

# A Global NPL Perspective

**SELLERS AND INVESTORS  
LOOK TO THE BIG PICTURE**



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# Foreword

Over the past 12 months, we have assisted clients pursuing NPL transactions in the UK, Ireland, Spain, Portugal, Italy, Germany, Greece, Cyprus and China. Indeed, the supply and demand for non-performing assets across the globe shows no signs of abating. We believe that 2019 will continue to be similarly active regardless of whether a European, or even global, recession ensues.

2018 was another very busy year for the Ashurst global NPL practice. Our clients, ranging from sell-side banks to distressed investors, servicers and debt-on-debt providers, have taken on new challenges in both mature and emerging jurisdictions, participated in market-formative transactions and pushed the boundaries of NPL transaction structures.

Building on the success of our earlier Greek NPL Report<sup>1</sup> and following our clients' quest for the "next big thing" in the NPL markets, this year we wanted to go global, aiming to better understand where the future pipeline will come from and where the investment preferences of our buy-side clients currently lie.

We have therefore once again partnered with Debtwire to conduct research into various NPL markets across the globe.

Debtwire and Ashurst sought and received input from 103 senior-level executives about their experiences and their outlook for various established and emerging NPL markets.

The research sample includes financial institutions (in their capacity as sellers), NPL servicers, buy-side investors and professional financial and legal advisors from across EMEA, Asia-Pacific and the Americas. All participants confirmed that they were actively involved in NPL transactions. The research was based on a combination of qualitative and quantitative questions with 100 interviews conducted over the telephone by appointment and three conducted via an online survey. Statistical results were collated and analysed by Debtwire and

specialists within Ashurst, with all responses anonymised and presented in aggregate.

Given the wide remit, this report is not intended to be exhaustive with regard to each individual jurisdiction or geography, but rather focuses on the key features and prospects of each one and gives a direction of travel as to where NPL activity may migrate.

Our sincere thanks go to the 103 participants who contributed so willingly to this research, our Ashurst partners and colleagues across the globe who provided valuable input and insights to this report, Gopika Pant, Vineet Gupta and Anandini Rathore of Indian Law Partners for their contribution to the section on India, and of course Debtwire.

We hope that the report makes for interesting reading and look forward to speaking to you about the findings of this report in more detail.



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<sup>1</sup> Greek NPL momentum builds. Ashurst. <https://www.ashurst.com/en/news-and-insights/insights/greek-npl-momentum-builds/>

## Market Snapshot

It was another record year for the European NPL market in 2018. Over €205bn in completed NPL sales were tracked by Debtwire during the period and over €45bn were in the pipeline at the end of January 2019.

The European market is clearly changing, but will remain active for several years to come. The flow of NPL trades has been moving steadily from Northern Europe to the South over the past few years, and the Mediterranean countries are now at the heart of the action.

In Italy, the Garanzia sulla Cartolarizzazione delle Sofferenze (GACS) scheme, which was devised to help banks offload bad loans, is set to expire in March 2019 and its renewal remains uncertain. Banks in the region are now focusing on the disposal of the large amount of Unlikely To Pay (UTP) loans that remain on their books.

In Spain, after a new series of significant deals, large banks are in the advanced stages of cleaning up their balance sheets. Some are now turning to retail residential mortgages, involving potentially challenging political scenarios.

Greece, meanwhile, is searching for a systemic solution to the mountain of bad loans still on its banks' balance sheets.

Despite all this activity, 2018 may have been the peak year for NPL sales in Europe. Investors are already seeking new opportunities, both in terms of types of asset on the market as well as geographies. China and India are both clearly on their radar.

The Chinese market has been the talk of the NPL town for years, and International investors including Bain Capital Credit, the Blackstone Group and Oaktree Capital Management have already bought sizeable portfolios in China. But the deals are on the order of several hundred million dollars, rather than the billions seen in Europe.

Average non-performing loan ratios for Chinese commercial banks stood at 1.9% at the end of 2018, up from 1.74% a year earlier, according to data released by the China Banking and Insurance Regulatory Commission (CBIRC). While this may appear to be a relatively low NPL ratio, it represents a ten-year high in China, where "lending at risk of becoming non-performing" also rose to 3.4 trillion yuan by the end of December 2018.

Bad loans held by India's banks, meanwhile, stood at 10.36 trillion rupees (US\$150.21 billion) at the end of March 2018, up from 9 trillion rupees in December 2017, according to a statement by then-Finance Minister Piyush Goyal in Parliament.

With a looming recession and debts at record high levels, the time is ripe for investors to consider these new geographies and asset classes for the opportunities they offer in the distressed debt market.

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# Introduction

Over the past decade, the issue of NPLs has posed a significant economic challenge within the Eurozone – hampering economic growth and driving increased regulatory reform across Europe.

The Eurozone has witnessed NPL resolution transaction activity migrate gradually in the past ten years through a range of different countries, market sectors and asset classes.

Now, two considerable milestones have been reached:

- the volume of NPLs in the European market as a whole has been reduced by over a third since 2016 alone, from €1.12trn to €714.3bn, according to the latest available data from the European Banking Authority<sup>2</sup>; and
- tangible market activity has now commenced in all of the major European NPL-burdened jurisdictions following the successful launch and completion of a number of formative transactions in both Greece and Cyprus in 2018.

European interest rates remain at sustained lows and high levels of undeployed capital pervade the markets. It is, therefore, unsurprising that in these special situations, investors continue to find it challenging to source attractive investment opportunities with meaningful upside in Europe.

The mature Western European markets are close to buy-side saturation and the demand-supply imbalance is increasingly pushing prices beyond the levels at which distressed and special opportunities investors are customarily prepared to participate.

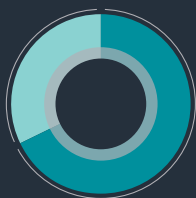
For these reasons, the focus of NPL investors has continued to evolve and migrate in recent years with seasoned buy-side investors increasingly expanding their geographical reach, seeking to replicate their past investment successes, in more mature jurisdictions, further afield.

Italy, Spain and Greece are currently at the forefront of the investor community's attention and are continuing to experience significant deal volumes. For the purposes of this report, we were keen to understand how NPL sellers and investors viewed the current and prospective opportunities in Europe at this pivotal point in time and where their potential focus may migrate next.

<sup>2</sup> <https://eba.europa.eu/risk-analysis-and-data/risk-dashboard>

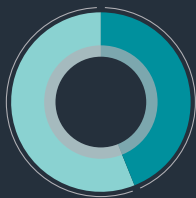
# Key Findings

## SELLERS EXPECT TO KEEP UP SUPPLY OF NPLS TO THE MARKETS GLOBALLY



**68%**

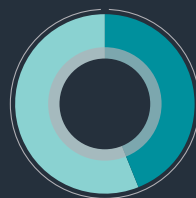
of financial institutions say that they are either very likely or certain to bring an NPL portfolio to market within the next 12 months.



**44%**

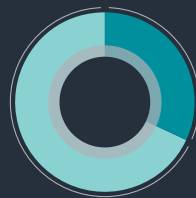
of financial institutions say their primary strategy for NPL reduction is transferring them outright on either a portfolio or single-name basis.

## SELLERS ALSO AGREE ON WHERE THEY WILL FACE CHALLENGES



**44%**

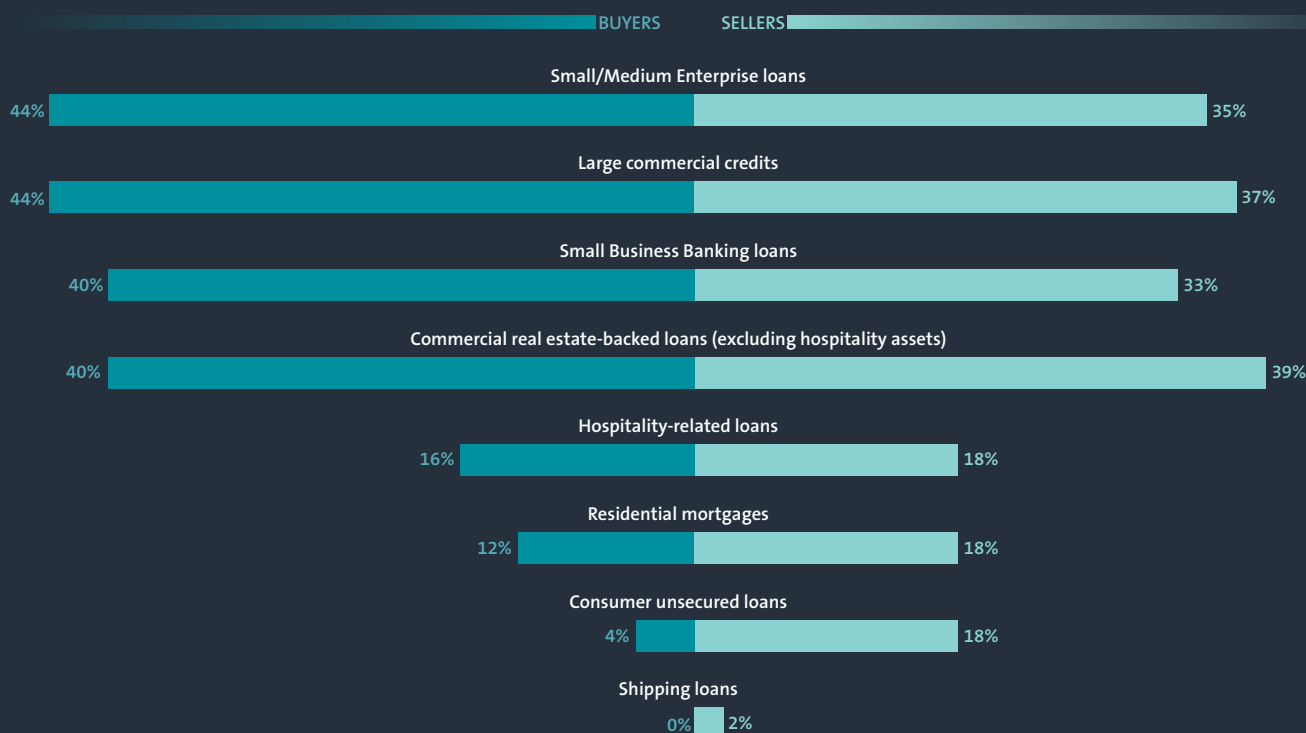
of financial institutions say the large commercial credits sector presents one of their greatest NPL challenges.



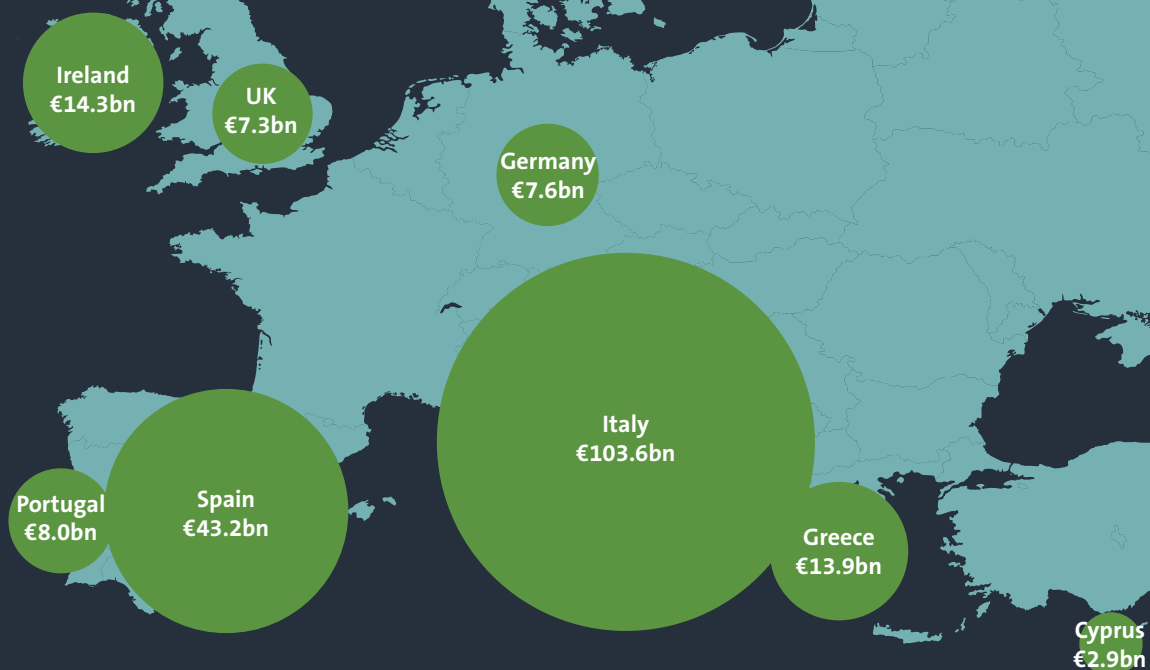
**32%**

of financial institutions have notable issues with both commercial real estate-backed loans and consumer unsecured loans.

