

# EUROPEAN NPL 2019 REVIEW AND OUTLOOK: European banks' NPL stockpiles decline steadily in 2019; Greece set to lead 2020 charge with multi-billion-euro reduction plans.

CapitalStructure

Stocks of non-performing loans (NPL) in the European Union banking sector continued their steady march downwards in 2019: current volumes now stand at c.€636bn, down from a peak of €1.15trn in June 2015. According to Deloitte, overall sales in 2019 will be down 30% on the previous year's record €202bn total. Nevertheless, 2020 promises to be very busy, and Greek systemic banks look set to lead the charge with multi-billion-euro 'mega deals'.

Greece's parliament has recently approved a securitisation-based asset protection scheme, which is expected to bolster activity in the New Year. Meanwhile investors can expect to see a nascent market for NPL ABS in Spain, alongside continued deal flow from Portugal and Ireland. The Italian market, which was somewhat quieter this year compared with 2018, is by no means out of the picture, with UTP sales and more NPL securitisations in the pipeline.

But despite securitisation's pivotal role in the deleveraging of Europe's banks, there remains a dichotomy between what regulators demand of banks in terms of NPL reduction targets and what EU securitisation rules dictate: current securitisation legislation is making it difficult for potential issuers of NPL securitisations to comply – and a recent Opinion Piece from the EBA recommending various amendments to the Capital Requirements Regulation (CRR) as well as to the Securitisation Regulation underlined this. The ball now lies in the EC's court.

Quarterly trend in NPL and NPE ratios (%) and NPL volumes (€bn) — December 2014 to June 2019



Source: EBA

Approximately €27.3bn (gross book value) of European NPLs and RPLs (re-performing loans) were securitised in publicly rated deals in 2019 (as of 17 December):

Deal name	Originator/seller	Portfolio GBV (€m)	Region/deal type	Completion Date
Leviticus SPV	Banco BPM	7400.00	Italy/GACS	February
Juno 2	Banca Nazionale del Lavoro	968.00	Italy/GACS	February
Jepson Residential	Lone Star	620.00	Ireland/Refi	March
Pillar Finance DAC	Eurobank	2000.00	Greece	May
Gaia Finance	Montepio	234.30	Portugal	May
ProSil Acquisition/Salduero	KKR	494.70	Spain	July
ERLS 2019-NPL1	Lone Star	458.87	Ireland	July
ERLS 2019-PL1	Lone Star	675.90	Ireland	October
Prisma SPV	UniCredit	6000.00	Italy/GACS	November
ERLS 2019-NPL2	Lone Star	1330.00	Ireland	November
Marathon SPV	Hoist Finance	5000.00	Italy/Reg Cap trade	December
Iseo SPV	Ubi Banca	857.60	Italy/GACS	December
Futura 2019	Guber Banca	1260.00	Italy/non-GACS	December

Source: CapitalStructure

## GREECE

### **Wholesale NPE reduction plans**

The Greek market was a hive of activity in 2019, and this is unlikely to change in 2020 as banks vie to reach stringent reduction targets for their overall NPE holdings. As of end-June 2019, Greek banks' combined NPE stock totalled nearly €80bn, or approximately 43% of their gross loans, on a consolidated basis. Revised Single Supervisory Mechanism (SSM) targets set out in March mean that Greek banks are aiming to lower their NPE levels to below €60bn by end-2019 and to €25bn by the end of 2021.

Large securitisation deals – some of which will be supported by the launch of the Greek government's Hercules Asset Protection Scheme – and continued M&A in the servicing industry are set to shape the market in 2020.

Greece's four systemic banks - Alpha Bank, National Bank of Greece (NBG), Eurobank and Piraeus - sold a range of non-performing collateral via portfolio sales in 2019. This included NBG's **Project Mirror** (unsecured loans) and **Project Symbol** (secured SME), Piraeus Bank's **Project Nemo** (shipping loans), and Eurobank's **Project Pillar**, the first publicly rated securitisation of Greek mortgage loans.

At the same time banks began work on much larger-scale, multi-billion-euro projects that in some cases combine the sale of majority holdings in their NPE servicing platforms. Eurobank, which merged with Grivalia Properties earlier this year, is set shortly to close **Project Cairo**, a c.€7.5bn mortgage securitisation, and **Project Europe**, the sale of a majority stake of its loan servicing operation, Financial Planning Services (FPS). PIMCO had appeared set to win the bidding process, but following the expiry of exclusive negotiations in October, Fortress is now considered the likely buyer.

