Deleveraging Europe

June 2021

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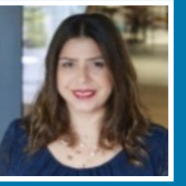

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About this report
Unless specified otherwise, all the data in the Deloitte Deleveraging report is based on ongoing tracking and monitoring of deal activity, based on Deloitte practitioners' insights into the respective markets together with public and industry sources, notably Debtwire. This combination of sources limits the detail we can provide on individual transactions or identifiable data segmentation.
All data in this report correct as of March 2021.

Introduction

The COVID-19 pandemic cast a long shadow over 2020, creating not only a public health crisis but also unprecedented economic and social challenges.

As a result of containment measures to halt the spread of the virus, the European loan portfolio market effectively went into a deep freeze during the first half of 2020, with activity resuming during the second half of the year driven largely through the use of government-guaranteed securitisation schemes. Italy and Greece accounted for 75% of the total value of loan transactions closed in 2020, with Italy's Garanzia Cartolarizzazione Sofferenze (GACS) and Greece's Hellenic Asset Protection Scheme (HAPS) supporting their respective markets.

With the development in record time of a number of vaccines against COVID-19, the prospects for an economic recovery in Europe have improved in recent months. In spite of ongoing lockdowns, activity in many sectors has picked up as society has adjusted to the restrictions and found new ways of working. Vaccine rollout, although uneven, is gaining momentum and further government stimulus has continued to provide a boost to economic activity. Growth in the Eurozone overall is projected to be 3.9% in 2021 (OECD, March 2021 forecast) after a historic fall of 6.8% in 2020, significantly greater than anything seen during the global financial crisis (GFC) in 2007-2008. However, prospects for sustainable growth vary widely between countries and sectors.

The roots of the GFC lay in excessive or imprudent lending and over reliance on wholesale funding but in early 2020 banks' balance sheets were in a much stronger position, enabling them to weather the immediate stresses and draw down on available funding lines as borrowers 'made a run for liquidity'. However, the impact of lockdowns has been far-reaching for businesses and markets, with the initial onset of the pandemic triggering enormous market volatility globally in nearly all asset classes.

Thanks to government support measures and the expected time lag before the effects of the initial economic shock are felt, defaults and insolvencies are still at a moderate level across Europe. Many stakeholders are waiting to see the impact that the unwinding of government support measures will have; for example, the ending of loan moratorium periods in most countries, which in some cases applied for 18 months. In a severe but plausible scenario, stress tests in 2020 by the European Central Bank (ECB) suggest that Non-Performing Loan (NPL) levels could reach €1.4 trillion once COVID-related reliefs are withdrawn, which is c€200bn higher than the previous peak of €1.2 trillion in 2015.

If the economic downturn is temporary, with much depending on the race to vaccinate and emerging new variants of the virus, respective NPLs may relate to otherwise viable, but illiquid entities, which can be restructured.

However, if the recovery is slow and protracted a rise in credit losses could reasonably push NPL stocks in some countries close to or over the levels reached during the GFC and potentially increase systemic risk in countries where banks are less well capitalised. Likewise, some sectors have been affected more than others by the pandemic and may take longer to recover, for example the Aviation and Shipping industries, which are both discussed later in this report.

Several macroeconomic factors may increase the complexity of NPL resolutions. According to the ECB, government gross debt has risen substantially in the Eurozone, from 84% of GDP in Q1 2019 to 98.2% in Q1 2021. In addition, bank profitability has been affected by 'lower for long' interest rates and increased regulatory capital requirements. There is also a real risk that a 'zombie' class of borrower will emerge, propped up by government and other COVID-related support measures but otherwise unviable.

As part of our 2021 deleveraging report we will walk through how banks across Europe reacted in the first year of the pandemic, with record levels of provisions in the first half of 2020. As we move into the second year of the pandemic, growing confidence from asset quality improvements and the macro recovery, buoyed by vaccination efforts, resulted in banks either tailing off or reversing provisions in Q1 after full throttle charges booked in 2020.

The ECB has acknowledged that most banks are adopting prudent financial projections in their reporting since the pandemic. However, as consensus of a stronger than expected recovery has grown the ECB have stressed continued caution ahead of releasing any provisions. Of particular concern is the steady growth of Stage 2 loans, a leading indicator for future NPLs, that rose to 9.1% in December 2020 from 6.5% in December 2019 (EBA) of total loans across Europe. This area will be a key focus of potential stress as government measures and moratoria come to an end. With even a subset of these loans souring to NPL, banks would face a significant challenge and see a material rise in NPL volumes

In conclusion, although the COVID-19 health crisis is over a year old, it is still difficult to predict the full magnitude of the economic impact. An increase in NPLs is widely expected to revive activity in both the NPL and non-core markets as solutions developed in the aftermath of the GFC are utilised, including functioning loan portfolio markets with an extensive servicing network, structured credit solutions, and Bad Banks, which gained particular traction early into the pandemic.

In this edition of our annual review of the European NPL market, as well as looking at key trends in the market and providing our usual country round-up on NPL transaction activity, we provide insights on developments in the European loan servicing market, we look at the renewed focus on Asset Management Companies as a tool for NPL resolution and developments in the shipping and aviation NPL sectors.

NPL 2020 market overview

Most NPL transaction activity came to a halt during the second quarter of 2020 as the first wave of the pandemic spread throughout Europe. In the second half of the year €53.8bn gross book value traded as processes that were initially put on hold returned to the market, bringing total transaction activity to €77.8bn for 2020, across 103 transactions. This marked a major slowdown in activity from previous years, with volumes traded down 35% below the total for 2019 of €119.2bn and 62% down from the high-water mark in 2018, when €203.6bn was traded.

Government guaranteed securitisation schemes dominated the deals that were closed during 2020. The Italian market led the way with 51 completed deals (c€44.0bn), more than half of European portfolio trades, primarily through AMCO, Italy's state-owned asset management company, as well through GACS.

Greece was the second most active market, although some way behind Italy, and again benefiting from government guaranteed securitisation schemes (HAPS). This helped Greek banks close transactions totalling €12.4bn in the year, including Eurobank Ergasias' €7.5bn Project Cairo which involved the sale of junior notes to DoValue. Greece also has a strong pipeline, with €21.6bn closed in Q1 2021 or expected to close imminently, and several banks already announcing or indicating their intention to launch transactions in 2021 totalling €24.3bn.

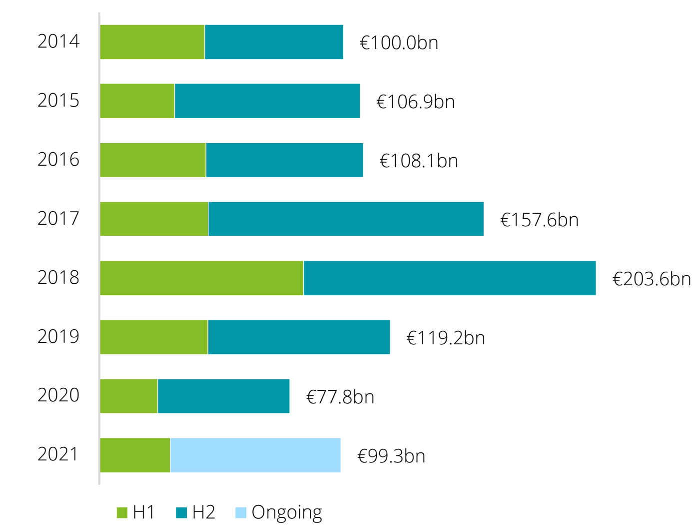
From a buyer perspective, with the bid-ask spread seen as too wide for many of the 'traditional' buyers of recent years, AMCO was the top purchaser of portfolios in Europe, completing €11.3bn of deals. This included the largest that closed in the year, namely an €8.0bn mixed NPE portfolio from Banca Monte dei Paschi di Siena, as well as €2.0bn of UTPs from Banca Popolare di Bari.

In contrast, Spain saw a significant drop off in activity, with sales at their lowest since the clean-up after the GFC. Under Project Atlas, €1.7bn of NPLs was sold by Banco Santander to CPPIB in the first quarter just as the pandemic was reaching Europe. Other transactions in Spain were placed on hold due to the pandemic.

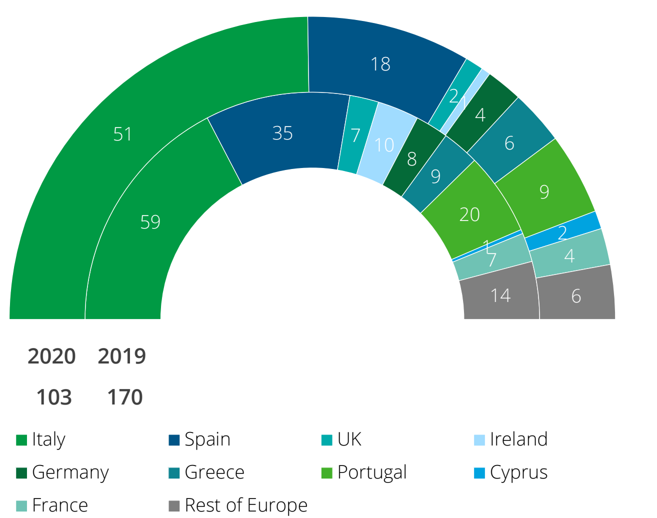
In the UK, NatWest Group purchased a large £3.3bn (€3.7bn) performing residential book from Metro Bank, helping to ease some of the regulatory pressures on the UK challenger bank.

Despite the continuing impact of the virus throughout Europe, €29.1bn has been sold so far in Q1 2021, with an additional €70.2bn in the pipeline for the year, bringing the total close to 2019 levels.

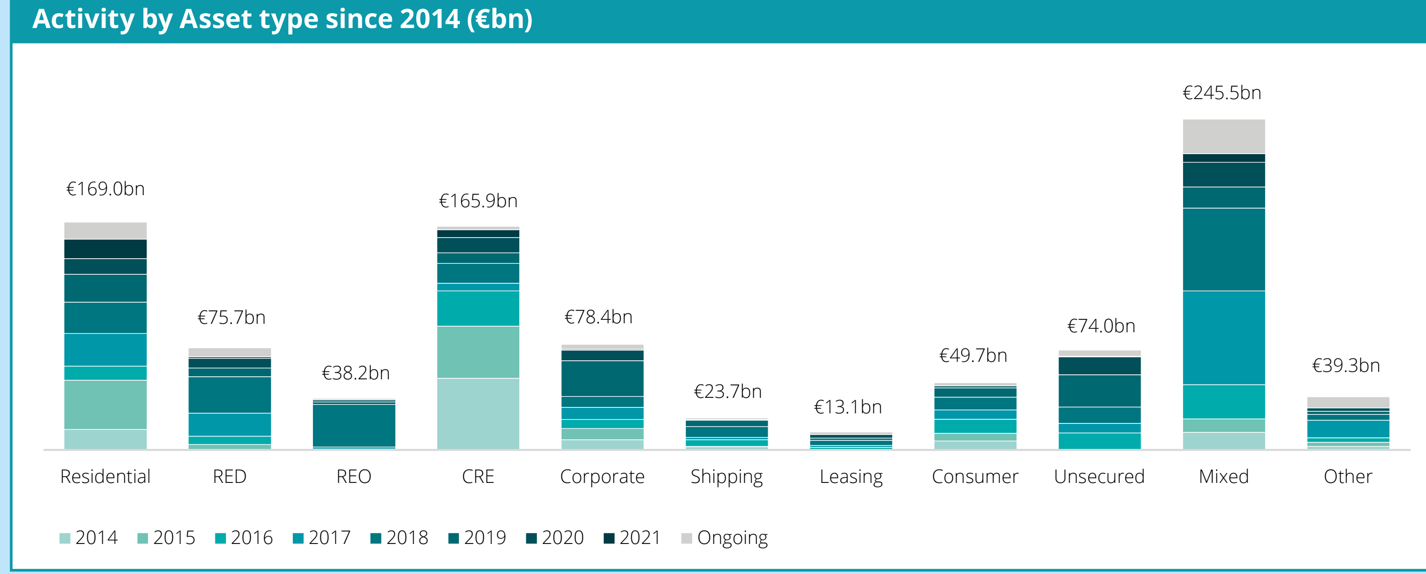
European activity by year (€bn)



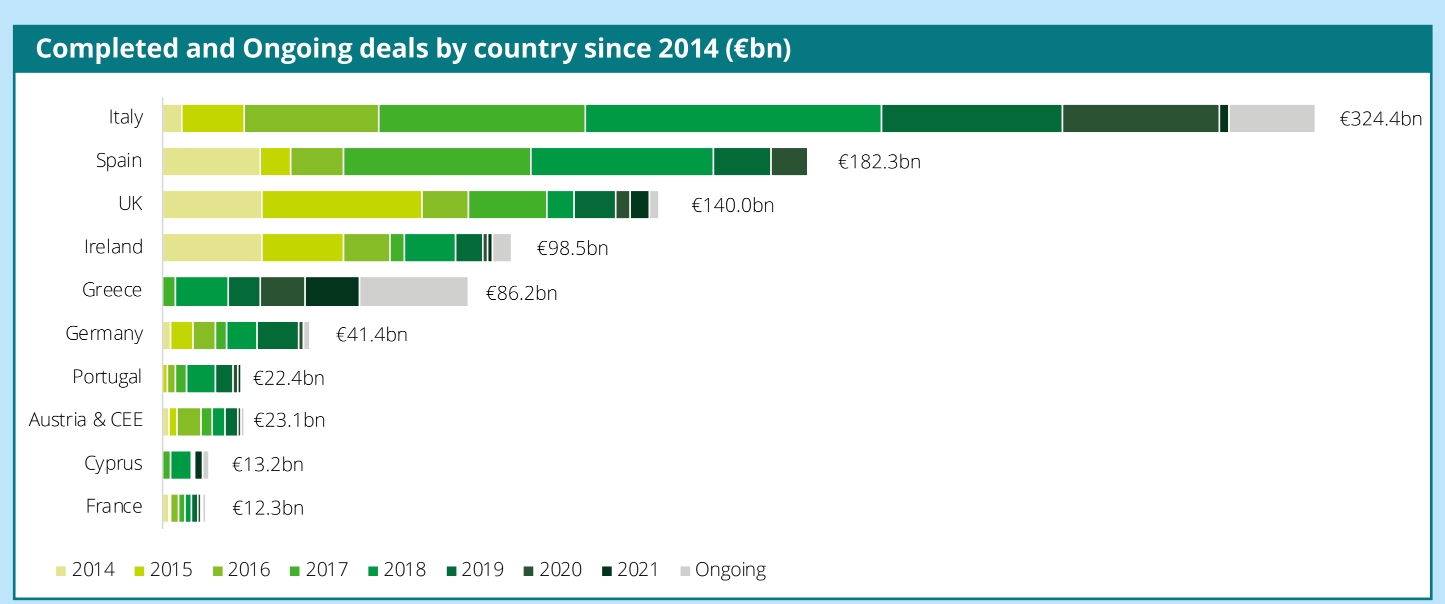
Completed deals by country



Activity by Asset type since 2014 (€bn)



Completed and Ongoing deals by country since 2014 (€bn)



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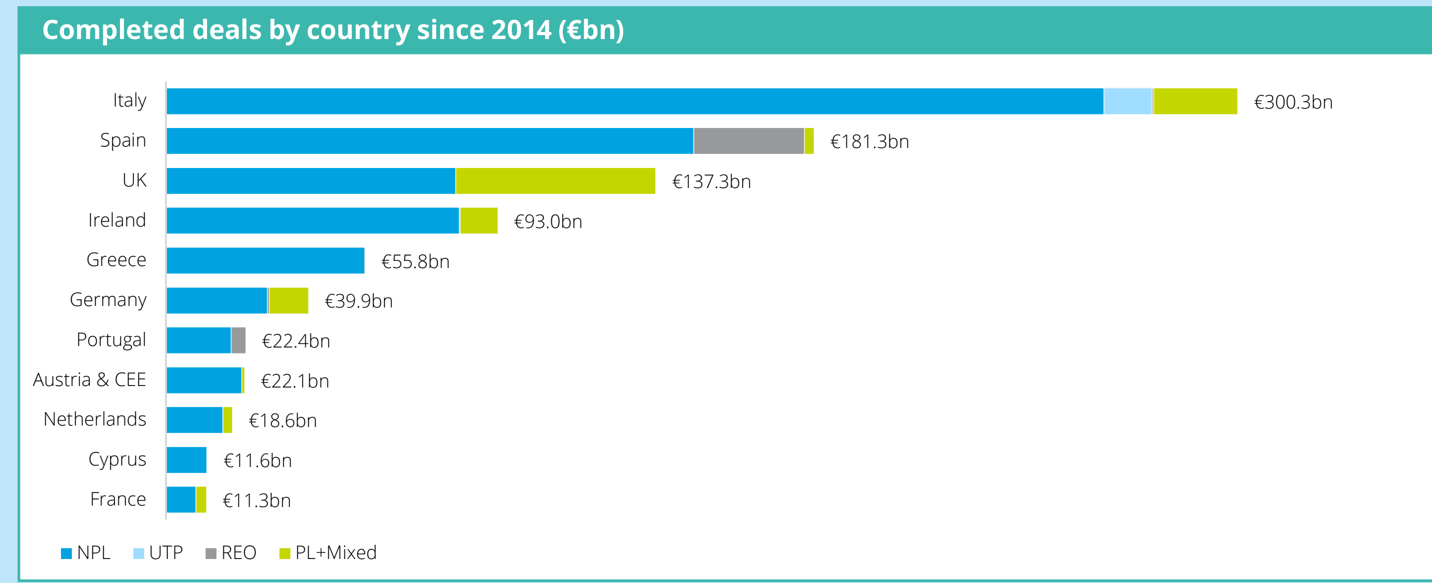
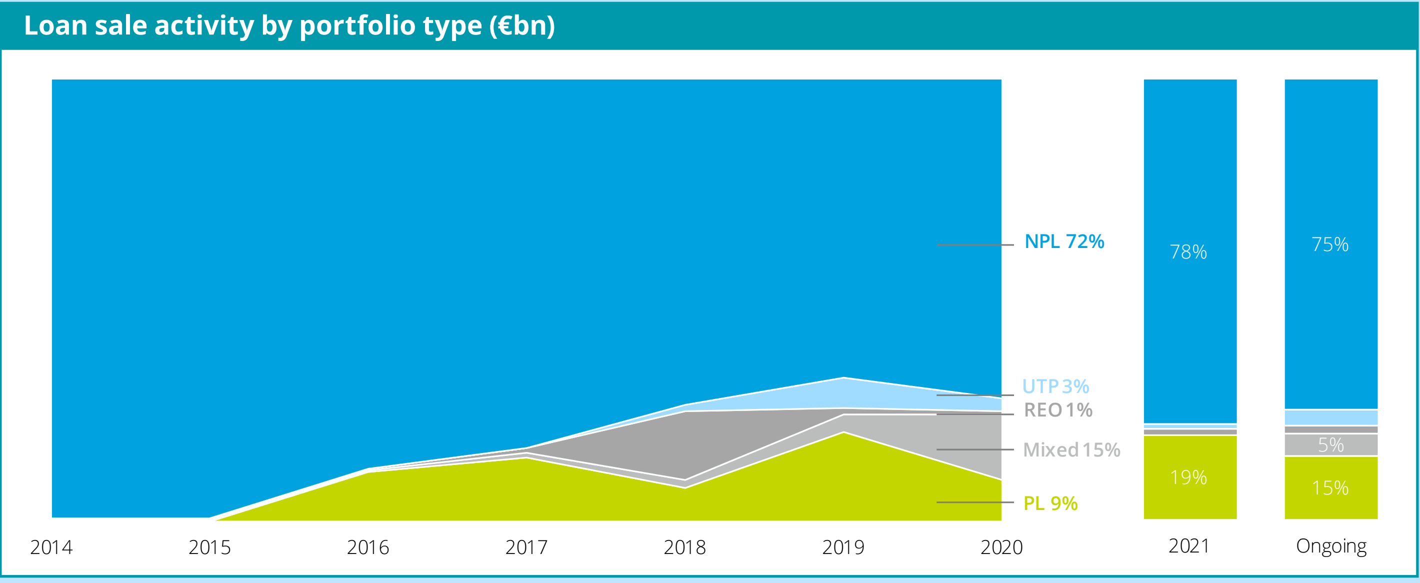
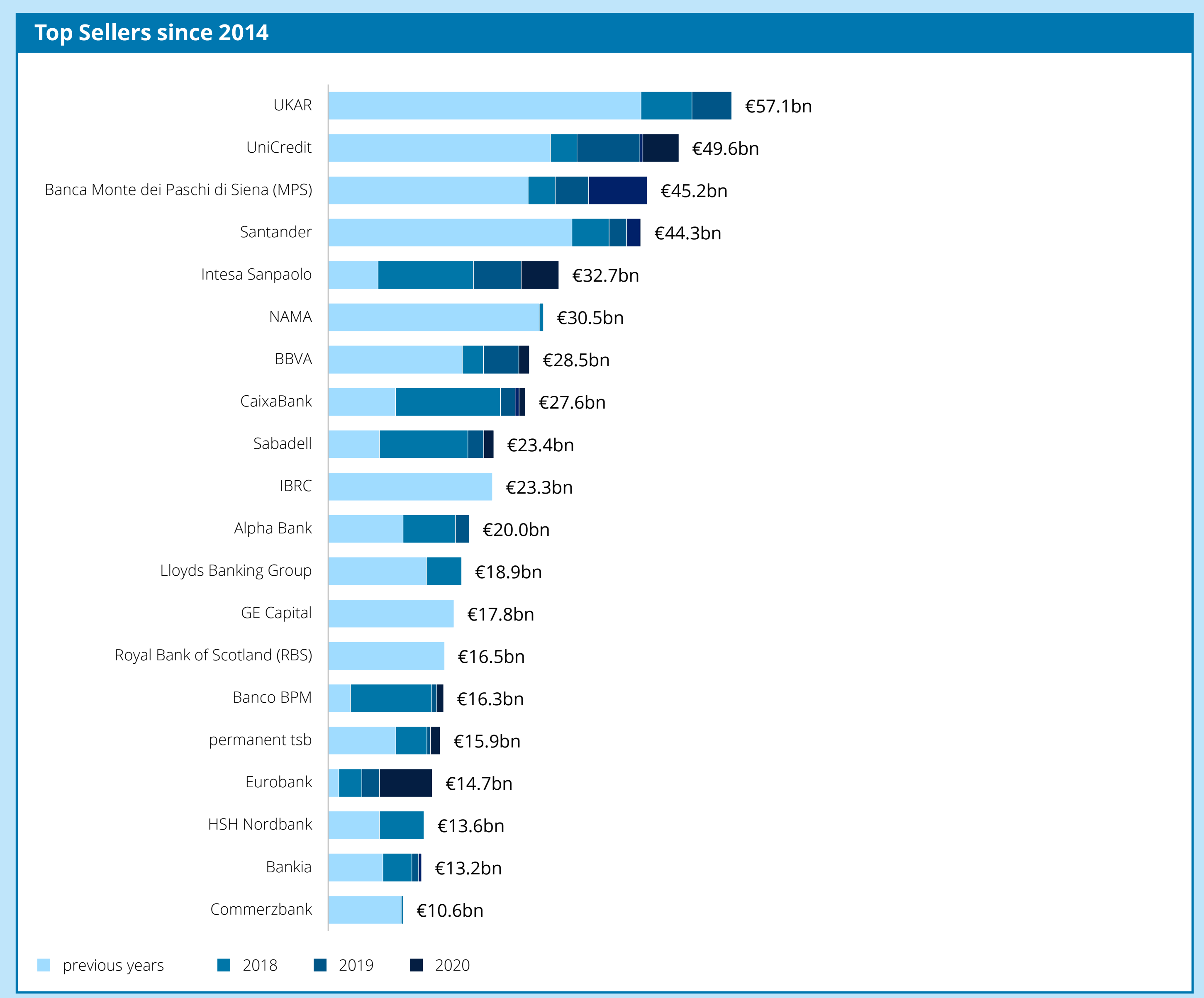
Completed deals by country since 2014 (€bn)



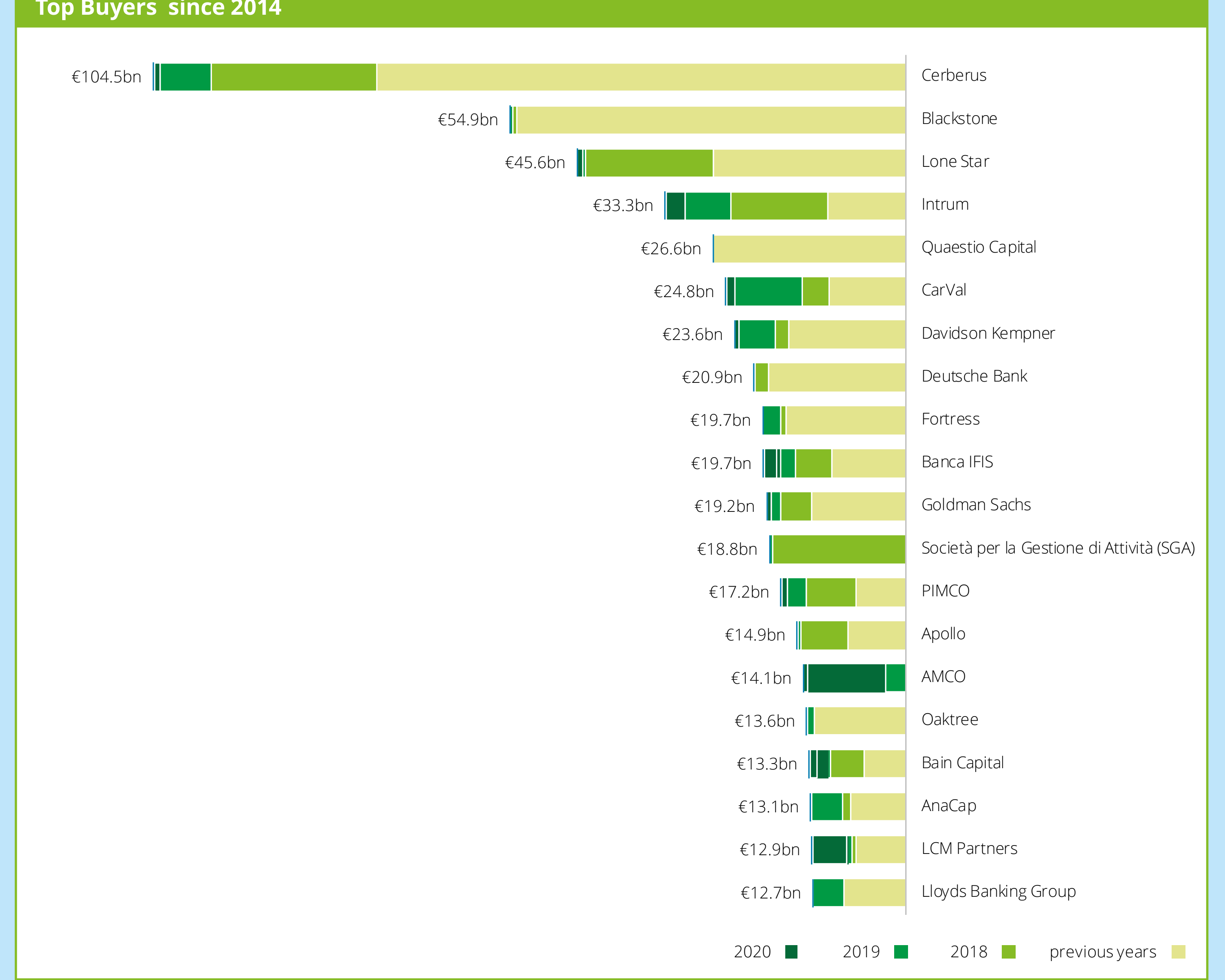
Loan sale activity by portfolio type (€bn)



Top Sellers since 2014



Top Buyers since 2014



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Gearing Up for a New Peak

As the pandemic spread rapidly through Europe, banks were quick to react, with record levels of provisions booked in anticipation of an expected deterioration in asset quality. Much of the heavy lifting was seen at the 2020 half-year reporting stage, after the first wave of the virus began to subside.

According to the European Banking Authority (EBA), more than 75% of banks in its September 2020 survey were expecting a deterioration in asset quality for corporate portfolios as well as consumer credit. Unlike the GFC in 2008, the exposures with greatest stress are concentrated in sectors such as retail, leisure and hospitality, where borrowers were already struggling and most directly impacted by COVID-19.

Among the largest banks in the countries analysed by Deloitte, €118.1bn of provisions were set aside during 2020, double the €54.5bn in 2019, as banks looked to frontload their expected credit losses. Of this total, €76.5bn of loan losses were provisioned in the first half of the year, with a big drop in the second half of the year to €41.6bn as economic forecasts showed slight signs of a recovery.

Despite the pandemic, the EBA's Q4 2020 Risk Dashboard indicates the total stock of European bank NPLs[1], including the UK, decreased over the year. This was attributable to COVID-related loan moratoria and other measures that have likely masked the true picture. NPL volumes were down by €56bn to €528bn as of December 2020, from €584bn in December 2019, and down from a peak of €1.2 trillion[2] in 2015.

The average NPL ratio across EBA banks fell in Q4 2020 by 20bps[3] to 2.6%. This lower NPL ratio reflects both a reduction in NPL volumes and also an increase in total loans and advances, including those through government-backed loan support schemes launched in response to the pandemic.

1 Please note throughout this report we refer to both non-performing loans (NPL) and non-performing exposures (NPE) held by banks throughout Europe. It is important to consider NPL as a subset of NPE, with NPE including all non-performing risk positions (on and off-balance sheet).

2 Q4 2020 EBA Interactive Dashboard

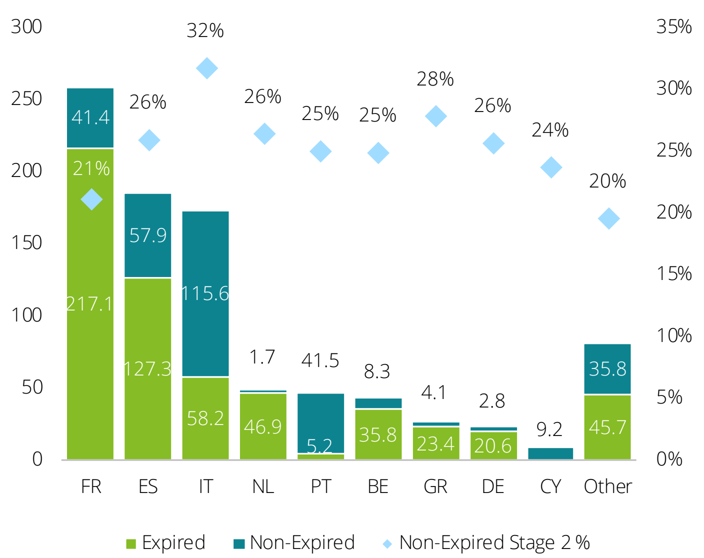
3 Q4 2020 EBA Risk Dashboard

From our analysis of banks' financial reports, the improvement in NPL volumes and ratios is driven principally by the main banks in Greece and Italy. The NPL portfolio markets in these countries continued to function thanks to the use of securitisation guarantees. In contrast, UK and Irish banks saw a moderate rise in distress volumes and ratios, despite government measures aimed at softening the immediate impact of the pandemic. Even so, the impact would have been far worse without them.

Impact of loan moratoria and other measures

Over the period since the pandemic began, €900bn of European loans received support through EBA-eligible moratoria. Of these, 70% were granted by banks in France, Spain and Italy, making these jurisdictions potential hotspots as measures are unwound.