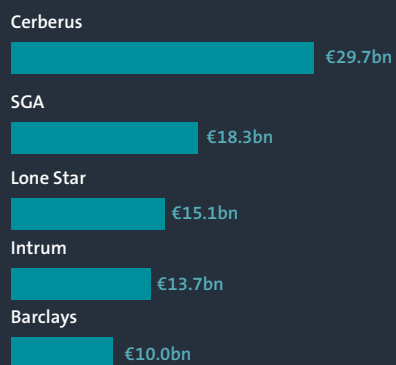
## BUYERS, WHICH ASSET CLASSES WOULD BE OF MOST INTEREST TO YOU IN THE NPL MARKET? SELLERS, WHICH ASSET CLASSES DO YOU THINK THE MARKET IS MORE RECEPTIVE TO ACQUIRE? (SELECT TOP TWO OPTIONS)



## HOTSPOTS AND COMING ATTRACTIONS: NPL TRANSACTIONS BY COUNTRY IN 2018



### TOP FIVE BUYERS IN EUROPE, 2018



### TOP FIVE SELLERS IN EUROPE, 2018



\*Transfer to bad bank SGA.

Source: Debtwire

# Seller and Investor Perspectives: Key Trends

## From panic to purpose – sellers are better prepared to deal with NPLs

### The NPL pipeline remains strong for the foreseeable future

Despite the ever-increasing maturity of the European markets and declining NPL volumes in Europe generally, our research results suggest that there will be little slowdown in the short-term supply of transactions being brought to market in Europe and elsewhere. Ninety-six percent of sell-side institutions report that they are at least “Moderately Likely” to bring a portfolio to market in the next 12 months – 68% are either “Certain” or “Very likely” to do so.

Similarly, while the types of disposal and resolution transactions and strategies deployed by NPL sellers have evolved and broadened, sellers continue to demonstrate a fundamental preference for outright sales processes.

Forty-four percent of sell-side institutions express a preference for outright loan sales, demonstrating the importance to sellers of the “clean break” principle which prevailed in the early Western European NPL markets.

Thirty-two percent of sell-side institutions are primarily seeking to enter into either joint venture arrangements or synthetic transactions. The appetite for securitisation can be attributed to jurisdictions such as Greece and Italy, where established securitisation laws can be used to facilitate disposals where local law and regulation present greater impediments to “plain-vanilla” sales.

While securitisations (16%) and joint ventures (16%) typically involve more complex structuring, they bring certain key advantages such as the ability to replicate outright sale structures while maintaining execution certainty by using tried and tested securitisation laws. Securitisations are also more conducive to facilitating larger transactions (by allowing the tranching of risk and the ability of the vendor to retain an element of economic upside in the portfolio being sold).

It is interesting that 24% of selling financial institutions stated a preference for internal work-out of their NPL books. This is a higher percentage than seen in previous years and demonstrates an increased confidence by banks in their own internal infrastructure to manage NPL positions.

Clearly, when evaluating transaction pipeline, sell-side need has to be matched by investor community appetite and the ability to deliver appropriate levels of return to investors. Our research demonstrates an expectation among investors and financial advisors that, in general, IRRs are set to rise – the data indicates that this general expectation spans not only emerging markets (Latin America, India and China) but also some of the mature markets (UK, Ireland and Italy).

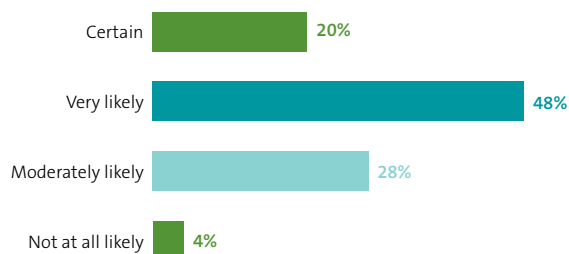
Notable exceptions to this trend include Greece and Spain where opinion is fairly evenly divided as to whether IRRs will increase or decrease in the next two years.



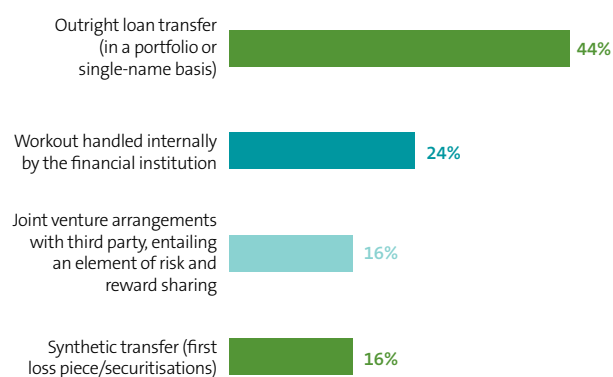
*“As the securitisation markets in general continue to open up across Europe following increased activity over the past 12 months, we can expect to see a continued increase in the use of securitisation structures for NPL resolution going forward.”*

**OLGA GALAZOULA, PARTNER, ASHURST LONDON**

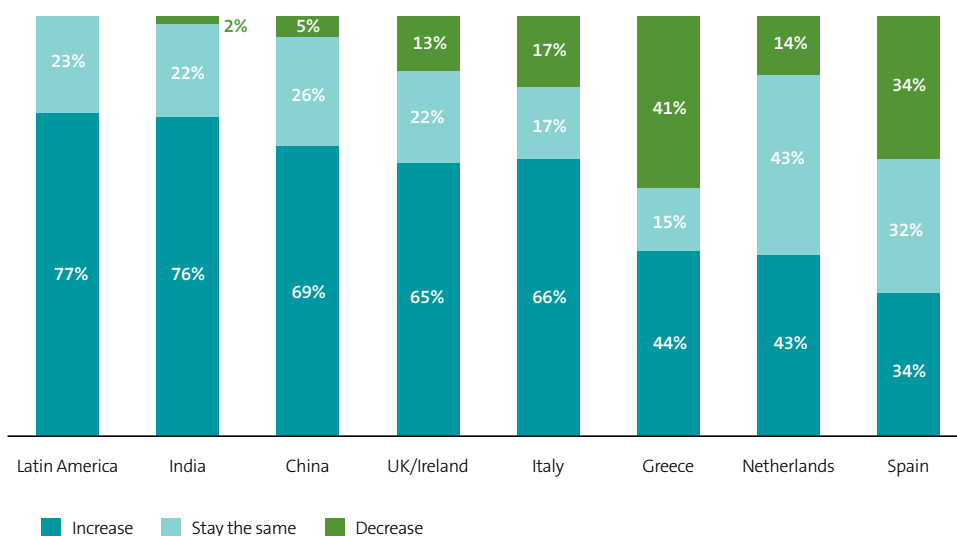
### SELLERS: HOW LIKELY IS YOUR ORGANISATION TO BRING AN NPL PORTFOLIO TO THE MARKET IN THE NEXT 12 MONTHS?



### SELLERS: WHAT IS YOUR ORGANISATION'S PRIMARY STRATEGY FOR NPL REDUCTION?



### INVESTORS, FINANCIAL ADVISORS: HOW DO YOU THINK THE AVERAGE IRR FOR NPL INVESTMENTS IN THE COUNTRIES/REGIONS LISTED BELOW IS LIKELY TO CHANGE OVER THE NEXT TWO YEARS?



## The impediments to establishing active NPL markets appear to be evolving

In each nascent NPL jurisdiction, primarily in Europe, the principal impediments have been the all-important “bid-ask spread”, data quality and insufficient sell-side resources. While those factors clearly still remain, our research suggests that the sell-side community is now finding transaction costs and reputational concerns as more pertinent considerations when bringing NPLs to market.

The process of preparing loan books for sale has always been resource and time intensive for financial institutions. In the aftermath of the global financial crisis, NPL transactions were a boardroom priority and budgets, in general, were simply “found”.

Now, in a more mature market, NPL resolution is perhaps viewed as more business-as-usual and commoditised (with the exception of financial institutions located in jurisdictions with high NPL ratios that are subject to intense regulatory scrutiny and targets to fix their NPL problem). In general, there is less appetite for significant outlays. The increased use of securitisation-based structures in some markets

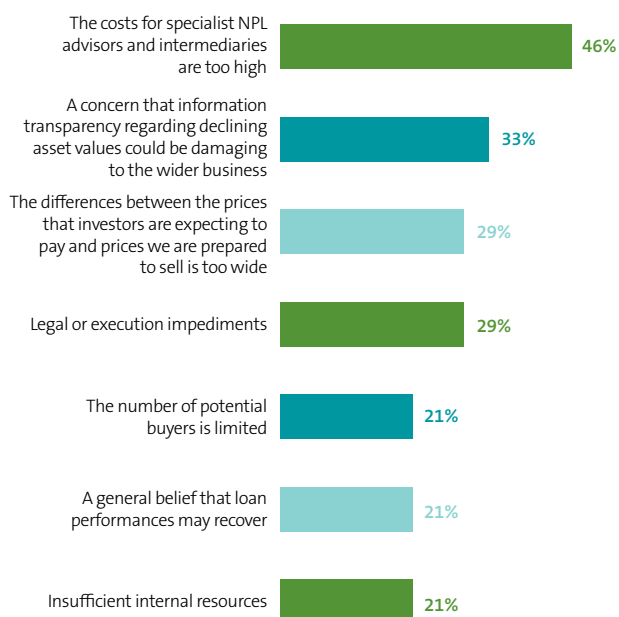
also inevitably generates higher transaction costs given the complex structuring required for these types of transaction.

Reputational concerns are another indication of an increasingly mature market. In recent years, European economies have generally been recovering and individual banks are progressing through their NPL resolution programme. In the mature Western markets, some banks have concluded their processes altogether. It is, therefore, unsurprising that financial institutions are increasingly unwilling, to the extent possible, to show their hand on the extent of their current NPL burden and the impact of declining asset values where that is a consideration.

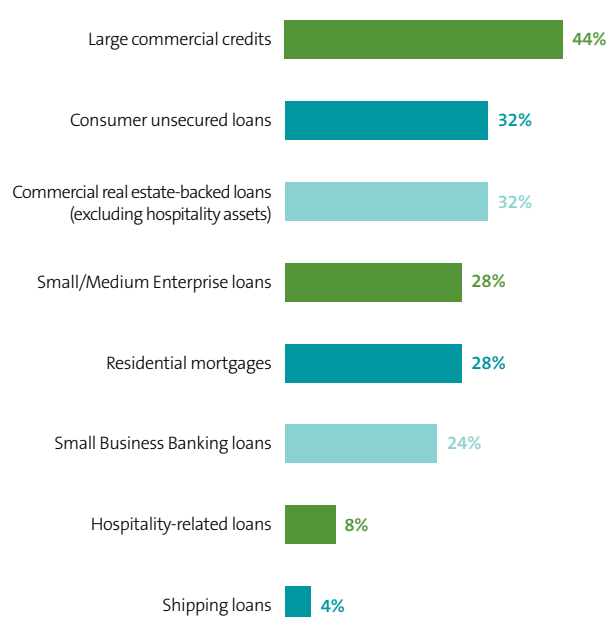
It is interesting that sellers cite a limited number of potential buyers as an impediment to sales processes. While this sits at the bottom of the list, it was unexpected to see it feature at all, given that there is so much dry powder apparently in the market.

