 48.4% over a weighted average life of 5.5 years. By portfolio segment, Scope has assumed gross recovery rates of 73.5% and 16.7% for the secured and unsecured portfolios, respectively.

Figure 4: Business plan expected recoveries vs Scope's rating-conditional vectors



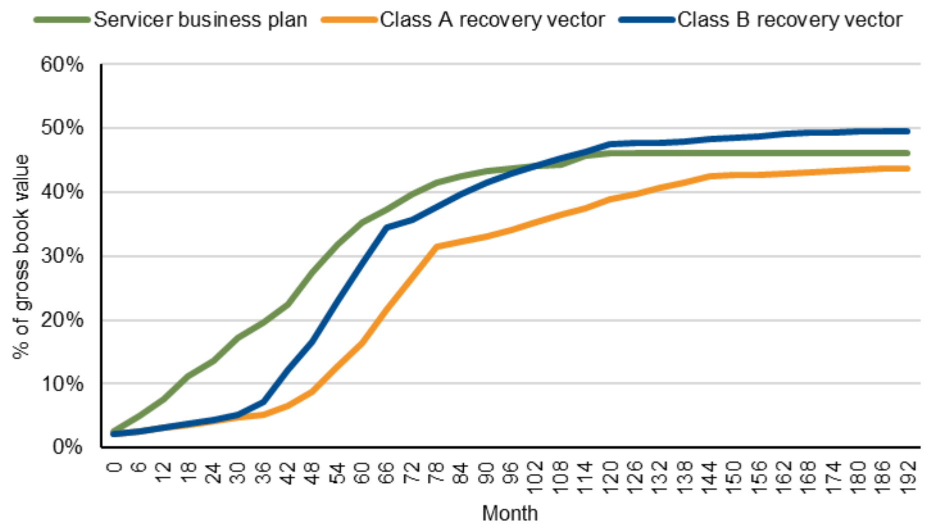
Sources: Special servicer's business plan and Scope Ratings

3.1. Analysis of secured portfolio segment

Valuation haircuts mainly address forward-looking market value and liquidity risks

Figure 5 shows Scope's rating-conditional lifetime gross-collections vector for the secured portfolio segment. Scope's analytical approach consists mainly of estimating the security's current value based on property appraisals and then applying security-value haircuts to capture forward-looking market value and liquidity risks. Recovery timing assumptions are based mainly on the efficiency of the assigned court (using historical data on the length of proceedings), the type of legal proceeding, and the stage of the proceeding. Scope's analysis also captures borrower concentration risk, the servicer's business plan, and available workout options.

Figure 5: Scope's rating-conditional secured recovery rate vectors



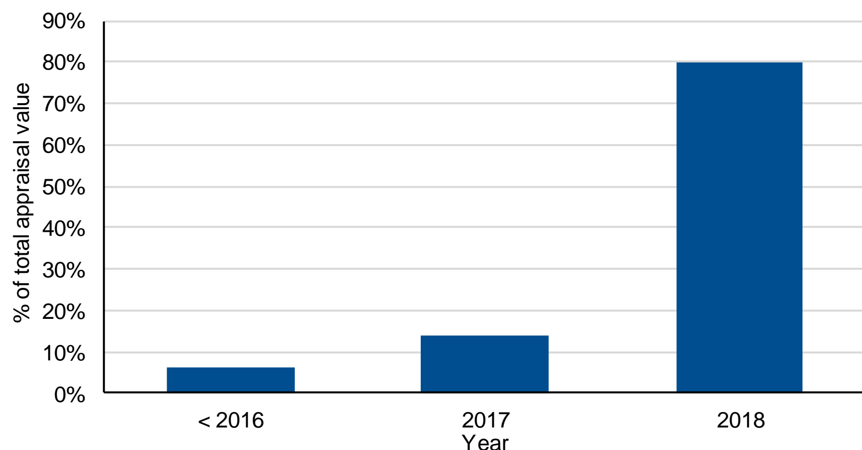
Source: Scope Ratings

3.2. Property appraisal analysis

Positive credit given to the date and quality of property appraisals

Scope has relied on line-by-line property market value appraisals conducted by authorised and qualified third parties. Most of the valuations are very recent, i.e. conducted in 2018. Scope has indexed seasoned valuations using a variety of price indices. The indexation has a marginal impact on this NPL portfolio because property prices in Italy have remained fairly flat since 2015.

Figure 6: Valuation dates



Sources: Data tape from BDB and BPS; calculations and/or assumptions by Scope Ratings

Scope views positively that most of the portfolio's collateral appraisals are either a drive-by or full valuation (79.6%). A smaller portion is composed of desktop (12.0%) and CTU (8.4%) valuations, to which Scope applied 5% and 10% haircuts respectively, reflecting the agency's view of their lower levels of quality and accuracy due to the simplified procedures.

Figure 6: Portfolio appraisal types and Scope assumptions

Valuation type	% of collateral value	Class A haircut (BBB stress)	Class B haircut (B stress)
Drive-by	79.0	0.0%	0.0%
Desktop	12.0	5.0%	4.0%
CTU	8.4	10.0%	8.0%
Full	0.6	0.0%	0.0%

Sources: Data tape from BDB and BPS; calculations and/or assumptions by Scope Ratings

4. Property market value assumptions

Moderate risk of market downturn

Figure 7 details Scope's assumptions by rated tranche on stressed average property prices over the transaction's lifetime. These assumptions are transaction- and region-specific and based on an analysis of historical property price volatility and on fundamental metrics relating to property affordability, property profitability, private-sector indebtedness, the credit cycle, population dynamics and long-term macroeconomic performance.

Figure 7: Portfolio collateral location and Scope assumptions

	North						Centre			South		Islands	
Region	Milan	Turin	Genoa	Bologna	Venice	Others	Rome	Florence	Others	Naples	Others	Metropolitan cities	Rest of provinces
Class A	4.6	4.6	5.4	4.6	8.0	6.7	8.9	6.7	6.7	8.9	11.0	9.7	11.0
Class B	-7.0	-7.0	-7.0	-7.0	-7.0	-7.0	-7.0	-7.0	-7.0	-7.0	-7.0	-7.0	-7.0
Portfolio distribution (%)	11.0	1.7	0.6	0.4	0.1	29.7	9.2	0.6	41.5	0.1	4.2	0.1	0.8

4.1. Collateral liquidity risk

High NPL collateral liquidity and obsolescence risk

At times of severe economic stress during which NPLs typically accumulate, tight financing conditions and/or restricted access to capital markets drive liquidity risk. During recovery and expansionary phases of the cycle, liquidity risk may persist, mainly due to information asymmetries and collateral obsolescence risk, the latter primarily affecting industrial properties.