Alpha Bank is working on **Project Galaxy** – a €12bn NPE securitisation, the portfolio of which is understood to include 20,000 properties. The transaction will also include a carve-out of the bank's NPE platform to Cepal Hellas: the 'new' Cepal Hellas will be sold to those participating in the securitisation.

Meanwhile **Piraeus Bank** has entered into a strategic partnership with Sweden's **Intrum** for the management of NPEs and Real Estate Owned Assets (REOs). While the partnership does not

immediately deal with the bank's loans, Piraeus is understood to be planning two securitisations in 2020, targeting €6bn of loans.

"As expected, the earlier Greek NPL portfolio vintages contained better and larger assets in order to attract investors and kick-start the market but, as time goes by, we are observing portfolios with more granular assets," said Tassos Kotzanastassis, managing director at 8G Capital Partners. "The evidence is that the market is now moving towards large, 'wholesale' solutions for Greek NPEs."

### ***Hercules - the Greek GACS***

The Greek parliament recently approved the Hellenic Financial Stability Fund's **Hercules Asset Protection Scheme (HAPS)**, a scheme that will enable the Greek state to provide a public guarantee for the most senior tranche of NPL securitisations. HAPS has many similarities with Italy's Fondo di Garanzia sulla Cartolarizzazione delle Sofferenze - commonly known as 'GACS'.

Under the Hercules scheme, an individually managed, private securitisation vehicle will buy NPLs from the bank and sell notes to investors. The state will provide a public guarantee for the senior, publicly-rated notes. The scheme is due to be applicable to €30bn of NPLs, or around 40% of the country's outstanding stock.

"All banks are working on NPL disposal projects and some are more advanced than others," said Alessio Pignataro, senior vice president at DBRS Morningstar. "We expect the HAPS to be approved by the end of this year and we have already received data for a number of potential transactions."

According to Sokratis Koutroumpis, a seasoned investment banker specialised in real estate structured finance, the Hercules Asset Protection Scheme is a step in the right direction with its overall impact, but depends on the relative capital relief benefit against the upfront borne guarantee and credit rating costs, as well as on investors' appetite for such products.

"Against a backdrop of traditional securitisations, the Scheme offers a level of comfort for the senior tranche, but compresses the overall spreads and makes opportunistic investing in NPL less appealing in comparison to directly investing in mezzanine / junior tranches," he said. "In that framework, bids higher than 5% for the subordinated mezzanine and junior tranches are highly unlikely, save for the cases where investors acquire a stake in the loan servicer, attaining a steady stream of servicing fees and improving their risk adjusted returns."

Ultimately, both the investors' returns and the lenders' deleveraging efforts fundamentally depend on the timely and successful monetisation of the collateral, rather than the structure of a securitisation, Mr. Koutroumpis added. "The applicable legal framework and the market's capacity to absorb an increased asset supply in an expedited manner, at the assets' long-term economic value, are the key determinants. To that end, further initiatives are required to address the market frictions, by improving the legal framework and providing the right conditions to boost liquidity in the market."

### ***Prime property assets in demand***

End-investor appetite remains mixed for Greek assets. Mr. Kotzanastassis commented that there had been a "feeding frenzy" for Greek prime property assets over the past year. Buyers included local REICs as well as certain local private equity funds that surprisingly outbid the lower-cost-of-capital competition. Mr. Kotzanastassis suggested that this could be down to local firms' lower operational cost structure; cheaper debt funding from abroad; a different strategy – e.g. macro play; or simply that they have wildly higher growth expectations.

"On the other hand, secondary and tertiary assets have not attracted the same interest and liquidity remains very low," he said.

According to Vishal Soni, co-founder of Oxane Partners, hotel assets (the most lucrative assets in Greece given its tourist destination status) have not formed a significant proportion of deals until now. He said banks had typically wanted to hold onto the assets due to long-standing relationships with the borrowers and given the expectation that these would become re-performing with the Greek economic recovery and uptick in demand in the tourism industry.