This may be indicative of the difficulty sellers face with niche asset classes such as shipping. Equally, not all investors are prepared to undertake securitisation transaction investments or invest the time and money needed to fully understand and evaluate less mature NPL markets.

### SELLERS: WHAT DO YOU SEE AS THE BIGGEST IMPEDIMENTS TO YOUR ORGANISATION BRINGING AN NPL TO MARKET IN THE NEXT 12 MONTHS? (SELECT TOP TWO OPTIONS)



### SELLERS: IN WHICH SECTORS DOES YOUR ORGANISATION FACE THE BIGGEST NPL CHALLENGE? (SELECT TOP TWO OPTIONS)



**There appears to be a broad correlation between the asset classes that sellers wish to sell and the asset classes that investors wish to purchase**

Acknowledging that the data on this point looks holistically across all regions, there does appear to be a broad degree of correlation between supply and demand for commercial real estate assets, large commercial credits, SME loans and shipping loans.

Interestingly, however, responses suggest that there may be greater sell-side need than investor appetite for retail assets (i.e. consumer unsecured loans and residential mortgages) and that there is a greater investor appetite than sell-side need for hospitality sector loans. The hospitality sector has generally out-performed the market and has been a key driver for economic recovery in jurisdictions such as Greece and Cyprus. Therefore, while hospitality assets represent attractive growth potential for investors, there can be an understandable reluctance among sellers to dispose of assets in this sector.

Eighty percent of investors favoured secured portfolios as opposed to unsecured NPLs with commercial real estate remaining the most sought-after asset class.

One of the particular challenges for investors in ever-maturing NPL markets is sourcing portfolios with the optimal composition. Our survey demonstrates that investors are most interested in portfolios comprised of a smaller number of borrower connections with higher-value assets (59%) or, alternatively, single name credit sales (41%).

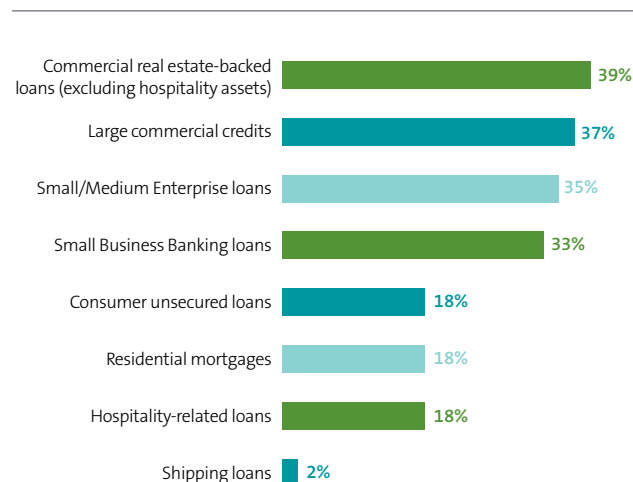
In other words, most investors are looking for a smaller collection of higher value connections upon which they can deploy their work-out expertise. These are very much the types of portfolios that dominated the early market in Western Europe and were popular with investors on loan-to-own enforcement strategies.

Granular portfolios with many connections, each with lower individual value, were less popular at 33%. In principle, this could present a potential problem going forward as granular portfolios now dominate some of the more mature European NPL markets such as Ireland and the UK. The Italian market is still providing a good supply of large commercial real estate secured portfolios while the active Spanish market is arguably at the point of becoming more granular as most commercial real estate-backed portfolios are resolved. Generally, the Greek and Cypriot lending markets, where NPL activity is now taking off, consists mostly of lower “value-per-connection” assets.

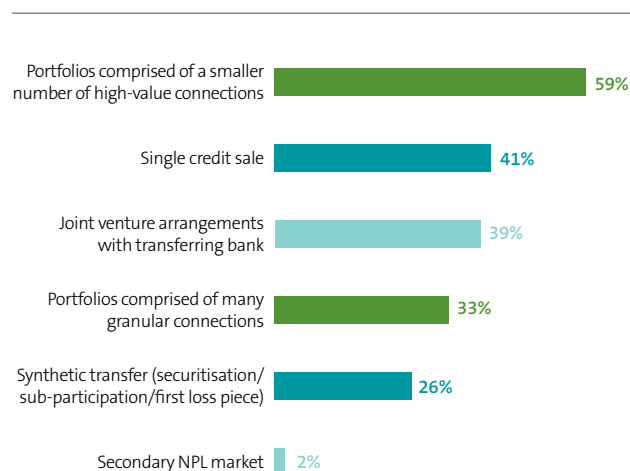
Granular loan books generally lend themselves better to securitisation and hence their prevalence is another broad reason for securitisation transactions being on the rise in markets generally. Looking at these trends as a whole, investors seeking less granular, higher-value connection portfolios may find the landscape becoming increasingly challenging in Europe going forward because of the declining number of such portfolios coming to market.

The popularity of joint venture arrangements seems surprisingly high at 39% given that, while there are some examples completed in the European market, these have been relatively few in number and volume.

**INVESTORS: WHICH ASSET CLASSES WOULD BE OF MOST INTEREST TO YOU IN THE NPL MARKET? (SELECT TOP TWO OPTIONS)**



**INVESTORS: WHICH TYPES OF NPL TRANSACTION WOULD BE OF MOST INTEREST TO YOU? (SELECT TOP TWO OPTIONS)**



# European Focus

## Established markets are still a source of growth

Given the increasing maturity of the European markets and the increasing challenges of finding attractive asset classes and portfolio compositions, we were interested to understand how the investor community currently views opportunities in the existing active European markets.

Europe continues to house significant stockpiles of NPLs. Market activity remains focussed on the Southern European jurisdictions of Italy, Greece and Spain where the greatest stock volumes and ratios reside. Significant further NPL resolution activity is therefore expected in Europe and each jurisdiction will continue to progress at its own pace.

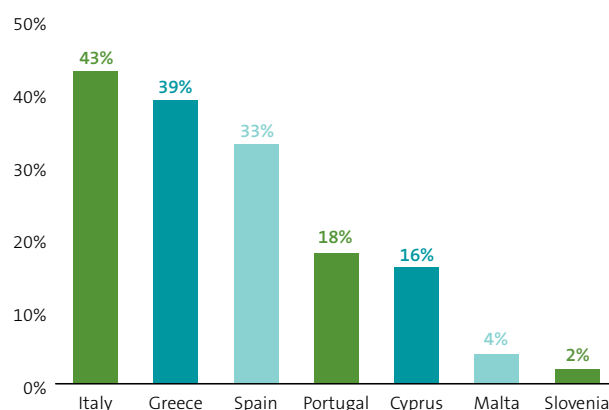
It is unsurprising that 43% and 33% of investors have already invested in Italy and Spain, respectively, in the last two years and that 51% and 45%, respectively, are likely to invest in those two jurisdictions going forward. The data also shows a correlation for continued investment appetite in each of Portugal and Cyprus going forward, albeit in smaller volumes.

### ONGOING DEALS CURRENTLY MONITORED BY DEBTWIRE

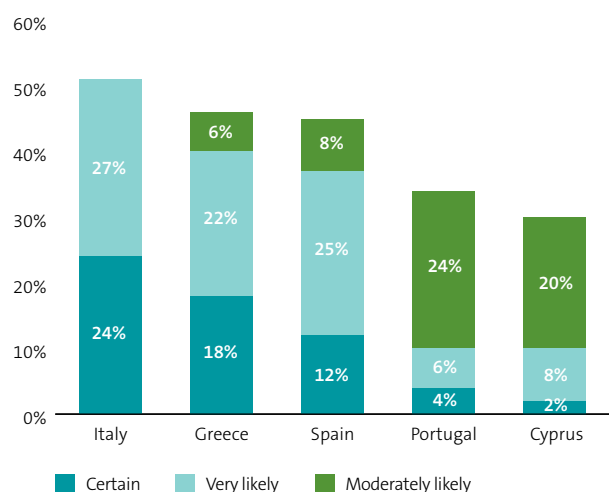
	Total deal value (€bn)	Number of NPL portfolios
Italy	12.1	9
Germany	8.4	2
Ireland	6.6	2
Greece	5.5	5
Spain	3.2	3
Portugal	1.6	3
Cyprus	1.0	1

Source: Debtwire (deals monitored as at 31 January 2019)

### INVESTORS: IN WHICH COUNTRIES IN SOUTHERN EUROPE HAS YOUR ORGANISATION ALREADY INVESTED IN NPLS OVER THE PAST TWO YEARS? (SELECT ALL THAT APPLY)



### INVESTORS: HOW LIKELY IS YOUR ORGANISATION TO INVEST IN NPLS IN THESE COUNTRIES OVER THE NEXT TWO YEARS?



Italy's NPL burden is by far the largest in Southern Europe, eclipsing that of both Spain and Greece. However, at approximately 12%, Italy's NPL ratio is a fraction of Greece's, which stands at 45%.

The results for Greece provide some interesting insight: 39% of investors report that they have already invested in Greece which is a higher percentage than most would likely anticipate given that the Greek market remains in its formative stages.

This figure may be indicative of investors having acquired assets in Greece under single-name transactions or other smaller private transactions. Nonetheless, appetite in Greece clearly remains high, with 46% of investors stating that they are at least moderately likely to invest there in the next two years. This is despite the question mark over IRRs in Greece (see *GREECE: Has its time come at last?* on page 22).



## Things to watch out for: EU's Accelerated Extrajudicial Collateral Enforcement

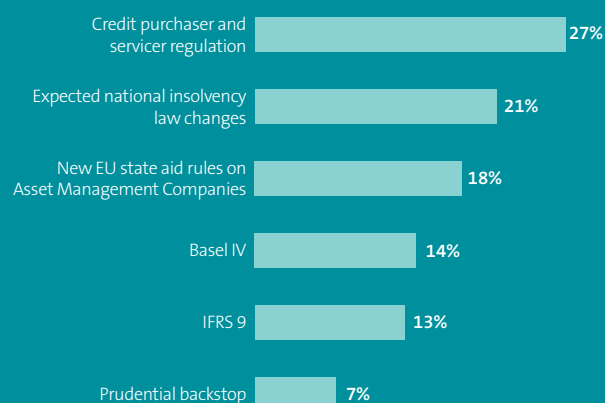
Concerns around the high NPL ratios found in several EU countries continue to dominate the European agenda on banking stability and prudential measures and appear to be a key contributing factor in the shaping of European restructuring and insolvency legislative reforms.

One of the key pillars to the EU's response to the 2008 financial crisis, and the euro crisis that ensued, has been the Banking Union project which includes a raft of initiatives designed to create a safer financial sector, including stronger prudential requirements for banks, improved protection for depositors and rules for managing failing banks. The continued existence of large swathes of NPLs in some member states continues, unsurprisingly, to have a destabilising effect on their banks and consequently an action plan to reduce them has been produced under the umbrella of the Banking Union project.

The European Central Bank is also introducing regulatory measures to tackle the future accumulation of NPLs – designed to make their retention by sellers an increasingly costly and complex affair. The Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral is cited by most respondents (27%) as being the measure that will have the biggest impact on the European market. When asked specifically about the directive, more than 61% believe it will have a positive effect on the European NPL market.