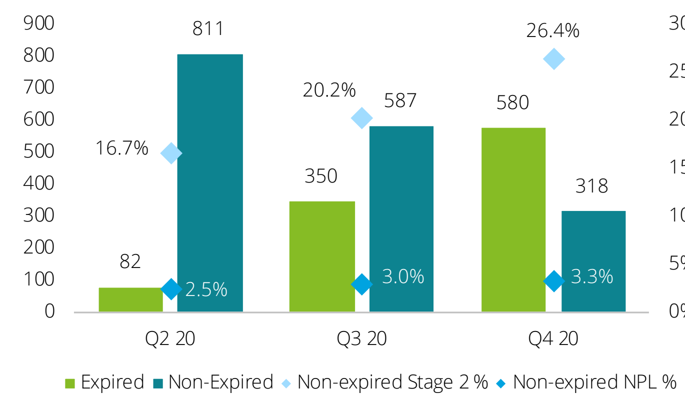
EBA loans Under Moratoria (€bn) by Country



Source: Q4 2020 EBA Risk Dashboard – data as of Q4 2020

In Q4 2020, loans under EBA-eligible moratoria almost halved, decreasing from €587bn at the end of Q3 to €318bn, with exposures to non-financial companies (NFC) declining the most. Meanwhile, the proportion of Stage 2 loans under non-expired moratoria continued an upward trend, standing at 26.4% in Q4 2020, up by 6.2 percentage points from Q3. Although it is still early to draw conclusions about asset quality, it is noteworthy that the proportion of Stage 2 loans under moratoria is almost three times higher than the 9.1% ratio for total loans across Europe, emphasising the potential downside risks once the moratoria expire.

EBA Expired vs Non-Expired Loans Under Moratoria (€bn)



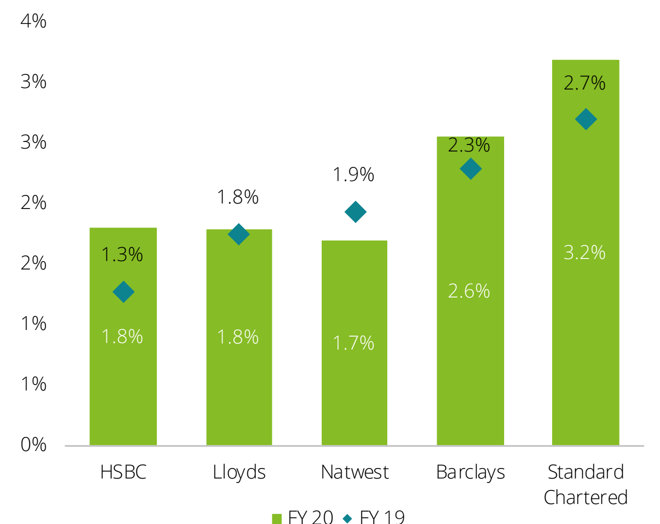
Source: Q4 2020 EBA Risk Dashboard

During the same time, the proportion of loans under public guarantee schemes (PGS) across EBA banks increased by 19% reaching €343bn during Q4 2020, up from €289bn at the end of Q3. According to EBA's Q4 2020 Risk Dashboard, approximately 40% of the loans subject to PGS have a residual maturity of two to five years.

UK

Reversing years of steady decline since the GFC, NPL volumes at the five main banks increased during 2020, rising by 9.9% to £45.2bn (€50.5bn) since the end of 2019. The UK's largest bank, HSBC, saw Stage 3 loans increase by 38.4% up to £14.0bn (€15.6bn) at the year-end. NPL ratios across major UK banks also increased, edging up from 1.8% in 2019 to 2.0% in 2020.

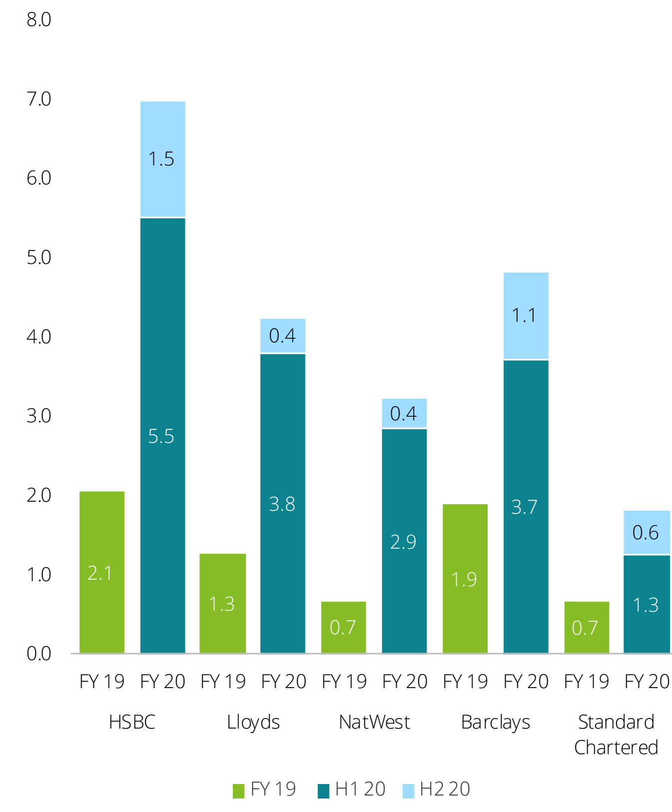
Top 5 UK Banks NPL Ratio (%)



Source: Company Financial YE reports, Deloitte analysis

UK banks, like their European counterparts, increased loan loss provisions substantially. The five main banks booked £17.2bn (€19.2bn) of provisions in the first half of 2020, with a full year charge of £21.2bn (€23.5bn). Provisions in the second half were lower as recovery indicators improved slightly. Overall, the full year charge during 2020 was 3.2 times higher than the 2019 charge of £6.7bn (€7.9bn).

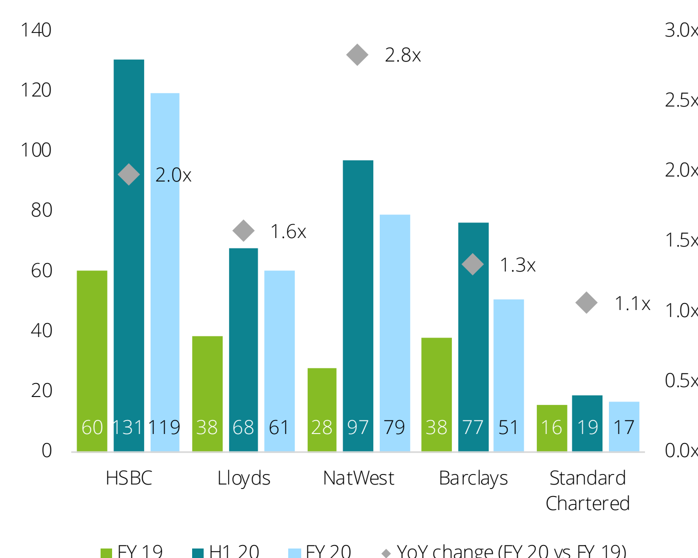
Top 5 UK Banks Loan Loss Provisions (£bn)



Source: Company Financial YE reports, Deloitte analysis

More loans were classified as Stage 2 when the economic outlook deteriorated in the first half of 2020, increasing the uncertainty of future stress. NatWest in particular saw an increase of 2.8 times over the previous year, with £78.9bn (€88.2bn) of loans classified as Stage 2 at the end of 2020. This highlights the potential risks arising from the winding down of loan moratoria and other government measures.

Top 5 UK Banks Stage 2 Loans (£bn)



Source: Company Financial YE reports, Deloitte analysis

Bank of England data indicates that consumer lending fell in 2020, whilst mortgage and corporate lending increased. Consumer portfolios saw a large paydown of credit as individuals were locked down at home. Credit card balances were down 17.7% (£11.1bn), and other consumer lending fell by 8.7% during the year. In contrast, there was an increase of 3% (£38.2bn) in UK mortgage lending in the same period. Corporate lending also jumped to £27.7bn in March 2020 as businesses made drawdowns on all available funding lines as the virus spread. A further £20bn was drawn by the end of the year for a total increase of 9.5% in corporate lending. Loans to smaller unincorporated businesses increased by £5bn during the second quarter of 2020, and by a total £7.8bn over the year as a whole. This indicates that whilst the SME and corporate sectors have felt the full force of the economic shock, households have reaped the benefits in terms of enforced savings, which may indicate a strong rebound once restrictions are lifted.

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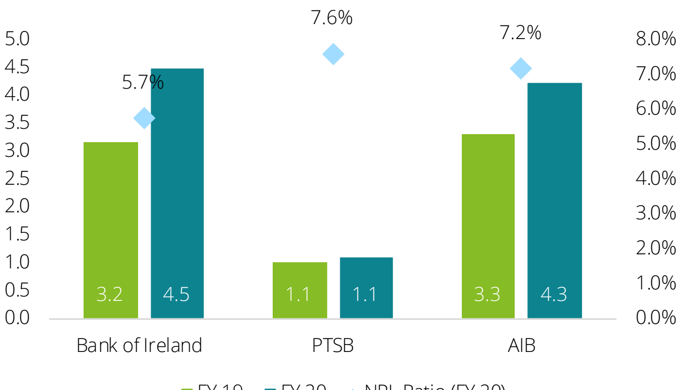
Ireland

NPL volumes at the three largest Irish banks increased by 25.3% from €7.9bn in FY 2019 to €9.9bn at the end of FY 2020. Bank of Ireland (BOI) and Allied Irish Bank (AIB) had increases in NPL volumes of €1.3bn and €1.0bn respectively. NPL ratios of 5.7% at BOI and 7.2% at AIB compare favourably to the ratios over 30% that were reached in 2013, reflecting a successful series of NPL portfolio sales and deleveraging that has helped shore up bank balance sheets.

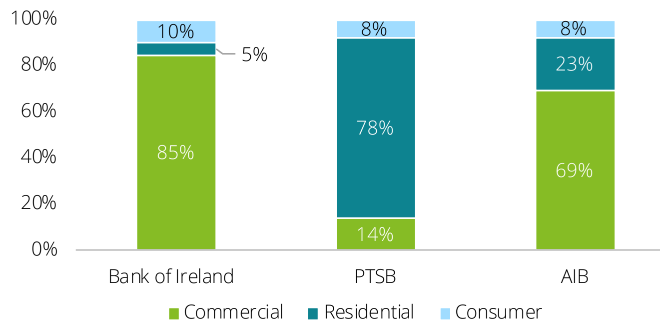
Top 3 Irish Banks NPL Volumes (€bn)



Source: Company Financial YE reports, Deloitte analysis

Loan loss provisions increased significantly across Ireland's main banks in FY 2020, up to €2.7bn from €241m in the previous year. In line with other banks across Europe, these were frontloaded to the first half of the year. AIB made provisions of €1.5bn in the year, with €1.2bn of this in the first half of the year. BOI and Permanent TSB booked €1.1bn and €155m, respectively. At AIB and BOI, loan loss provisions were focused on their corporate and SME portfolios, particularly in the hospitality and retail sectors. Permanent TSB (PTSB) has limited commercial exposure, so the bulk of its charges were booked against household lending.

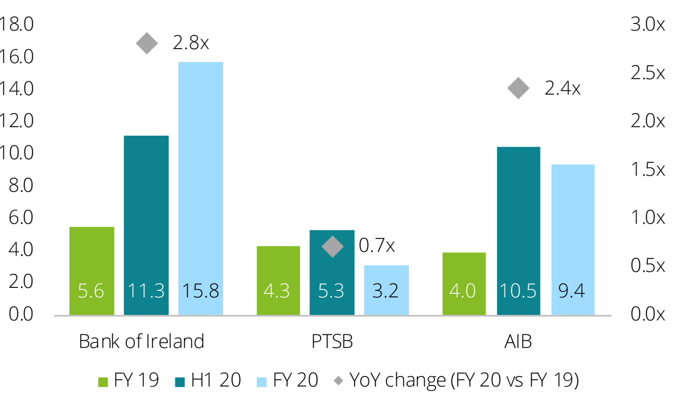
Top 3 Irish Bank Provisions by Type (%)



Source: Company Financial YE reports, Deloitte analysis – data as of FY 2020

Across the three main banks, Stage 2 loans increased substantially from 8.7% of gross lending in 2019 to 18.6% in 2020. In line with increased provisions, the deterioration in asset quality was driven primarily by a deterioration in the hospitality and retail segments of the corporate and SME portfolios - a potential downside risk as moratoria expire during 2021.

Top 3 Irish Banks Stage 2 Loans (€bn)

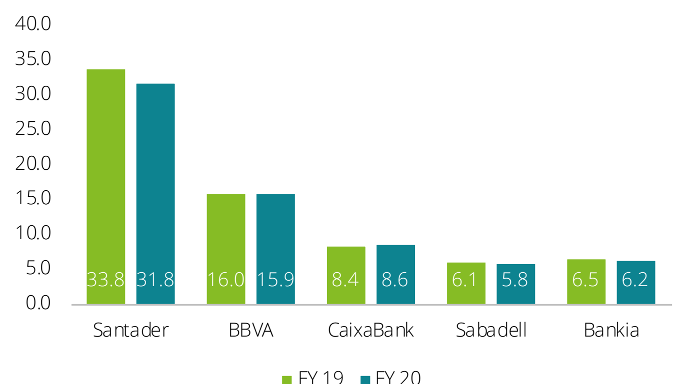


Source: Company Financial YE reports, Deloitte analysis

Spain

NPL volumes in Spain, which had experienced very high NPLs after the GFC, continued to fall year-on-year across the 11 largest banks, with a 4.4% fall from (€78.9bn) in December 2019 to €75.4bn in December 2020. This was despite a slowdown in NPL portfolio sales, with only €7.2bn trading in 2020. Average NPL ratios also fell, from 3.8% to 3.6%. At half-year reporting, gross lending had increased by 1.5% since December 2019, as a result of the surge in lending during the initial wave of the virus. However, by year-end gross lending had fallen with year on year growth mostly flat at 0.3%.

Top 5 Spanish Banks NPL Volume (€bn)



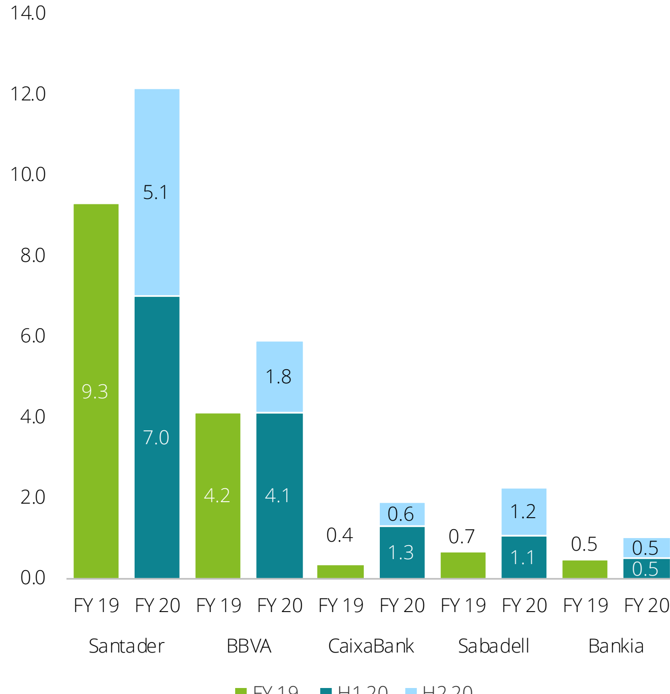
Source: Company Financial YE reports, Deloitte analysis

Santander, Spain's largest bank, accounted for the bulk of the decrease in NPL, with volumes down from €33.8bn to €31.8bn due largely to the sale to CPPIB of its €1.7bn NPL portfolio, Project Atlas.

Spanish banks were among those in Europe with the largest increase in loan loss provisions, most of which (€15.0bn) were charged in the first half of the year. Provisions for the 11 largest banks increased from €15.9bn in 2019 to €24.9bn in 2020.

Santander accounted for about 50% of this total, making provisions of €12.1bn in 2020 (2019: €9.3bn).

Top 5 Spanish Banks Loan Loss Provisions (€bn)

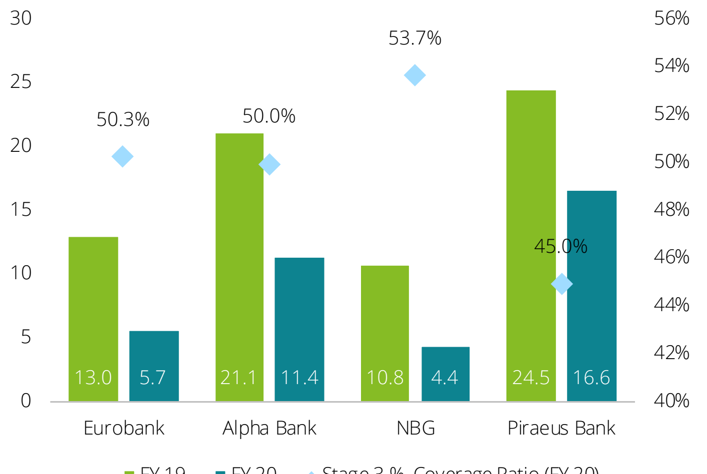


Source: Company Financial YE reports, Deloitte analysis

Greece

Despite the pandemic, Greek banks continued to make significant progress with their deleveraging, helped by HAPS-backed securitisations. NPE disposals in 2020 and Q1 2021 totalled €34.0bn, resulting in a 45.1% decrease in the NPE stock to €38.1bn* from €69.4bn in December 2019.

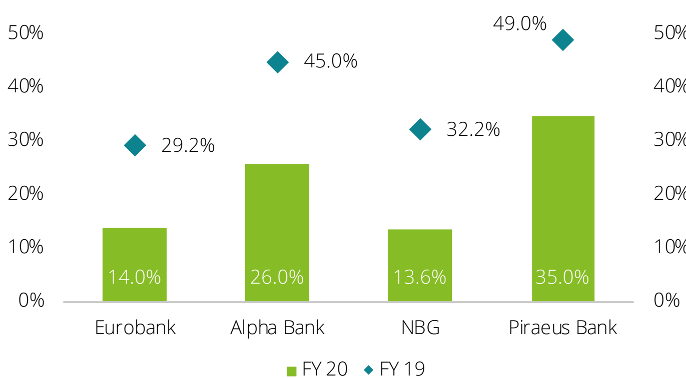
Top 4 Greek Banks NPE Volumes (€bn) and Coverage Ratio (%)



*NBG, Alpha Bank and Piraeus Bank figures are pro-forma for the recognition of Frontier, Galaxy, Vega and Phoenix securitisations
Source: Company Financial YE reports, Deloitte analysis

In absolute terms, Alpha Bank recorded the largest reduction in volumes of €9.7bn on pro-forma NPEs, primarily because of Project Galaxy. Eurobank and NBG saw their pro-forma NPEs decrease by €7.3bn (down by 56.2% YoY) and €6.4bn (down 59.3% YoY) respectively, and driven by Cairo and Frontier HAPS securitisations. Piraeus Bank has the largest pipeline for FY 2021 with a goal to reach a single-digit NPL ratio within 12 months, having already announced €11bn of NPE HAPS disposals through Project Sunrise 1 and 2.

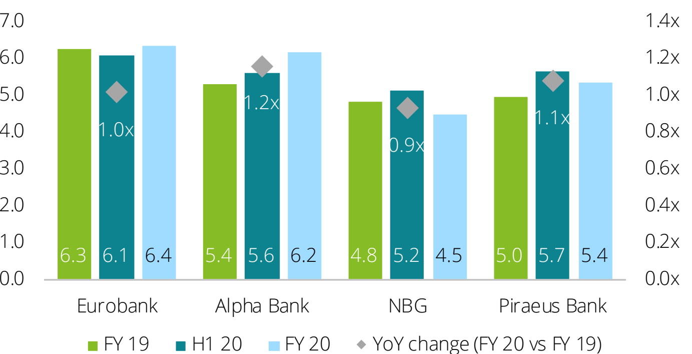
Top 4 Greek Banks NPE Ratio (%)



*NBG, Alpha Bank and Piraeus Bank figures are pro-forma for the recognition of Frontier, Galaxy, Vega and Phoenix securitisations
Source: Company Financial YE reports, Deloitte analysis

Compared to elsewhere in Europe, Stage 2 loans in Greece were relatively static. Stage 2 loans at Alpha Bank and Piraeus Bank increased by 14.8% and 8.0% respectively in 2020. In contrast, NBG's Stage 2 loans fell by 6.25%. Greater visibility on asset quality, as indicated by Stage 2 loans, will likely become clearer after loan moratoria expire at the end of 2020.

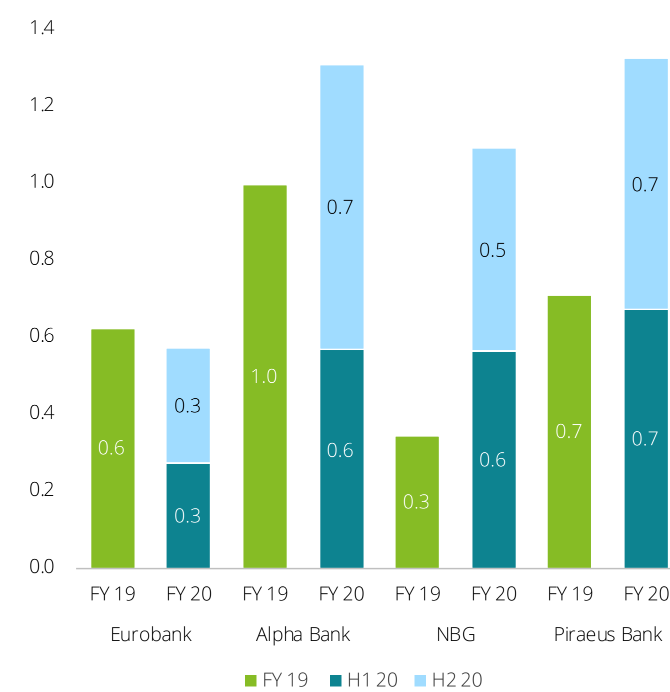
Top 4 Greek Banks Stage 2 Loans (€bn)



Source: Company Financial YE reports, Deloitte analysis

Provisioning charges across the four main Greek banks were up by 61% in 2020, a similar percentage increase compared to Spain (57%) albeit from a smaller base, rising to €4.3bn from €2.7bn. NBG had the largest increase in provisions, 2.6 times greater than in 2019, whilst Piraeus made the largest provisions in absolute terms, at €1.4bn.

Top 4 Greek Banks Loan Loss Provisions (€bn)

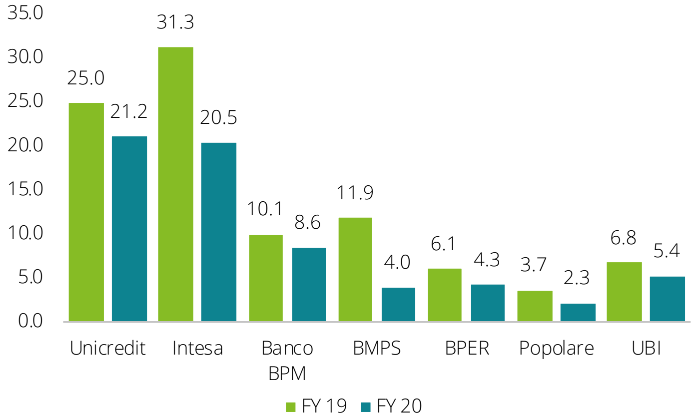


Source: Company Financial YE reports, Deloitte analysis

Italy

NPE volumes in Italy fell during the year, with the Italian loan portfolio market largely shrugging off the impact of the pandemic and thereby dominating the overall European sales market. NPE stocks fell to €66.3bn from €95.0bn across the seven major banks, with the support of the GACS scheme and AMCO portfolio purchases.

Top 7 Italian Banks NPE Volumes (€bn)

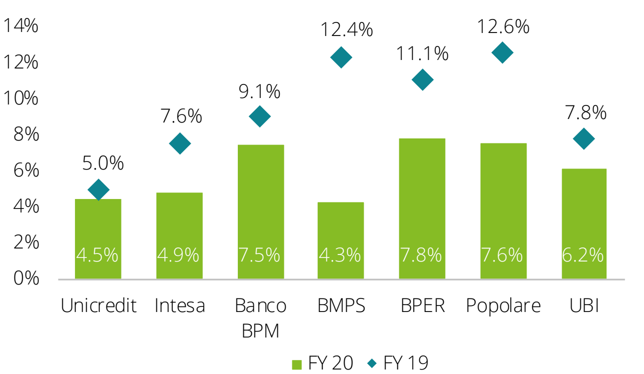


Source: Company Financial YE reports, Deloitte analysis

Intesa Sanpaolo and Banca Monte dei Paschi di Siena (BMPS) had the largest reductions in NPEs, with volumes falling to €20.5bn and €4.0bn respectively. For BMPS this fall was largely due to the sale of its €8.0bn UTP and NPL portfolio to AMCO during the final quarter, the largest deal in Italy in 2020.

Average NPE ratios across the largest banks in Italy fell to 5.2% in 2020, down from 7.3% in FY 2019, with BMPS, BPER and Banca Popolare di Sondrio all reducing double-digit ratios from 12.4%, 11.1% and 12.6% to 4.3%, 7.8% and 7.6% respectively, thanks to successful deleveraging.

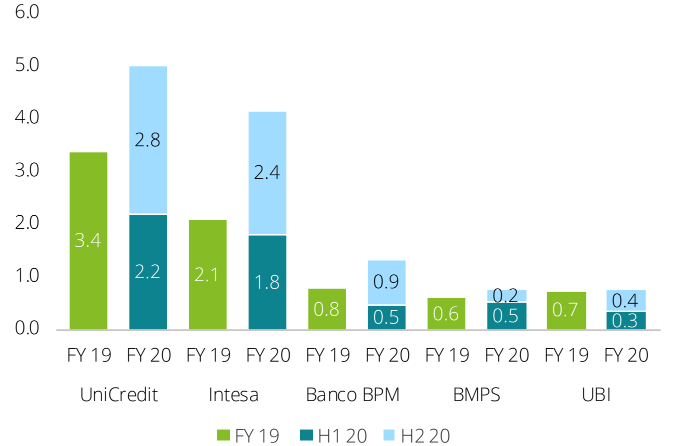
Top 7 Italian Banks NPE Ratio (%)



Source: Company Financial YE reports, Deloitte analysis

Total provisions for the seven largest banks in Italy amounted to €12.7bn in 2020, compared to €8.2bn in 2019. UniCredit and Intesa Sanpaolo led the way: provision charges were increased by 47% to €5.0bn at UniCredit and by 100% to €4.2bn at Intesa Sanpaolo.

Top Italian Banks Loan Loss Provisions (€bn)



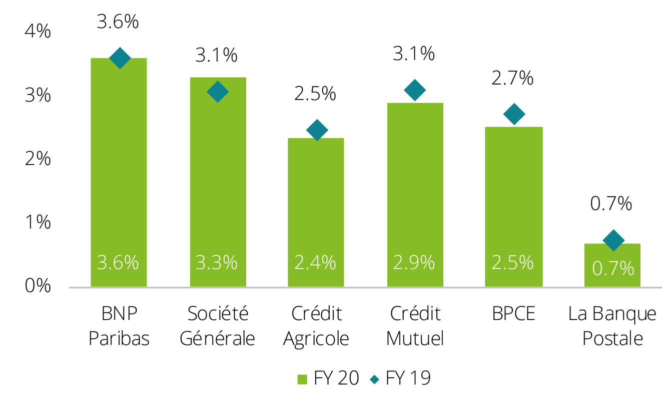
Source: Company Financial YE reports, Deloitte analysis

France

With Italian banks dominating the portfolio sales market over the past two years, France has now overtaken Italy in having the highest volume of NPLs in Europe. As of December 2020, the total volume of NPLs held by French banks amounted to €119.3bn[4], down marginally from €120.2bn in 2019.

Despite being among the countries hardest hit by the pandemic, unprecedented support measures in the form of moratoria and public guarantee schemes (amounting to €385bn) have so far prevented a sharp rise in NPLs. Average NPL ratios across French banks fell to 2.2% in 2020 from 2.5% in 2019, in part due to the increase in total gross loans.

Top 6 French Banks NPL Ratio (%)

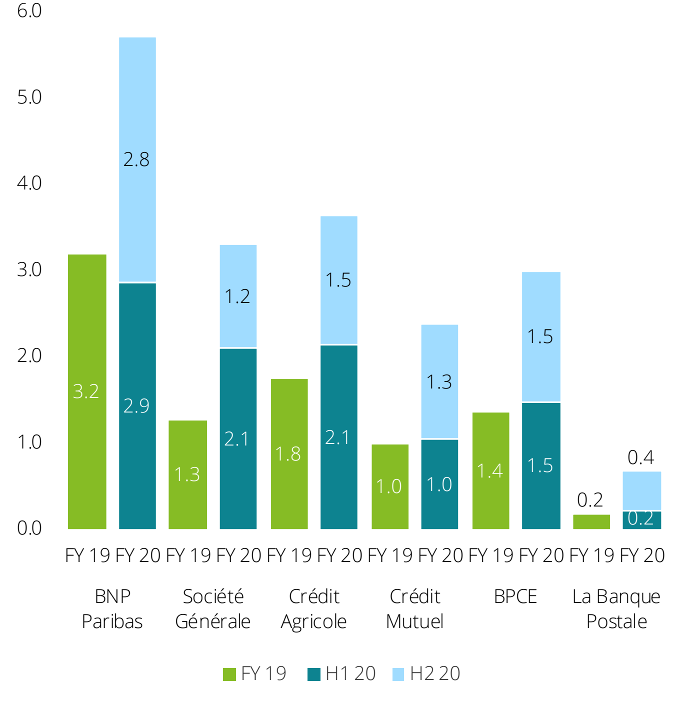


Source: Company Financial YE reports, Deloitte analysis

Provisions across the largest French banks in the year more than doubled, with the total amount charged reaching €18.5bn, among the highest in Europe. This was a major increase compared to the €8.9bn booked in 2019, with BNP Paribas and Crédit Agricole responsible for the lion's share, at €5.7bn and €3.6bn respectively.

4 Q4 2020 EBA Risk Dashboard.

Top 6 French Banks Loan Loss Provisions (€bn)

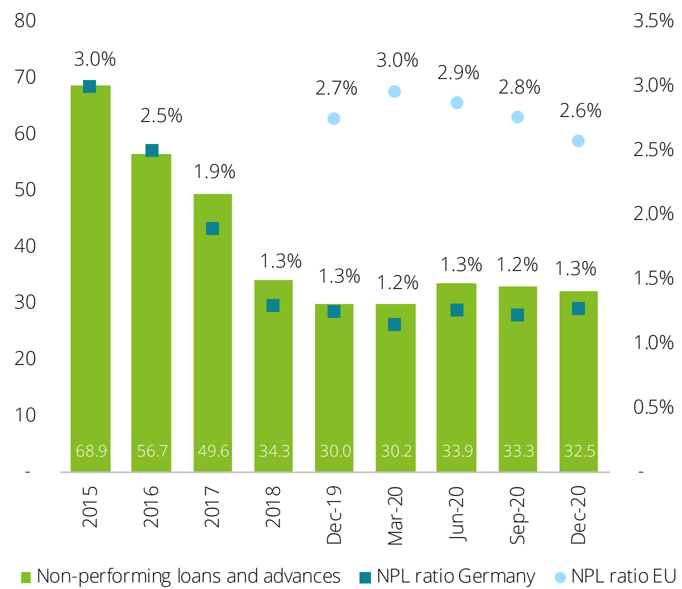


Source: Company Financial YE reports, Deloitte analysis

Germany

German NPL volumes, which had fallen significantly over previous years, have increased only slightly since the outbreak of the pandemic. For EBA-reported German banks, NPL volumes stood at €32.5bn at the end of 2020, up from €30.0bn in 2019. The NPL ratio remains relatively stable at 1.3% and at a favourable level compared to other European countries.