Asset illiquidity risk is captured by Scope's fire-sale discount assumptions specific to the respective classes of the notes, as detailed in Figure 8 below. These assumptions are based on historical distressed property sales data provided by the special servicer and reflect Scope's view that non-residential properties tend to be less liquid, resulting in higher distressed-sale discounts.

Figure 8: Fire-sale discount assumptions

Collateral type	% of collateral value	Class A haircut (BBB stress)	Class B haircut (BB- stress)
Residential	44.4	25.0%	20.0%
Non-residential	55.6	30.0%	24.0%

4.2. Concentration haircuts

Scope has addressed borrower concentration risk by applying a 10.0% recovery haircut on the 10 largest borrowers for the analysis of the class A notes.

4.3. Residual claims after security enforcement

Scope addresses potential residual claims after security enforcement

A secured creditor may initiate enforcement actions against a debtor despite the closure of an enforcement action concerning the mortgaged property. Secured creditors generally rank equally with unsecured creditors for amounts that have not been satisfied with the security's enforcement. The creditor's right to recover its claim, whether secured or unsecured, arises with an enforceable title (i.e. a judgment such as an agreement signed before a public notary).

No credit given to residual claims from corporate borrowers

For corporate loans, however, Scope has given no credit to potential further recoveries on residual claims after the security is enforced. This is due to three practical limitations: Firstly, unsecured recoveries tend to be binary with a high probability of zero recoveries and low probability of 100% recoveries. This implies that under a scenario in which secured creditors are not fully satisfied after the security's enforcement, expected recoveries for unsecured creditors will be close to zero[2].

Secondly, special servicers are generally less incentivised to pursue alternative enforcement actions, given that foreclosure proceedings are more cost-efficient. Lastly, in a bankruptcy proceeding the receiver will decide to close the proceedings after a prudential time, setting a practical limit for any potential recovery upside.

Partial credit to residual claims from individuals

Scope has however given credit to residual claims on 80% of loans to individuals. This is because if the borrower is an individual, the elapsed time after a default might have a positive impact. An individual may, for example, find new sources of income over time and become solvent again.

4.4. Tribunal efficiency

Scope applied line-by-line time-to-recovery assumptions that consider the court in charge of the proceedings, the type of legal proceeding (i.e. bankruptcy or non-bankruptcy), and the current stage of the proceeding.

The total length of the recovery process is mainly determined by the efficiency of the assigned court and the type of legal proceeding. To reflect this, Scope has grouped Italian courts into seven categories, based on public data regarding the average length of bankruptcy and foreclosure proceedings between 2015 and 2017, as shown in Figure 9 below. Most courts are concentrated in groups 2 to 3, with proceedings reasonably distributed across the centre and north of Italy.

Northern regions tend to have more efficient tribunals

Figure 9: Total length of the recovery process by court group in years (Scope's assumptions)

Court group	Bankruptcy proceedings	Non-bankruptcy proceedings	% of courts
1	4.0	2.0	1.5%
2	6.0	3.0	32.9%
3	8.0	4.0	49.6%
4	10.0	5.0	4.9%
5	12.0	6.0	10.5%
6	14.0	7.0	0.6%
7	18.0	9.0	0.1%

4.5. Analysis of unsecured portfolio segment

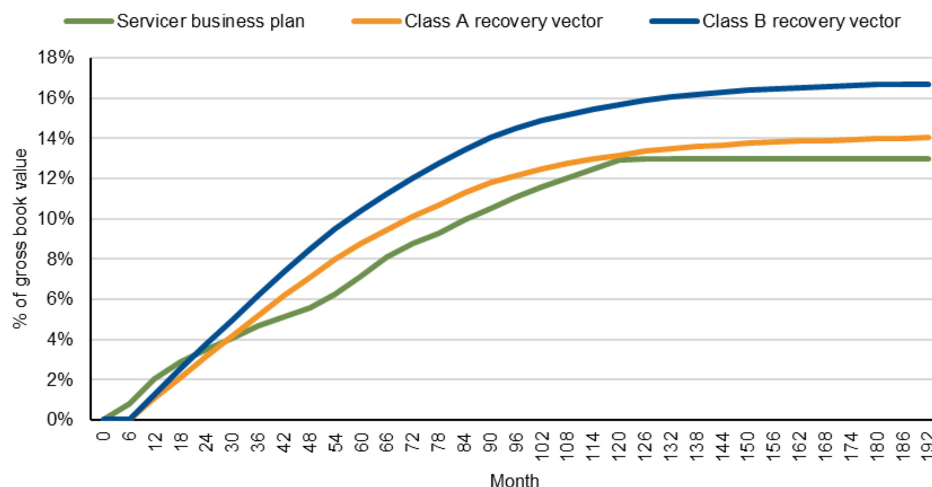
The assumptions for unsecured exposures consider the nature of the recovery procedure because bankruptcy proceedings are generally slower and result in lower recoveries than non-bankruptcy proceedings.

[2] Conversely, in the unlikely scenario that secured creditors are fully satisfied after the enforcement of the security, expected recoveries for unsecured creditors could be close to 100%.

Lifetime recovery rates are calibrated to capture portfolio seasoning

The assumptions are calibrated to reflect that unsecured borrowers in the portfolio are classified as having defaulted for an average of 3.2 years as of the cut-off date.

Figure 10: Rating-conditional lifetime unsecured recovery rate



Source: Scope Ratings

5. Portfolio characteristics

The charts below provide further detail on key portfolio characteristics as of 31 December 2017. Percentage figures refer to gross book value, unless otherwise stated.

