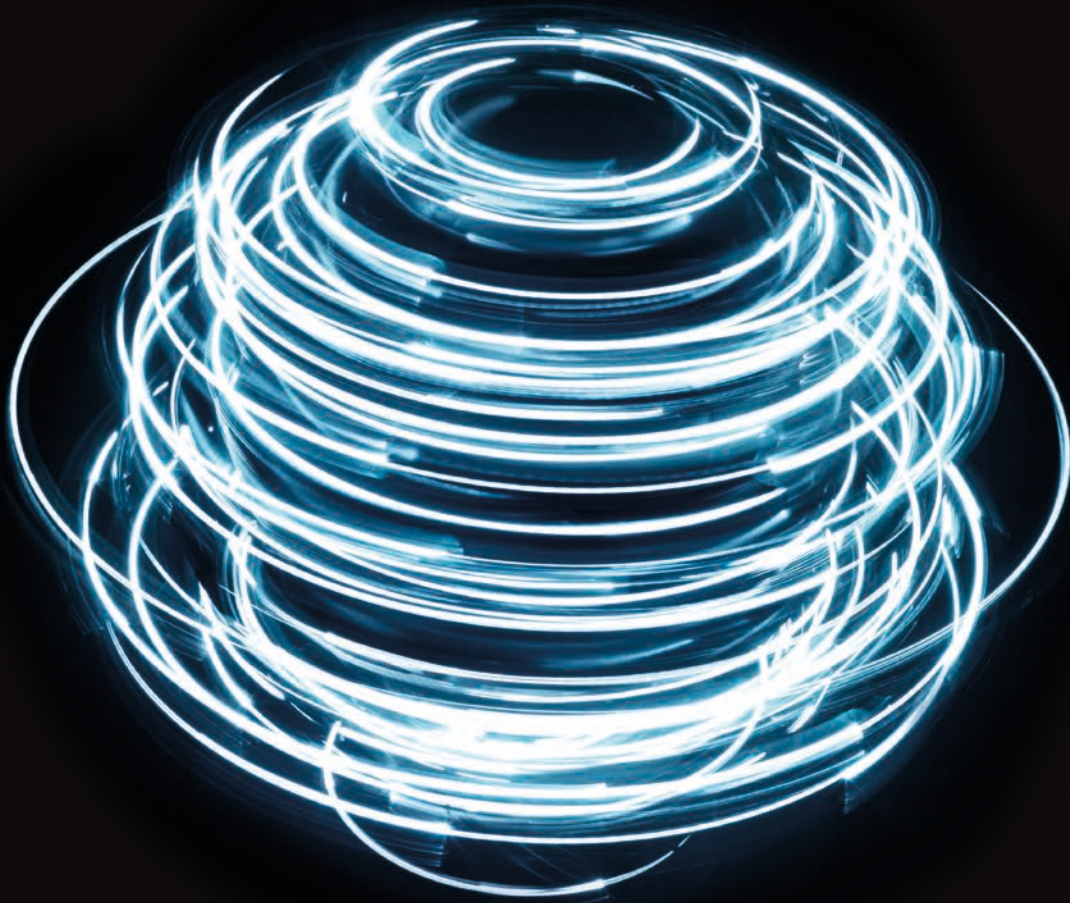


Deloitte.



Shifting momentum

Regulation driving change in
European loan portfolio markets

Deleveraging Europe H1 2017

Financial Advisory ●

Contents

Introduction	01
Market overview	03
European NPLs – The clash of politics and the markets	09
Italy	13
United Kingdom & Ireland	16
Spain & Portugal	20
Germany & Netherlands	25
Greece & Cyprus	29
Austria & CEE	31
France	34
Nordics	36
Emerging markets	37
China	38
Indonesia	38
Thailand	39
India	39
Middle East	40
Brazil	41
Deloitte Portfolio Lead Advisory Services	42
Contacts	43



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Introduction

The European loan portfolio market had a slow start in the first half of 2017 compared to the same period last year, as sellers and investors pushed deals into the second half of the year. But with a large number of ongoing deals still in the pipeline for the second half, the total market for 2017 is currently set to exceed the record deal making of the previous two years when over €100 billion of deals were concluded.

The pipeline is busy

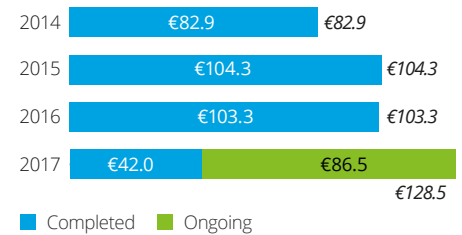
At the mid-year point €42 billion of deals had been completed in Europe (compared to €45 billion last year) with another €3 billion in emerging markets, and €87 billion of deals were ongoing. The only market that has currently outperformed last year is the UK, where the €20.2 billion of completed sales is accounted for almost entirely by a single sale of a residential mortgage portfolio from the UK wind-down institution UKAR. The rate of deal completions in Ireland, the Netherlands and Germany has been modest given the strong momentum built up in 2016, while Spain and Italy – the busiest markets in Europe last year – has seen €4.7 billion and €9.3 billion of deals completed respectively by mid-2017 (excluding the €26.1 billion loan portfolio that was transferred to Intesa as part of its acquisition of Banco Popolare di Vicenza and Veneto Banca). With a total of €75 billion in ongoing deals these two markets have busy times ahead.

Regulatory influence

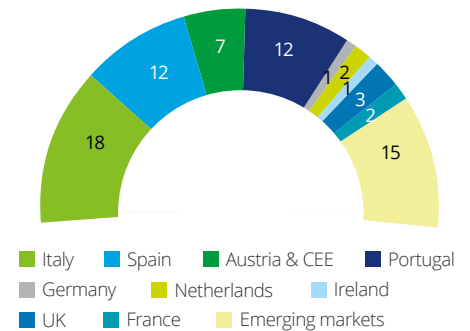
One element that has tempered the pace of deals in 2017 has been the heavy regulatory load on potential NPL sellers in 2017. They are dealing with the European Central Bank's new guidelines on NPL recognition and disposal strategy, the forthcoming adoption of IFRS 9 standards which will push banks towards a more forward-looking and rigorous approach to loss provision, and the European Banking Authority's 2017 Transparency Exercise, which draws data from all significant eurozone banks on current NPL exposure. The first two of these regulatory changes have created a heavy workload for banks. They have had to hire new staff and create new divisions to identify NPLs in considerable granular detail, and to report back to the ECB on exposures and disposal strategies. In some cases, they have simply been too busy to sell.

Headline facts and figures

Activity by year (€bn)



Number of completed deals H1 2017



Data as of 30 June 2017

But these regulatory initiatives are positive for the market. Unaddressed NPLs in high NPL-ratio economies such as Portugal, Greece and Cyprus are likely to come to market. Markets that have paused in early 2017 are likely to see many more deals than in the past, like Ireland.

Emerging markets

As the European portfolio market evolves and matures the focus of investors gradually widens to include markets in the east. In several western European economies such as the UK, Ireland and the Netherlands, the large distressed portfolio trades have already taken place, but more deals are yet to come. Investor appetite for portfolio trades remains exceptionally high – the stock of dry powder in distressed debt buyout funds combined with leverage means that in Europe there is c. €300 billion waiting to be deployed – but the search for greater risk adjusted returns continues. There has been an increase in emerging NPL markets such as India, China, Thailand, Indonesia and Brazil.

The market matures

The market continues to mature in other ways. In most markets loan sales have already moved from unsecured loans to more difficult-to-price secured assets, often SME and corporate loans. Banks and buyers are getting better at understanding what is required to accurately price loans,

however sourcing and delivering data on these loans remains a challenge for some sellers. Markets are considering securitisation funding for some loan sales both in the performing and non-performing categories, something which we take as a sign of returning broad confidence and a lack of product and yield in traditional ABS markets. Securitisation is attractive because of its ability to spread risk, and to appeal to a wider range of potential buyers which enlarges the funding base of distressed debt market. Its success is largely dependent on good quality data being available.

So while the European loan portfolio market is changing, it also still has some considerable way to run. We continue to believe that it will take five or more years of bank restructuring and risk reduction before the demands of regulators and the capital resources of banks reach a point of equilibrium. Meanwhile the European Banking Authority estimated in its last eurozone 'Transparency Exercise' that there are just over €1 trillion of NPLs still on banks' books in the eurozone; we estimate that when non-eurozone and non-core assets are included in the total there is around €2 trillion in European loans that could come to market. This is despite the many years of deleveraging we have seen to date. There are busy years ahead.

“We continue to believe that it will take five or more years of bank restructuring and risk reduction before the demands of regulators and the capital resources of banks reach a point of equilibrium.”

Market overview

Deloitte prediction: Italy will be the busiest market in Europe for the second year running. New European markets that have not seen much activity in the recent past will now emerge, especially Portugal and Greece where momentum for significant deleveraging is building. Overall volumes in Europe are likely to exceed the record years of 2015 and 2016.



The **UK** market has begun to recover from the pause induced by the Brexit vote in mid-2016; already this year we have seen a €19 billion sale of a mortgage portfolio from UK Asset Resolution (UKAR). Future mortgage portfolios from UKAR are likely and challenger banks continue to be significant players in the UK market, but overall the UK deal flow is likely to continue to be dominated by residential assets. Alternative assets such as student loans and Public Finance Initiative (PFI) loans may begin to appear as well as potential sales from other Ireland based lenders.

Irish sales have been c. €1 billion in 2017 to date. But the beginning of the re-privatisation of Allied Irish Banks, one of the pillar banks nationalised at the height of the financial crisis, is likely to create a new deal flow as well as potential sales from other Ireland based lenders. The float of AIB could trigger substantial sales of residential and corporate loan portfolios (AIB holds €16 billion in NPLs).

A securitised market is also emerging in Ireland, with various Residential Mortgage Backed Securities placed in the last 12 months.

Deals in **Germany** this year are likely to be c. €3 billion, less than the completed deals of €10 billion in 2016. Nevertheless regulatory pressure from the ECB will likely start to prompt more deals, as German banks held €67 billion in NPLs according to last year's EBA data, and the two German 'bad banks' EAA and FMS-WM also hold around €130 billion in non-core assets, with mandates to wind down these portfolios by 2027 and 2020 respectively. It remains the case that seller price expectations are higher in Germany than elsewhere in Europe.

Deal flow fell in the **Netherlands** although that mainly reflects the very large sale of the Propertize loan book in 2016. Nevertheless Rabobank, its subsidiary FGH Bank and Propertize all have loan sales under negotiation in the second half of 2017. Rabobank in particular is likely to sell more portfolios as part of its plan to remove €150 billion in non-core assets from its balance sheet by 2020.

Activity in **France** is expected to rise. Banks are gradually moving from their preferred model of internal workouts for secured NPLs to sales of portfolios such as residential mortgages. Investors are also committing more resources to the French market. Despite a relatively low

"The float of AIB could trigger substantial sales of residential and corporate loan portfolios in Ireland, while the UK market is likely to be continue to be dominated by residential assets."

NPL ratio the large size of the financial market means that the potential NPL deal flow could also be large. The adoption of IFRS 9 is also pushing banks towards a better recognition that their NPL holdings are a practical and strategic burden, and we expect a rise in deal making over several years. The fall in deal making in **Spain** which has the third largest stock of NPLs in Europe does not fully reflect the pace of underlying activity in the market. €4.7 billion of deals were completed in the first half compared to €6.2 billion in H1 2016; however, the takeover of Banco Popular by Santander in a previously unseen process supervised by the EU's Single Resolution Board means that Santander now has €53.2 billion of NPLs to deal with. Santander has already initiated the sale process of a 51% stake in an SPV that would house approximately €30 billion of NPLs and REOs.

Although the rate of completed transactions in **Italy** fell in the first half of 2017, the second half of 2017 is set to correct that: with €9.3 billion of deals completed and over €44 billion of deals ongoing, Italy is again set to be the most active market for distressed debt in Europe. The bailout of troubled bank Monte Paschi di Siena (MPS) and the insolvency of Banco Popolare di Vicenza and Veneto Banca will help the deal flow,

“The takeover of Banco Popular by Santander in a previously unseen process supervised by the EU's Single Resolution Board means that Santander now has over €50 billion of NPLs to deal with.”

and a steady flow of improvements to the legal and recovery environment is building confidence in a market that is becoming more efficient at processing large, complex deals.