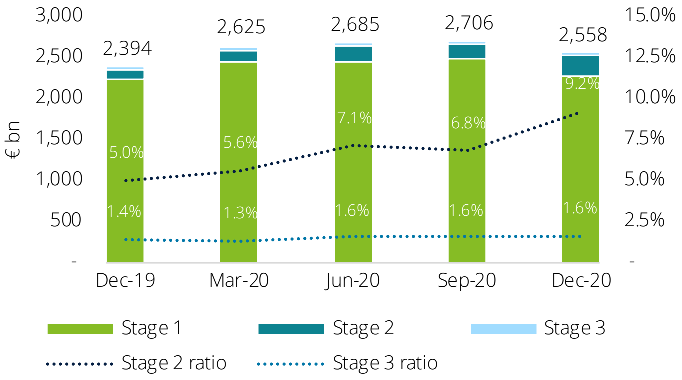
NPL Volume (€bn) and NPL ratio (%)



Source: Q4 2020 EBA Risk Dashboard

However, there are signs of deterioration in asset quality with an increase in the amount of Stage 2 loans since December 2019. Whereas some sectors such as hotels and restaurants, arts, entertainment and recreation have been the most affected by the pandemic, the impact on the real estate sector is not yet visible.

Loans and Advance by Stage (€bn) and Ratio (%)



Source: Deloitte analysis and Q4 2020 EBA Risk Dashboard

Portugal

Portugal has seen a steady decrease in NPL volumes in recent years. This trend has continued despite the pandemic, with NPL volumes falling to €12.3bn in the Q4 2020 EBA Risk Dashboard, down from €15.1bn in 2019. NPL ratios also fell significantly, reaching 4.9% in December 2020, down from 6.5% in 2019 and 10.1% in 2018. Gross lending across Portuguese banks reached a high point at the end of 2020, an annual increase of 6.9% to €249.5bn.

Conclusion

Despite overall declining trends in total NPL volumes across Europe, a wave of new NPLs is widely expected, driven by repeated lockdowns and the level of loans still under moratoria. The precise timing for this is as yet uncertain, and will depend on how quickly economies are able to recover. In the meantime, we expect legacy portfolios, including disposal processes paused as a result of the pandemic, to be the first brought back to the market. All this points to heightened activity in loan portfolio markets, towards the end of the year and beyond.

Ongoing consolidation of European loan servicing market

Consolidation in the loan servicing industry in 2019 and 2020 was driven by regulation, increased competition and the development of some European NPL markets.

Factors that continue to shape the European loan servicing and debt collection industry are: new regulations; operating compliance; technological sophistication; cross-over service offerings; new market players (e.g. PE funds, hybrid investor-servicers); and mass customisation of recovery and asset liquidation.

Ongoing market consolidation of third party loan servicers resulted in specialised firms by geographies or asset type, enabling integrated solutions and expertise.

Further consolidation is expected as new markets mature and competition increases. Currently, the majority of M&A activity is predominantly taking place in growth markets such as Italy and Greece.

The sector transformation is giving rise to hybrid investor-servicers that combine the sophistication of private equity and hedge fund investors with state-of-the-art technology to meet the operational challenges of growth and regulatory compliance. A number of large servicing platforms were recently acquired by hybrid investor-servicers including:

- Piraeus Bank partnership with Intrum (AuM €28bn)
- Eurobank FPS acquisition by doValue (AuM €27bn)
- iQera acquisition of Italian servicer Sistemia (AuM €10bn)

"We look for loan servicing partners that possess a sheer work-out experience and mindset. The COVID-19 will only increase their relevance. Such specialists appear too far and few between."

Top tier US PE investor

"Banks NPE and NPE ratios will increase when moratoriums end. It could be necessary for Banks to sell consistent volumes of NPE, but this is expected to happen starting from 2022. Sophisticated servicing partnership will make a difference."

Andrea Clamer, Head of Distressed Credit Investment and Servicing at Illimity, interview with Italo Informa Quotidiano Online

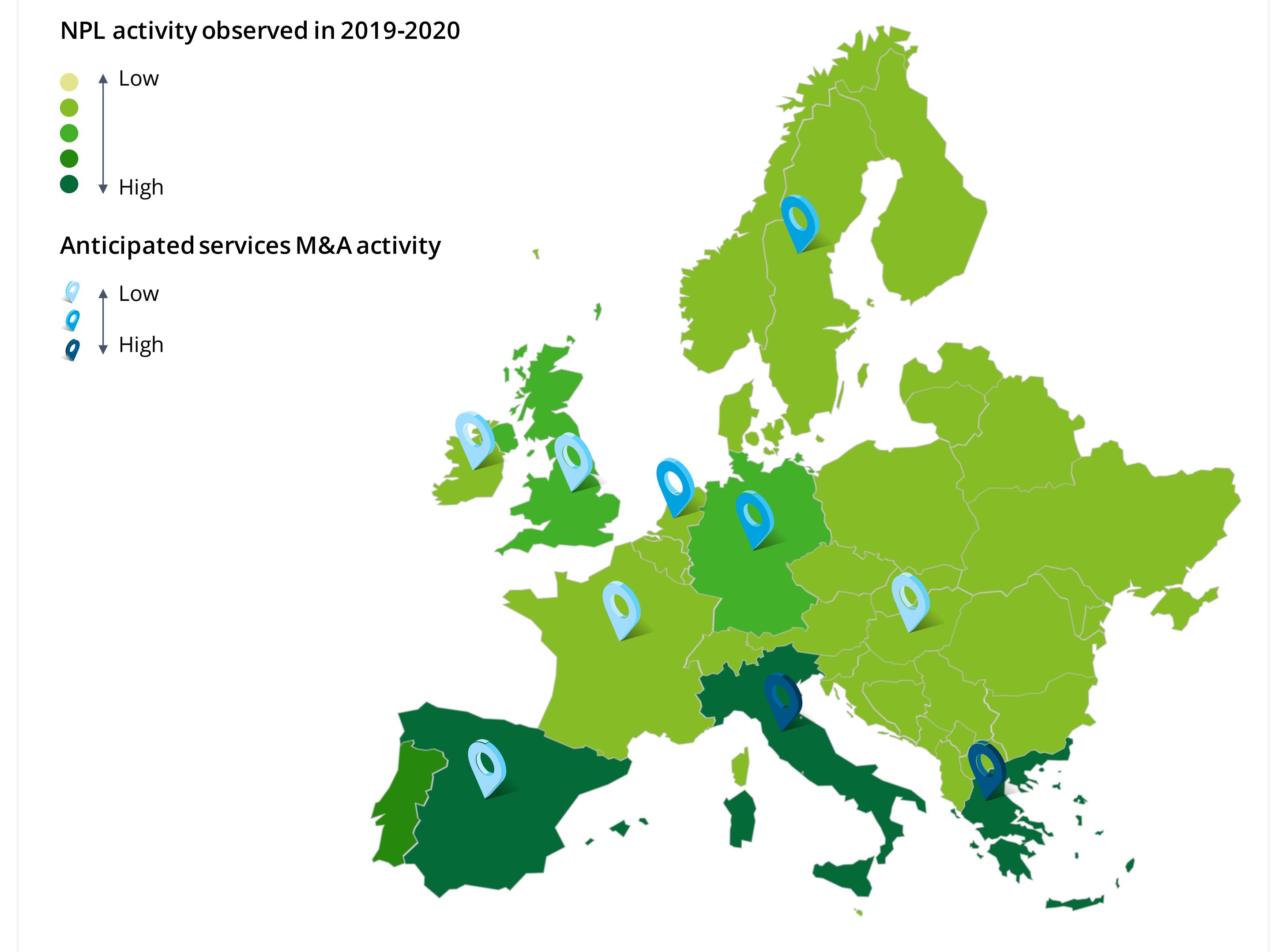
NPL stock growth expected to accelerate pace of transformation

Servicers with real NPL work-out expertise and agility will likely prevail post-COVID.

The expiration of forbearance programmes and government support measures implemented in response to the global pandemic is expected to increase NPL stocks.

As a result, NPL transaction volumes are expected to increase. In addition, market competition is likely to intensify due to participation by sophisticated investors, regulatory compliance, and the integration of state-of-the-art technology.

The market transformation should benefit companies that are agile, tech-driven, client-focused and well versed in mass customisation – including the recently established Italian servicer CNF or Central Eastern and Southern European focused asset & loan servicer AxFina.



Maturity of the European servicing industry

Despite jurisdictional differences, the European servicing industry is becoming more standardised and integrated as markets mature and competition gets tougher.

NPL market regulation in Europe varies by country, but regulatory oversight and investor demand have pushed servicers to evolve in order to stay relevant. Investor competition for loan portfolios has increased demand for high quality data, which translates into greater technological investment. Additionally, the European Banking Authority is attempting to harmonise jurisdictional differences in the NPL market as well as promote cross-border firms through regulation. This has also impacted the cost of doing business, benefitting companies of scale.

Competition in France was heightened by large European players entering the market and domestic servicers scaling up their capabilities. Historically, NPL portfolios were sold to local investor-servicers (e.g. NACC, EOS, and MCS now known as iQera). Investor appetite for French distressed assets has grown as international investors seek to deploy capital in a nascent market. Greater investor participation drove transaction growth between 2018 and 2020, with larger secured portfolio transactions on the horizon.

A handful of key players (iQera, Intrum, EOS, Hoist, etc.) dominate the servicing/debt collection market with 70% of AuM. Bank affiliates (i.e. Filaction, Concilian, etc.) and over 400 local practices of modest size share the remaining 30%.

The German NPL deal pipeline has been relatively sporadic and event-driven in recent years, due to the conservative lending principles inherent in the German banking sector. The NPL ratio (1.3% as of Q4 2020) has been historically lower than the EU average. Consequently, third party servicing in Germany has traditionally consolidated across asset classes (e.g. LOANCOS covering NPL, PL and residual claims), geographies (e.g. Silverton's expansion in the US and other EU markets), and full value chain offerings.

One of the emerging loan servicing trends in Germany is an increase in partnerships between servicers and banks, illustrated by the relationship between Aareal Bank and Mount Street. A large number of German banks have entered mutually beneficial agreements on servicing or IT systems.

> *"The significant cost pressure in a sustained low-interest environment is leading banks and insurers to consider third party credit platforms for originating mortgage forward flow and for effecting loan portfolio management as a comprehensive solution, or even to buy the whole mortgage loans ready-to-invest through a fund vehicle structure that delivers one line item for the balance sheet.*
>
> *Simply digitising old processes can not solve the entire problem"*
>
> *- Clifford Tjiok, LOANCOS*

Spain has become a mature market for NPL transactions following concerted efforts in the past decade to clean up banks' balance sheets. The pipeline of portfolio transactions has led to numerous M&A deals in the servicing market, which is now highly concentrated with a few large players.

The last major deals took place in early 2019. Apollo sold its 85% stake in Altamira to doValue, and Banco Sabadell sold its real estate servicer Solvia to Intrum. Other key players include Haya Real Estate (merged with Divarian), Servihabitat, and Aliseda.

2019 and 2020 were marked by large M&A deals and NPL sales in Greece. In addition, Greek banks have explored different ways to manage their bad loans, including partnerships with credit management companies and private equity funds:

- Alpha bank sold its Cepal subsidiary, a market leading servicing platform, to Davidson Kempner in early 2021.
- doValue acquired Eurobank's loan servicing unit FPS to form doValue-Greece. It has also entered into a long-term partnership, making doValue a market leading Southern European servicer.
- Intrum acquired Piraeus Bank's Recovery Management Services platform. It also secured long-term NPE servicing deals that places Intrum as a market leader in one of Europe's largest NPL markets.

Inorganic growth is an opportunity to integrate services

The loan servicing market in Europe continues to transform, with servicers investing to meet market demand and exploit growth opportunities by consolidating across asset classes and geographies.

Overall, the highly competitive European servicing market is likely to result in firms specialising in markets where they outperform.

We expect that servicing giants will continue to manage large NPL portfolios and securitisations, while smaller servicers focus on the local market for secondary and tertiary portfolios.

Looking Forward

The European loan servicing market is on track to provide integrated client services that span across geographies and asset types. Investment in highly skilled professionals, automation and artificial intelligence, in conjunction with increased jurisdictional agility, can attract new investors.

Credit servicing future operating model	Developments and examples
Pan-regional or global reach	• Systemic and company-specific risks exposed by the pandemic may spark a new wave of consolidation, including the possibility of a pan-European bad bank • Market consolidation occurred at a higher rate in 2020, evidenced recently by the Link Group's interest in Pepper European Servicing
Highly skilled professionals	• In-person customer interactions are a critical part of the servicer business model and pivotal for customer engagement (i.e. customer service, risks assessment and quality assurance) • Complementary technological investment should support competitive differentiation through customer service and improved operations
IT and AI backbone	• Investment in comprehensive IT infrastructure and digitalisation are crucial for enhanced data analytics, regulatory compliance, financial reporting, customer service and operational management • The shift to digital is driving investment in RegTech, digital banking, data analytics, open banking and payments
Jurisdictional agility	• The Credit Servicers Directive published this year by the European Banking Authority calls for an extended EU passporting regime • Servicers have also expanded into new geographies: for example Intrum's expansion into Spain and Greece, and Lowell's acquisition of Solvencia in Spain
Hub & spoke model	• The hub and spoke model allows a servicer to leverage local knowledge while centralising common functions: this model optimises economies of scale and knowledge transfer • Country-based repository of servicing data informs decision making

2020 EBA Credit Servicers Directive

In the first quarter of 2020, the European Banking Authority published an update to the Credit Servicers Directive, which is based on the best practices observed in Ireland and Spain, countries hardest hit by the financial crisis.

The Directive aims to blend best practice and level the playing field for competition, to encourage new market entrants and deepen liquidity of the NPL market. Recommendations include a passporting regime, data standardisation, and infrastructure.

The Italian servicing market in 2020

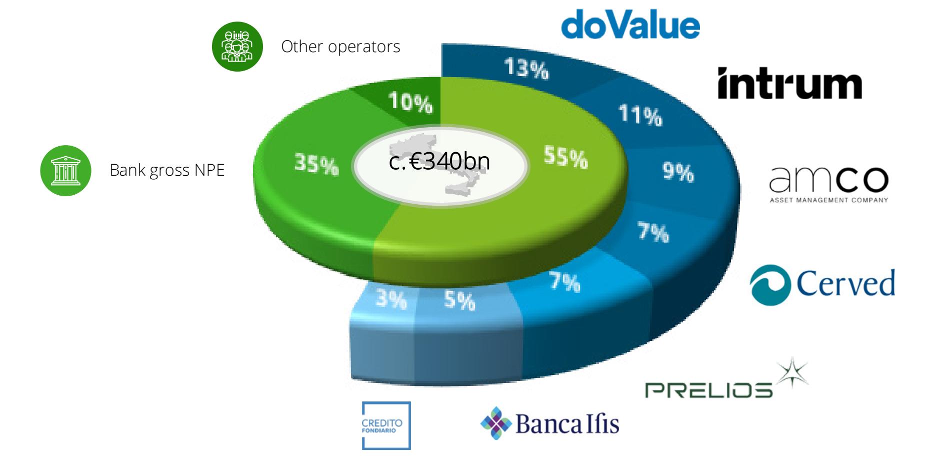
The Italian servicing market is concentrated, with seven large servicers managing c55% of the €340bn NPE stock. With more distressed debt expected to come to the market, servicers anticipate new opportunities to develop and expand.

Over recent years there has been significant deleveraging across the Italian banking sector. Currently, we estimate there are approximately €340bn of NPE in the financial system, of which about €220bn are controlled by distressed credit investors and €120bn sitting on banks' balance sheets.

More financial distress and de-risking activities are expected in the coming months. According to Banca IFIS, the impact of lockdown measures could add up to €100bn of NPEs in Italy alone.

"The market needs specialised players with specific and technical competences allowing end-to-end control of the value chain, from evaluation to remarketing."

Andrea Clamer, Head of Distressed Credit Investment and Servicing at Illimity, interview with Italo Informa Quotidiano Online



The Italian servicing market is highly fragmented with more than 950 servicers and collection agencies.

Seven large servicers (AuM over €10bn) dominate the credit management market. Typically, they combine teams dedicated to legal work-out, real estate valuations, and special servicing. Property management and remarketing is most commonly outsourced to local brokers and asset managers.

The remaining segment of the market can be classified into three categories: regional practices (AuM <€3bn) that support legal processes and service assets purchased by their shareholders or for local institutions; medium size servicers (AuM €3 - €10bn), usually specialising in one asset class that service exposures outsourced by banks, larger servicers, and industries like insurance, telecommunications or utilities; and large size players (AuM over €10bn) which usually have multiple partnerships with financial institutions.

Emerging opportunities in the Italian servicing market

The fungibility and monetisation of real estate assets repossessed after foreclosure is a key factor in managing Italian NPLs, providing loan servicers and asset operators with a unique opportunity.

Challenges in the Unlikely To Pay (UTP) market

Total UTP loans at the top five banks by NPE exposure amount to about €31.2bn as of December 2020. There are two main constraints limiting the UTP market:

- Relatively modest level of provisioning (around 41% average coverage): a large proportion of UTP exposures have provisioning levels significantly lower than NPLs (between 56 - 78% average coverage).
- Shortage of servicers with the expertise to actively manage and restructure real estate properties and price sub-performing UTP exposures.

Banks do not have enough industrial partners with a solid real estate asset management platform to outsource the servicing of properties on a large scale as an alternative solution to portfolio sales.

Underperforming GACS securitisations

In December 2020 Scope Ratings, the European rating agency, reported that 13 of the 22 rated GACS transactions are currently underperforming, in terms of gross collections, compared to business plans. This has triggered two main events:

- Outsourcing to specialised sub-servicers large parts of the loan book to speed up the recovery process
- Sale of small portfolios to remove unsecured tails and anticipate future recoveries.

In 2019 (the latest data available), GACS collections amounted to about €231m or 4.7% of total collections. 2019 saw the highest amount of secondary trades on record, with €183m collected compared to €47m in 2018 — confirming the importance of this sector in Italy.

The performance of state-owned operators like AMCO and programmes such as GACS will remain under scrutiny by other financial institutions, especially with respect to the speed of their workouts, the fungibility of NPLs and the ability to monetise foreclosed assets.

Secondary real estate market challenges

Italian servicers specialise predominantly in legal work-out and operate in a fragmented real estate management market, without an integrated local network to commercialise real estate. This creates a challenge for the re-marketing of non-prime and granular assets which are not located close to the main city centres. Coordination of local real estate brokers with national servicers is lacking, which limits divestment opportunities and asset value protection options. Inefficiencies in the real estate disposals process is an opportunity for servicers that can promote efficient solutions with asset management teams developed internally.

"UTPs are undoubtedly the new challenge that banks and specialised servicers should focus on. In the next few years bad loans will remain the prevalent distressed assets; but it is likely that UTP, together with real estate assets, will increase their weight in NPE portfolios."

Andrea Mangoni, CEO of DoValue, interview with Italo Informa Quotidiano Online

Asset management companies and bad banks

Introduction

The GFC and its aftermath left many banks with a large volume of problematic non-performing assets. To deal with these, asset management companies (AMCs) and 'bad banks' (non-core asset management units of individual banks) have emerged as a way of cleaning up banks' balance sheets and allowing them to start lending again.

In recent months, as governments and policy makers look to protect economies from the impact of the COVID-19 pandemic, the spotlight has once more turned upon the role that AMCs (specifically national AMCs) can play in dealing with the widely anticipated large increase in NPLs.

> *"Experience shows that when [AMCs] were used after the crises, bank balance sheets have been cleared up quicker with a more effective restoration of banks' ability to lend"*
>
> *Andrea Enria, Chairman of the Supervisory Board of the European Central Bank, interview with the Financial Times*

A Tool for NPL resolution

As a policy tool, national AMCs have historically played an important role in bridging the pricing gap after an economic shock, rebuilding dysfunctional NPL markets, and providing banks with an efficient, less value-destructive strategy to wind down assets over a longer timescale than might otherwise be the case, while at the same time improving transparency and helping rebuild investor confidence.

Early examples include Korea, with the establishment in 1962 of KAMCO as a permanent bad bank, to purchase and resolve NPLs - a role that was greatly expanded during the Asian financial crisis (AFC) in the late 1990s.

In 1988 Mellon Bank established its own bad bank (Grant Street National Bank), using a combination of own funds and bonds sold to investors, to focus on resolving high levels of NPLs in the bank's loan portfolio (primarily in the energy and real estate sectors).

The concept of separating good and bad assets has also been used via several different models during past banking crises in Sweden, France and Germany, and again to significant effect during the GFC, when the concept was revived.

Although AMCs and bad banks can have different scopes and structures, every non-core unit will ultimately look to optimise its balance sheet via risk minimisation and value maximisation.

During the GFC, the systemic impact of the crisis on the banking sector meant that the emphasis was on rebuilding trust with stakeholders by visibly separating bad assets and providing transparency on operating performance. Generally, given insufficient bank capital levels, this needed government intervention and covered more than one institution's impaired loans, as well as driving sectoral solutions.

Thus in 2009 in Ireland the National Asset Management Agency (NAMA) was established to acquire and manage the impaired commercial real estate loans of six Irish banks which had required government support. Similarly in 2012, SAREB was established to manage the impaired loans and foreclosed real estate assets of four nationalised Spanish banks.

Source: Deloitte research and analysis of various public data sources. The list is compiled on a best-efforts basis and is not exhaustive.

Since then, other countries have followed suit and the concept is once again being discussed as an option for dealing with the potential significant uptick in NPL levels as a result of the COVID pandemic and the gradual withdrawal of regulatory reliefs and government backed loan support schemes and loan moratoria.

Regulatory interventions

For governments and policymakers, AMCs (when used in conjunction with other measures, including pro-active asset quality reviews to identify loans that are non-performing and need restructuring and bank recapitalisation) have historically been a useful tool for resolving banking crises – helping rebuild confidence in the banking system and facilitating a return to normal lending on the part of banks. On their own, however, they are not a silver bullet.

Options under consideration in Europe for dealing with a likely uptick in NPL levels as a result of the current pandemic include a pan-European bad bank. However, the obstacles to this are formidable, not least at the political level. Economies which stand to suffer less than others are likely to baulk at having to fund measures for which they may see little benefit for themselves. Moreover, with the shape and extent of the increase in NPLs still uncertain there is a strong temptation for governments and policy makers simply to 'kick the can down the road'. The possible existence of government guarantees and payment moratoria is a further complicating factor.

It is also far from clear to what extent such an initiative would benefit the current situation. Typically, AMCs extract value through economies of scale in dealing with homogenous assets and driving sectoral solutions. NPLs stemming from the COVID 19 pandemic are likely to be heterogeneous in nature.

Moreover, the existence of different judicial systems and processes should be considered an impediment to the generation of EU-wide economies of scale. The speed to enforce and recover claims and the capacity of courts, which even prior to the pandemic was severely constrained in many countries, will only have worsened as a result of enforced lockdowns.

Separation of good and bad assets makes the balance sheets of 'good banks' more transparent, steadies their market access, and lets them focus on extending new loans. AMCs and 'bad banks' proceed to extract value from bad assets in an orderly way over time

Alternatives under consideration include a centralised data hub for sharing portfolio information and a network of national AMCs (as determined by each member state) with the ability to trade assets between each other and potentially create larger portfolios of homogenous assets which could then be sold off.

At a national level, we note that the Bank of Greece is looking at a 'bad bank solution' ahead of a new potential increase of COVID-related NPLs. It submitted a proposal to the Greek government at the end of September 2020, stipulating that potential losses relating to the existing NPL legacy stock will be covered only by the private sector and not by the Greek taxpayer, up to the level of the minimum capital adequacy requirement. Any such AMC structure would need to be checked for compliance with the EU's current state aid parameters.

Benefits

AMCs work best as dynamic entities: their overall aim is a disposal of assets in an orderly manner, phased to optimise pricing and market conditions, rather than simply sitting on assets and awaiting a recovery in their value.

The idea is that once shorn of impaired assets of uncertain value, individual banks should become a more investible proposition in terms of likely necessary recapitalisation actions.

AMCs work only as instruments for repairing banks alongside complementary banking sector measures, including recapitalisations and governance improvements, and appropriate NPL market measures

As such, the success or otherwise of an AMC strategy is dependent on the existence or development of a functioning NPL market, as well as an effective legal framework and court capacity for enforcement against underlying collateral and liquidating companies which are not viable.

Banks can transfer the troubled assets to the AMC or non-core units at reasonable valuations (long-term or real economic value may be used in situations where state support is provided – although this is still likely to be at a discount to book value) with these distressed assets then being sold by the AMC over a longer time frame than might otherwise be the case and so avoiding 'fire sale' prices.

An AMC will also typically have a longer divestiture time horizon than a bank, given the contradicting pressures that banks face from their stakeholders. This means that the AMC can partake in any upturn in macroeconomic conditions, as well as avoiding the risk of flooding the market and pushing down prices. Nevertheless, to act as a focus for management actions, AMCs are usually set up with a specific (suitably long) time horizon in mind for the disposal of assets.

Moreover, transferring assets can help sharpen the focus on 'high risk' assets and exploit economies of scale in terms of the specialism required to workout optimum strategies. This improved clarity of purpose helps to provide an AMC with a clear directive, as well as providing for stronger oversight and better disclosure.

Equally, it may be argued that AMCs enjoy more of a free hand when implementing recovery actions, which existing management with established relationships do not – although this benefit may be partly offset by a less detailed understanding of the underlying collateral. Typically, a combination of existing and new management may be used.

The benefits for the 'good bank' include allowing management to focus on rebuilding the core franchise, as well as potential capital benefits[5] and a higher level of market stability and investor confidence.

Challenges

Centralised national AMCs, which have some degree of public ownership and government support, are complex and time-consuming to establish and may require primary legislation and state aid approval.

Appropriate processes and protections will be required to ensure that transfer prices are set appropriately and avoid any risk of losses being shifted from the bank to the state. (This risk can be mitigated by claw-back provisions, e.g. a bank levy.)

From a governance and transparency perspective, robust operational structures are required to minimise the risk of political interference, which was a problem for instance for certain AMCs set up in response to the GFC. Institutional independence needs to be balanced by clear accountability and reporting frameworks – particularly where state support has been provided.

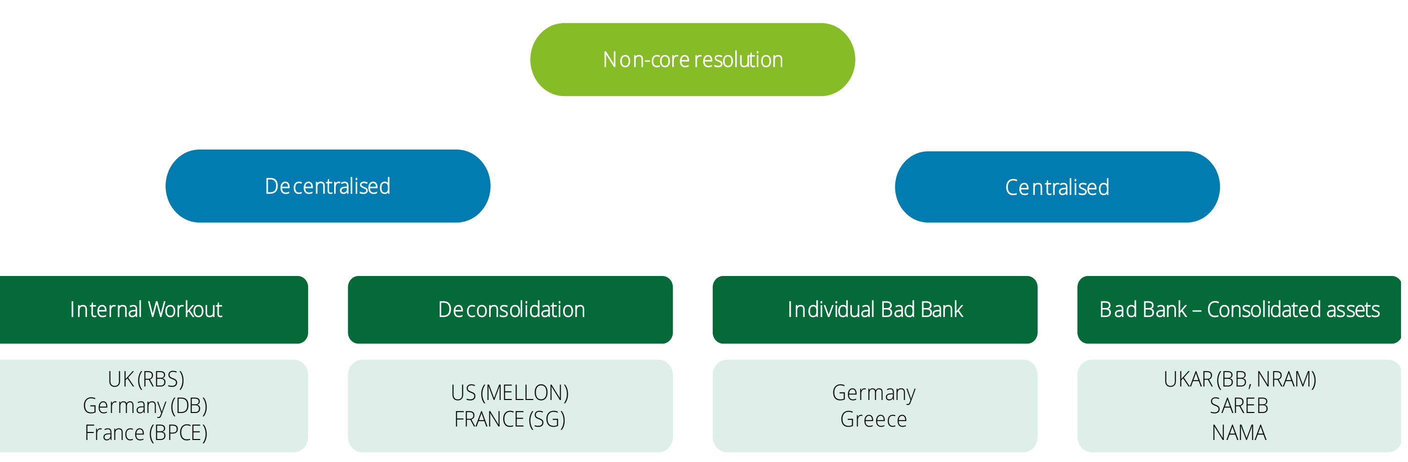
As AMCs typically do not accept deposits and or hold banking licences (and hence may not be under central bank supervision) an alternative supervisory framework may need to be defined. A downside to this is that it may limit the AMC's operational flexibility.

5 Lower NPE ratios (if deconsolidating) thereby freeing up capital which can serve as a buffer to absorb losses

Servicing infrastructure and capacity must also be available. While activities may sometimes be outsourced back to banks under SLAs, there needs to be in place appropriate mechanisms to ensure that banks continue to focus on collection activity. Ideally (from a clarity of purpose perspective) such arrangements should only be on a temporary basis while the AMC develops its own infrastructure.

Alternative Structures

AMCs have evolved to meet the needs of their respective crises. Bad banks either remain in a private structure or can involve becoming centralised with government funding, backstops or guarantees. The appropriate mechanisms are dependent on the complexity of assets to be transferred, requirement for third party investors, as well as the scope of financial stress in the wider banking system.



Decentralised model

In a decentralised model, asset management, work-out and disposal activities are undertaken by the bank itself, leveraging retained knowledge and established relationships with borrowers to help support a successful recovery. Ownership structures are therefore typically private.

Decentralised AMCs typically focus only on one specific bank and specific asset classes, and may take two alternative forms.

Internal work-out unit

In this model, bad assets are moved to a separate non-core unit with specialist resources deployed to affect their work-out or disposal. Establishing a non-core division sends a strong market message that management are serious about tackling the problem of non-performing loans. Policies, procedures and systems can be tailored specifically towards problem debt management and exit without being restricted by the business-as-usual environment. Staffing can be focused on ensuring that the right skills are in place for exit, which calls for credit and workout skills rather than traditional relationship management. Royal Bank of Scotland and Citibank are examples of banks that have done this in the past.

Full legal separation and deconsolidation

Full legal separation, whereby the assets are transferred into an SPV (which may be a fully standalone organisation, separate from the originating bank) is more complex and expensive to achieve. However, it has a potential immediate capital benefit (depending on how it is structured) and may facilitate bringing in of external investors or the sale of the bank. Mellon Bank in the US provides an example of this type of structure.

Non-core units (whether on a divisional or standalone basis) can be run as a project with a finite lifetime. Done properly, costs can be taken out of the business as the portfolio is reduced in size, allowing an overall right-sizing to the post-crisis environment. Equally it may enable a tailored data and reporting environment: this not only assists management, but also provides a platform for future investment by third parties, as market conditions improve, whether into a future structure or as part of a tailored portfolio sale programme.

A deconsolidated model is typically the preferred option for dealing with distressed homogeneous assets, as it allows for economies of scale and tailored strategies and infrastructure.