5.1. Eligible loans

Customary NPL loan eligibility criteria

The loans must fulfil customary eligibility criteria for Italian NPLs. The main eligibility criteria for inclusion in the securitised portfolio are as follows:

- All loans are denominated in euros.
- All loan agreements are governed by Italian law.
- All borrowers are reported by the originator as defaulted (in sofferenza) to the Italian Credit Bureau (Centrale Rischi) of the Bank of Italy as of 31 May 2018.
- The relevant borrowers have been reported as long past due (in sofferenza) between 1 January 1998 and 30 May 2018 for Banco di Desio e della Brianza S.p.A.; relevant borrowers have been reported as in sofferenza between 1 January 1991 and 30 May 2018 for Banca Popolare di Spoleto S.p.A.
- The outstanding amount due in respect of any of the financings does not exceed EUR 4,000,000 for Banco di Desio e della Brianza S.p.A.; EUR 7,500,000 for Banca Popolare di Spoleto S.p.A.
- The borrowers are i) individuals resident or domiciled in Italy or ii) entities incorporated under Italian law with a registered office in the country.
- Secured loans are backed by a mortgage over real estate assets located in Italy.
- The relevant borrowers are not employees, managers or directors of any banking members of Gruppo Banco Desio e della Brianza.
- The relevant borrowers are not banks and/or other financial institutions.

5.2. Borrower and loan types

Slightly positive share of individuals

Corporates and individuals represent 73.6% and 26.4% of the pool respectively. The share of loans to individuals is slightly positive for the transaction, mainly due to Scope's view of residual claims after security enforcement, as discussed in the previous section.

The relatively high amount of secured loans (53.2%) is moderate. Scope has assumed the same level of recovery proceeds for junior-lien secured loans and unsecured loans.

Figure 11: Borrower type

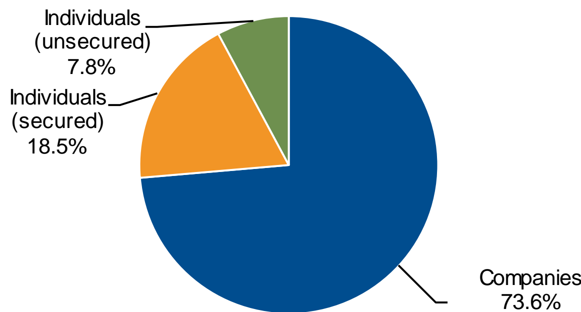


Figure 12: Loan type

Sources: Data tape from BDB and BPS, calculations by Scope Ratings

5.3. Geographical distribution

Geographical concentration in the north and centre is credit-positive

Scope expects the portfolio's locations to positively affect the level and timing of recovery proceeds in the transaction: both the collateral and the court proceedings are concentrated in Milan, Rome and other northern and central Italian regions. These regions benefit from the most dynamic economic conditions in Italy, reflected by the more resilient property values (i.e. lower market-value-decline assumptions), and generally the most efficient tribunals, reflected by the shorter recovery timings.

Figure 13: Collateral location

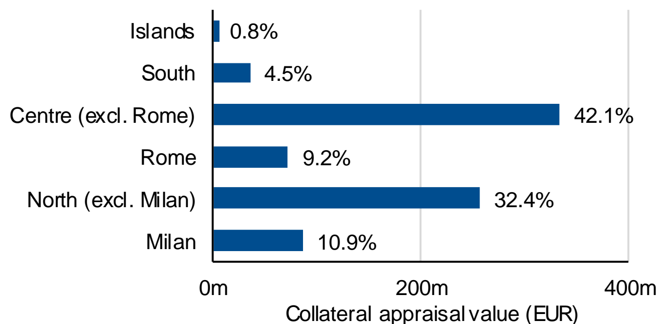
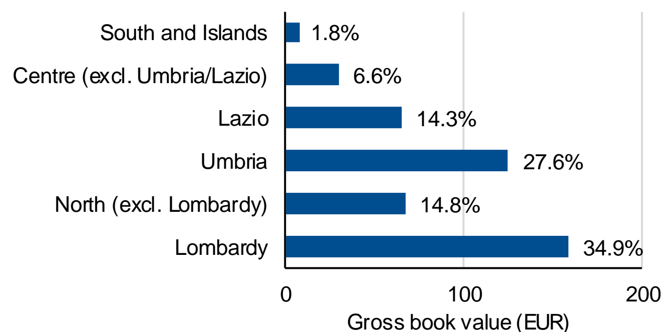


Figure 14: Locations of unsecured loans



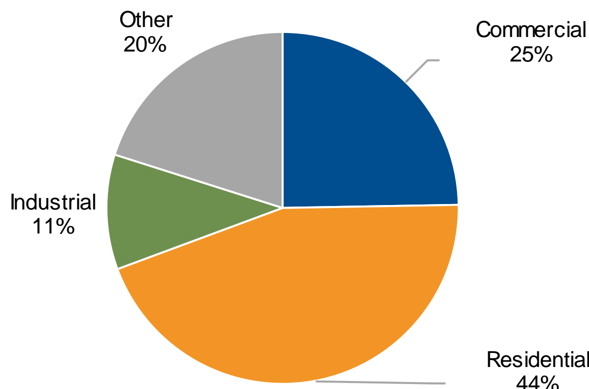
Sources: Data tape from BDB and BPS, calculations by Scope Ratings

5.4. Collateral type

Lower liquidity stresses applied to residential properties

The collateral is composed of residential (44%), commercial (25%), industrial (11%) and other non-residential assets (20%) (e.g. accommodation services properties, buildable land and agricultural land). The relatively large share of residential properties is positive for the transaction given the generally better liquidity of such properties, reflected in Scope's lower fire-sale discount assumptions (see Figure 8).

Figure 15: Distribution by type of collateral



Sources: Data tape from BDB and BPS, calculations by Scope Ratings

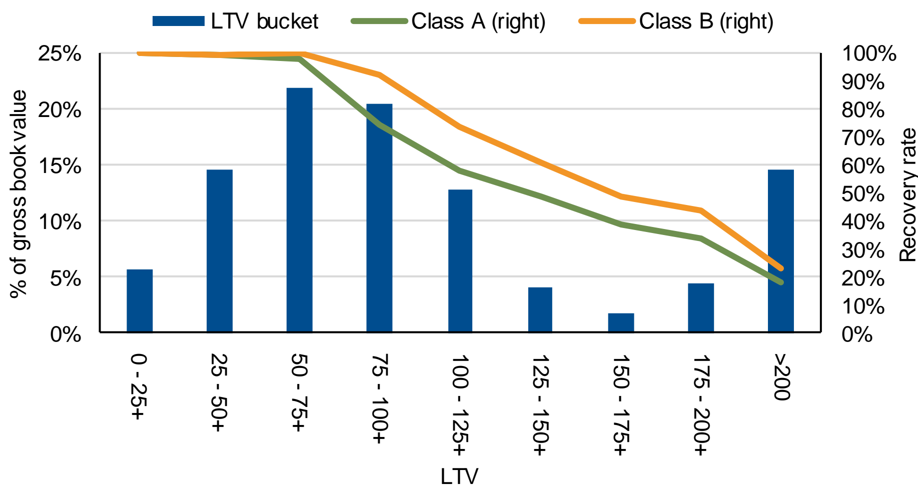
5.5. Collateral valuations and Scope's recovery rate assumptions

Expected recoveries reflect the secured portfolio's loan-to-value distribution

Figure 16 shows the secured loans' distribution by loan-to-value bucket as well as Scope's rating-conditional recovery rate assumptions for each bucket. This results in weighted average recovery rates for the secured loans of 65.5% for the class A and 73.5% for class B.