One of the key measures contained in the proposed Directive published on 14th March 2018 is a new enforcement right for secured creditors to provide a more efficient method of value recovery from secured loans in default. The right is described as an expedited and efficient out-of-court enforcement mechanism which enables secured lenders to recover value from collateral granted solely by companies and entrepreneurs to secure business loans. The European Commission has named its new creation, somewhat un-snappily, "Accelerated Extrajudicial Collateral Enforcement" or "AECE" for short.

### ALL PARTIES: IN YOUR OPINION, WHICH REGULATORY DEVELOPMENT WILL HAVE THE BIGGEST IMPACT ON THE NPL MARKET? (SELECT ONE OPTION)



### ALL PARTIES: WHAT DO YOU EXPECT WOULD BE THE IMPACT ON THE NPL MARKET FROM THE PROPOSED DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON CREDIT SERVICERS, CREDIT PURCHASERS AND THE RECOVERY OF COLLATERAL?





For those familiar with English law, the AECE bears resemblance to an English mortgagee's power of sale. It might behave in much the same way except it is intended that this right is not available for consumer loans or where the collateral is the borrower's primary residence. Enforcement can be by way of private sale or public auction (at the choice of the implementing member state) but not, it would seem, by appointing a receiver.

The AECE is supposed to help with NPLs because it will address one of the problems common to many of those member states where enforcement through the courts is too slow and/or too difficult to provide a workable solution. Hence why the Commission has come up with the idea of a contractual, out-of-court, collateral enforcement method for secured creditors.

The initiative is definitely to be welcomed as it aims to create a more level playing field when it comes to the perceived attractiveness of individual EU jurisdictions from an ease of enforcement perspective, will likely open up previously unattractive jurisdictions to certain NPL investors and will be conducive to creating a more vibrant European secondary NPL market.

This initiative is also quite interesting in policy terms. For years, the EU has been pushing the rescue agenda, not an enforcement agenda. And where rescue has not been possible, the focus has been on court-driven collective insolvency procedures (i.e. for the benefit of all creditors), not self-help secured creditor contractual remedies (i.e. for the benefit of one creditor).

This reflects a global trend. In the UK, for example, administrative receivership (an enforcement procedure) used to be the insolvency process of choice until the early 2000s, when the government legislated to mostly replace it with administration (a collective procedure). Despite being promoted as a complement to the restructuring framework draft directive discussed above, the Commission's proposal

for the AECE seems to row back against the main direction of travel, but as mentioned, the main driver is to facilitate a swifter enforcement solution in connection with NPLs and where a rescue of a going concern is not a commercially viable option.

It should be noted though that even if this proposal is implemented and becomes law, its impact on the attractiveness of historic NPLs will likely be limited as the AECE has to be agreed between the lender and its borrower upfront. It could therefore only benefit future secured non-performing business loans.

As a result, local law restructuring and insolvency reforms balancing the interest of stakeholders in a more equitable way, in the manner that we have recently seen in Spain, Italy, Cyprus and Greece and, very importantly, their commercial and timely application and interpretation by domestic courts, will continue to be an area of crucial importance when assessing the attractiveness of a European jurisdiction as a secondary NPL market.

## ITALY: Opportunities abound

Italy is currently the largest NPL market in Europe, with 64 deals undertaken with a total gross book value of €103.6bn in 2018.

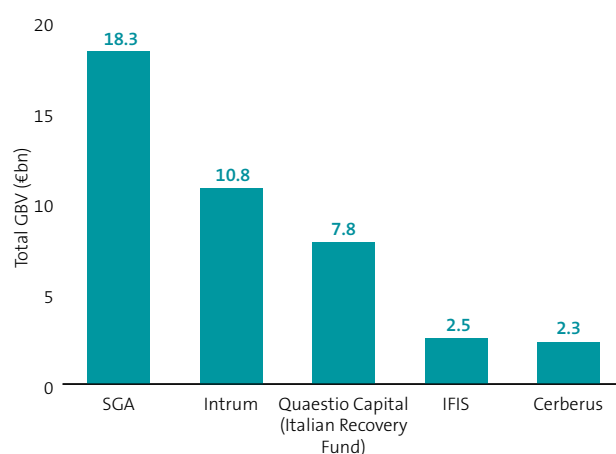
The Italian Government's GACS scheme, pursuant to which the Italian Government provides a guarantee of the senior note receivables of a securitisation, has contributed notably to an increase in Italian NPL disposals over the last two years. A further six-month extension of the scheme, to March 2019, has given extra time to banks to avail themselves of this incentive. At the end of January 2019, the nine live deals being monitored by Debtwire had a combined value of €12bn.

Our research shows that investors remain positive about the anticipated IRR over the next two years: 76% of investors and financial advisors expect their target rate for the country to be 16% or higher for secured NPLs while over half would set their target IRR at the same level for secured NPLs in Greece (64%), Spain (67%) and the United Kingdom (55%).

Target rates are typically at relatively higher levels for unsecured NPLs with almost half (48%) of buyers and financial advisors setting the IRR target at 20% or more for an Italian NPL.

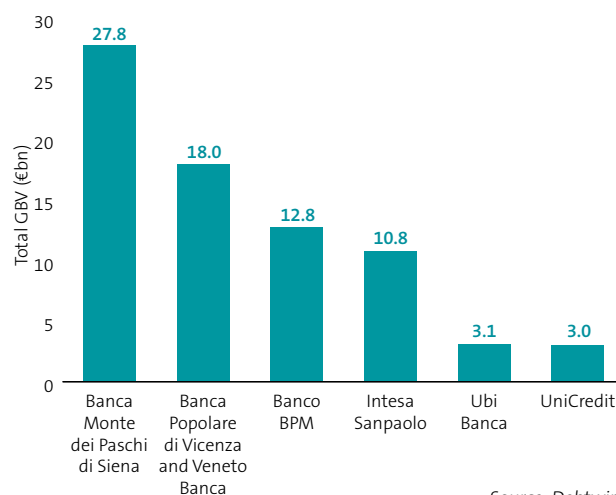
Looking forward, the pressure on Italian banks to deleverage the huge stock of NPLs will lead to other sales opportunities during 2019 and 2020. This is equally true in respect of the country's banks' extensive volumes of UTP loans.

### ITALY: TOP BUYERS IN 2018



Source: Debtwire

### ITALY: TOP SELLERS IN 2018



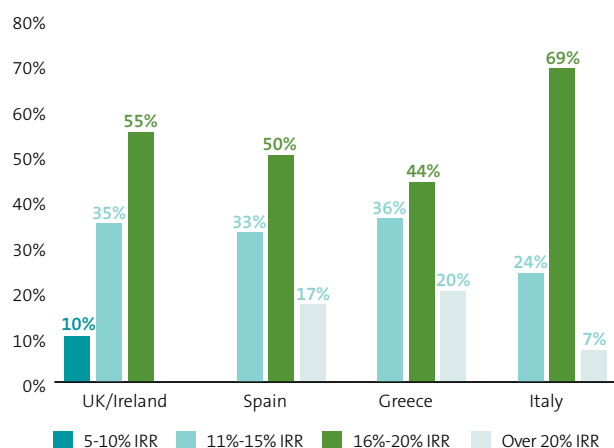
Source: Debtwire

### ITALY: TOP DEALS IN 2018

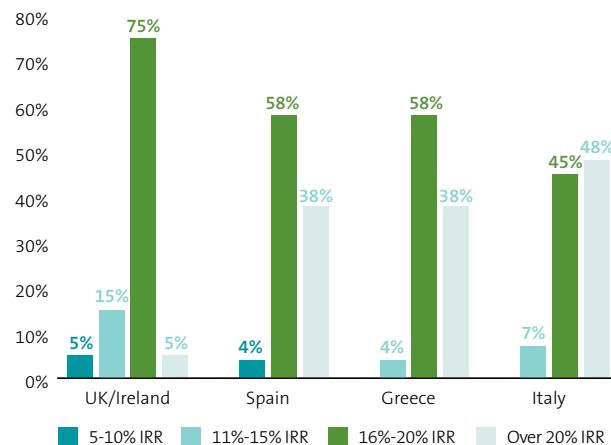
Seller	Name	GBV (€m)	Buyer	Collateral type	Closed
Banca Monte dei Paschi di Siena	Siena NPLs 2018	23,939	Quaestio Capital SGR (Italian Recovery Fund)	Mixed Secured and Unsecured (GACS)	June
Banca Popolare di Vicenza and Veneto Banca	n/a	18,000	SGA	Mixed Secured and Unsecured (NPL and UTP)	April
Intesa Sanpaolo	Project Savoy	10,800	Intrum and CarVal	Mixed Secured and Unsecured, and Platform	April
Banco BPM	Project Ace	7,800	Elliott and Credito Fondiario	Mixed Secured and Unsecured, and Platform	December
Banco BPM	Red Sea	5,097	CRC	Mixed Secured and Unsecured (GACS)	June

Source: Debtwire

## INVESTORS, FINANCIAL ADVISORS: WHAT WOULD BE YOUR TARGET IRR IN RESPECT OF AN INVESTMENT IN SECURED NPLS IN THESE COUNTRIES/REGIONS?



## INVESTORS, FINANCIAL ADVISORS: WHAT WOULD BE YOUR TARGET IRR IN RESPECT OF AN INVESTMENT IN UNSECURED NPLS IN THESE COUNTRIES/REGIONS?



From a legal perspective, UTPs are a more delicate form of asset class than NPLs and require more complex treatment and management in order to preserve their validity when being traded.

Their attraction to investors is that they do extend to cover all industries. Selling institutions are, however, likely to need to deploy significant resources to prepare stocks of UTPs for sale. In most cases, the most effective strategies are likely to be outright sale processes or the outsourcing of the management of UTP portfolios to specialised servicers.

Where an outright sale strategy is adopted, the fundamental nature of UTPs means that it will not be possible for sellers to group them into large, granular portfolios. Instead, UTP credits will need to be dealt with as single-name sales or small, high-value portfolios which, advantageously, is the composition of portfolio that investors report they were most actively seeking.



*“Italy will keep investors busy for at least the next two years. As the survey shows, smaller, less granular portfolios with good-quality connections are preferred by buyers. While we will still be witnessing transfers of large NPL portfolios and GACS securitisation schemes to reduce the non-performing exposure (NPE) ratios, the upcoming UTP deal flow will offer to investors single names and small portfolio opportunities.”*

PAOLO MANGANELLI, PARTNER,  
ASHURST MILAN

## SPAIN: Deals under the radar

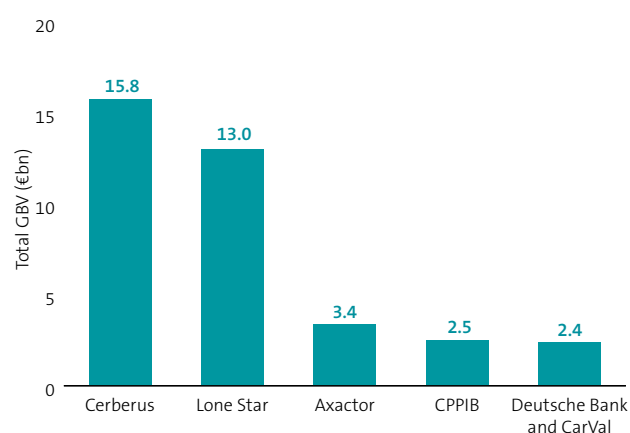
After years of heavy restructuring and consolidations, over the past 12 months Spanish banks have been looking to reduce their NPL ratios at pace. The country saw 27 deals undertaken with a total gross book value of €43.2bn in 2018.

Notwithstanding this, there have been examples of significant bank distress such as the collapse of Banco Popular, which was eventually sold to Banco Santander in 2017 for €1. However, after a market that has been active for many years, the Spanish banks are now emerging in better financial health and stability and with increasing levels of international business.