A deal pipeline is now established in **Portugal** – over €2 billion of deals were completed last year, with roughly the same either completed or ongoing this year. There is also a prospect of two very significant changes to the market, with the likely sale of Novo Banco (the ‘good bank’ successor to Banco Espirito Santo which has Portugal's largest NPL stock at €12.8 billion) to Lone Star, and the possibility the creation of a ‘bad bank’ solution to some of Portugal's outstanding stock of NPLs. These two developments together would effectively restructure the Portuguese NPL market, with large deals to follow.

Austria/CEE is another market where a fall in the number of completed deals in the first half of 2017 (sharply down on 2016 at only €600 million) is deceptive. The market is in fact quite active with at

least 20 portfolio deals currently under negotiation. All these deals are CEE deals; although several involve Austrian banks there have been no sales of Austrian assets. Significantly Raiffeisen, the Austrian cooperative banking group which has the largest unaddressed NPL stock of all Austrian banks has begun to sell.

Investors have been waiting a long time for the **Greek** NPL market to take off; there are now signs that is happening. Greek banks have already disposed of most of their non-Greek assets in Central and Eastern Europe and portfolio sales in Greece are beginning. There have also been improvements in the market environment, with reforms that make it easier to obtain NPL management licenses, and that reduce the personal liability of banking executives over NPL disposals (previously a powerful disincentive for banks clearing their NPL books). However, the **Cyprus** market remains largely untested, despite having the highest NPL ratio in Europe and a

banking sector that holds €21.3 billion of non-performing assets: this year has seen only two transactions. The **Nordic** region remains a peripheral market both in terms of NPL holdings and portfolio deals. There has been only one small

portfolio sale so far in 2017, reflecting Nordic banks' preference for internal work-outs of distressed loans. Nevertheless we consider that continued regulatory pressure on NPL resolution and capital adequacy could drive banks

to review their lending portfolios and bring to market assets that no longer fit their core business strategies. As European loan portfolio markets mature, investor interest is moving to emerging markets. In **China** the volumes

Securitisation is back

Securitisation of assets such as real estate loans earned itself a bad name in the wake of the financial crisis. Today both sellers and buyers are older and wiser, and securitisations – mainly in the form of Residential Mortgage Backed Securities or RMBSs – are back. Last year over €36 billion in European RMBSs were placed, with big deals in the UK, Ireland, Italy and Spain, compared against €27.5 billion placed in 2015, €26.9 billion in 2014 and €21.2 billion in 2013.

The increase in the volume in recent times is mostly represented by the securitisation of crisis era mortgages bought by the PE houses from the struggling financial institutions.

For issuers, whether they are the loan originating banks or specialist investors who have bought the loans, financing has been made easier as RMBS spreads have narrowed significantly over the last year. The yield compression has not only been witnessed in the core European markets but also in the peripheral markets such as Spain, Ireland and Italy. The mortgage backed bonds also attract a wider investor market than unstructured NPL portfolios, bringing institutions like pension funds and insurers to the table who are attracted by the opportunities for a balanced spread of risk and return.

The PE investors who bought these portfolios have been able to enhance their returns through the use of the securitisation financing. Lone Star and Oaktree have been active issuers in Ireland and have securitised a number of performing and non-performing loan portfolios recently.

For bank sellers there is another attraction: it is quite likely that the capital requirements regulation likely to form part of the forthcoming Basel IV regulations will allow banks to reduce their capital ratios where they can show risk reduction through securitisation.

The securitised share of NPL trading may be small compared to its 2006 height when over €254 billion in real estate asset-backed securities were placed, but it is growing. The availability of cheap financing from the ECB and BoE will play a pivotal role in the future shape of the RMBS market. As the tap of cheap financing is turned off, there is a likelihood that more securitisations will come to market.

Breaking news: The recent change in securitisation law bans the self-certified loans from being included in the securitised pools. This would disqualify a high percentage of legacy loans from being securitised after 1 January 2019. Whilst such loans can be securitised now, these will be caught under the ban when refinanced post 1 January 2019.

of NPLs and Special Mention Loans (SML) are such that it is a market that cannot be ignored. Sales to foreign investors have picked up pack H2 2016 and continued into 2017. Government initiatives around NPL securitisation contribute to the sentiment of a market starting to welcome back foreign capital. Deal flow is expected to increase significantly over the next 18 months.

In **Indonesia** NPL growth has also been accelerating over the last three years; to date the market has been struggling with matching bid ask spreads, but the adoption of IFRS 9 is likely to increase NPL recognition and encourage disposal strategies.

Thailand has a historically active NPL market; portfolios have been getting larger and institutional investors have started to acquire or establish licensed platforms in preparation for future loan trades. And in **India**, recognised stressed assets have approximately doubled from 2013 levels to an estimated US\$150 billion in 2016, thanks to regulatory pressure from the central bank. International

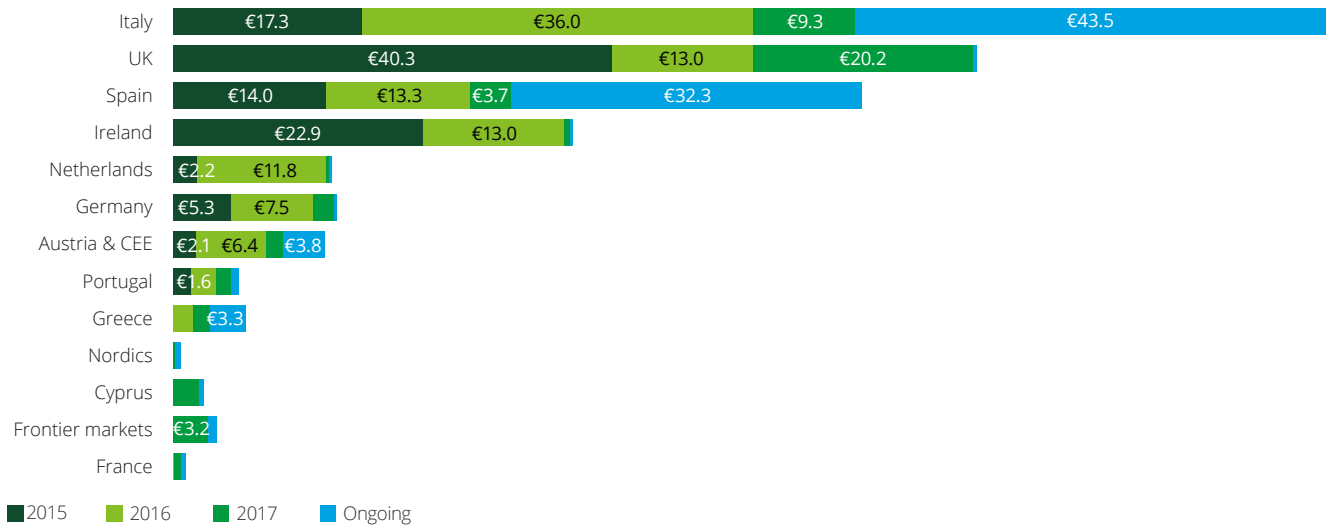
investors are now applying for licenses to start asset recovery platforms, and the legal environment for recovery has been improving.

We consider that the **Gulf Cooperation Council countries (GCC)** represent the possibility of a market in the Middle East. Although portfolio sales have yet to emerge, the consolidation of this over-banked market is already underway, and may well lead to loan sales opportunities. Regional banks have also been under increasing pressure from regulators to adopt stricter asset quality approaches as the deadline for IFRS 9 adoption approaches.

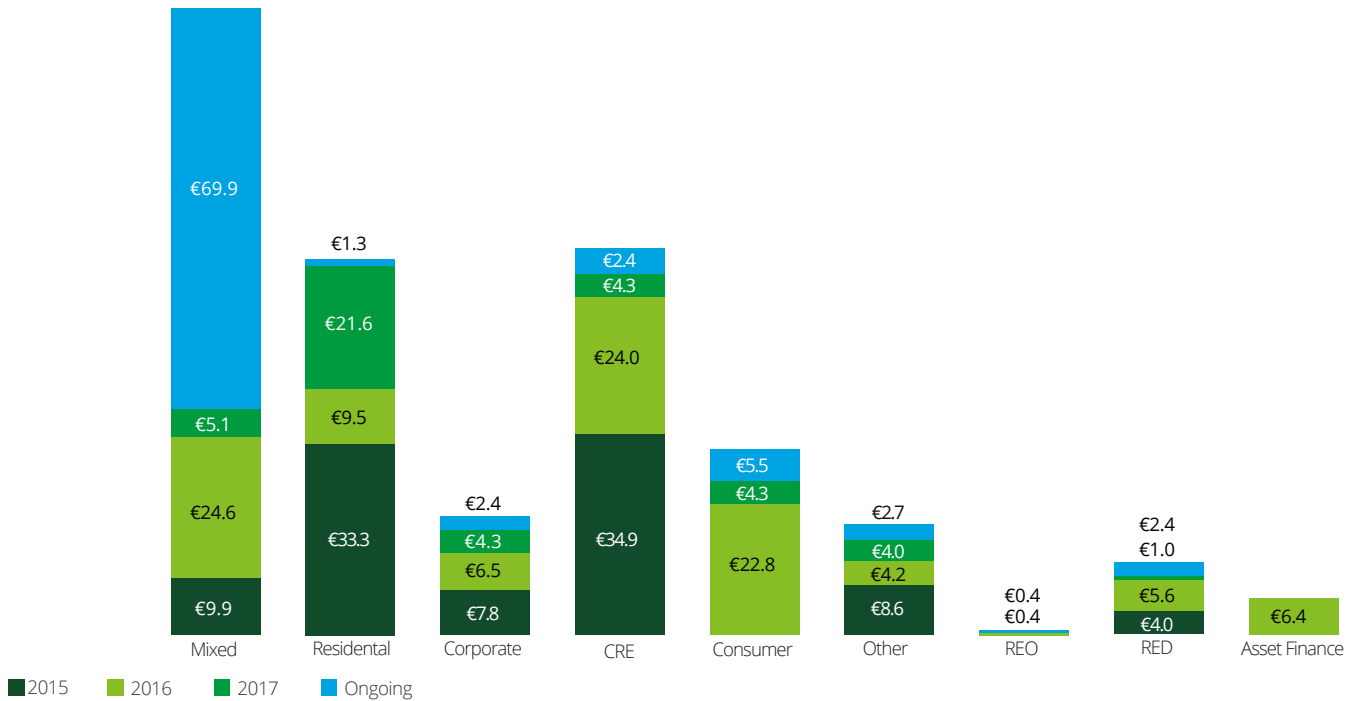
One more NPL market that will emerge over the next few years is **Brazil**, where banks are moving from internal work-outs of distressed loans towards portfolio sales. Although Brazilian banks are well capitalised the volume of NPLs generated by three years of deep recession is too great for the banking system to absorb without specialised investor participation. We expect this NPL market to grow rapidly.

"As European loan portfolio markets mature, investor interest is moving to emerging markets such as China, South East Asia, India, Middle East and Brazil."