All else equal (e.g. for two portfolios with equivalent loan-to-value ratios on an aggregated basis), collateral is less beneficial if its value is skewed towards low loan exposures. This is because, on a loan-by-loan basis, recovery proceeds are capped by the minimum of the loan's gross book value and mortgage value. This partly explains why recovery rates flatten at low loan-to-value buckets.[3]

Figure 16: Secured borrowers' loan-to-value ratio



Sources: Data tape from BDB and BPS, calculations by Scope Ratings

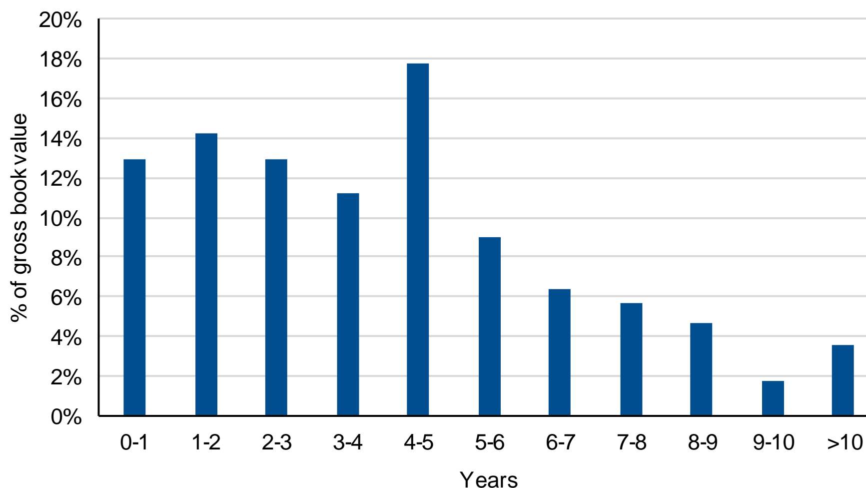
5.6. Loan seasoning

Ageing of unsecured portfolio reduces expected recoveries

The weighted average time since default is around 3.2 years for unsecured exposures. The pool's ageing reduces the expected recoverable amount of unsecured loans significantly, since most recoveries are concentrated in the first years after a default, according to historical vintage data.

[3] Another reason is that syndicated loans are concentrated in the low LTV buckets for this portfolio. The reported LTVs of syndicated loans are downward-biased because the loan amount reflects only the syndicated percentage whereas the appraisal reflects the total collateral value.

Figure 17: Unsecured portfolio seasoning distribution as of cut-off date



Sources: Data tape from BDB and BPS; calculations by Scope Ratings

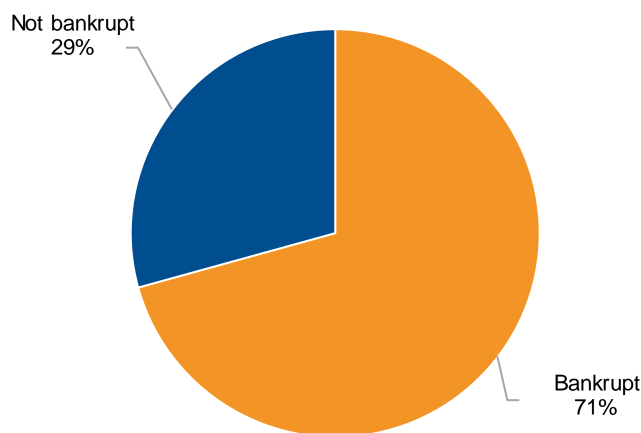
5.7. Borrower status

Recovery stresses address the high portion of bankruptcy proceedings

A significant amount of the portfolio's borrowers is under bankruptcy proceedings or have been assumed by Scope to fall into bankruptcy in the future. This is credit-negative as bankruptcy processes are generally more complex, lengthy and costly. Bankruptcies also result in lower expected recoveries for unsecured exposures given the focus on liquidating assets rather than maintaining borrowers as a going concern.

Figure 18 below shows the portfolio distribution by main type of legal proceeding as assumed by Scope (a single position can have various types of simultaneously ongoing proceedings).

Figure 18: Main types of legal proceedings (Scope assumptions)



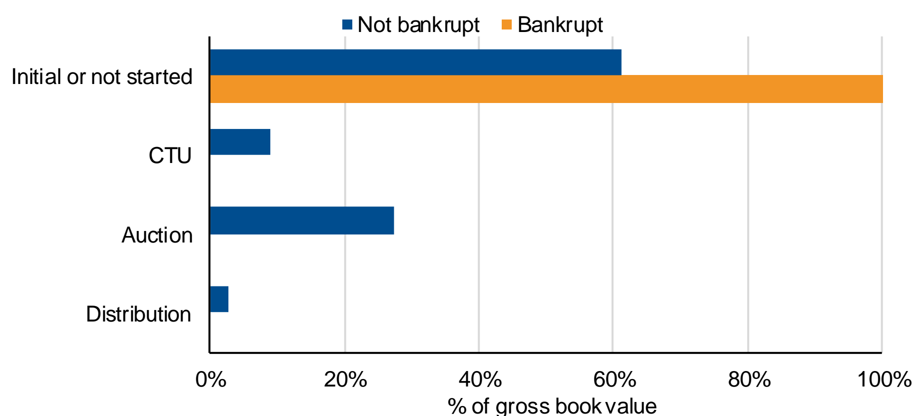
Sources: Data tape from BDB and BPS; calculations by Scope Ratings

5.8. Recovery stage of secured exposures

High portion of initial or non-started proceedings drive relatively back-loaded collections

A large portion of the secured loans is in initial stages, which partly explains the long expected weighted average life of portfolio collections. Figure 19 below shows the stage of legal proceedings for bankruptcies and non-bankruptcies in relation to secured loans.

