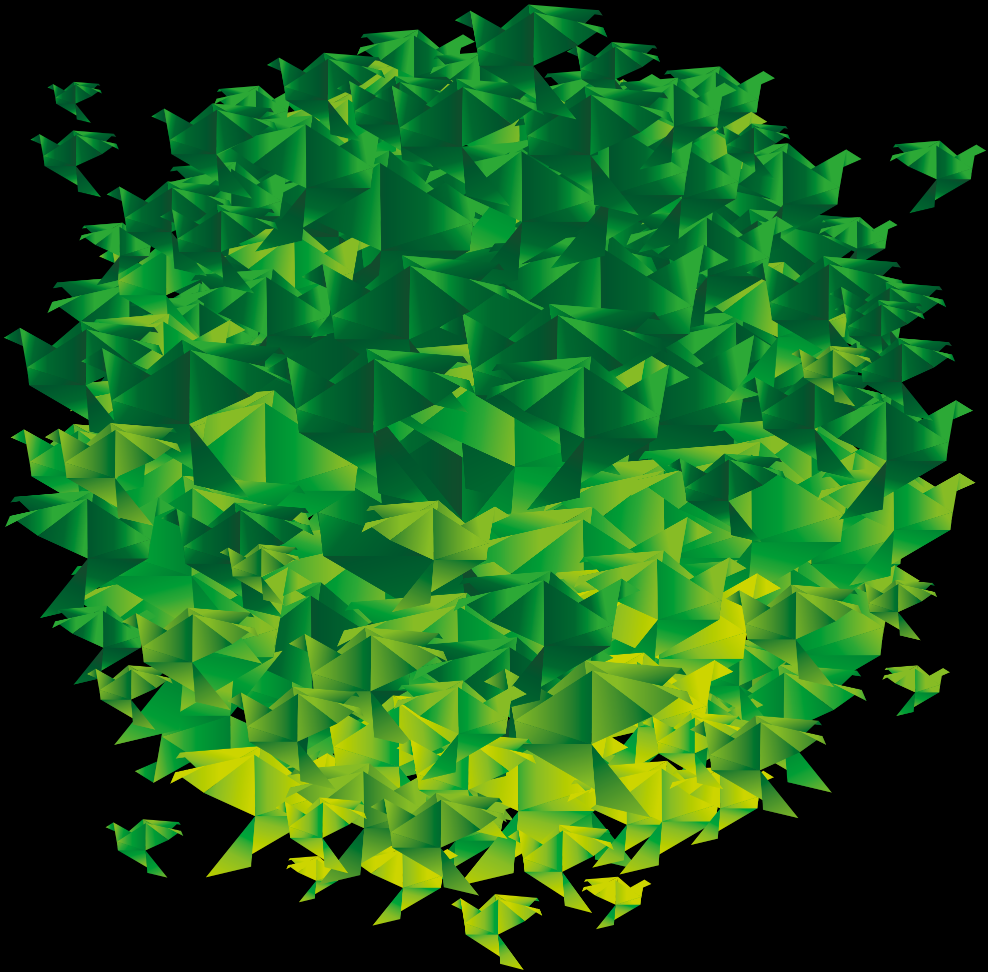


Lift off

Loan portfolio markets continue to soar: Focus on Europe

Global Deleveraging Report 2017 – 2018

Financial Advisory

Contents

Introduction

The European loan portfolio market accelerated in the second half of 2017, after a relatively slow first half. While just over €40 billion worth of deals had been concluded by mid-2017, the full year total reached €144 billion, exceeding the record total deal-making in 2015 and 2016.

Much of the value of the total 2017 deal activity is in a small number of large one-off deals – UKAR's €17 billion Project Ripon, Monte Paschi's €27 billion NPL securitisation, and the largest transaction of the year, the €30 billion portfolio sold by Santander following its acquisition of Banco Popular.

As we look ahead to 2018, we expect continued deleveraging activity from European financial institutions spurred by continuing regulatory and supervisory pressure and the adoption of IFRS 9, which is expected to lead to more proactive balance sheet management on an ongoing basis. In addition, markets that have dealt with most of their NPLs have started tackling their non-core assets and are expected to sell more performing loan books.

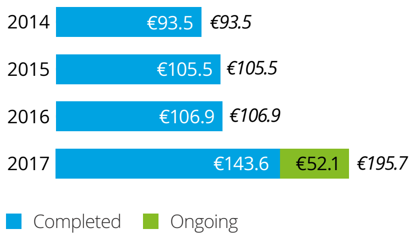
With over €52 billion in reported ongoing transactions and what looks like a busy deal pipeline, 2018 is set to be another eventful year in the loan sale market with total volumes likely to exceed the €100 billion mark for the fourth year running.

Exploring new horizons

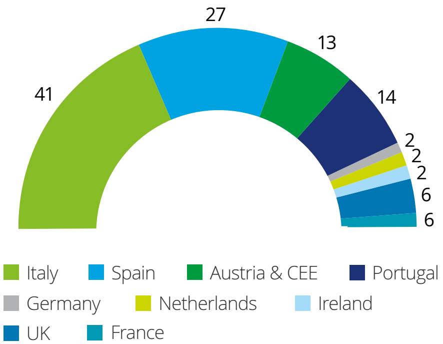
The global loan portfolio market has over the last few years been geographically centred on Europe. But as investors start to look for new opportunities to deploy their capital it is clear that emerging markets in Asia and South America are now firmly on the investment radar. In Asia, total official NPL and special mention loans (SML) numbers are in the vicinity of $518 billion, whilst Brazil alone has an estimated total NPL stock of $160 billion. From an investor's perspective these markets present opportunities that clearly cannot be ignored.

Headline facts and figures

Activity by year (€bn)



Number of completed deals 2017



Data as of 31 December 2017

Market summary and forecast

Deleveraging and balance sheet optimisation continues across the European banking system, and loan sales remain an important deleveraging tool for banks.

2017 has been the most active year in the loan sale market, and looking ahead, activity levels are likely to persist. Top PE buyers in 2017 include Blackstone, Cerberus, Bain Capital and Goldman Sachs, having acquired a total of €63 billion of loans during the year.

With numerous deals currently ongoing combined with a strong deal pipeline, the European market is expected to have a busy year ahead. 2018 is also likely to see the opening of a new debt trading frontier, with the first deals in the potentially very large Asian and Brazilian NPL markets.

The **UK** market continues to be dominated by UK Asset Resolution (UKAR), the state-owned wind-down institution. The UKAR deleveraging process is likely to produce more big deals in 2018 following the €17 billion Project Ripon sale of residential mortgages to Blackstone and Prudential; the coming month will see the completion of UKAR's Project Durham, a portfolio of around £5.5 billion of residential mortgages. The UK has also seen other smaller residential sales, and given that the UK market remains one of the strongest in Europe with healthy investor appetite the prospects for continued disposals during 2018 remain good.

Pressure from the European Central Bank (ECB) has contributed to an increased deal flow in 2017 from **Irish** banks. The largest portfolio deal currently in the Irish market is a €5 billion portfolio from Lloyds Banking Group together with Project Redwood, a mixed portfolio with a face value of €3.76 billion. One of the biggest emerging Irish loan portfolio sellers is expected to be Permanent TSB (PTSB), but Bank of Ireland, Rabobank and Ulster Bank are also potential sellers in 2018. We expect the Irish market to see at least another two years of significant deal-making.

Recent legislative proposals regarding regulation of loan buyers and other aspects of the bill may result in some disruption in the portfolio market.

German banks currently hold €56 billion in largely corporate NPLs but the German loan sales market has continued to be small in relation to potential. After 2016 which saw completed and ongoing transactions reach €10 billion, the 2017 market was dominated by two deals from HSH Nordbank, a €200 million CRE sale to Cerberus, and a €2 billion mixed portfolio sold to Macquarie and BAML.

The start of 2018 also brought to a close the much anticipated sale of HSH Nordbank to a group of investors led by Cerberus Capital Management and JC Flowers, who acquired 94.9% of the large lender. Unconfirmed portfolios for 2018 include at least two from FMS-WM, and small ad hoc sales from Commerzbank (which has €6.3 billion in NPLs) are possible. Despite the 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, and the bid-ask gap is wide.

The NPL stock held by banks in the **Netherlands** remains substantial – the three largest banks still hold over €40 billion of primarily commercial property NPLs. External investor interest in the Dutch loan portfolio market remains high following the successful sale of the €1.5 billion Project Stack to CarVal and the €200 million Project Stack commercial portfolio by ABN-Amro in 2017. Further portfolios are expected to come to market in 2018.

There have been only modest disposals in the **French** loan portfolio market despite the high volume of NPLs held by French banks worldwide at €139 billion. Regulatory pressure for NPL disposals has been low in France; banks have long preferred internal work-out solutions for distressed mortgage loans in particular. We expect this to change in 2018: four mortgage portfolio sales are ongoing, and we understand that four more portfolios of mortgage loans are in preparation for marketing most likely in Q2 2018.

After a strong first half in which €5 billion of deals were completed the **Spanish** NPL market has grown by the end of 2017 to €52 billion – The largest transactions in 2017 were the sale of a €30 billion real estate portfolio by Banco Santander to Blackstone, and the divestment by BBVA of its real estate business with €12 billion in assets to Cerberus. 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 and pressure continues to mount from government bodies for banks to accelerate the cleansing of their balance sheets.

Italy was the second biggest loan sales market in Europe in 2017 after Spain, with expectations for deal-making in 2018 running high. There have been a lot of positive developments including the improvement of the macroeconomic backdrop, the ability of some banks to deliver more coherent and rationally priced portfolios, and pressure by the banking authorities on the most heavily NPL exposed banks to clean up their balance sheets. The government guarantee on NPL securitisations, known as GACS, has had an important role in 2017 and more large state-supported deals are expected in 2018. The acceleration in the Italian NPL market has been accompanied by consolidation and restructuring of the debt servicing market. We expect Italy to remain one of the most active European NPL markets in 2018.
Activity in the **Portuguese** NPL market accelerated markedly in the second half of 2017. A significant boost to the market was the successful conclusion of Lone Star's acquisition of a 75% stake in Novo Banco. Portugal's largest bank, the state-owned Caixa Geral de Depositos (CGD) is expected to sell €1.8 billion worth of NPLs between now and the end of 2018, while Portugal's largest listed bank, Millenium BCP, has outstanding NPLs of over €8 billion. By the end of 2017 BCP was on track to meet its target of reducing NPLs by at least €1.5 billion a year. These sales are building momentum in the market, and the next two years are likely to see the biggest deal pipeline since the financial crisis.

The **Austria/CEE** NPL market is entering the final phase of the current cycle with another 12 to 18 months of significant deal-making to go. HETA and Raiffeisen are expected to be the most active sellers in the region going forward. Investor interest has remained high due to the higher return potential compared to more advanced markets, and competition remains strong despite the gradual wind-down of the deal pipeline.

The long-awaited **Greek** deal pipeline is finally becoming visible; with over €3 billion in deals completed in 2017, and more in progress, the market is beginning to find its feet. Deal-making has already been kick-started by Eurobank's Project Eclipse, the sale of €1.5 billion of consumer loans to Intrum, while another €12.5 billion worth of deals are currently ongoing. The rapid development of the market has been accelerated by the Bank of Greece's adoption of NPL resolution targets which aim to reduce over €100 billion of Greek bank NPLs to around €67 billion by the end of 2019.

The **Nordic** region remains Europe's outlier in terms of NPL holdings and portfolio deals. Apart from private deals there has been only one publically disclosed portfolio sale so far in 2017 in the form of a small €105 million consumer loan portfolio from Bank Norwegian. 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.

Opportunities beyond Europe

Emerging markets in Asia and Brazil are of increasing interest to debt investors.

+ After a sustained period of growth, the past year in **China** has seen a continuing ramp up in the process of deleveraging – largely aimed at supporting the official policies to address concerns of the risk positioning of the financial sector. The growth in the use of debt for equity swaps, non-performing loan (NPL) securitisation and distressed debt management foreign buyers have been increasingly participating in a market that has seen lower levels of activity since the onset of the financial crisis in 2008. To that end we have seen total issuances in the NPL securitisation market reach $3.3billion (RMB 21.144 billion) during the period from the restart of NPL securitisation trial programme in 2016 to August 2017 according to the statistical data of Shanghai Securities News.

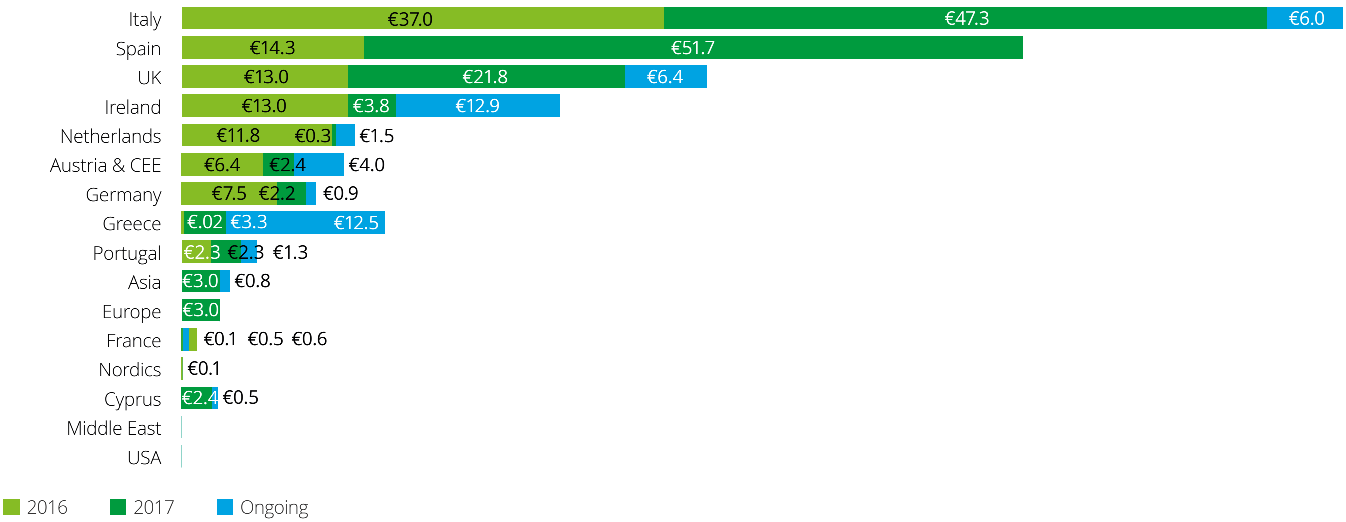
+ In **Indonesia** the NPL ratio at several large banks remains high. Distressed debt in the banking sector had been increasing steadily since 2008, although 2017 saw signs a stabilization of the rate of NPL formation. By mid 2017 the average NPL ratio at the largest 15 Indonesian banks was around 3.5%, although several large banks including Permata, Bank Mandiri and CIMB Niaga had ratios in the 4-6% range. Indonesia remains an early stage Asian NPL market: banks are actively seeking solutions for the disposal of their NPL loans but the bid-ask gap is wide and state-owned banks remain unable to sell at the discounts the market expects.

+ Both the household and SME sectors in **Thailand** remain highly indebted; NPL ratios are high in regional terms and continue to grow. Historically Thailand has had an active loan sales market dominated by state owned asset management companies (AMCs) but it seems unlikely that they are capable of absorbing all outstanding NPLs. Recently several large institutional investors have started to consider acquiring or establishing licensed platforms in preparation for future loan trades.

+ The **Indian** banking sector has historically been slow in recognising and impairing stressed assets. Recent measures by the Reserve Bank of India (RBI) to get banks to correctly classify and provide for loans has resulted in the sector seeing a significant increase in stressed assets, which have doubled from 2013 levels to an estimated $154 billion in 2017. A new Insolvency and Bankruptcy Code (IBC or the Code) was also approved in May 2016. Better recognition of stressed assets has led to increased provisioning and that coupled with an operational framework under the new Code and pressure from the RBI to resolve larger non-performing exposures should see increased transaction flow.