Activity by country (€bn)

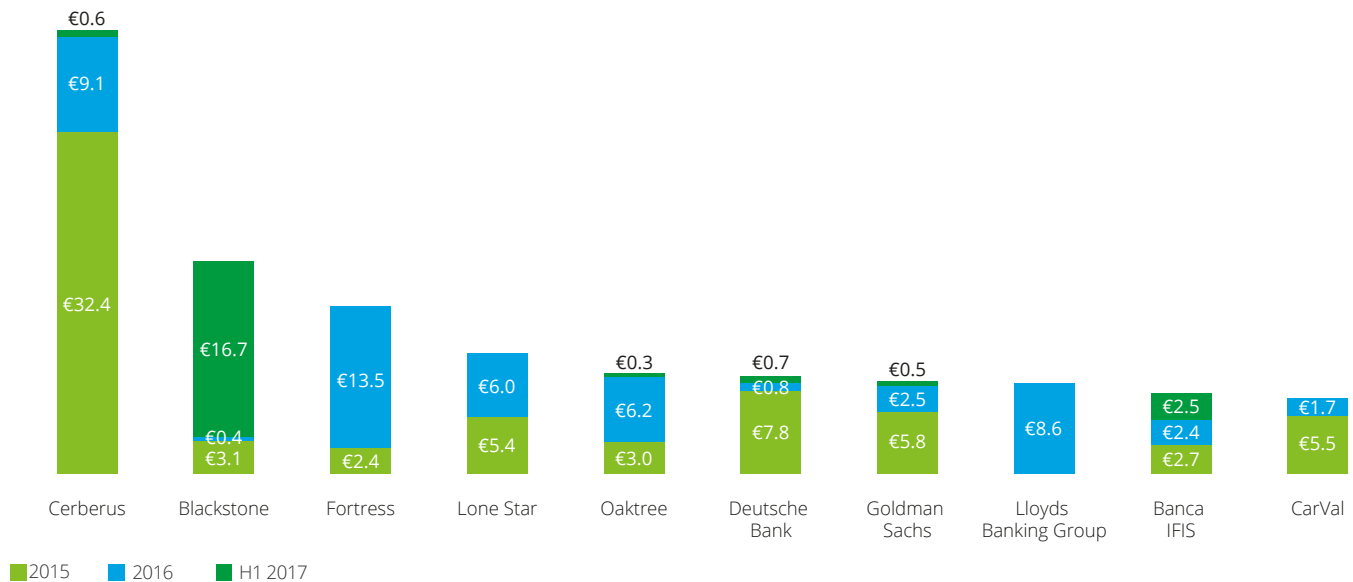


Activity by asset type (€bn)

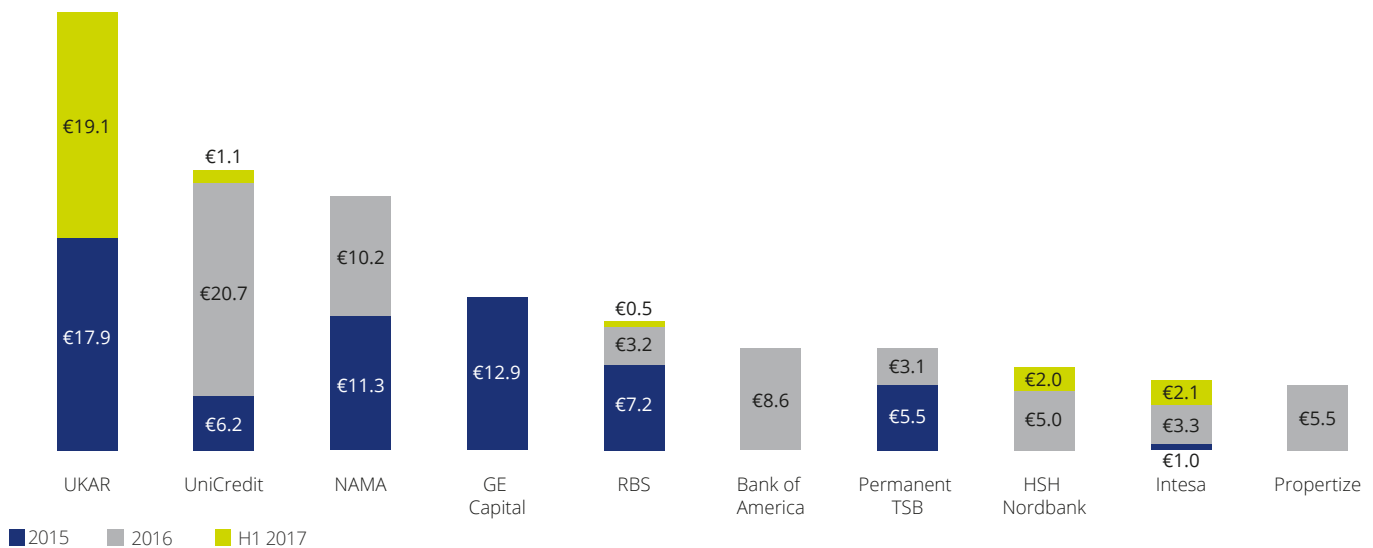


Note: All data as of 30 June 2017

Top buyers 2015 - H1 2017 (€bn)



Top sellers 2015 - H1 2017 (€bn)



Note: Data as of 30 June 2017 and based on GBV

European NPLs – The clash of politics and the markets



Conflicting views

The last two years have seen a flurry of political and supervisory activity focused on tackling the overhang of NPLs in the European market which, some ten years after the initial onset of the crisis, have remained stubbornly high at around the €1 trillion mark. This wave of activity started after the completion of the 2014 Comprehensive Assessment with the formation of the ECBs High Level Group on NPLs in July 2015, followed by the publication of the IMF Staff Discussion Note on a strategy for resolving European NPLs in September that year. Since then, we have seen a series of initiatives, speeches, alternative working groups (at both political and supervisory levels) and, of course, the publication of the ECBs final guidance to banks on non-performing loans (“NPL Guidance”) in March this year followed by, just prior to publication, the European Council’s conclusions on an action plan to tackle NPLs in Europe, all of which have sought to find, in one form or another, solutions for resolving the problem and, in so doing, help to stimulate lending to the wider economy.

One interesting recent publication, the ECBs Financial Stability Review published in May 2017 (“ECB FSR”) contained various proposals designed to support NPL securitisation and true sale markets using the provision of State-supported funding as a tool to enhance pricing. What is more important, however, about this document is the persistent theme that in many ways the market as it currently stands is failing in its role of providing a conduit for the banks to reduce NPL levels, for example “A comprehensive range of policy options may have to be pursued to tackle large stocks of NPLs and to *address the attendant market failures*¹”.

This theme of market failure seems now to be embedded in the thinking of policy makers, hence the European Council’s action plan, and yet, at the same time, as our latest deleveraging report shows, record levels of NPL and non-core assets are being sold, countries like Italy have gone from zero to a market-leading position over the last 3 years, and investors have record amounts of cash to deploy in the sector when factoring in leverage. So are policy-makers correct in their view that public initiatives are required if the volumes traded are to

increase and, if so, are some of the proposals being made workable in practice?

Have the actions supported market development?

To look at this in detail, we should first consider the key attributes required for successful market development. Firstly, the need for relative macro-economic and political stability: this does not have to be perfect but the situation does need to be sufficiently stable to allow risks to be understood and priced accordingly. Secondly, the question arises as to whether the market really exists: are there committed sellers and a visible pipeline; is the size, scale and duration of the opportunity sufficiently attractive and does the capital available allow sellers to have realistic price expectations? Thirdly, is there a supportive, realistic and effective legal (the effectiveness of both relevant law and the court systems), tax, regulatory and accounting framework in place? And, finally, is it possible for investors to make sufficient money from an investment, in turn dependent on whether a liquid market exists for the underlying security; whether servicing skills are available or can be created; and

¹ *Emphasis Added*

“Providing the SSM applies pressure, we should start to see the impact of increased deal flow on the markets in 2018.”

whether debt leverage is available to enhance returns. It is these key criteria that determine the relative attractiveness of markets, and/or whether a market takes off at all, and so it is against these that recent initiatives should be benchmarked.

The question of macro-political and economic stability lies outside the scope of this Deleveraging Report. Thereafter, top of the discussion lists over recent months has been the introduction of the NPL Guidance. Put simply, this document represents the most detailed manual yet published on how banks should steer the management of their NPL portfolios. Whilst the Guidance applies to all significant banks it is designed to be proportionate in nature and the focus for the JSTs will be on those institutions with above average NPL levels. To date, the requirements in the Guidance for high

priority banks, to produce a detailed, quantitatively-led strategy and operational plan do not seem to have caused major headaches. However, initial indications from the SSM are that it will insist on a significant level of granularity to underpin this work and that, over a period, the JSTs will force banks to develop the level of detail required and, thereafter, to deliver upon the deleveraging targets agreed. Providing, the SSM follows through with this pressure, we should start to see the impact of increased deal flow on the markets in 2018 and this should be deal flow that is supported by robust strategies providing the visibility required over pipelines. The European Council's proposals to spread ECB-style guidance to all EU banks in due course can only further support this.

Whilst the NPL Guidance forms a major part of the required transformation of the regulatory system, market-friendly enhancements to the legal and tax frameworks remain patchy. Progress in many countries has been positive and we have seen the benefits of this in several major European jurisdictions such as Ireland, Spain and Italy. However, a jurisdiction will always be impacted by the weakest link in the system and it

remains the case that pressure continues to be required to force further change. It is also the case that little visibility exists on the extent to which this pressure is being applied and, even when it results in changes, it may take many months or even years before sufficient precedent exists for banks or investors to trust the workings of the new law or regime enacted.

When it comes to the issues of making money, the ability to value real estate with relative certainty is critical and continues to create issues where these markets function at sub-optimal levels; Greece and Cyprus remain classic examples of this. The lack of servicing capability has often been cited by the authorities as a major barrier to successful market development but this is an area where history shows that the market will always create capacity where the underlying demand exists. We saw it in Ireland and in Spain, and we are now seeing it in Italy and Greece despite the teething issues in the time to issue licences in the latter market. To that end, the European Council's proposal's to consider the simplification and harmonisation of future licensing can only be a good thing.

The availability of debt leverage at relatively high levels and low rates remains a significant driver of the high prices being paid by investors in the more mature markets. However, there are still not that many providers and lenders remain nervous of markets where there is less experience. For newer markets, such as Greece, the question arises over whether the JSTs will allow vendor finance packages to be provided where banks can demonstrate that they have the appropriate risk management infrastructure in place. The set of proposed alternatives to the provision of vendor finance contained in the ECB FSR, whilst laudable in their aims, are likely to be difficult to make work in practice as the relatively low level of successfully completed transactions utilising the GACS structure in Italy have shown.

Finally, there is the issue of capital sufficiency which remains the biggest driver of whether or not a bank has the capability to become a "willing seller". Whilst the Comprehensive Assessment went a long way to increasing the transparency over NPLs and in forcing banks to raise more capital, it is clear that the costs of litigation and the huge regulatory changes that continue to pressurise the sector, combined with the

low interest rate and profitability environment, have forced banks to continue to ration whatever new capital is raised and that more will be required before those log-jams that exist can be removed.

Linked to this, a lot of speculation exists on the impact of the introduction of IFRS 9 on NPL markets. In reality, it is likely to have a relatively low impact on core NPLs since their treatment under the new regime will be relatively similar. Where the impact will be significant is on the bucket of underperforming loans whose performance has deteriorated materially since origination and where the calculation of lifetime expected losses is likely to lead to much higher provisioning levels than today, i.e. book value for these loans will be much closer to market value.

Other than this specific impact, which may result in a larger universe of loans being designated non-core and, therefore, potentially available for sale, the more interesting question is whether many banks will be forced to raise additional capital to offset the impact of IFRS 9 and, in so doing, with the spectre of the NPL Guidance in their rear-view mirror, whether they also take the opportunity to bridge further the gap to market prices on their NPL stock.

Certain other initiatives have also been proposed including a European bad bank, new individual country-specific bad banks and a common platform for the submission of standardised NPL data. These are worth brief comments. Centralised bad banks have proved useful tools historically especially in Asia and in Europe for the early adopters. However,

"The introduction of IFRS 9 will have a significant impact on the bucket of underperforming loans. The new calculation is likely to lead to much higher provisioning levels."

they are expensive and operationally complex to establish and typically take two years to start delivering according to their mandate. So to push forward with a central bad bank, there has to be a clear underlying rationale for why recoveries will be enhanced through the structure versus the status quo. Combining loans from different European jurisdictions does not appear to offer this and with establishing country-specific bad banks currently highly problematic as a result of State Aid, it appears as though this tool is now part of history for the European sector unless the European Council's latest plans to develop an AMC blueprint somehow manage to overcome this obstacle.