While the sale of NPL portfolios have proceeded with a steady flow of competitive auction processes over the last 18 months, certain banks have taken advantage of the sellers' market and negotiated large-scale transactions on a bilateral basis outside of traditional auction processes.

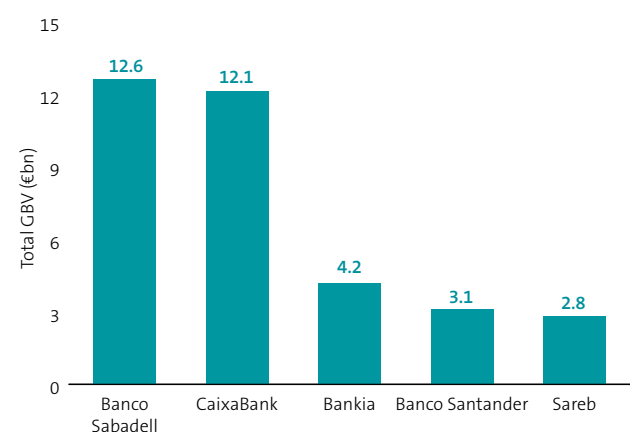
Illustratively, in 2017 Santander ran a streamlined process to sell Banco Popular's €26.6 billion real estate assets portfolio. The process was open to a small group of selected bidders only. In some cases, sellers did not hold competitive auction processes at all. Notable sellers who have adopted this approach include BBVA and CaixaBank. These tailored processes avoided the expense involved in competitive processes for the sellers and avoided uncertainty for the bidders.

## SPAIN: TOP BUYERS IN 2018



Source: Debtwire

## SPAIN: TOP SELLERS IN 2018



Source: Debtwire

## SPAIN: TOP DEALS IN 2018

Seller	Name	GBV (€m)	Buyer	Collateral type	Closed
CaixaBank	Project Gama	10,000	Lone Star	Real Estate, and Platform	June
Banco Sabadell	Project Challenger	5,880	Cerberus	REOs	July
Banco Sabadell	Project Coliseum	3,430	Cerberus	REOs	July
n/a	Project Mauser	3,154	Cerberus	Consumer and SME Loans	December
Bankia	n/a	3,070	Lone Star	NPLs and REOs	December

Source: Debtwire

Most of the portfolios sold in competitive processes involved land and developments under construction. Several investors subsequently bought their own construction companies to restart development.

As a mature market with an established population of strong purchasers, we are expecting to see an increase in the volume of secondary portfolio sales in Spain going forward. This trend is already becoming more prevalent together with the increasing use of acquisition debt to leverage acquisitions of NPL portfolios.

A further interesting development in the Spanish market is the return to structures whereby NPLs are sold by way of direct asset transfers to a purchaser. This reflects a move away from hive-down structures that were first used in 2017 under which NPLs were transferred to a transaction special purpose vehicle (SPV) which was itself then sold to investors in order to implement an NPL sale.

While such hive-down structures still remain popular for the transfer of real estate assets forming part of a portfolio, it is now increasingly common for the loans assets themselves within a portfolio to be sold directly to the purchaser.



*“As the Spanish NPL market matures, the development of a secondary market, an increased use of debt on debt finance and greater legal certainty on structuring points will continue to help drive large volumes of transaction activity.”*

**JOSE CHRISTIAN BERTRAM,  
PARTNER, ASHURST MADRID**



## Things to watch out for: Data Protection and NPL Transactions

The European General Data Protection Regulation 2016/679 (GDPR) introduces the potential for high fines (of up to 4% of worldwide annual turnover) and regulatory sanctions which brings into sharp focus the need for compliance. However, less widely understood are the implications that GDPR holds for NPL transactions. Virtually all NPL transactions will, after all, include the need to process personal data by virtue of the information in the underlying loans. This includes customers' credit information and risk profiles.

Under the GDPR, the concept of personal data is widely cast and encompasses any information relating to an identified or identifiable natural person. Specific examples given in the GDPR include name, identification numbers and references. Personal data is therefore not limited to the identifiers themselves but also includes almost anything linked to those identifiers. A "data controller" is an entity which, alone or jointly, determines the purposes and means of processing, and both the seller and the potential buyer will usually be data controllers.

Almost any interaction with personal data will amount to processing including collecting, organising, storing, altering, retrieving, using and erasing. Given the wide scope of personal data and processing activities, data protection requirements are therefore most likely to impact an NPL transaction at two stages: the Due Diligence stage and the Completion stage.

### Lawful Basis of Processing

A fundamental principle of the European data protection regime is that all processing of personal data must be lawful. This means that processing activities must fall within one of the six lawful bases set out in Article 6 of the GDPR. The most appropriate lawful basis for processing in the context of an NPL transaction is "legitimate interest". While this is the most flexible basis, it does require organisations to assess and document their assessment of the interests of the seller versus the interests of the individual, giving

consideration to the impact on their fundamental rights and freedoms (Legitimate Interest Assessment). Completing such an assessment is not an easy exercise and requires due consideration to the purpose of disclosure, the impact on the individual and, indeed, whether the purpose of processing can be achieved without the disclosure of the personal data.

From an accountability perspective, the Legitimate Interest Assessment should be prepared by the counsel to the seller, considered carefully by the board, the deal team and the responsible data protection officer and a detailed record thereof should be retained by the seller as part of its data protection governance documentation.


### Due Diligence and Data Minimisation

The seller should consider whether the personal data being disclosed in the dataroom (or otherwise) is necessary for the purpose. This is the principle of data minimisation. Typically, where data is not necessary for the purpose, it should be removed or redacted. Redaction exercises can be costly, difficult and time consuming. It is important to note that redaction may not be required in every instance and sellers should agree a scope of documents required for the due diligence exercise and may wish to consider a phased approach to the exercise.

From a data governance perspective, while the potential buyers will be considered a controller, any NDAs entered into for access to the dataroom should include relevant controls limiting the use of personal data similar to those used for other confidential information.

### Fairness and Transparency

A controller is required to notify individuals of the basis of its processing activities. Sellers will commonly already include "the sale of a business, assets or portfolio" or "corporate restructuring" in their standard privacy notice. This should have been provided to the underlying loan customers at the time of originating the loan but, depending on the



jurisdiction of the NPL seller and its internal procedures, this may not always be the case. We have witnessed a number of recent cases where sellers' standard privacy notices have not been updated for GDPR purposes and consequently have been insufficiently detailed. This can lead to protracted discussions between the transaction parties (and third parties such as the domestic data protection commissioners) as to the appropriate way forward to facilitate the NPL transaction in a data protection-compliant manner.

The obligation to notify also exists where personal data is not directly collected from the individual. On completion of the transaction and once the NPL portfolio has been transferred, the buyer will need to comply with this obligation by issuing a privacy notice, identifying itself as the new controller and the purposes of its processing.

#### **International Transfers**

Where, as will be the case most pertinently for transactions involving US NPL investors, there may be a transfer of data outside of the European Economic Area, further considerations come into play. It is worth noting that the impending Brexit is likely to broaden the number of transactions where such extra disclosure considerations becomes relevant. Such data transfers are further restricted unless the jurisdiction is subject to an adequacy decision from the European Commission or an appropriate safeguard is put in place. The most common safeguard relied on in the absence of an adequacy decision would be the European Model Clauses. These are standard EU Commission issued contractual clauses which are to be entered into between the exporting and importing entities.

## GREECE: Has its time come at last?

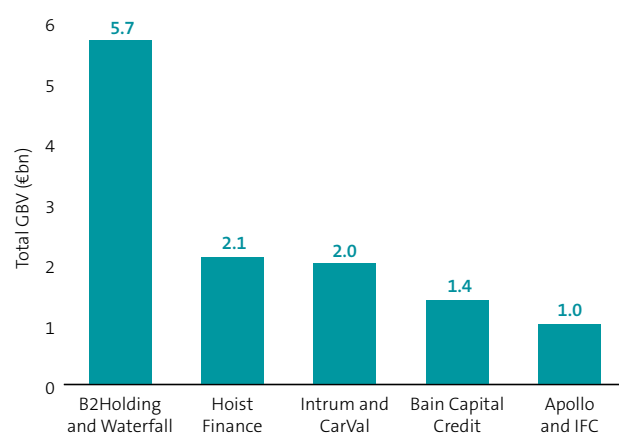
Greece has long been expected to be the next key European NPL market. We have witnessed first-hand since 2015 the major NPL institutional investors increasingly turn their focus to the country and gradually increase their investment in understanding local market dynamics and legal and regulatory frameworks. In 2018, we have seen the first two major secured NPL acquisitions successfully conclude (Project Amoeba and Project Jupiter), in addition to continuing unsecured and retail NPL transaction activity. The country saw eight deals undertaken with a total gross book value of €13.9bn in 2018.

While the economic outlook for Greece has improved significantly in recent years, Greek banks continue to be under pressure to progress their NPL resolution programmes. The banks have now been recapitalised three times since the 2010 debt crisis and are still weighed down by bad loans to a greater extent than their counterparts in any other EU country.

Pursuant to targets agreed with the European Central Bank, the aim of the Greek banks is to reduce their aggregate NPL exposure to €65 billion by the end of 2019. In addition, in November 2018, the Central Bank of Greece published a proposal for a “centralised management scheme” wherein banks would transfer a “significant part” of bad loans and deferred tax claims to an SPV.

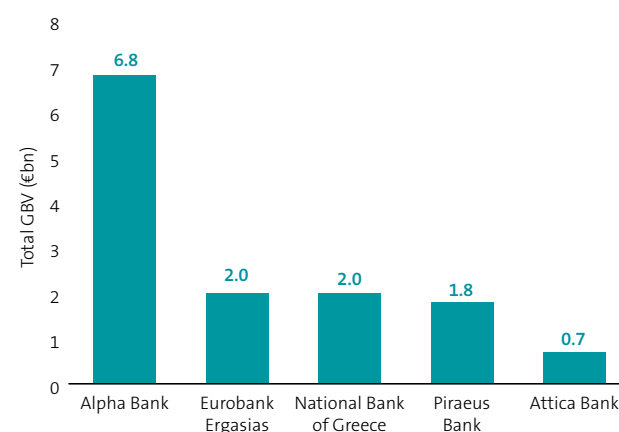
The bank could then “transform the transferred deferred tax credit into an irrevocable claim of the SPV on the Greek State with a predetermined repayment schedule.” This is designed to achieve a single-digit exposure ratio within three years.