Brazil's stock of non-performing loans is estimated at c.$160 billion including fully written off exposures but not including restructured/sub-performing loans estimated at an additional c.$120 billion. This stock of problematic assets remains almost entirely unaddressed by loan sales, however, there are early signs that the country's main banks are recognising that portfolio sales will have to form part of the recovery strategy for the Brazilian banking sector. External investors recognise this opportunity and are already devoting resources and the market is projected to reach a significant scale over the coming years.

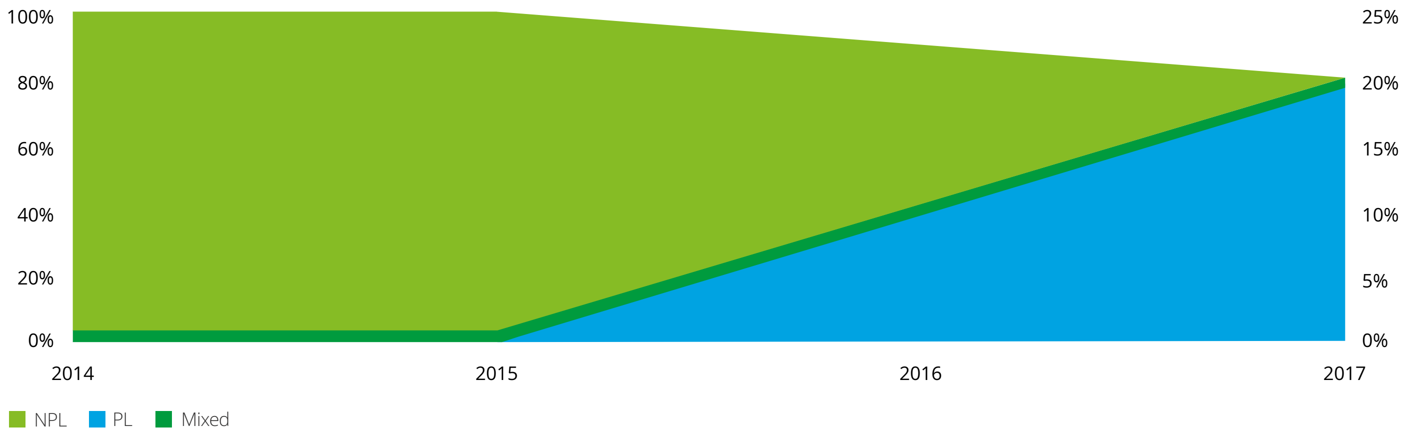
Activity by country (€bn)



Activity by asset type (€bn)

Note: All data as of 31 December 2017

Activity by loan type

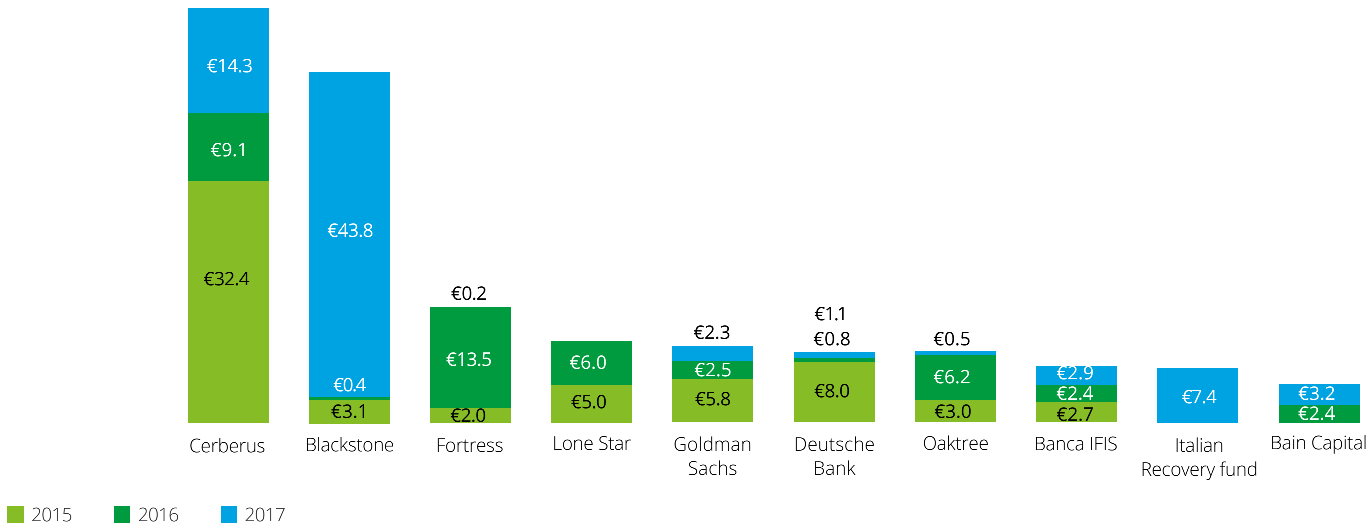


2017 has witnessed an increase in sales of performing loan portfolios. 20% of the total 2017 deal value was sales of performing books, up from 9.5% in 2016.

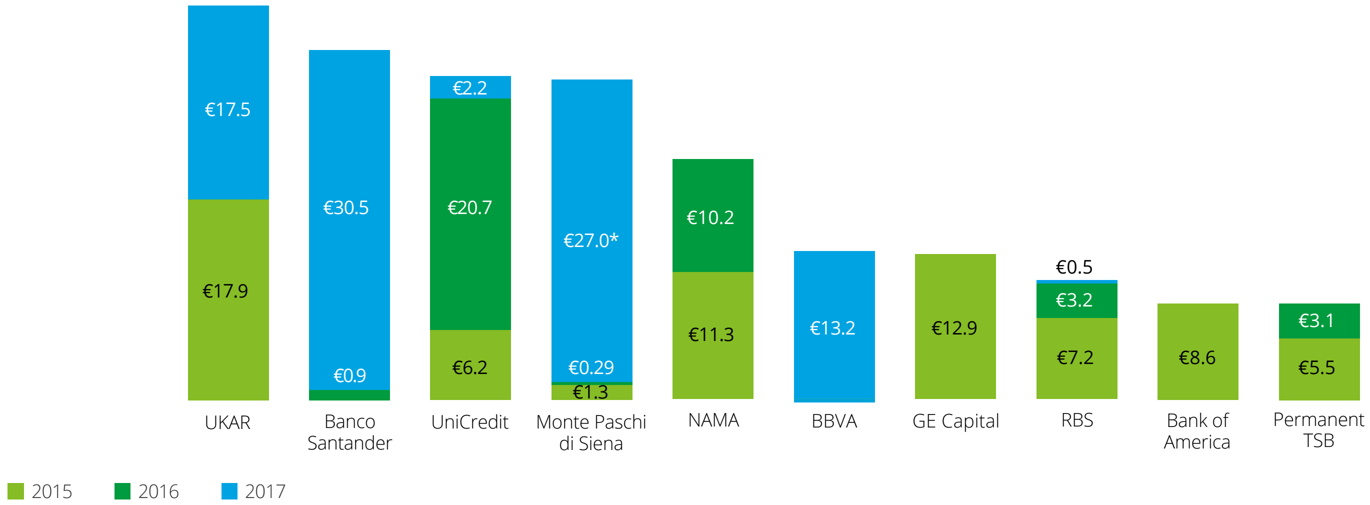
More performing assets are expected to be sold in 2018, particularly in the UK and potentially in Ireland.

Activity by loan type (2014 – 2017) – country breakdown

Top buyers in 2015 – 2017 (€bn)



Top Sellers in 2015 – 2017 (€bn)



Note: All data as of 31 December 2017.
*Denotes that €4.8bn was transferred to the Italian Recovery Fund and MPS retained the remaining €22.2bn.

Regulatory pressure continues

European Council action plan

Innovation in the regulatory agenda continued in Europe through 2017 with further developments scheduled for 2018: the net effect is a further build-up of pressure on slow-moving banks and national regulators for a more rapid clearing of Europe's non-performing loans.

The groundwork for further regulatory developments was laid with the mid-2017 release of an NPL action plan from the Council of Europe, the EU's policy-setting body. The action plan focuses on the classification of supervisory powers, enforcement and insolvency frameworks, the development of secondary markets for NPLs and macro-prudential approaches to prevent the emergence of future system-wide NPL problems. In particular the plan calls on the European Central Bank (ECB) to implement by the end of 2018 guidance on NPLs that covers smaller banking institutions, along the lines of the already issued NPL guidance for significant institutions, and for the European Banking Authority (EBA) to issue guidelines on NPL management for all banks in the EU.

The EBA is also called on to issue by the end of 2018 enhanced disclosure guidance on asset quality and non-performing loans, and to develop a standardised data approach to all NPLs.

In fact the EBA has already issued standardised data templates for NPLs broken down by asset classes – adoption of these templates is not a supervisory requirement although the EBA intends that they become the EU standard for reporting impaired loan data, and for transactions.

In addition to these initiatives the ECB somewhat surprised the market in late 2017 by issuing proposals for back-stop levels of capital to be held against loans classified as NPLs from 1 January 2018. This addendum to the 'final guidance' on NPLs published in March 2017, proved contentious, and the ECB is now due to issue a report clarifying the position by the end of the first quarter of 2018.

EBA transparency exercise

As part of its ongoing efforts to foster market discipline and awareness, the latest EBA Transparency Exercise was published in late 2017. This found that the NPL ratio across the 132 largest banks in the EU declined from 5.4% to 4.5% during the 12 months to June 2017. However, NPL ratios remain above 10% in around one-third of the 25 jurisdictions surveyed, and the absolute levels of NPLs remain high by historical standards at €893 billion.

Innovation in the regulatory agenda continued in Europe through 2017 with further developments scheduled for 2018: the net effect is a further build-up of pressure on slow-moving banks and national regulators for a more rapid clearing of Europe's non-performing loans.

Ratios are falling, slowly

The EBA data also shows there are great differences in asset quality and risk across the region. In most cases bank NPL ratios have tended to track downwards improving regional economic performance which is moving some NPLs into performing territory, in some cases bank ratios have actually increased over the last year due to more stringent NPL recognition practices in the wake of the ECB's publication of guidelines on the management and recognition of NPLs. The implementation of IFRS 9 accounting standards in early 2018 is also likely to force banks to recognise higher levels of NPLs (according to surveys by Deloitte, four fifths of banks expect their retail and corporate impairment to rise, and one bank in six expects a 50% increase or more).

The EBA Transparency Exercise includes data on a wide range of 'Key Risk Indicators' including liquidity, funding, solvency, profitability and market risk, as well as asset quality including NPL ratios and totals. The data do not include NPLs held by state-owned 'bad banks' such as Ireland's NAMA or the UK's UKAR, and also do not reflect asset sales in the second half of 2017. Nevertheless the EBA data does provide comprehensive baseline reading of the size of the outstanding NPL pool in Europe.

Non-performing exposures (€bn) as of H1 2017

Source: European Banking Authority

Italy is the big market

In terms of overall NPL ratios reported by the EBA southern European economies continue to dominate – Greece (46.5%), Cyprus (42.7%), Portugal (18.9%) and Italy (12%). However, for investors a more significant measure is the total stock of NPLs – on this measure Italy remains by far the biggest NPL market with €199.7 billion on bank balance sheets (prior to the sale of assets held by MPS), followed by Spain with €127.3 billion (prior to the sale of Santander's assets derived from Banco Popular), Greece with €108.1 billion, and the UK with €63.1 billion. The Netherlands (€41.2 billion) and Portugal (€33.4 billion) also have high NPL totals.

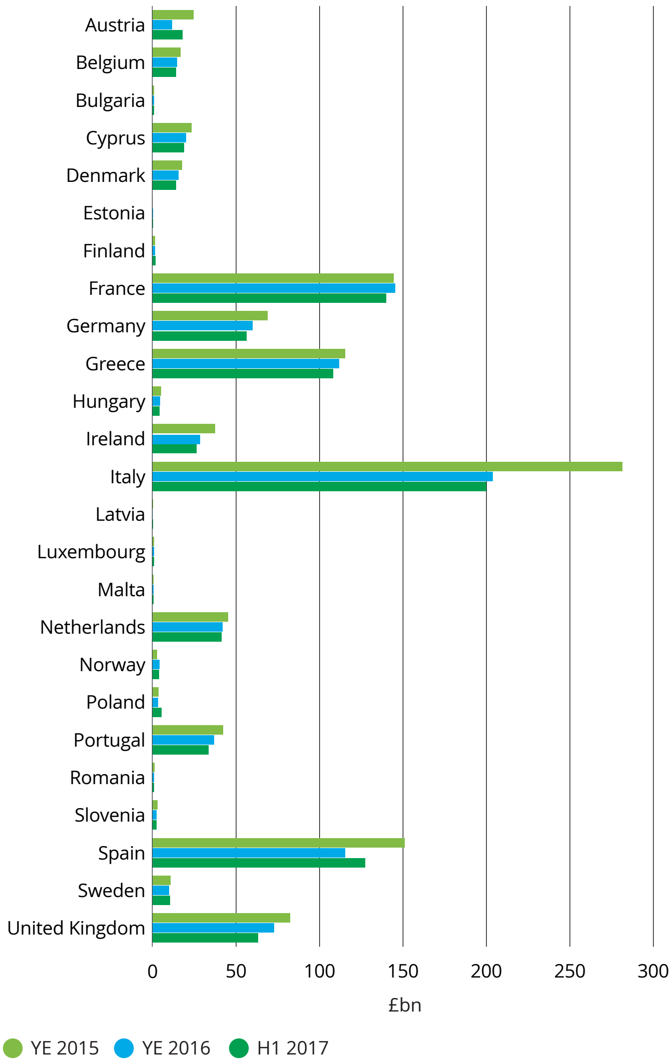
Despite the high totals of NPLs in the UK and Netherlands, these are mature markets with low NPL ratios and where banks are now just as likely to follow internal workout strategies for their remaining NPLs than outright portfolio sales.

In 2018 and beyond investors are likely to concentrate on the three southern European economies where NPL ratios are high (Greece, Portugal and Italy) and regulatory pressure to clear them is intense. Despite having the second highest NPL ratio in Europe, Cyprus is an outlier in that market momentum remains low due to a shallow real estate market. Furthermore, the total stock of NPLs of €18.6 billion is considerably lower than in other southern European states.

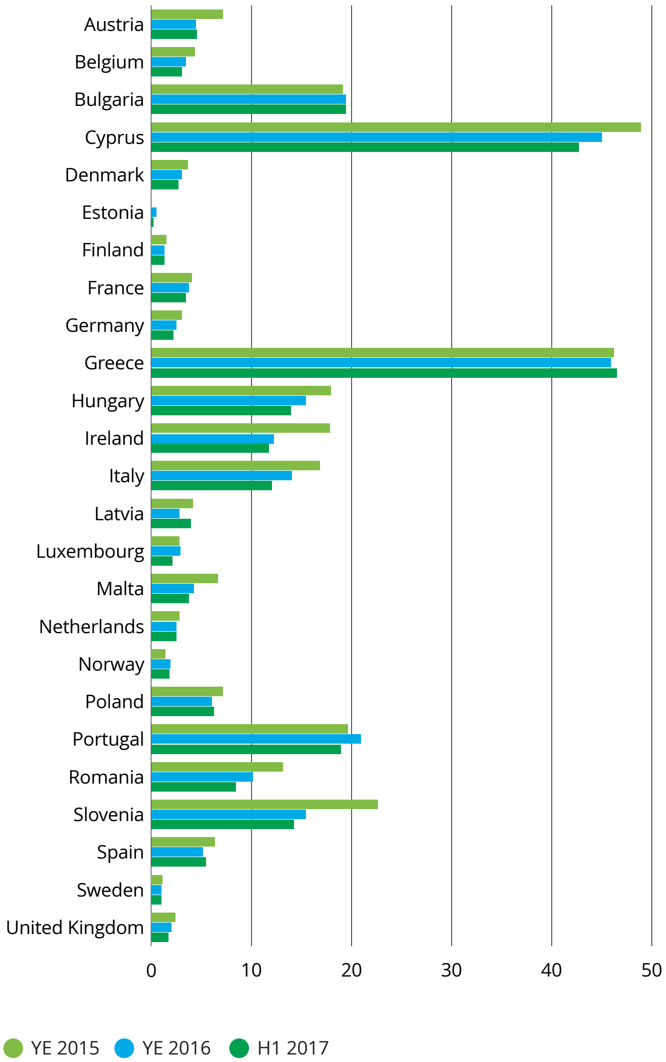
A slow process

The data on total exposures up to the first half of 2017 shows how difficult banks have found it to achieve rapid deleveraging – in many cases total exposure has fallen only slowly, and in the cases of Spain, Austria and Poland it has actually risen somewhat. Italy achieved a large NPL exposure reduction in 2016, and in the UK, Ireland and Germany the banking sector continued to reduce exposures throughout the period. Overall, NPE levels across the 25 jurisdictions have reduced by 19%, from €1.1 trillion in 2015 to €893 billion in H1 2017.