The initiative to enhance NPL data is more interesting. The EBA will be at the forefront of these developments which will include not only the development of standardised NPL templates for data submission but also an attempt to utilise this data to create some form of more automated trading in NPLs create some form of more automated trading in NPLs through the establishment of transaction platforms. The initiative is based on the premise that poor data is impacting the bid/ask spread through the establishment of transaction platforms and that if this

can be solved then this will further support the market. Whilst this is true, it is also true that the ability to provide complete, accurate and relevant data always lies in the hands of a selling bank and that, with the right advice and a lot of hard work, all banks should be capable of producing appropriate data to maximise the value in a sale; this is why, appropriate data does not appear in our list of essential market requirements. It is also true that the potential success of this initiative is highly dependent on the banks being required to put in place robust processes to capture and update the information on a regular basis, including that sourced from paper-based records. Time will tell whether this initiative creates value add or not to NPL markets. However, it is interesting to note that any such data produced would prove invaluable to the Single Resolution Board if required to value a submitting bank in a resolution or pre-resolution scenario.

Conclusions

So, in conclusion, our view is that the market does function and it functions well. Cash is available and investors remain keen. Whilst barriers remain to optimising market effectiveness, the most significant remain the fundamental

ones: insufficient capital in many parts of the sector and, on a more focused basis, the effectiveness of the legal framework and problematic real estate markets in certain countries. The twin combination of the NPL Guidance, if strictly enforced, and IFRS 9 should help to support further capacity-building but further work must be done by Governments to remove the remaining obstacles to recovery optimisation; the European Council's latest announcement is to be broadly welcomed in this regard albeit that several of the initiatives will not be fully developed until 2018. We are ten years into the crisis but, against this back-drop, it remains in the balance as to whether we are only half way through resolving this issue.

Italy



The most active European loan sale market last year with €36 billion in completed deals, Italy is still on track to match or even outdo that performance in 2017. Although the rate of completed transactions fell in the first half of 2017, the pace of negotiation below the line is hectic: with over €9 billion of deals completed and over €44 billion of deals ongoing, Italy is this year likely to be the most active market for distressed debt in Europe. The largest deal is the sale of a mixed portfolio of NPLs by the troubled bank Monte Paschi di Siena (MPS) with a nominal value of ca. €26.1 billion, which was backed by the Italian state through GACS. Resolution of this issue has removed one of the key uncertainties in the Italian market – MPS has the third largest single-bank NPL stock in Italy (after UniCredit and Intesa) at over €45 billion.

Additional NPL sales from recapitalised troubled banks are possible as Banco Popolare di Vicenza (BPVi) and Veneto Banca enter insolvency. Intesa Sanpaolo acquired the ‘good bank’ including some €26 billion in performing loans. The ‘bad bank’ will be liquidated with the government hoping to recoup funds spent in the liquidation by recovering the bad loans. Between them BPVi and Veneto Banca have over €17 billion in unaddressed NPLs. These are potential deals that could drive the market in 2018 and beyond.

“Italy remains a loan portfolio market that is maintaining momentum. Pricing has become much more realistic, and as a result deals are being done faster.”



The NPL market is deep and wide

According to the latest EBA data Italy’s large banks have €271 billion of NPLs outstanding giving it the highest overall NPL ratio of the big five European economies, at 15%. So far this year the market has seen large portfolio sales from Intesa (a €2.1 billion corporate loan package sold to Christofferson Robb & Company together with Bayview) and a €700 million CRE package acquired by Algebris from Banco BPM. The hybrid bank/distressed debt specialist Banca IFIS has also been an active investor buying corporate and consumer debt from Deutsche Bank, Santander and BNL, among others. But ongoing sales likely to complete in the second half of 2017 will dwarf sales so far. The MPS NPL package is the largest, but there are also large consumer, mixed and CRE sales in negotiation – the largest of these is a multi-bank sale of mixed assets with a nominal value of €8.5 billion.

The scale of these completed and ongoing sales reflects the fact that Italy continues to be very committed to resolving Europe’s largest national NPL challenge. Last

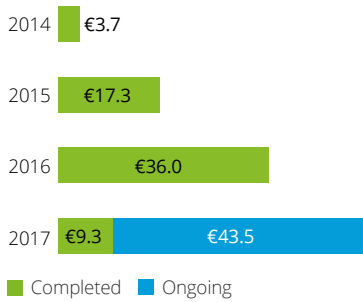
year brought legal reforms designed to speed the asset recovery process, with more flexible management of real estate auctions by courts, and limitations on the power of borrowers to delay recoveries. This year has seen legislation allowing the securitisation of real estate leasing assets. The introduction of state guarantees on NPL securitisation, the so called ‘GACs’ (Garanzia Cartolarizzazione Sofferenze) has so far had a limited effect on the market.



Bigger, and more complex

Nevertheless, Italy remains a loan portfolio market that is maintaining momentum. Pricing has become much more realistic over the last 18 months, and as a result deals are being done faster. Investors have become more confident in the potential return from recovery processes, recovery strategies have become more efficient, and sellers are achieving higher prices. Portfolios are also getting more complex – ongoing sales in the second half of 2017 include more mixed packages, and they are also becoming larger in terms of the underlying loans, making documentation and diligence an easier process.

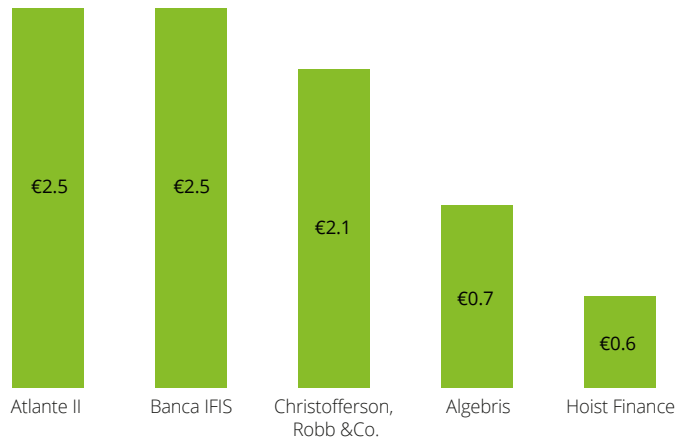
Italy activity by year (€bn)



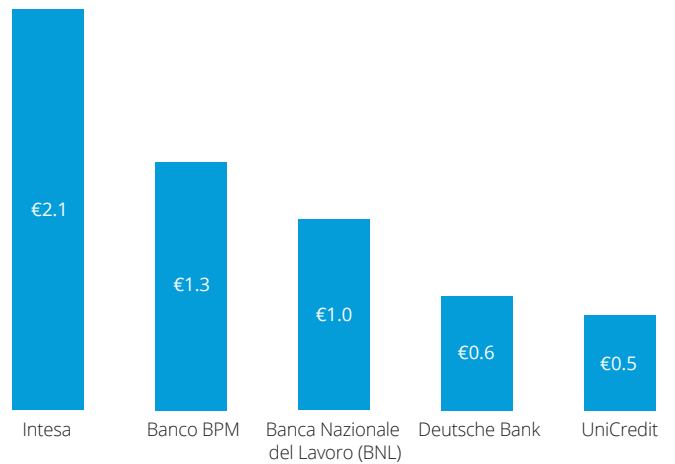
Italy activity by asset class (€bn)



Italy top buyers (€bn)



Italy top sellers (€bn)



Italy completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Confidential	Jan-17	Corporate	Banca IFIS	BNL	650
Confidential	Jan-17	CRE	Banca IFIS	BNL	350
Project Dante	Jan-17	Corporate	Anacap	Barclays	177
Confidential	Feb-17	Corporate	Hoist Finance	Banco BPM	641
Confidential	Mar-17	CRE	Confidential	CreVal	50
Confidential	Mar-17	Consumer	Banca IFIS	Deutsche Bank	413
Confidential	Mar-17	Consumer	Banca IFIS	Santander	160
Confidential	Apr-17	Consumer	Banca IFIS	Confidential	302
Confidential	Apr-17	Consumer	Banca IFIS	Confidential	112
Project Beyond the Clouds	May-17	Corporate	Christofferson, Robb & Co.	Intesa	2,100
Confidential	May-17	CRE	Atlante II	Banca Marche, Banca Etruria, Carichieti	2,200
Project Rainbow	Jun-17	CRE	Algebris	Banco BPM	693
Project Manzoni	Jun-17	Consumer	Banca IFIS	Barclays	190
Confidential	Jun-17	Consumer	Kruk	Deutsche Bank	132
Confidential	Jun-17	Consumer	MB Credit Solutions	UniCredit	450
Confidential	Jun-17	Consumer	Banca IFIS	Findomestica Banca	321
Confidential	Jun-17	Consumer	Banca IFIS	Consel	17
Confidential	Jun-17	Consumer	Atlante II	Cariferrara	343
Total					9,301

Italy ongoing transactions

Project name	Asset type	Seller	Size (€m)
Confidential	Mixed	CARIGE	1,500
Confidential	Mixed	Monte Paschi di Siena	27,000
Project Botticelli	Residential	Erste	340
Confidential	CRE	Cassa Centropadana	170
Confidential	Mixed	Carichieti, Banca Etruria, CR Ferrara, Banca Marche	8,500
Project Buonconsiglio	Mixed	Cassa Centrale Banca	780
Project Terzo	Other	Hypo Alpe Adria	750
Project Arcade	Consumer	Gruppo Delta	2,200
Project REP	CRE	Intesa	1,300
Project Rossini	CRE	REV Gestione Crediti	1,000
Total			43,540

Note: Data correct as of 30 June 2017

United Kingdom and Ireland



UK

The UK is in the final phase of its post-crisis deleveraging journey. Most significant non-performing holdings have been sold – the market is now moving towards more non-core performing and sub-performing deals, and sales of new classes of assets.



A late-phase market

Although loan sales in the first half of 2017 have been higher in face value than for all of 2016, the €20.5 billion total is almost entirely accounted for by a single residential portfolio, part of the mortgage books of the Bradford & Bingley building society and Northern Rock, sold by UK Asset Resolution (UKAR) as Project Rippon to Prudential Capital and Blackstone. There have been other small residential sales as well, with the Project Morag €269 million portfolio from Skipton Building Society, and a secondary sale of a €735 million portfolio from Cerberus. This latter portfolio was sold to Metrobank, a UK ‘challenger’ bank, and is representative of the strong interest that challenger banks have in building up their balance sheets by buying UK loan assets.

Further sales from UKAR are expected; the government-controlled body holds a further €37.8 billion in mortgage loans: we expect further transactions in 2017 to be similar to Project Rippon – that is, good

quality largely performing residential loans. Lower quality assets will probably follow in 2018.

Other deals are also in the pipeline. RBS disposed of a shipping book last year to the Japanese bank, Orix, and may consider further disposals in the second half of 2017. The Nationwide Building Society is closing down its commercial mortgage business and may consider a sale of legacy loans to accelerate the wind-down.



Alternative assets to follow

The UK is likely to see alternative portfolios come to market. The government is considering the sale of student loan books of €13.6 billion and Public Finance Initiative loans may also come to the market. And whilst a slightly different asset class, there is also the possibility of insurance companies beginning to sell their portfolios of annuity backed books.

The UK market has clearly begun to recover from the pause induced by the Brexit vote in mid-2016; investors are taking a business-as-usual approach to deal making, against a background of confidence in the creditor-friendly legal environment, established and predictable deal processes, and the quality of returns on investment.

“The UK market is moving towards more non-core performing and sub-performing deals, and is likely to see portfolios of alternative asset classes come to market.”

Ireland

After three strong years that saw €63 billion of mainly corporate and CRE loans sold to private investors, the loan market has currently reached less than €1 billion worth of completed deals in 2017. Ongoing sales from Danske Bank (Danske Bank is looking to sell more than €2 billion of residential and buy-to-let mortgages), NAMA and potential sales from AIB could see the market just hit under €10 billion for 2017.



Residential mortgage sales to come

The NPL stock in the Irish banking sector stands at around €32.5 billion according to the latest EBA data, a third of what it was in 2014, although the NPL ratio remains relatively high at just under 20%. Allied Irish holds €16 billion in NPLs, Bank of Ireland €10.2 billion, and Permanent TSB €6.2 billion. Up to now most disposals have been in corporate real estate, with a

smaller market in other corporate lending. The stock of residential property loans is now in focus.

Investors hoped that 2017 would be the year when the market for residential loans would be tested. AIB has completed one residential portfolio, the €450 million Project Cypress sold to Goldman Sachs, with the other loan portfolio openly under negotiation in the second half of 2017 is the €250 million corporate real estate Project Lee offered by NAMA, the Irish ‘bad bank’ (NAMA’s assets are not included in the banking sector totals given above). Several other portfolios are rumoured to be either quietly on the market or about to launch.