### GREECE: TOP BUYERS IN 2018



Source: Debtwire

### GREECE: TOP SELLERS IN 2018



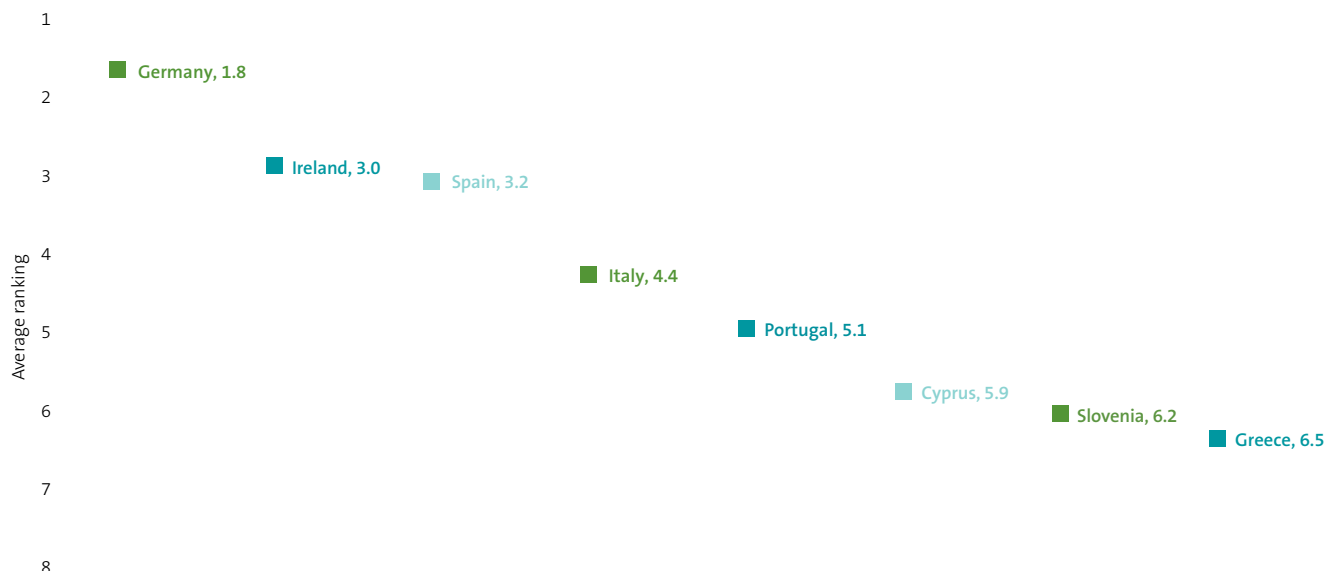
Source: Debtwire

### GREECE: TOP DEALS IN 2018

Seller	Name	GBV (€m)	Buyer	Collateral type	Closed
Alpha Bank	Project Venus	3,740	B2Holding and Waterfall	Unsecured Consumer Loans	October
Alpha Bank	Project Mercury	2,100	Hoist Finance	Unsecured Consumer and Small Business Loans	November
Eurobank Ergasias	Project Zenith	2,024	B2Holding and Waterfall	Unsecured	October
National Bank of Greece	Project Earth	2,000	Intrum and CarVal	Unsecured	June
Piraeus Bank	Project Amoeba	1,450	Bain Capital Credit	Secured	May
Alpha Bank	Project Jupiter	1,056	Apollo and IFC	Secured and REO	November

Source: Debtwire

**SERVICERS, LAWYERS: PLEASE RANK THE FOLLOWING EUROPEAN COUNTRIES FROM THE MOST TO THE LEAST EFFICIENT REGULATORY REGIME FOR OBTAINING AND OPERATING UNDER A LICENCE TO BE A SERVICER OF NPLS. (WHERE 1= THE MOST EFFICIENT AND 8= THE LEAST EFFICIENT)**



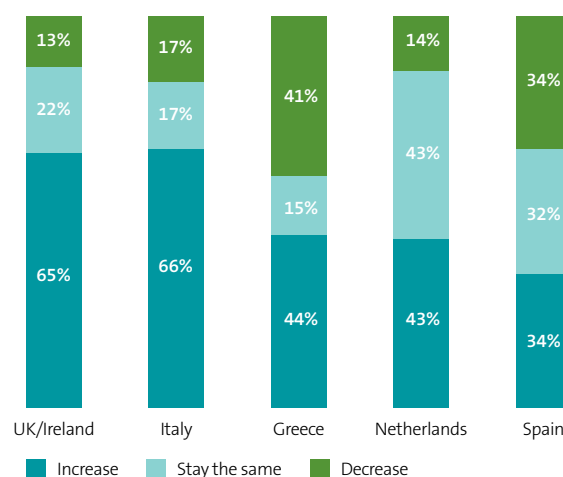
A second plan promulgated by the Hellenic Financial Stability Fund envisages the creation of an NPL securitisation programme guaranteed by the Hellenic Republic, akin to the structure adopted in Italy.

It is understood that both of these plans are to be considered by the European Competition Commission in order to determine what, if any, state aid issues they create before they are taken further. Experience suggests that things are traditionally not fast moving in the country, so it remains to be seen whether concrete changes will indeed be effected within a sensible timeframe.

Greece has thrown up some unexpected results in our survey, reflecting uncertainty over this market and its medium- and long-term prospects. By way of illustration, respondents are split almost equally as to whether they expect average IRR to increase or decrease over the next two years in respect of transactions pursued in the country.

Despite the number of licensed servicers having considerably increased in the past year and the licensing process having been simplified compared to when it was first introduced, investors still report that they find the process for obtaining a licence onerous. Indeed, our research concludes that servicers and lawyers rank Greece as having the least efficient

**INVESTORS, FINANCIAL ADVISORS: HOW DO YOU THINK THE AVERAGE IRR FOR NPL INVESTMENTS IN THESE COUNTRIES/REGIONS IS LIKELY TO CHANGE OVER THE NEXT TWO YEARS?**



regulatory regime for obtaining and operating under a licence out of all of the principal European markets.

In terms of legal structures followed in the NPL transactions that have taken place, it is encouraging to see that the 2003 Greek Securitisation Law has been successfully utilised to facilitate execution of those sales. This is a long-established statutory regime which brings the notable benefit to Greek disposal transactions of not requiring a seller to provide advance notice of a loan sale to the underlying borrower population.

It is further encouraging that the original concerns of the legal community on the correct interpretation of the interaction between the 2015 NPL transfer law and the 2003 Greek Securitisation Law appear to have been sufficiently addressed as a result of recent clarifications in the legislation.

With these positive developments, our view is that the Greek legal and regulatory environment appears to be embracing the new world of NPL sales with a renewed sense of commitment. These formative successful NPL sales, together with the recent insolvency and security enforcement law reforms, should in principle be conducive to maintaining a healthy level of interest in the Greek market.

Having said that, Greece remains a new and developing market, with an economy that remains susceptible to wider market shocks, as evidenced late last year with a period of sustained and aggressive bank stock sell-off. This first half of 2019 will likely prove pivotal in assessing Greece's prospects as a sustainable NPL market, with the country in pre-election mode.



*“After a lead period of many years, tangible NPL market activity is now underway in Greece and we only expect that activity to further gear up over the next two years.”*

MARK EDWARDS, PARTNER,  
ASHURST LONDON

## Things to watch out for: Securitisation/Significant Risk Transfer (SRT) of NPLs

While the securitisation market has developed at pace in the past year with the new Securitisation Regulation and associated restatement of the Capital Requirements Regulation (CRR) both coming into force at the beginning of 2019, the development of clear guidelines relating to the NPL market has lagged behind the development in the rest of the market.

The Discussion Paper issued by the European Banking Authority (EBA) in 2017 specifically sought to deal with the particular issues of SRT in the NPL market and attracted a variety of comments from market participants. According to the consultation paper issued by the Prudential Regulatory Authority (PRA) in May 2018, the EBA will report its findings in relation to harmonising SRT by 2 January 2021 and will, it is assumed, clarify the position with regard to NPL securitisation. Following this, the European Commission (EC) may choose to adopt a Delegated Regulation to further specify certain aspects of the CRR SRT framework. Until such time, however, no specialised regime is applicable to NPL exposures.

The areas under consideration by the EBA are, in summary:

- (i) recognition that standards applicable to performing exposures may not be appropriate and/or may require further elaboration in the case of transactions in which NPLs are securitised;
- (ii) recognition that further work may need to be carried out in relation to amortisation structures and/or the use of excess spread to take due account of the specific aspects of NPL securitisation transactions; and
- (iii) specific regulatory treatment of expected and unexpected loss risk may need to be tailored to NPL securitisation transactions including defaulted exposures or where purchase prices are set at sub-par levels.

While the EC is openly committed to an action plan relating to the reduction of NPLs and specifically commented on the desire to see further developments as regards risk reduction in the banking sector as part of progress to a more integrated and stable EU financial system (see their statement to this effect in November 2018), further specifics on when to expect the more tailored proposals on what is needed for SRT in NPL transactions (as opposed to SRT for securitisations generally – already provided for in the new CRR (Article 244 et seq.)) are still eagerly awaited by the market participants. It is to be hoped that these are delivered well before the January 2021 deadline as this is an area clearly requiring a level of clarity and certainty currently not provided.

# New Markets in Focus

There is increasing evidence that NPL investment appetite is continuing to drive investors to seek out new markets outside of Europe and that certain emerging markets may have already been more active than widely perceived.

At this point in time, our survey indicates that China is the main focus of investors outside of the European markets: 55% of investors report that they are at least moderately likely to invest in China in the next two years with 33% saying that they are certain to do so. This, of itself, is perhaps unsurprising given that NPL volumes have been rising in China for some time. However, one unexpected finding from our research is that 57% of investors state that they have already invested in Chinese NPLs in the last two years – this is far higher than most commentators would have expected.

Generally, our research suggests that Asia may be set to outpace Latin America on NPL transaction volumes over the next two years. The data suggests that China, India, Thailand, Indonesia, Brazil, Argentina and the Middle East will each see a constant or increasing number of investors looking to invest in NPLs over the next two years when compared to the last two years.

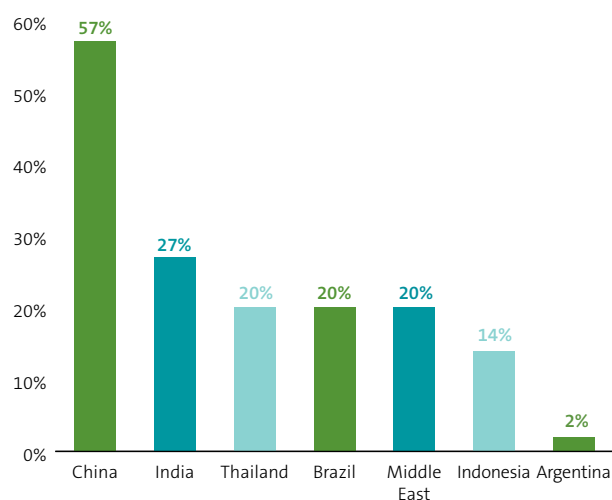
In terms of IRR expectations for the emerging markets, over half of NPL investors and financial advisors (53%) report that they would target an IRR of 16-20% for Chinese secured NPLs, with 9% setting their sights at over 20%. The range is much lower in India and Latin America where the majority report that they would adopt a more conservative target IRR of 11-15% for secured deals.

This figure would be higher for unsecured NPLs across the three emerging NPL market regions, with China again out in front – a third of respondents report a target IRR of over 20%.

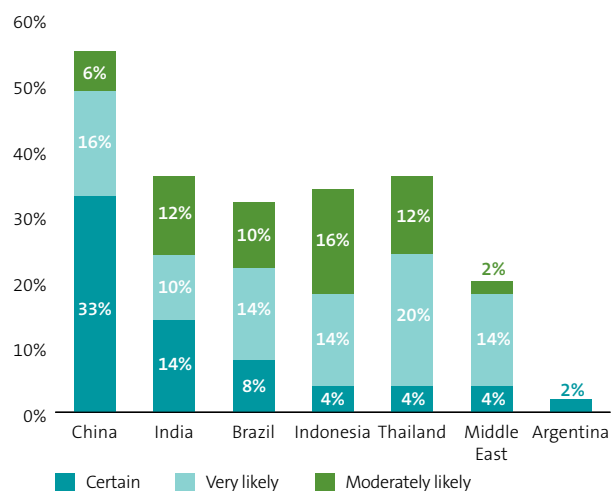
The majority of NPL investors and financial advisors expect the average IRR for NPL investments to increase in China (69%), India (76%) and Latin America (77%) in the future.