Non-performing exposures 2015 – H1 2017



Non-performing exposure ratios 2015 – H1 2017



Source: EBA Transparency Exercise 2016 & 2017

Italy

2017 has been a record year for Italian NPL transactions which made the country the most active market in Europe by number of closed deals and the second most active by volume behind Spain. There have been a lot of positive developments including the improvement of the macroeconomic environment, the ability of some banks to deliver more coherent and rationally priced portfolios, and pressure by the banking authorities on heavily NPL exposed banks to clean up their balance sheets. The Italian market has matured in the past few years although some challenges remain.

Expectations for 2018 remain high with several banks having announced large disposals and investor interest running high.

The servicing sector, which until now had been dominated by a few large and numerous small players, is also maturing thanks to a number of mergers, IPOs, and acquisitions of smaller players by large international groups.

However, the downside to this development being that the number of truly independent operators is shrinking which potentially creates an obstacle for new entrants into the market.

Against this backdrop of positive developments, there are still challenges ahead. One important element of uncertainty – paradoxically – are the GACS securitisations. These are NPL securitisations backed by an Italian Government guarantee – or GACS (Garanzia Cartolarizzazione Sofferenze). This scheme was introduced in 2016 with the aim of creating a more liquid NPL market.

This well-intentioned piece of legislation might be creating unintended consequences including reducing the actual transfer of problematic assets from banks to investors, therefore slowing the pace of work-out of the country's large stock of bad loans.

So far the deals structured under the scheme have seen banks retaining the senior tranche of the securitisations (the one covered by GACS) and selling only the mezzanine or junior tranches to third party investors. In all GACS securitisations the senior tranche typically represents the large majority of the exposure and therefore only a relatively small fraction of the risk is effectively transferred to investors.

Whilst these types of deals do make a lot of sense for banks, which can free up capital at the same time as retaining the Government guaranteed notes, it is still up for debate whether they are beneficial at a systemic level as they do not actually rid the system of the bad loans. What seems clear is that in the short term the GACS are contributing to the reduction in activity in straight NPL portfolio disposals.

So far traditional distressed debt investors have not shown much interest for the GACS structured deals for reasons of pricing and lack of control over management over the underlying portfolios. The GACS scheme expires in September 2018 and it is unclear whether the Government will be willing or able (it needs the European Commission approval) to extend it. This can explain the current rush by banks to come to market with more portfolios using the GACS scheme.

An important year

The year behind us has certainly included a number of milestones. Some of the larger and more troublesome situations in the banking system have been addressed. Monte dei Paschi di Siena (MPS) was bailed out by the Italian Government in July and is now 70% state owned. Also the crisis at the two large banks in the Veneto region (Banca Popolare di Vicenza and Veneto Banca) was resolved in June by the Government backed sale of most of the performing assets, including the branches, of these two entities to Banca Intesa. The most problematic assets were retained by the administrators of the two Veneto banks and are being gradually disposed, whilst €18 billion of NPLs were transferred to the SGA (Società Gestione Attività) bad bank. The aforementioned events, in combination with the wind-down of several smaller central Italian banks.

In addition to these corporate rescue transactions some of the large banks have undertaken far-reaching NPL clean-up operations. Between the end of 2016 and the beginning of 2017 Unicredit closed the €17.7 billion Project Fino, one of the largest European NPL transactions. After retaining an initial 49% stake in Fino at the outset of the operation, the bank has disposed of a further 29% over the course of 2017 and now retains only a 20% interest in the portfolio. Unicredit is not the only bank to look at jumbo transactions to substantially clean up their balance sheet. Intesa Sanpaolo is understood to be in negotiations with Lindorff-Intrum and potentially other investors for the sale of their division known as the Capital Light Bank (CLB) together with an NPL package of between €10 billion and €12 billion of bad loans.

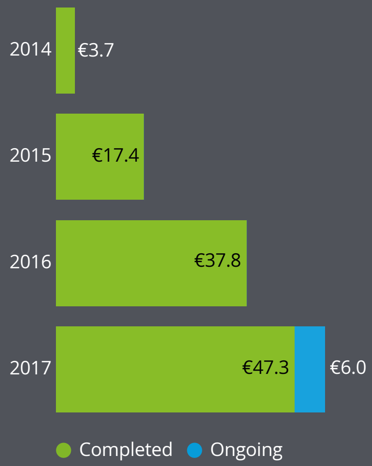
A number of other transactions have been announced or are expected including a large portfolio of legacy loans by Credit Agricole Investment Bank, a portfolio of unlikely to pay (UTP) loans by Cariparma, as well as the closure of two transactions that have been on the market for some time: the sale of the consumer loans of Gruppo Delta and Intesa Sanpaolo's project REP. Deals currently in the pipeline (assumed to be structured under the GACS securitisation scheme) include two large portfolios by BPER (one ongoing and one in preparation), a transaction by Banco di Bari, one by BancoBPM, and one by REV (an Italian bad bank).

In addition to the above, an opportunity that is currently much talked about by market participants consists of the large stock of UTP loans representing around €120 billion. As opposed to NPLs, which are worked out in a relatively standardised way, UTPs require more individually tailored strategies. This could provide the opportunity for investors to be able to apply more sophisticated work out strategies including loan-to-own strategies and refinancing as the underlying businesses in UTP exposures often require the injection of new funds.

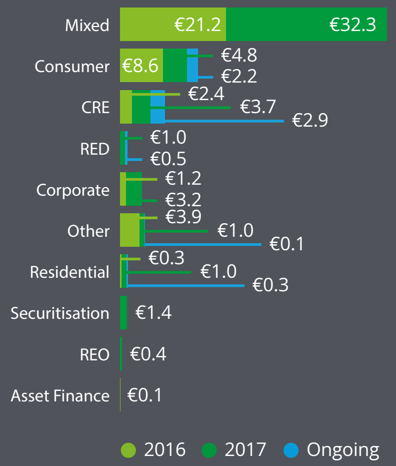
Servicing is gearing up

The acceleration in the Italian NPL market activity has been accompanied by a flurry of consolidation and restructuring of the debt servicing market during 2017. In addition to the sale of CAF to Lindorff-Intrum (making Intrum the third largest debt service provider in Italy), Varde bought 33% of Guber (Italy's fifth largest servicing company), MPS sold its servicing platform code-named "Juliet" to a JV between Cerved and Quaestio, Carige sold its platform "Gerica" to Credito Fondiario, KKR acquired servicer Sistemia, and Davidson Kempner recently signed a Sales and Purchase Agreement (SPA) for the purchase of Prelios. Furthermore, Fortress completed the merger of Italfondiario into DoBank and placed part of the shares on the Milan Stock Exchange as part of an IPO. Other transactions currently in the making include the proposed acquisition of Intesa's Capital Light Bank with all its servicing operations by Lindorff-Intrum, and the mandate given to an investment bank to find a buyer for FBS, a the real-estate focussed Italian servicer.

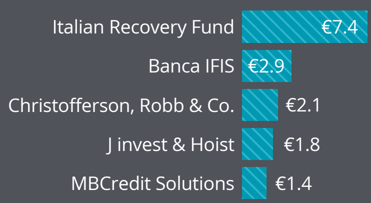
Italy activity by year (€bn)



Italy activity by asset class (€bn)



Italy top buyers (€bn)



Italy top sellers (€bn)

*Denotes that €4.8bn was transferred to the Italian Recovery Fund and MPS retained the remaining €22.2bn

Italy ongoing transactions

Project name	Asset type	Seller	Size (€m)
Project Botticelli	Residential	Erste	340
Confidential	CRE	Cassa Centropadana	170
Project Arcade	Consumer	Gruppo Delta	2,200
Project REP	CRE	Intesa	1,300
Confidential	CRE	Commerzbank	280
Confidential	RED	Carim	200
Confidential	RED	Banca Popolare di Bari	300
Confidential	CRE	FMS Wertmanagement	100
Project Telamone	Other	Intesa	90
Confidential	CRE	Cariparma	1,000
Total			**5,980**

Italy completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Sun	Dec-17	Consumer	J Invest & Hoist	Banco BPM	1,800
Project Saturnia	Dec-17	Corporate	Intrum	Banca Nazionale del Lavoro (BNL)	1,000
Project Sword	Dec-17	Mixed	Credito Fondiario	CARIGE	1,200
Project Spritz	Dec-17	Other	Intrum	Lone Star	–
Project Hemera	Dec-17	REO	Bain Capital & Castello	Intesa	150
Confidential	Dec-17	Residential	Confidential	Creval	24
Confidential	Dec-17	Consumer	Banca IFIS	Intesa	85
Confidential	Dec-17	Consumer	Banca IFIS	Confidential	251
Project Leda	Dec-17	Mixed	Axactor	Cariparma	93
Confidential	Dec-17	Other	MBCredit Solutions	UniCredit	250
Project Firenze	Nov-17	Corporate	MBCredit Solutions	Unicredit	715
Project Sherazade	Nov-17	Consumer	Mediobanca	Intesa	600
Project Rossini	Oct-17	Mixed	Cerberus	REV Gestioni Crediti	1,000
Confidential*	Oct-17	Mixed	Italian Recovery Fund	Monte Paschi di Siena	27,000
Project Buonconsiglio	Oct-17	RED	Locam	Cassa Centrale Banca	560
Project Vasari	Oct-17	RED	Locam	Rev Gestione Crediti	300
Project Terzo	Sep-17	Other	Bain Capital	Hypo Alpe Adria	750
Confidential	Sep-17	Mixed	B2 Kapital	Credit Agricol & Banco Desio	175

Italy completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Fellini	Sep-17	Mixed	Algebris	Cariscena, Carim and Carismi	380
Project Brisca	Sep-17	Residential	Davidson Kempner	Carige	938
Project Arona	Aug-17	REO	Fortress	Commerzbank	234
Confidential	Jul-17	CRE	Bain Capital	Banca Mediocredito del Friuli Venezia Giulia	400
Confidential	Jun-17	Consumer	Kruk	Deutsche Bank	132
Project Rainbow	Jun-17	CRE	Algebris	Banco BPM	693
Project Manzoni	Jun-17	Consumer	Banca IFIS	Barclays	190
Confidential	Jun-17	Consumer	MBCredit Solutions	UniCredit	450
Confidential	Jun-17	Consumer	Banca IFIS	Findomestic Banca	321
Confidential	Jun-17	Consumer	Banca IFIS	Consel	17
Confidential	Jun-17	Mixed	Italian Recovery Fund	Cariferrara	343
Project Beyond the Clouds	May-17	Mixed	Christofferson, Robb &Co.	Intesa	2,100
Confidential	May-17	CRE	Italian Recovery Fund	Nuova Banca Marche, Nuova Banca dell'Etruria, Nuova Cassa di Risparmio di Chieti	2,200
Confidential	Apr-17	Consumer	Banca IFIS	Confidential	302

Italy completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Confidential	Apr-17	Consumer	Banca IFIS	Confidential	112
Confidential	Mar-17	CRE	Confidential	CreVal	50
Confidential	Mar-17	Consumer	Banca IFIS	Deutsche Bank	413
Confidential	Mar-17	Consumer	Banca IFIS	Santander	160
Project San Marco	Jan-17	RED	Cerberus	Creval	105
Confidential	Jan-17	Corporate	Hoist Finance	Banco BPM	641
Confidential	Jan-17	Corporate	Banca IFIS	Banca Nazionale del Lavoro (BNL)	650
Confidential	Jan-17	CRE	Banca IFIS	Banca Nazionale del Lavoro (BNL)	350
Project Dante	Jan-17	Corporate	Anacap	Barclays	177
Total					**47,311**

Note: Data correct as of 31 December 2017.
*Denotes that €4.8bn was transferred to Italian Recovery Fund and MPS retained the remaining €22.2bn.

Viewpoint: Momentum is building, says Italy's UniCredit

"The Italian NPL market is still maturing," says Jose Brena of Unicredit, the Milan-headquartered global banking group that is one of the biggest sellers of distressed debt in the Italian market. "There is still work to be done, by sellers and by buyers," he adds, "but there is now a market dynamic that is driving sales."

Italy will be one of the biggest European markets for NPL sales this year, with almost €100 billion of portfolio sales likely to complete. "Despite the volume of sales we still don't see the number of distressed sellers you might expect," says Mr Brena. "Regulatory pressure and the reality of what is on balance sheets are pushing sellers into the markets, but they are not dumping assets. In fact pricing is improving, and that is not least because data is improving. From a buyer point of view there is a strategic need to get into the Italian market."

"The market will always penalise the unknown. When the market sees missing data, it exacts a price for that."

Jose Brena, Unicredit

More volume, more data

There is also a slow but steady evolution of the market from unsecured fully provisioned assets to more complex secured and real estate owned portfolios says Jose Brena. "There is a lot more volume coming into the market, and that is good for sellers and buyers. But the unsecured loans which have been the biggest part of the Italian market are the easy stuff. Those are the assets where people understand the data, and where the loans have usually been serviced for a long time. But now secured assets are coming into the market. And that brings a lot more challenges."

One of the biggest sales of the year in Europe has been Unicredit's Project Fino deal with Fortress and Pimco that saw €17.7 billion of NPLs sold through securitization vehicles part-backed by the Italian government under the GACS (Garanzia Cartolarizzazione Sofferenze) scheme. "Project Fino was big – some said it was too big – but in the end we were rewarded for being bold," says Jose Brena. "This was an attempt to deal with our legacy issues very quickly, and the market rewards you for facing reality. The Project Fino securitized assets already have an A rating from the credit agencies, which is quite remarkable in the Italian market."

Jose Brena says he believes that the Project Fino deal will mark the beginning of a pipeline of securitised portfolio deals in the Italian market. But he adds that there is still work to be done on bridging the price-ask gap for Italian NPLS.

Italy is catching up

"In general, banks do not carry assets at valuations that reflect the impact of the IRR to investors. This effect is compounded in Italy by the long recovery periods and the premium expected for uncertainty of outcomes" he says. "But as the market develops with more efficiency in the courts, better data and more precedents, we will see tighter pricing. In addition, with the potential implementation of calendar provisioning, banks know that that there is an outside date by which they will need to provision for total loss."

"My hope is that the market becomes more efficient," concludes Mr Brena. "For example it is interesting to see how fast the market has matured in Central and Eastern Europe, but not so fast in Italy. The problem in Italy is always time – it is not a question of what will happen, but when it will happen."

United Kingdom

Deals in the UK continue to be dominated by UK Asset Resolution (UKAR), the state owned wind-down institution that remains the biggest seller in the UK market. The UKAR sales are reflective of the broader maturing of the UK market, with more performing assets coming to market and the emergence of more buyers including asset managers, challenger banks and insurers in addition to traditional PE buyers.

The loan book of UKAR still contains over £17 billion of largely performing residential mortgages. The UKAR deleveraging process is likely to produce more big deals in 2018 following the €17.5 billion Project Ripon sale of residential mortgages to Prudential and Blackstone, but the end of the process is in sight.

One big deal

The coming year will see the completion of UKAR's Project Durham, a portfolio of c. £5.5 billion of residential buy-to-let (BTL) mortgages originated by the Bradford & Bingley building society. Although UKAR originally intended to run down its loan book through organic redemption well into the next decade, a supportive market and attractive pricing has encouraged a strategy of larger portfolio sales. We expect Project Durham to be followed by more large portfolios (see the interview with UKAR on page 30).