Investors expect that the AIB flotation will trigger substantial sales of residential and SME loans, with portfolios amounting to €8-9 billion in sales either before or after the IPO; the bank is currently working on a portfolio called Project Redwood which has not yet come to market but which could include anything up to €3 billion in loans mainly secured on properties in the UK and Northern Ireland. Like other Irish banks AIB is under mounting pressure to review and dispose of NPLs; to the poor performance of Irish banks in the 2016 European Banking Authority stress tests there has been added pressure from the ECB’s guidelines for NPL disposal and the

2018 deadline for IFRS 9 adoption, with its more forward looking loss accounting provisions.



Securitisation is growing

Irish banks are also likely to turn increasingly to securitisation approaches to NPL resolution. Residential Mortgage Backed Securities (RMBSs) were common in the Irish market before the financial crisis; after a long period out of favour they are now making a comeback.

Irish RMBS transactions have been on the rise, with €4.4bn issued in 2016 compared to just €0.9bn in 2012. The notes distributed represents €0.4bn of €0.7bn in 2017, compared against €0.8bn of the €4.4bn issued in 2016. Irish RMBS spreads on senior AAA notes have also fallen significantly to 60bps from 140bps 12 months ago.

We have noted an increase in RMBS issuance from private equity firms who are capitalising on the cost-effective financing and term funding available through securitisation to finance their portfolio acquisitions.

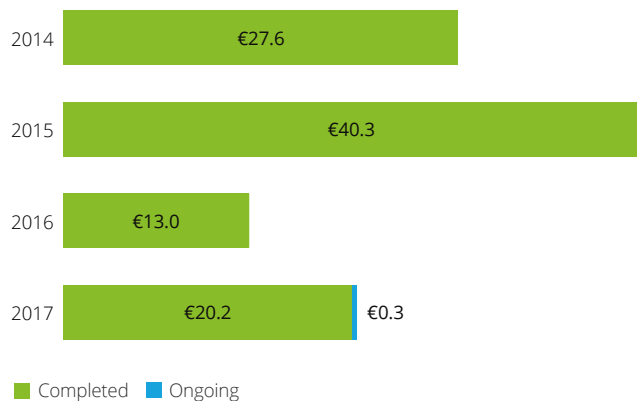
In the last 8 months, US PE firm Lone Star has launched three RMBS deals in Ireland backed by both performing and non-performing mortgages meanwhile

“Up to now most disposals have been in CRE lending, with a smaller market in other corporate lending. The stock of residential property loans has barely been touched.”

Mars Capital, an affiliate of Oaktree Capital Management, launched an Irish RMBS deal backed by performing mortgages in April this year.

Such sales come against the background of a strongly improving Irish property market. Successful residential portfolio or RMBS sales may encourage Irish lenders to begin to dispose of their residential NPL holdings, possibly before the end of this year. Buyers remain in the market in the expectation of at least two more years of significant deal making to come.

UK activity by year (€bn)



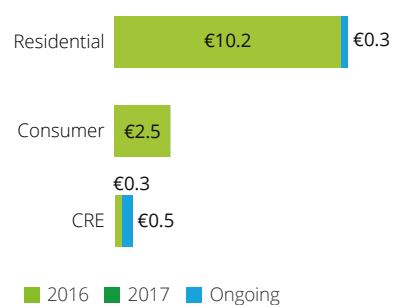
Ireland activity by year (€bn)



UK activity by asset class (€bn)



Ireland activity by asset class (€bn)



UK completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Rippon	Mar-17	Residential	Prudential & Blackstone	UKAR	19,146
Project Morag	Apr-17	Residential	Confidential	Skipton Building Society	269
Confidential	Jun-17	Residential	Metrobank	Cerberus	735
Total					20,150

UK ongoing transactions

Project name	Asset type	Seller	Size (€m)
Confidential	CRE	Confidential	300
Total			300

Note: Data correct as of 30 June 2017

Ireland completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Cypress	Apr-17	Residential	Goldman Sachs	Allied Irish Bank	450
Total					450

Ireland ongoing transactions

Project name	Asset type	Seller	Size (€m)
Project Lee	CRE	NAMA	250
Total			250

Spain and Portugal



Spain

The rate of deal making in Spain continues to show momentum with more than €6 billion in debt and REO portfolio sales ongoing and completed in the first half of 2017, in line with prior years. However, we estimate that in investment terms the capital deployed in the market by investors will increase by one third compared to the first half of 2016 as real estate secured portfolios become a larger portion of the overall traded volume.



New strategies

The landscape of active sellers continues to be represented by repeat players with Sabadell, Bankia and Caixabank representing more than 40% of the divested volume. However, hinting at shifts in strategy and of things to come, BBVA brought to market one of its largest secured portfolios to date in the form of Project Jaipur and Banco Popular became the most active seller with c. €1bn of sales, almost 20% of the total assets brought to market during the first half of 2017. Yet these deal totals do not reflect the fact that the takeover of Banco Popular by Santander is potentially a game-changer for the Spanish loan sales market.

We believe this to be a sustained trend as Spain continues to have the third largest stock of NPLs in Europe (after Italy and France) with over €125 billion in non-

performing loans held by banks alone, with the key potential deterrent being larger bid-ask spreads as the banks look to the disposal of more complex asset classes to achieve their wind-down targets. However this will likely be mitigated by Spain's now large, tested and experienced pool of buyers and servicers and by the increased provision levels resulting from further market consolidation and new ECB guidelines. The four largest NPL stocks are held by Santander with c. €50 billion (estimated including the assets acquired from Banco Popular), BBVA (€23.2 billion), Caixabank (€14.8 billion), Bankia (€11 billion) and Sabadell (€9.3 billion).



Banco Popular sale is transformative

Banco Popular was bought by Santander in June 2017 under a process initiated by the EU's Single Resolution Board which was set up to deal with failed eurozone banks, with shareholders and junior bondholders entirely wiped out. This is the first time the Single Resolution Board has acted to take over a failing eurozone bank, and the speed and effectiveness of what had been an entirely untried process has encouraged investors to expect more such resolutions and subsequent loan sales.

The acquisition was followed by Banco Santander announcing that it planned

“Spain continues to have the third largest stock of NPLs in Europe with over €125 billion in non-performing assets held by banks alone.”

to dispose of approximately 50% of its combined non-performing asset (NPA) book in the next 18 months and most of it in three years. The acquisition is expected to result in approximately €7 billion in additional provisions for the target's real estate non-core exposures, thus resolving one of the key factors believed to be limiting the pace of Popular's non-core deleveraging in the past and allowing for the possibility of a speedier unwinding. In line with this, Santander has recently invited a limited number of investors to evaluate the acquisition of a portfolio of approximately €30 billion of NPLs and REOs, through the acquisition of a 51% stake in an SPV that would house the assets (Banco Santander would retain the other 41%). The investment opportunity may also include a 51% stake in Aliseda, the servicing platform that Banco Santander recently repurchased from Varde and Kennedy Wilson. If successful, the transaction could prove one of the largest non-core divestments in recent years.

This follows the announced merger between Bankia and BMN, a deal which has been talked about since 2016 when Spain's state resolution fund for banks, FROB, announced it was taking the necessary measures to analyse the reorganisation of the banks in which it participates.

This is the beginning of further consolidation in the sector. As large Spanish banks have been divesting and optimising their balance sheets for many years we expect that further consolidation in the sector will lead to a second wave of non-core divestments as the acquirers follow a similar cleansing process with their acquisitions.



A more homogenous asset mix

Spain's evolving loan sale market continues to show a consolidation

in the real estate driven space towards larger and less granular portfolios. Banks are finding it easier to bring to market more complex portfolios – a sign of a maturing market – with SME & Corporate secured loans dominating the portfolio mix and interested buyers finding an increasing number, albeit still limited, of specialised servicers capable of managing these types of portfolios.

Portugal

The challenges in the Portuguese loan sale market have historically been seller commitment, bid-ask spread and lack of a foreseeable deal pipeline. Banks have not made serious inroads into their NPL stocks despite having one of Europe's highest NPL ratios at around 15%.

Total NPLs in the Portuguese banking system are €36.8 billion; in addition to the Novo Banco holdings, BCP has €10.2 billion in NPLs while CGD has €11.6 billion. These holdings were largely generated during Portugal's long and deep recession following the financial crisis and although SMEs are the key issue, the total NPL pool is a mixture of consumer, SME, residential, corporate and REO.



A year of uncertainty

The need to address this sizeable NPL issue has received consistent attention from the Portuguese government over the last 12 months. The Portuguese loan sale market has been mostly on hold in the past year while options were considered and while a 'bad bank' type systemic solution was discussed at a European Union level. This has impacted the number of portfolios brought to market so far in 2017, which have been mostly small to mid-sized and mainly unsecured and fully provisioned. In early June, the Portuguese

government clarified that a global solution for large corporate syndicated loans should be introduced in the near future, and that a holistic 'bad bank' is not an option at the moment for Portugal.



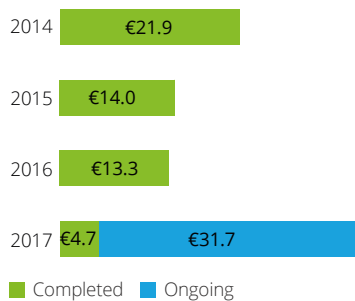
NPL market outlook

As there is now more clarity around NPL policy banks are

likely to start deleveraging their NPLs in a well-defined manner. We expect Caixa Geral de Depositos (CGD) and Banco Comercial Portugues (BCP) to become active sellers as both banks have raised capital and increased provision levels over the last 24 months, which should bridge a significant part of the bid-ask gap and help drive non-core deleveraging plans. The more than likely sale of Novo Banco to Lone Star means that the new shareholder will need to deleverage a part of the non-core book, as required by the EU.

This should lead to a strong deal pipeline from the second half of 2017 onwards as CGD, BCP and Novo Banco are the top three NPL holders in Portugal. Investor interest in Portugal is high and in position to deploy capital provided there is a conducive market environment and foreseeable pipeline. The big deals are still to come but for the first time in the past several years there seems to be light at the end of the tunnel.

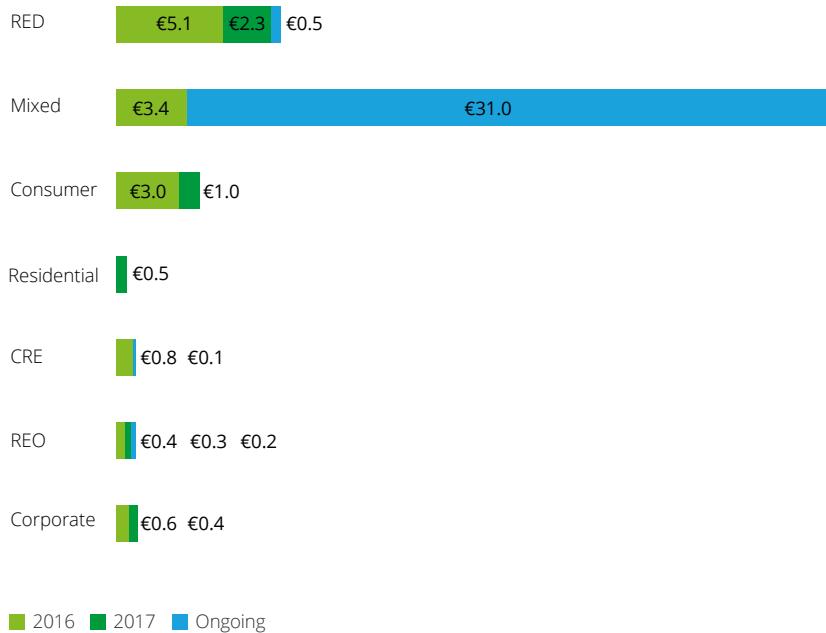
Spain activity by year (€bn)



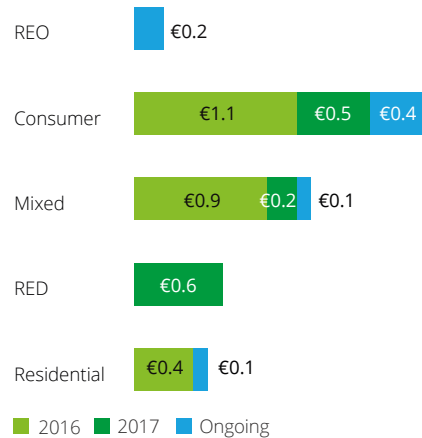
Portugal activity by year (€bn)