Figure 19: Secured recovery stage by borrower status



Sources: Data tape from BDB and BPS; calculations by Scope Ratings

6. Key structural features

6.1. Priority of payments

Combined waterfall

On each semi-annual payment date, the funds available to the issuer (i.e. collection amounts received from the portfolio, the cash reserve, and payments received under the interest rate cap agreement) will be used in the following simplified order of priority:

1. Senior fees (costs, taxes and expenses, fees for services provided to the issuer by entities such as the master servicer, special servicer and cash manager)
2. Interest on limited-recourse loan
3. Fees payable to GACS guarantor regarding GACS guarantee
4. The cap replacement premium, if the cap collateral amount available cannot cover the premium in full
5. Recovery-expense reserve amount
6. Interest on class A notes
7. Amounts due under GACS guarantee (other than amounts paid under item 3)
8. Cash reserve target amount
9. Principal on limited-recourse loan
10. Interest on class B notes, provided that an interest subordination event has not occurred
11. Principal on class A notes
12. Interest on class B notes, if an interest subordination event has occurred
13. Pro rata and pari passu: i) principal on class B notes, and ii) if a servicer underperformance subordination event has occurred, a portion of the servicer performance fees
14. Junior payments, including a portion of the servicer performance fees if a servicer underperformance subordination event has occurred

An interest subordination event occurs in the event of any of the following:

Reversible but relatively tight class B subordination triggers

1) The cumulative collection ratio[4] is lower than 85%;

2) The present value cumulative profitability ratio[5] is lower than 85%; and

[4] 'Cumulative collection ratio' is defined as the ratio between i) the cumulative aggregate net collections since the economic effective date of transfer of the portfolio; and ii) the net expected collections. Net collections are the difference between the gross collections and the recovery expenses.

[5] 'Present value cumulative profitability ratio' is defined as the ratio between i) the sum of the present value of the net collections of the receivables which are exhausted debt relationships, and ii) the sum of the target price (as defined in the servicer's base case scenario of the business plan) of all receivables which are exhausted debt relationships. The present value will be calculated using an annual interest rate of 3.5%.

3) Interest payments are missed on class A notes on the previous interest payment date

The subordination event is curable. This means that if the class B interest subordination triggers are not breached, all amounts due and unpaid at the preceding interest payment dates will be paid senior to the principal of the class A notes.

The interest due on the limited-recourse loan is equal to the six-month Euribor plus a margin of 0.4%, with a cap at 1% and a floor at 0%. The principal due on the limited-recourse loan is the lower of i) the outstanding amount of the limited-recourse loan, and ii) 35% of the positive difference between the cash reserve amount and the target cash reserve amount.

If, on any payment date, the special servicer fails to deliver the servicer report, the calculation agent will prepare a provisional payment report in which the cash reserve and the portfolio collections from the last payment date will be earmarked as funds available to the issuer. These funds will be used to cover items 1 to 8 in the above order of priority (except for the fees of special servicer). The remaining amounts due will be paid on the next payment date.

Scope ratings do not address the GACS guarantee

The GACS guarantee would ensure timely payment of interest and ultimate payment of principal by final maturity. Scope's rating does not give credit to the GACS guarantee, but it considers the potential cost (i.e. GACS premium) if added to the structure at a later stage.

Non-timely class A interest payment would trigger accelerated waterfall

Non-payment of timely interest on the senior notes (implying the GACS guarantee is not in place) among other customary events such as issuer unlawfulness, would accelerate the repayment of class A through the full subordination of class B payments.

6.2. Alignment of interests (servicer performance fees)

Fee structure mitigates potential conflicts of interest

The special-servicing fee structure (see section below on servicing fees) links the portfolio's performance with the level of fees received by the special servicer, which mitigates potential conflicts of interest between the servicer and noteholders. In the case of underperformance, a portion of the fees will be paid on a junior position in the priority of payments. The servicer is therefore incentivised to maximise recoveries and comply with the initial business plan.

An overview of the servicer's activities and calculations, prepared by the monitoring agent, mitigates operational risks and moral hazard that could negatively impact the interests of noteholders. This risk is further mitigated by the discretionary servicer termination event should the servicer underperform.

6.3. Servicing structure

Monitoring functions protect noteholders' interests

The special servicer (Cerved Credit Management S.p.A.) will perform the servicing activities, monitored by the master servicer (Cerved Master Services S.p.A.) and the monitoring agent.

Under the servicing agreement, the master servicer will perform the servicing, administration, and collection/recovery of receivables, as well as the management of legal proceedings. The master servicer will delegate to the special servicer the servicing, administration, and collection/recovery of receivables, and will monitor the special servicer's activities.

Securitisation Services S.p.A. has been appointed as back-up master servicer. In the case of a master-servicer disruption, the back-up master servicer will step in as master servicer within 45 days. If a special-servicer disruption occurs and the back-up master servicer fails to find a suitable replacement within 45 business days, the back-up master servicer will be removed from its role.

The monitoring agent (Securitisation Services S.p.A.) is tasked with providing an overview of the servicer's activities. This agent will verify the calculations of key performance ratios and amounts payable by the issuer, as well as perform controls based on a random sample of loans.

The monitoring agent will report to a committee that will represent both junior and mezzanine noteholders' interests. The committee can authorise the revocation and replacement of the special servicer or the master servicer, in case of occurrence of a termination event, subject to the approval of the noteholders' representative. The monitoring agent can also authorise the sale of the receivables, the closure of debt positions, as well as the payment of additional costs and expenses related to recovery activities.

6.4. Servicing fees

Fee structure is incentive-based to maximise recoveries

The servicers will be entitled to i) a base fee, calculated at each payment date on the outstanding portfolio's gross book value; and ii) a performance fee, calculated at each payment date on the period's collections net of legal costs (collectively, the servicing fees). These constitute the majority of the expected servicing fees.

In addition to the performance fees, a servicer fee payment subordination trigger further incentivises the servicer to comply with or outperform business plan targets issued at closing date. Subordinated fees will be paid at a more junior position in the order of payments, either together with the class B principal payments or with the junior notes' principal payment.

Incentive fees constitute most of the expected servicing fees. The following additional features also incentivise servicers to comply with or outperform business plan targets set on the closing date.