Some of the principal challenges that offshore investors naturally face in emerging markets revolve around access, repatriating cash proceeds and competing with domestic

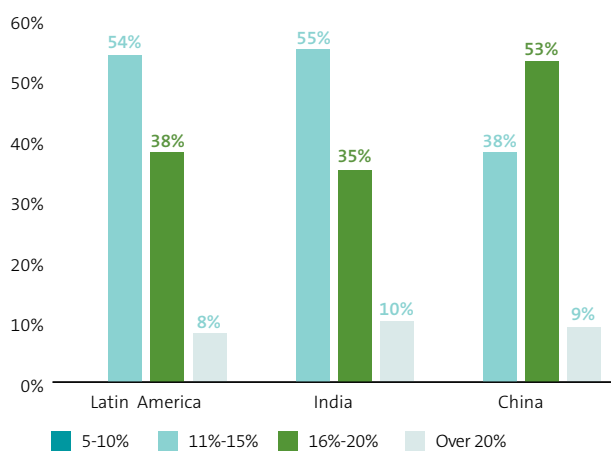
## INVESTORS: IN WHICH EMERGING COUNTRIES/REGIONS HAS YOUR ORGANISATION ALREADY INVESTED IN NPLS OVER THE PAST TWO YEARS? (SELECT ALL THAT APPLY)



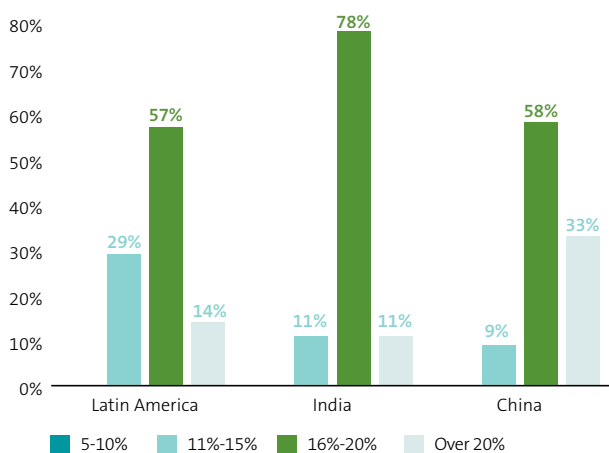
## INVESTORS: HOW LIKELY IS YOUR ORGANISATION TO INVEST IN NPLS IN THESE EMERGING COUNTRIES/REGIONS OVER THE NEXT TWO YEARS?



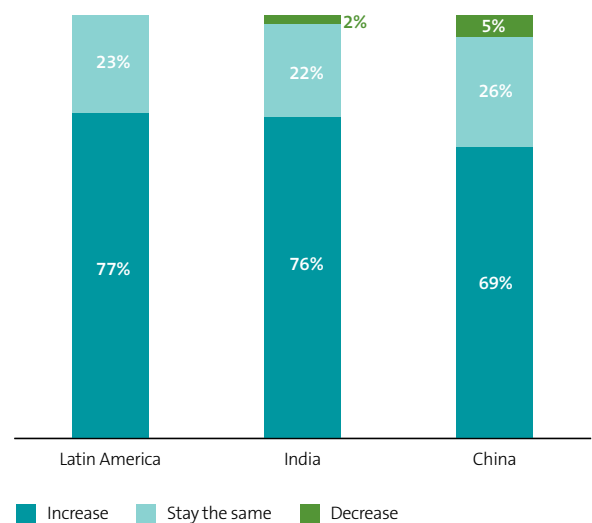
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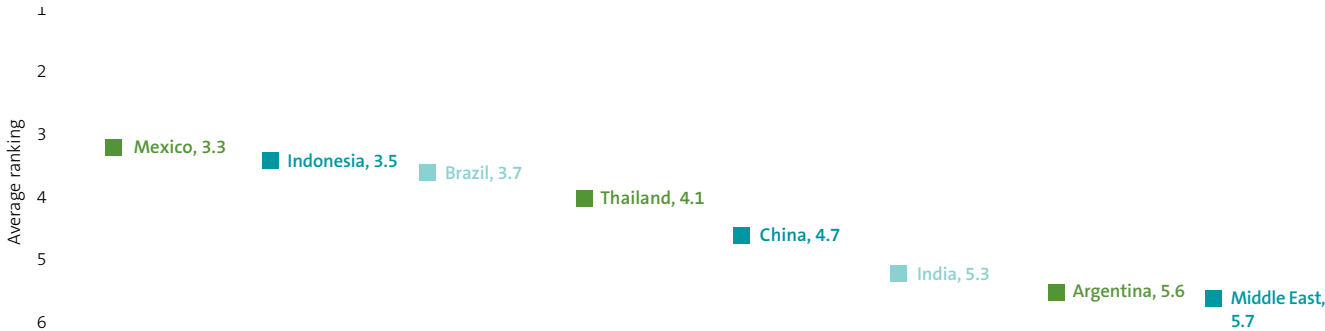
buyers. Offshore investors targeting these jurisdictions will need to be well-resourced and conduct their financial, legal, regulatory and local custom research in order to be successful. In addition to these very practical challenges, we can expect to see initial market inertia as we have in every NPL jurisdiction before tangible market activity commences.

Historically, as explored earlier (see “*The impediments to establishing active NPL markets appear to be evolving*” on page 10), the principal impediments widely cited to an active market commencing in any country have been “bid-ask spread”, data quality and insufficient sell-side resources. Emerging regions trying to develop a stronger NPL market face a range of challenges. In Asia, 43% of respondents (including both buy- and sell-side respondents in the industry) believe that the resource-intensive nature of NPL sales has made it difficult for the continent’s banks to handle them internally. Other challenges include loans generally being too granular to create streamlined portfolios and an absence of quality debtor data (according to 37% and 40% of respondents, respectively).

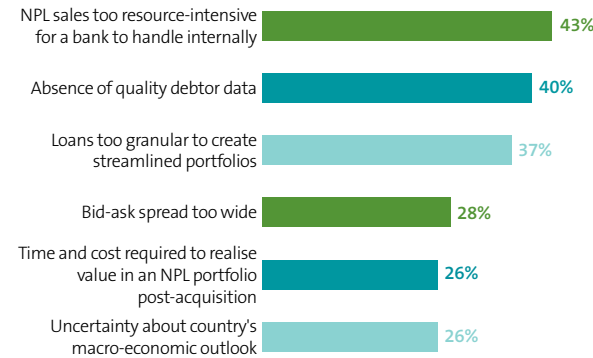
Conversely in Latin America, the two least popular responses for Asia come out top: 55% of respondents cite macro-economic outlook uncertainty as the greatest challenge to creating a more active NPL market; 38% report that the time and cost required to realise a value in an NPL portfolio in Latin America is their key concern.

In terms of the regulatory landscapes for NPL resolution in the emerging regions, our respondents’ views were mixed. While Mexico, Indonesia and Brazil are deemed relatively efficient, the Middle East, Argentina and India are ranked at the bottom.

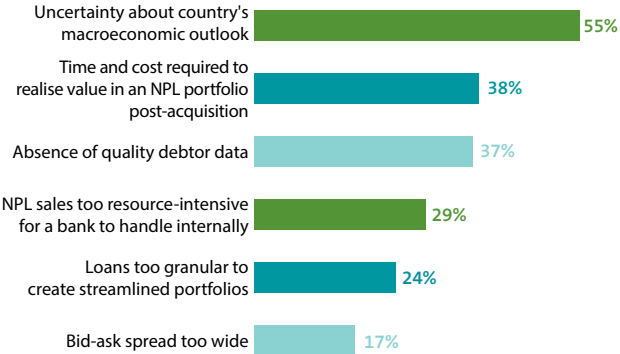
SERVICERS, LAWYERS: PLEASE RANK THE FOLLOWING COUNTRIES FROM THE MOST TO THE LEAST EFFICIENT REGULATORY REGIME FOR OBTAINING AND OPERATING UNDER A LICENSE TO BE A SERVICER OF NPLS. (WHERE 1= THE MOST EFFICIENT AND 8= THE LEAST EFFICIENT)



ALL PARTIES: WHAT DO YOU CONSIDER TO BE THE MAJOR CHALLENGES TO CREATING A MORE ACTIVE NPL MARKET IN ASIA? (SELECT TOP TWO OPTIONS)



ALL PARTIES: WHAT DO YOU CONSIDER TO BE THE MAJOR CHALLENGES TO CREATING A MORE ACTIVE NPL MARKET IN LATIN AMERICA? (SELECT TOP TWO OPTIONS)



## CHINA: All eyes on the prize

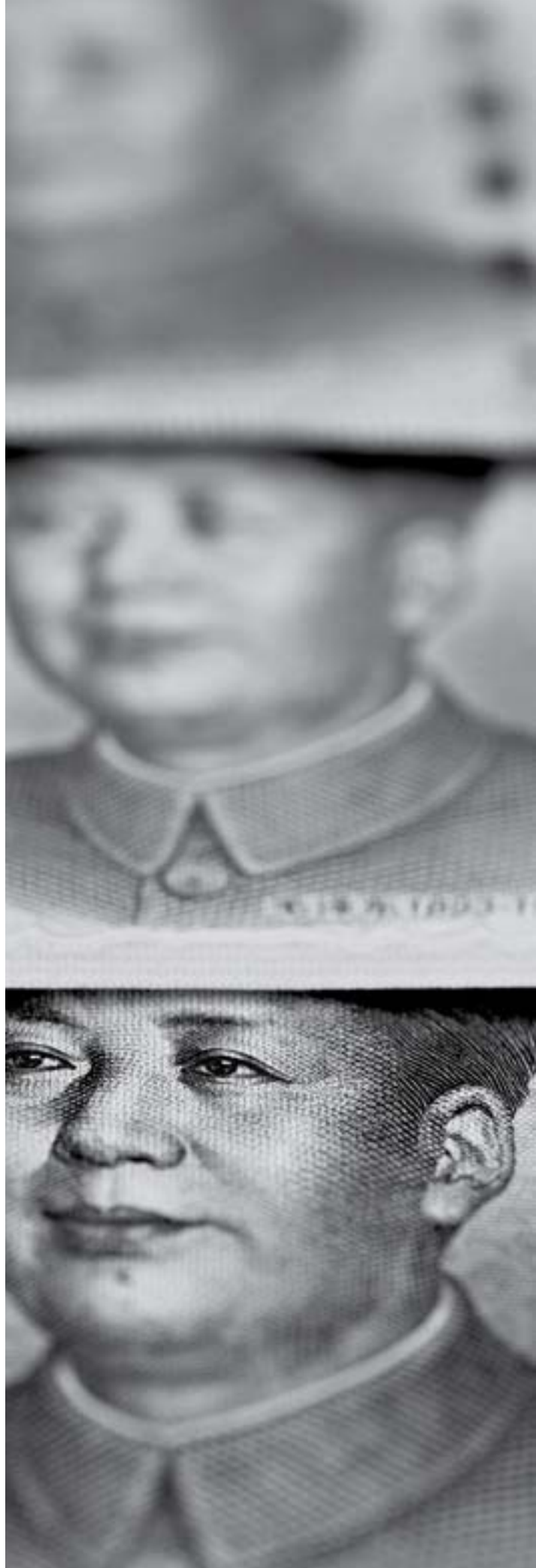
Referring to China as an “emerging” NPL market is a misnomer. The country has an established NPL infrastructure, which dates from 1999 when the Chinese Government set up the original four AMCs for the purposes of acquiring NPLs from the four largest Chinese banks and preparing them for sale to investors. China’s first NPL cycle ran from 2001 until 2008 and is widely heralded as having been a great success for the country. Although there was strong interest from international banks looking to invest during this cycle, offshore investors ultimately had very limited success. Commentators widely attribute this to the opaque Chinese legal system, political and strategic issues related to working out state-linked assets, currency controls and a reluctance on the part of Chinese courts to allow foreign investors to restructure businesses where jobs were at stake.

China’s second NPL cycle commenced in 2015 and the original infrastructure and landscape has now progressed and developed significantly. In addition to the four original AMCs, there are now 50-60 regional managers capable of selling loans. Infrastructure for online auction processes, OTC trades and securitisation projects has been developed. In addition, there are ongoing legal and structural changes bringing greater legal certainty and the emergence of initiatives such as databases on which asset titles and liens can be checked and verified.