Over €21 billion of UK loans were sold in 2017 with several deals ongoing at year end. The most recent portfolio in the market was Project Pine from Allied Irish Bank (AIB), closed in early 2018. Although relatively small at €370m Project Pine was a precursor to a much larger AIB portfolio – the €3.8 billion Project Redwood.

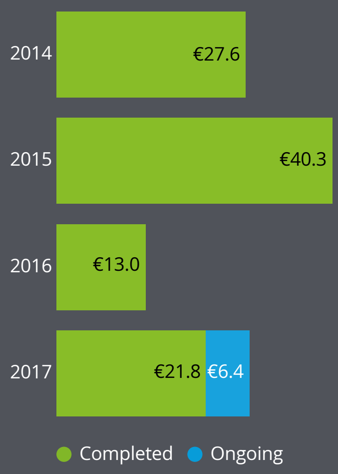
A new class of assets

The UK market has also seen other smaller residential sales, with the Project Morag €269 million portfolio from Skipton Building Society, and a secondary sale of a €735 million portfolio from Cerberus sold to Metrobank, a UK 'challenger' bank. RBS disposed elements of its shipping book in 2016 and may consider further disposals; the Nationwide Building Society is closing down its commercial mortgage business and may consider a sale of legacy loans to accelerate the wind-down.

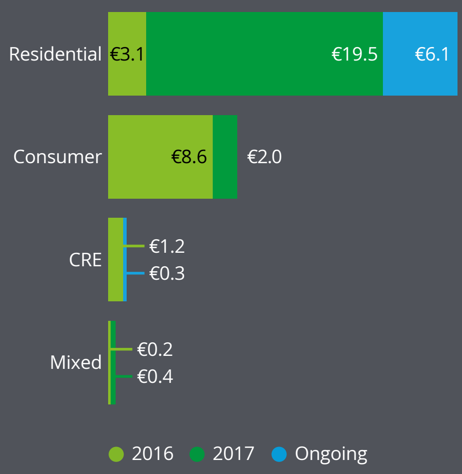
Market expectations of sales of new classes of assets such as UK student loans and Public Finance Initiative assets have so far only been partially realised. The sale announced by the UK government of £3.7 billion of student loans to specialist investors resulted in a loss to the Government of some £800 million. However with potentially a further £40 billion in student loans outstanding, more may be seen in this space over the next 12 months.

Given that the UK market remains one of the strongest in Europe with healthy investor appetite for deals in a creditor-friendly legal environment with established and predictable deal processes, the prospects for continued disposal during 2018 remain good.

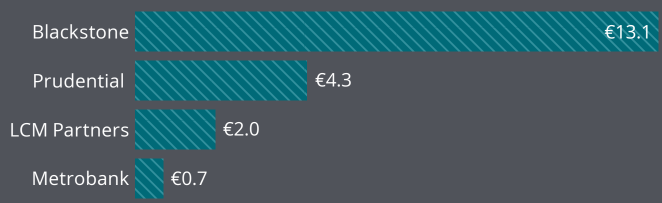
UK activity by year (€bn)



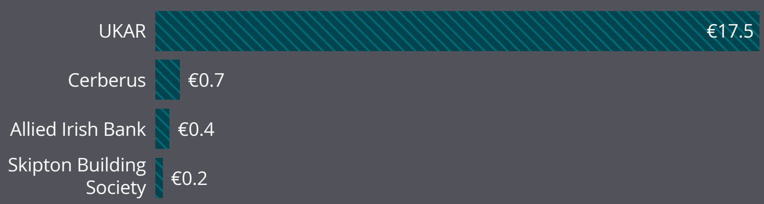
UK activity by asset class (€bn)



UK top buyers (€bn)



UK top sellers (€bn)



UK completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Pine	Dec-17	Mixed	Confidential	Allied Irish Bank	370
Confidential	Oct-17	Residential	Confidential	Confidential	1,116
Confidential	Jul-17	Consumer	LCM Partners	Confidential	1,953
Confidential	Jun-17	Residential	Metrobank	Cerberus	670
Project Morag	Apr-17	Residential	Confidential	Skipton Building Society	246
Project Ripon	Mar-17	Residential	Prudential & Blackstone	UKAR	17,457
Total					**21,812**

UK ongoing transactions

Project name	Asset type	Seller	Size (€m)
Confidential	CRE	Confidential	300
Project Durham	Residential	UKAR	6,139
Total			**6,439**

Note: Data correct as of 31 December 2017

Given that the UK market remains one of the strongest in Europe with healthy investor appetite for deals in a creditor-friendly legal environment with established and predictable deal processes, the prospects for continued disposal during 2018 remain strong.

Ireland

Pressure from the ECB has contributed to increased deal flow in 2017 and into 2018. There remains significant NPL levels in the sector, driving deal flow together with non-core performing portfolios.

The Irish stock of NPLs has been reduced by extensive asset sales since 2014, with NPLs falling from over 30% in early 2014 to just over 15% by the end of 2017. The loan sale market is no longer dominated by the National Asset Management Agency (NAMA); most of NAMA's assets have now been sold and the Agency is due to wind down in 2020.

The final phase

There are a number of large transactions currently in process including Project Redwood from Allied Irish Bank (AIB), a mixed portfolio of buy-to-let and commercial property loans with a face value of €3.8bn. The conclusion of Project Redwood will leave the newly re-privatised AIB with a face value NPL book of around €4 billion.

One of the biggest emerging Irish loan portfolio sellers is expected to be Permanent TSB (PTSB), the majority state-owned bank which has the largest NPL ratio of any Irish bank with €5.8 billion of NPLs. Project Glas represents the sale of up to €4 billion of non-performing residential mortgages. PTSB has said that its medium term aim is to reduce its NPL ratio from 28% to 10%, implying further sales to follow this initial portfolio.

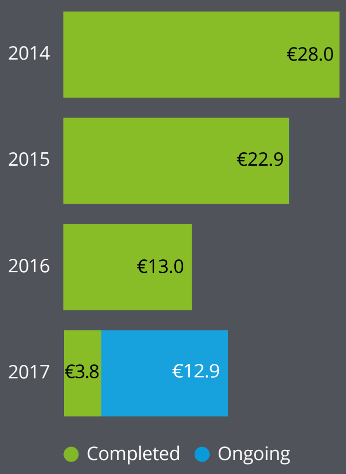
Lloyds Banking Group is disposing of around €5 billion of performing Irish residential mortgages.

Recovery has firmed prices

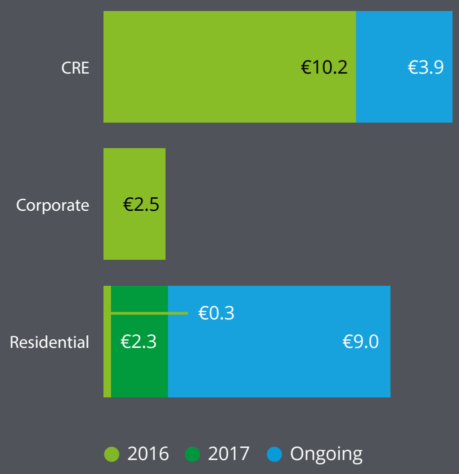
Pricing has firmed up the Irish market: Danske Bank's sale of the €1.8 billion Project Proteus portfolio of performing residential loans to Goldman Sachs and PIMCO achieved a price at the top end of expectations. The securitisation of Proteus was a factor in the high price: it is clear that investors increasingly want exposure to Irish RMBS instruments, Lone Star having placed an Irish RMBS in the first quarter of the year, while PTSB sold a €500 million tranche of securitised performing loans in late 2017, part of its Project Fastnet pipeline of securitisations.

We expect the Irish market to see at least another two years of significant deal-making. New potential buyers such as PIMCO are appearing in the market, and against the background of a strongly improving property market, Irish banks are keen to acquire mortgage books to make up for a shortfall in new originations in a market where lending rates are markedly higher than the European average.

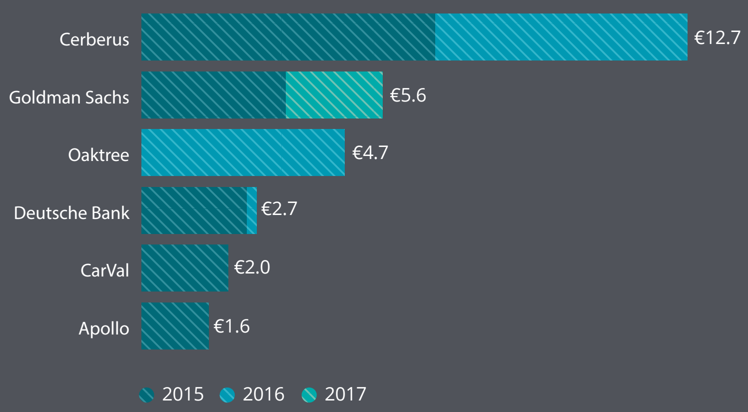
Ireland activity by year (€bn)



Ireland activity by asset class (€bn)



Ireland top buyers 2015 – 2017 (€m)



Ireland completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Confidential	Dec-17	Consumer	Confidential	Confidential	1,500
Project Proteus	Oct-17	Residential	PIMCO/ Goldman Sachs	Danske Bank	1,800
Project Cypress	Apr-17	Residential	Goldman Sachs	Allied Irish Bank	450
Total					**3,750**

Ireland ongoing transactions

Project name	Asset type	Seller	Size (€m)
Project Lee	CRE	NAMA	150
Project Redwood	CRE	AIB	3,760
Project Glas	Residential	PTSB	4,000
Confidential	Residential	LBG	5,000
Total			**12,910**

Viewpoint: Bigger is better, says UKAR

More to come, says UK Asset Resolution

One of the biggest sellers of loan assets in the European market is UK Asset Resolution (UKAR). In 2017 UKAR completed one of the year's largest transactions with the sale of the 'Project Ripon' mortgage portfolios to Prudential and funds managed by Blackstone for £11.8bn, and according to Asset Sales Director Mark Wouldhave there may be more to come.

The state owned workout organisation was set up in 2010 to facilitate the orderly management of the closed mortgage books of NRAM plc (formerly named Northern Rock plc) and Bradford & Bingley (B&B) following the financial crisis. "Our current balance sheet is still over £21 billion and is dominated by residential and buy-to-let mortgages but also includes around £250 million in commercial loans and £280 million in unsecured lending," says Mark Wouldhave. "But that is significantly down on the £115 billion we had in 2010; largely due to natural run-off but we have also completed one significant transaction each year since 2012, with the next deal likely to complete in the first half of 2018."

"We have seen strong demand and pricing from debt markets, with several portfolio sales being supported by securitisation exits in recent years. There is continued appetite for assets from traditional PE buyers but also from new entrants, covering both performing and non-performing assets."

Mark Wouldhave, UKAR

Choosing the moment

The vast majority of the remaining UKAR assets are residential and buy-to-let mortgages. "We are fortunate in that unlike a lot of sellers in the market our balance sheet is relatively homogenous," says Mark Wouldhave "and, given that taxpayer value is a primary consideration, we are not a forced seller. That means we retain the option to allow the balance sheets to run down naturally through redemptions if we don't believe a sale will deliver value for money or that our requirements around the ongoing fair treatment of customers will not be met. We have spent a lot of time understanding the assets and our customers and that means we are well placed to put ourselves in the shoes of the buyer, so we can provide the right kind of documentation, data and evident risk information to drive an effective transaction process. That kind of preparation is key if you want to maintain bidder engagement and stop the market pricing against you."

A question of appetite

In addition to issued securities the NRAM and B&B balance sheets were financed by almost £49 billion of loans from the UK Treasury, including a portion funded by the Financial Services Compensation Scheme. Portfolio sales in a market that has shown increasing appetite for UK loan assets have contributed to UKAR paying back over three quarters of its government loans, and almost all of its private sector finance. Mark Wouldhave says that the accelerated payback of all funding will ultimately depend on market appetite for more deals – but he expects the market to be supportive.

"The aim is to wind down the asset book and obviously you can make more of a step change with bigger transactions," he says. "It is roughly the same amount of work to do a £5 billion deal as a £1 billion deal, so bigger is better in that respect as long as the market conditions are right."

More in the tank

The next deal from UKAR is Project Durham – a performing loan portfolio that would reduce the UKAR balance sheet to close to £12 billion on completion. "Project Durham is a financeable asset class that the market is very familiar with and, subject to delivering value for money and meeting our customer treatment requirements, we expect it to complete early in the 2018/19 financial year," says Mr Wouldhave.

Like the earlier Project Ripon, Durham offers investors a securitisation option, a structure increasingly seen in European loan asset sales. "Essentially what that means is that the assets are accessible to a wider group of buyers," says Mark Wouldhave. "However, they don't have to use the securitisation option – if they have an alternative funding preference then we are very open to bids on that basis."

And beyond Project Durham? Industry experts see the UK deleveraging process nearing its completion. From UKAR's perspective, Mark Wouldhave said "what comes next is still open to debate. Assuming market conditions remain supportive then there may be a time in the foreseeable future when we are able to divest of all remaining assets. There are not many organisations in business to put themselves out of a job, but if we are good at what we do that is a real possibility."

"We always ask the question, is this a good time to sell? And that really depends on market liquidity, strength and depth of debt availability and the subsequent investment returns that market participants expect."

Mark Wouldhave, UKAR

Spain

The Spanish non-core market is now one of Europe's largest and most mature, with a growing and competitive buyer community, a large spread of different asset classes and an established and predictable transaction process against the backdrop of an improving economy and property market.

Spanish financial institutions have taken an active role in deleveraging their loan books since the financial crisis but plenty of work remains to be done by both private and public institutions, including by Sareb the Spanish 'bad bank' that continues to hold up to €39 billion of assets.

After a strong first half of 2017 in which c. €5 billion of deals were completed the Spanish NPL market has grown in the second half of the year to become the largest in Europe. The market has been shaped by two large deals – the divestment by Banco Santander of a €30 billion real estate portfolio (Banco Popular) to Blackstone, and the divestment by BBVA of its real estate business with €12 billion in assets to Cerberus. The Spanish market characteristic of a large number of smaller deals continued, the level of activity approached almost €10 billion in completed transactions.

A consolidated pool of tested and known sellers accounted for almost 90% of the total volume divested over the year, including Banco Santander, BBVA, Caixabank, Banco Sabadell and Bankia, all of which, excluding the two largest transactions of the year, completed very similar volumes. The year also witnessed some key transactions from Liberbank, Ibercaja, Bankinter and Cajamar, amongst others.

Spanish institutions have been active in deleveraging their loan books, but plenty of work remains to be done by both private and public institutions.

A year marked by consolidation and large transactions

2017 proved to be a year of significant changes in the Spanish banking landscape, with a number of large bank acquisitions and divestments and increased pressure from the European central bank (ECB) for a more structured and effective financial deleveraging – all of which occurred against the backdrop of some political uncertainty driven by instability in Catalonia and continuing Brexit discussions.

Banco Popular was bought by Santander in June 2017 under a process initiated by the EU's Single Resolution Board (SRB). This is the first time the Board utilised its resolution powers, and the speed and effectiveness of what had been an entirely untested process seems to have been broadly welcomed as evidenced by the relatively low market volatility that followed. Following the acquisition Santander decided against integrating the entire Banco Popular non-core book and proceeded to sell a majority stake in its €30 billion real estate-related asset portfolio to Blackstone. Although Santander has independently sold other portfolios in 2017 its NPL book following this transaction remains in excess of €30 billion.

Santander is likely to continue deleveraging, although historically it has been perceived to favour an in-house management of its non-core assets against larger recurrent portfolio trades.

The second largest transaction of the year was the sale by BBVA of its Spanish real estate business to US private equity group Cerberus Capital. The Spanish bank's 78,000 real estate assets, with a gross book value of approximately €12 billion, will be transferred into a joint venture 80% owned by Cerberus.