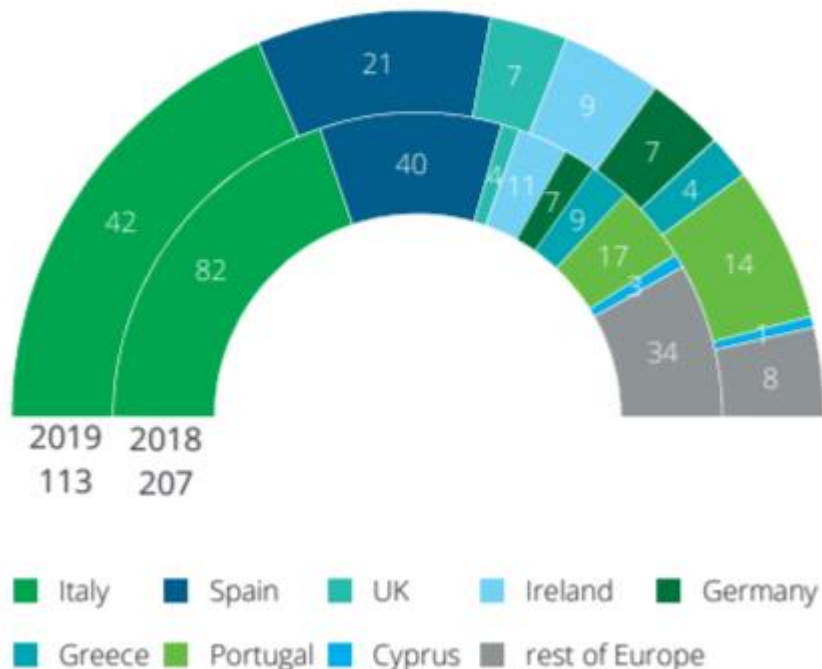
“But with large deals getting done quickly in 2019, we expect property prices to cool down as the real estate market is expected to be flooded with oversupply of properties as part of the resolution for mega deals,” he said. “This could very well lead to a situation when the funds may find it difficult to exit with an oversupply of properties up for sale in the market - something that happened in Spain earlier this year.”

Another consequence, according to Kanav Kalia, head of marketing and sales at Oxane Partners, could be that the market slows next year: “Some of the deals might be pushed to next year due to the tight timelines and the same set of investors bidding for these pools,” he added.

Most of the main players have now established themselves in Greece, but there are a few notable absentees. Sources pointed to Cerberus, which has been known to consider Greek and Cypriot portfolios, as well as Lone Star and Kildare, which have bid for NPEs but which are said to have found pricing too aggressive and made the decision to remain on the sidelines, expecting that pricing would fall.

“The next wave of transactions – NBG’s Project Icon and Alpha Bank’s Project Neptune – will show whether pricing will abate,” a source said.

### Number of deals completed by country



Source: Deloitte Deleveraging Europe report, dated 31 October

#### ITALY

**Activity to pick up following 2019 lull**

The pace of deal flow in the Italian market slowed in 2019 – particularly in comparison with 2018. While a mammoth €200bn in NPLs have been divested over the past five years, banks still hold around €220bn in NPLs and UTPs (unlikely-to-pay loan) on their balance sheets. Several securitisation deals are expected to close before the year is out (some with the GACS guarantee, some without) and several more are expected in 2020. UTPs are also expected to be a key focus for banks.

Harish Kumar, managing director at Alvarez & Marsal, said the lull in activity in the Italian market experienced in 2019 was partly due to market participants getting to grips with UTP loans, which now represent the lion's share of NPE stock left on Italian banks' books.

"UTPs are a very different breed to NPLs and specific to the Italian market: The whole NPL ecosystem is having to adapt to understand, value and provision for these loans," said Mr. Kumar. "But activity is picking up rapidly. Banks are sitting on a huge stock of UTPs, and regulatory and accounting pressures mean that the banks will have to deal with them sooner rather than later."

Mr. Kumar said he saw scope for a combination of direct sales and securitisations in 2020. Given the deleveraging pressure as well as recent efforts in facilitating the UTP secondary market, he has observed large and smaller banks looking for avenues to dispose of stock. "As the UTP is a very complex asset class, investors are carefully looking for the right strategies and ways to overcome current market challenges. But we observed few ice-breaking transactions (e.g. Intesa – Prelios) in 2019 and we anticipate the pace will pick up in 2020."

Under the agreement reached between Intesa Sanpaolo and Prelios, Prelios has been given a 10-year contract to service a c.€6.7bn GBV portfolio of Intesa's corporate and SME UTP loans.

Mr. Kumar also highlighted that as many UTPs could be currently misclassified, there will be a point when banks will have to correct classifications - i.e. a proportion of UTPs will have to be reclassified as bad loans.

### ***GACS, non-GACS and re-performing deals anticipated***

The Italian government formally approved a renewal of its state guarantee for senior tranches of NPL securitisations (the GACS) in March. The scheme was renewed for at least 24 months, but as anticipated, the new documentation contained some key changes, including more stringent targets for servicers and a higher rating cap for eligible tranches (Triple B rather than Triple B minus).

To date, just two transactions have closed (UniCredit's **Prisma SPV** and UBI Banca's **Iseo SPV**) since the GACS was renewed, but two further transactions (from Banco Popolare di Bari and Iccrea Banca) are due to close before year-end.