The Chinese Government has also been testing initiatives designed to facilitate offshore investment in NPLs. In June 2017, the State Administration of Foreign Exchange (SAFE) launched a pilot programme in Shenzhen for cross-border NPL disposals. In May 2018, the Government announced the extension and enhancement of this successful programme, which allows AMCs and commercial banks to sell NPLs to foreign investors via a private sale process, rather than through the customary court administered process, provided that certain prescribed criteria are fulfilled.

Similarly, the Shenzhen Qianhai Financial Assets Exchange was established to help streamline sale processes and reduce time and transaction costs for overseas investors. It provides a platform service which can facilitate cross-border payments and transaction settlement, notarisation and execution of NPL sale documentation and cover tax payments including withholding arrangements.

These initiatives come at a time where commentators widely expect China’s NPL ratio and volumes to rise dramatically. This is largely as a result of Beijing’s tightening of NPL reporting standards and the China Banking and Insurance



Regulatory Commission's (CBIRC's) push towards accurate NPL recognition by banks.

Regulatory changes have been introduced targeting the country's shadow banking sector, including reclassifying all loans overdue for more than 90 days as NPLs.

These changes are well documented and commentators expect a 14% rise in NPLs as a result of the change in reporting standards. Some commentators believe that the big four banks will be relatively unaffected by these changes and that 95% of the impact will fall upon the smaller banks within China who have a grace period until 2019 for compliance. Illustratively, in the second quarter of 2018, NPL assets in the country's rural banking sector grew by 183 billion Yuan according to data from the CBIRC.

China has also removed limits on foreign ownership of banks and bad debt managers, with the Regulator announcing in August 2018 that foreign financial institutions will effectively be treated the same as local companies.

In addition, asset quality has remained stable in line with macro-economic expansion. Average non-performing loan ratios for Chinese commercial banks stood at 1.9% by the end of 2018, up from 1.74% as at the end of 2017, according to data released by the Banking Regulator. All of this represents an opportunity for investors looking to new returns.

China's National Banking Regulator also introduced rules in late 2017 forcing the country's national AMCs to meet core and tier 1 capital thresholds. Whereas the AMCs once needed

to maintain an overall capital adequacy ratio of no less than 12.5%, the new rules dictate that core capital should be no lower than 9% and tier 1 capital should be at least 10%. As a result, AMCs sought to resell NPLs and minimise liquidity pressures, which discouraged them from bidding up prices on NPL portfolios.

While increased NPL volumes and an improving landscape for overseas investors all ostensibly give cause for optimism for European and US investors in China, our view is that acquiring NPL portfolios in this region will remain challenging for such offshore investors. This is principally because of the dominance of domestic investors who have been prolific in their home territory.

To date, only a small number of the largest investment houses have managed to compete successfully, although a changing economic climate in China may work to the advantage of offshore investors going forward.

The cultural implications of investing in China should not be underestimated. Outside of the principal cities, the number of parties that can be potentially involved in the workout of credits can be significant and include unexpected third parties such as local mayors, landlords and local officials. Additionally, the State's drive to avoid any sense of civil unrest can be an unfamiliar dynamic to non-Chinese investors looking to restructure credits and businesses. The key to successful investment in China, more than anywhere, is likely to turn upon access to an established and experienced domestic servicer to deal with all the issues that can arise.



*"In China, one of the greatest challenges is finding a book of NPLs that are serviceable, backed by assets in a decent area of jurisdiction like a tier 1 or tier 2 city, at enough of a discount to generate the returns investors are looking for. Some of the more premium NPLs are still priced very high, which starts to impinge upon returns and profitability for offshore and local investors alike"*

**DAMIEN WHITEHEAD, PARTNER, ASHURST  
HONG KONG**

## INDIA: Coming into focus

China is not the only emerging market attracting investor attention.

By the end of 2017, India's NPL ratio had reached a new high of 9.97%. At the end of March 2018, bad loans held by India's banks stood at 10.36trn rupees (US\$150.21bn). According to a statement by then-Finance Minister Piyush Goyal in the Indian Parliament, State-backed lenders held more than 86% of those loans. As per the data compiled by the Insolvency and Bankruptcy Board of India (IBBI), creditors in India have recovered approximately 56% of their admitted claims from 32 stressed debtors after the approval of the insolvency resolution plans as at June 2018.

There is now an increasing focus on India's NPL market thanks to the country's bankruptcy reforms which overhauled the previous fragmented and poorly structured insolvency laws. The new Insolvency and Bankruptcy Code (IBC) aims to facilitate investment activity in India by increasing certainty of legal recourse under a single unified corporate insolvency framework. Commentators widely credit it with bringing a legal structure with well-defined processes, responsibilities and timelines to distressed asset resolution.

The Reserve Bank of India (RBI) now also has the power to direct banks to initiate insolvency resolution proceedings against borrowers, which is a welcome step to help resolve a distressed asset regime. These developments have contributed

significantly to increased bank recoveries – the IBBI states that banks are now recovering approximately 55% of their claims.

Although India now has a robust insolvency resolution mechanism, there do remain certain key issues which can frustrate NPL resolution processes. These include interference by promoters and parties related to the corporate debtor at various stages during insolvency resolution who may try to stall or regain control of the corporate debtor. However, the Indian Legislature has been prompt in recognising such issues and has been addressing the concerns of stakeholders through amendments to the IBC and its related regulations.

To further tackle the rise of NPLs, the RBI has issued a revised framework for the resolution of stressed assets in 2018 to scheduled commercial banks and to financial institutions in India. The revised framework imposes the requirement of early identification and reporting of stress, implementation of resolution plans under the IBC, Prudential Norms, supervisory reviews and disclosures.

As reported by Moody's<sup>3</sup>, the new rules will prevent a build-up of problem loans in the system and help improve banks' ability to deal with NPLs in on-going resolution proceedings and limit risks to their profitability.

This will be vital if the country is to progress in its ongoing efforts to reform the banking sector.

<sup>3</sup> "Indian banks' final push for NPL recognition will hurt profitability in the coming quarters". May 2018. Moody's Investor Services. [https://www.moody.com/research/Moodys-Indian-banks-final-push-for-NPL-recognition-will-hurt-PR\\_382949](https://www.moody.com/research/Moodys-Indian-banks-final-push-for-NPL-recognition-will-hurt-PR_382949)

## Things to watch out for: The Indian Insolvency and Bankruptcy Code (IBC)

The IBC provides for the implementation of liquidations of defaulting corporate debtors within more certain timeframes and introduces a more creditor-friendly restructuring regime. In particular, the IBC facilitates the sale of corporate debtors as a going concern, thereby seeking to preserve asset values, minimise disputes and ensure continuity of the business by transferring the corporate debtor to the purchaser. Therefore, insolvency resolution has emerged as being far more viable than liquidation.

Key to the effectiveness of the IBC is that it introduces a time-bound and court-monitored resolution process which, upon approval of a resolution by the National Company Law Tribunal, is binding upon third-party stakeholders such as the bidder, the corporate debtor, other creditors, employees and guarantors.

## Conclusions

NPLs, as both an investment thesis and an asset class, have established a global reach and outlook. In the aftermath of the global financial crisis, the emergence of significant volumes of NPLs in Western Europe provided investors with opportunities to pursue new investment strategies. Early market successes for first-movers, combined with a broadening market supply and increasing volumes of undeployed capital, have fuelled the development of specialist NPL investing and continually spread its geographical reach.

What is promising is that the international NPL investor community is becoming ever more sophisticated in terms of knowledge of the strategies that work best in each country and the pitfalls to avoid – their deep knowledge of their markets is amply demonstrated in the results of our research.

In respect of sell-side institutions, while supply shows no signs of abating, the mix and frequency of portfolios that will come to the market will likely become even more varied – investors with fluid investment strategies and a breadth of expertise in terms of the types of NPLs they can acquire and work out are likely to fare better when it comes to deal flow.

While the above are opinions based on the conclusions of our research, one thing is an undisputed fact: NPL market resolution which looked to be a short-term opportunistic market some 10 years ago is here to stay in the long term.





## CONTACT US

Get in touch with any questions or inquiries. We would be delighted to answer your questions and set up a meeting with you.



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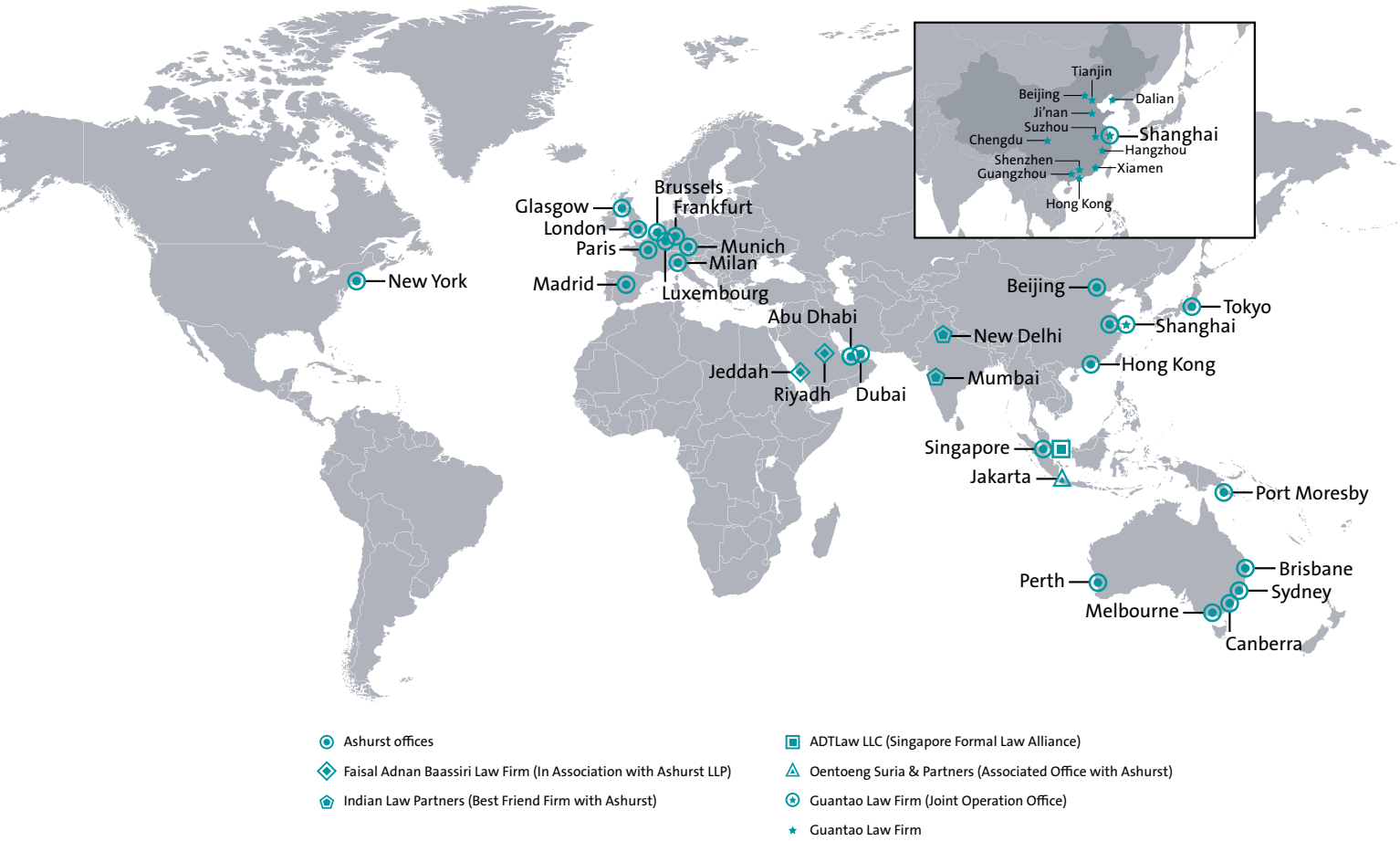
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