- Haircut/Increase on servicing fees upon closure of a position: On the payment date in which a position is closed, servicing fees might be increased or decreased by a maximum of 15%, depending on the final value of present value profitability ratio of the closed position
- Payment subordination of servicing fees: based on the level of the present value profitability ratio, a portion of the servicing fees might be paid at a more junior position in the order of payments, either together with the class B principal payments or with the junior notes' principal payment.

6.5. Servicer termination events

Master back-up servicer and monitoring agency role mitigate servicing disruption risk

Master-servicer termination events include: i) insolvency, ii) unremedied breach of obligations, iii) unremedied breach of representation and warranties, iv) loss of legal eligibility to perform obligations under the servicing agreement, and v) failure to find a replacement for the special servicer in the case of a special-servicer termination event.

In the event of any of the above, the back-up master servicer will replace the master servicer. If there is no back-up master servicer, the monitoring agent will help to find a suitable replacement, which will then be approved by the noteholders' representative.

Special-servicer termination events include: i) insolvency, ii) failure to pay due and available amounts to the issuer within two business days, iii) failure to deliver or late delivery of a semi-annual report, not remedied within 5 business days, iv) unremedied breach of obligations, v) unremedied breach of representation and warranties, and vi) loss of legal eligibility to perform obligations under the servicing agreement.

The special servicer can be replaced, from the sixth collection period (i.e. 30 months from closing), if for two consecutive payment dates (i) the cumulative collection ratio is below 90%, or (ii) the present value cumulative profitability ratio is below 90%.

The monitoring agent and the back-up servicer will cooperate to find a special servicer (which will then be approved by the noteholders' representative) to perform the servicing, administration, and collection/recovery of receivables.

In the event of a simultaneous withdrawal of the master servicer and the special servicer, the back-up servicer will take over the master servicer's role and some of the special servicer's activities until a suitable replacement is found for the special servicer. The monitoring agent will collaborate with the back-up servicer to find a replacement for the special servicer.

6.6. Liquidity protection

Cash reserve protects liquidity of the senior noteholders

A cash reserve of 4.05% of the outstanding balance of class A and B notes will be funded at closing through a limited-recourse loan provided by the originators.

The cash reserve will amortise during the life of the transaction. The target amount of cash reserve at each payment date will equate to 4.05% of the outstanding balance of class A and B notes.

The cash reserve will be available to cover any shortfalls in interest payments on the class A notes as well as any items senior to them in the priority of payments.

Class B will not benefit from any liquidity protection.

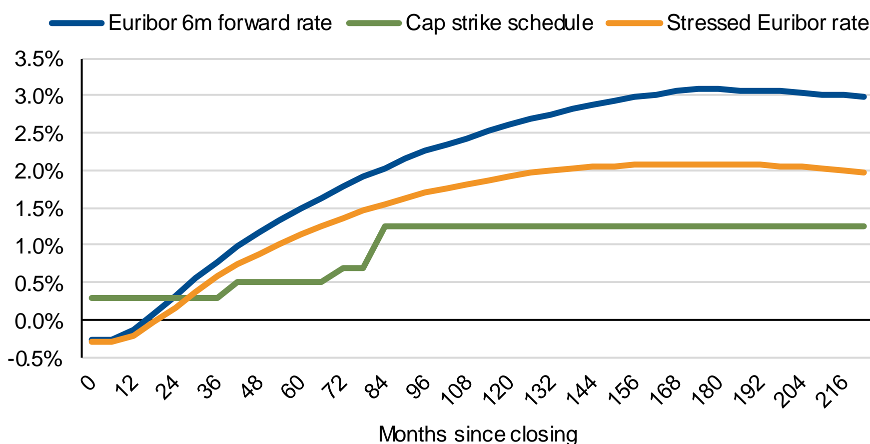
6.7. Interest rate hedge

Structural features strongly mitigate the senior noteholders' exposure to rising Euribor

On the asset side, due to the non-performing nature of the securitised portfolio, the issuer will not receive regular cash flows and the collections will not be linked to any defined interest rate. On the liability side, the issuer will pay a floating coupon on the notes, defined as six-month Euribor plus a fixed margin.

An interest rate cap, with a progressively increasing strike (cap rate) as shown in Figure 20, partially mitigates the risk of increased liabilities on the notes due to a rise in Euribor. The swap counterparty is Banca IMI S.p.A.

Figure 20: Interest rate cap



Sources: Transaction documents and Scope Ratings

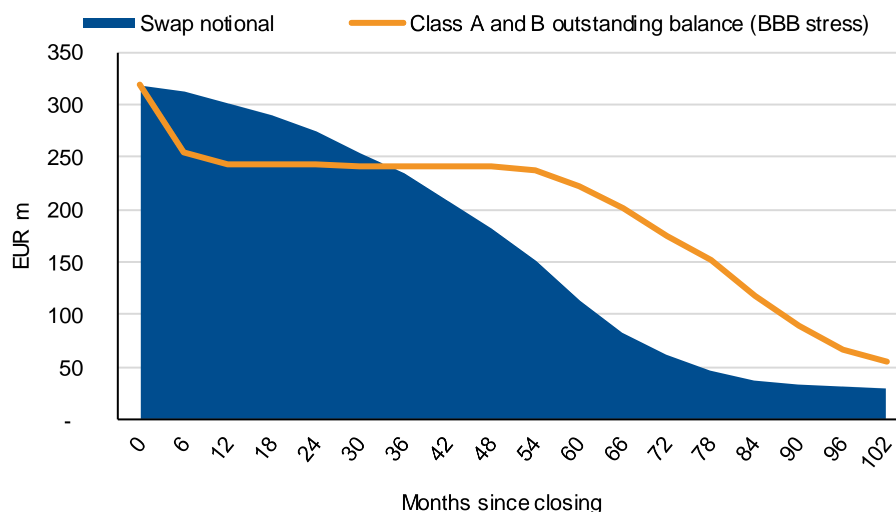
Slower-than-expected note amortisation could reduce the effectiveness of the swap

Scope does not expect interest rates to pose a material risk for the class A noteholders. However, if the notes were to amortise slower than the scheduled notional amount defined in the cap agreement, a portion of the outstanding notes would be unhedged.

Figure 21 shows a comparison between the swap notional schedule and the outstanding balance on the class A notes, under Scope's rating-conditional assumptions applied for the analysis of the class A notes (i.e. commensurate with BBB stress levels).

The subordination of the class B interest component is another layer of protection for the class A notes against the risk of increasing Euribor rates.

