

## **Deleveraging Europe 2018: Focus on France**

Is the French non-performing loan market ready for growth?

December 2018

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# Introduction

French banks' non performing loan (NPL) outstanding is high and represents the second largest NPL stock in Europe, in 2018. In France, the market remains immature and is characterised by opportunistic transactions. But in a context of a tightening regulatory framework, notably through the European Central Bank's (ECB) guidance, increasing investor appetite and profitability pressure, banks should further accelerate NPL disposals.

After a stagnation of 1% between 2015 and 2016, French gross domestic product (GDP) growth doubled in 2017. Despite such recovery, NPL stock remains high in a context of profitability pressure and a tightening regulatory framework.

According to the European Banking Authority (EBA), the NPL ratio of European banks continued to decrease to 4.1% as at December 2017 (-1.0% yoy) reflecting the effect of supervisory directives, and banks strengthened return on equity (RoE) to 6.0% in 4Q17 (+2.7% yoy). However, the level of NPL outstanding (€140bn as at June 2017 for French banks) and the sustainability of banks' profitability remain a major concern. NPL exposures are capital and cost consuming, reduce operational and execution capacity, increase funding costs, hence lowering banks' profitability and returns. Moreover, the ECB considers NPL management as one of its top priorities, thus adding pressure on banks holding large amounts of NPL.

On a European scale, NPL sales are expected to grow driven by increasing investor appetite, significant flows from countries and banks showing large NPL exposures and a tightening regulatory framework. Initially, the regulator was more focused on banks and countries with a high NPL ratio, whereas now its focus has shifted also on banks with significant NPL outstanding. French banks should anticipate accordingly and establish a detailed NPL management strategy to accelerate the reduction of NPL stock.

In France, banks tend to focus more on solving delinquency situations at the early stages of default before disposal processes are considered in accordance with profitability requirements and market timing.

While banks are not divesting portfolios as the primary tool to manage NPL exposures, this is gaining momentum as it allows banks to carve out doubtful exposures on a short term period.

Disposals are expected to further accelerate amid profitability pressure, IFRS 9 and ECB regulatory directives implementation. The ECB is notably contemplating structural approaches to resolve the NPL situation of banks in the European Union through stricter provisions methodology or the establishment of an efficient secondary NPL market.

The credit management sector is undergoing a consolidation phase as competitors seek to strengthen loan portfolio acquisition and servicing capacities in order to address a growing NPL market. Foreign investors are also turning their attention to the French market as appetite is growing for a largely unexploited NPL base.

The implementation of an efficient secondary NPL market, the consolidation of the credit management sector and banks' openness to carve out loan portfolios will further increase NPL transactions over the coming years in France.

# Macroeconomics trends

French economic recovery was confirmed after a decade of limited growth, illustrated by numerous positive indicators. Consumer and corporate financing is increasing, supported by a favourable economic environment and economic directives, whereas corporate bankruptcies are declining.

Nevertheless, some indicators remain alarming with significant public debt, NPLs and private sector debt growing faster than nominal GDP growth. In June 2018, the Haut Conseil de Stabilité Financière (HCSF) expressed concerns about such trend and raised banks' counter cyclical buffer to 0.25%.



**The French economy is improving but concerns about debt to private sector emerge**

French real GDP growth reached 2.2% in 2017, its highest level over the last six years, and is expected to reach c.1.6% in 2018.

French unemployment rate decreased to 9.4% in 2017 from 10.1% in 2016 but this rate remains higher than the Eurozone (9.1%) and the UK (4.4%) average.

Gross public debt level in France represents 97% of GDP in 2017 and is forecast to decrease to 96% in 2018. This is well above the UK and the Eurozone with public debt corresponding to 88% and 87% of GDP in 2017, respectively.

Consumer and corporate financing continued to increase with an annual growth rate of 5.6% as at June 2018, driven by the current low interest rate environment and attractive economic policy measures.

The credit to GDP gap is a metric set up by the Bank of International Settlement (BIS) and measures the difference between the credit-to-GDP ratio and its long-run trend. The indicator was created as part of Basel III and is used as a criterion to build-up the countercyclical capital buffers. For France, the gap reached 3.6% in December 2017, whereas the Eurozone gap remained negative, implying that loan dynamics surpass real economy dynamics in France. As a result, HCSF pushed banks to raise the counter cyclical buffer to 0.25% in June 2018 to prevent companies indebtedness.

**Supported by favorable economic conditions and new regulations, French NPL drivers gradually improve**

The number of over-indebtedness filings increased by 3.6% in 2014 (231k), but subsequently fell by 21.6% between 2014 and 2017 to 181k, driven by interest-rate reduction, new public policies aimed at better protecting households from excessive practices and credit refinancing. Universal banks, credit management companies and consumer captives are the main debtholders and own 74.6% of the total outstanding, according to Banque de France.

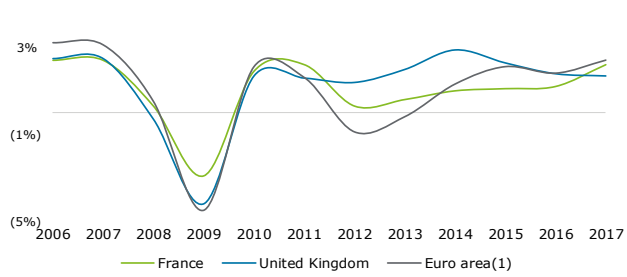
Bankruptcies in France also declined and reached an all time low since 2007 (decrease of 4.3% in 2017 to 52k).

In 2017, NPLs owned by French banks still represent the second highest stock of gross NPLs in Europe behind Italy, though declining with the NPL ratio decreasing from 3.9% to 3.4% between June 2016 and 2017.

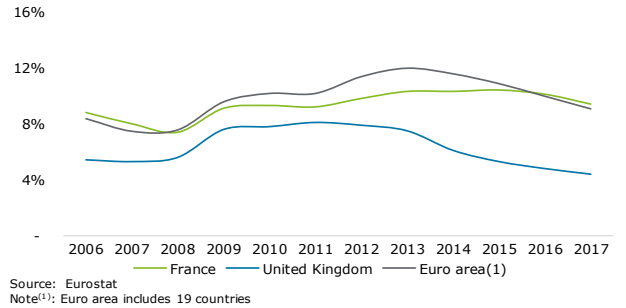
Since 2014, gross NPLs in France dropped by 1.9% on an annual basis but remain high, amounting to €72bn in 2017. This should be considered in light of a decreasing provisioning ratio of 49% in 2017 vs 50% in 2016. More than half of NPL exposures are not covered, which could imply further provision recognitions and a decrease in profitability.

French economic recovery confirmed, but loan dynamics seem to exceed real economy dynamics.

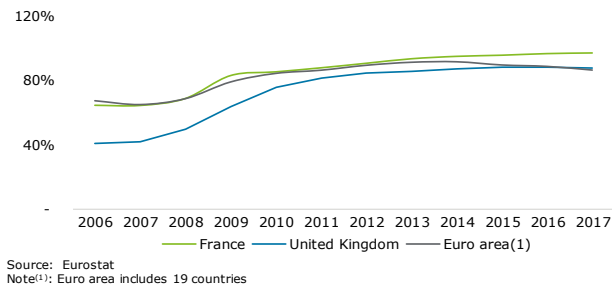
**Nominal GDP growth**



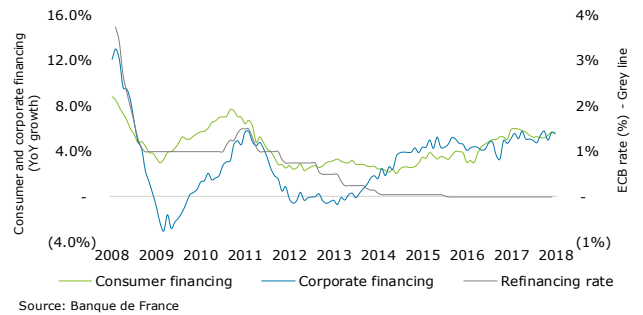
**Unemployment rate**



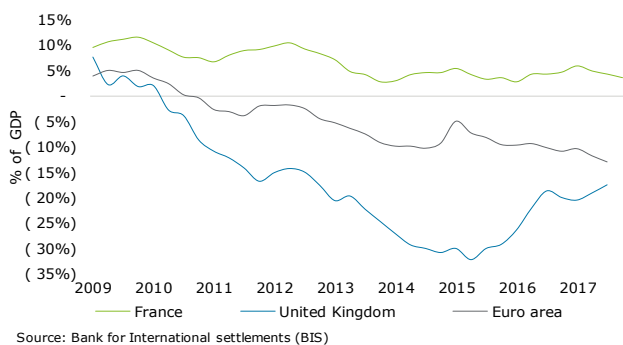
**Gross public debt level**



**Consumer & corporate financing and ECB refinancing rate**

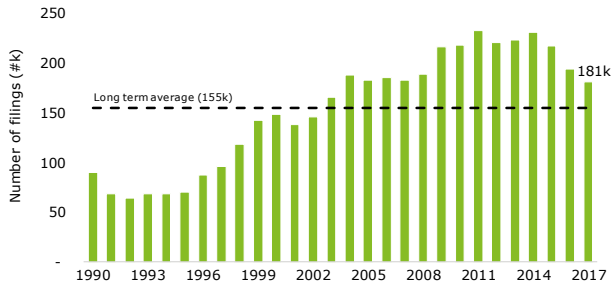


**Credit-to-GDP gaps**



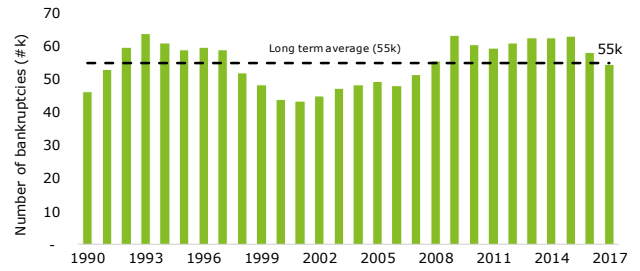
Improving French NPL drivers but gross NPLs owned by French banks represent the second highest stock in Europe.

### Household over-indebtedness filings



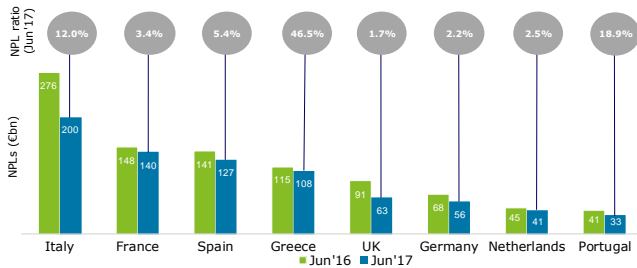
Source: Banque de France

### Corporate bankruptcies



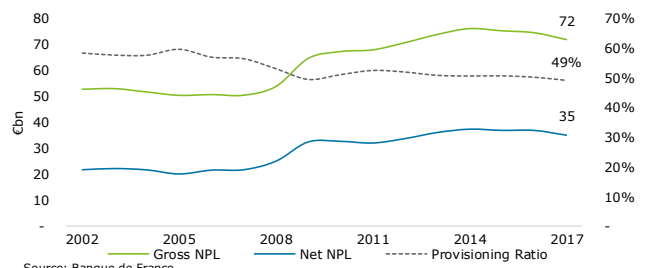
Source: Banque de France

### Gross NPLs of European banks: NPLs owned in Europe and abroad



Source: June 2017 - EBA Wide Transparency Exercise  
 Note: €140bn NPL exposure of French banks includes NPLs owed in France (51%) and abroad (49%)

### Gross and net NPLs and provisioning ratio in France: NPLs owned in France only



Source: Banque de France  
 Note: Net NPLs amounts do not take into account the level of collateral pledged.