In another step towards further consolidation of the Spanish financial sector, Bankia, the fourth largest Spanish bank, announced during the year it would acquire Banco Mare Nostrum (BMN) in an all-stock deal. The deal had been under discussion since 2016 when Spain's Fund for Orderly Bank Restructuring (FROB) announced it was taking necessary measures to reorganise the banks it has a stake in. The FROB described the merger as the best strategy to recoup public funds ahead of a potential future privatisation.

The takeover will entail additional provisions and writedowns for BMN's portfolio and increase the size of Bankia's overall non-core book, which many believe will lead to increased deleveraging activity in the coming years.

2017 proved to be a year of significant changes in the Spanish banking landscape.

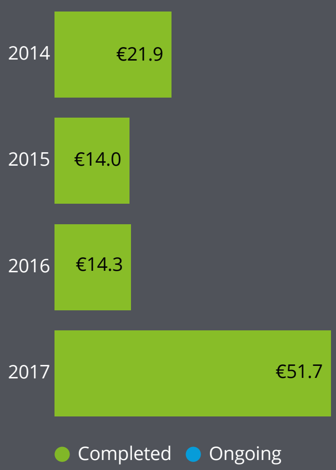
NPL market outlook

The Catalonian elections in December – where the three independence parties declared victory after winning an absolute majority in parliament – has increased the region's political uncertainty. But investors have plenty to like about Spain, with its economy set to grow 3.1% in 2017, making it one of the fastest growing Eurozone economies, and with an improving real estate market and a legal framework that continues to provide confidence for international creditors.

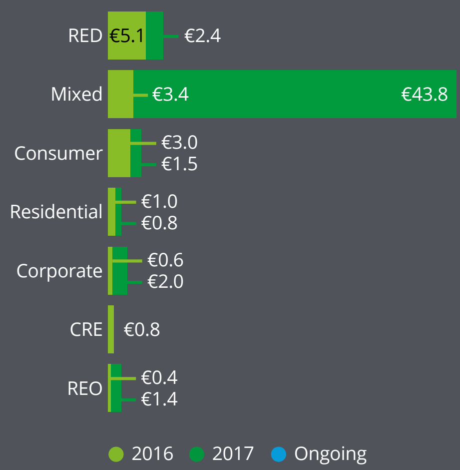
We believe the Spanish market can look forward to another very active year as Spain continues to have the third largest stock of NPLs in Europe (after Italy and France) with over €125 billion in non-performing loans. The introduction of IFRS 9 accounting standards early in 2018 with its more stringent NPL provision requirements will likely add to the momentum of a market that has demonstrated its capacity – and willingness – to absorb larger transactions.

In addition, further consolidation is expected in the Spanish financial sector, which will likely lead to additional non-core divestments as the larger entities begin to apply their deleveraging plans in their new acquisitions.

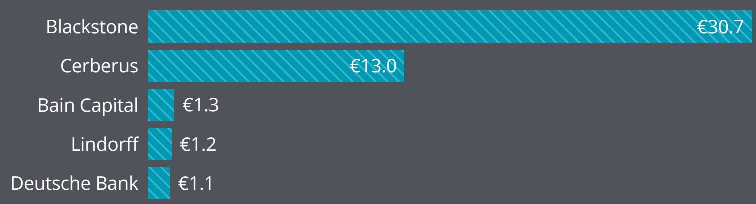
Spain activity by year (€bn)



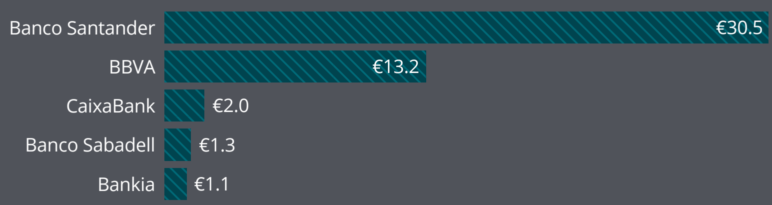
Spain activity by asset class (€bn)



Spain top buyers (€bn)



Spain top sellers (€bn)



Spain completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Confidential	Dec-17	Corporate	Confidential	Banco Sabadell	800
Project Ines	Dec-17	Residential	Deutsche Bank	Sareb	400
Project Egeo	Dec-17	Mixed	Cerberus & Lindorff	CaixaBank	700
Project Indianapolis	Dec-17	Consumer	Lindorff	Santander	500
Project Tango	Dec-17	REO	Lindorff	Cajamar	60
Project Escullos	Dec-17	Mixed	Carval	Cajamar	180
Project Sopelana	Dec-17	Corporate	Confidential	Bankia	150
Project Tribecca	Dec-17	Corporate	DE Shaw	CaixaBank	600
Project Tambo	Dec-17	RED	Oaktree	Sareb	150
Project Marina	Dec-17	Mixed	Cerberus	BBVA	12,000
Project Invictus	Oct-17	REO	Bain Capital	Liberbank	600
Project Lemon	Aug-17	REO	Neinor	Unicaja	100
Project Quasar	Aug-17	Mixed	Blackstone	Banco Santander	30,000
Project Gregal	Jul-17	Mixed	D.E. Shaw / Lindorff / Grove Capital	Banco Sabadell	500

Spain completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Fleta	Jun-17	RED	Bain Capital	Ibercaja	500
Project Jaipur	Jun-17	RED	Cerberus	BBVA	600
Project Tramuntana	Jun-17	RED	Deutsche Bank	CaixaBank	700
Project Marina	Jun-17	Consumer	Axactor	Banco Santander	500
Project Galdana	Jun-17	Consumer	EOS Spain	Bankia	500
Project Champions	May-17	Mixed	Axactor	Bankinter	450
Project Tour	Apr-17	Residential	Bain Capital	Bankia	200
Project MacLaren	Apr-17	Residential	Cabot	Lone Star	150
Project Gold	Mar-17	Corporate	DE Shaw	Bankia	200
Project Boston	Mar-17	REO	Oaktree	BBVA	300
Project Buffalo	Feb-17	REO	Blackstone	BBVA	300
Project Whale	Jan-17	Corporate	Apollo	Banco Popular	200
Project Patriot	Jan-17	RED	Blackstone	Banco Popular	400
Total					**51,740**

Note: Data correct as of 31 December 2017

Viewpoint: Opportunities will be in southern Europe

Given the elevated level of NPE ratios, southern Europe is where debt investors will find growth in 2018 says Fabio Longo, Head of NPLs & RE at Bain Capital Credit.

“Pressure from ECB, changes in accounting rules and consolidation in the banking sector, are leading banks to sell NPEs, and we see the emergence of more asset types. We expect that some of these markets will surprise on the upside, particularly Spain and possibly Portugal. Italian sales have been slightly below our expectations for 2017” he comments. Some of the sales are to government-linked institutions or have used GACS. If you strip out those deals the real investor market has been smaller than our expectations at the beginning of 2017.

GACS good for banks, not for private investors

The Italian market has opened up compared to past years, although some of the flow has been taken up by Government related entities and / or GACS. On the latter point, much attention has been paid to the introduction of Italy’s state-guaranteed securitization framework, the so-called GACS (Garanzia Cartolarizzazione Sofferenze) scheme.

“In some cases GACS sales are a good trade for the banks,” argues Fabio Longo. “GACS securitisations may lead to higher prices than selling to funds. The securitisation focuses on senior guaranteed debt, which means the rest of the debt could see further impairments.”

But the state is not the only player of size in Italy, and there will be private sector deals to be done in 2018 believes Mr Longo.

"I expect that IFRS 9 and the EBA guidelines on NPL treatment will be material catalysts for disposals in 2018 – and that applies to Spain and Portugal as well as Italy. Italy could also become attractive in the unlikely-to-pay sector – those loans are complex to underwrite, leading to fewer participants in transactions."

While Italy might perform somewhat below potential, the opposite is likely to be true of other southern European markets adds Nikolay Golubev, Director in Bain's Non-Performing Loan and Real Estate team.

Spain and Portugal will surprise

"Spain will surprise on the upside," he believes. "We think 2017 was better than expected in Spain, and 2018 will be better still. Banks are being encouraged by the appetite of the market.

"Portugal is also likely to surprise on the upside – we are cautiously optimistic, although the first deals will be small. We are getting close to the point where banks cannot postpone the issue any longer."

"Spain will surprise on the upside," he believes. "We think 2017 was better than expected in Spain, and 2018 will be better still. Banks are being encouraged by the appetite of the market.

Greece has potential

Bain believes that there is also great potential in Greece – but whether that potential will be realised is still to be seen.

"Greece is an interesting market," says Fabio Longo. "We like Greece as a potential market, but very little has traded so far. Greek banks certainly need to sell their NPLs, but the recovery is nascent and there still are uncertainties to be dealt with, particularly in the legal regime. The market has been expecting Greece to open up for many years, but at the moment the direction is still unclear."

"Greece could be the market story of 2018," concludes Mr Longo. "There has been a lot of change in Greece, but little has been tested."

Portugal

The Portuguese NPL market is accelerating. With €2 billion of deals in 2016 and slightly more completed in 2017, it is clear that there is growing momentum as banks plan to deleverage their NPL books.

Portuguese banks have been slow to make serious inroads into their NPL stocks despite having one of Europe's highest NPL ratios. However, banks are now moving faster to prepare their NPL holdings for sale helped by an improving economic environment and growing positive sentiment from international investors towards Portugal, where sovereign debt recently regained investment grade. One critical factor in the Portuguese market has been the government's decision to abandon a long-debated plan to create a bad bank vehicle for NPL disposals. This was instead replaced by a joint debt management company aiming to service large syndicated exposures from the country's three biggest banks: CGD, Novo Banco and Millennium BCP.

Another critical factor is the substantial increase of provisioning levels at these banks following their recapitalisation in 2016-17. The combination of these two factors has changed the mood and dynamic in the Portuguese market.

Activity in the NPL market accelerated markedly in the second half of 2017. A positive sign to the market was the successful conclusion of Lone Star's acquisition of 75% of Novo Banco, (successor to Banco Espírito Santo which has Portugal's largest NPL ratio of 25.9% representing an NPL stock of €6.3 billion).

The pipeline is building

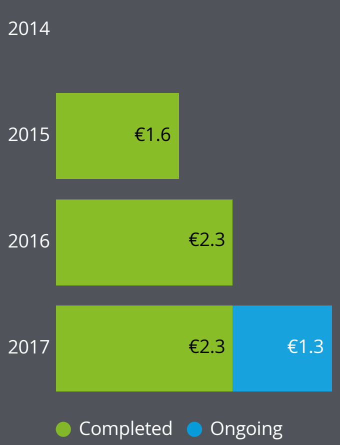
Portugal's largest bank, the state-owned Caixa Geral de Depositos (CGD) is expected to sell €1.8 billion worth of NPL between now and the end of 2018; CGD has already completed a sale of €476 million of NPLs to Bain Capital in 2017 (this was Bain's first acquisition in Portugal). CGD's restructuring plan also includes the sale of a significant part of its foreign assets, with operations in Brazil, France, Spain and South Africa, marked for disposal before 2020.

Portugal's largest listed bank, Millennium BCP, with a reported outstanding NPL balance of over €8 billion has put a deleveraging plan in place. We understand BCP has put a c. €500 million real estate secured loan portfolio in the market, early this year and is likely to continue deleveraging.

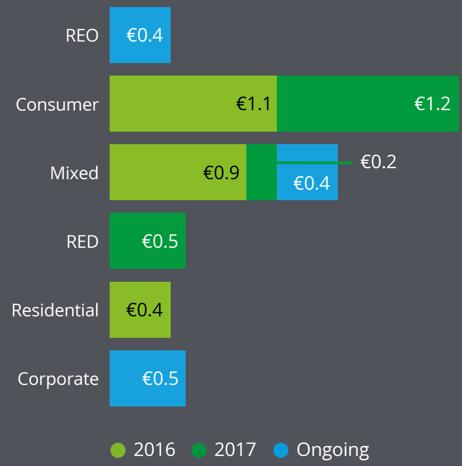
Santander's acquisition of Banco Popular included a Portuguese NPL book of around €1 billion, which mostly contain non-performing or sub-performing SME loans. We understand that this portfolio could be coming to market later this year.

These sales are building momentum in the market, and the next two years are likely to see the strongest deal pipeline since the financial crisis. The Portuguese NPL ratio remains high at over 14.6% but provisioning levels have increased, and the market mood is increasingly optimistic on future deal flow.

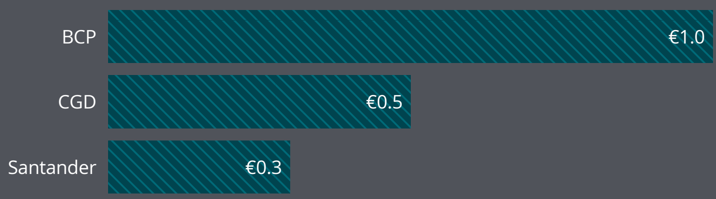
Portugal activity by year (€bn)



Portugal activity by asset class (€bn)



Portugal top sellers (€bn)



Portugal completed transactions

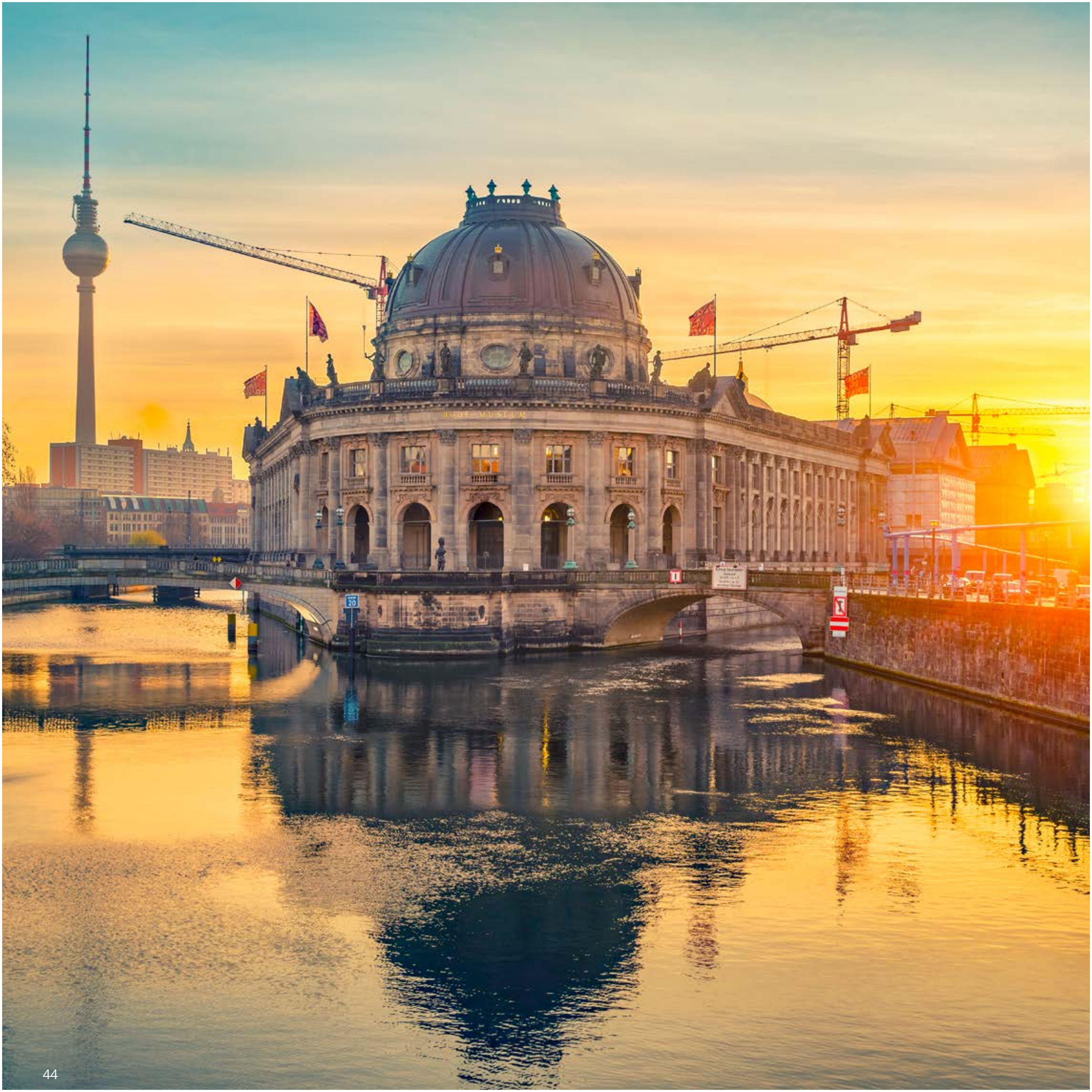
Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Berry	Jul-17	Consumer	Confidential	BCP	240
Project Pool XXXVII	Jul-17	Consumer	Confidential	Santander	200
Project Pack	Jul-17	Consumer	Confidential	BCP	150
Project Pool XLII	Jul-17	Consumer	Confidential	Santander	40
Pool XL	Jul-17	Corporate	Confidential	Santander	55
Project Block	Jul-17	Consumer	Confidential	BCP	120
Other	Jul-17	Consumer	Confidential	Confidential	235
Project Andorra	May-17	RED	Bain Capital	CGD	476
Project Protheus	Apr-17	Other	Altamira	Oitante	n/a
Project Branch	Apr-17	Consumer	Confidential	BCP	130
Project Evora	Apr-17	Mixed	Confidential	Santander	15
Confidential	Mar-17	Consumer	Confidential	Confidential	220
Project Tree	Jan-17	Mixed	Confidential	BCP	200
Project Seed	Jan-17	Consumer	Confidential	BCP	200
Total					**2,281**

Portugal ongoing transactions

Project name	Asset type	Seller	Size (€m)
Project Pacific	Mixed	CGD	350
Project Crown	Corporate	Millennium BCP	520
Project Golden	REO	Confidential	400
Total			**1,270**

Note: Data correct as of 31 December 2017

Portugal's largest listed bank, Millennium BCP, has reported outstanding NPL of over €8 billion and has set a deleveraging plan in place. We understand BCP currently has put a c. €500 million secured loan portfolio in the market, and that it is likely to continue deleveraging its secured loan portfolio in 2018.