	Model	Operations	Risk transfer	Market confidence	Facilitation of External Investments in Bad Bank	Ease of Portfolio Sales in Bad Bank
In-house Management	Segregated portfolios • Management reporting only	Simplest	Limited Risk Transfer Upon Setup *(Subsequent portfolio sales will transfer risk)*	Least Transparent	Challenging *(mixed value attribution, impacts "good bank")*	Least Straightforward
In-house Management	Virtual Non-core • Creation of internal division • External reporting					Straightforward
Legal Separation	SPV or classic 'bad bank' • Separate legal entity	Most complex	Maximum Risk Transfer Upon Setup	Greatest Transparency	Most Straightforward *(simple attribution, insulation of "good bank")*	Straightforward

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Centralised model

Using a consolidated centralised structure, distressed assets from several banks, usually with a focus on specific sectors, are pooled to help ease systemic stress in the broader banking system.

Typically, this model involves some degree of public ownership or support. For example, NAMA and SAREB were both established as a result of a financial crisis (in Ireland and Spain respectively) and picked up a substantial portion of the total NPLs and troubled assets in each of those countries.

NAMA in particular is seen as a success story in dealing with the consequences of the Irish real estate bubble and putting Irish banks back on an even keel. As part of its original formation, NAMA issued €30.2bn of government-backed senior debt and €1.6bn of subordinated debts. The subordinated debt was redeemed in full in March 2020, and as a result NAMA has fully repaid all the debt issued to acquire loans from the participating banks.[6]

On the other hand, FMS Wertmanagement (established following the collapse of Germany's Hypo Real Estate group) and UKAR (which took over the assets of two failing UK banks) were vehicles set up to resolve individual banks or banking groups, but were both 100% publicly owned. The relative speeds with which their portfolios were realised reflected the underlying nature of the assets, highlighting the benefits which can be gained from dealing with homogenous assets (UKAR) and the challenges in terms of diverse, complex portfolios (FMS).

6 Source: Annual report

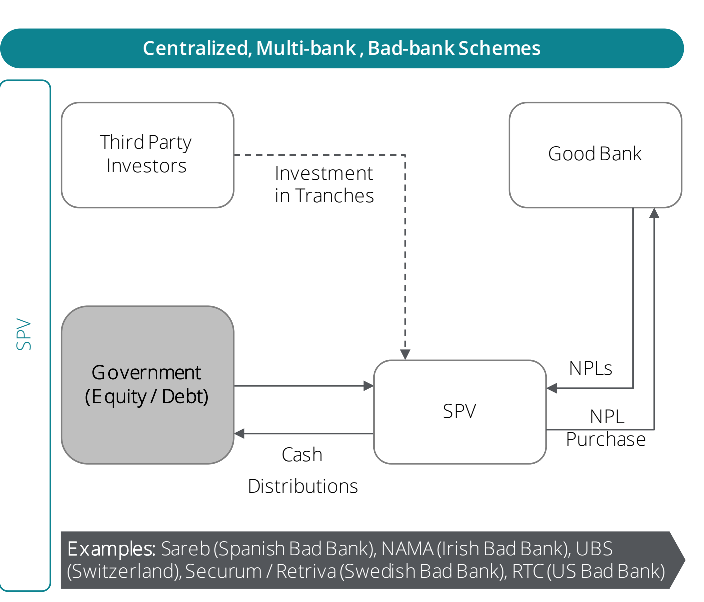
Entity	Country	Ownership structure	Year Established	Orignal Year due to be wound down	Participation	Book Value (€bn)	Transfer Value (€bn)	Implied haircut (%)	Nature and location of assets	Disposed to date (FY19)
NAMA	Ireland	51% private/ 49% public	2009	2020 (subsequently extended to 2025)	6 Irish banks	74.2	31.8	57%	Commercial real estate loans connected mostly to properties in Irish and British urban centres	70%
FMS	Germany	100% public	2010	not set	Single bank	175.7	175.7	0%	A diversified portfolio including complex products that are located all over the world	61%
SAREB	Spain	55% private/ 45% public	2012	2027	4 nationalised Spanish financial institutions	107	50.8	53%	Loans and actual real estate, exclusively Spanish and spread throughout the country	36%
UKAR	UK	100% public	2010	not known	2 nationalised UK banks	132.2	not known	n/a	Principally residential mortgages, including buy to let, secured over properties located in the UK	93%

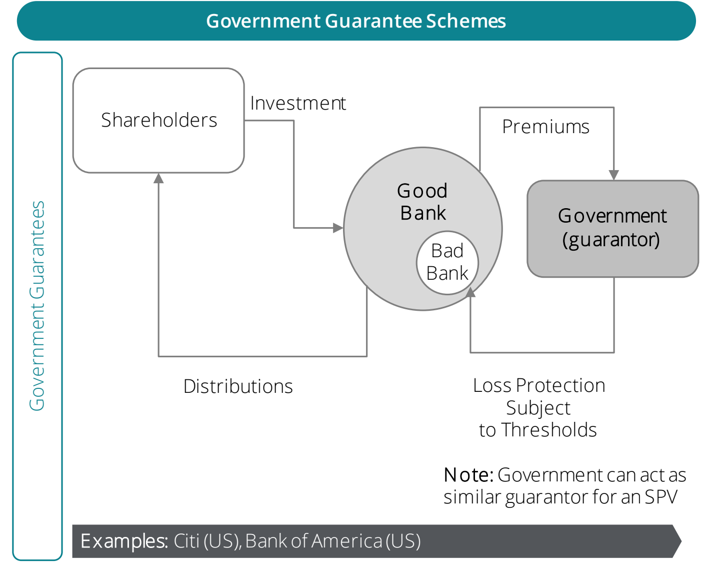
Source: Annual reports

Funding

State-guaranteed senior debt, subordinated debt or common equity are all types of funding that can be used for a national AMC. Purchased portfolios typically come with a liability mismatch and so there is a need for strong risk management and hedging. The purchase consideration for assets is usually in the form of debt securities issued by the AMC with a government guarantee.

Funding structures may include profit sharing arrangements, whereby the participating banks retain a stake in the AMC/ bad bank. In return for a lower initial purchase price, the participating bank receives preferential funds flow from the AMC, which reduces the participating bank's outstanding claim. In any event there is usually some form of loss sharing arrangement between the bad bank and the participating banks (which may include their shareholders) requiring the participating bank to take at least some level of 'first loss'.





Asset Scope

The types of asset selected, along with the macroeconomic environment, are key factors in the success or otherwise of an AMC strategy. Generally, AMCs work best for homogenous asset pools where economies of scale can be generated and standardised approaches adopted.

An objective assessment should be made to identify loans that would benefit from an AMC approach – it may be more effective to leave smaller loans with the originating bank. A forward-looking view should be applied (including the future business model of the originating bank).

Thus, for NAMA and SAREB the focus was troubled real estate loans (and foreclosed real estate assets); FMS had a more diverse portfolio as a liquidation vehicle.

NAMA Commmercial real estate loans with collateral		**SAREB** Loans and physical real estate		**FMS** Diverse portfolio	
Office	15%	Residential	34%	Public sector	50%
Retail	14%	Retail	3%	Workout	4%
Other investment properties	15%	Projects under construction	7%	Infrastructure	10%
Hotels	10%	Mixed collateral	18%	Structured products	25%
Residential	17%	Land	11%	Commercial real estate	11%
Land	19%	No guarantees	5%		
Development	10%	Residential - physical	11%		
		Land - physical	6%		
		Property assets for commercial use, industrial & other buildings - physical	5%		

Generally speaking, transfers of distressed assets should be one-time events, or occur within a limited timeframe (e.g. over six months) to maintain the credibility of the bank following carve-out and to avoid moral hazard issues.

Identifying and executing an optimal strategy for the transferred assets (rundown, portfolio disposal or work-out) is crucial to maximising recovery value. A 'factory' approach that implies active management of assets is generally considered preferable to a 'warehouse' approach that relies mostly on time, for assets to recover in value.

When determining optimal strategy, costs, risks and liquidity must all be considered and feed into the overall AMC business plan with regards to risk management, P&L impact, capital and funding.

What Price to Transfer Assets?

The transfer price should be set on a reasonable and transparent basis. Typically, the transfer should be at market value. In Europe, AMCs need to abide by EU state aid regulations when acquiring impaired assets, which would include appropriate loss sharing arrangements to protect public finances and payment for any asset guarantees provided by the state.

In some cases that could lead to immediate crystallisation of loss - the very thing that banks are seeking to avoid. The European Commission (EC) has recognised that market value at times may be lower than would normally be expected due to certain extraordinary and temporary distortions. This view was applied on a number of occasions and in varying forms in Ireland, Spain, and Slovenia, following the GFC.

In such a situation, the charged risk and liquidity premiums are likely to be significantly higher than the usual premiums in a well-functioning market. This observation lies at the heart of the concept of real economic value (REV) which tries to reflect underlying long-term economic value or intrinsic value, on the basis of the existing cash flows, for example under a broader time horizon assuming the risk and liquidity premiums that would exist in a well-functioning market for recovery of debts from borrowers.

In essence, REV is based on current market value (CMV)[7] but with adjustments to reflect the extraordinary and temporary non-functioning of the market.

Generally speaking, the transfer value (TV) must be at or below REV; the difference between the TV and CMV equals the state aid amount.

State aid does not arise if the transfer price of the assets is equal or lower than the market value at the time of the transfer. However, if the transfer price exceeds the market price then the impaired asset measure involves state aid

However, asset relief measures can be declared compatible with state aid rules if the transfer price of the assets is less than REV (or underlying long-term economic value) of the assets.

A TV above the REV will be approved only if accompanied by deep-seated restructuring and claw-back provisions for any excess.

The EU's state aid rules are set out in the EC's Impaired Asset Communication (IAC) and include: full ex-ante transparency and disclosure of impairments and an upfront viability assessment of eligible banks; a 'correct and consistent approach' to the valuation of assets. An independent valuer may be appointed; and there should be suitable sharing of the costs relating to the transfer of assets between the government and the banks' shareholders and creditors (the haircut applied has to make banks recognise losses, and AMCs will also need to pay a fee at market rates for any state guarantees provided). There should also be an alignment between incentives for distressed banks with public policy objectives; and the timeframe for the bank to participate in asset relief schemes should be limited, to encourage a rapid resolution and to avoid moral hazard. The IAC also includes follow-up provisions for the restoration of banks to viability.

Conclusion

Regulators and policy makers have sought to get on the front foot of the NPL issue since before the start of the pandemic. The potential benefits of AMCs are highlighted in the European Commission's December 2020 communication, including the proposal for a network of national AMCs which could work together to reduce NPL stocks across the EU. While the timing and scale of increase in NPLs post pandemic is still uncertain, AMC's will continue to play an important role in NPL resolution.

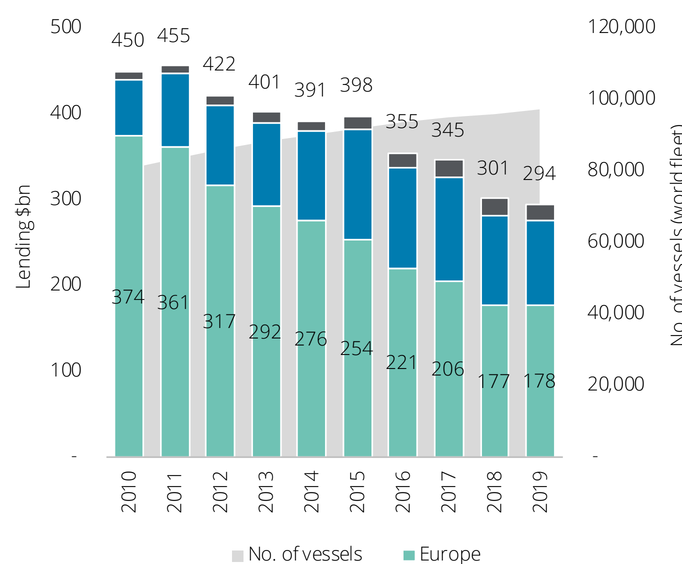
7 Where CMV is deemed to be the price between a willing buyer and willing seller after an adequate period of due diligence to understand what is being acquired but without remediation of any deficiencies in the documentation, collateral available, or the economic environment to which the assets are subject

Shipping

Major ship lenders continue to reduce lending volumes

The global stock of ship financing granted by banks has decreased substantially over the past decade to about $300bn in 2019, despite growth in the size of the world fleet over the same period, signalling a significant shift from bank lending to alternative financiers.

Lending Volume ($bn) and Vessels in World Fleet



Source: Clarksons; Petrofin Research (Top 40 ship finance banks)

The number of vessels in the world fleet has grown continually over the past ten years, at an average rate of 2% per year. Whereas Asian and US lenders increased their books, the total lending volume of the major, traditional ship finance banks decreased significantly, by nearly 40% since 2011. European, especially German, banks that have historically been leading lenders to the global shipping industry have significantly reduced their books, with an increasing share of financing being provided by alternative sources.

Several European banks decided strategically to withdraw from the sector, or at least shrink their books significantly, given heavy losses during the shipping sector crisis starting in 2008/2009. However, implementation of this strategy was delayed and was not visible before 2012/2013. This was related to contractual commitments for post-delivery financing of vessels ordered pre-crisis. Additionally, banks were also often required to provide 'bridge financing' for the equity portion as the Kommanditgesellschaft (KG) market was no longer liquid and the equity amount could not be raised.

A significant portion of the aging ships financed were not able to comply with the debt service obligations even after several rounds of financial restructuring. The remainder of these exposures are still with the banks. While there are signs of stabilisation of the lending provided by European ship finance banks, however, by trend, the exposure (at least for merchant shipping) is of an older vintage.

Although historically some banks have shrunk their loan books through portfolio transactions (e.g. Deutsche Bank's sale of the Lioness portfolio to Oak Hill Advisors and Värde Partners, and NordLB's sale of Big Ben portfolio to Cerberus), the European market has been relatively quiet in recent months. Whereas there have been some secondary sales of portfolios, banks are focusing more on winding down their loan books via single transactions.

Nevertheless, there are signs that the European market for shipping loan portfolios may be picking up, with the current economic environment potentially leading some banks to consider strategic divestments of their exposures in different asset classes through portfolio sales. In addition, some banks have a significant exposure to the offshore segment and may consider a disposal option as fleets are ageing and significant recovery potential is not currently on the horizon.

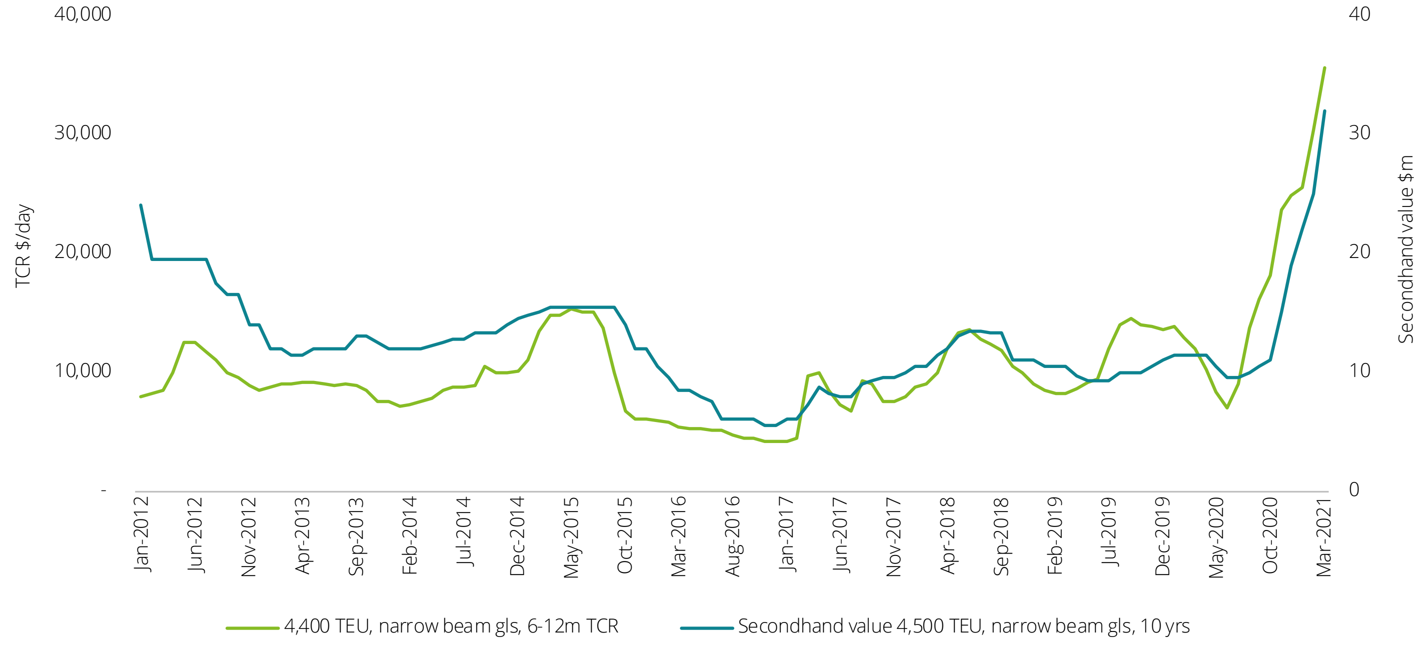
Spotlight – Container vessels

The volume of seaborne trade decreased significantly in the first half of 2020 on the back of disruptions to the world economy, consumer activity and supply chains as a consequence of COVID-19.

Since then, growth in exports and a shortage of containers for shipments out of China accelerated a recovery in the container market to levels not seen for several years. Although the sustainability of this trend is in question, the market expects some of it to be sustained, as evidenced by an increase in the average length of charter contracts. This is also supported by the increase in second-hand values over recent months.

Whereas the current market environment should allow for compliance with debt servicing obligations, or even some catch-up on late payments, lenders are not benefitting directly from the upturn in second-hand values, due to a lack of default triggers. Loan sales may therefore be an option to participate in the market upturn in order to recover outstanding debt and unwind recorded provisions.

Container: Time Charter and Secondhand Value



Source: Clarksons

Spotlight – Offshore

The offshore market has been in distress for several years. A recent glimmer of hope died when surging oil production coincided with plummeting oil demand as a result of the pandemic. Oil companies have since slashed capex, and spending is expected to remain low in the near term as a result of the ongoing uncertainty.

The oil price is projected to recover slowly, with expectations that it will approach 2019 levels by 2022, although this is still below the break-even price for several exploration platforms. This is unlikely to lead to a marked improvement in utilisation of the offshore fleet in the near to medium term. Loan-to-value ratios for these loans are therefore not expected to improve and market values will depreciate further from age.

Capital Expenditure Supermajors ($bn) vs Oil Price

Capex in $bn: 160, 140, 120, 100, 80, 60, 40, 20, -

Right axis: 80, 70, 60, 50, 40, 30, 20, 10, -

2015 2016 2017 2018 2019 2020 2021 2022

Oil & Gas Capex — Brent price

Average break-even price
$/bbl

- Arctic: 70-80
- Oilsands: 70
- NA Shale 60-70
- Ultradeppwater: 55-60
- Deepwater: 50-55
- Onshore RoW: 50
- Offshore Shelf: 40-45
- Onshore ME: 25-30

Source: Statista, Company websites, eia.gov

Shipping deals since 2019

Portfolio name	Type	Country	Seller	Completed	Buyer	Size
Project Big Ben	NPL	Germany	Nord/LB	19H1	Cerberus	€2.6bn
Project F.I.Nav	UTP	Italy	Intesa Sanpaolo, UniCredit	19H1	Pillarstone	€0.3bn
Confidential	UTP	Italy	Banco BPM, UBI Banca, Banca IFIS	19H1	DeA Capital	€0.2bn
Project Nemo	NPL	Greece	Piraeus Bank	19H1	Davidson Kempner	€0.5bn
Project Leo	NPL	Greece	National Bank of Greece	19H2	Cross Ocean	€0.3bn
Project Nassau	PL	Germany	Cerberus	19H2	Cross Ocean, Fortress	€0.9bn
Project Wave I	Residual Claims	Germany	Cerberus	20H1	LCM Partners	€0.3bn
Project Wave II	Residual Claims	Germany	Cerberus	20H2	Confidential	n/a

Aviation

Overview of the current crisis

The civil aerospace industry is facing a crisis of an unprecedented magnitude. It has been severe and unexpected and is capable of inflicting long-term and sustained damage to the sector.

The lockdowns announced by governments across the world in March 2020 brought the demand for global travel to a shuddering halt, reducing flying hours by 50% in March alone. Any optimism with respect to a quick recovery for the industry was subsequently dampened by second and third waves of the pandemic and further national lockdowns in major European countries. In general, international and domestic travel is still widely affected, not only in Europe but everywhere, which has significantly reduced the number and frequency of routes operating.

Overall, IATA has forecast that revenue passenger kilometres (RPKs) would fall by 68% over the course of 2020 and does not see sector profitability returning until at least 2022. This has impacted industry participants across the supply chain, including airlines, lessors, aircraft and engine Original Equipment Manufacturers (OEMs) and ground handling providers, amongst others.

Airlines collectively have been burning cash at a rate of about $13bn per month. IATA believes that in 2021, carriers will continue collectively to burn cash at a rate of $5bn-$6bn per month, even if COVID-19 vaccines are successfully rolled out during the year. Based on 2020 half-year reports and the levels of cash burn at the time, airlines on average had enough funding to last just 8.5 months from June 2020, taking them to February 2021.

As a result, and due to the current market overcapacity, some airlines and lessors have sought to defer or cancel new aircraft deliveries from manufacturers, which have reduced production significantly. Production may fall by as much as 40% in 2020 and 2021 compared to 2018. The cuts will not impact all models equally: with wide body models such as the Boeing 787 and Airbus 330 suffering larger cuts as operators focus on narrow body models.

Sources of liquidity

In order to survive the COVID-19 pandemic, airlines, lessors and OEMs globally have raised capital through government support schemes, as well as debt and equity markets. Balance sheet and liquidity strength are key priorities for surviving the downturn, with stronger companies extending their liquidity whilst weaker companies have limited back-up liquidity sources.

Government support schemes

- In the UK, airlines secured loans of about £1.8bn during summer 2020 through the Treasury and the Bank of England's Covid Corporate Financing Facility (CCFF). This included £600m for Easyjet, £600m for Ryanair, £300m for IAG and £300m for Wizz Air. In addition, thousands of employees were furloughed, with permanent headcount reductions also announced (e.g. by British Airways).
- Across Europe as a whole, total support measures have exceeded €33bn. Air France-KLM received a combined bail-out of about €10bn from the French and Dutch governments through state-backed commercial funding and direct government loans. However, the Dutch government withdrew support as pilots and other unions rejected plans to cut wages for up to five years. Lufthansa received a bailout package of about €9bn from the German government including €3bn in KfW loans. Support for other major European companies have varied in size and type (e.g. TAP, SAS, Finnair, IAG–Iberia etc).
- In the US, $25bn in Treasury loans and $25bn in payroll support through the CARES Act supported the aviation industry. Loans were provided to Alaska Airlines, American Airlines, Frontier Airlines, JetBlue Airways, Hawaiian Airlines, SkyWest Airlines, and United Airlines. In March 2021, a further $14bn was provided to airlines through the Payroll Support Program.

Lenders, lessors and capital markets

Alongside government support schemes, commercial lenders and aircraft lessors remain an important source of liquidity for airlines.

Over 100 sale and leasebacks were completed in 2020 including transactions by Delta Air Lines, United Airlines, Southwest Airlines and JetBlue in North America; Easyjet and TUI in Europe; and China Airlines, Cathay Pacific and Qantas in the Asia Pacific region. Bank of China was particularly active, closing sale and leaseback transactions relating to over 60 aircraft. The sale and leaseback transactions made up a considerably larger share of the total aircraft trade activity in 2020.

Airlines have been particularly active in the capital markets, in search of liquidity. Airlines have looked beyond aircraft to alternative sources of collateral to raise capital. In July, American Airlines secured $1.2bn of senior notes with Goldman Sachs through a first lien on the 'American Airlines' trademark and 'aa.com' domain and a second lien on certain take-off and landing slots at US airports. Delta and United undertook landmark transactions raising a combined $15bn using loyalty programmes as security. In March 2021 American Airlines announced that it would launch the biggest debt deal in the industry's history with a $10bn bond and loan offering backed by its frequent-flyer programme. The order book was four-and-a-half times subscribed for the total $10bn deal, with $30bn of orders for the bond portion.

Beyond airlines, Rolls-Royce has put together a £5bn recapitalisation plan to see it through the COVID-19 crisis which includes about £1bn of new loan commitments. Boeing drew down its $13.8bn loan facility in full alongside a mammoth $25bn bond issuance. Airbus also expanded its credit facility by €15bn earlier in 2020, whilst GE entered a $15bn credit agreement in April 2020.

Across airlines and OEMs, it remains to be seen whether further capital will be required as government support is withdrawn. Another round of capital raising is likely.

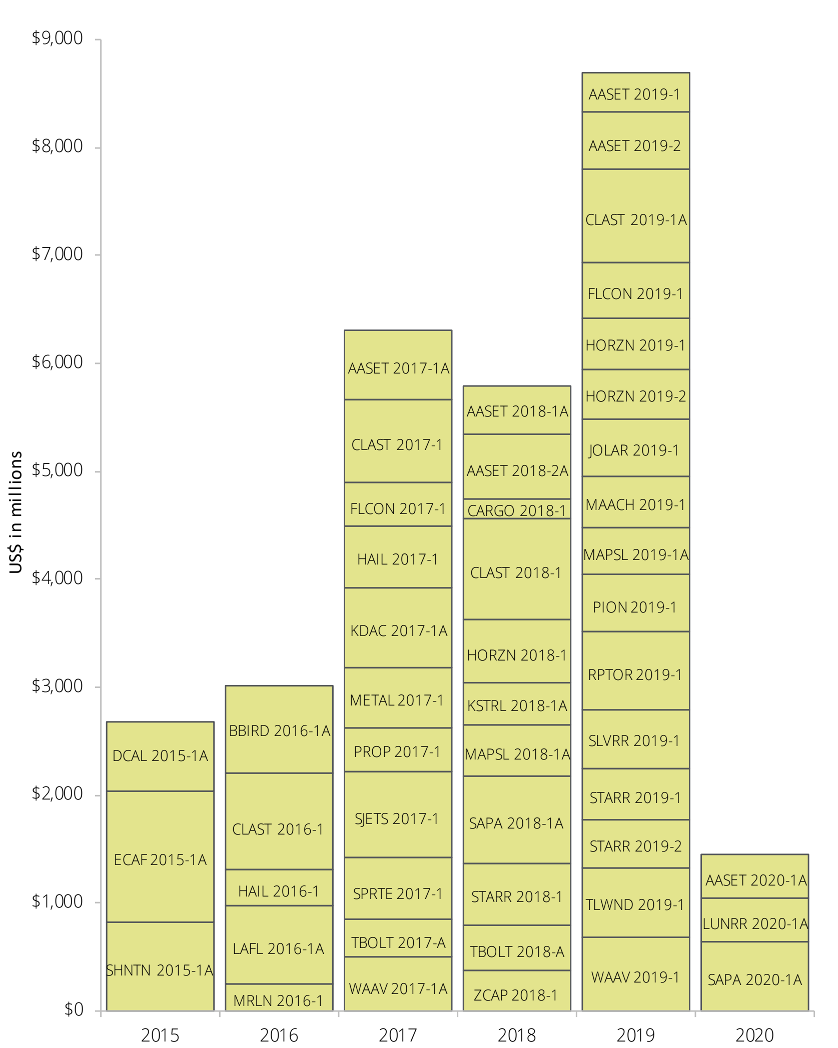
ABS market:

The commercial aircraft ABS market was slammed shut after Q1 2020, with only three deals completed before March 2020, covering 101 aircraft (AASET 2020-1, SAPA 2020-1, LUNAR 2020-1).

Current Outstanding ABS Debt by Servicer

Source: The current state of the Aircraft ABS market and the impact of the COVID-19 crisis, IBA & Split Rock Aviation, April 2020

Transaction by Year and Debt Amount ($mn)



Source: The current state of the Aircraft ABS market and the impact of the COVID-19 crisis, IBA & Split Rock Aviation, April 2020

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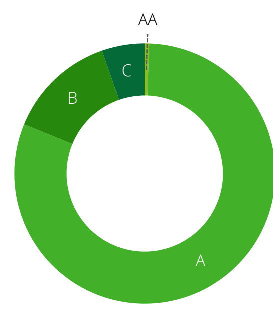
Current Outstanding by Tranche



Tranche	Typical Rating at Issuance	Amount Outstanding
AA	AA	$121
A	A	$17,233
B	BBB	$2,881
C	BB	$1,143
Total		**$21,378**

Source: The current state of the Aircraft ABS market and the impact of the COVID-19 crisis, IBA & Split Rock Aviation, April 2020

Prior to the pandemic, notes were generally priced in the following ranges:

Rating at issuance	Average coupon
AA	2.5%-3.0%
A	4.0%
BBB	5.0%-6.0%
BB	6.5%-7.5%

Source: The current state of the Aircraft ABS market and the impact of the COVID-19 crisis, IBA & Split Rock Aviation, April 2020

However, there has been unprecedented pressure on credit ratings with all agencies taking significant downgrade action in relation to outstanding ABS, as the pandemic continues to impact asset performance negatively. Key credit factors driving ratings actions include:

- Deteriorating airline credit and related ratings despite government support/aid received by most airlines globally. This is due to factors such as ongoing airline lessee bankruptcies and lease deferrals, as well as returned aircraft from lease maturities and/or defaults being parked, stored, and/or retired
- Declining aircraft values and the impact on loan-to-value ratios (LTVs)
- Updated asset assumptions/stresses across all transactions driven by rapidly evolving sector events, and the impact on ABS cash flow and structural features.

There has been talk of lessors beginning a new wave of ABS deals in order to find some stable financing once government schemes dry up. However, if this is the case, we expect that there will be a material impact on pricing, with issuances rated several notches below pre-pandemic levels, resulting in a higher required investor return.

Deferrals and restructuring activity

There has been an increase in lease defaults as well as lessors agreements for rent deferrals. This has affected the ability of lessors to service their debt and improve their credit risk profile.

Lease-end events are expected to increase due to a rise in defaults and terminations. We have observed sponsors stepping in to cover principal and interest repayments over the short-term (6-12 months). As a result, covenant waivers were granted to amend or waive breaches of equity cure rights, as well as DSCR and LTV breaches. The key question is: how long will this continue?

As well as ABS issuances, rating agencies have also taken downgrade actions in relation to airlines and lessors. Liquidity strength is a key priority in the assessment of creditworthiness.

Lenders and lessors have already been impacted through a spate of bankruptcy proceedings and financial restructurings. For example in July 2020, a restructuring agreement for Nordic Aviation Capital was approved by the High Court in Ireland. Under the scheme, interest was capitalised for six months and repayment of the principal deferred for 12 months, with a corresponding 12-month extension of the maturity date for the facility.

This followed the solvent recapitalisation of Virgin Atlantic, which included about £170m of secured financing by Davidson Kempner and the sale of Virgin Australia to Bain Capital. Significant distress and limited government support has led to several Latin American airlines to file for Chapter 11, including Avianca, Azul, LATAM Airlines and Aeromexico. As support schemes tail off, we expect structural changes and consolidation in the sector to continue.