# French banking competitive landscape

Against a backdrop of tightening regulation, French banks strengthened their strategies to limit the impact of NPLs on capital and profitability. Retail banking represented 66% of total net banking income (NBI) in 2017, making the optimization of NPL management crucial to meeting high capital requirements while sustaining a strong competitive and profitable position.



## A highly decentralised French banking industry

At first glance, the French banking market appears concentrated as five main groups dominate the market: BNP Paribas (BNPP), Société Générale (SG), Crédit Agricole Group (CAG), BPCE Group (BPCE) and Crédit Mutuel Group (CMG).

However, this hides a highly fragmented market. Mutual and cooperative banking groups such as CAG, BPCE and CMG delegate NPL management, including disposals, to their regional entities. Even more centralised banking groups such as BNPP and SG have autonomous specialised subsidiaries with independent governance and organisational structure managing their own NPL disposal processes. This often results in NPL sales characterised by small volumes (between €20m to €100m in nominal value) and widespread bilateral processes.

## Improvement of loan portfolio credit quality

French banking groups default exposure reached 3.5% in 2017. While most of the credit risk exposure is in France, some banks are highly exposed in Europe, such as BNP in Belgium and Italy, CAG in Italy and Société Générale in Eastern Europe.

The main French banking groups focused on strengthening regulatory capital, and increased their Common Equity Tier 1 (CET1) ratio from 13% in 2016 to 14% in 2017, on an aggregated basis. Aggregated cost of risk declined from 0.14% of total assets in 2016 to 0.11% in 2017, driven by economic recovery, favorable financing conditions and efficient NPL management.

European regulators consider that banks need to further improve loan portfolio credit quality given the high levels of NPLs, affecting profitability. According to the "Autorité de Contrôle Financière et de résolution" (ACPR), RoE of French banks declined between 2016 and 2017 to reach 6.3% (-20bps).

Since 2014, the ECB and other regulators have been discussing key topics focused on reducing the stock of NPLs, notably how to:

- Improve legal proceedings;
- Improve management of company financial difficulties and individual insolvency; and
- Build an efficient NPL secondary market.

Banks have implemented operational strategies to prevent further increase in NPLs by applying a more rigorous client selection process.

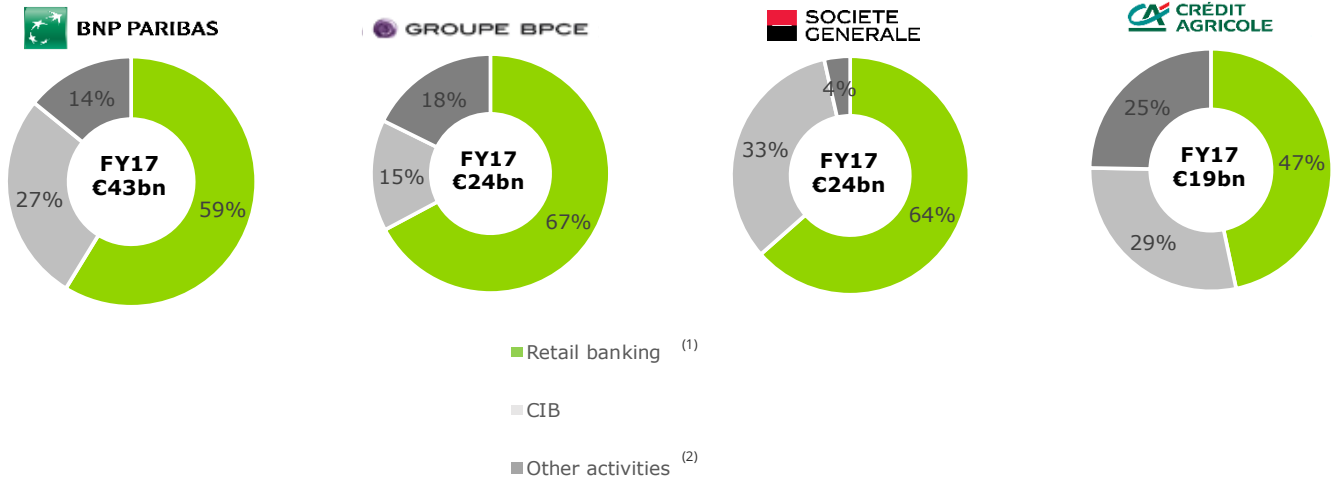
Optimisation of collection processes beyond the early stage of payment delinquency could also be a key focus as banks aim to limit Banque de France plans, which are generally more debtor friendly and can include moratoriums or full debt forgiveness. Over-indebtedness outstanding slightly decreased to €34bn and the number of individuals under a Banque de France (BDF) plan represents 3% of the French workforce.

## Unsecured consumer loans are the main contributor to total defaulted exposures but real estate exposure gains weight

Unsecured consumer loans remain the main contributor of NPLs held in France, representing c.60% of total NPL stock in 2017. But retail NPL mortgages are shifting the weighting with a significant increase over the last 5 years, reaching €14bn in 2017 (annual growth rate of 7%) or 1.5% of total retail mortgage loans.

The retail banking market is characterised by a high level of decentralisation.

**NBI breakdown of top four banks**



Source: Bank annual reports

Note: (1) including lending and specialised financing activities (leasing, fleet, personal finance, ...) for individuals, professionals and Small and Medium Enterprises (SMEs) (2) including insurance, asset and wealth management

**Selected retail banking and specialised services players**

Category	BNP Paribas	Société Générale	BPCE Group	Crédit Agricole Group	Crédit Mutuel Group	La Banque Postale
<b>French banks</b>	BNP Paribas	Société Générale	BPCE Group	Crédit Agricole Group	Crédit Mutuel Group	La Banque Postale
<b>Retail banking</b>	BNP PARIBAS Hello bank!	SOCIETE GENERALE Boursorama Banque Crédit du Nord	BANQUE POPULAIRE CAISSE D'ÉPARGNE	CRÉDIT AGRICOLE LCL BANK	Crédit Mutuel LA banque à qui parler CIC FORTUNEO BANQUE	LA BANQUE POSTALE
<b>Specialised services</b>	BNP PARIBAS PERSONAL FINANCE cofinoga Cetelem PLUS RESPONSABLES, ENSEMBLE	SOCIETE GENERALE Equipment Finance FRANFINANCE	NATIXIS FINANCEMENT NATIXIS LEASE NATIXIS FACTOR	CRÉDIT AGRICOLE LEASING & FACTORING CRÉDIT AGRICOLE CONSUMER FINANCE sofinco	Financo CM=CIC Factor CM=CIC Bail CM=CIC Cofidis creatis	LA BANQUE POSTALE FINANCEMENT
<b>Foreign and independent banks</b>	HSBC	MyMoneyBank	Milleis	Fintechs		
<b>Retail banking</b>	HSBC	mymoneybank	MILLEIS BANQUE	younited credit. Empruntez. Investissez. Entre vous.	N26	october
<b>Consumer captives</b>	Banque PSA Finance	Carrefour	Auchan	E.Leclerc	Casino Group	
<b>Retail banking</b>	BANQUE PSA FINANCE	Carrefour Banque	oney	banque edel	BANQUE Casino	

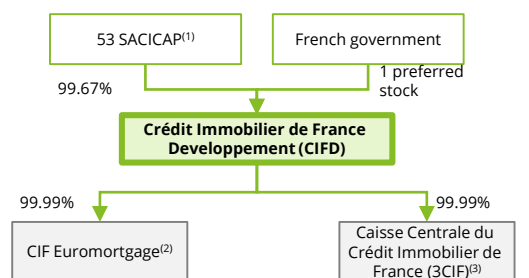




CRÉDIT IMMOBILIER DE FRANCE

## Three large banks are currently in run-off (1/2).

Created in 1908, Crédit Immobilier de France (CIF) is a mortgage lending company promoting home ownership.



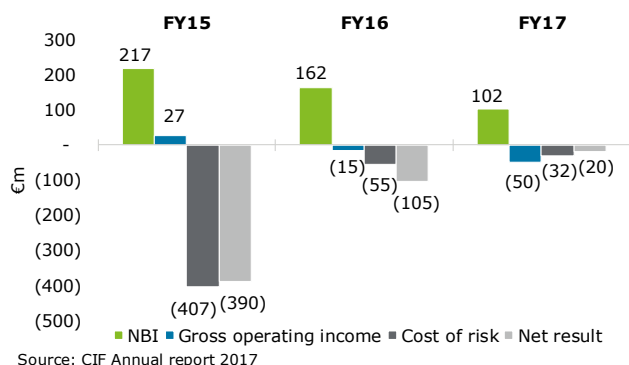
Note: (1) Société anonyme coopérative d'intérêt collectif pour l'accès à la propriété (2) Mortgage credit company (3) Credit institution, responsible for the group funding, issuing senior unsecured securities

The company refinances its portfolio through covered bonds and unsecured issuances (no funding through customer deposits).

Following a three-notch downgrade by Moody's in 2012, CIF could no longer borrow funds from financial markets. The French Government provided CIF with a state guarantee and its activity was placed under a resolution plan in 2013, which consisted of ceasing originations and servicing the portfolio until extinction.

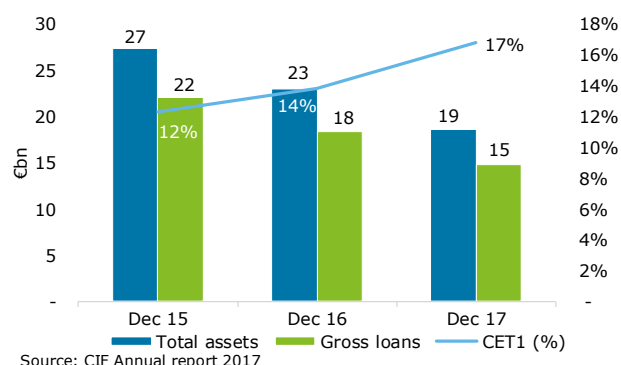
The CIF servicing platform was acquired by MCS, a credit management specialist, in April 2017, and it currently services the CIF run-off portfolio. The gross book value of the loan portfolio reached €15bn as at December 2017.