Germany

Despite substantial NPL stocks, loan sale activity in the German market has remained subdued. While 2016 saw completed transactions reach €7.5 billion, most of the 2017 market has consisted of two deals from HSH Nordbank, a €200 million CRE sale to Cerberus, and a €2 billion mixed portfolio sold to Macquarie & BAML.

The start of 2018 brought to a close the much anticipated sale of HSH Nordbank. A group of investors led by Cerberus Capital Management and JC Flowers agreed to acquire 94.9% of the large lender from the two German federal states of Hamburg and Schleswig-Holstein for about €1 billion. This sale represents a key milestone in the German portfolio landscape in that the lender had been one of the most active sellers in the market. German banks hold €56 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. According to the EBA three banks account for the majority of NPLs – Deutsche Bank with €11.2 billion, HSH Nordbank also with €11.2 billion (not counting the late 2017 sale of €2.2 billion of NPLs), and NordLB with €10.4billion, although there are several other banks with significant NPLs including Commerzbank, Deutsche Zentral-Genoss 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.

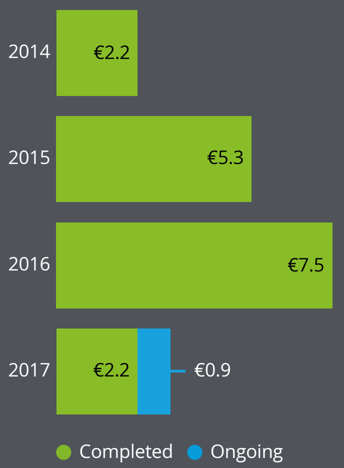
A pricing issue

Despite this overhang of non-performing and non-core assets, German banks remain reluctant to sell at prices the market is prepared to pay and have chosen a more measured work-out approach to their bad loans. 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. This year's largest portfolio deal was the €2 billion sale of Project Leo to Australian Macquarie and Bank of America Merrill Lynch. Originally marketed as a mixed corporate and CRE portfolio at €3.2 billion and due to be completed in 2017, the shipping loan component was eventually removed from the portfolio before agreement could be struck.

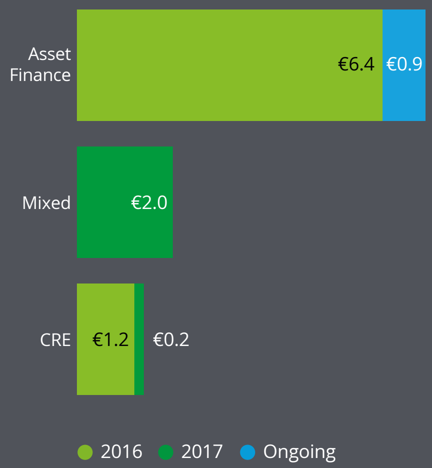
The bad banks will sell

Unconfirmed portfolios for 2018 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 EEA will eventually materialise; small trades from Commerzbank (which has €6.3 billion in NPLs) are also possible. The bid-ask gap remains relativity high, and while banks are under pressure from the ECB to do more to tackle non-core assets and NPLs they remain reticent to initiate large scale portfolio disposals as part of their strategy.

Germany activity by year (€bn)



Germany activity by asset class (€bn)



Germany top buyers (€bn)

Germany completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Air	Aug-17	CRE	Cerberus	HSH Nordbank	200
Project Leo	Jan-17	Mixed	Macquarie & BAML	HSH Nordbank	2,000
Total					**2,200**

Germany ongoing transactions

Project name	Asset type	Seller	Size (€m)
Confidential	Other	Confidential	n/a
Confidential	Asset Finance	Deutsche Bank	851
Total			**851**

Note: Data correct as of 31 December 2017

FMS-WM is believed to have around €3 billion of real estate lending still to dispose of. Further sales from FMS-WM and EEA will eventually materialise; small ad hoc sales from Commerzbank are also possible.

The Netherlands

The Dutch economy recovered strongly through 2017; full year GDP growth is likely to be close to 3% making the Netherlands one of the fastest growing economies in the Eurozone. Property prices have improved thanks to the buoyant economy, with loan-to-value ratios and bank NPL ratios falling. Property price growth in 2017 was the highest since 2002, and lenders feel under less pressure to dispose of their non-performing portfolios. Nevertheless the NPL stock remains substantial – the three largest banks still hold over €40 billion of primarily commercial property NPLs – and we expect more portfolio deals in 2018 after a quiet 2017.

Investor interest in the Dutch NPL market remains high following the successful sale of the complex €200 million Project Stack commercial portfolio by ABN-Amro in 2017. Project Stack was acquired by Attestor.

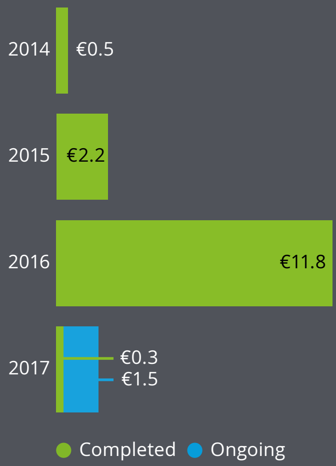
2018 saw the sale of Project Purple from Rabobank/FGH to CarVal-owned RHNB. The Portfolio with an outstanding balance of €1.3 billion was a follow on from the successful acquisition of Project Yellow by CarVal in 2016.

The restructuring option

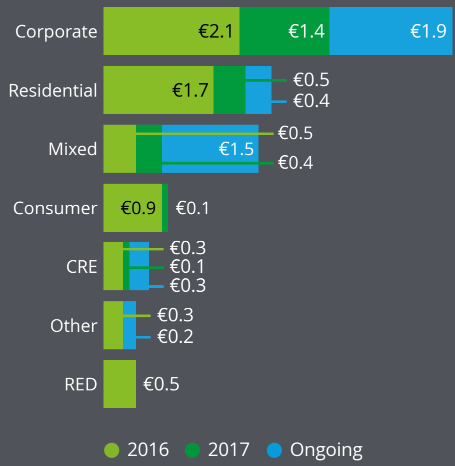
Of the two other top-three banks, ING remains a large holder of NPLs but they make up a small proportion of the loan book, and portfolio sales are unlikely in 2018. ABN-Amro may follow its successful sale of Project Stack with more portfolios, although there is nothing in the pipeline in early 2018.

The last year has seen Dutch banks turn to restructuring as well as outright sales to manage their loan books – one such refinancing was the €300 million syndicated loan refinancing of Bouwfonds Investment Management, the commercial asset management subsidiary of Rabobank.

Netherlands activity by year (€bn)



Netherlands activity by asset class (€bn)



The Netherlands completed transactions

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

The last year has seen Dutch banks turn to restructuring as well as outright sales to manage their loan books.

The Netherlands ongoing transactions

Project name	Asset type	Seller	Size (€m)
Project Purple	CRE	Rabobank	1,500
Total			**1,500**

Note: Data correct as of 31 December 2017

Greece & Cyprus

The Greek NPL market is witnessing real deal-making for the first time: the long-awaited deal pipeline in what is potentially a large European NPL market is finally becoming visible.

Early deal-making experiences have been tentative, but with over €3 billion in deals completed in 2017, and more in progress, the market is beginning to find its feet in an economy that is gradually showing signs of macroeconomic recovery. We expect 2018 to be a busy and formative year in Greek NPL deal-making.

The four 'pillar' banks which are also the largest banks by NPL holdings – Piraeus Bank, Alpha Bank, National Bank of Greece and Eurobank – have been busy in 2017 preparing for NPL disposals, with assets due for sale divided roughly equally between unsecured, SME loans, real estate lending and large corporate loans.

Greek deal-making has already been kick-started by Eurobank's project Eclipse, the sale of €1.5 billion of consumer loans to Intrum (with servicing retained by Eurobank's servicing subsidiary FPS). Greek banks have already disposed of most of their non-Greek assets in the CEE and are now fully focused on domestic assets. The Special Single Liquidator office created in 2016 which is responsible for €9 billion of NPLs derived from banks that failed in the wake of the financial crisis is also expected to bring portfolios to market in 2018.

A budding market

However the Greek market remains in its infancy. Loans to SMEs which make up a third of Greek NPLs have not yet been a significant part of the deal pipeline: SME borrowing tends to be multibank in nature and investors expect multibank portfolios that will enable total resolution of non-performing loans. One emerging solution to managing multibank lending is Project Solar, an initiative in negotiation in early 2018 that could see doBank (a subsidiary of Fortress that is Italy's largest NPL service company) take on the servicing of up to €2 billion of multibank SME lending currently spread between the books of the four pillar banks.

Meanwhile the recovery environment continues to improve. Legislation passed in May 2017 has streamlined the application process for NPL management licenses for Loan Asset Management Companies (LAMCs), and 10 LAMC licenses have now been granted, four of them within the last six months of 2017.

The legislation has also reduced the burden of personal liability for decisions taken in relation to loan restructurings or write-offs. In early 2018 the Greek government published a review of compliance with the European Stability Mechanism's Stability Support Programme for Greece, noting that rapid progress had been made on improving the insolvency framework and introducing electronic auctions for REO disposals. The review also highlighted that banks are going to have to increase the pace of NPL sales through 2018 and 2019 to meet agreed disposal targets.

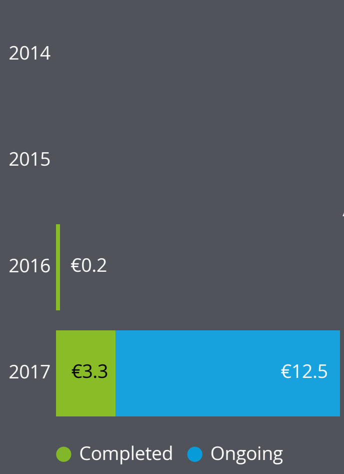
The rapid development of the Greek NPL market in 2017 and into 2018 has been accelerated by the Bank of Greece's adoption of testing NPL resolution targets which aim to reduce over €100 billion of

Greek bank NPLs to around €67 billion by the end of 2019, through a mixture of resolutions and liquidations. Initially, the reduction target involved €7.5 billion of loan portfolio sales. However, the ECB has put added pressure for NPL reduction, and as a result Greek banks will have to sell €12.5 billion of NPLs in the next two years.

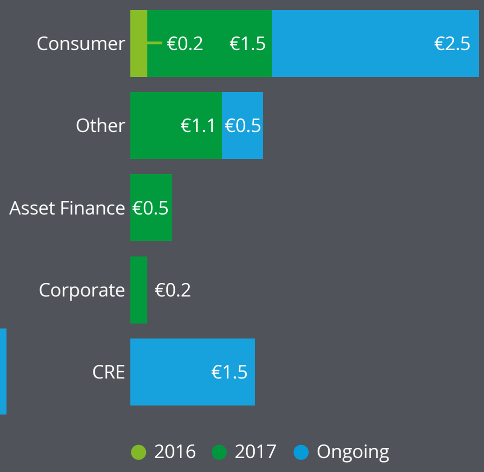
Cyprus – an untested market

With the highest NPL ratio in Europe and a banking sector that holds €22.8 billion of non-performing assets the Cyprus loan portfolio market remains largely untested. Market expectations of Cypriot portfolio sales have been disappointed; Cypriot banks are concentrating on improving the management of distressed assets. In 2017, Hellenic Bank sold a controlling stake in its servicing operation (which manages €2.5 billion of loans) to Czech APS, while state owned Cooperative Bank (with over €7 billion in NPLs) has done a similar servicing deal with Altamira of Spain, selling a majority stake in a new servicing vehicle created to manage all of the Cooperative Bank NPL portfolio. More recently, Pepper entered into an agreement with Bank of Cyprus to manage an €800 million portfolio of retail and SME NPLs. In early 2018 there are market expectations of a significant portfolio from Bank of Cyprus which has almost €10 billion of NPLs and one of Europe's highest bank NPL ratios at 50%.

Greece activity by year (€bn)



Greece activity by asset class (€bn)



Greece completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Project Eclipse	Oct-17	Consumer	Intrum	Eurobank	1,500
Confidential	Feb-17	Other	Aldrige EDC	Attica Bank	1,000
Confidential	Jan-17	Asset Finance	Orix & Berenberg Bank	RBS	510
Confidential	Jan-17	Other	Confidential	Confidential	117
Confidential	Jan-17	Corporate	Confidential	Confidential	150
Total					**3,277**

Greece ongoing transactions

Project name	Asset type	Seller	Size (€m)
Confidential	Other	Confidential	450
Confidential	CRE	Confidential	1,500
Project Venus	Consumer	Alpha Bank	2,500
Confidential	Consumer	Confidential	5,200
Confidential	Consumer	Confidential	2,800
Total			**12,450**

Cyprus completed transactions

Project name	Date	Asset type	Buyer	Seller	Size (€m)
Confidential	May-17	RED	CDB Bank	Bank of Cyprus	20

Cyprus ongoing transactions

Project name	Asset type	Seller	Size (€m)
Confidential	Unknown	Alpha Bank Cyprus	360
Confidential	Mixed	Hellenic Bank	145
Total			**505**

The rapid development of the Greek NPL market in 2017 and into 2018 has been accelerated by the Bank of Greece's adoption of testing 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.

Viewpoint: More experience needed to build the market, says Greece's Eurobank

Greece is expected by many investors to be the European growth market story of 2018. Are they right? We asked General Manager and Head of Group Strategy, Apostolos Kazakos, and Manager, Group Strategy, Konstantinos Vrettos, at Eurobank, one of the four Greek 'pillar banks', for their forecasts of the Greek NPL market.

In 2017 Eurobank closed a landmark €1.5 billion sale of consumer loans in Project Eclipse, and Apostolos Kazakos says that will be followed by more portfolios from Eurobank and other sellers. "There will certainly be increased activity vis-à-vis what witnessed in 2017. In fact, all other three systemic banks are preparing either sales or just about to launch them in 2018. Overall, banks in 2018 will be focusing on liquidations, loan restructuring and sales efforts. We want to achieve the SSM's NPL reduction targets and we believe the other big banks also want to achieve the targets."