According to Norman Pepe, partner at Italian Legal Services, the GACS will continue to play an important role in the Italian NPL market in 2020. However, given the sub-performance of some existing transactions at this juncture, he expects investors to be more selective.

"Given that most of the toxic assets have been cleared from banks' balance sheets, focus should shift to new recovery strategies," he said. "The quantity of NPLs offloaded on the market in recent years and the relatively small number and size of servicers seem to have resulted in a significant backlog, which is pushing performance down. From this perspective, GACS deals could be reconsidered in their purpose."

Several completed GACS transactions are performing below initial expectations, with actual recoveries lower than those expected in servicers' initial business plans. Scope recently downgraded two tranches of **Popolare Bari NPLs 2017** and earlier in the year downgraded CreVal's **Elrond NPL**

**2017** Srl. In the case of Elrond, aggregate gross collections (€141.2m as of 31 December 2018) were approximately 25% below the initial business plan. For BP Bari, aggregate gross collections were €21.1m versus original business plan expectations of €24.9m.

Possible trends for 2020, according to Mr. Pepe, include re-performing transactions and the resale of assets on the secondary market on a greater scale. In this latter scenario, the GACS deals could be used to aggregate assets and streamline a “wholesale” process on the primary market, he suggested. However, originators will probably be required to be more heavily involved in secondary trades as indemnity providers (by way of assignment of the benefit of R&W and other support).

“Some changes on the regulatory side will be also necessary to clarify that new article 7.1 ReoCo can be used in connection with the recovery of receivables acquired in the secondary market,” said Mr. Pepe. “At present there are doubts that it can be, and this issue may result in the NPLs currently held by banks being less liquid and have an undesirable impact on pricing, and should be addressed as soon as possible.”

A new initiative sponsored by ACLI (the Catholic association of Italian workers) in the social housing space could meanwhile spur a new breed of NPL securitisations in 2020.

Under the plans, known as Project Snowdrop, NPLs collateralised by residential real estate or commercial real estate used by small businesses would be sold to an SPV that would issue rated senior notes and unrated junior notes. Mr. Pepe explained that the SPV’s ReoCo would acquire the real estate assets from the borrowers by assuming the relevant debt, while the borrowers continued to use the real estate assets as tenants and pay rent (with the right to purchase back the assets) to the ReoCo, which would in turn repay the debt to the SPV.

Originators, bank foundations and other public or private investors (such as pension funds or municipalities) would be able to invest in the notes, provided that de-recognition of the portfolio was achieved, Mr. Pepe said.

Other collateral could also feature in 2020 transactions: Scope Ratings predicts as much as €2bn in NP lease securitisations in the year ahead.

## **IBERIA**

### ***Spain’s nascent NPL securitisation market***

One of Europe’s most mature NPL markets – Spain – saw sustained deal flow in 2019, which included a number of ‘jumbo’ deals. According to Deloitte, the past 12 months saw a total of 13 portfolio sales worth over €1bn, including CaixaBank’s €13bn Project Gamma; and Banco Sabadell’s Projects Challenger and Coliseum, with a combined GBV of more than €9bn.

Transactions of this scale are expected to continue in 2020, being placed with regular investors such as Cerberus, Bain and Deutsche Bank, while a number of mid-sized deals are likely to be placed with a wider audience of investors – some of which are new to Spain.

According to Juan Verdugo Garcia, partner at Garrigues, a number of legal developments that were enacted in 2019 may influence the market in 2020 – particularly the Real Estate Mortgage Act. Since March 2019 this Act has forced a number of players dealing with Spanish consumer mortgage loans to abide by a book of consumer-related rules and also request registration with the Bank of Spain (BoS) in order for a firm to handle such loans.

Whether the BoS will force the sellers’ SPVs and their dedicated servicers to become registered in order to collect and service such loans is still uncertain, according to Mr. Verdugo Garcia, but some market players are currently taking legal action in order to be fully released from registering obligations.

“Should BoS conclude SPVs shall be registered to acquire and/or handle consumer mortgaged loans, we expect fierce activity in the secondary market as those SPVs would rather divest such exposures instead of being forced to be registered in Spain, due to tax-related issues,” he said.

One deal that caught the market’s attention was a public securitisation of Spanish NPLs. **Salduero (ProSil Acquisition)** is a Spanish NPL securitisation and the first publicly rated Spanish NPL ABS. The transaction securitises the Proyecto Sil NPL portfolio that KKR bought from Abanca in 2016.

Gonzalo Garcia-Fuertes, partner at Garrigues, said he expected there could be some rated/public securitisations of Spanish NPL assets in 2020, but highlighted that there are still a number of concerns around the process, not least NPL investors’ unfamiliarity with Spanish SPVs.