### CIFD – Income statement KPIs (€m)



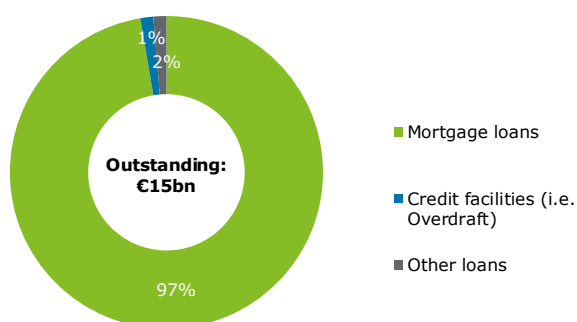
Source: CIF Annual report 2017

### CIFD – Balance sheet KPIs (€bn)



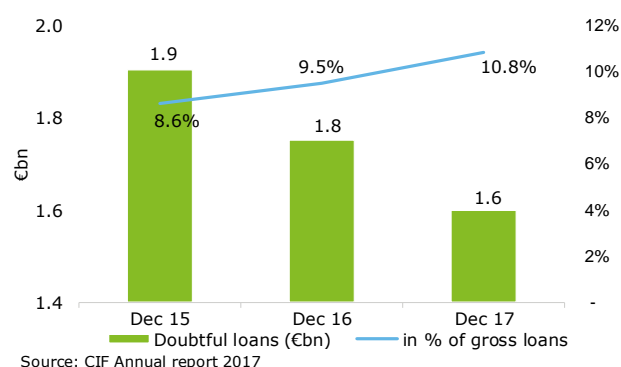
Source: CIF Annual report 2017

### CIFD – Breakdown of gross loans portfolio



Source: CIF Annual report 2017

### CIFD – Doubtful loans evolution



Source: CIF Annual report 2017

## Three large banks are currently in run-off (2/2).



Dexia is a French Belgian banking institution providing retail and commercial banking services to individuals and SMEs.

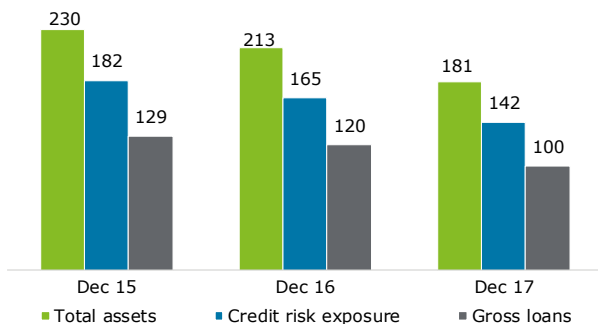
The bank was bailed out for €6bn in 2008 and faced heavy losses during the 2011 sovereign debt crisis. A resolution process was established in October 2011. The current portfolio is in run-off.

In 2017, Dexia had 994 employees and a net loss of €(462)m.

Dexia announced the disposal of 58.9% stake in Dexia Israel Bank in March 2018.

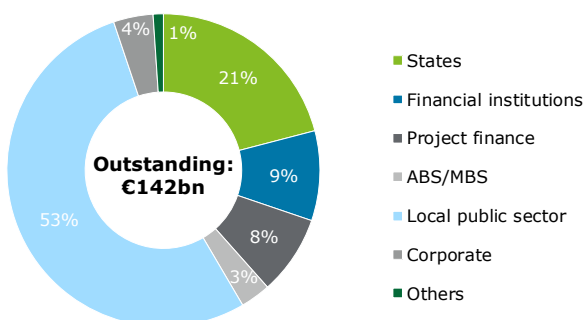
In April 2018, following the application of IFRS 9, the bank announced a positive impact of €2.8bn on its shareholder's equity (as at January 1st 2018).

### Dexia – KPI Balance sheet (€bn)



Source: Dexia annual report 2017

### Dexia – Breakdown of credit risk exposure



Source: Dexia annual report 2017



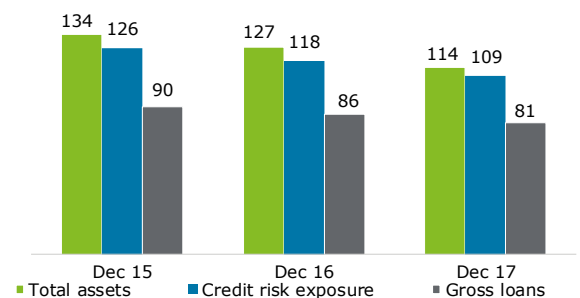
CRÉDIT FONCIER

Created in 1852, Crédit Foncier de France (CFF) is a French specialised bank, dedicated to real estate financing and services. The bank is fully owned by BPCE.

Following a strategic review by BPCE Group, the business model of CFF was put into question as the mortgage bank has no customer deposits and refinances its assets only through financial markets, making it less competitive. As a result, BPCE announced a project consisting in the integration of the CFF activity into the banking subsidiaries of BPCE Group - Banque Populaire and Caisse d'Epargne - in June 2018. It is envisaged that CFF will continue servicing the loan portfolio until extinction and new loan production will be allocated to the BPCE subsidiaries.

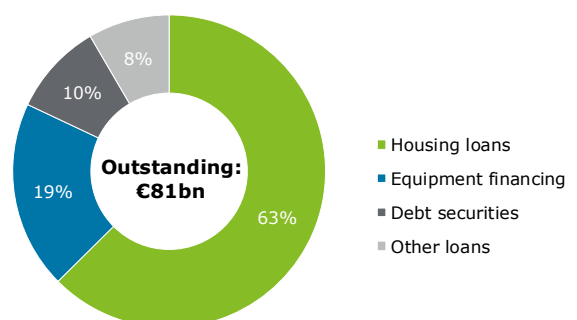
CFF's gross loans amounted to €80.6bn as at 31 December 2017.

### CFF – KPI Balance sheet (€bn)



Source: CFF annual report 2017

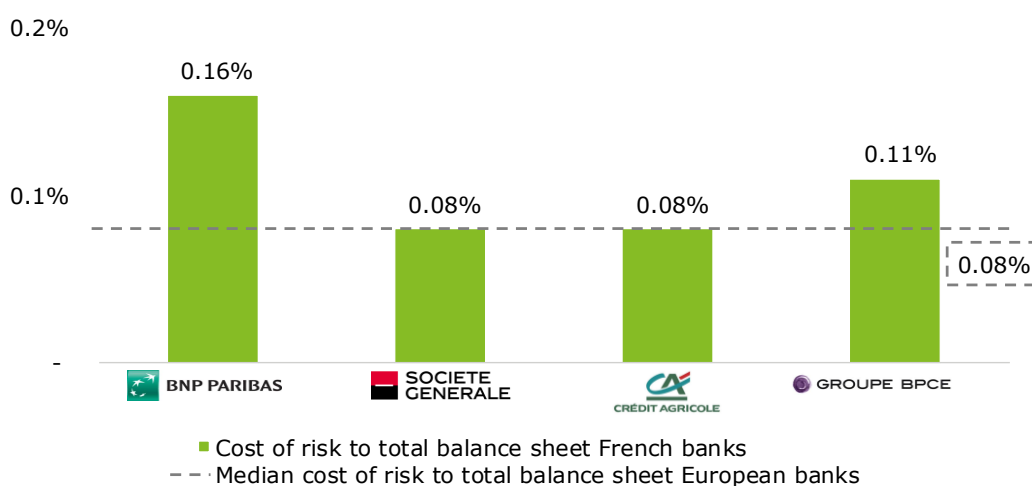
### CFF – Breakdown of the portfolio (gross)



Source: CFF annual report 2017

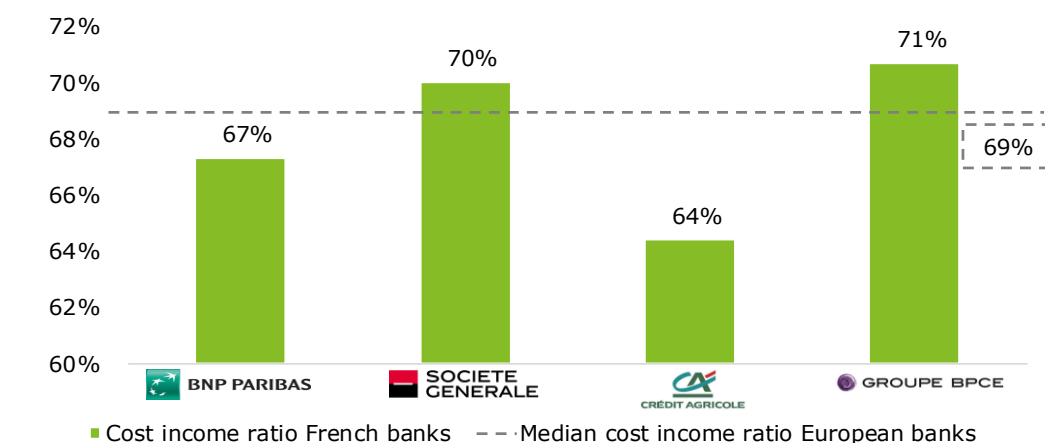
High level of NPLs affect profitability through higher cost of risk and additional operating costs.

### Cost of risk to total balance sheet



Source: ACPR (2017)

### Cost income ratio



Source: ACPR (2017)

Defaulted exposures comprised mainly unsecured consumer and corporate loans. Performing, non-performing and credit risk exposures depend on the bank's profile (universal, retail, etc.).

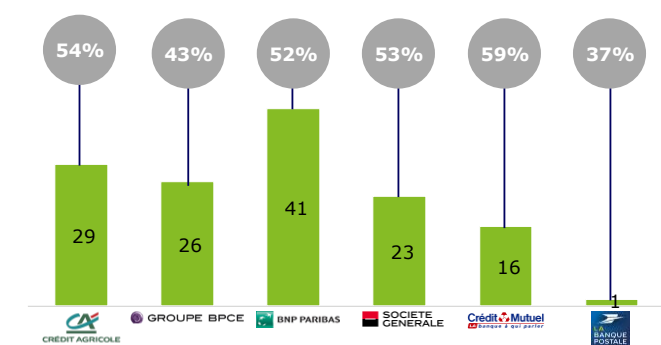
### Loans & advances exposure by counterpart (June 17)

€bn	Status	Households <sup>(1)</sup>	Non financial corporations <sup>(2)</sup>	Other financial corporations	Credit institutions	General government	Central Bank	Total
BNPP	Performing	304	317	53	17	37	244	972
	Non-performing	17	22	1	0.3	0.5	0	41
	<b>Total exposures</b>	<b>321</b>	<b>339</b>	<b>54</b>	<b>18</b>	<b>38</b>	<b>244</b>	<b>1,013</b>
CAG	Performing	433	283	22	64	39	57	898
	Non-performing	12	16	1	0	0.1	0	29
	<b>Total exposures</b>	<b>445</b>	<b>299</b>	<b>23</b>	<b>64</b>	<b>39</b>	<b>57</b>	<b>928</b>
BPCE	Performing	316	212	59	38	130	4	758
	Non-performing	11	14	0	0.8	0.2	0	26
	<b>Total exposures</b>	<b>326</b>	<b>226</b>	<b>59</b>	<b>39</b>	<b>130</b>	<b>4</b>	<b>784</b>
CMG	Performing	292	91	23	46	9	68	530
	Non-performing	13	3	1	0.0	0.0	-	16
	<b>Total exposures</b>	<b>305</b>	<b>95</b>	<b>24</b>	<b>46</b>	<b>9</b>	<b>68</b>	<b>547</b>
SG	Performing	176	180	54	29	20	1	460
	Non-performing	11	11	0	0.1	0.2	0.01	23
	<b>Total exposures</b>	<b>187</b>	<b>191</b>	<b>55</b>	<b>29</b>	<b>20</b>	<b>1</b>	<b>483</b>
<b>Top 5 banks</b>	Performing	1,521	1,084	211	194	236	374	3,620
	Non-performing	64	66	3	2	1	0	135
	<b>Total exposures</b>	<b>1,585</b>	<b>1,150</b>	<b>214</b>	<b>196</b>	<b>236</b>	<b>374</b>	<b>3,755</b>