Figure 21: Cap notional schedule vs outstanding class notes



Sources: Transaction documents and Scope Ratings

7. Cash flow analysis and rating stability

Scope has examined the transaction's specific cash flow characteristics. Asset assumptions have been captured through rating-conditional gross recovery vectors. The analysis captures the capital structure, an estimate of legal costs based on the servicer's business plan, and annual senior fees of about EUR 200,000. We have taken into account the reference rate payable on the notes based on the six-month Euribor forward curve, considering the progressive cap rates of the swap.

Class A rating reflects relative performance stability and liquidity protection

The BBB rating assigned to the class A notes reflects expected losses over the instrument's weighted average life commensurate with the idealised expected loss table reported in Scope's General Structured Finance Ratings Methodology. The rating also takes into account the available liquidity provided by the structure to the class A notes.

Class B rating reflects lack of liquidity protection

The B rating assigned to the class B addresses the high volatility of the ratings to Scope's input assumptions, and the lack of liquidity protection.

Scope tested the resilience of the ratings against deviations from expected recovery rates and recovery timing. This analysis has the sole purpose of illustrating the sensitivity of the ratings to input assumptions and is not indicative of expected or likely scenarios. Scope tested the sensitivity of the analysis to deviations from the main input assumptions: i) recovery rate and ii) recovery timing.

The following shows how the results for class A change compared to the assigned credit rating in the event of:

- a decrease in secured and unsecured recovery rates by 20%: four notches; and
- an increase in the recovery lag by two years: two notches

The following shows how the results for the class B change compared to the assigned credit rating in the event of:

- a decrease in secured and unsecured recovery rates by 10%: zero notches; and
- an increase in the recovery lag by one year: zero notches

8. Sovereign risk

No mechanistic ratings cap

Sovereign risk does not limit the ratings. According to Scope, the risks of an institutional framework meltdown, legal insecurity or currency convertibility problems due to Italy's hypothetical exit from the eurozone are remote enough to be immaterial for the ratings.

For more insight into Scope's fundamental analysis on the Italian economy, refer to the agency's rating report on the Republic of Italy, dated 30 June 2017.

9. Counterparty risk

Counterparty risk does not limit the transaction's rating

The transaction is exposed to counterparty risk from i) Banco di Desio and Banca Popolare di Spoleto, the two originators, regarding representation and warranties and the eventual payments that might be made by the borrowers, especially for the cash-in-court cases, ii) Cerved Credit Management S.p.A., the special servicer, iii) Cerved Master Services S.p.A., the master servicer, iv) Securitisation Services S.p.A., the back-up servicer, calculation agent, and representative of noteholders, v) Zenith Service S.p.A., the monitoring agent, vi) BNP Paribas Securities Services (Milan Branch), the account bank, cash manager, and principal paying agent, and vi) Banca IMI S.p.A., the cap counterparty. In Scope's view, none of these exposures limits the maximum ratings achievable by this transaction.

The issuer's accounts will be held at BNP Paribas Securities Services, Milan Branch. There is a rating trigger for the replacement of the account bank, and a replacement must be found within 30 calendar days.

Scope has analysed the counterparty risk exposure to BNP Paribas Securities Services, Milan Branch and Banca IMI S.p.A. based on public ratings. BNP Paribas SA is rated AA-/S-1+/Stable by Scope.

9.1. Servicer disruption risk

A servicer disruption event may have a negative impact on the transaction's performance. However, the back-up servicer and monitoring agent will assist the issuer in finding a suitable replacement for the special-servicing activities in the event of a special-servicer disruption (see section 5.3.2). In the case of a master-servicer disruption, the back-up servicer is committed to stepping in within 45 days.

9.2. Commingling risk

Collections are paid directly to the issuer

Commingling risk is limited, as debtors will be instructed to pay directly to an account in the name of the issuer. In limited cases where the servicer received payments from a debtor, the servicer would transfer the amounts within two business days.

9.3. Claw-back risk

The originators have provided: i) a good standing certificate from the Chamber of Commerce, ii) a solvency certificate signed by a representative duly authorised, and iii) a certificate from the bankruptcy court (tribunale civile – sezione fallimentare) confirming that the originator is not subject to any insolvency or similar proceedings. This mitigates claw-back risk, as the issuer should be able to prove that it was not aware of the issuer being in a state of insolvency as of the transfer date.

Assignments of receivables made under the Italian Securitisation Law are subject to claw-back in the following events:

(i) pursuant to article 67, paragraph 1, of the Italian Bankruptcy Law, if the bankruptcy declaration of the relevant originator is made within six months from the purchase of the relevant portfolio of receivables, provided that the sale price of the receivables exceeds the value of the receivables by more than 25% and the issuer is unable to demonstrate that it was unaware of the originator's insolvency, or

(ii) pursuant to article 67, paragraph 2, of the Italian Bankruptcy Law, if the adjudication of bankruptcy of the relevant originator is made within three months from the purchase of the relevant portfolio of receivables, provided that the sale price of the receivables does not exceed the value of the receivables by more than 25% and the originator's insolvency receiver can demonstrate that the issuer was aware of the originator's insolvency.

9.4. Enforcement of representations and warranties

Representations and warranties limited by time and amount

The issuer will rely on the representations and warranties, limited by time and amount, provided by the originators in the transfer agreement. If a breach of a representation and warranty materially and adversely affects a loan's value, the originators may be obliged to indemnify the issuer for damages within 10 business days of the notification. However, the total indemnity amount will be capped to a maximum of 30% of the portfolio purchase price, and it will be only be paid out for claims within two years since the closing date. In addition, the minimum claimable amount is EUR 400,000, on a portfolio basis, and EUR 10,000, on a single loan basis

10. Legal structure

10.1. Legal framework

Transaction governed by Italian law

The transaction documents are governed by Italian law, whereas English law governs the interest cap agreement and the deed of charge.

The transaction is fully governed by the terms in the documentation and any changes are subject to the risk-takers' consent, with a superior voting right of the most senior risk-taker at the date of the decision.

10.2. Use of legal opinions

Scope had access to the legal opinions produced for the issuer, which provide comfort on the legally valid, binding and enforceable nature of the contracts.

11. Monitoring

Continuous monitoring of ratings

Scope will monitor this transaction based on performance reports as well as other public information. The ratings will be monitored continuously and reviewed at least once a year, or earlier if warranted by events.

Scope analysts are available to discuss all the details of the rating analysis, the risks to which this transaction is exposed, and the ongoing monitoring of the transaction.