Deleveraging plans and opportunities

Industry sector stress has resulted in a significant increase in Stage 2 and Stage 3 exposures. Through Q3 2020 and Q4 2020 banks have reviewed their portfolios and assessed their strategic options. We expect the process of deleveraging to accelerate from the end of 2021 and through 2022 as banks manage their credit risk and capital requirements, with prospective sellers broadly falling in two categories:

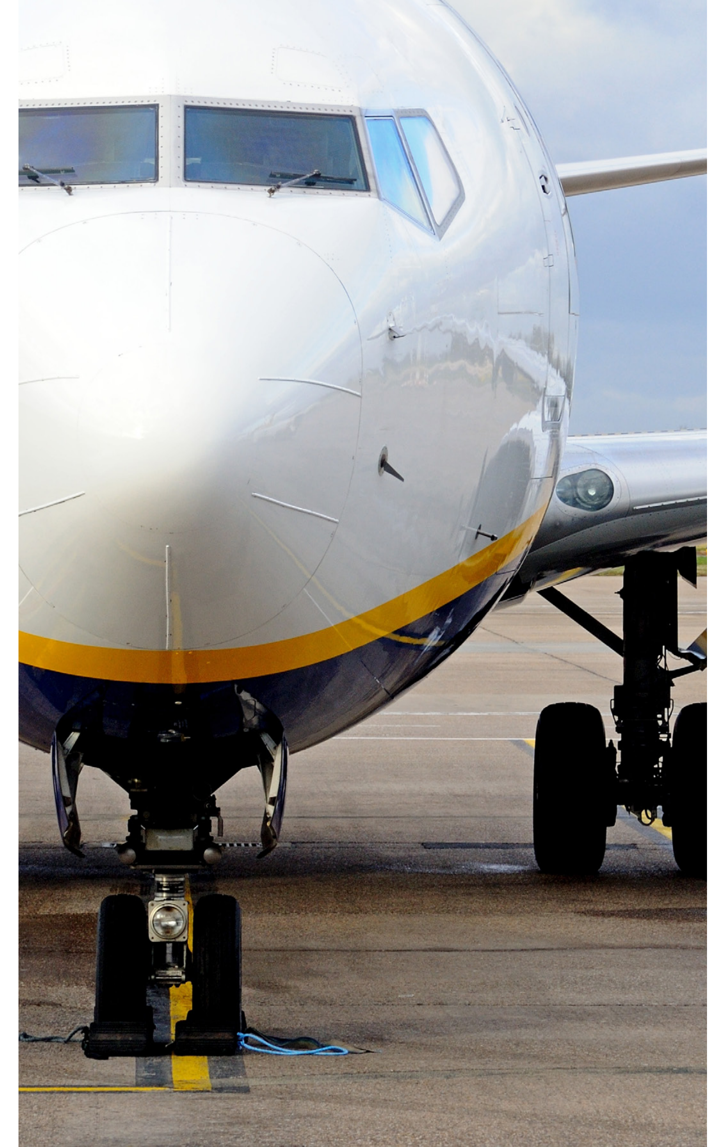
- Aviation as a core asset class, with disposal of non-performing and stressed exposures to manage portfolio credit risk and capital
- Aviation as a non-core asset class, with sellers looking to exit the business.

On the buy side, the crisis presents opportunities for special situation investors in both debt and equity. Investors have teamed up with leasing companies to provide new funding options and inject liquidity into the market (e.g. PIMCO and GECAS). Investors have also been looking at investment opportunities with airlines (e.g. Virgin Australia and Virgin Atlantic). In relation to loan portfolio trades, we expect that special situation investors will show some interest in acquisitions, although there is likely to be a period of price discovery as bid-ask spreads narrow. We expect that specialist lenders with higher yield requirements than traditional lenders will also be interested in portfolio trades for performing/sub-performing tranches.

Whilst it is still early days, this asset class is likely to be highly active over the coming years.

Vaccine rollouts and aviation recovery

To date, the speed of rollout of vaccine programmes has varied considerably across regions and countries. Government policy and the demand for air travel remain highly uncertain in the short-to-medium term. The pandemic will have a lasting impact on the aviation industry, with market participants anticipating a substantial recovery between 2023 and 2025. Moreover, COVID-19 has demonstrated the drastic impact that a pandemic (or other severe shock) can inflict on this industry, and the increased risk of this asset class.



United Kingdom

The UK has been hit particularly hard by the coronavirus pandemic, exacting a heavy toll on lives and livelihoods. During a resurgence of the virus over the winter months approximately 1 in 5 people contracted the virus, 1 in 150 were hospitalised, and 1 in 550 died - the fourth highest mortality rate in the world. Lockdowns were imposed to control the spread of the virus, and as a result GDP contracted by 9.9% in 2020, the largest economic shock for the country in over 300 years (source: OBR). Despite a stronger than anticipated rebound during the second half of 2020, GDP is expected to fall again in the first quarter of 2021 due to the ongoing lockdown and temporary disruption to EU-UK trade resulting from Brexit.

The UK's vaccination programme has been among the most rapid in the world, giving hope to a sustainable recovery as the government eases public health restrictions. The UK economy is expected to recover strongly to pre Covid levels over the remainder of this year as restrictions are loosened, and as concerns around health and general uncertainty begin to fade. The Bank of England has forecast that the UK economy could reach pre-pandemic levels as early as the end of 2021, with the economy expected to expand by 7.25% through 2021 (Bank of England).

The impact of the pandemic was hardest on SMEs in retail, hospitality and leisure. In the retail sector, already suffering before the outbreak of the pandemic, there was a considerable decline in sales volumes in 2020, with clothing sector brick-and-mortar stores registering a 25% year-on-year fall (source: ONS). Similarly, the hospitality sector suffered a 90% fall in output during the first lockdown (source: OBR). Despite a slight recovery in the second half of 2020, activity in hospitality remains considerably below pre-pandemic levels due to further lockdowns. Several high-profile retail businesses have entered administration, including Debenhams, Arcadia Group and DW Sports.

For households, the impact on employment and earnings has been uneven. Some have experienced material falls in income and increased levels of debt, whilst others, with limited savings opportunities, have saved considerable amounts.

Government measures

The UK government response to the crisis included a number of measures to support the economy, including the Coronavirus Job Retention Scheme (furlough), the Coronavirus Business Interruption Support Loan Scheme (CBILS), the Bounce Back Loans Scheme (BBLS) as well as various sanctioned moratoria. The government has also provided dedicated schemes for the retail, hospitality and leisure sectors, such as the Retail, Hospitality and Leisure Grant Fund (RHLGF). A business rate holiday for 2020-21 is estimated to provide £10.8bn in additional relief with more than 374,000 businesses eligible (source: House of Commons Library).

As of February 2021, a total of £53.8bn has been disbursed under the Coronavirus Job Retention Scheme, with 11.2 million jobs furloughed and 1.3 million employers having used the scheme. £16.6bn was disbursed under the Self-Employment Income Support Scheme (SEISS), with 7.2 million claims. Business loan schemes disbursed a total of £74.1bn, particularly in BBLS (62%) and CBILS (30%). Sectors with the highest loan uptake as a proportion of their business population were retail, hotels and restaurants, real estate, and manufacturing.

The grants and guaranteed loans to businesses across the spectrum have helped to keep viable firms on life support. However, these interventions have to some extent delayed rather than avoided the business insolvencies and higher unemployment that will inevitably accompany the withdrawal of government support and debt moratoria. These businesses are now saddled with higher debts than before and it is estimated that up to 40% of the BBLS and CBILS could potentially default (source: OBS).

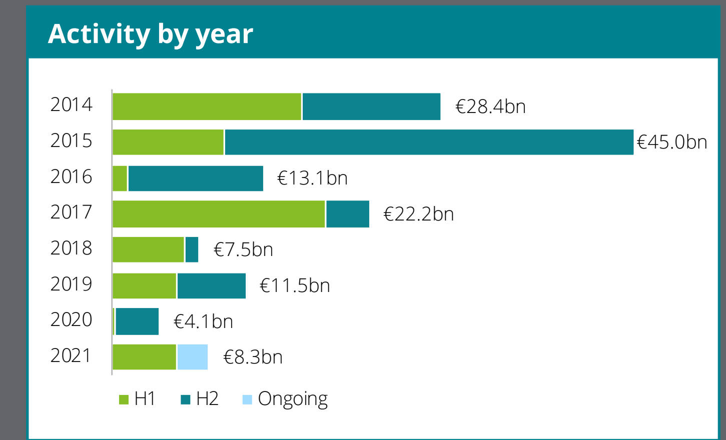
Portfolio market

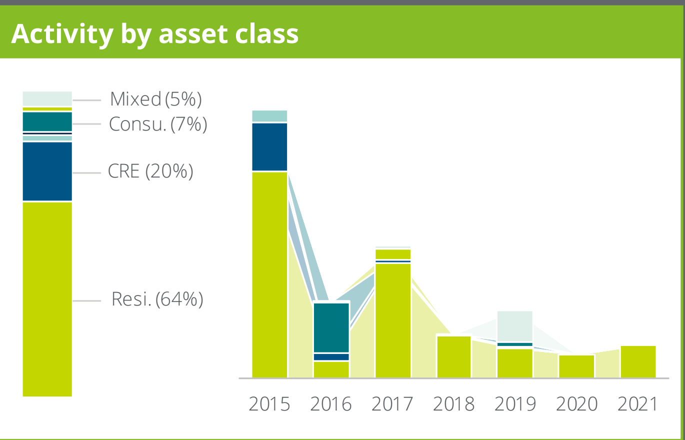
Following the initial outbreak of the pandemic, very few loan portfolio transactions were launched globally, and the UK was no exception. The pre-pandemic slowdown in UK deal activity was exacerbated by some major deals put on hold. This included UK Asset Resolution's (UKAR) Project James - the final £5bn tranche of the Bradford & Bingley and NRAM's assets. After being postponed in March 2020 due to the pandemic, the process was resumed in the autumn with a sale agreed in early 2021 to Citi and Davidson Kempner, marking the end of the 11-year UK bad bank process. Towards the end of 2020, Metro Bank completed the sale of one-third of its residential mortgage book to NatWest, consisting of about £3.3bn (€3.7bn) of performing loans.

Further UK transactions are expected. Sainsbury's Bank had been in the process of selling about £1.9bn (€2.1bn) of performing mortgages to Nationwide, but the transaction was cancelled due to the pandemic. It is now expected to explore options to sell its entire banking arm.

NatWest is proceeding with the sale of £0.5bn (€0.6bn) of non-performing commercial real estate secured loans to test the post-pandemic portfolio market environment. With additional complications due to Brexit, banks are also expected to accelerate plans to wind down and sell off non-core assets, with Allied Irish Bank and the Bank of Ireland already signalling their intention to exit the UK market.

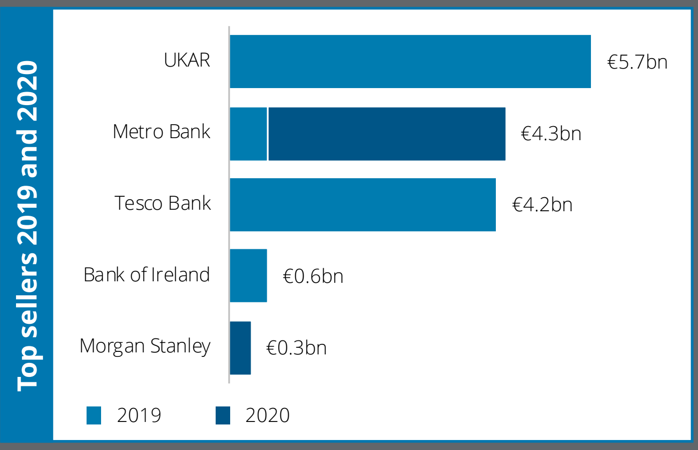
Banks will continue to assess their post-Brexit and post-pandemic requirements as government measures are removed. We expect to see several non-core disposals over the course of 2021 and into 2022, as banks accelerate plans to wind down and deleverage non-core assets, whether through equity sales or pure asset trades.

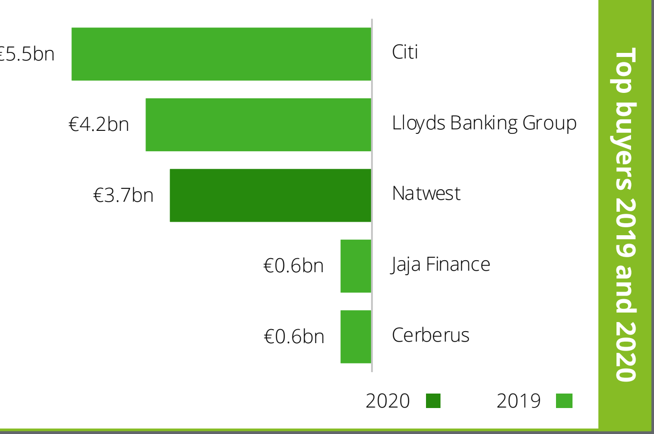




Completed transactions in 2019

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Residential	NPL	Metro Bank	Cerberus	589
Confidential	Residential	PL	Tesco Bank	Lloyds Banking Group	4,181
Project Chester	Mixed	PL	UKAR	Citi	5,548
Project Falcon	CRE	NPL	Lone Star	Palm Capital	200
Project Santiago	Residential	PL	Raphael Mortgages	Arbuthnot	303
Project Wylam	Corporate	PL	UKAR	Arrow Global / Davidson Kempner	119
UK credit card business	Consumer	PL	Bank of Ireland	Jaja Finance	599





Completed transactions in 2020

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Residential	PL	Metro Bank	NatWest	3,729
Project Abacus	Residential	PL	Morgan Stanley	Confidential	337

Completed transactions in 2021 and ongoing

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Residential	PL	Arbuthnot	One savings bank	61
Project Jupiter	Residential	PL	UKAR	Citi / Davidson Kempner	5,556
Confidential	Residential	PL	Sainsbury's Bank	-	2,111
Project Mercatus	CRE	NPL	NatWest	-	596

Ireland

After years of strong growth following the GFC, Ireland was hit particularly hard by the pandemic and multiple lockdowns. Despite the pandemic, GDP grew 3.4% in 2020 (CSO). This was driven by the export sector, where many international companies use Ireland as a gateway to the European market. The domestic economy struggled, however. Modified Domestic Demand saw the economy shrink 5.5% in 2020 with household consumption falling 9%.

The pandemic had an uneven impact, with sectors focused on the domestic market worst hit. Distribution, transport, hotels and restaurants registered a decrease of 16.7% in revenues while professional, administrative and support services declined by 15.5% and construction by 12.7%. In contrast, the more globalised sectors performed well with industry (excluding construction) growing by 15.2% and information and technology by 14.3% (CSO).

Various financial support measures were introduced in Ireland at the onset of the pandemic, including wage subsidies, unemployment payments, business grants/loans, credit guarantees, tax deferrals and payment moratoria.

Data released by the Central Bank of Ireland indicate that over half a million private sector employees were reliant on some form of government financial support at the end of August 2020, and also that about 10% of Irish mortgage holders took advantage of COVID-19 payment holidays. Although more than half of these borrowers have since returned to making full payments, the extent of any repayment problems will not be clear until sometime after other borrowers have resumed their normal repayment schedules.

At the start of the pandemic, 8% of all principal dwelling house (PDH) mortgage accounts in Ireland were in arrears to some extent. The level of arrears has fallen considerably in the years since the GFC, thanks to a strengthening economy and lenders seeking better resolutions, but arrears remain elevated, and long-term arrears represent a high proportion of those under financial stress. Despite this decline, the remaining arrears cases are concentrated increasingly in the longer-term arrears. A high number of PDH mortgages remain in long-term arrears some ten years after the GFC.

The Irish residential mortgage market had experienced sustained growth prior to the pandemic, with confidence returning to the housing market after the GFC. The housing market has continued to defy expectations of a heavy decline during the pandemic: ongoing supply shortages were compounded as construction came to a standstill during the spring 2020 lockdown. As a result, the Society of Chartered Surveyors Ireland (SCSI) has estimated that prices are set to rise by an average of 4% in 2021. Residential property values, including houses and apartments, fell by just 0.4% (CSO) nationally in the year to October 2020.

Loan provisions by Ireland's main banks increased significantly in FY 2020, rising to €2.7bn from just €241m in the previous year, as banks prepared for the credit stress caused by the pandemic. The banks made heavy provisions as the pandemic took effect in the first half of the year, reducing their charges in the second half of the year despite returning to lockdowns as the second wave of the virus took effect.

Portfolio market

2019 was a busy year for the Irish portfolio loan sales market with €7.7bn traded, but the market was frozen in 2020 as the pandemic brought a number of processes to a halt. Just one sale eventually closed in 2020, with Citi securitising a €1.4bn performing BTL book from Permanent TSB, with PIMCO as the main investor.

AIB paused Projects Oak and Iris as the pandemic unfolded, resuming them only during the final quarter of the year. Project Iris was subsequently sold in first half 2021 to Home Solution Initiative group, a consortium that includes LCM Partners and provides ethical borrower-friendly solutions. Project Oak was sold to a consortium of Mars Capital and Apollo. AIB is also planning to exit

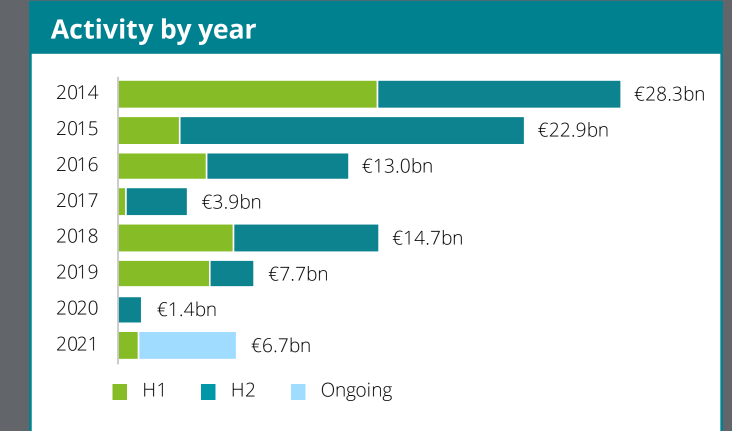
the UK SME market and is in the process of selling its €1.2bn UK SME loan book along with associated deposits.

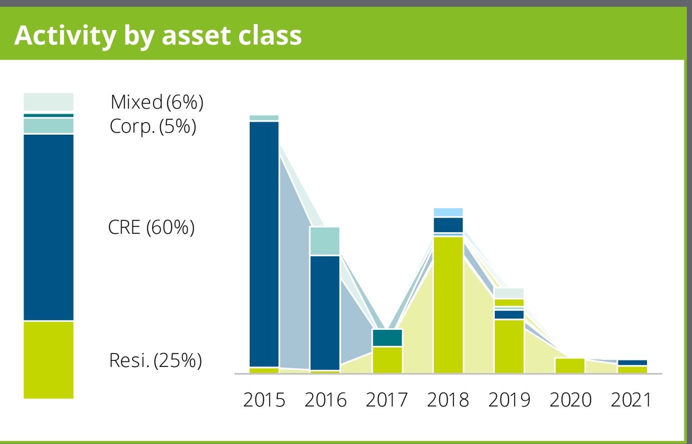
NatWest has recently announced its intention to exit the Irish market gradually, after a strategic review of Ulster Bank. With Ulster having a loan book of more than €20bn in Ireland as well as €22bn in deposits, most of the attention will be focussed around its carve-out and sale to the other Irish banks. Talks are ongoing with AIB to sell €4bn of performing commercial loans, while discussions continue with PTSB and other banks for other parts of its business.

Other disposals of loan portfolios by Irish banks are expected to remain subdued as:

- Incumbent banks focus on acquiring Ulster Bank assets
- Government support and moratoria remain in place until July 2021
- Banks continue to monitor levels of distress within their own portfolios until the full impact of the pandemic and associated support measures come to an end
- Impact of increased borrower credit risk on securitised mortgages, which will likely squeeze RPL RMBS the most

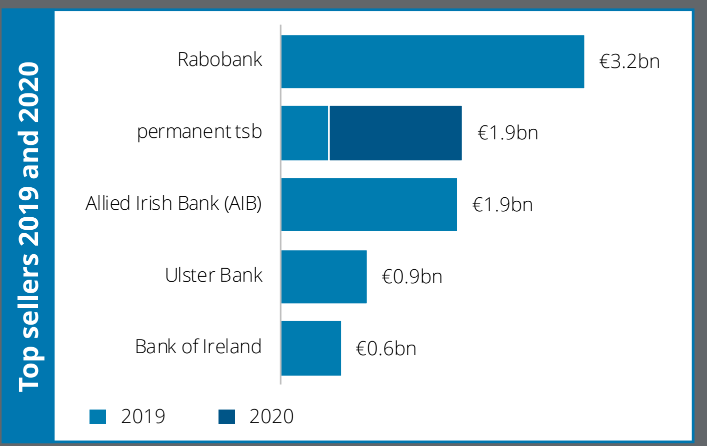
However, we may see secondary sales of NPLs come through with the exit of several funds holding large stock of NPLs from previous transactions. A number of such transactions were planned for 2020 but put on hold due to the pandemic. These may attract significant interest from funds in the short-medium term, as they look to deploy their 'dry powder' in a well-understood market with strong servicing solutions.

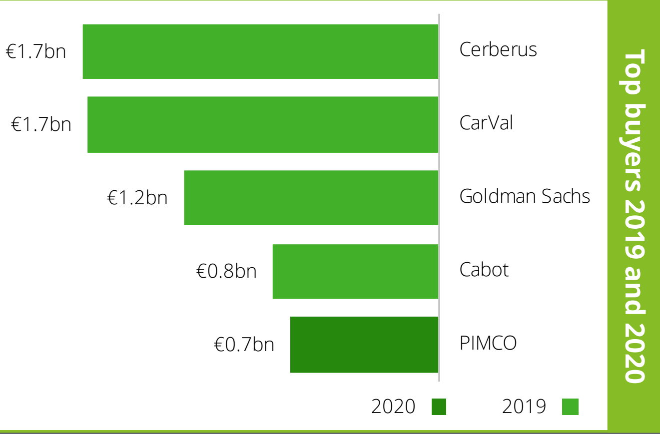




Completed transactions in 2019

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Corporate	PL	KBC	Bank of Ireland	260
Mulcair Securities	Residential	NPL	Bank of Ireland	[securitisation]	377
Project Alder	CRE	NPL	Allied Irish Bank (AIB)	Everyday / Cerberus	850
Project Beech	Mixed	NPL	Allied Irish Bank (AIB)	Cerberus	1,000
Project Deenish	Residential	NPL	Ulster Bank	Pepper / CarVal	900
Project Glas II	Residential	NPL	Permanent tsb	Lone Star	506
Project Omni (residential)	Residential	NPL	Rabobank	Goldman Sachs / CarVal	2,400
Project Omni (unsecured)	Unsecured	NPL	Rabobank	Cabot	783
Project Snow 2	Residential	NPL	Bank of Ireland	Cerberus	250
Shamrock Residential	Residential	PL	Lone Star	Morgan Stanley	336





Completed transactions in 2020

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Glenbeigh 2	Residential	PL	Permanent TSB	Citi / PIMCO	1,400

Completed transactions in 2021 and ongoing

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Iris	Residential	NPL	Allied Irish Bank (AIB)	Everyday Finance / LCM Partners	180
Project Oak	Residential	NPL	Allied Irish Bank (AIB)	Mars Capital / Apollo	600
Project Toucan	CRE	NPL	Goldman Sachs	Balbec Capital	450
Confidential	Mixed	PL	Ulster Bank	-	4,000
Project Robin	CRE	PL	Goldman Sachs	-	160
Project Wren	CRE	PL	Goldman Sachs / CarVal	-	100
Confidential	Corporate	PL	Allied Irish Bank (AIB)	-	1,200

France

The Banque de France estimates the French economy shrank by 8.2% in 2020 and is expected to rebound during the following two years. Nevertheless, a return to the GDP level reached in 2019 is not expected before the end of 2022. The unemployment rate was falling before the crisis and the full impact of the pandemic is not yet known, given the government's partial unemployment scheme, the cost of which was estimated at €27bn as at December 2020.

The French government responded to the crisis with fiscal measures worth around €140bn, not counting PGE government guaranteed loans to the private sector. France may also draw on the various COVID stimulus packages announced by the EU.

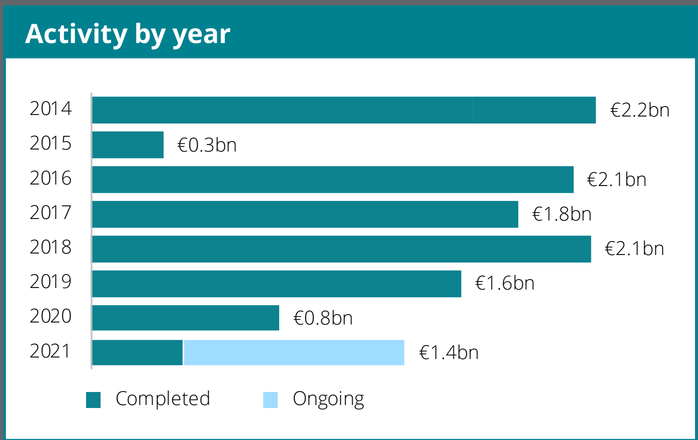
Whilst the French stimulus package is expected to result in higher government indebtedness – with the debt to GDP ratio set to reach 115% – the country's banks entered the current crisis in much better shape than at the outset of the previous two crises – the GFC and the sovereign debt crisis. Banks' capital ratios are solid and the NPL ratio, 2.2% at the end of 2020, is relatively low.

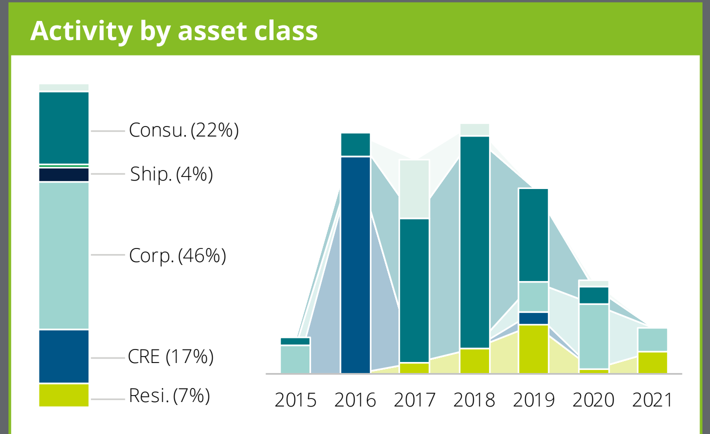
The low NPL ratio could be a consequence of the considerable expansion in lending in France over the past few years (increasing the denominator in the ratio). Fuelled by low interest rates, lending in the country has expanded by 37% from 2010 to 2020. Mortgage lending for home purchases, for example, has grown at an annual rate of almost 4% in the same period, propelled by a buoyant residential market.

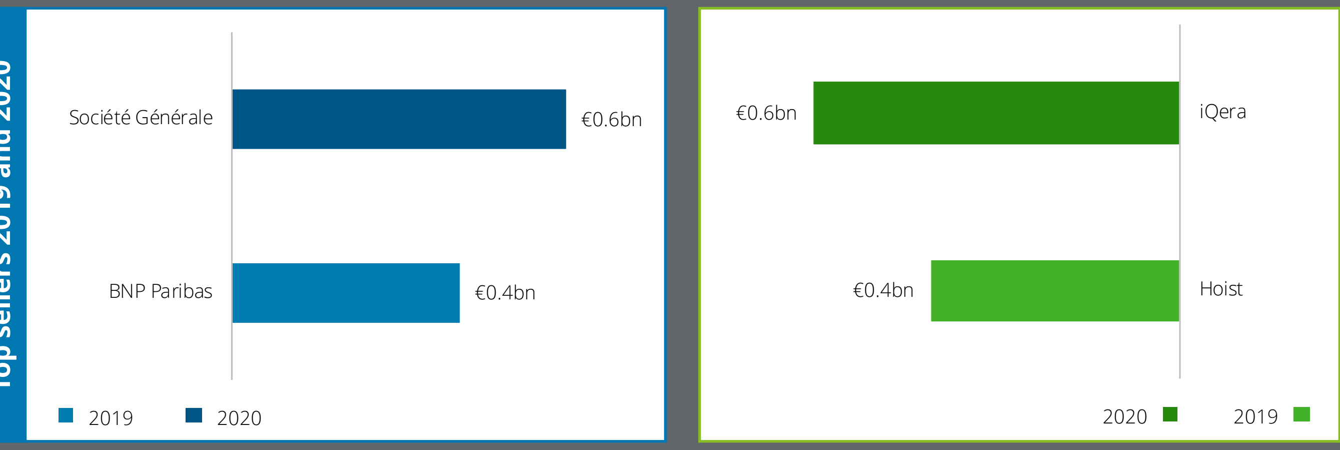
So although the NPL ratio may be comparatively low, the total stock of domestic NPLs in France stood at around €70bn at the end of 2020, and the stock owned by French banks – which includes exposures abroad – stood at €119.3 at December 2020. This amount of bad debt is very large, and places France among the top countries by this measure.

Historically France has had relatively few NPL transactions when compared to other countries in Europe, with French banks choosing primarily to work out NPLs themselves. Moreover, many of the portfolios sold in recent years were traded to servicers/investors with established operations in the country, as opposed to international private equity buyers that make up much of the market in other European countries.

Some of these dynamics started to change even prior to the beginning of the pandemic. Larger deals and new sellers are coming to the market, mainly for secured debt, and there is greater transparency in the transaction pipeline, although it remains difficult to predict long-term trends. The servicing landscape is increasingly professionalised with incumbents consolidating the market and new players seeking to expand into France. International distressed credit investors, who are active in other European markets, have begun to enter the French one. It may be too early to confirm a dramatic change, but given the market dynamic and impact of the health crisis, we are bullish about transaction activity in the medium term.







Completed transactions in 2019

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Residential	NPL	Confidential	Confidential	50
Confidential	Consumer	NPL	Confidential	Confidential	150
Confidential	Consumer	Mixed	Confidential	Confidential	350
Project Agate	Residential	NPL	BNP Paribas	Hoist	375
Confidential	CRE	NPL	Confidential	Confidential	115
Confidential	Consumer	NPL	Confidential	Confidential	300
Project Soccer	Corporate	NPL	Confidential	Confidential	250

Completed transactions in 2020

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Gaya	Corporate	NPL	Société Générale	iQera	550
Confidential	Consumer	NPL	Confidential	Confidential	150
Confidential	Residential	NPL	Confidential	Confidential	50
Confidential	Mixed	NPL	Confidential	Confidential	60

Completed transactions in 2021 and ongoing

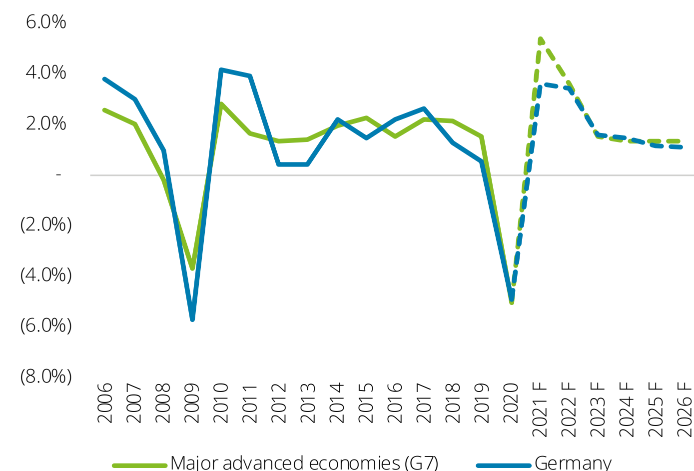
Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project House	Residential	NPL	Crédit Logement	Confidential	160
Project Orsay	Corporate	NPL	Société Générale	iQera	200
Confidential	Residential	NPL	Confidential	Confidential	40
Confidential	Consumer	NPL	Confidential	-	800
Project Ariane	Residential	NPL	Confidential	-	150

*Top buyers and sellers only for transactions where this information has been publically disclosed.

Germany

The German economy was already showing signs of slowdown prior to the outbreak of COVID-19, which led to a significant contraction in GDP. Although a strong recovery is projected in 2021, economic growth is heavily dependent on the speed of vaccination rollouts and the risk from virus mutations.