Source: 2017 EU-wide transparency exercises - EBA

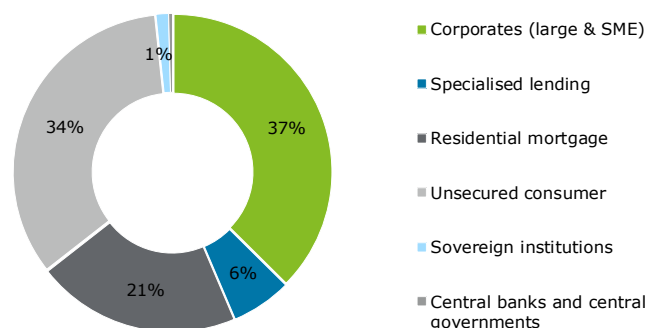
Note: (1) Households relate to individuals or groups of individuals as consumers and producers of goods and non-financial services for their own consumption; (2) Non financial corporations relate to corporations and quasi-corporations not engaged in financial intermediation but principally in the production of market goods and non-financial services

### Global non-performing provision coverage and exposures (€bn - June 17)



Source: EBA - 2017 EU-wide Transparency Exercise

### Credit risk - Defaulted exposures by asset type<sup>1</sup> (June 17)

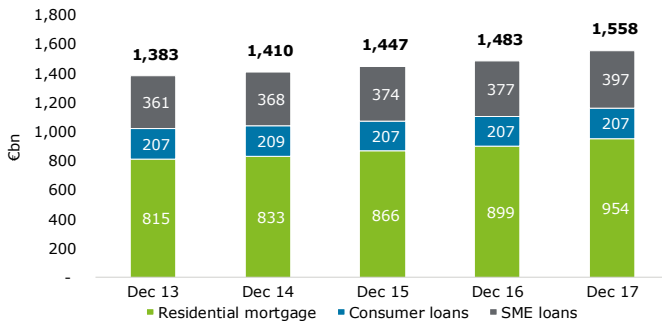


Source: 2017 EU-wide transparency exercises - EBA

Note: (1) IRB approach - NPLs of French banks owned in France and abroad

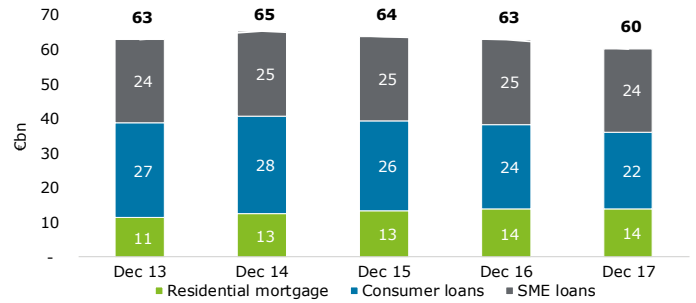
## Unsecured loans dominate the French retail NPL market.

### Retail loans outstanding (€bn)



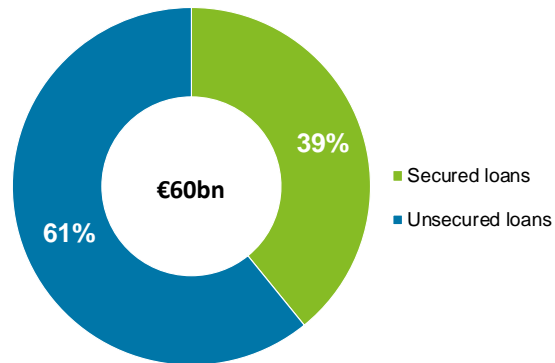
Source: Banque de France  
 Note: SME loans include credit facilities and real-estate loans

### Retail NPLs outstanding (€bn)



Source: Banque de France for Mortgage NPL rate, EBA stress state for SME NPL rate and Deloitte analysis for consumer loans  
 Note: Consumer loans comprise non-real estate loans to individuals; SME loans include credit facilities and mortgage loans

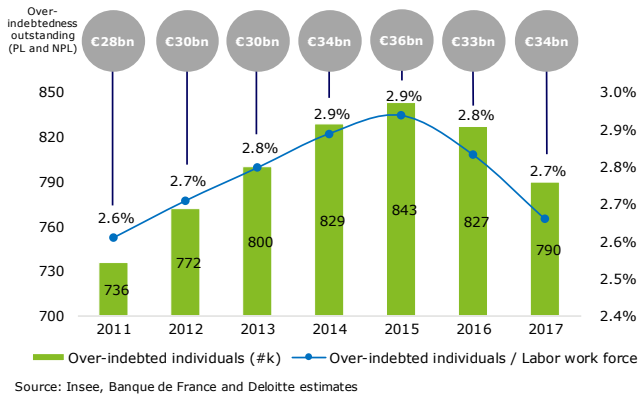
### Retail NPLs breakdown (Dec-17)



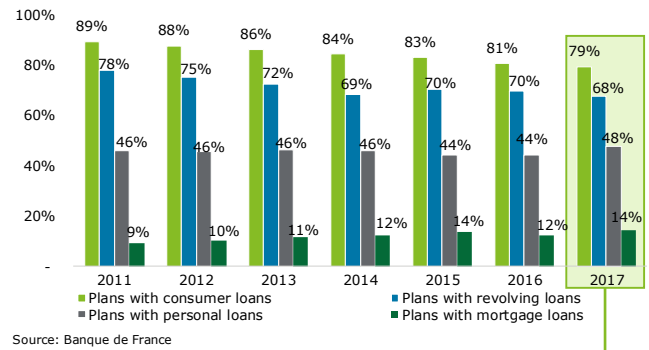
Source: Banque de France, EBA Stress Test Result and Deloitte analysis  
 Note: Secured loans include only residential and SME real estate loans

Over-indebted individuals in France represented 790k in 2017. BDF plans mainly included unsecured loans (14% had a mortgage in 2017).

### Over-indebted individuals and outstanding



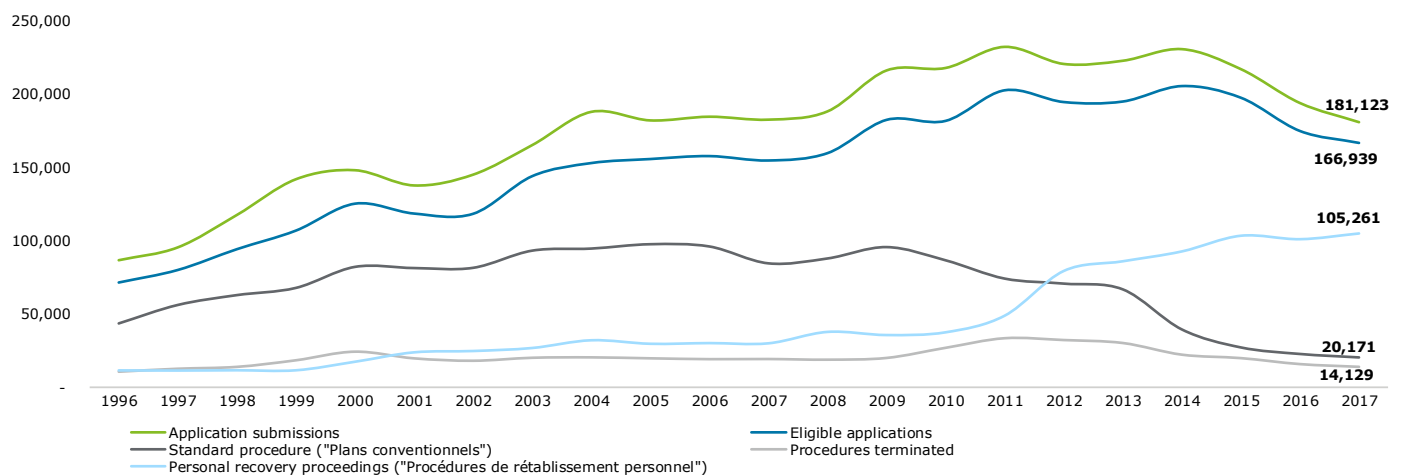
### Loans outstanding in BDF plan applications



**For 100 BDF plan applications in 2017:**

- 79 plans incl. at least a consumer loan
- 68 plans incl. at least a revolving loan
- 48 plans incl. at least a personal loan
- 14 plans incl. at least a mortgage loan

### BDF plan activity by stage (#)



Note: chart presented above shows the evolution of the number of BDF plan applications by stage:

- **Application submissions:** in case of severe defaulted situation, individuals initiate process by submitting a BDF plan application to Banque de France. When the application is submitted, the individual is registered to the national payment incident database, FICP ("Fichier national des Incidents de remboursement des Crédits aux Particuliers")
- **Eligible applications:** BDF examines the application to assess the eligibility of a plan
- **Standard procedure:** BDF defines a solution tailored to applicant's economic situation (new repayment schedule, deferment and/or partial write-off)
- **Personal recovery proceedings:** in a highly deteriorated financial situation, BDF can implement a total write-off (FICP registration continues for 5 - 7 years)
- **Procedures terminated:** BDF plan is closed (full repayment or total write-off)

# Credit management landscape

Credit management market is fragmented as few key players and several mid-sized local and foreign competitors constitute the market. Most of the transaction volume is completed at a regional seller level and on a bilateral basis with no external communication. This results in a lack of transparency regarding the size of the market.



## Fragmented but consolidating credit management market

The French retail banking sector is among the largest in Europe with loans outstanding of c.€1,600bn<sup>(1)</sup> while retail NPLs in France reached c.€60bn<sup>(1)</sup> (incl. SMEs loans) as at December 2017.

Credit management companies continue to dominate the defaulted loan portfolio market, benefiting from robust acquisition and servicing capacities. A few key players and many small/medium sized local competitors compete with local subsidiaries of larger European groups. While the strategic focus varies in terms of activity and nature of loans acquired or serviced, an increasing number of debt purchase specialists are focusing on the financial services sector. International NPL specialist funds are increasingly focused on the French market as the last two years have seen an uplift in traded portfolios.

Barriers to entry are high due to reputational and technical factors, as well as the absence of credit bureaus in France making it difficult for new entrants with no consumer credit history. Purchase capacity depends on shareholder financing and access to capital markets, whereas servicing capacity is correlated to operational and organisational scale mainly driven by internal resources and market expertise.

The competitive landscape is fragmented, but experiencing a consolidation phase. Local players seek to reinforce debt purchase and servicing capacities and European competitors are eager to enter the market to address a sizable opportunity, which remains untapped. In July 2018, MCS, one of the leading French market players, announced the acquisition of DSOgroup, an independent French debt collection management company. In March 2018, B2 Holding, a Norwegian company present in 22 countries, acquired NACC, a French debt purchasing and servicing company.