"Maturity is about numerous factors. You cannot sell if servicing is not in place. You cannot sell if the legal environment is not right – in the past we had no legal framework to govern servicing companies or NPL portfolio sales."

Apostolos Kazakos

The framework is ready

Greece has been on the global investment radar for more than a year, but the NPL market has been slow to start. Mr Kazakos says that is partly because the regulatory and legal frameworks needed to give confidence to investors have not been in place – but that has already changed. "The legal environment is much more mature," he says. "The framework is now in place – albeit not fully tested, but we think it is ready to support sales. In addition, the loan servicing market has been increasingly developing. There are at least 10 companies licensed to service loans – what we need now is to see them up and running, and that is about getting the people and processes in place. Moreover banks are now more ready to sell because they have built provisions. No doubt, there will be losses to be absorbed but they are losses we can live with."

A healthy NPL market needs willing buyers as well as sellers, points out Konstantin Vrettos. "The lack of NPL portfolio trades in the Greek market requires the seller to assist buyers in understanding the market, and forms one of the big issues we have to face among the different asset classes," he says. "In our last sale we had several investors in the process, but many were not familiar with the Greek market or the way that asset classes perform in Greece. We spent a lot of time generating the data to support the underlying value of the assets."

Greek banks already have experience of NPL portfolio sales, having disposed of most of their CEE assets in the recent past. "The banks have been doing a lot of deleveraging deals in the Balkans, but that is a much more active market," says Mr Vrettos. "There are more participants and there are more servicing options. That is knowledge that can be transferred to Greece, but investors are aware that there are still fewer servicing companies and for the time being there is more ambiguity."

The gradual recovery of the Greek economy is also a positive factor in driving the NPL market, adds Apostolos Kazakos. "The improving macro environment will accelerate NPL reduction," he says. "Borrowers will be more ready to engage with banks, and better conditions mean that you can achieve better prices. Investors are willing to accept a lower IRR, and they are willing to deploy more capital when they see the prospect of better returns."

Overall, Eurobank sees a Greek market where reform of processes has already been achieved, where investors are poised to engage with banks who are committed to Government NPL reduction targets, and where the mood is increasingly positive. "The tools are all in place," says Konstantin Vrettos. "Now the market just needs to test them."

"There is still some way to go on making the market more efficient and improving the bid-ask spread. The lack of precedents and prior experience force us to draw benchmarks from activity in other markets. But in a year or two it will be much easier."

Konstantin Vrettos

Austria & CEE

Austrian and CEE deal volumes in 2017 will be close to the €6.4 billion of deals concluded in 2016. We anticipate the market will start to wind down in 2018/2019 as the NPL market enters the final phases of the current cycle with another 12 to 18 months of significant deal-making to go.

Regional deal-making has been driven by Austrian, Italian and Greek banks deleveraging their CEE exposures. The Austrian and Italian banks have completed most of their asset sales in Central Europe as have the Greek banks which were active largely in South Eastern Europe and have now turned their attention to their large domestic Greek NPL holdings.

Two institutions where we expect continued NPL activity in the region are HETA (the Austrian wind-down institution for Hypo Alpe) and Raiffeisen (the Austrian cooperative banking group with subsidiaries throughout the CEE region).

HETA close to completion
HETA stepped up portfolio disposals in 2017 commencing portfolio sales in Serbia, Bosnia, and Montenegro. In 2018, we expect HETA will dispose of its portfolios in Croatia and Slovenia.

Raiffeisen by contrast has been slower to sell NPLs despite having almost €7.8 billion of NPLs. In 2017, only relatively small portfolio sales in Romania and Croatia proceeded.

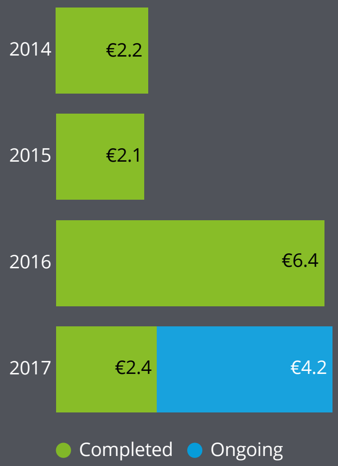
Other significant sellers such as Erste, Unicredit, and Immigon (the wind-down vehicle for Volksbanken) have largely completed their NPL disposals in the region.

Regional deal-making has been driven by Austrian, Italian and Greek banks deleveraging their CEE exposures.

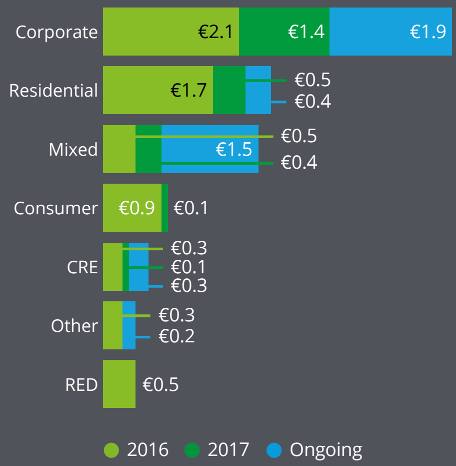
The Austria/CEE NPL market is one that developed and matured rapidly with few failed transactions in 2017 due to a closing of the price gap between buyers and sellers.

Investor interest has remained strong due to the high potential returns available in the market, and competition remains fierce despite the gradual wind-down of the deal pipeline.

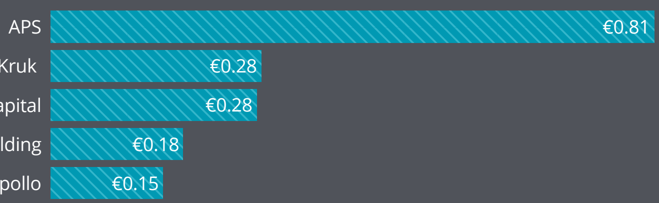
Austria & CEE activity by year (€bn)



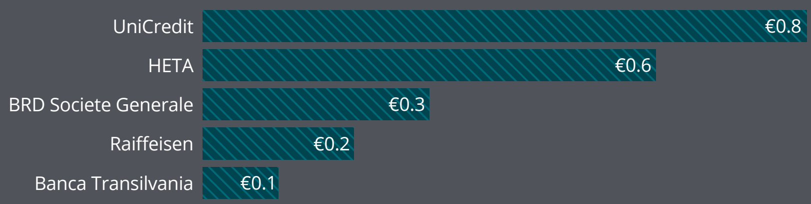
Austria & CEE activity by asset class (€bn)



Austria & CEE top buyers (€bn)



Austria & CEE top sellers (€bn)



Austria & CEE completed transactions

Project name	Country	Date	Buyer	Seller	Size (€m)
Project Rosie	Hungary	Dec-17	APS & Balbec	Raiffeisen	80
Confidential	Bulgaria	Nov-17	B2 Holding	UniCredit	84
Project Bigova	Montenegro	Oct-17	Confidential	HETA	50
Project Onyx	Serbia	Sep-17	Apollo & APS	HETA	299
Project Sunset	Croatia	Aug-17	DDM	Raiffeisen	140
Confidential	Romania	Jun-17	Confidential	Banca Transilvania	110
Project Taurus	Bulgaria	May-17	APS	UniCredit	450
Confidential	Hungary	May-17	Confidential	Confidential	250
Project Iris	Romania	May-17	Kruk	BRD Societe Generale	282
Project Sunrise	Croatia	Feb-17	APS	HPB	100
Project Drava	SEE	Jan-17	B2 Kapital	HETA	276
Confidential	Hungary	Jan-17	APS & Balbec	UniCredit	139
Project Taurus	Bulgaria	Jan-17	B2 Holding	Unicredit	93
Total					2,353

Investor interest has remained high due to the high potential returns available in the market.

Austria & 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	CRE	Erste Group	110
Confidential	Slovenia	Other	NLB	90
Confidential	Bosnia & Herzegovina	Corporate	Confidential	437
Project Metro 2	Bulgaria	Corporate	Eurobank	65
Confidential	Slovenia	Corporate	HETA	120
Confidential	Serbia	Corporate	Confidential	60
Confidential	Romania	Corporate	Alpha Bank	500
Project Fain	Romania	Corporate	Raiffeisen	300
Confidential	Slovenia	Mixed	Abanka	246
Project Tara	Montenegro	Corporate	HETA	200
Project Arena	Romania	Mixed	Banca Transilvania	250
Total				**4,217**

Note: Data correct as of 31 December 2017

France

Although France has a relatively high stock of NPLs in absolute terms – according to the EBA's 2017 figures the total of NPLs held by French banks worldwide was €139 billion – there have been only modest disposals. The largest NPL stocks lie with BNP Paribas (€40.9 billion), Credit Agricole (€29.3 billion), BPCE (€25.1 billion), Societe General (€22.7billion) and Credit Mutuel (€16.4 billion). Societe General and BNP Paribas have the largest NPL ratios, but no significant French bank has an NPL ratio in excess of 5% (the EBA's low-NPL threshold).

Ongoing sales into 2018

Regulatory pressure for NPL disposals has been low in France; banks have long preferred internal work-out solutions for distressed mortgage loans in particular, and most retain significant internal debt servicing capacity. Apart from the 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 small ticket corporate, SME and leasing loans.

But this is now changing. Banks are selling their servicing capabilities (BNP sale of EIFFICO), and many new sellers are expected to bring portfolios to market. A mixed consumer/mortgage portfolio sale and a small consumer loan portfolio sale were completed in the second half of 2017, four mortgage portfolio sales are ongoing, and we understand that four more slightly larger portfolios of mortgage loans are in preparation for marketing most likely in Q2 2018.

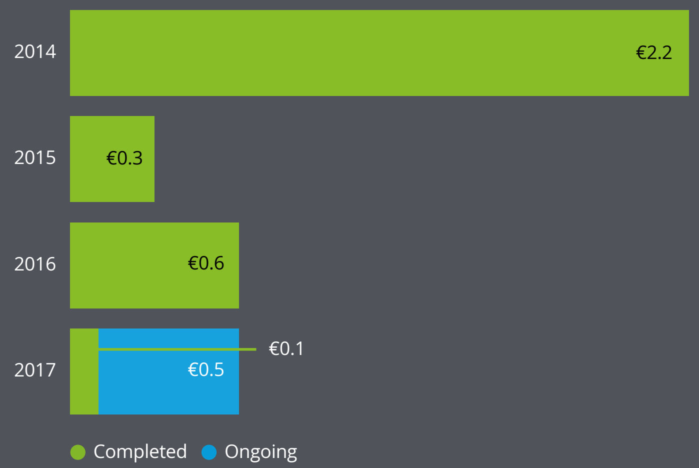
French banks have also sold NPLs from their Italian lending books – both Credit Agricole and Societe Generale have sold portfolios in Italy during 2017.

Attitudes change

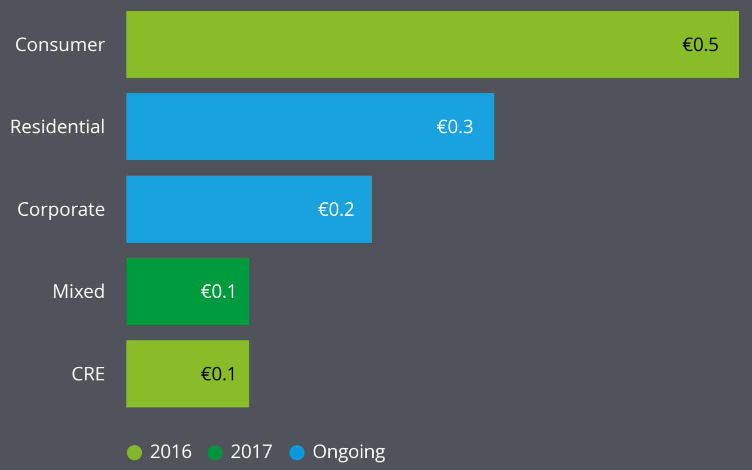
In the past investors considered France a low-activity market and did not build up a significant presence; they were often discouraged by the structure of the banking system which is highly fragmented with several large banks being regional networks of small banks, which works against the marketing of coherent NPL portfolios. Therefore the appearance of a pipeline of mortgage portfolios is of some significance – although the total value of sales is small compared to other European markets, for France they are relatively large.

The investor community has built significant purchase capacity and large scale operations. This is helping prospective 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 activity by year (€bn)



France activity by asset class (€bn)



France completed transactions

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

France ongoing transactions

Project name	Asset type	Seller	Size (€m)
Confidential	Residential	Confidential (Mortgage bank)	115
Confidential	Corporate	Confidential (Retail bank)	150
Confidential	Residential	Confidential (Mortgage bank)	160
Confidential	Mixed	Confidential (French foreign territory)	30
Total			**455**

Note: Data correct as of 31 December 2017

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 Nordics

The Nordic region remains Europe's outlier in terms of NPL holdings and portfolio deals. A regular seller has executed a fairly large unsecured NPL transaction during 2017 and a small €105 million consumer loan portfolio from Bank Norwegian was also successfully sold.

It's a workout market
Nordic banks have traditionally taken a non-aggressive approach to NPL resolution – they prefer agreed work-outs with customers and loan repayment freezes to NPL sales, and in any case recovery processes in the region are extremely effective. This is reflected in the low NPL stock across the region.

Sweden and Denmark have a combined NPL stock of €24 million in H1 2017, while Norway and Finland did not have any reported NPLs in the same period.

This is likely to remain so long as the macro-economic background continues to improve. However, the adoption of IFRS 9 is expected to affect Nordic banks.

Although most Nordic financial economies are not directly regulated by Eurozone institutions (only Finland is in the Eurozone) 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.

Furthermore, continued regulatory pressure on capital adequacy could drive banks to review their non-core assets and potentially dispose of assets that no longer fit their core business strategies. The alternative consumer lenders however take a different approach and are more proactive in terms of divesting NPLs on a more frequent basis. On the buy side, we see that Servicers and Buyers often are the same – with an increasing emphasis on forward flow/off take agreements as part of the pricing discussions.

Nordics completed transactions

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

Note: Data correct as of 31 December 2017

Nordic banks prefer agreed work-outs with customers to NPL sales, and loan recovery processes are extremely effective.

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Buy-Side Advisory
Assisting buyers in portfolio acquisitions in analysing, understanding and pricing loan portfolios. We help them to develop a strategy and understand the risk profile of the portfolios.

Advising holders, buyers and sellers of performing, distressed and non-core debt in deleveraging planning, loan portfolio management and strategy.