Real GDP Growth (%)



Source: IMF WEO April 2021

The pandemic has exposed sectoral risks that have accelerated the pace of certain changes in the economy. The retail industry suffered from extended lockdowns, which accelerated the shift to online shopping. The future of work has also come into question with an increase in working from home. This is likely to change the city landscape by lowering demand for office space once current leases expire. A significant increase in the vacancy rate may have a negative impact on debt servicing capacity and act as a as catalyst for asset quality deterioration.

Debt moratoria led to lower insolvency applications in 2020 than in 2019, but government support may have created 'zombie' companies that would not have survived under normal market conditions. Some estimates claim that about 5,000 zombies applied for temporary relief, and this may drive an increase in insolvency applications once government support is withdrawn. Although estimates of the magnitude of the increase may vary, an increase in German NPLs seems inevitable.

The profitability of German banks remains at a very low level. Persistently low interest rates have compressed net margins, which have come under further pressure from high liquidity buffers, and this has led to negative returns. In the past, German banks have trimmed operating costs by restructuring NPL management and work-out departments and making large reductions in headcount.

The expected increase in NPLs, in conjunction with the reduced capacity for management, may affect the NPL recovery ratio and further squeeze the already low profitability margins. In anticipation, some banks have started to add internal and external resources to their NPL management teams. Banks have also begun screening their loan books, which will likely increase the number of portfolio transactions in the near term as well as expand the asset classes coming to market beyond shipping portfolios, which had previously been the main source of transactions.

Insolvency and residual claims portfolios are two areas with overlooked potential. The sale of a residual claim portfolio generates direct cash and extraordinary gains to the bank as the loan is already fully impaired. In recent months, some of these portfolios have started to trade on the German market, and more are expected.

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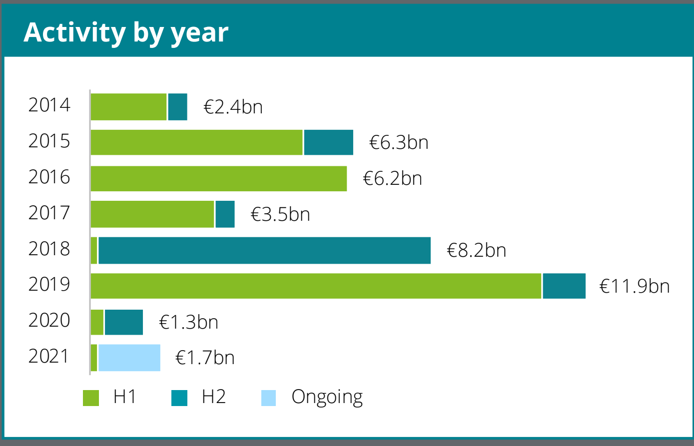
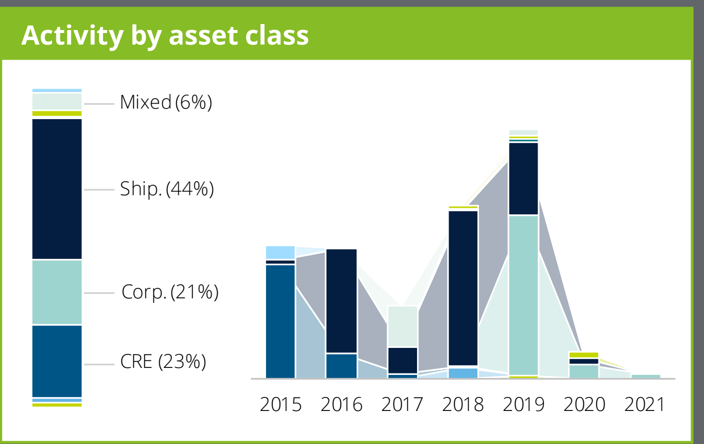
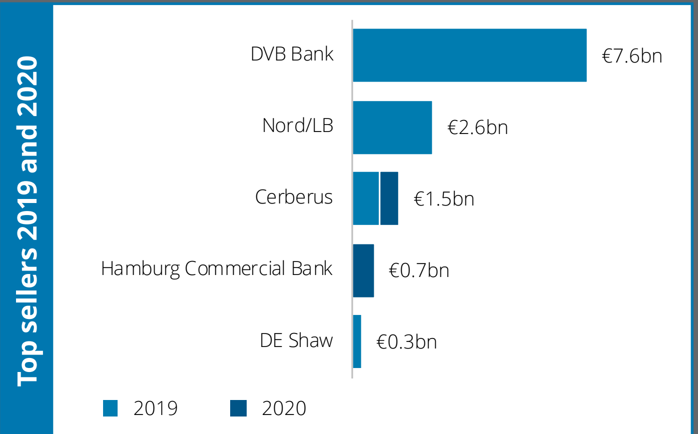
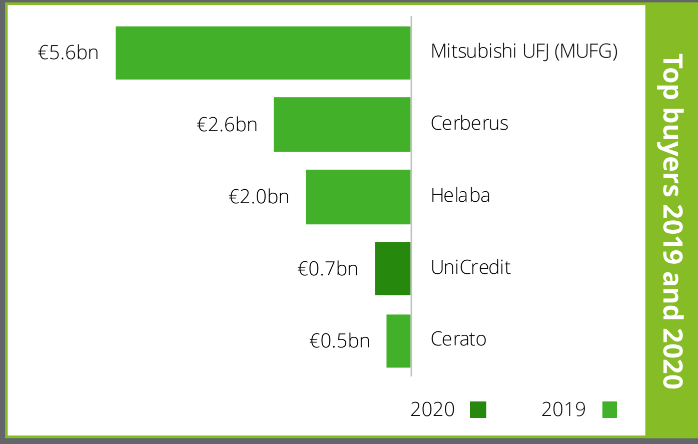








Completed transactions in 2019

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Corporate	PL	DVB Bank	Helaba	2,000
Confidential	Consumer	NPL	DSK Hyp	Cerato	175
Confidential	Unsecured	NPL	Confidential	Axactor	145
Project Big Ben	Shipping	NPL	Nord/LB	Cerberus	2,600
Project Cologne	Mixed	NPL	DE Shaw	Cerato	300
Project Diana	Corporate	PL	DVB Bank	Mitsubishi UFJ (MUFG)	5,600
Project Green	Residential	PL	Erste Abwicklungsanstalt (EAA)	Apollo	133
Project Nassau	Shipping	PL	Cerberus	Cross Ocean Partners / Fortress	900

Completed transactions in 2020

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Lyra	Corporate	PL	Hamburg Commercial Bank	UniCredit	700
Project Wave I	Shipping	NPL	Cerberus	LCM Partners	250
Project Nugget	Unsecured	NPL	Cerberus	Confidential	360
Project Wave II	Shipping	NPL	Cerberus	LCM Partners	n/a

Completed transactions in 2021 and ongoing

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Corporate	NPL	DVB Bank	Strategic Value Partners / Entrust	200
Project Omega	CRE	NPL	UniCredit	-	750
Confidential	Shipping	NPL	Confidential	-	550
Confidential	Residential	PL	Confidential	-	200

Italy

The deleveraging strategy implemented by Italian banks since 2015 continued in 2020, with overall NPE stock on banks' balance sheets reduced by more than two-thirds between these two dates (based on the latest available data, €122bn in 2020 vs €340bn in 2015). However, the pace of the decrease slowed markedly in 2020 as a result of lockdown measures and general uncertainty related to the COVID-19 pandemic.

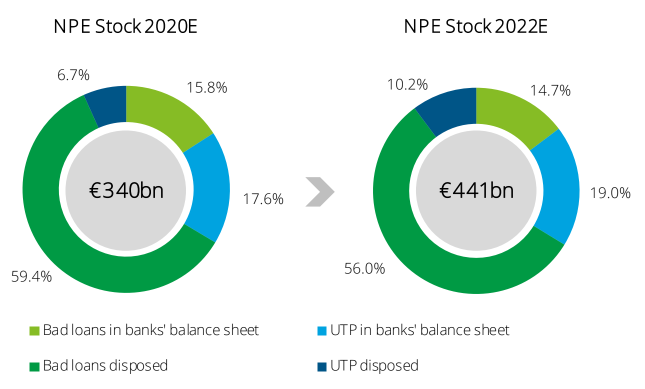
Compared to the 2008 financial crisis, the Italian banking system entered 2020 more resilient and better prepared to face a potential new wave of NPLs. Although Italy's 2020 NPE ratio (around 6%) is well above the EU average of about 2.6%, the gap is significantly smaller than in previous years. The downward trend in Italian NPEs is unlikely to continue as government support due to COVID is withdrawn and the volume of NPEs increases. However, the NPE forecast of 7.8% in 2022 remains far below the 2014 peak of 17.1%.

Moreover, the Italian government acted quickly to implement stimulus and regulatory relief measures to limit the impact of the pandemic on new NPE flows, introducing state guarantees, loan repayment moratoria and other measures aimed at injecting liquidity and preventing an increase in insolvencies.

Nevertheless, once the regulatory relief and other stimulus measures come to an end, the total NPE stock, including disposed NPL, UTP and past-due positions, is expected to increase by around €100bn over the next 18 months, reaching a high of €441bn in 2022. This translates into an estimated NPE ratio of 7.8% in 2022 compared to 17.1% in 2014.

With more than €200bn of NPLs disposed over the past five years and considering the likely new inflows following the pandemic, Italy will remain a large market for third party loan servicing and NPE transactions.

NPE Stock Growth Expectation



Source: Bank of Italy

Portfolio market

The NPE market in Italy saw transactions with a total value of about €44bn in 2020, compared to €51bn in 2019. This includes an increase in UTP transactions with c€9bn traded in 2020 (compared to c€7bn in 2019), justifying the recent growth in private equity funds specialising in UTPs management:

- In December 2020, Banco BPM completed the disposal of a UTPs portfolio with a GBV of more than €960mn to AMCO and Credito Fondiario, two of the main NPEs servicers in Italy. This is one of the biggest transactions involving UTPs in the Italian servicing market.
- In November 2020, Banco MPS concluded a demerger in favour of AMCO of a portfolio of non-performing exposures, among other assets. This consisted of bad debts and UTPs with values of €4.8bn and €3.3bn respectively.

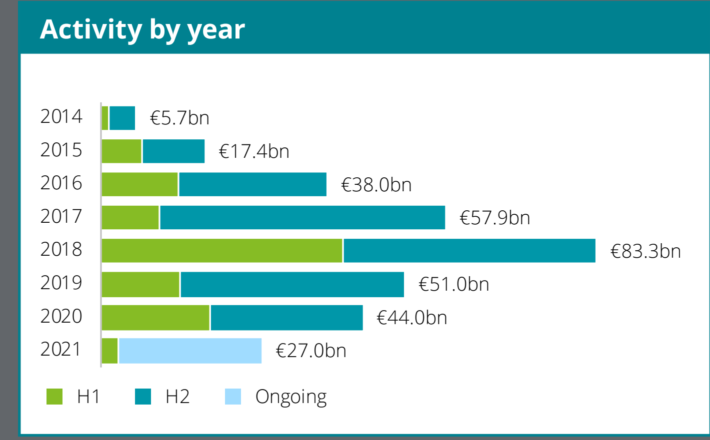
Since its introduction in 2016, GACS (Garanzia sulla Cartolarizzazione delle Sofferenze) has been the cornerstone for development of the NPL securitisations market in Italy, supporting 35 transactions with an overall value of €85bn. In December 2020, the following NPL transactions were assisted by GACS:

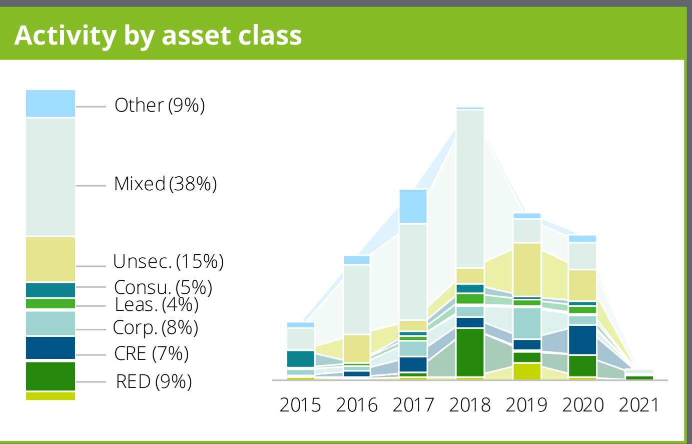
- Intesa Sanpaolo securitised an NPL portfolio with a GBV of €4.3bn, its first NPL transaction involving GACS.
- UBI Banca, part of the Intesa Sanpaolo Group, completed its third NPL disposal backed by these public guarantees. The transaction mostly involved €1.2bn of bad SME loans.
- UniCredit Leasing, part of the UniCredit Group, successfully completed the securitisation of a c€1.6bn real estate portfolio of non-performing leases. This is the first GACS transaction backed by leases receivables and may open the way for others to follow.

However even before the pandemic, the cumulative net collections of several GACS transactions underperformed business plan forecasts, and this situation may only worsen with the likely impact of further lockdown measures on collection activities. This may create a new opportunity for the development of the secondary market.

Finally, long-term partnerships between Italian banks and specialised servicers have in recent years become another important alternative for the implementation of a de-risking strategy:

- In April 2018, Intesa Sanpaolo and Intrum entered a ten-year exclusivity servicing agreement for most of the bank's new NPLs inflows.
- Due to specific characteristics of the management of UTP loans, Intesa Sanpaolo has also reached a long-term agreement with Prelios, leader in UTP management, for the servicing of a portfolio with a nominal value of €6.7bn.
- In 2019 Banco BPM signed a similar strategic partnership with Credito Fondiario and Elliott, under the name Project Ace, paving the way to other potential partnerships in the future.
- AMCO and Prelios Group realised the first multi-originator platform to manage real estate UTP loans, through an agreement with several Italian major banks. In a first phase, the project - named Cuvée – saw the involvement of 50 single-name NPLs with a total value of about €450m.
- Illimity SGR launched a Credit & Corporate Turnaround Fund focusing on the acquisition of UTP exposures from Italian banks in exchange for stakes in the fund.





Completed transactions in 2019

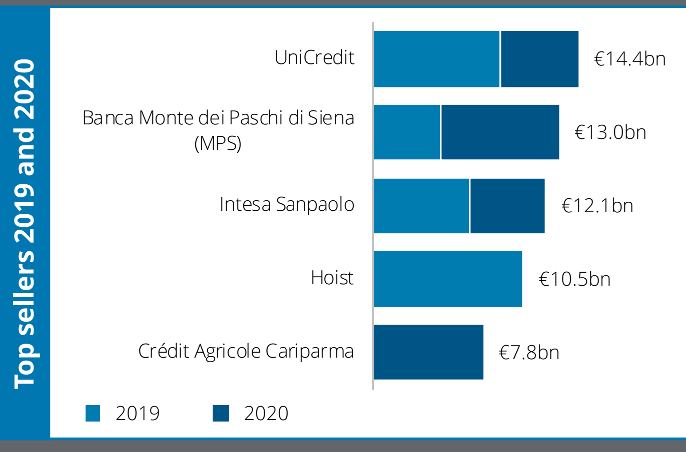
Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Fucino NPL S.r.l.	Other	Mixed	Banca del Fucino	[securitisation]	297
BCC Crediper Consumo	Consumer	NPL	ICCREA Banca	[securitisation]	660
Confidential	Leasing	NPL	UniCredit	Guber Banca / Barclays / Banca IFIS	154
Confidential	Corporate	UTP	Banca Monte dei Paschi di Siena (MPS)	Illimity	450
Confidential	Leasing	NPL	UBI Banca	Credito Fondiario (Fonspa)	740
Confidential	Other	Mixed	Banca del Fucino	Società per la Gestione di Attività (SGA)	314
Confidential	Shipping	UTP	Banco BPM / UBI Banca / Banca IFIS	DeA Capital	193
Confidential	Mixed	UTP	BPER	Unipol	1,000
Confidential	Mixed	NPL	Confidential	Illimity	175
Confidential	CRE	NPL	Banca Mediocredito del Friuli Venezia Giulia	Illimity	40
Confidential	Consumer	NPL	UniCredit	MBCredit Solutions	51
Confidential	Consumer	NPL	UniCredit	MBCredit Solutions	160

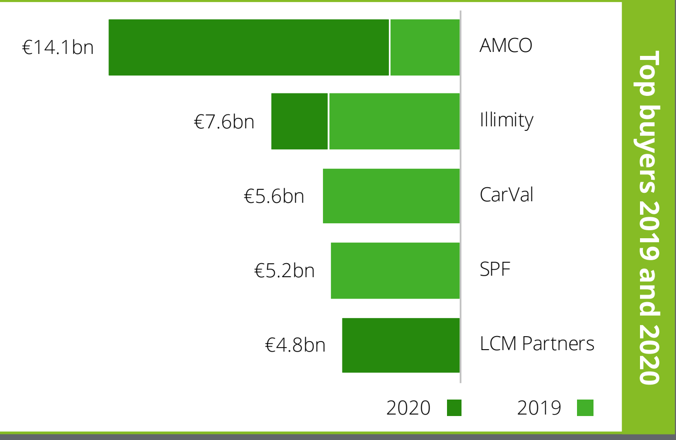
Completed transactions in 2019 - continued

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Consumer	NPL	CentroMarca Banca	B2 Holding	46
Confidential	Unsecured	NPL	Confidential	Guber Banca	328
Confidential	CRE	NPL	Confidential	Guber Banca	24
Confidential	Mixed	NPL	Banca Monte dei Paschi di Siena (MPS)	Illimity	240
Confidential	Leasing	NPL	BNP Paribas	Illimity	80
Confidential	CRE	UTP	Banca Monte dei Paschi di Siena (MPS)	Confidential	202
Confidential	Mixed	NPL	Banca Monte dei Paschi di Siena (MPS)	Confidential	137
Confidential	Other	NPL	Banca Popolare di Sondrio (BPSO)	Prelios	1,500
Confidential	Unsecured	NPL	Banca del Fucino	J-Invest	100
Confidential	Unsecured	NPL	N/A	Banca IFIS	1,531
Etna SPV	Mixed	NPL	Cassa Centrale Banca	Arrow Global	345
Futura 2019 S.r.l.	Mixed	NPL	Consortium of local banks	[securitisation]	1,256
Iberico	REO	NPL	N/A	Bain Capital	400
Iseo SPV	Residential	NPL	UBI Banca	[GACS securitisation]	858
Kerma SPV S.r.l.	Corporate	UTP	Intesa Sanpaolo	Davidson Kempner	2,700
Marathon	Unsecured	NPL	Hoist	CarVal	5,300
Marathon SPV S.r.l.	Unsecured	NPL	Hoist	[securitisation]	5,000
Pinzolo	Unsecured	NPL	Hoist	CarVal	225
Pop NPLs 2019	Mixed	NPL	N/A	[GACS securitisation]	826
Prisma SPV S.r.l.	Residential	NPL	Unicredit	SPF	4,100
Project Ace (leasing tranche)	Leasing	NPL	Banco BPM	Illimity	650
Project Buonconsiglio 2	CRE	NPL	Cassa Centrale Banca	Värde Partners / Barclays / Guber Banca	734
Project Capri	Unsecured	NPL	UniCredit	Guber Banca / Illimity	450
Project Charlot	Residential	NPL	CheBanca!	AnaCap	137
Project F.I.Nav	Shipping	UTP	Intesa Sanpaolo / UniCredit	Pillarstone	300
Project Hydra	RED	Mixed	Banca Carige	AMCO	2,800

Completed transactions in 2019 - continued

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Ismea	Corporate	NPL	Banca Monte dei Paschi di Siena (MPS)	Illimity	517
Project Juno 2	Mixed	NPL	Banca Nazionale del Lavoro (BNL)	[GACS securitisation]	968
Project Langhe	CRE	NPL	Cassa di Risparmio di Savigliano	Fire Spa	n/a
Project Lima	Other	UTP	Banca Monte dei Paschi di Siena (MPS)	Bank of America	130
Project Matera	CRE	NPL	UniCredit	Illimity	730
Project Mercury (Secured)	CRE	NPL	Banca Nazionale del Lavoro (BNL)	Confidential	400
Project Mercury (Unsecured)	Unsecured	NPL	Banca Nazionale del Lavoro (BNL)	Kruk	200
Project Neptune	Unsecured	NPL	Banca Nazionale del Lavoro (BNL)	Banca IFIS / Barclays / Guber Banca	1400
Project Octavia	CRE	NPL	ICCREA Banca	[GACS securitisation]	1,300
Project Papa 2	RED	UTP	Banca Monte dei Paschi di Siena (MPS)	Cerberus	500
Project Pixar	Consumer	UTP	Intesa Sanpaolo	Kruk	80
Project Quebec	Corporate	NPL	Banca Monte dei Paschi di Siena (MPS)	Illimity	500
Project Race	Unsecured	NPL	Banca Monte dei Paschi di Siena (MPS)	Illimity	1,600
Project River	Leasing	NPL	Banca Nazionale del Lavoro (BNL)	Illimity	100
Project Roma	Corporate	NPL	UniCredit	SPF	1,100
Project Sand	Mixed	NPL	Banca Valsabbina	Guber Banca / Barclays	150
Project Sandokan 2 (residual tranches)	Mixed	UTP	UniCredit	PIMCO / GWM / AREC	2,000
Project Terzo	Corporate	UTP	Banca Monte dei Paschi di Siena (MPS)	Cerberus	455
Securitisation	Consumer	NPL	Eni	P.E.S.	230
Securitisation	Unsecured	NPL	Banco Desio / Confidential	Confidential	180
Synthetic securitisation	Corporate	PL	Intesa Sanpaolo	AnaCap	4,000





Completed transactions in 2020

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
BCC NPLs 2020	RED	NPL	ICCREA Banca	[GACS securitisation]	2,400
Carve-out	Mixed	Mixed	Banca Popolare di Bari (BPB)	AMCO	2,000
Confidential	REO	REO	Banca Monte dei Paschi di Siena (MPS)	Ardian	300
Confidential	Other	NPL	Banca di Ragusa	[GACS securitisation]	400
Confidential	CRE	NPL	Banca Valsabbina	Balbec	20
Confidential	Other	NPL	Cassa di Risparmio di Volterra	Confidential	64
Confidential	CRE	NPL	UniCredit	Illimity	115
Confidential	Unsecured	NPL	Illimity	Sorec Srl / Phinance Partners SpA / CGM Italia SGR SpA	182
Confidential	CRE	NPL	Creval	AMCO	177
Confidential	Corporate	NPL	Unicredit	Illimity	73
Confidential	Unsecured	NPL	Unicredit	Banca IFIS	155
Forward Flow	Unsecured	NPL	Unicredit	Banca IFIS	180
Confidential	Consumer	NPL	Crédit Agricole Cariparma	LCM Partners	150
Confidential	Consumer	NPL	Crédit Agricole Cariparma	MBCredit Solutions	206
Confidential	Unsecured	NPL	Creval	Hoist	357

Completed transactions in 2020 - continued

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Unsecured	NPL	Illimity	Banca IFIS	266
Diana SPV	Mixed	NPL	Banca Popolare di Sondrio (BPSO)	[GACS securitisation]	1,000
POS SPV	Unsecured	NPL	Banca Sella	[securitisation]	400
Project Buonconsiglio 3	Residential	NPL	Intesa Sanpaolo/ Cassa Centrale Banca	[GACS securitisation]	680
Project Camelot	CRE	NPL	Intrum	Illimity	400
Project Dawn	Corporate	UTP	UniCredit	Illimity	750
Project Demetra	Unsecured	NPL	Intrum	Banca IFIS / Kruk	250
Project Django	Mixed	UTP	Banco BPM	AMCO / Credit Fondario	960
Project End of Term	CRE	NPL	Prelios	LCM Partners	18
Project HydraM	CRE	Mixed	Banca Monte dei Paschi di Siena (MPS)	AMCO	8,000
Project Lisbon	Corporate	NPL	Unicredit	Illimity /Guber /Barclays Bank	840
Project Loira	Consumer	NPL	Unicredit	Banca Ifis	200
Project Marengo	Mixed	Mixed	Creval	AMCO / MB Credit / Italian NPL Op Fund II	300
Project Marina Bay	RED	NPL	Prelios	LCM Partners	30
Project Melograno	Unsecured	NPL	ICCREA Banca	Banca IFIS	231
Project New York	Corporate	NPL	Unicredit	Illimity	692
Project Pelican	Unsecured	NPL	Crédit Agricole Cariparma	LCM Partners	4,000
Project Pelican	Unsecured	NPL	Crédit Agricole Cariparma	Elliott	1,700
Project Poppy (Island SPV)	Mixed	NPL	Crédit Agricole Cariparma	Goldman Sachs / LCM Partners / Elliott	1,700
Project Simba	Consumer	NPL	Intesa Sanpaolo	Banca Ifis	700
Project Titan	Leasing	NPL	Alba Leasing S.p.A. ; Banco BPM S.p.A.; Release S.p.A..	[GACS securitisation]	335
Project Tokyo	Corporate	NPL	Unicredit	Banca IFIS / Guber	900
Project Ultimo	Leasing	NPL	Hypo Alpe-Adria-Bank (HBI)	Bain Capital	482
Relais SPV	Leasing	NPL	Unicredit	[GACS securitisation]	1,600

Completed transactions in 2020 - continued

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Securitisation	Unsecured	NPL	Popolare Bari NPLs 2016 / BCC NPLs 2018 / Maggese 2018	Cherry 106	30
Sirio NPL	Mixed	NPL	UBI Banca	Confidential	1,230
Spring SPV	Other	NPL	BPER	[GACS securitisation]	1,400
Yoda SPV Srl	RED	NPL	Intesa Sanpaolo	[GACS securitisation]	4,300
Confidential	Unsecured	NPL	J-Invest	Confidential	1,701
POP NPLs 2020	Mixed	NPL	Luigi Luzzatti	[GACS securitisation]	920
Confidential	Unsecured	NPL	Banca Nazionale del Lavoro (BNL)	MBCredit Solutions	129
Elrond notes resale	Mixed	NPL	Waterfall	Phoenix	158
Confidential	Unsecured	NPL	4Mori Sardegna / Maggese 2018	AnaCap	31
Messina Group Receivable	Shipping	NPL	Banca Carige	AMCO	324
Project Aces	Unsecured	NPL	Crédit Agricole	CarVal	90
Cuvee	Other	UTP	Banca Monte dei Paschi di Siena / Banco BPM	AMCO / Prelios	450

Completed transactions in 2021 and ongoing

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Unsecured	NPL	Illimity	Sorec Srl / Phinance Partners SpA / CGM Italia SGR SpA	129
Project Sunrise	Mixed	NPL	Deutsche Bank	Confidential	980
Project Winter	Mixed	Mixed	BPER	Intrum / Deva Capital	248
Summer SPV Srl	Mixed	NPL	BPER	[GACS securitisation]	271
IFIS NPL 2021-1 SPV S.r.l.	RED	NPL	Banca IFIS	Confidential	1,300
Confidential	CRE	NPL	ING / Erste Abwicklungsanstalt (EAA)	64 Investments	19
Confidential	RED	NPL	Banca Popolare di Vicenza (BPVI)	-	400
Confidential	RED	NPL	UniCredit	-	500

Completed transactions in 2021 and ongoing - continued

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	RED	n/a	UBI Banca	-	300
Confidential	Mixed	Mixed	UniCredit	-	3,000
Confidential	Corporate	NPL	UBI Banca	-	800
Confidential	REO	REO	Banca Monte dei Paschi di Siena (MPS)	-	350
Confidential	Residential	UTP	Crédit Agricole Cariparma	-	700
Confidential	Residential	NPL	N/A	-	750
Confidential	Consumer	NPL	N/A	-	1,500
Confidential	Other	unknown	UBI Banca	-	870
Gruppo Statuto loans	RED	UTP	Banco BPM	-	450
Project Dream	REO	REO	EMPA - Fund	-	700
Project Heidi	Other	NPL	Intesa Sanpaolo	-	n/a
Project Kenobi	Unsecured	NPL	Intesa Sanpaolo	-	4,500
Project Plate	Corporate	UTP	UniCredit	-	200
Project Portland	Leasing	NPL	Intesa Sanpaolo	-	1,200
Project Rialto	Leasing	NPL	A Leasing	-	185
Project Sparta	CRE	NPL	Crédit Agricole	-	320
Secondary Sale	RED	NPL	Bain Capital	-	1,000
Confidential	Other	NPL	UBI Banca	-	5,000
Confidential	CRE	NPL	BPER	-	350
Confidential	Other	UTP	Crédit Agricole Italia	-	1,000

Spain

Market dynamics in 2020 were strongly affected by macroeconomic concerns surrounding the COVID-19 crisis. The large number of processes that stalled during 2020 were a direct effect of this general uncertainty, with both sellers and buyers adopting a 'wait and see' approach. That said, some transactions, launched prior to the pandemic, were completed successfully. A more positive sign was the swift initiation of transactions shortly after emerging from lockdown, which gained traction among the investor community. These transactions opened the doors to additional disposals across a variety of asset classes in Q4 2020, proving that market competition is alive and well, and that banks can continue to carry out NPA sales as part of their long-term divestment strategy.

In 2020, the volume of NPLs traded in the Spanish market totalled about €9.9bn, considerably below the €16.2bn divested in 2019, €51.2bn divested in 2018, and the €53.1bn in 2017, when the market was enlarged by jumbo deals. Since 2018, the Spanish market has moved towards mid-size transactions and 2019 is a good example of this new trend.

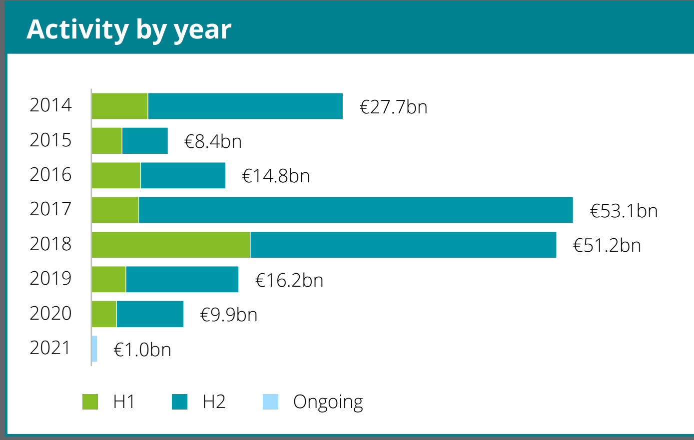
The general uncertainty created by the pandemic limited the number of transactions that closed in 2020. The Spanish market is still one of the largest and most active markets in Europe, even as the portfolio size has shifted towards mid-size deals from the jumbo deals that occurred in 2017 and 2018.

A further trend that emerged during 2019 and 2020 has been the rise of secured SME portfolio transactions, replacing the developer portfolios that predominated in the previous years. Banks will also continue to explore alternatives to efficiently manage re-performing loans, which are capital intensive, as well as bring fresh vintages of consumer loans to market. This asset class accounted for almost a third of the total volume of portfolios traded in 2019 and 2020.