## Market remains opaque with limited transparency in loan portfolio activity

Unlike the Italian or UK NPL markets which are significantly more mature, the French market is still emerging and thus remains opaque. Many transactions are completed on a bilateral basis and at a regional level under strict confidentiality clauses limiting public communications. As a result it is difficult to gather all the portfolio transactions completed in the market.

Whereas larger transactions trading in auction processes benefit from increased transparency, neither sellers nor buyers tend to disclose the completed deals.

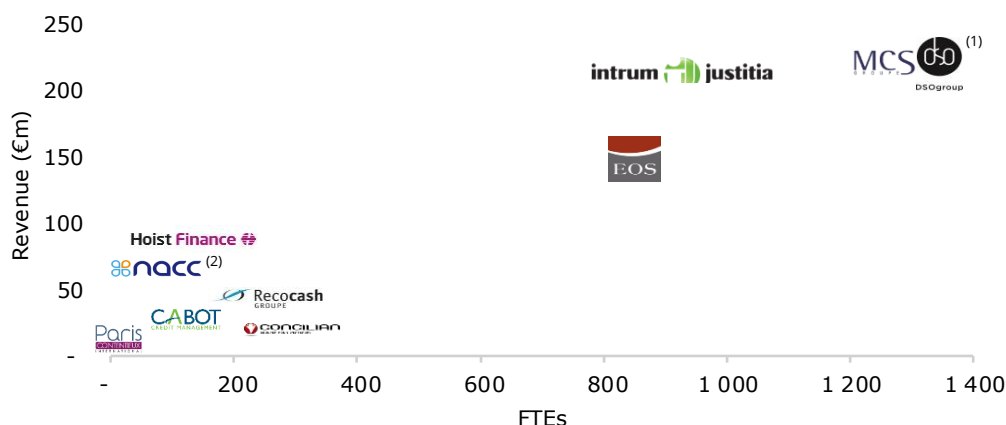
In an attempt to present a more reliable picture of the market and complement publicly available data, Deloitte leveraged this study to request proprietary information from a pool of credit management companies operating in France. The focus was on company financials and key performance indicators as well as the number and high level details of transactions observed in the market in FY17 and 1H18. As a quorum was not reached in terms of responses, Deloitte could not publish the information received. This outlines the complexity and opaqueness of the market.

Selected platform and retail loan portfolio transactions are presented further in the report. The magnitude of portfolio deals is not representative of the market size given the volume of deals completed through bilateral processes and forward flow agreements could represent up to 50% of transactions, based on discussions and interviews with key market players.

Note: (1) Including SME loans

The market remains fragmented, however is undergoing consolidation.

### Credit management competitive landscape in France (FY17)



Source: Diane, public information and Deloitte estimate

Note: (1) MCS acquisition of DSO signed in July 2018, (2) B2Holding acquired NACC in March 2018

### Selected Credit management players operating in France (FY17)

Ownership	Revenues (€m)	FTEs (#)	Type of seller	Activity	
				Debt purchase	Debt servicing
MCS DSO (PE fund (BC Partners/ Montefiore Investment))	187	1,161	FIG and non-FIG	PL / NPL	PL / NPL
intrum justitia (Public)	85	652	FIG and non-FIG	PL / NPL	PL / NPL
EOS (Public)	83	540	FIG and non-FIG	PL / NPL	PL / NPL
nacc (Corporate (B2Holding))	30	97	FIG	PL / NPL	PL / NPL
Hoist Finance (Public)	12	107	FIG and non-FIG	PL / NPL	NPL
CABOT (Corporate (ENCORE Capital Group))	11	80	FIG and non-FIG	NPL	PL / NPL
164 (Private individuals)	4	35	FIG and non-FIG	NPL	NPL

Source: Diane and public information



## Selected international credit management companies and valuations.

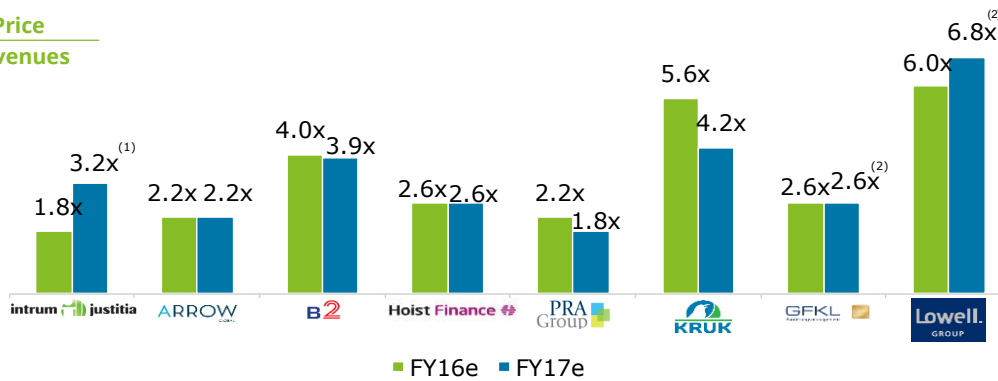
### Credit management sector selected competitors and valuations (FY17e)



Source: Company annual reports and Deloitte estimates

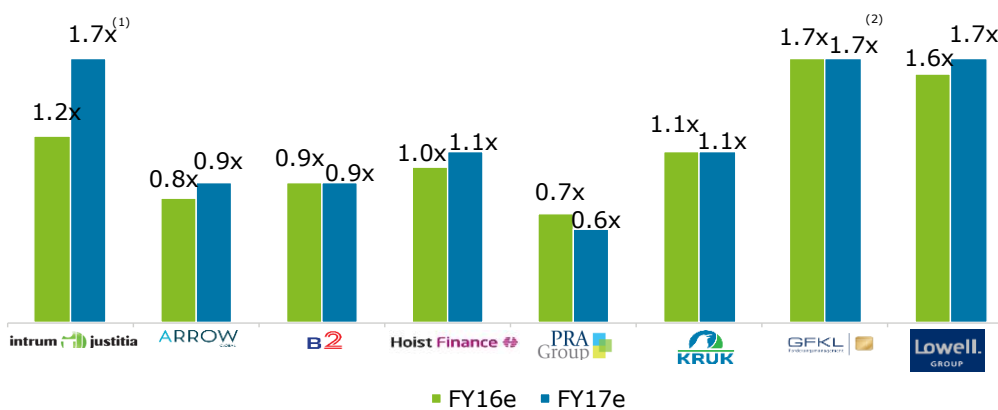
Note: Proforma revenue and ERC (LTM March 2017) for Intrum Justicia following the acquisition of Lindorff in June 2017

#### Price Revenues



Source: Company annual reports and Deloitte estimates

#### EV ERC



Source: Company annual reports and Deloitte estimates

Note: (1) Proforma revenue, ERC and net debt for Intrum Justicia following the acquisition of Lindorff in June 2017

(2) Estimated transaction multiples related to the acquisition of GFKL and Lowell Group by Permira (July 2015)

## Selected platform transactions (not exhaustive).

Year	Target	Buyer	Consideration	Price
2018	Serfin	MCS-DSO	100%	Confidential
2018	DSOgroup	MCS	100%	Confidential
2018	NACC	B2Holding	100%	€90m
2017	Ijcof	Intrum	100%	n/a
2017	Crédit Immobilier de France	MCS	Portfolio servicing	n/a
2017	Effico	DSO Group	Confidential	Confidential
2016	Lindorf	Intrum	100%	c. €4bn
2016	Contentia	EOS Group	100%	n/a
2016	Nemo Recouvrement	Cabot Credit Management	50.1%	c.€1.2m
2015	NACC	Pragma Capital	70%	n/a
2015	Teotys	DSO Group	100%	Confidential
2015	DSO Group	Montefiore Investment	75.5%	Confidential
2014	MCS	Cerberus European Investment	n/a	n/a
2014	Sedree	DSO Group	100%	Confidential
2014	Aktiv Capital	PRA Group	100%	c.€950m
2014	Buro 230	DSO Group	100%	Confidential
2011	Credirec	EOS Group	100%	n/a

Source: Company annual reports, press releases, Mergermarket and Deloitte estimates

## Selected portfolio transactions (not exhaustive, approximate nominal amounts).

Year	Asset type	Buyer	Seller	Exposure (€m)	PL/NPL
Ongoing	Consumer	N/A	Confidential (Retail bank)	300	PL/NPL
Ongoing	Mortgage loans	N/A	Confidential (Mortgage bank)	500	PL/NPL
Ongoing	Consumer and Mortgage loans	N/A	Confidential (Retail bank)	40	NPL
2018	Consumer and Mortgage loans	Confidential (Debt purchaser)	Confidential (Retail bank)	25	NPL
2018	Consumer and Mortgage loans	NACC	Confidential (Retail bank)	30	NPL
2018	Consumer loans	Confidential (Debt purchaser)	Confidential	35	NPL
2018	Overdrafts and instalment loans	Hoist Finance AB	Confidential (Retail bank)	45	NPL
2018	Consumer and Mortgage loans	NACC	Confidential (Retail bank)	47	PL/NPL
2018	Auto loans	Hoist Finance AB	Confidential (Specialty finance)	49	NPL
2018	Auto loans	Confidential (Debt purchaser)	Confidential (Specialty finance)	55	NPL
2018	Mortgage loans	Hoist Finance AB	Confidential (Mortgage bank)	95	PL/NPL
2018	Consumer loans	Confidential	Confidential (Bank)	135	NPL
2017	Consumer loans	1640	Confidential (Retail bank)	20	NPL
2017	Consumer loans	Confidential (Debt purchaser)	Confidential (Bank)	28	NPL
2017	Consumer and SME loans	Confidential (Debt purchaser)	Confidential (FR foreign territory)	25	NPL
2017	Consumer loans	Confidential (Debt purchaser)	Confidential (Bank)	30	NPL
2017	Consumer loans	Confidential	Franfinance	40	NPL
2017	Consumer loans	Hoist Finance AB	Confidential (Retail bank)	44	NPL
2017	Consumer loans	Confidential	Confidential (Bank)	60	NPL
2017	Consumer and Mortgage loans	Confidential (Debt purchaser)	BPCE	68	NPL
2017	Consumer and Mortgage loans	EOS Contentia	CMP Banque	70	PL/NPL
2017	Consumer and Mortgage loans	NACC	Confidential (Retail bank)	85	NPL
2017	Mortgage loans	Confidential (Debt purchaser)	Confidential (Mortgage bank)	100	NPL
2017	Consumer and Mortgage loans	NACC	Confidential (Retail bank)	100	NPL
2017	Consumer loans	Confidential	Crédit Mutuel	120	NPL
2017	Consumer and SME loans	Confidential (Debt purchaser)	LCL	150	NPL
2017	Consumer loans	Confidential	Confidential (Bank)	180	NPL
2017	Consumer loans	1640	Confidentail (Investment fund)	215	NPL
2017	Consumer loans	Confidential	Crédit Agricole CF	500	NPL

Source: Company annual reports, press releases, Mergermarket and Deloitte estimates

# Regulatory framework

The recent publications by the EBA of its consultation on the guidelines for management of NPLs, followed by a set of recommended measures by the European Commission, reinforce the will of the authorities to accelerate the reduction of non-performing loans within the Euro area.