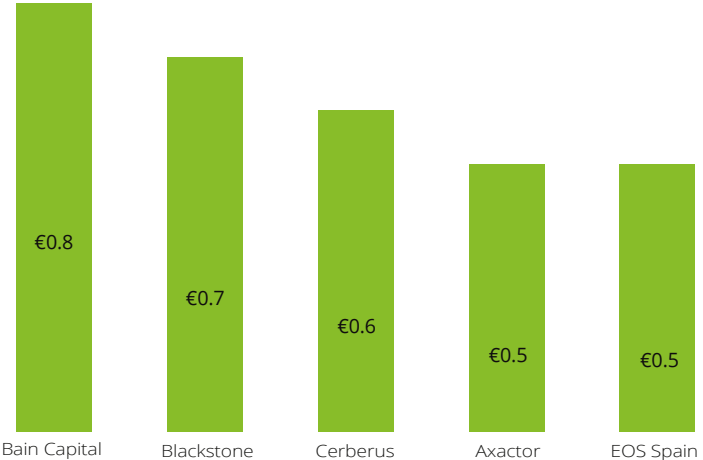
Spain activity by asset class (€bn)



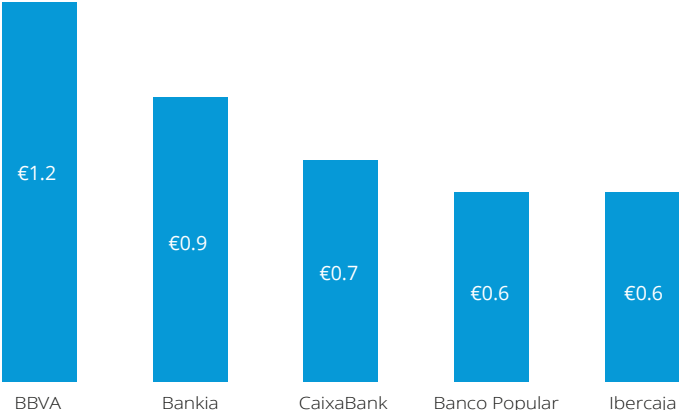
Portugal activity by asset class (€bn)



Spain top buyers (€bn)



Spain top sellers (€bn)



Spain completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Confidential	Jan-17	Corporate	Apollo	Banco Popular	220
Project Buffalo	Feb-17	REO	Blackstone	BBVA	300
Confidential	Jan-17	RED	Blackstone	Banco Popular	400
Project Gold	Mar-17	Corporate	DE Shaw	Bankia	200
Project Boston	Mar-17	CRE	Confidential	BBVA	120
Project Tour	Apr-17	Residential	Bain Capital	Bankia	300
Project MacLaren	Apr-17	Residential	Cabot	Lone Star	150
Project Fleta	Jun-17	RED	Bain Capital	Ibercaja	600
Project Jaipur	Jun-17	RED	Cerberus	BBVA	600
Project Tramuntana	Jun-17	RED	Deutsche Bank	Caixabank	700
Project Galdana	Jun-17	Consumer	EOS Spain	Bankia	500
Project Marina Bay	Jun-17	Consumer	Axactor	Banco Santander	500
Total					4,670

Spain ongoing transactions

Project name	Asset type	Seller	Size (€m)
Confidential	Mixed	Banco Popular	30,000
Project Gregal	Mixed	Banco Sabadell	800
Project Icaria	RED	Banco Popular	500
Project Fox	Mixed	Liberbank	200
Confidential	Other	Confidential	-
Project Lemon	RED	UniCaja	200
Total			31,700

Portugal completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Tree	Jan-17	Mixed	Confidential	Confidential	200
Project Seed	Jan-17	Consumer	Confidential	Confidential	200
Confidential	Mar-17	Consumer	Confidential	Confidential	220
Project Brunch	Apr-17	Consumer	Confidential	Confidential	122
Project Evora	Apr-17	Mixed	Confidential	Confidential	20
Project Protheus	Apr-17	Other	Altamira	Oitante	-
Project Andorra	May-17	RED	Bain Capital	Confidential	600
Total					1,362

Portugal ongoing transactions

Project name	Asset type	Seller	Size (€m)
Project Listing	Residential	Confidential	94
Project Cassiopeia 2	Mixed	Confidential	59
Project Berry	Consumer	Confidential	200
Project Belem	REO	Confidential	160
Project Pool XXXVII	Consumer	Confidential	200
Total			713

Note: Data correct as of 30 June 2017

Germany and the Netherlands



Germany

Deals in Germany this year are likely to reach c. €3 billion, less than in 2016 which saw completed and ongoing transactions reach €10 billion. However regulatory pressure from ECB could prompt German banks to start selling more than portfolios.



The NPL stock is substantial

German banks hold €67 billion in NPLs, the great majority of them being corporate lending in sectors like aviation, shipping and infrastructure; non-core assets are greater still and the total of non-core and NPLs is estimated to be in excess of €240 billion. Three banks account for the majority of NPLs – Deutsche Bank with €14.9 billion, HSH Nordbank with €13.6 billion, and NordLB with €9 billion, although there are several other banks with significant NPL exposures including Commerzbank, DZ Bank and Bayerische Landesbank. The two German ‘bad banks’ EAA and FMS-WM also hold around €130 billion in non-core assets, with mandates to wind down these portfolios by 2027 and 2020 respectively.

Despite this overhang of non-performing and non-core lending, German banks remain reluctant to sell at prices the market is prepared to pay. There is little domestic regulatory pressure on banks to sell, their cost of capital thanks in part to

state participation is often low, and there remains a strong disinclination to repeat the experience of the early part of the previous decade when loan assets were sold to international investors at what are now seen as knock-down prices.



The deal of the year

This year’s largest deal to date and likely the largest deal in the full year is the €2 billion sale of Project Leo sold in two lots to Australian Macquarie and a consortium led by Bank of America Merrill Lynch. This proved a troubled sale: originally marketed as a mixed corporate and CRE portfolio at €3.2 billion and due to be completed in 2017, the shipping loan and the renewable energy components were eventually removed from the portfolio before agreement could be struck. Project Air, a commercial real estate portfolio from HSH Nordbank at €200 million is currently on the market.

Unconfirmed portfolios include at least two from FMS-WM. This ‘bad bank’ is believed to have around €3 billion of real estate lending still to dispose of, and further sales from FMS-WM and EAA will eventually materialise. In 2017 some small ad hoc sales from Commerzbank (which has €6.6 billion in NPLs) are possible. But in all cases the bid-ask gap tends to remain high in Germany, and while banks in Germany

as elsewhere in Europe are under pressure from the ECB to do more to tackle non-core assets and NPLs they remain reluctant to recognise losses.

Netherlands

While the Dutch banking sector is large compared to the size of the country (c. three to four times banking assets relative to GDP), the loan sales market is relatively small with an NPL stock of €44.5 billion implying an NPL ratio of only 2.5% – considerably lower than most other European economies.



Banking is highly concentrated

There is a high level of concentration with the three largest banks also being the three largest holders of NPLs – Rabobank has €19.4 billion ING €13.9 billion and ABN-AMRO €9.5 billion. The momentum of loan portfolio sales witnessed in other European markets has not been matched in the Netherlands, primarily as the key banks have managed to build capital buffers and sufficient provisioning and face less regulatory pressure or urgency to deleverage. The trend in recent years has been for one or two significant auctioned portfolio trades every quarter from a wide range of sellers (and not concentrated on the larger financial institutions).

Portfolio sales in 2017 are unlikely to repeat the 2016 levels, when sales reached €11.8 billion dominated by the sale of the Propertize 'bad bank' to Lone Star. With an established servicing capability, the expectation was that Lone Star would use this as a platform for further loan acquisitions in the Netherlands; however, with deal flow somewhat less than envisaged, it will be interesting to see whether there are any strategic changes in the next six to twelve months. Lone Star's recent initiation of an arbitration dispute with the Dutch state over one small part of the acquisition is unlikely to be resolved soon but we cannot see this directly impacting any longer term strategy.



Investors have appetite

As reported last year, Rabobank withdrew from the sale of Project Orange its €250 million CRE portfolio, relatively late in the process, and while no new portfolios have been brought to market in 2017, we expect the bank to feature as a seller in the second half of 2017 or early 2018 given its core strategic objectives. This withdrawal has not dampened investor appetite, and the market focus of the first half of 2017 has been ABN-AMRO's sale of Project Stack, a €200 million package of corporate real estate loans which attracted widespread investor interest, including from Cerberus,

Davidson Kempner and Deutsche Bank. The Project Stack portfolio acquired by Cumberland (and to be managed by Attestor Capital), was comparable in characteristics to Project Lucas, one of the first loan portfolio sales in the Netherlands. The portfolio comprised of around 70 distressed borrower connections and 250 properties (office and residential properties and land) widely spread across the country. Given the success of its inaugural portfolio trade, we expect further sales from ABN-AMRO.

While we still wait to see if the pace of portfolio sales increases in this highly concentrated banking sector, there have been a growing number of real estate focussed sales – the two most recent being FGH Bank's acquisition of loan secured against a €400 million Dutch property portfolio, and Goldman Sachs' refinancing of Dutch property company Merin.

“The market focus of the first half of 2017 has been ABN-AMRO's sale of Project Stack, a €200 million package of corporate real estate loans which attracted widespread investor interest.”

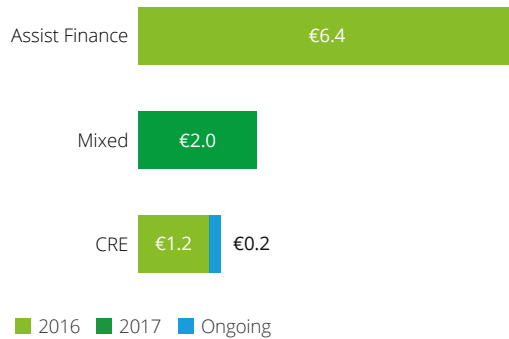
Germany activity by year (€bn)



Netherlands activity by year (€bn)



Germany activity by asset class (€bn)



Netherlands activity by asset class (€bn)



Germany completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Leo	Jan-17	Mixed	Macquarie & BAML	HSH Nordbank	2,000
Total					2,000

Germany ongoing transactions

Project name	Asset type	Seller	Size (€m)
Project Anfield	Residential	Confidential	n/a
Project Air	CRE	HSH Nordbank	200
Confidential	Other	Confidential	-
Total			200

Note: Data correct as of 30 June 2017

Netherlands completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Stack	May-17	CRE	Cumberland	ABN AMRO	200
Confidential	Jun-17	CRE	FGH Bank	ING	80
Total					280

Netherlands ongoing transactions

Project name	Asset type	Seller	Size (€m)
Eurocommerce Loans - Secured	CRE	ING	150
Project Rembrandt	CRE	FGH Bank	n/a
Project Triple +	CRE	Propertize	140
Total			290

Greece and Cyprus



Greece

The long-awaited NPL deal pipeline is gradually beginning to emerge in Greece: there have been portfolio sales in the first half of 2017 including a €1 billion portfolio sale from Attica Bank, one of Greece's smaller lenders, to Aldrige EDC (although this is expected to be a one-off); the Bank of Greece has reiterated its ambitious NPL wind down targets for the sector, and there have been changes proposed to the legal environment that make it easier to obtain asset management licenses and that reduce the personal liability of banking executives over portfolio disposals, previously a powerful disincentive for banks clearing their NPL books.

Domestic sales are next

Greek banks have already disposed of most of their non-Greek assets in the CEE and are now actively focusing on domestic assets. The four 'pillar' banks which are also the largest banks by NPL holdings – Piraeus Bank, Alpha Bank, National Bank of Greece and Eurobank – have started preparing data for loan portfolio disposals, and the first portfolio from Eurobank is in the market. As expected, the first portfolios to come to market are the unsecured exposures. Given the scale of the issue the banks are also working jointly to assess their SME/ Small Business Loans (SBL) loans in particular as much of this borrowing is multibank in nature.