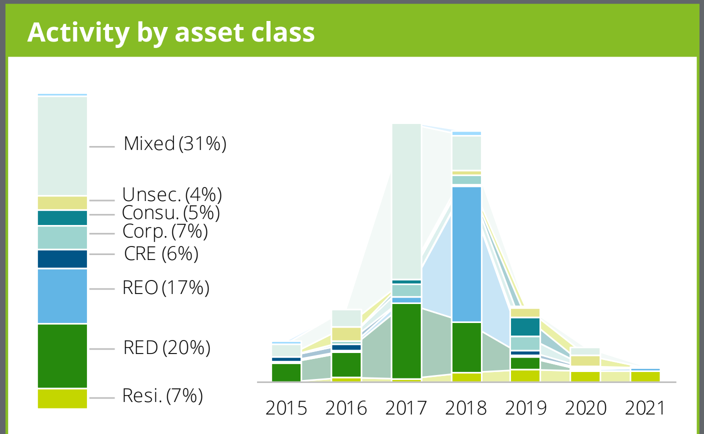
Portfolio transaction activity is likely to rise in the near term driven by high Spanish NPL volume that totalled €75.4bn at the end of 2020, with continued loan sales expected by large banks that have significant NPL stocks. Large private equity funds that purchased portfolios between 2014 and 2016 are also likely to come to market with securitisations of portfolios that have reached their five-year exit timelines.

A potential new wave of NPLs is slowly but surely emerging, particularly as forbearance policies come to an end.

Activity by year



Activity by asset class

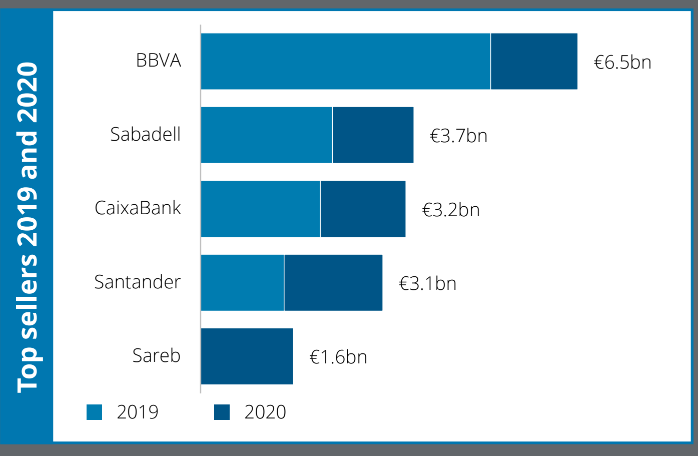


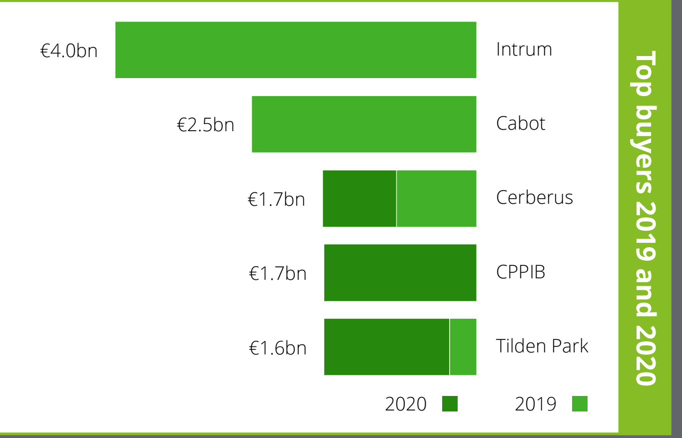
Completed transactions in 2019

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	CRE	NPL	Santander	Apollo	200
Confidential	RED	NPL	Bankia	Blackstone	300
Confidential	Consumer	NPL	Confidential	Intrum	100
Confidential	Unsecured	NPL	Confidential	Axactor	77
Confidential	CRE	NPL	Confidential	Axactor	40
Confidential	REO	REO	Unicaja	Castlelake / Urbania	477
Confidential	Residential	NPL	Sabadell	Azora	150
Project Aloe	Residential	NPL	Unicaja	Cerberus / Davidson Kempner	227
Project Astún	Consumer	NPL	CaixaBank	Intrum	865
Project Barrosa	Unsecured	NPL	Bankia	Cerberus / Kruk	150
Project Biznaga	Residential	PL	Unicaja	Mediterráneo Vida	245
Project Buick	Residential	NPL	PIMCO	LCM Partners	250
Project Castillo	Residential	NPL	Blackstone	CarVal	1,000
Project Chamonix	Residential	NPL	CaixaBank	Waterfall	600
Project Galia	Consumer	NPL	Oney	Savia Asset Management	113
Project Greco	RED	Mixed	Sabadell	Oaktree	882
Project Hera	Corporate	NPL	BBVA	Cabot	2,500

Completed transactions in 2019 - continued

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Hokkaido	RED	NPL	CaixaBank	Farallon	350
Project Juno	Consumer	NPL	BBVA	Intrum	2,500
Project Kingfisher	REO	REO	Lone Star	Tilden Park	300
Project Loeb	Consumer	NPL	Santander / PSA	Intrum	100
Project Lezama	Residential	NPL	Kutxabank	Cerberus	358
Project Marshmello	Corporate	NPL	Bankia	LCM Partners	37
Project Match	Corporate	NPL	Bankia	Marathon Asset Management	500
Project Old Trafford	Unsecured	NPL	Santander	Axactor	600
Project Ordesa	RED	NPL	Ibercaja	Marathon Asset Management	534
Project Rex	RED	NPL	Sabadell	Cerberus	342
Project Salduero	CRE	NPL	KKR	[securitisation]	495
Project Sapporo	Mixed	NPL	CaixaBank	DE Shaw	250
Project Silex	Unsecured	NPL	ING	Axactor	77
Project Stamford Bridge	Unsecured	NPL	Santander	Gescobro / LCM Partners	500
Project Vento	Unsecured	NPL	Sabadell	Intrum / Gescobro	900
Project Regazzoni	Consumer	NPL	Santander	B2 Holding	90
Project Godia	Consumer	NPL	Santander	Confidential	n/a
Project Eclipse	Consumer	NPL	Bankinter	Confidential	133





Completed transactions in 2020

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Mixed	NPL	CaixaBank	Farallon	445
Confidential	Corporate	NPL	CaixaBank	Farallon	130
Project Atlas	Residential	NPL	Santander	CPPIB	1,700
Project Aurora	Mixed	NPL	Sabadell	Confidential	500
Project Dakar	Residential	NPL	BBVA	KKR	1,500
Project Eume	Residential	PL	Abanca	CarVal	250
Project Explorer	Corporate	NPL	Sabadell	Tilden Park	300
Project Hermitage	RED	NPL	CaixaBank	Confidential	200
Project Higgs	Residential	NPL	Sabadell	Lone Star	600
Project Jarama	REO	REO	Bankia	Tilden Park	400
Project Louvre	Corporate	NPL	Caixabank	Tilden Park	400
Project Montserrat	Residential	NPL	Caixa Geral de Depósitos (CGD)	Confidential	100
Project Ryder	RED	NPL	Bankinter	Confidential	120
Project Saona	Unsecured	NPL	Sareb	Procobro	1,600
Project Wave & Zenith	REO	Mixed	Chenavari	Metric / Albatris	700

Completed transactions in 2020 - continued

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Cabernet	Mixed	NPL	Targobank	Confidential	100
Project Encina	Mixed	NPL	Unicaja	Cerberus	563
Project Hercules	Unsecured	NPL	Anticipa	Cerberus	264

Completed transactions in 2021 and ongoing

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Wimbledon	Residential	PL	Bankinter	-	480
Confidential	Residential	PL	Confidential	-	70
Project Okabango	Residential	Mixed	Titulización de Activos (TDA)	-	110
Confidential	CRE	NPL	Confidential	-	n/a
Project Jaguar	Residential	REO	BCC-Grupo Cooperativo Cajamar	-	300

Portugal

Overview of 2020

Banco de Portugal estimates GDP decreased by 7.6% in 2020, affected significantly by the reduction in tourism, which accounted for 16.4% of Portuguese GDP in 2019. Sectors such as accommodation and food services, industry and transportation were also badly hit by the crisis and government lockdowns. In contrast, construction contributed to economic growth in the first half of 2020 driven by positive investment momentum.

To mitigate the impact of COVID-19, the government introduced and then subsequently extended the loan moratorium period until September 2021. At the close of 2020, €41.5bn of loans remained with unexpired moratoriums, consisting of 45% of mortgages and consumer credit, and 55% of corporate debt.

Prior to the pandemic, Portuguese banks had steadily reduced their NPL stocks with the NPL ratio down to 4.9% in December 2020 from a peak of 20.0% in June 2016. The pandemic is likely to delay efforts to reduce these levels further.

In the meantime, banks are implementing measures to assist with early identification of a reduction in the ability of borrowers to pay, in order to avoid delayed recognition of credit losses. Regular assessments of borrowers' credit performance are carried out, to implement suitable recovery strategies and to maintain an adequate level of provisions.

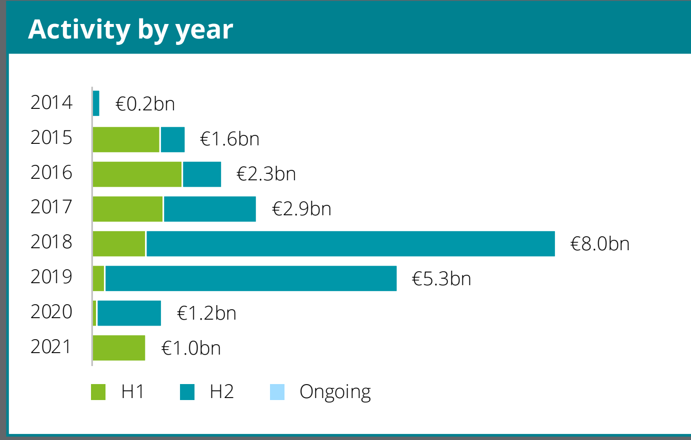
NPL trends and developments

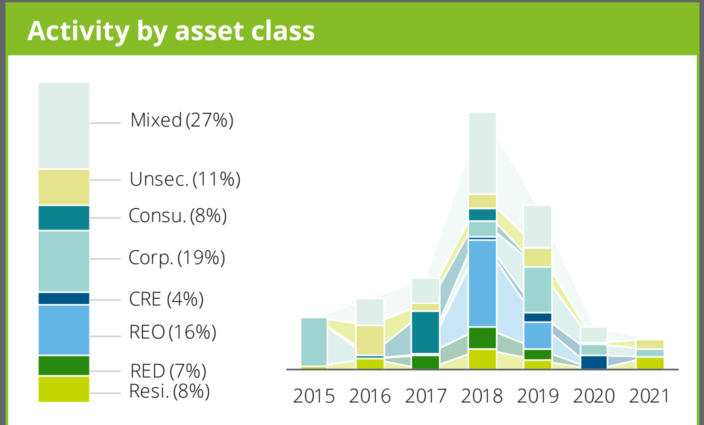
The Portuguese banking system is concentrated largely in five financial institutions: Caixa Geral de Depósitos, Santander, Banco Comercial Português, BPI and Novo Banco. These continued to push forward with their deleveraging agendas and were involved in eight of the ten transactions in 2020. The majority of these happened in the second half of the year, reflecting the impact of the virus containment measures on business activity and market sentiment. Approximately €1.2bn of gross exposures were sold through competitive processes across the year as a whole.

Investors displayed appetite across a range of asset classes, from unsecured portfolios (Project Lime and Pool 53) to REOs (Project ZIP), mixed (Project Carter and Pool 52) and SME and corporate exposures (Project Wilkinson).

The future is certainly challenging, but investor appetite for non-performing loans remains strong. NPL investment funds have recently consolidated their position in the country, acquiring additional portfolios. The country has political stability, a real estate market that has so far proved resilient, with qualified and experienced local servicers and sellers.

In this context, it is expected that banks will continue to bring NPL portfolios to market, as well as sub-performing exposures. We expect a focus on the disposal of mid-sized portfolios, single names and corporate portfolios, and some freshly defaulted granular portfolios.





Completed transactions in 2019

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Gaia Finance	Mixed	NPL	Caixa Economica Montepio Geral	Davidson Kempner	234
Guincho Finance	Mixed	NPL	Santander	Confidential	481
Pool 50	CRE	NPL	Santander	Confidential	85
Pool 51	Unsecured	NPL	Santander	Confidential	135
Project Albatros	Mixed	NPL	Novo Banco	Waterfall	303
Project Amália	Residential	NPL	Confidential	Confidential	57
Project Atlas 2	RED	NPL	Montepio	Arrow Global	321
Project Brick	REO	REO	Montepio	AXA Investment Managers	105
Project Eagle	Mixed	NPL	Millennium BCP	LX Partners	300
Project Jupiter	Unsecured	NPL	Caixa Geral de Depósitos (CGD)	LX Partners	240
Project Lemon	CRE	NPL	BPI	Tilden Park	200
Project Lion	Unsecured	NPL	Millennium BCP	EOS	120
Project Mars	Residential	REO	Caixa Geral de Depósitos (CGD)	Christofferson, Robb & Co. (CRC)	150
Project Nata 2	Corporate	NPL	Novo Banco	Davidson Kempner	1,454
Project Neptune	Corporate	NPL	Caixa Geral de Depósitos (CGD)	Bracebridge	140
Project Pumas	REO	REO	Millennium BCP	AnaCap	210

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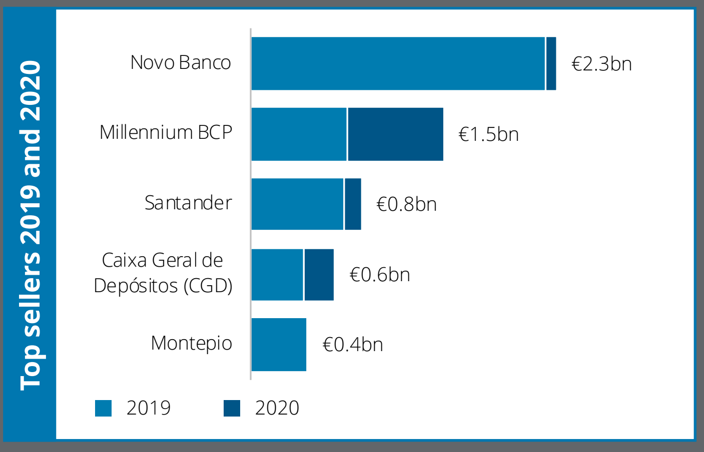
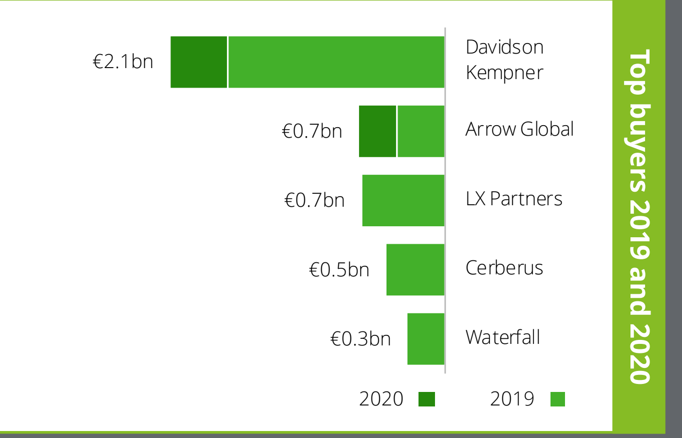
Completed transactions in 2019 - continued

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Sertorius	REO	REO	Novo Banco	Cerberus	469
Project Tawny	REO	REO	Confidential	Arrow Global	55
Project Tiger	Unsecured	NPL	Millennium BCP	Altum Capital	100
Project Victoria	Residential	NPL	Castlelake	LX Partners	120





Completed transactions in 2020

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Pool 52	Mixed	NPL	Santander	Arrow Global	65
Pool 53	Unsecured	NPL	Santander	Arrow Global	66
Project Carter	Mixed	NPL	Novo Banco	Arrow Global / CRC	79
Project Ellis	CRE	NPL	Millennium BCP	Davidson Kempner	455
Project Gaia	CRE	NPL	Ares Lusitani STC, S.A.	CRC	30
Project Mountain - Montserrat	Mixed	NPL	Caixa Geral de Depósitos (CGD)	Bracebridge	80
Project Webb	Mixed	NPL	Millennium BCP	Arrow Global / CRC	266
Project Mountain - Aire	Corporate	NPL	Caixa Geral de Depósitos (CGD)	Core Capital	20
Project Mayfair	Corporate	NPL	Bain Capital	Orthogon Portugal	160

Completed transactions in 2021 and ongoing

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Lime	Unsecured	NPL	BPI	LX Partners	300
Project Wilkinson	Corporate	NPL	Novo Banco	Davidson Kempner	216
Project Zip	Residential	REO	Solucao Arrendamento/ Arrendamento Mais	Albatross	435

Greece

Overview of 2020

The coronavirus pandemic halted the upward growth trajectory of the Greek economy, which went into deep recession in 2020. More specifically, in the first nine months of the year Greek GDP fell by 8.5%; and against the backdrop of new lockdown restrictions during Q4, the Bank of Greece (BoG) anticipated that economic activity for 2020 would contract by 10%. 2021 and 2022 are seen as recovery years, with GDP growth projected at 4.2% in 2021 and 4.8% in 2022.

The lingering presence of the virus also led the BoG to revise upwards its estimate for pandemic-related NPLs, from €2bn - €6bn at the onset of the pandemic to €8bn - €10bn as of January 2021.

With the expectation of increases in NPLs due to the disruption caused by COVID-19, Greek banks made a further €1.6bn of loan loss provisions in the fourth quarter of 2020 after €2.7bn had already been set aside to cover future losses during the first nine months of the year.

As reported by the EBA, the total amount of loans in Greece that received support under EBA-compliant moratoria following the onset of the pandemic reached €27.6bn, of which €4.1bn was still in place at the year-end. The share of participating households in December 2020 was considerably low at 7.7%, down from 49.7% in June 2020. Currently, the banks are processing new solutions for borrowers with loans under moratoria, in order to stem a potential new wave of NPLs. The banks expect about 20%-25% of the loans currently under moratoria to turn into NPLs, due to the second wave of COVID-19 and the reinstated lockdown restrictions.

At a macroeconomic policy level, the Greek government is exploring a number of interventions to support the banking system. More specifically, HAPS has been prolonged until October 2022, while BoG is looking at a bad bank solution (establishment of AMC) to deal with a potential wave of COVID-related NPLs and it submitted its proposal to the Greek government at the end of September 2020.

In addition, the government is considering legislation that will allow the Hellenic Financial Stability Fund (HFSF) to participate in future right issues by Greek banks, to help strengthen their capital positions. Under current legislation, HFSF cannot participate in rights issues by banks, as this would break EU state aid rules.

At the end of October, the Greek Parliament approved the new bankruptcy law (L. 4738/2020) which has been into force for corporate borrowers since 1 March 2021. For small businesses and individuals, the new bankruptcy law will come into effect on 1 June 2021. Its aim is to help over-indebted households and businesses make a fresh start after a decade-long debt crisis. The new law is applicable for both individuals and legal entities and will enable them either to restructure or to settle their existing debts, having as a prerequisite the liquidation of their personal assets. This is considered innovative for the Greek market as it will allow individuals for the first time to declare bankruptcy, after which they can continue living in their residences for the next 12 years by paying rent, which will be subsidised by the Greek state; and after the expiration of this 12-year lease period they can buy back their property at its market value at that point of time. The new law is a significant development, since it simplifies and accelerates the court procedures, creates a single Electronic Bankruptcy Register and allows interconnection between the databases of the tax authorities and the banks, which will lead to the provision of accurate information about the real financial situation of debtors. Despite some reservations, there seems to be general agreement that the new law is a move in the right direction and provides a holistic solution to the NPEs issue.

NPE trends and developments

Despite the pandemic and the resulting slowdown in loan portfolio market activity across Europe, Greek banks disposed of about €34.0bn of NPEs during 2020 and Q1 2021, reducing their total

volume of NPEs to €38.1bn[8] from €69.4 in 2019. This was primarily through NPE securitisations following the successful implementation in late 2019 of the Hellenic Asset Protection Scheme (HAPS), also known as the Hercules scheme. Under HAPS the Greek state provides a guarantee for the senior notes, with private investors acquiring most of the mezzanine and junior notes.

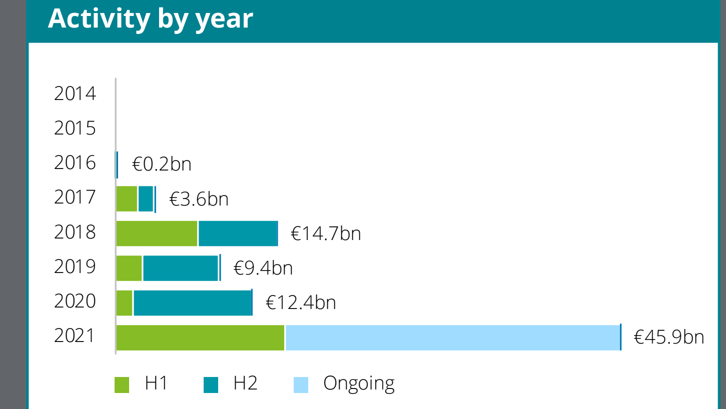
Alpha Bank reduced its exposure the most on an absolute basis, after taking into account a €9.7bn fall in pro-forma NPEs, primarily thanks to Project Galaxy. The pro-forma NPEs of Eurobank decreased in 2020 by €7.3bn (down 56.2% YoY) and those of NBG fell by €6.4bn (down 59.3% YoY), driven by Cairo and Frontier HAPS securitisations. Piraeus Bank brought to market two NPE HAPS securitisations, project Vega and Phoenix, amounting to €5bn and €2bn respectively. Intrum was the preferred bidder in both securitisations, with the deals expected to complete during the first half of 2021. However, despite the flurry of deleveraging activity through HAPS and the measures that Greek banks have taken in response to the pandemic in order to stop the reversal of the progress they have made over recent years, a new wave of non-performing exposures is expected to follow the winding down of payment moratoria.

In terms of the pipeline for FY 2021, Piraeus Bank is currently leading the way with its plan to reach a single-digit NPE ratio within 12 months, having already announced €11bn of NPE HAPS disposals through Project Sunrise 1 and 2, and an additional €1.5bn outside the HAPS scheme. Alpha Bank has already brought an additional €3.3bn to market in the first half of 2021 through three different portfolios, the largest being Project Cosmos, a €2bn mixed NPE HAPS securitisation. The bank is planning to sell a €0.9bn consumer Greek NPL portfolio, known as Project Orbit, and dispose of a €0.4bn Cypriot portfolio, comprising primarily of mortgages and wholesale loans. Following the successful closing of €7.5bn Project Cairo in 2020, Eurobank is planning to launch a €3.3bn HAPS securitisation, Project Mexico, comprising 85% retail and 15% corporate loans. As with Piraeus Bank, Alpha Bank aims to reduce its NPE ratio to a single digit figure by the end of 2021. NBG is also expected to bring an additional €1.5bn of NPEs to the market by the end of 2022 but has not yet provided details on specific transactions.

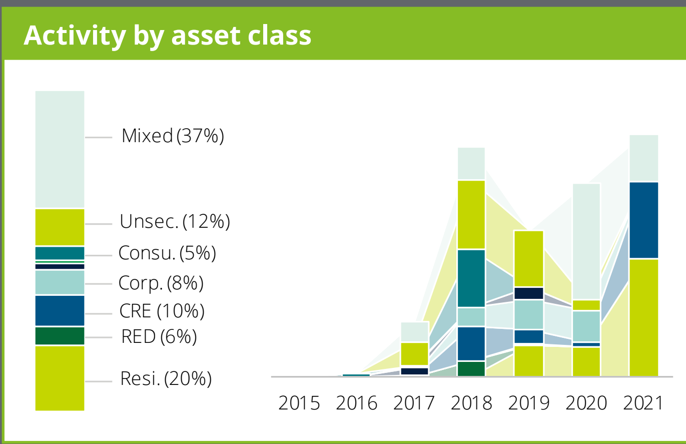
On top of the €38.1bn NPEs currently on banks' balance sheets, more than €40bn of non-performing exposures have been transferred from Greek banks to specialised financial institutions abroad and are managed by credit servicing companies, which along with banks and insurance companies constitute the third pillar of the country's financial sector. As at year-end 2020, the Greek servicing landscape consisted of 25 companies (of which 3 were licensed by BoG in 2020), with DoValue, Cepal and Intrum being the main players. The current players also have significant experience in the servicing markets of Italy, Spain, Portugal and Ireland, and significant changes are expected in the Greek NPL market through solutions that have been tested in other markets. This could have a positive impact on efforts to reduce NPEs in the country. Some consolidation in the sector, with potentially six or seven players remaining in the market, may be expected in the coming years.

8 Year-end NPE volumes are pro-forma for Galaxy, Frontier, Phoenix, and Vega NPE HAPS securitisations

Activity by year

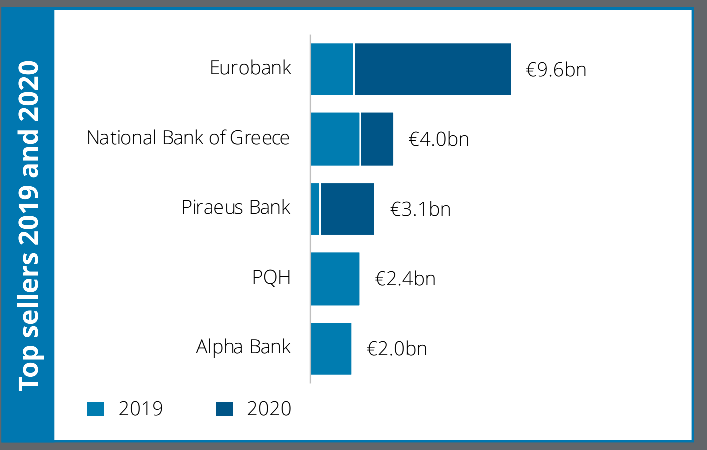


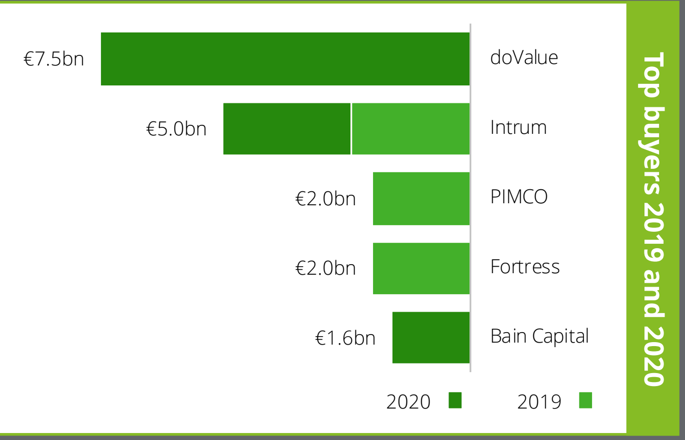
Activity by asset class



Completed transactions in 2019

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Leo	Shipping	NPL	National Bank of Greece	Cross Ocean Partners	300
Project Aeolus	Unsecured	NPL	PQH	Intrum	2,400
Project Mirror	Unsecured	NPL	National Bank of Greece	CarVal	1,200
Project Nemo	Shipping	NPL	Piraeus Bank	Davidson Kempner	507
Project Neptune	Corporate	NPL	Alpha Bank	Fortress	2,000
Project Opus	REO	REO	Eurobank	Brook Lane Capital	84
Project Pillar	Residential	NPL	Eurobank	PIMCO	2,000
Project Star	REO	REO	Eurobank	Apartners Capital	24
Project Symbol	CRE	NPL	National Bank of Greece	Centerbridge / Elliott	900





Completed transactions in 2020

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Astir NPL Finance 2020-1 DAC	Corporate	NPL	Attica Bank	[securitisation]	341
Astir NPL Finance 2020-2 DAC	CRE	NPL	Attica Bank	[securitisation]	371
Project Cairo	Mixed	NPL	Eurobank	doValue	7,500
Project Icon	Corporate	NPL	National Bank of Greece	Bain Capital	1,600
Project Iris	Unsecured	NPL	Piraeus Bank	Intrum	700
Project Phoenix	Residential	NPL	Piraeus Bank	Intrum	1,920

Completed transactions in 2021 and ongoing

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Galaxy (Retail)	Residential	NPL	Alpha Bank	Davidson Kempner	7,600
Project Galaxy (Wholesale)	Mixed	NPL	Alpha Bank	Davidson Kempner	3,000
Project Vega	CRE	NPL	Piraeus Bank	[securitisation]	4,900
Project Frontier	Residential	NPL	National Bank of Greece	-	6,100

Completed transactions in 2021 and ongoing - continued

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Kastor	Corporate	NPL	Pancretan Bank	-	297
Project Istros	Corporate	NPL	Piraeus Bank	-	200
Project Pivot	Corporate	Mixed	Piraeus Bank	-	400
Project Trinity	Corporate	NPL	Piraeus Bank	-	300
Project Sunrise 1	Mixed	NPL	Piraeus Bank	-	7,000
Project Cosmo	Mixed	NPL	Alpha Bank	-	2,000
Project Orbit	Mixed	NPL	Alpha Bank	-	900
Project Sunrise 2	RED	NPL	Piraeus Bank	-	4,000
Project Sunshine	Leasing	NPL	Piraeus Bank	-	500
Project Dory	Shipping	NPL	Piraeus Bank	-	600
Confidential	Corporate	NPL	Piraeus Bank	-	300
Project Mexico	Mixed	NPL	Eurobank	-	3,300
Project Ariadne	Mixed	NPL	PQH	-	4,500

Cyprus

In line with other countries in Europe, the onset of the COVID-19 pandemic resulted in a pause in NPLs transactions in 2020. During this time, the Cypriot government provided €1.6bn in support for the economy, as well as implementing a moratorium regimen and special foreclosure legislation to offset the effects of the disruption caused by the pandemic.

The main government decrees directly affecting the NPL market include:

- Suspension of all foreclosure proceedings from 18 March 2020 to 31 August 2020. These were frozen again from 21 December 2020 until 31 March 2021 and recently extended for a third time until the 31st July 2021. This most recent protection applies only to i) primary residences valued up to €500,000, ii) primary location for businesses with annual turnover up to €2mn and up to 10 employees, and iii) agricultural plots of land valued up to €250,000.

- A loan moratorium initially implemented for nine months to 31 December 2020 (for performing borrowers). A new moratorium extended the scheme for a further six months, to 30 June 2021, for those who had not fully utilised the nine-month moratorium in 2020. (The total duration of a moratorium per borrower is a maximum of nine months.) Facilities eligible for a moratorium include those secured by main residence mortgage valued up to €350,000, facilities by businesses under mandatory suspension due to the lockdown measures, and facilities of companies in the hospitality sector.

- Government grants to cover payroll, rents and other operating expenditures, for businesses and self-employed individuals experiencing a reduction in excess of 35% in turnover due to the containment measures imposed by the authorities to control the pandemic.

- For businesses fully suspending operations due to the lockdown measures, professional lease rentals are reduced to 30% for two months in Q1 2021, with suspended amounts becoming due by instalments until February 2022; ii) ability for deferral of lease payments to the State, for two months in Q1-2021.

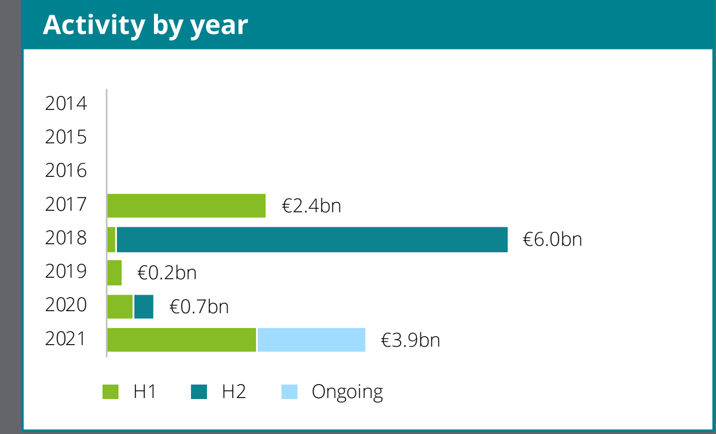
- Interest rate subsidy schemes:
  - Interest rate subsidy for new business loans, approved from 1 March 2020 until 31 December 2021, for a maximum of four years, granted to performing borrowers (as at December 2019), that now face difficulty as a result of the pandemic. Loans should cover liquidity needs and /or investments and should not be used to repay existing borrowing facilities.
  - Interest rate subsidy for new housing loans up to €400,000 that were approved from 1 March 2020 to 31 December 2021.