## ECB guidance on NPL management

*Application since March 2017*

In its strategy against NPLs, the regulator requires institutions to follow 4 levers :

**Strategy:** A NPL reduction strategy must be designed by banks and should include both qualitative and quantitative objectives. This strategy should support an operational plan for reducing NPLs.

**Governance:** The governance of NPLs can be structured in different manners, including the set up of specific management units.

**Processes:** The goal for banks is to ensure that the day-to-day management of NPLs is as automated as possible so that formerly extraordinary operations can become standardised management cases.

**Tools and Data:** Banks must set up management and reporting tools adapted to NPL issues. Economic data as well as all relevant information (e.g. historical portfolio transfer pricing) must be available and operational.

## Addendum to the NPL

*Publication in October 2017*

The addendum specifies minimum impairment rate thresholds depending on the time spent in default and the level of collateral. These measures should be seen as "prudential provisioning backstops" aimed at a prudent treatment of non-performing exposures (NPEs) and therefore avoiding excessive build-up of non coverage aged NPEs on banks' balance sheets in the future.

## IFRS 9

*Application since January 2018*

The IASB published the final version of IFRS 9 Financial Instruments in July 2014.

The main changes compared to IAS 39 are focused on the following points :

- Classification and measurement of financial assets
- Impairment
- Classification and measurement of financial liabilities
- Hedge accounting

On the impairment side, IFRS 9 introduces a new model based on expected losses rather than incurred loss as per IAS 39. To address these requirements, banks have developed statistical models and staging rules for all their portfolios (Internal Rating Based - IRB - or not). In most cases, staging criteria appear to be close to early warning indicators as defined in the NPL guidelines. Banks are thus expected to monitor these indicators and their behaviour, and adjust their loan portfolios management when necessary.

## Guidelines on disclosure of non-performing and forborne exposures

*Consultation paper published in June 2018*

The development of the secondary market for NPLs is a priority for the authorities. In this way, these guidelines specify the information related to non-performing, forborne exposures and foreclosed assets that banks should disclose and they provide uniform disclosure formats. By addressing potential asymmetries of information and providing common disclosure on the quality of banks' assets, the guidelines seek to foster transparency and market discipline.

## Recent months have seen an increasing and evolving focus on NPL management and associated risk issues with significant impacts for the banking sector.

The 2008 financial crisis highlighted the pro-cyclical nature of the banking system as a whole. The lack of homogeneity and comparability of the risks incurred by the banks reached its peak with the sharp increase in the stock of NPLs and defaults more generally. The impacts of this increase are significant since they highlight the lack of caution taken by the estimators used so far, so the losses suffered by banks during this period were greater than the amounts provisioned. To address these challenges, regulators have initiated several measures designed to push institutions to adjust their business management and stress the profitability of NPL portfolios.

### Operational limits and relative costs

Ensure an overall consistency of concepts and increase the operational constraints relative to NPL management and reporting to enable a more proactive and efficient monitoring:

- Guidance on NPLs, Sept-16, and NPL templates
- Guidance on the application of the definition of default, Sept-16
- Half year risk reports and dashboards on the potential impact of NPL on the profitability

### Risk Weighted Assets (RWA) and constraints on IRB models

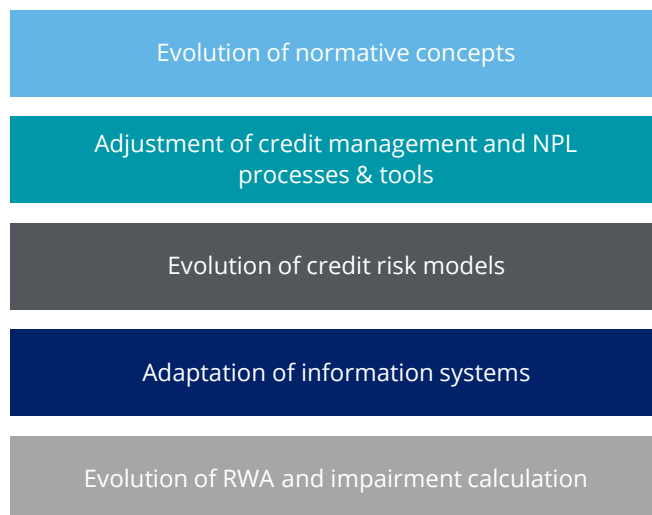
Ensure comparability and conservatism of RWA, specifically for deteriorated loans:

- Guidance on the application of the definition of default, Sept-16
- New set of constraints on IRB models, Nov-16
- TRIM : Global review of IRB models
- Evolution of CoRep and FinRep, Anacredit
- ECB Addendum including provisioning thresholds

### Impairments with IFRS 9

- Introduction of new provisioning rules and calculation methods including staging rules to differentiate deteriorated loans
- Potential recognition of NPL deleveraging in IFRS 9 expected credit loss (ECL)

### Key impacts



### Adjustment of business models

### Key success factors

- 1** Ensure compliance with the new set of regulatory constraints
- 2** Ensure consistency between new normative concepts of default, credit risk models and credit management processes
- 3** Deploy new sets of indicators to measure credit performance and support the dynamic management of credit portfolios
- 4** Develop an enhanced NPL strategy incorporating a focus on deleveraging supported by detailed operational plans

In March 2017, the ECB published its final guidance on NPL recognition and management, covering the life cycle of NPLs.

The guidance is dedicated to credit institutions per Article (1) of Regulation (EU) 575/2013 (CRR), and is particularly relevant for banks with high level of NPLs. Nevertheless, Significant Institutions (SIs) will have to comply with this guidance, which is currently non-binding in nature. Banks should explain and substantiate any deviations upon supervisory request. Non-compliance may trigger supervisor measures.

The ECB established reduction objectives for high NPL levels over a relatively ambitious timeframe, clearly outlining the approach and objectives regarding effective management and reduction of NPL stocks.

The NPL approach covers 6 main steps:

- NPL strategy
- NPL governance and operations
- Forbearance
- NPL recognition
- NPL impairment measurement and write-offs
- Collateral valuation for immovable property

Banks are expecting to consistently adjust their operational management of NPLs from strategy to IT through organisation and processes.

The overall objective is to ensure that all appropriate means have been mobilised to set up a target organisation and business model that will support an efficient management and thus limit the risk of a potential increase of NPL stocks and reduced profitability.

These measures should be seen as “prudential provisioning backstops” aimed at a prudent treatment of NPEs and therefore avoiding excessive build-up of non coverage aged NPEs on banks’ balance sheets in the future.

## Key impacts



### Strategy

- Development of NPL management strategies to reduce stocks and flows in line with the Banks’ credit policies
- Focus on policies related to forbearance management and monitoring and effective assessment and management of collaterals



### Governance

- Creation of dedicated units for implementing actions for reducing NPLs stocks
- Strengthening of structures in charge of credit collection with particular reference to restructured credits management and to a periodic and effective assessment of collateral



### Operational management

- Development of policies and standard processes that, based on the portfolio features, enable optimal strategies for reducing NPLs to be promptly identified and developed
- Efficiency measures and operational processes review for preventing NPLs and credit collection based on portfolio features



### Tools and Data

- Development of NPL management systems supported by Data Analytics tools that enable both the optimal strategy and the credit collection performance trend to be assessed

ECB guidelines target both NPLs stock reduction and future flows minimisation at a structural level.



### Strategy

#### Reducing NPLs stock

Objectives related to NPL stock reduction have to be formalised within a multiyear plan defining objectives coherent with RAS targets. The plan has to be approved by the strategic supervisory body and sent to JST on an annual basis.

#### Preventing NPLs

The plan has to outline the credit policies that have to be defined coherently with the macroeconomic context analysis, internal competences and operational capabilities and have to direct the origination and granting policies in order to foster the possible collection activity in case of non performing classification.



### Governance

NPL management has to be assigned to 'ad hoc' offices, separated from those in charge of loans management. The operational model has to be based on a portfolio segmentation that may foster specialised competences development and maximise the credit collection performance through industrialised approaches embedded into the ordinary activities.



### Operational management & monitoring

Extraordinary transfer operations have to turn into a bank's ordinary activity, performed by a specialised function and supported by dedicated processes and procedures.

Institutions should implement "early warning" systems for prompt intervention should deterioration signals arise, and should develop tools for optimal NPL management that may support the bankers during the decision-making process.



### Tools and Data

When formulating a strategy, dynamic tools have to support it and have to enable the prompt identification of transferable portfolios, coherently with the market conditions and performance (financial and/or economical) maximisation.

Strategies monitoring requires adequate tools availability and an adequate and updated information dataset that allows the assessment, in terms of timing and costs, of the results deriving from credit collection actions and to start possible review of such strategies.

The application of IFRS 9 should be articulated with the NPL measures. It significantly changes the provisioning method of banks, as well as their understanding of and ability to assess profitability of NPL portfolios.

IFRS 9 elaboration began in 2009 with successive amendments until the final version was issued in 2014. The 2014 standard supersedes all previous versions and is mandatorily effective for periods beginning on or after 1 January 2018, with early adoption permitted (subject to local endorsement requirements).

The final version of IFRS 9 brings together the classification and measurement, impairment and hedge accounting phases of the International Accounting Standards Board's (IASB) project to replace IAS 39 Financial Instruments: recognition and measurement.

IFRS 9 is built on a logical, single classification and measurement approach for financial assets that reflects the business model in which they are managed and their cash flow characteristics. Built upon this, is a forward-looking expected credit loss model that will result in more timely recognition of loan losses and is a single model that is applicable to all financial instruments subject to impairment accounting.

In addition, IFRS 9 addresses the so-called own credit issue, whereby banks and others book gains through profit and loss as a result of the value of their own debt falling due to a decrease in credit worthiness when they have elected to measure that debt at fair value.

Steering these adjustments involves several projects for banks:

- Adaptation of information systems
- Evolution of credit risk models
- Adjustment of credit risk policies and closing processes

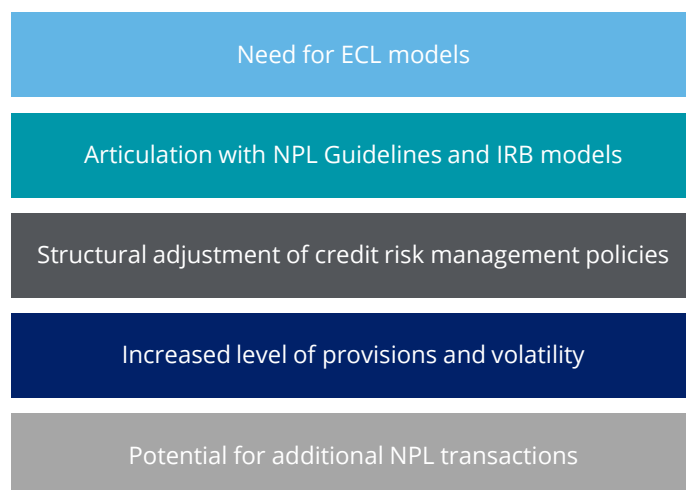
In practice, banks have had to develop statistical models for all their portfolios (IRB or not), design appropriate staging rules for differentiating deteriorated exposures and design comprehensive forward looking approaches to quantify expected credit losses.

The IFRS 9 implementation led to an increase of volatility and amount of provisions, but also enables banks to better understand the risks of their portfolios and thus adjust their management.