“This year has also already seen a round of Greek bank restructuring announcements with implications for NPL stocks.”

The Special Single Liquidator office created in 2016 which is responsible for €10 billion of NPLs in a special liquidation vehicle is also preparing its first NPL portfolio, expected before the end of 2017. The pillar banks continue to prepare unsecured and other portfolios and we expect this to be a 2018/19 opportunity.

Meanwhile the recovery environment has been improving. Legislation passed in May 2017 has streamlined the application process for asset management licenses for Loan Asset Management Companies (LAMCs) and extended the scope of LAMCs. Four LAMC licenses have now been granted and there are more pending; the most recent license approval took only two months from application to approval. Recent legislation also reduces the burden of personal liability for decisions taken in relation to loan restructurings or write-offs; the new law provides immunity for decisions taken after 19 May 2017 for public servants taking part in debt reduction agreements (decisions taken before that date are still subject to liability).

Sales are exceeding targets

This year has also already seen a round of Greek bank restructuring announcements with implications for NPL stocks. Piraeus Bank has announced its intention to sell subsidiaries in Albania, Bulgaria, Romania and Serbia, part of a plan to reduce its NPL stock from €23 billion to €8 billion by 2020; Alpha Bank completed the sales of its Serbian and Bulgarian subsidiaries in early 2017; and National Bank of Greece sold United Bulgarian Bank and Interlease in June.

These sales come within the context of the Bank of Greece's NPL resolution targets which aim to reduce over €100 billion of Greek bank NPLs to around €67 billion by the end of 2019, through a mixture of resolutions and liquidations. According to the latest Q1 data from the Bank of Greece, banks are slightly exceeding the targets set; by the end of last year the total 'non-performing exposures' stock was €104.8 billion, €1 billion lower than targeted. Ratios and actual cash recoveries from non-performing exposures also exceeded target levels.

Cyprus

With the highest NPL ratio in Europe and a banking sector that holds €21.3 billion of non-performing assets (according to the EBA's 2016 figures) the portfolio market remains largely untested with only two transactions from Bank of Cyprus. However there has been progress on bank restructuring: Hellenic Bank (the third largest Cypriot lender) has established a servicing JV with Czech APS Holding and recently sold its €2.3 billion NPL portfolio and real estate management business to the entity. National Bank of Greece is also in the process of selling its Cyprus subsidiary and Pireaus Bank has completed a similar sale.

Greece completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Confidential	Jan-17	Asset finance	Orix & Berenberg Bank	RBS	542
Confidential	Jan-17	Other	Confidential	Confidential	117
Confidential	Jan-17	Corporate	Confidential	Confidential	150
Confidential	Feb-17	Other	Aldrige EDC	Attica Bank	1,000
Total					1,809

Greece ongoing transactions

Project name	Asset type	Seller	Size (€m)
Project Eclipse	Consumer	Eurobank	2,800
n/a	Other	Confidential	450
Total			3,250

Cyprus completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Confidential	Jun-17	Other	APS Holding	Hellenic Bank	-
Total					-

Cyprus ongoing transactions

Project name	Asset type	Seller	Size (€m)
Confidential	Corporate	Bank of Cyprus	500
Total			500

Austria and CEE



The largest Italian, Austrian and Greek banks all continue to dispose of their Central and Eastern European non-performing assets built up during the boom years prior to the financial crisis. Although the number of completed deals in the first half of 2017 is down compared to the first half of 2016, that masks the continued pace of activity in the market. There are c. 10+ portfolio deals currently under negotiation ranging from small sub-€100 million corporate and CRE portfolios to larger €500 million+ deals. The full year should see deal volumes almost reaching last year's c. €6 billion of deals.

Corporate secured lead the market

Corporate secured loans continue to be the most active traded loan portfolios in the region with the exception of Hungary whereby there has been a recent trend of Banks looking to dispose of their residential mortgage portfolios which are being bought by local investors. There is also continued sales of small unsecured retail portfolios which are being bought by local debt recovery specialists mainly in Romania.

Raiffeisen, the Austrian banking group, continues to be slower than its Austrian rivals to sell loan portfolios despite having one of the largest NPL stocks of all the Austrian banks (amounting to almost €10

billion). It is likely that the Raiffeisen group will be impacted by latest ECB regulatory guidance on NPLs and therefore become a more active seller this year particularly in Romania and Croatia.

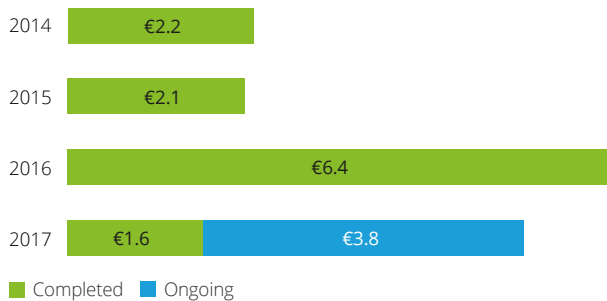
HETA (the Austrian wind-down institution for Hypo Alpe Adria) by contrast has stepped up portfolio disposals in line with its strict wind-down targets. We expect that the disposal of its Serbian exposures will close in the second half of 2017 followed by the disposal processes of its portfolios in Bosnia and Montenegro.

Consolidation continues

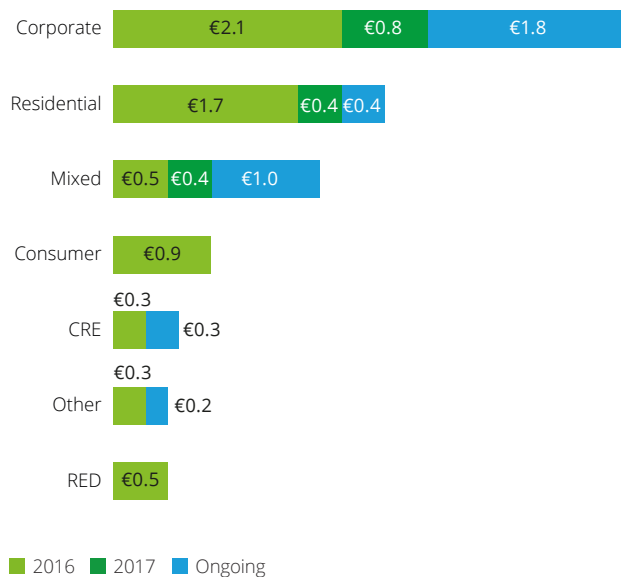
Despite the difficulties posed for investors by the multi-jurisdiction nature of the CEE market, the regional price gap has narrowed and deals are being executed. The trend has been smaller and more granular deals so far in 2017 but we expect some larger transactions to close in the latter part of the year. Investor interest remains high due to the higher return potential of the CEE market compared with Western Europe. In addition to loan sale transactions, we are also starting to see a wave of banking consolidations across the region, starting with the Greek banks looking to sell their subsidiaries in Romania, Bulgaria and Serbia – we expect this trend of consolidation to continue in what is a fragmented banking market.

“Investor interest remains high due to the higher return potential of the CEE market compared with Western Europe.”

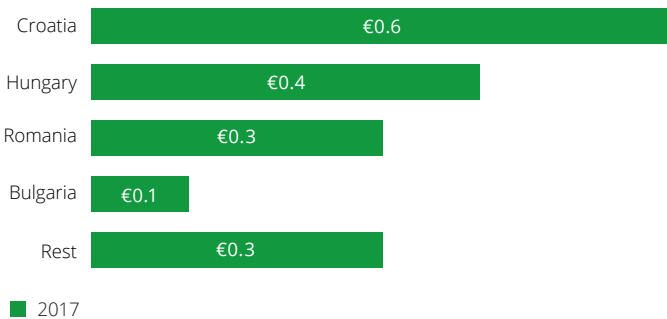
Austria & CEE activity by year (€bn)



Austria & CEE activity by asset class (€bn)



Activity by country - Austria & CEE (€bn)



Austria and CEE completed transactions

Project name	Date	Country	Asset type	Buyer	Seller	Size (€m)
Project Drava	Jan-17	SEE	Corporate	n/a	HETA	276
Confidential	Jan-17	Hungary	Residential	APS/Balbec	UniCredit	139
Confidential	Jan-17	Bulgaria	Mixed	B2 Kapital	UniCredit	93
Project Sunrise	Feb-17	Croatia	Corporate	APS	HPB	100
Project Taurus	May-17	Croatia	Corporate	APS	UniCredit	450
Confidential	May-17	Hungary	Residential	Confidential	Confidential	250
Project Iris	May-17	Romania	Mixed	Kruk	BRD Societe Generale	282
Total						1,590

Austria and CEE ongoing transactions

Project name	Country	Asset type	Seller	Size (€m)
Confidential	Austria	Other	Confidential	100
Confidential	Bosnia & Herzegovina	CRE	HETA	17
Project Vitosha	Bulgaria	Corporate	HETA	130
Confidential	Croatia	CRE	HETA	155
Confidential	Croatia	Corporate	HETA	47
Project Otto	Hungary	Residential	Aegon	360
Confidential	Romania	Mixed	Veneto Banca	1,030
Confidential	Romania	Corporate	Alpha Bank	500
Confidential	Romania	Consumer	Banca Transilvania	110
Confidential	Romania	CRE	Erste Group	110
Confidential	Slovenia	Other	NLB	90
Confidential	Serbia	Corporate	Confidential	299
Confidential	Bosnia & Herzegovina	Corporate	Confidential	437
Project Metro 2	Bulgaria	Corporate	Eurobank	65
Confidential	Croatia	Corporate	Confidential	140
Project Bigova	Montenegro	CRE	Confidential	50
Confidential	Slovenia	Corporate	HETA	120
Confidential	Serbia	Corporate	Confidential	60
Total				3,820

France



Although France has a relatively high stock of NPLs in absolute terms – according to the EBA's 2016 figures the total of NPLs held by French banks (worldwide) was €147 billion – there have been only modest disposals in the French NPL market. The largest NPL stocks lie with BNP Paribas (€42.5 billion), Credit Agricole (€30.7 billion), BPCE (€26 billion), Societe General (€25.2 billion) and Credit Mutuel (€16.3 billion).

Regulatory pressure for NPL disposals has been low in France. The total stock of non-performing loans represents an NPL ratio of less than 5% (the EBA's low-NPL threshold), and banks have long preferred internal work-out solutions for distressed loans. On top of the usual consumer unsecured deal flow coming mainly from regional banks, few such portfolios have come to market over the last five years – almost all portfolio sales up to 2016 have been corporate, SME and leasing loans. But this is now changing. A mixed consumer/ mortgage portfolio sale was completed in the first half of 2017, and two more large mortgage portfolios sales are ongoing.

In the past investors considered France a low-activity market and did not build up a significant presence; they were often discouraged by the structure of the banking system which is highly fragmented with several large banks being regional networks of small banks, which works against the marketing of coherent NPL portfolios. The investor attitude is also changing, and we have seen specialist NPL investors put resources into the French market. This is helping potential sellers to understand the potential of the secured NPL market, just as the high-NPL banks are coming up against capacity limits on internal work-outs. The adoption of IFRS 9 is also pushing banks towards a better recognition that their NPL holdings are a practical and strategic burden. France remains a relatively untapped market, but we now expect growth over several years.

“France remains a relatively untapped market, but we now expect growth over several years.”

France activity by year (€bn)



France activity by asset class (€bn)



France completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Confidential	Jan17	Mixed	EOS Contentia	CMP Banque	70
Confidential	Jan-17	Consumer	Confidential	Franfinance	40
Total					110

France ongoing transactions

Project name	Asset type	Seller	Size (€m)
Confidential	Residential	Confidential	115
Confidential	Corporate	Confidential	150
Confidential	Residential	Confidential	160
Confidential	Mixed	Confidential	30
Total			455

Nordics



The Nordic region remains Europe's outlier in terms of NPL holdings and portfolio deals. There has been only one portfolio sale so far in 2017 in the form of a small €105 million consumer loan portfolio from Bank Norwegian, and only one ongoing deal in a €600 million CRE portfolio from Finansiell Stabilitet, the Danish NPL wind-down organization. This is the first sale from Finansiell Stabilitet since 2015.