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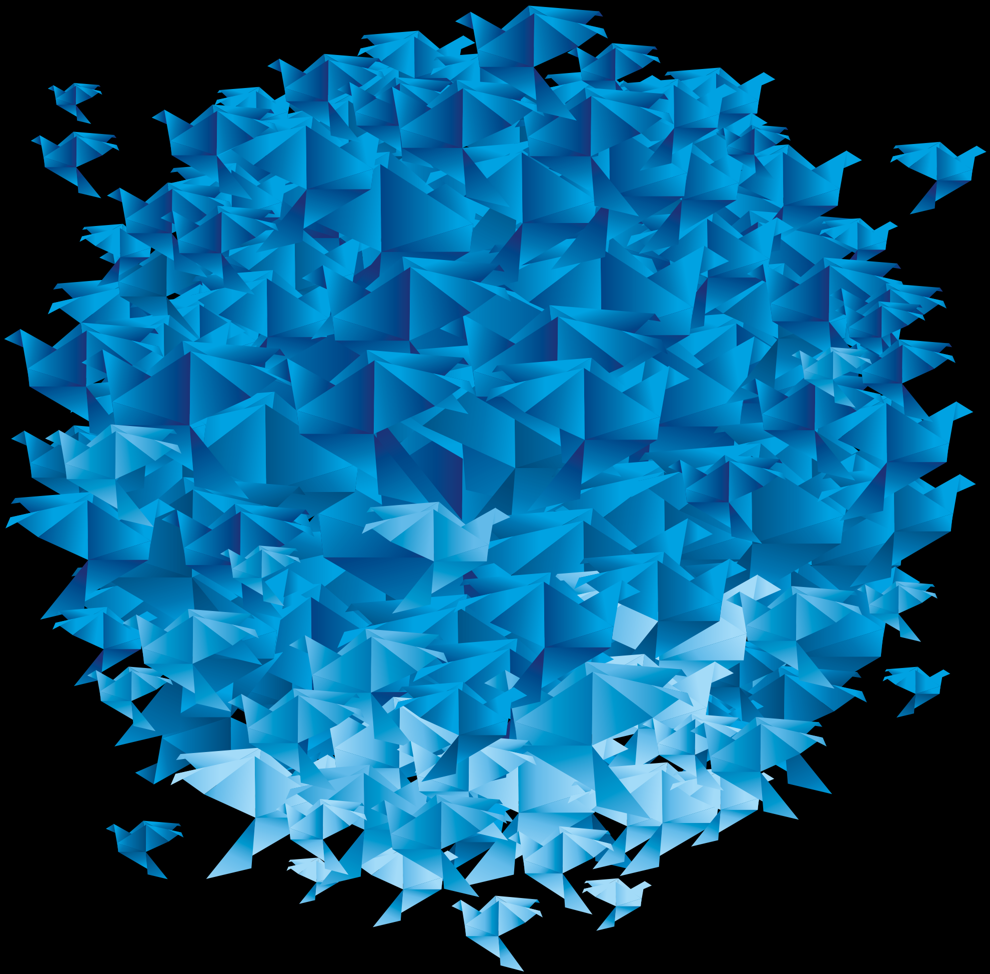
Emerging markets



Introduction

The global loan portfolio market has over the last few years been geographically centred around Europe as the ongoing deleveraging from the Global Financial Crisis continue. The last three years have seen nearly $320 billion of loan portfolios being traded across Europe. As investors start to look for opportunities outside of the core European market it is clear that emerging markets in Asia and Brazil, is firmly on their investment radar.

As Europe moves closer to the end of its debt deleveraging journey, investor interest is switching to newly industrialized markets where growth is moderating, credit stress is increasing, and where external investors have yet to play a significant role in clearing NPLs from banking sector balance sheets. Asia is a new promising debt market, although limitations on external investor participation remain a disincentive to commit resources to the region. Brazil is also emerging as a new market for debt investors due to a large overhang of unaddressed non-performing/sub-performing loans and what seems to be a growing willingness on the part of banks to engage with investors on the possibility of significant portfolio sales..

The Asian setting

Asian economies are strongly influenced by the fact that the Chinese economy is slowing. Many regional economies have experienced static or falling demand and growth over the last two years, and this in turn is generating higher NPL levels.

Despite a modest uptick in regional economies in 2017 as commodity prices have firmed and tourism numbers have grown, 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 dealt with in the near term. In addition to macro-economic factors, the introduction of IFRS 9 in January 2018 is likely to contribute to the recognition of Asian NPLs as banks adopt a forward-looking view of credit quality that requires higher levels of provisioning for loss.

A challenging environment

The servicing of distressed debt – a significant business area for debt investors in the OECD economies – is 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 most cases the regional NPL market is nascent: many jurisdictions have little in the way of formal debt resolution frameworks, and there is a low level of recognition of real levels of debt distress. Notwithstanding this, in several jurisdictions reform is underway or imminent.

While most Asian economies remain far from recession with growth in many cases only easing down from 6% plus to 5% or a little under, for fast industrialising economies this represents a significant slowdown. Overall it appears that the era of strong external demand and relatively easy credit is ending, and NPLs are rising up the regional agenda.

China

Following 25 years of unprecedented pace in economic growth, the Chinese economy has been progressively slowing to level out at a "new normal".

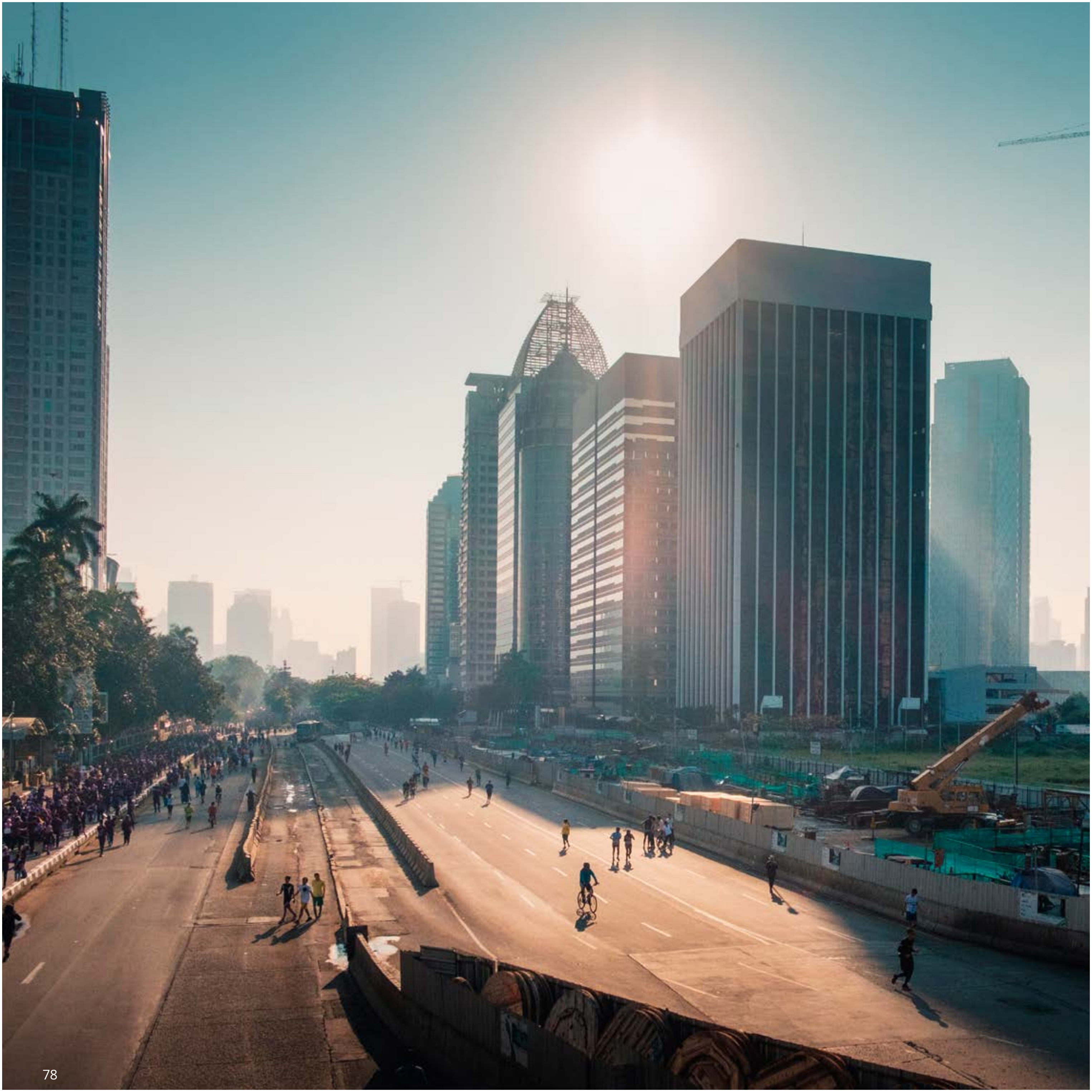
Following 25 years of unprecedented pace in economic growth, the Chinese economy has been progressively slowing to level out at a "new normal". In part this growth has been fueled by an equally rapid expansion in credit at all levels of the economy including corporations, so called state owned enterprises (SOEs), local government enterprises and individuals. Not surprisingly there has been an increase in the overall stock of NPLs – both from the sheer volume of credit but also arising from the increasing challenges to credit quality that a slowdown in economic activity will inevitably generate. The policy makers in China have this firmly on their radar and continue to progressively introduce measures aimed at a systematic deleveraging of the economy.

Banking landscape and NPL development

The Chinese Banking market is characterized by a significant concentration amongst a few very large players with the four major banks, Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB), Bank of China (BoC) and Agricultural Bank of China (ABC) collectively holding some 47.2% market share in total banking sector (36.7% in total financial banking institutions covering both banks and other non-banking institutions). By Q3 2017, with $13.1 trillion (RMB88.15 trillion) in assets these entities alone are similar in size and scale to the entirety of the US banking market. Clearly when looking for opportunities they provide a strong indicator of potential market activity.

The slowdown in the growth of the Chinese and global economy has continued to focus the attention of policy makers and regulators alike within China. We have seen a progressive increase in the nominal and relative level of NPL within the banking sector with each respectively achieving $254.2 billion (RMB1,705.7 billion) and 1.74% at Q4 2017. Whilst the obvious cause for concern is being progressively addressed – it should provide an opportunity for increasing the level of participation in the distressed debt market in China.

Market opportunities should also be enhanced through the implementation of further reforms aimed at the so called "shadow banking" market. The previously unbridled proliferation of wealth management products is being firmly addressed through the introduction of restrictions in distribution, fees and product structure. As this sector is increasingly regularized (and potentially being brought back on balance sheet) there is the possibility for a further increase in the official levels of NPLs. Add to that the impact of the debt for equity swap regime and the ground is set for supporting the continued development of the distressed market.



Indonesia

Distressed debt in the Indonesian banking sector has been increasing since 2008 and NPL growth has accelerated in the past three years. NPL volumes reached $10.1 billion in June 2017 (giving an NPL ratio of 3%, the ratio having nearly doubled since 2013). SMLs reached $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.

The government continues to have a significant involvement with the Indonesian banking sector, a legacy from the Asian banking crisis in the late 1990s. Four of the top ten banks by total assets are state owned. There are over 120 banks in Indonesia and the five largest (Bank Mandiri, Bank Rakyat Indonesia, Bank Central Asia, Bank Negara Indonesia and Bank CIMB Niaga) account for over 50% of total banking assets.

Distressed debt in the banking sector had been increasing steadily since 2008, although 2017 saw signs a stabilization of the rate of NPL formation. By mid 2017 the average NPL ratio at the largest 15 Indonesian banks was around 3.5%, although several large banks including Permata, Bank Mandiri and CIMB Niaga had ratios in the 4-6% range.

An early stage market

The bulk of NPLs are held by state owned banks and enterprises, which are not allowed to sell at a loss. This has contributed to the pattern of loan restructuring rather than portfolio sales – in 2015 loan restructuring regulations were altered to make it easier for banks to extend loans or ease payment rates. Banks have explored NPL sales, but there have been a number of failed deals in the market mainly due to pricing expectations and poor sales processes – the only deal of size was the sale of a corporate loan portfolio by Permata Bank, which has the highest NPL ratio among the ten largest banks.

Indonesia remains an early stage Asian NPL market: banks are actively seeking solutions for the disposal of their NPL loans however, but the bid-ask gap is wide and state owned banks remain unable to sell at the discounts the market expects. The introduction of IFRS 9 (the Indonesian equivalent standard is known as PSAK 71) is likely to increase the volume of recognized NPLs in the banking sector, and may push the NPL ratio at several banks above the regulatory ceiling of 5%.

Thailand

Economic growth in Thailand is largely driven by tourism and exports, and both have seen a marked improvement in 2017 with GDP growth approaching 4%. However both the household and SME sectors remain highly indebted; NPL ratios are high in regional terms and continue to grow.

Historically Thailand has had an active loan sales market. State owned asset management companies (AMCs) dominate the market with the largest deals done by two state owned AMCs: Bangkok Commercial Assets Management (BAM) and Sukhumvit Asset Management (SAM) although there are more than 30 other smaller local AMCs active. International debt investors can only acquire NPL portfolios via a locally incorporated AMC.

Investors are arriving

Whether Thai AMCs can absorb the growing stocks of NPLs on Thai lenders' books remains an open question. Household sector debt is high at an equivalent of 80% of GDP, and listed banks have an average household sector NPL ratio of close to 4%. Gross NPL volumes reached $11.6 billion in July 2017, representing a 20% year-on-year increase. The largest NPL exposures by value are in the manufacturing, auto and household sectors.

Given the continued rise of NPL volumes and ratios in Thailand, several large institutional investors have started to consider to acquire or establish licensed platforms in preparation for future loan trades. Over the last 18 months we have seen the re-emergence of foreign participants in the local market with Bain Capital, Apollo and Lone Star entering into various portfolio opportunities.

India

India has been one of Asia's fastest growing economies since the financial crisis, but the twin impacts of banknote 'demonitisation' (when large value banknotes were rendered worthless in late 2016) and the introduction of a country-wide VAT system known as GST have led to growth falling below 6% in 2017, although GDP growth is now gradually rebounding. Weak growth has led to further stress on loan performance, and India now has the highest regional bad debt ratio with NPLs (including restructured loans and unrecognized NPLs) at close to 17%.

According to IMF estimates Indian lenders had around $150 billion of NPLs in 2017, with asset quality continuing to deteriorate through the year. Some 80% of NPLs are held by state owned banks, and concentrated in certain sectors including metal, construction and infrastructure. This high NPL volume was largely generated during India's high growth phase in the previous decade when the economy largely escaped the effects of the financial crisis and future growth expectations were high.

The environment improves

A large proportion of effectively non-performing loans remain unrecognised; the government of India has recently acted to force banks to more fully recognise their NPLs by giving the Reserve Bank of India (RBI) powers to force banks to initiate insolvency proceedings for specific borrowers, and to appoint advisory committees to advise lenders on asset resolution. These measures are expected to lead to an increased capital requirement owing to improper classification of exposures and a lack of adequate provisioning for stressed assets.

India has not yet seen international investor participation in the debt portfolio market, although the growing mood of realism about the extent of the NPL problem is encouraging.

While the Insolvency and Bankruptcy Code (IBC or the Code) was approved in May 2016, it took about a year for the basic infrastructure to be in place with activity picking up from July 2017. This happened when the Reserve Bank of India (RBI) identified 12 large borrowers (forming close to 25% of the banking systems gross non-performing assets) for resolution under the IBC. The timeline for the resolution of these assets is over the next couple of quarters and market participants are watching proceedings with a keen interest on expected outcomes and precedents these set for future resolutions.

Brazil

Two years of economic recession followed by a year of relative stagnation has left Brazil's NPL stock at historic highs. It is estimated to have reached c.$160 billion (this takes into account off balance sheet amounts). This stock is mostly constituted of a first wave of NPLs made up of now fully written off consumer unsecured exposures. This first wave was weathered 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 has now clearly emerged with the steep increase in restructured loans (mostly mid-Corporate/SME and RED) on banks' balance sheets. We currently estimate these to be in the region of c.$130 billion. This could very well constitute a second wave of NPLs, the size of which will depend on the timing and strength of the recovery of the Brazilian economy. These types of exposures typically require significant resources and specialised expertise to workout and banks will be constrained by the current scarcity of third party special servicing capacity available in Brazil.

There is a change of mood
During the course of the second half of 2017 there have been signs that the country's large banks, including the three largest state-owned banks (Banco do Brasil, Caixa Economica Federal and Brazilian Development Bank (BNDES)), are gradually recognising the scale of their NPL problems.

The introduction of the IFRS 9 accounting standard in January 2018 for Brazil's 10 largest banks and in January 2019 for the remaining banks, means that these entities will no longer be able to put off NPL resolution only by loan restructuring making large-scale sales increasingly likely. Several portfolio sales of distressed loans are already being discussed and could be brought to market in the course of H1 2018.

Sales will also include REO books – the latest figures indicate that there are at least $5 billion worth of repossessed assets on bank books. The continuing growth of REO stocks in the country is supported by a marked improvement in the Brazilian framework for reals estate asset foreclosure including new limitations on the number of possible appeals available to defaulted creditors.

Investors are scaling up

While Brazil is still a relatively uncharted NPL market, a growing number of international investors recognise the potential opportunity and are already devoting substantial time and resources to the exploration of the market. Some of the more advanced players have recently set up a local presence. We expect the NPL loan sale market to gradually reach a significant scale over the coming years.

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