In addition, IFRS 9 recognises the possibility to take into account possible portfolio disposals, in particular in a forward looking logic, since these transactions are part of the structural management of the business and are no longer accidental or opportunistic.

This strategic adjustment should strengthen the bank's appetite for entering into these mechanisms and move into a more dynamic management of their NPL portfolios.

#### Key impacts





# What's next?

Five banks are the main contributors to the NPL market in France, but this hides a fragmented network of autonomous subsidiaries managing their own NPL strategies. Increasing pressure on banks' profitability and a tightening regulatory framework will likely escalate deleveraging activities as banks look to offload assets.



The NPL situation is improving on an European scale with stock of NPLs steadily declining across Europe. This trend was confirmed in France through a c.5% decrease of the aggregated NPL stock of the top 5 French banks between June 2016 and June 2017.

Still, NPL outstanding remains significant in France and represents the second largest NPL stock in Europe. Furthermore, concerns emerge as credit outstanding to the private sector continues to increase in France and regulators consider that European banks need to further improve loan portfolio credit quality.

The NPL market remains underdeveloped and opaque in France, but banks are gradually implementing NPL disposal processes as part of their NPL management strategy, hence further opening the market. To address the growing NPL market, credit management companies are consolidating to reinforce loan purchase and servicing capacities.

Banks are currently experiencing increasing pressure from regulatory bodies. An action plan for the accelerated resolution of NPLs is a priority for the European Union. In March 2018, the ECB presented a package of measures whose expected impacts aim to accelerate legacy NPL stock reduction and prevent future accumulation by facilitating secured loans recovery and developing secondary markets dedicated to NPL management.

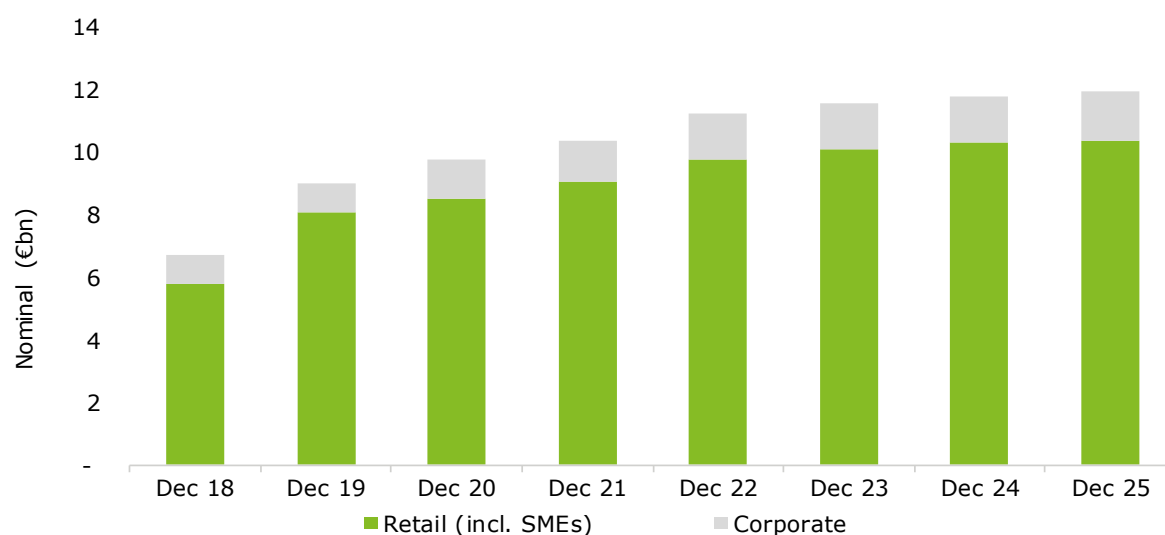
Secondary markets would enable NPL trades between banks and third party investors, broadening the investor spectrum and better reflecting NPL pricing for sales. In 2017, the EU published a consultation paper regarding its work on legislative measures to reduce potential impediments implementing such a market.

ECB recently indicated that new measures should be enforced if banks' efforts are considered insufficient. Moreover, the EBA 2018 Stress Test indicated that some European banks, including some French banks may need to strengthen their regulatory capital as an adverse scenario showed CET1 ratio below 9%.

Investor demand, profitability and regulatory pressure will drive banks to continually improve asset quality, leading to accelerated activity in the disposal of non-core and non-profitable loan portfolios. In order to generate capital and strengthen profitability, French banks will also seek acquisition opportunities, especially within the retail banking market, which meets strong return on equity levels compared to other business lines. This consensus generates numerous opportunities for investors looking for both acquisitions and divestitures.

The outlook for the French NPL market remains optimistic as key indicators reveal more acquisition opportunities to come.

### Non-performing loan sales estimate



Source: EBA-wide stress transparency result, Banque de France and Deloitte

Note: Forecast NPL sales are based on statistical considerations using historical NPL outstanding data from EBA and Banque de France, as well as historical and forecast macro-economic data including real GDP growth, unemployment rate and gross public debt as a percentage of GDP.

“The simpler way to reduce NPLs consists in selling to remove outstanding from the balance sheet, but a market and a value are necessary to avoid regulatory thresholds and find willing buyers. This presupposes that sellers defined correct levels of provisions and buyers can be provided with collateral of satisfactory quality.”

Olivier Guersent, Director-General for Financial Stability , European Commission

# Appendix 1 – Debt collection market

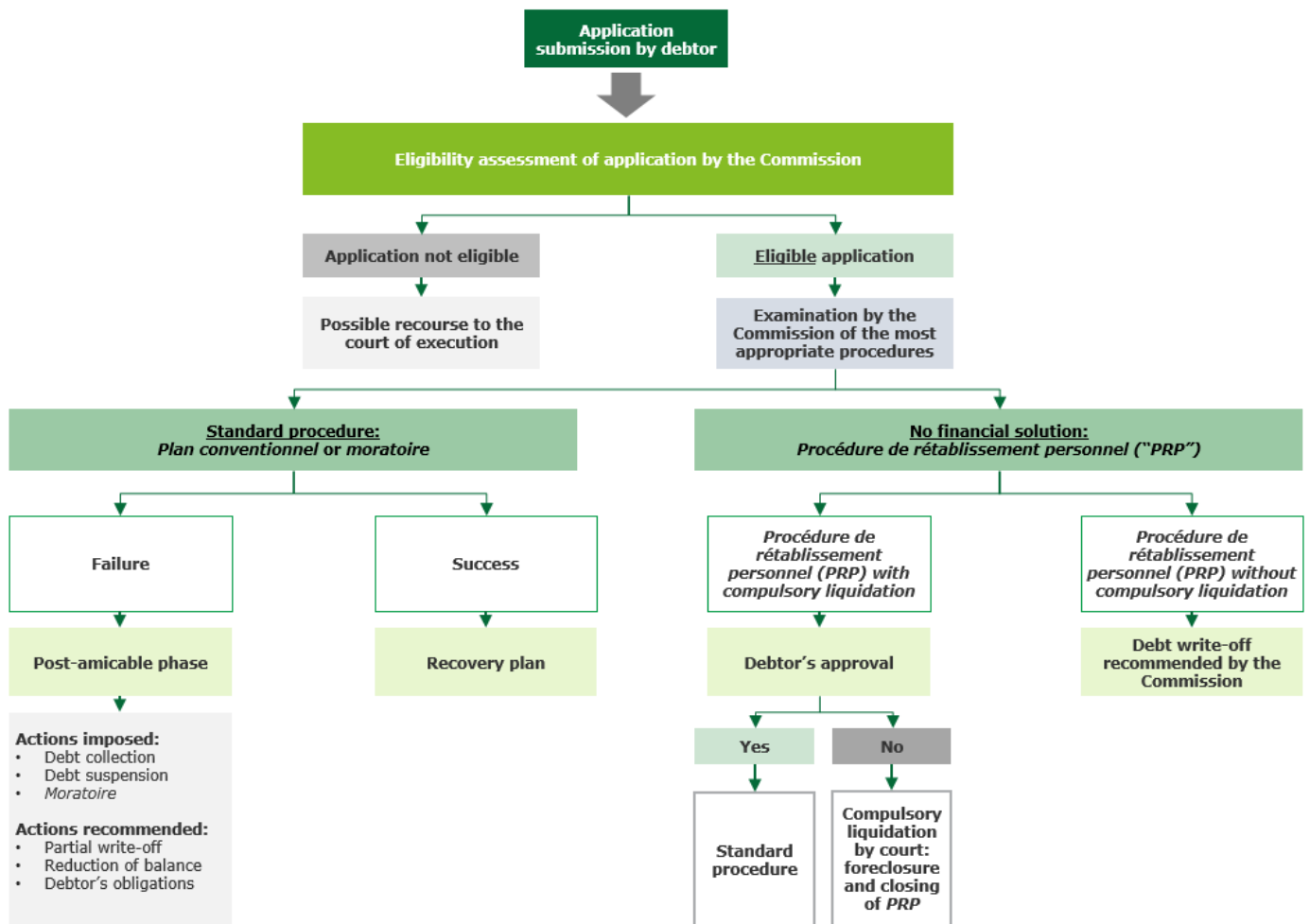
Selected Players	Ownership	Key figures (FY17a)	Type of seller	Debt collection	NPL purchase	Type of debt
	PE fund (BC Partners/ Montefiore Investment)	Revenue: €187m FTE: 1,161	FIG and non-FIG	✓	✓	Secured/ Unsecured/ Corporate
	Public	Revenue: €85m FTE: 652	FIG and non-FIG	✓	✓	Secured/ Unsecured/ Corporate
	Public	Revenue: €83m FTE: 540	FIG and non-FIG	✓	✓	Secured/ Unsecured
	Corporate (B2Holding)	Revenue: €30m FTE: 97	FIG and non-FIG	✓	✓	Secured/ Unsecured/ Corporate
	Corporate (Verdoso)	Revenue: €14m FTE: 190 <sup>(1)</sup>	FIG and non-FIG	✓	✗	Unsecured
	Public	Revenue: €12m FTE: 113	FIG and non-FIG	✓	✓	Secured/ Unsecured/ Corporate
	Corporate (Société Générale)	Revenue: €12m FTE: 217	FIG and non-FIG	✓	✓	Secured/ Unsecured
	Corporate (ENCORE Capital Group)	Revenue: €11m FTE: 80	FIG and non-FIG	✓	✓	Secured/ Unsecured
	Private individuals	Revenue: €8m FTE: 105	FIG	✓	✗	Unsecured
	Private individuals	Revenue: €8m FTE: 135	Non-FIG	✓	✗	Unsecured
	Corporate (Crédit Mutuel – CIC Group)	Revenue: €5m FTE: 71	FIG and non-FIG	✓	✗	Unsecured
	Private individuals	Revenue: €5m FTE: 33 <sup>(1)</sup>	Non-FIG	✓	✗	Unsecured
	Private individuals	Revenue: €4m FTE: 35	Non-FIG	✓	✓	Secured/ Unsecured
	Private individuals	Revenue: €3m <sup>(2)</sup> FTE: 24	Non-FIG	✓	✗	Unsecured

Sources: Diane, company annual reports, public information and Deloitte estimates  
Notes: (1) Data as at FY16; (2) Data as at FY14

# Appendix 2 – Banque de France loan restructuring process

Banque de France established a debtor friendly loan restructuring process.