Why the ECB matters

Nordic banks have traditionally taken a non-aggressive approach to NPL resolution – they prefer agreed work-outs with customers and loan repayment freezes to loan sales, and in any case recovery processes in the region are extremely effective. This is likely to continue so long as the macro-economic background remains benign. However, Nordic banks will be affected by the upcoming adoption of IFRS 9 standards that demand a more pro-active approach to credit quality, and by the ECB's push for credible NPL disposal programmes throughout Europe. Although most Nordic financial economies are not directly regulated by eurozone institutions (only Finland is in the eurozone; Finnish banks were estimated to hold only €1.2 billion in NPLs in the EBA's most recent bank transparency review), they operate in the same capital markets as the eurozone banks and do not want to fall out of step with the rest of Europe.

“Continued regulatory pressure on NPL resolution and capital adequacy could drive banks to review their lending portfolios and bring to market assets that no longer fit their core business strategies.”



Non-core will be key

The Nordic banking sector is highly concentrated with six large banks (Nordea, Danske, Handelsbanken, SEB, DNB and Swedbank) dominating the market. In total these six banks only have c. €14 billion of NPLs on their balance sheets. However, continued regulatory pressure on NPL resolution and capital adequacy could drive banks to review their lending portfolios and bring to market assets that no longer fit their core business strategies. These may include non-core or sub-performing consumer or residential property loans as well as non-performing corporate loans.

Nordics completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Confidential	Apr-17	Consumer	Axactor	Bank Norwegian	105
Total					105

Nordics ongoing transactions

Project name	Asset type	Seller	Size (€m)
Kappa 3	CRE	Finansiell Stabilitet	600
Total			250

Emerging markets

As West European economies move closer to the end of their deleveraging journey, investor interest is moving east. That is visible within Europe, but also in the growing interest in Brazil, the Middle East, and in Asian loan portfolio markets.



The slowdown bites

After 25 years of continuous growth the Chinese economy is now experiencing a slowing of growth, and the effects are being felt across the Asian region. Although India has maintained strong growth momentum, Thailand, Indonesia and China itself are generating higher NPL levels in a region that has seen relatively low levels of credit stress in recent years. We expect to see rising levels of debt write offs, new measures to improve the scope and pace of NPL resolution, some reforms of the region's under developed asset recovery procedures, and a growing realisation that off balance sheet and under reported NPLs will have to be addressed. The introduction of IFRS 9 with its forward-looking approach to credit quality will also increase the recognition of impaired bank assets.



In most cases the Asian loan sales market is nascent: many jurisdictions require a tightening of debt resolution frameworks, whilst there is also an element of non-recognition of real levels of credit stress. Servicing of distressed debt is also relatively under-developed in Asia, with investors typically creating ad hoc servicing solutions using local lawyers, financial advisors and state sponsored asset management companies (AMCs). In Brazil there is a greater level of NPL recognition, but banks continue to expect to work out their distressed assets internally - something that is not expected to be possible given the volume of emerging NPLs.

“The introduction of IFRS 9 with its forward-looking approach to credit quality will also increase the recognition of impaired bank assets.”

China



Indonesia



Official data show that at Q2 2016 lenders reported US\$227bn of NPLs, an almost 200% increase in the last five years. Special mention loans (SML) at the same time were recorded as US\$479 billion resulting in a total NPL and SML ratio of 5.61%. Actual leverage and distressed debt levels are thought to be even higher. On official numbers China alone represents a distressed credit market close to the size of the €1 trillion across Europe. As a result there has been increased activity from foreign buyers with a number of trades occurring last year and into 2017 in what has been a local dominated market for the last 10 years. The government is trying various initiatives to address the NPL issue including the introduction of NPL securitisations which saw a number of issuances to date with a total face value in the order of US\$3.3 billion.

Distressed debt in the Indonesian banking sector has been increasing steadily since 2008 and NPL growth has accelerated in the past three years. NPL volumes reached US\$9.8 billion in April 2016 (giving an NPL ratio of 3%, the ratio having nearly doubled since 2013). SMLs reached US\$17 billion meaning combined NPL and SML reached 8.2%. Domestic banks have not as yet been under significant regulatory pressure to resolve these growing NPL volumes, but given the regulatory changes expected in the imminent future, this is likely to change. NPLs are mainly concentrated in the 'big 4' state-owned banks who are reserved to sell these loans at the moment. The market has seen a number of foreign banks attempt to dispose of their NPLs.

Thailand

Thailand is one regional economy with a historically active NPL market. Gross NPL volumes reached US\$10.7bn in 2016, representing a 20% year-on-year increase. SMLs reached US\$10.7 billion in 2016 taking the total NPL and SML ratio to 5.4%. Reported NPL levels are highest in the manufacturing, consumer and retail sectors, which combined make up around 80% of total NPLs. The banking sector has already shed a significant amount of NPLs in recent years driven by growing regulatory pressure; most distressed assets have been sold to two state-owned AMCs, Bangkok Commercial Assets Management and Sukhumvit Asset Management. Over the last 18 months we have seen the re-emergence of foreign participants in the local market with Bain Capital, SSG and Apollo entering into various portfolio opportunities. We expect this trend to continue as the size of the likely transaction flow going forward increases requiring a greater capital base than has historically been active.



India



The Indian banking sector has been slow in recognising and impairing stressed assets, and deteriorating asset quality in sectors like steel, infrastructure and textiles remains to be fully addressed. Recent measures by the Reserve Bank of India (RBI) to get banks to correctly classify and provide for loans has resulted in the Indian banking sector seeing a significant increase in stressed assets, which have approximately doubled from 2013 levels to an estimated US\$150bn in 2016. The government has also enacted several reforms and new regulations in a bid to streamline NPL resolution. These include steps to make transactions between banks and Asset Reconstruction Companies (ARCs) more transparent and more recently empowering the RBI to direct commercial banks to initiate insolvency proceedings against defaulted borrowers in accordance with the Insolvency and Bankruptcy Code (IBC) which came into effect in 2016.

The IBC provides a single unified framework to deal with corporate insolvency and bankruptcy and fundamentally changes the framework from "debtor in possession" to "creditor in possession" and allows creditors to take control from the borrower. Lenders have started initiating proceedings under the IBC with several insolvency appointments being made but the effectiveness of the one year old IBC and tribunals to work through the complex cases will be tested over the coming months/years. One area of concern will be the lack of experienced external management teams in India and the role that the current owners/management will play in preserving the value of the assets.



The GCC countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) form a promising NPL market in the Middle East, but is yet to emerge. Low oil revenues, and a consequent slowdown in government spending together with over-banking in the region (there are more than 50 banks in the GCC) have led to a regional decline in asset quality. The breakdown of relations between Qatar and other GCC members will further stress Qatari assets in particular. Oman, Qatar, Saudi Arabia and the UAE have all seen rising loan loss provisioning and NPL ratios over the last year, and while provisioning and NPL ratios have fallen marginally in Bahrain and Kuwait the true scale of non-performing assets in all six economies is likely to be much greater than is visible on balance sheets.

The stalemate

Several factors contribute to what amounts to a hidden NPL issue in the region. A large proportion of lending is particularly sensitive. Banks prefer to focus on growth and profitability and would rather roll over non-performing lending than risk long-standing political or business relationships. Deloitte estimates that somewhere between 30-40% of lending is in unsecured personal borrowing – potentially creating a relatively straightforward opening to an international NPL market.

This NPL stalemate may change. One likely factor is the consolidation of banks; local banking mergers have been under discussion, and foreign banks have already consolidated with the exit of Lloyds and RBS from the region and the acquisition of their loan books by HSBC. Foreign banks are the most likely first movers in NPL sales. The currency peg to the US dollar is another significant factor (Kuwait pegs its currency to a basket currencies including the US dollar and euro; all other GCC states peg their currencies to the US dollar).

A break with the US dollar would most likely raise debt service costs in local currency terms and create a new generation of NPLs. Regional banks have also been under increasing pressure from regulators to adopt stricter asset quality approaches as the deadline for IFRS 9 adoption approaches, with Bahrain, Qatar, Oman and UAE in particular seeing stronger regulatory oversight over the last year. Overall, the pressure to recognise NPLs is rising and likely to rise further – we envisage the regions first significant loan sale to commence later this year.

Brazil



After more than a decade of uninterrupted growth, Brazil entered into a recession 3 years ago which was mostly triggered by commodity price weakness and continued political instability. Unsecured lending, mostly in the retail sector, has already generated an NPL stock which is estimated to be in excess of \$150 billion (taking into account off balance sheet amounts). Full provisioning of these unsecured exposures was faced by Brazil's highly concentrated banking system which had historically maintained high capital ratios (the top five banks entered the recession with Tier 1 ratios of 12-15%).

Another trend is now appearing with the steep increase in restructured loan levels (mostly mid-Corporate/SME and RED) on banks' balance sheets. We currently estimate it to be in the region of \$120 billion. This could very well constitute a second wave of NPLs, the size of which will depend on the duration of the recession and the strength of the eventual recovery of the Brazilian economy. We expect this segment of the loan sale market to become increasingly active in the years to come.

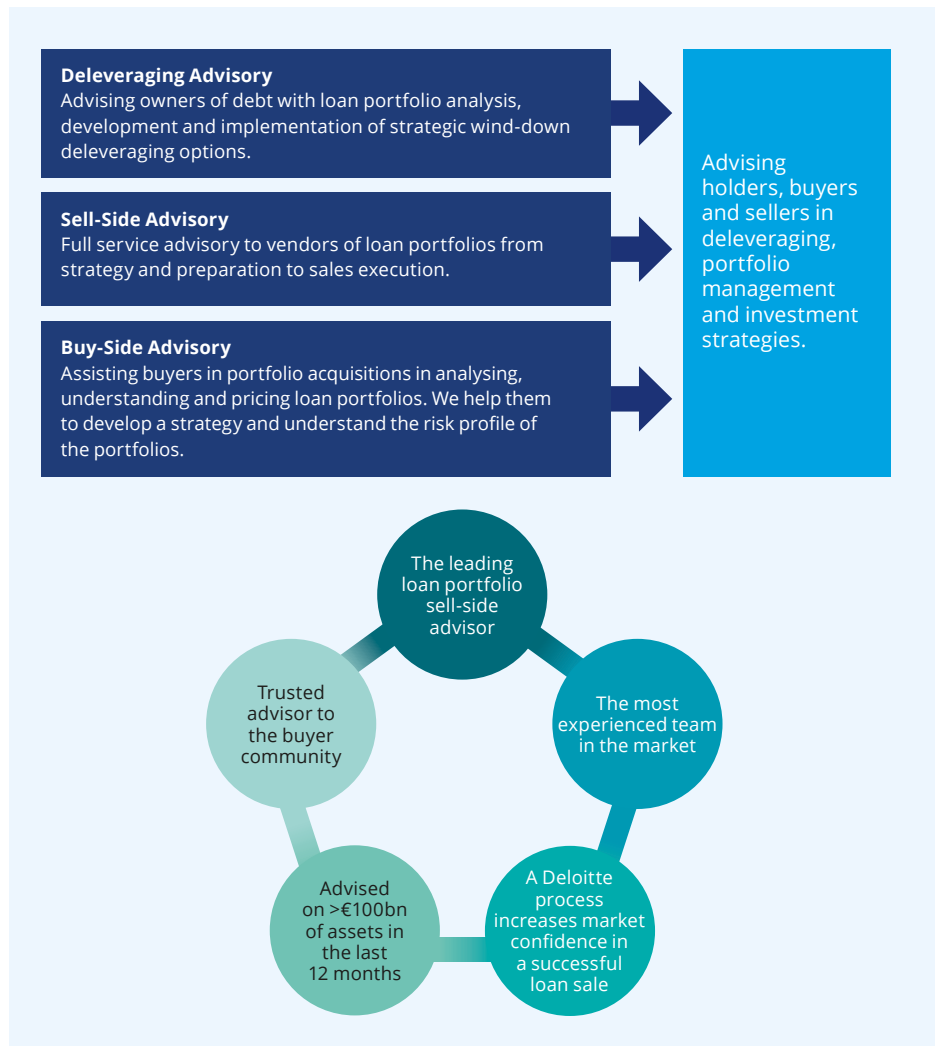
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Notes



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