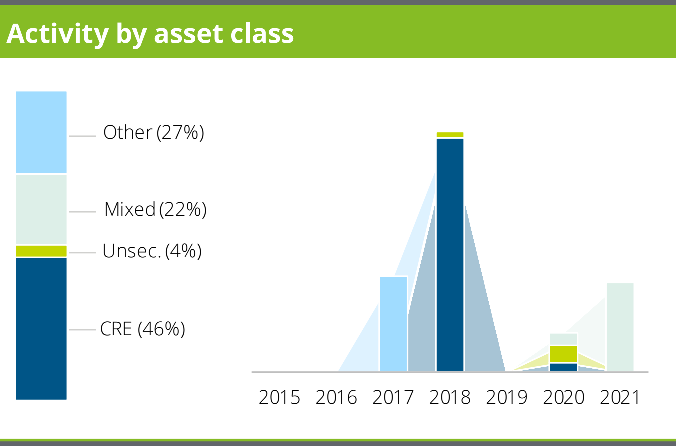
- The Ministry of Energy, Commerce & Industry announced a new grant scheme in February 2021, focused on SMEs based in Cyprus and operating mainly in the manufacturing sector. The grant covers construction of new business premises, or expansion/refurbishment of existing ones, and purchases of new machinery and motor vehicles. The maximum grant is €200,000 per business and can cover up to 60% of the investment.

- Foreclosure law updates were approved by Supreme Court (in force since 12 June 2020):
  - Notice periods were extended from 30 days to 45 days, for the initial notice/demand letter to repay (Type "I") and the auction notification, both to the borrower and to the public
  - Additional right of the mortgage debtor to appeal for the setting aside of the notice for the sale of the property in the event that the lender (including a credit acquiring company) refused to or did not proceed with a loan restructuring pursuant to the "Financial Ombudsman Law" or where such procedure is pending at the date of entry into force of the above law

- The right of a mortgage borrower to appeal to the Financial Ombudsman for breaches of the Code of Conduct on the Handling of Borrowers in Financial Difficulties
- An increase from three to six months in the period during which the reserved price cannot be less than 80% of the OMV
- In addition to these measures, the media have reported progress on converting KEDIPES (the entity managing NPLs of the collapsed Coop Bank) to a national bad bank to manage NPLs such as those relating to main primary residences up to €350,000 and main business premises up to €350,000.

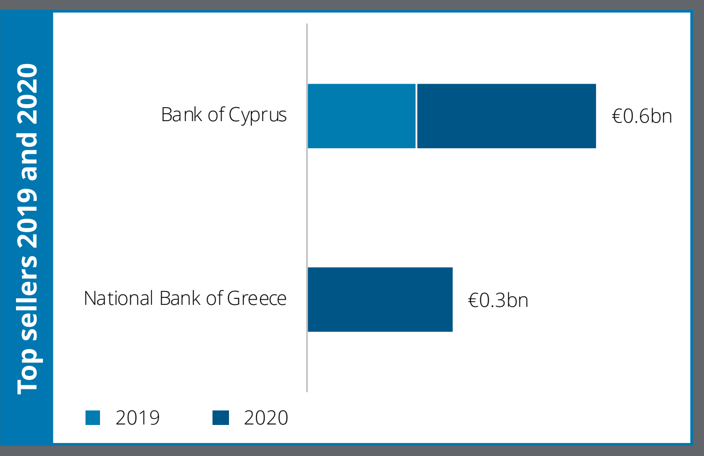
Total disposals of NPLs in 2020 were about €0.7bn, compared to €0.2bn in 2019 and €6bn in 2018. We expect that additional portfolios will be brought to market towards the end of 2021 and at the start of 2022 (with the €2.2bn Helix 2 portfolio already closed in Q1 2021 and a further sales of about €1.6bn known to be in the pipeline), as Cypriot banks continue their deleveraging efforts. As of Q4 2020, the average NPL ratio of Cypriot banks stood at 11.5%, significantly below the 50.9% peak in 2014. However, despite deleveraging efforts from Cypriot banks and measures implemented by the Cypriot government to provide relief to borrowers, the pandemic is likely to result in a new wave of NPLs, which the banks will need to prepare for.

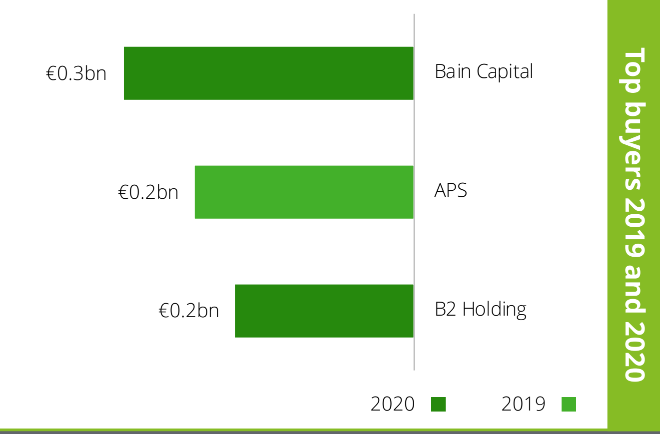




Completed transactions in 2019

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Velocity 1	CRE	NPL	Bank of Cyprus	APS	245





Completed transactions in 2020

Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Marina	Mixed	NPL	National Bank of Greece	Bain Capital	325
Project Velocity 2	Unsecured	NPL	Bank of Cyprus	B2Holding / Waterfall Asset Management	400

Completed transactions in 2021 and ongoing

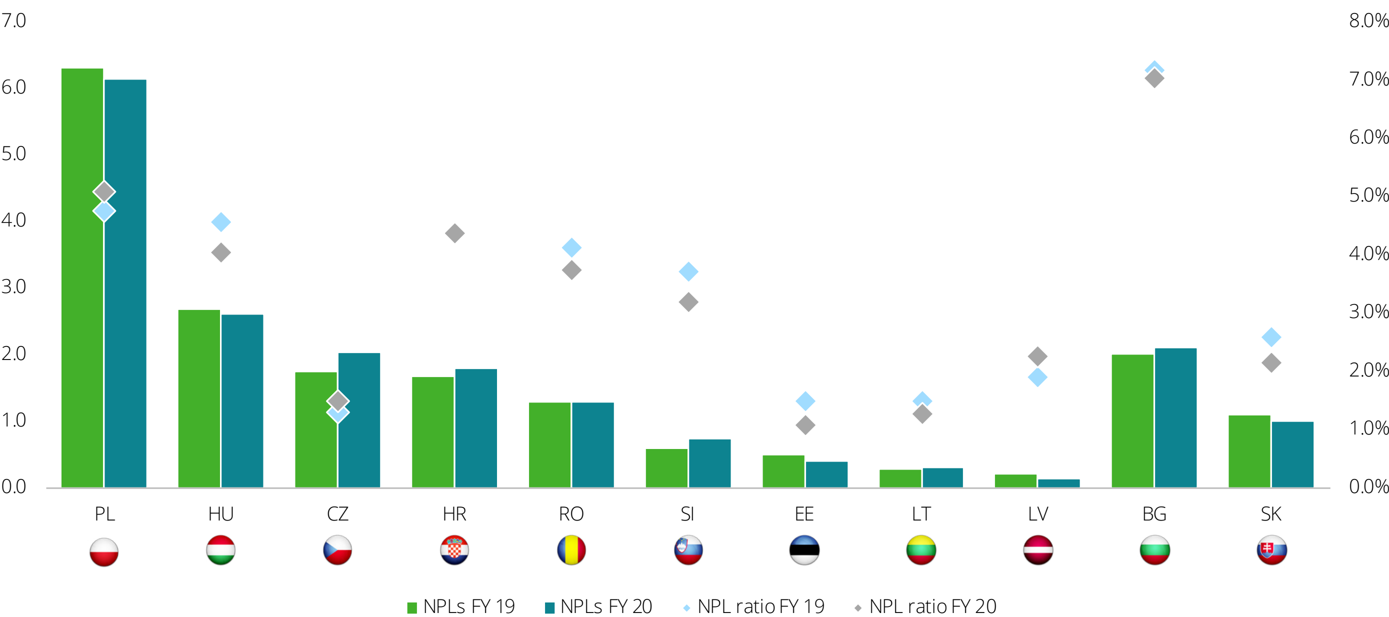
Portfolio name	Asset class	Loans	Seller	Buyer	Size (€m)
Project Helix 2	Mixed	NPL	Bank of Cyprus	PIMCO	2,243
Project Helix Tail	Unsecured	NPL	Bank of Cyprus	-	34
Project Ledra	Other	NPL	Kedipes	-	1,200
Project Sky	Mixed	NPL	Alpha Bank	-	400

Central & Eastern Europe

Following the GFC in 2008-09, the European Central Bank and national banks across the CEE region introduced several schemes and measures to support economic recovery and tackle underperforming assets on banks' balance sheets. These measures, combined with the banks' own efforts to dispose of non-performing assets in the secondary markets, resulted in significant improvements in asset quality for the 12 countries in our analysis[9], with the stock of NPLs down by €13.7bn over the past 5 years, to €31.1bn as of Q4 2020. The effects of the pandemic are not yet visible as a result of government support schemes, loan moratoria and regulatory forbearance.

The above measures, combined with a boost in demand for housing loans and (at least until the impact of COVID-19 becomes more evident) a more stable macroeconomic environment for almost all countries in the region, has led to a marked fall in the average NPL ratio, from 9.0% in 2016 to 3.2% as of Q4 2020 (excluding Ukraine), which is just 60bps higher than the European Union average of 2.6% (the average CEE NPL ratio is 6.4% if the Ukraine is included). Nevertheless, the picture is far from uniform, with several countries continuing to see high NPL ratios.

Effect of COVID-19 on NPL volumes (€bn) and NPL ratios (%) across CEE



Source: Q4 2020 EBA Risk Dashboard

Note: For scale purposes, Ukraine is not presented on the chart given its very high NPL levels. As of Q4 2020 the total NPL ratio stood at 41% and the total volume of NPLs amounted to €12.5bn

9 Poland, Hungary, Czech Republic, Croatia, Romania, Slovenia, Estonia, Lithuania, Latvia, Bulgaria, Slovakia plus the Ukraine.

Ukraine

The impact of COVID-19 on asset quality has been relatively moderate. The legacy NPL portfolio remains a burden for the banking sector, despite a marked reduction in 2020 primarily as a result of large write-offs at state-owned banks.

At the end of 2020, the NPL volume of solvent banks stood at €12.5bn (UAH 430bn), down by €7.5bn from 2019 (largely as a result of write-offs at state banks). The NPL ratio of 41% is the highest across the CEE region. Large amounts of NPLs are held by the Ukrainian Deposit Guarantee Fund (DGF), reflecting a number of failures that were subsequently placed under the administration of DGF. Taking into consideration all loan loss provisions, the NPL coverage ratio is 98%.

The impact of COVID-19 on the overall asset quality is not yet fully visible as banks supported borrowers and implemented debt restructurings. Close to 7% of the performing portfolio in the corporate segment and above 10% in the retail segment have been restructured. Legislative moratoria were introduced only for consumer loans. Nevertheless, increased risk is clearly visible as evidenced by the increases in provisioning by banks in 2020 (+91% year-on-year).

In July 2019, the National Bank of Ukraine (NBU) approved a new regulation aimed at accelerating the pace of NPL reduction at banks, part of which was a requirement for banks to prepare three-year strategies for NPL management. The overall aim of the NBU is to reduce the NPL ratio to 10% by 2025.

Regulation was also modified for state-owned banks so that they can sell non-performing assets more easily. Previously, sales at a discount created possible criminal charge risks (mismanagement of state funds) for management teams, and this was a deterrent on such transactions.

Poland

According to data from the EBA, the total volume of NPLs in Poland remained relatively stable at €6.2bn at the end of 2020, compared to €6.3bn in December 2019. The NPL ratio was 5.1%, an increase of 33bps from 4.8% at the end of 2019, due mainly to a reduction in total lending. However, the real impact on asset quality is likely to have been concealed by loan moratoria and public guarantee schemes, which amounted to more than €17bn in 2020.

With 90% of EBA-compliant moratoria now expired, the proportion of Stage 2 loans under this category has reached 39.8%. This is four times higher than the 9.1% proportion for Stage 2 loans across Europe. Meanwhile, the NPL ratio of loans under expired moratoria stands at 2.6%, indicating an increased risk in underlying asset quality.

In terms of NPL transaction activity, the market came to a halt at the end of Q1 2020 in response to the pandemic. Going forward, we anticipate loan provisioning charges to remain high, particularly as support from loan moratoria is starting to be phased out. We also expect that increased numbers of NPL portfolios will be brought to market as Polish banks tend to sell defaulted portfolios at a relatively early stage.

Hungary

Following a period of successful deleveraging in previous years, corporate and retail NPL ratios fell to sustainable levels and NPL transaction activity has been relatively subdued since 2019.

Despite the pandemic 2020 was no different, with NPL volume continuing a decline from €2.7bn at the end of 2019 to €2.6bn as of Q4 2020. During this time the NPL ratio fell by 53bps during the year from 4.6% in December 2019 to 4.0% in December 2020.

Hungary has a strong transaction track record of completed deals amounting to €5.1bn between 2015 and 2019. Given the limited amount of large corporate and retail NPL portfolios remaining, and with ongoing uncertainty around the impact of the pandemic on overall asset quality, corporate single tickets are more likely to be disposed of in the coming years.

Romania

According to 2020 year-end data from the EBA, the total volume of NPLs in Romania remained stable at €1.3bn, and the NPL ratio fell by 37bps during the year to 3.7%, down from 4.1% in 2019, due mainly to an increase in total lending. Despite the pandemic, the total volume of loans in Romania increased from €31.7bn in 2019 to €34.8bn in Q4 2020.

NPL transaction activity in Romania remained at low levels in 2020. More specifically, a €0.2bn corporate non-performing portfolio, known as Project Danube, was brought to market by NBG's subsidiary in Romania. NBG entered into a binding agreement with Bain Capital Credit, which is expected to close imminently.

We anticipate that NPL activity in Romania will remain subdued unless there is a significant uptick in NPL volumes or a favourable change in the tax treatment of NPL sales. This follows a change in the tax treatment of NPL sales that took place in 2018, with loan originators required to pay tax on the difference between the nominal value of the loans and the sale price. As a result of this, banks have relied instead on their internal workout functions.

Croatia

The impact of the pandemic on asset quality has been relatively moderate, primarily due to payment moratoria amounting to €4.7bn. At the 2020 year-end, the NPL ratio was 4.4%, up by 10bps compared to December 2019. Notably, the proportion of Stage 2 loans to total loans almost doubled, from 6.5% in Q4 2019 to 11.3% in Q4 2020. This potentially indicates increased risk in underlying asset quality.

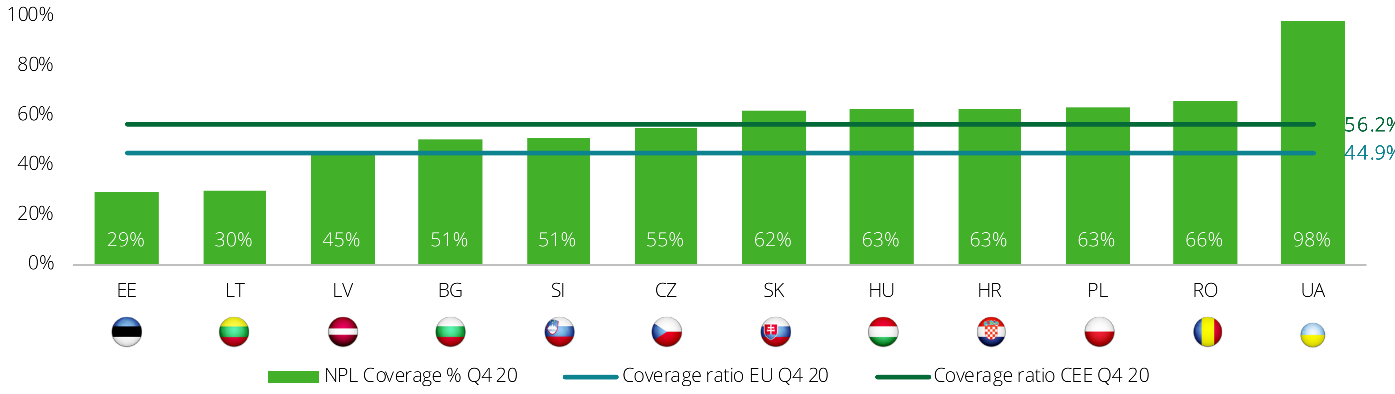
Croatia has seen relatively strong NPL transaction activity in previous years, although the banking sector still needs to tackle the relatively high NPL ratio, mainly in the corporate segment. Given the uncertain economic environment, most Croatian banks have chosen to 'wait and see', and no major NPL deals were completed in 2020. Looking ahead, we expect a revival in transaction activity, as the NPL ratio of the Croatian banking sector is still high compared to the regional and European average.

Bulgaria

Asset quality indicators improved significantly in the previous years in both the retail and corporate segments, due mainly to loan restructuring and write-offs mandated by the Bulgarian National Bank (BNB) and a comprehensive asset quality review in 2019.

Despite the pandemic, the positive trend of declining NPL ratios continued in 2020, reflecting support measures, loan moratoria and regulatory forbearance, as well as an increase in total lending. According to Q4 2020 data provided by the EBA, the NPL ratio fell by 15bps to 7% between December 2019 and December 2020. However, NPL ratios are likely to increase in 2021 as relief measures are gradually withdrawn and loan moratoria unwind, potentially leading to higher interest rates on new loans and tightened credit conditions in general. The total volume of NPLs has remained relatively flat, at €2.1bn.

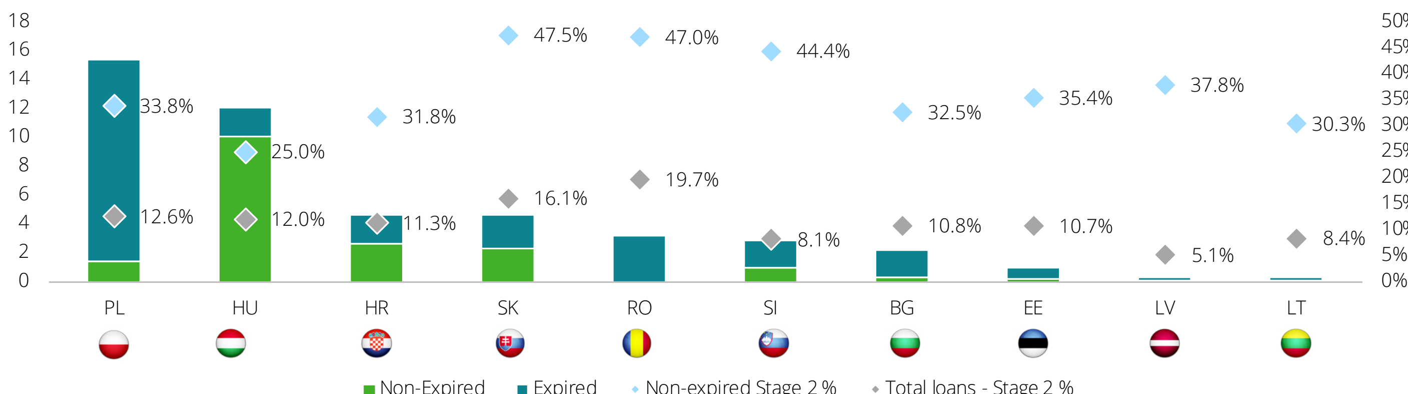
Coverage Ratios of NPLs Across CEE (%)



Source: Q4 2020 EBA Risk Dashboard and National Bank of Ukraine (NBU)

At the end of 2020, the average NPL coverage ratio across CEE countries in our report stood at 56.2% (or 52.4% excluding the Ukraine) and 11.3% points higher than the EU average of 44.9%. However, with over €23bn of government support still in place as at Q4 2020 and the average share of Stage 2 loans under non-expired moratoria reaching 36.6% across the region, which is four times higher than the 9.1% ratio for total loans across Europe, it is too early to assess whether this is sufficient.

Overview of Loan Moratoria Across CEE (€bn)



Source: Q4 2020 EBA Risk Dashboard
Note: Loan moratoria data was not available for Czech Republic and Ukraine which are therefore not included above.

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As elsewhere in Europe, the extent of the economic damage across the CEE region as a result of the pandemic and the effect on asset quality are highly dependent on several factors, including the shape and pace of the recovery as well as the impact of the phase-out of the government support schemes (job retention schemes, wage subsidy schemes, government transfers, and public loan moratoria).

As a result of this, and to prevent as far as possible a future accumulation of non-performing loans, the ECB's Banking Supervisory body is closely monitoring the banks in the region, with special attention given to current developments and the possibility of deterioration in asset quality.

NPL outlook

Despite banks in the CEE region being in a more robust shape than they were during the 2008-2009 financial crisis, we anticipate that the pandemic-induced stress will lead to a significant uptick in NPL volumes, with countries that are more dependent on tourism, such as Croatia, facing the largest increase in risk. However, the timing of the uptick may vary between the different countries in the region and will likely depend on the phase-out of payment moratoria and other public support schemes.

Throughout the pandemic, buyers and sellers of NPL portfolios across the region have largely adopted a wait-and-see approach, with deal flow remaining very limited.

However, considering the differences across CEE countries in terms of their pre-pandemic level of NPLs, primary industries, and historical approaches to disposals, we expect market activity to commence sooner in countries with higher volumes of NPLs such as Poland and the Czech Republic, which have also historically been inclined to sell defaulted portfolios at an early stage (even within a year of default).

The opposite is true for countries such as Bulgaria and even more particularly Romania, which is not likely to return to 2015-2018 levels of activity until a favourable change in the tax treatment of NPL sales or a considerable increase in NPL portfolios.

In terms of the asset mix in the NPL market, we anticipate that most banks across the CEE region will focus at first on the disposal of retail unsecured NPL portfolios.

This is supported by a Deloitte survey[10] of CROs and heads of workout departments among 69 CEE banks, designed to map out the potential impact of COVID-19 on banks across the region. In the survey, over one-third of the participating banks responded that retail unsecured NPL portfolios will be their priority, with banks likely to adopt a more cooperative and consumer-friendly approach to minimise reputational risk. In the corporate segment, the market view is that there will be more restructuring than during the GFC crisis, especially in the hospitality and CRE sectors. As a result, instead of large granular portfolios, we anticipate that banks will favour single ticket opportunities with sophisticated structures. Nearly one-half of the respondents in the survey foresaw an increase in the disposal of corporate NPL single tickets in the region.

10 Deloitte. "COVI-19 CEE Banking Sector Impact Survey – First Symptoms of the Coronavirus Outbreak", September 2020

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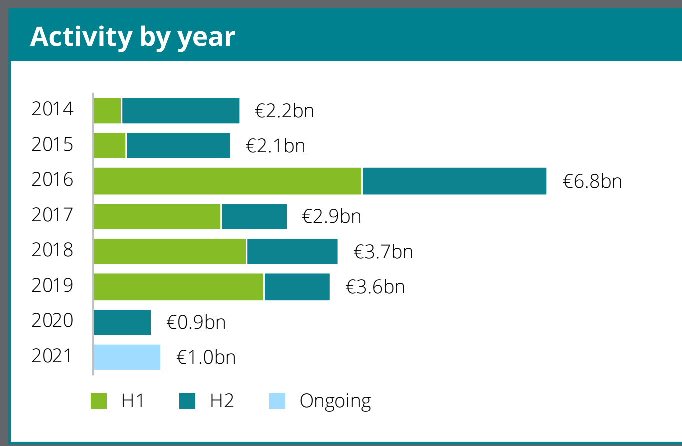
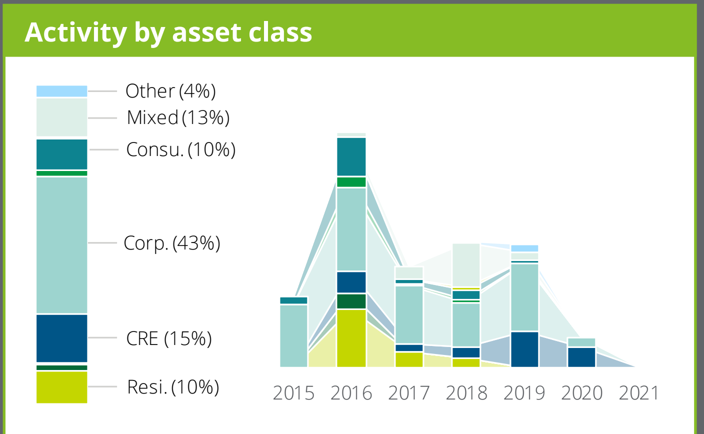
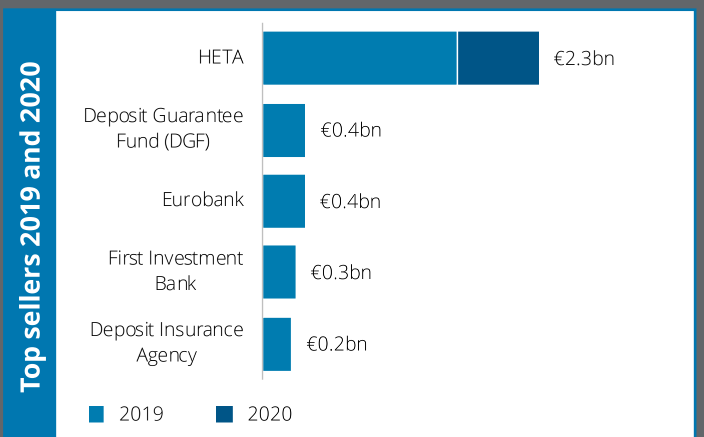
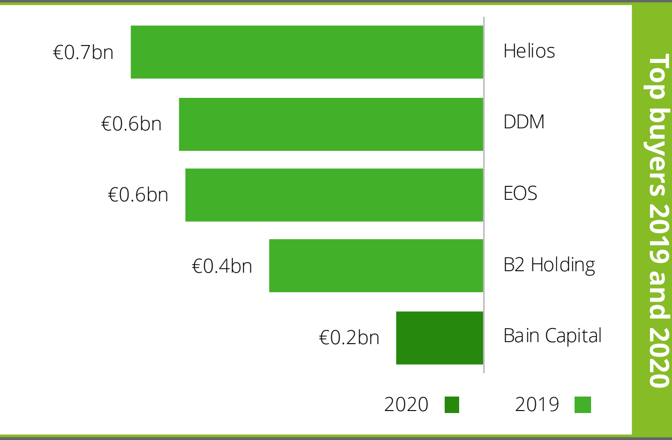








Completed transactions in 2019

Portfolio name	Country	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Serbia	Other	NPL	Deposit Insurance Agency	EOS	240
Confidential	Romania	CRE	NPL	Patria Bank	Kruk	70
Confidential	Poland	Consumer	NPL	GetBack	Hoist	92
Confidential	Croatia	Mixed	NPL	Zagrebacka Banka	DDM	203
Confidential	Bosnia & Herzegovina	Mixed	NPL	UniCredit	B2 Holding	25
Confidential	Ukraine	CRE	NPL	Confidential	Helios	341
Confidential	Ukraine	CRE	NPL	Deposit Guarantee Fund (DGF)	Helios	357
Confidential	Bulgaria	CRE	NPL	First Investment Bank	Confidential	275
Project Lara	Slovenia	Corporate	NPL	HETA	Confidential	800
Project Metro 2	Bulgaria	Corporate	NPL	Eurobank	EOS	350
Project Solaris	Croatia	Corporate	NPL	HETA	B2 Holding / DDM	800

Completed transactions in 2020

Portfolio name	Country	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Ukraine	CRE	REO	Imexbank	Allrise Capital	37
Project Danube	Romania	Corporate	NPL	National Bank of Greece	Bain Capital	174
Confidential	Slovenia	Corporate	NPL	HETA	Confidential	120
Confidential	Slovenia	CRE	Mixed	HETA	Confidential	551

Completed transactions in 2021 and ongoing

Portfolio name	Country	Asset class	Loans	Seller	Buyer	Size (€m)
Confidential	Romania	REO	NPL	Erste Group	-	110
Confidential	Austria	Other	PL	KA Finanz	-	200
Confidential	Ukraine	CRE	NPL	Deposit Guarantee Fund (DGF)	-	290
Confidential	Bulgaria	Mixed	NPL	Confidential	-	430

Deloitte PLAS

Deloitte's Portfolio Lead Advisory Services team ("PLAS") is a global market leading practice, with a dedicated team based in London, specialising in providing clients with end-to-end advisory and assistance across non-core and non-performing loan portfolios.

It has an outstanding market reputation covering deleveraging and strategic advisory, transaction advisory and support and balance sheet advisory.

The core senior team has advised governments, financial institutions, regulatory authorities and global investors on deleveraging and loan portfolio transactions across every major asset class covering over €560bn of assets.

PLAS is supported by a core team of 25 professionals who have worked in advisory, principal investment and banking and by a dedicated network of 140 professionals across the world.

Strategic advisory

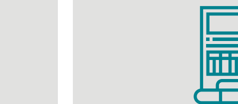
Advising financial institutions on loan portfolio analysis; development and implementation of strategic deleveraging options; structural and operational opportunities to maximise value including bad bank establishment, operational carve outs, operation wind-downs and outsourced servicing

Sell-side advisory

Full-service market advisory to financial institutions and sellers of loan portfolios from strategy and preparation to sales execution

Buy-side assistance

Supporting investors with all aspects of due diligence on loan portfolios including analysis, understanding and pricing



Balance sheet advisory

Advising financial institutions on their capital/liability strategies and options, credit risk management and de-risking tools. Comprehensive support in stakeholder outreach

How we can help

We specialise in providing end-to-end support and advice throughout the life cycle of a transaction

Portfolio Lead Advisory Services

01 Balance sheet advisory & capital optimisation

- Capital advisory and solutions, RWA optimisation / asset de-risking / issuance planning and optimisation
- Capital target positioning
- Resolution planning / capital allocation
- Capital performance benchmarking
- Liquidity risk management advisory
- Market intelligence on regulatory, rating agency, and investor developments

02 Strategic deleveraging options

- Identifying the optimal route to disposing of non-core assets

03 Portfolio optimisation

- Helping you identify the optimal portfolio composition to maximise price and minimise P&L and capital impact

04 Data analytics and insights

- Helping you understand the quality and integrity of your data
- We have a very good understanding of the data requirements and expectations of key investors in the loan portfolio market.

05 Market analysis/ Transaction preparation

- Helping you understand the market, buyers and key transaction considerations
- We can assist you in the four main areas requiring preparation:
- Data
- Documents
- Legal due diligence.

06 Portfolio pricing

- Helping you understand the market price of non-core assets

07 Lead advisory execution & transaction support

- Managing and leading the execution of the transaction from preparing marketing materials, advising on process to liaising with investors.
- Assisting you in preparing assets and operations for disposal
- We will provide sufficient resources and co-ordinate all workstreams, ensuring that the transaction runs smoothly with a minimal burden on you.

08 Migration & operational wind down

- Advising and assisting with the transfer of assets and wind down of non-core operations

Deloitte.

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