## Simplified BDF plan application cycle



# Appendix 3 – SME loan guarantees

SME loans are usually backed by several types of guarantees.

## Type of guarantees backing SME loans

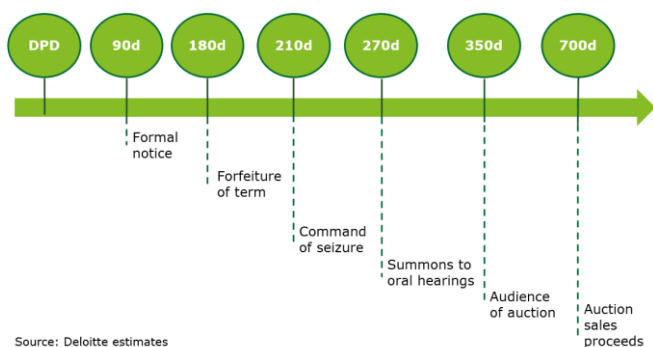
Type of guarantees	Real estate pledge	Personal guarantee	Financial guarantee (BPI, SIAGI etc.)	Company's undertaking pledge
<b>What it is ?</b>	<ul style="list-style-type: none"> <li>Owned property placed by the debtor (the pledger) as a security for a loan to a creditor (the pledgee).</li> <li>➤ <u>Considered to be a real security</u> (the property is tied directly to a loan guarantee).</li> </ul>	<ul style="list-style-type: none"> <li>Unsecured written promise from an individual or a business owner or executive guaranteeing payment of a loan in the event the business does not pay.</li> <li>➤ <u>Not tied to a specific asset.</u></li> </ul>	<ul style="list-style-type: none"> <li>Counter-guarantee provided by French Public Investment Bank (owned by Caisse des dépôts et consignations 50%, and the State 50%) which offers funding and guaranty to SMEs, Micro-enterprises, and independent / self-employed.</li> <li>Guarantees range from 40% to 70% of loan amount.</li> </ul>	<ul style="list-style-type: none"> <li>Pledge of the business (and its assets) to the benefit of the creditor to protect it against the risk of none refund (repayment) of the debt by the debtor.</li> </ul>
<b>How can it be triggered ?</b>	<ul style="list-style-type: none"> <li>Property should be registered to the mortgage office (for a given value and amount of time) by the notary to the benefit of the lender.</li> <li>Once the default has been pronounced by a judge, the lender can seize the property (foreclosure), sell it, and cover the remaining loan balance.</li> <li><b>Required : Mortgage registration document.</b></li> </ul>	<ul style="list-style-type: none"> <li>Guarantor must sign the written promise, with the bank holding the original document as the security.</li> <li>Can be revoked in several cases (physical loss of the guaranty, mandatory information that the guarantor has to sign is absent, disproportion between the patrimony of the guarantor and its commitment etc.).</li> <li><b>Required : Signed promise with mandatory information.</b></li> </ul>	<ul style="list-style-type: none"> <li>Can't be invoked by either the borrower nor the surety.</li> <li>Intended as guarantee for financial institutions to cover part of the bank's debt in the event of default by the borrower.</li> <li>Will only settle the bank's final loss after all other securities have been activated.</li> <li><b>Required : BPI's signed approval.</b></li> </ul>	<ul style="list-style-type: none"> <li>Contract should be signed between a debtor and their creditor.</li> <li>Eight days after a fruitless order to pay, a creditor who benefits from a pledge can ask the commercial court to order the public auction of the company's assets (collection). The holder of the pledge then has the right to be paid before other creditors.</li> <li><b>Required : registered deed deposited at the "greffe".</b></li> </ul>
<b>Valuation implication</b>	<ul style="list-style-type: none"> <li>One of the most solid types of guaranty.</li> <li>After the property foreclosure it can be valued according to market index and sold.</li> </ul>	<ul style="list-style-type: none"> <li>Unlike a real guaranty whose value can easily be determined, the assessment of the value of the personal security is difficult : it is based on the importance of what a debtor holds (RE, shares, options etc.).</li> </ul>	<ul style="list-style-type: none"> <li>After partial payments induced from activating other securities, BPI will refund the debtor the portion (40% to 70%) of their final loss.</li> </ul>	<ul style="list-style-type: none"> <li>Difficult to assess precisely the amount that can be recovered, as value of assets, and therefore the collection, will depend on the liquidation of whatever the company holds.</li> </ul>

Source: Public information

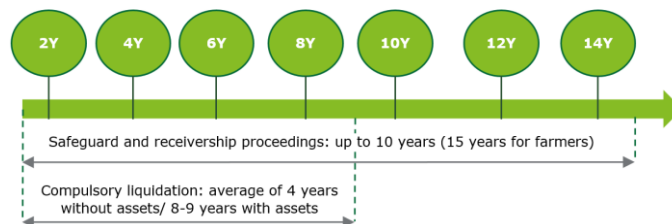
# Appendix 4 – Recovery process and legal proceedings

Debt holders can recover a mortgage loan after 700 days, on average, with large variances. SME legal proceedings can last between four to ten years.

## Mortgage standard recovery process



## Average length of legal proceedings



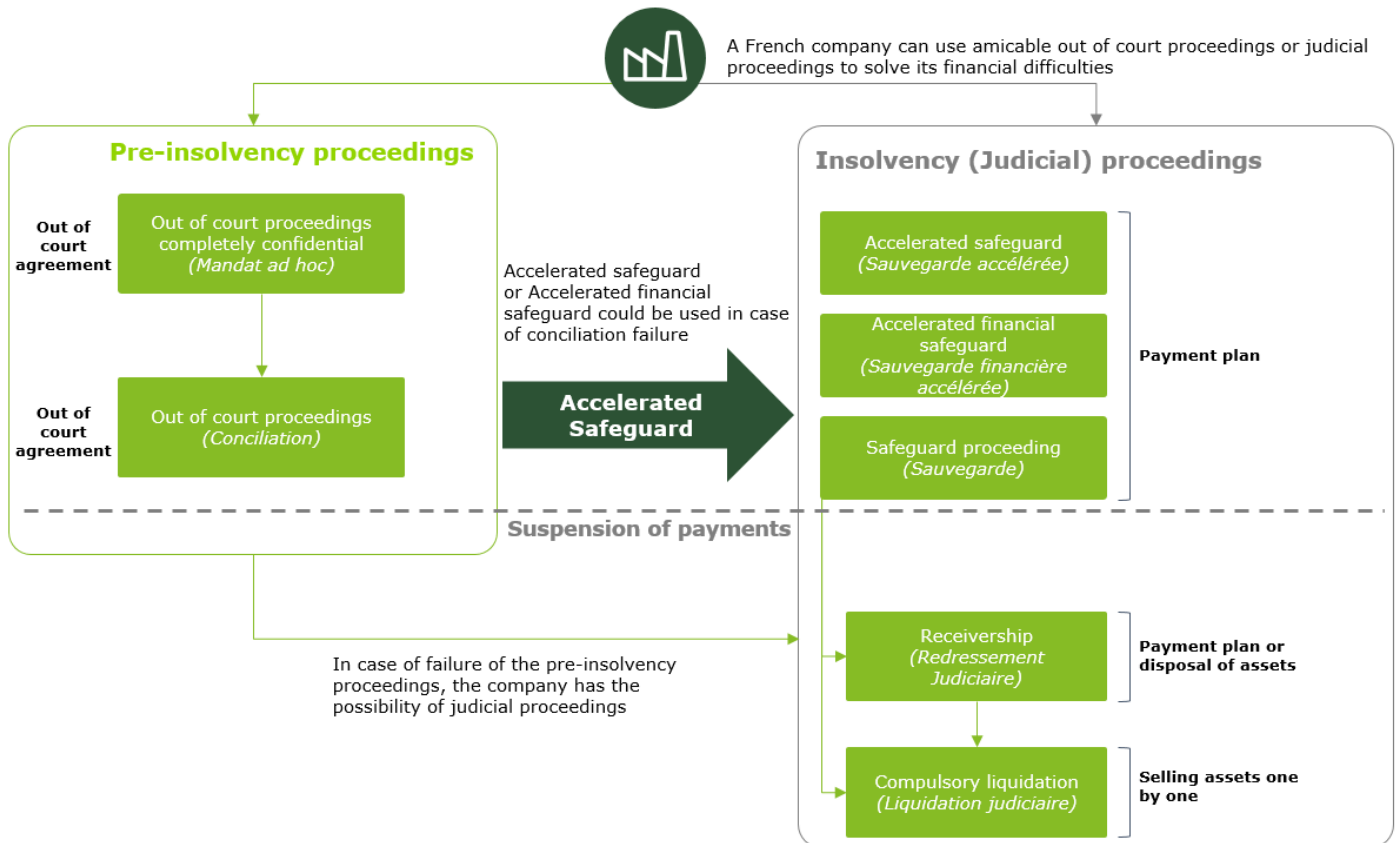
In the context of a mortgage, default is usually pronounced after 90 days past due. The process encompasses the following phases:

1. When the debtor is not able to meet the payment due date, the term is forfeited (*déchéance du terme*).
2. Following the forfeiture of the term, through the command of seizure (*assignation des débiteurs*), debt holders command debtors to pay the overdue amount and the capital.
3. The debtors and the guarantors are then summoned to a court hearing (*convocations pour audience*).
4. The Court usually decides to sell the collateral through an auction (*ordre de mise en vente*).
5. The proceed from the sale of the asset pledged is distributed to debt holders (*distribution des fonds*).

# Appendix 5 – Legal proceedings cycle

French legal framework is complex and tends to extend recovery process.

## Simplified legal proceedings cycle



# Contacts – Portfolio Advisory Services

## France

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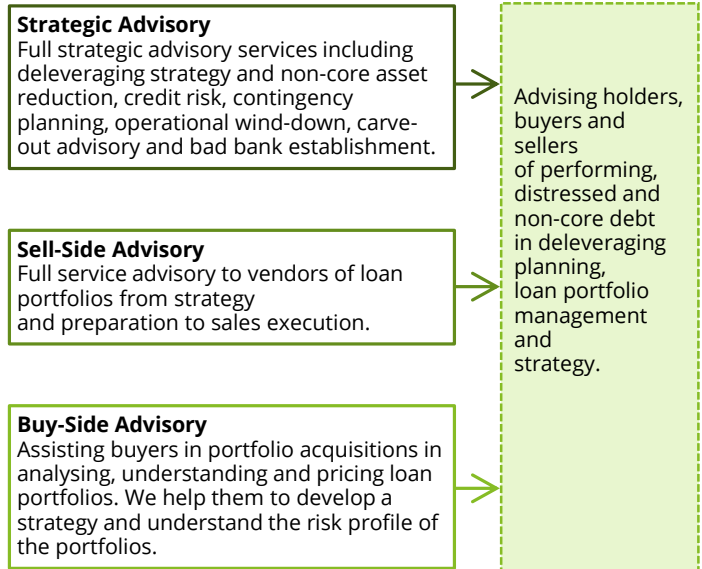


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