12. Applied methodology

For the analysis of this transaction Scope applied its General Structured Finance Instruments Rating Methodology and Methodology for Counterparty Risk in Structured Finance, both available on www.scoperatings.com.

I. Summary appendix – deal comparison

Transaction	2Worlds	4Mori Sardegna	Aragorn NPL 2018	Red Sea SPV	Siena NPL 2018	Bari NPL 2017	Elrond NPL 2017
Closing	Jun-18	Jun-18	Jun-18	Jun-18	May-18	Dec-17	Jul-17
Originators	BPS, BDB	Banco di Sardegna	Creval	Banco BPM, BPM	MPS	BPB, CRO	Creval
Master servicer	Cerved	Prelios	Credito Fondiario		Credito Fondiario	Prelios	Cerved
Special servicer	Cerved	Prelios	Cerved, Credito Fondiario	Prelios	Juliet, Italfondiario, Credito Fondiario, Prelios	Prelios	Cerved
General portfolio attributes							
Gross book value (EUR m)	968	900	1,676	5,113	23,939	345	1,422
Number of borrowers	3,956	11,412	4,171	12,651	79,669	1,565	3,712
Number of loans	13,234	20,098	8,289	33,585	545,939	4,569	6,951
WA seasoning (years)	2.7	4.8	2.5	3.8	4.4	4.5	3.7
WA seasoning (years) - unsecured	3.2	6.4	3.2	3.5	4.8	N/A	N/A
WA LTV buckets (% or secured							
bucket [0-25]	2.8	5.7	2.0	2.3	5.7	N/A	3.6
bucket [25-50]	13.0	14.6	4.2	8.1	12.4	N/A	11.1
bucket [50-75]	17.9	21.8	8.2	14.7	16.8	N/A	13.7
bucket [75-100]	15.8	20.4	13.9	18.1	17.0	N/A	19.6
bucket [100-125]	14.5	12.8	22.3	16.7	13.4	N/A	24.6
bucket [125-150]	7.5	4.0	17.9	12.0	8.3	N/A	8.6
bucket [150-175]	4.9	1.8	11.9	6.6	5.3	N/A	4.8
bucket [175-200]	6.6	4.4	3.7	4.8	3.9	N/A	1.6
bucket > 200	17.1	14.5	16.0	16.7	17.1	N/A	12.5
Cash in court (% of total GBV)	8.5	18.3	0.5	3.2	N/A	N/A	2
Loan types (% of total GBV)							
Secured first-lien	53.1	56.1	67.3	70.6	41.6	53.6	66.4
Secured junior-lien	0	0.6	8.1	1		2.5	7.6
Unsecured	46.9	43.3	24.6	28.4	58.4	43.9	26.0
Syndicated loans	3.8	3.3	1.8	1.4	5.7		
Debtors (% of total GBV)							
Individuals	26.4	24.4	9.9	28.4	19	12	12.7
Corporates or SMEs	73.6	75.6	90.1	71.6	81	88	87.3
Procedure type (% of total GBV)							
Bankrupt	29.3	39.1	55.0	49.4	36.6	46.5	57.6
Non-bankrupt	70.7	60.9	45.0	50.6	63.4	53.5	42.4
Other	-	-	-	-	-	-	-
Not started							
Borrower concentration (% of total GBV)							
Top 10	3.6	8	8.3	1.8	2.1	28.2	13.4
Top 100	18.1	27.7	39.5	9.1	9.5	69	42.4
Collateral regional concentration (% of total apparaisal value)							
North	43.5	1.3	58.5	67.8	35.9	18.3	61.6
Centre	51.3	11.5	18.4	20.7	36	14.1	14.6
South	5.2	87.4	23.1	11.4	28.1	67.6	23.8
Collateral type (% of total apparaisal value)							
Residential	44.4	51.3	43.4	54.8	28.2	43	32.6
Commercial	24.6	23.7	22	15.4	71.8	40	32.4
Industrial	10.5	11.3	15.3	9.4			23.2
Land	6.6	6.2	0.0	8.6		18	8.7
Other or unknown	13.9	7.6	19.3	11.8			3.4
Valuation type (% of total apparaisal value)							
Full or drive-by	79.5	38.8	96.1	74.0	10	96.31	70.8
Desktop	12.0	40.0	1.2	14.5	65		4.0
CTU	8.5	20.5	2.7	11.5	15	3.69	23.6
Other		0.6	0	0	10	0	0.5
Secured portfolio procedure stage (% of total apparaisal value)							
Initial	75.6	61.2	66.6	64.4	52.6	55.5	36.1
CTU	6.3	18.3	23.4	9.1	5.4	14.2	10.7
Auction	16.9	20.5	4.7	21.3	35.2	26.5	36.4
Distribution	1.2	0	5.5	5.2	6.7	3.8	16.8
Summary of assumptions (BBB rating-conditional stress)							
Remaining lifetime recovery rate (%)							
Secured (=net LTV after all stresses)	65.5	66.2	48.3	62.8	58.6	51.8	61.7
Unsecured	14	9.9	16.8	12.3	9.2	11.1	13.7
Total	**41.4**	**41.8**	**40.6**	**48.0**	**29.8**	**33.1**	**47.1**
Weighted average life of collections							
Secured	6.8	7.2	7.9	6.8	N/A	N/A	4.8
Unsecured	4.7	4.2	4.2	4.1	N/A	N/A	3.1
Total	**6.4**	**6.9**	**7.9**	**6.6**	**N/A**	**N/A**	**4.6**
Structural features							
Liquidity reserve (% of class A notes)	4.05 (% of A and B)	4.9 (% of A and B)	5.0	4.375 (% of A and B)	3.5	4.0	4.0
Class A Euribor cap strike	0.3% -1.25%	0.3% -1.25%	0.0-0.1%	0.5-2.0%	0.5-3.0%	0.10%	0.50%
Class A							
% of GBV	28.8	22.2	30.5	32.5	12.1	25.3	33.0
Credit enhancement	71.2	77.8	69.5	67.5	87.9	74.7	67.0
Class B							
% of GBV	3.0	1.2	4.0	3	3.5	3.1	3.0
Credit enhancement	68.2	76.6	65.5	64.5	84.4	71.6	64.0
Final rating							
Class A	BBB	A-	BBB-	BBB	BBB+	BBB	BBB-
Class B	B	BB-	B	NR	NR	B+	B+

Sources: Transactions' preliminary data tapes; calculations and assumptions by Scope Ratings.

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