“While this vehicle has been tested as a very cost-efficient vehicle for securitisation, we are still seeing other ‘foreign’ SPVs being used, as typically NPL investors are not familiar with the Spanish SPV,” said Mr. Garcia-Fuertes. “As a result, this increases costs and timing in developing the transactions. However, some high-profile investors have used this vehicle (Fondo de Titulizacion) in the past and they will do so again in 2020.”

In terms of loans and collateral underlying the securitisations, Mr. Garcia-Fuertes said he expected to see both consumer loans (unsecured) and real estate loans (secured with residential and commercial real estate units), but forecast that the number of public NPL securitisations would be limited.

“One concern will be how Spanish consumer regulations evolve next year - with the new government, which may not be very favourable to these type of transactions, making things slightly more complicated,” he said.

On a broader level, the current EU CRR requirements and Securitisation Regulation could also limit the number of these transactions in the near future. “Spanish local regulation is friendly and mature for these type of transactions and we expect deal numbers to increase, but slowly due to these constraints. EU regulations need to establish clear and simple rules so that the market can be developed smoothly,” he said.

### ***Portugal continues rapid deleveraging***

Portugal has the third highest NPL ratio in Europe (behind Greece and Cyprus) at 8.9% (corresponding to c.€25bn in loans), but the country’s ratio has dropped steadily in recent years following record sales in 2018 and continued deal flow in 2019.

Mega portfolio sales from Novo Banco – the ‘good bank’ established by Banco de Portugal and the Resolution Fund (now 75% owned by Lone Star) – have been responsible for much of the activity. Meanwhile the state-owned Caixa Geral de Depósitos (CGD), which sold €2bn in a number of portfolios last year, has a non-core divestment goal of €1.5bn for 2019 as it targets an NPL ratio of 7% by 2021. In addition to this year’s two portfolio sales, CGD is preparing to launch several loan transactions over the coming months, spanning a range of asset classes and originating both in Portugal and abroad, Deloitte notes.

In terms of securitisations, Caixa Economica Montepio Geral structured its second non-performing loan (NPL) securitisation in 2019. **Gaia Finance** - issued by Ares Lusitani - is backed by defaulted secured and unsecured assets totalling €234.3m (GBV). Unlike the bank’s first NPL securitisation, Evora 2017-1, Gaia Finance does not appear to have been publicly marketed.

As many as four NPL securitisations are expected from Portuguese issuers in 2020.

## IRELAND

### ***Lone Star drives Irish NPL/RPL securitisation***

Bank of Ireland, Allied Irish Bank, and Permanent TSB were all active sellers of NPLs in 2019 in Ireland, where mortgage NPLs currently count for a large portion of banks' distressed loans. Key investors included Lone Star (Permanent TSB's project Glas II), Cerberus (Allied Irish Bank's Project Beech and Bank of Ireland's Project Snow 2), and Goldman Sachs, CarVal and Cabot (Rabobank's Project Omni).

The market for Irish NPL and RPL securitisations remained buoyant during the year. Four Lone Star-sponsored RPL/NPL securitisations priced in 2019: **ERLS 2019-RPL1**, **ERLS 2019-NPL1** (securitisation of Permanent TSB's Project Glas portfolio), **ERLS 2019-NPL2**, and **Jepson Residential 2019-1**, a refinancing of ERLS 2017-PL1. The arranger was Morgan Stanley in each case.

NPL sales continue to attract political scrutiny, however, and a legislative bill put forward by political party Sinn Fein seeks to require mortgage borrower consent before banks can sell residential mortgages to third parties, such as private equity funds. The bill remains under debate in the Dáil Éireann (Irish House of Representatives) but if fully implemented it could constrain Irish NPL and RPL RMBS issuance in 2020.

## NEW MARKETS

2019 draws to a close with all eyes on the evolving loan servicing landscape, where big-name investors are vying to gain a significant pan-European market share. This time last year Fortress' doBank had just agreed to buy 85% of Altamira Asset Management. That same investor currently looks likely to be the purchaser of a majority share of Eurobank's loan servicing outfit FPS.

Alvarez & Marsal's Mr. Kumar expects to see more consolidation in the servicing industry in 2020 across Europe.

"Most mergers and acquisitions within the servicing industry have been on the assumption of synergies and capability to better serve customers, but based on what we have observed, this has proved much more challenging and many acquired businesses are still operating as standalone businesses - mainly because of different legal and regulatory requirements, different technology platforms and processes around them."

In terms of new opportunities within Europe, French and Nordic banks are ones to watch, according to Deloitte. In France's case, activity will be driven by increasing pressures on margins and profitability, along with the EBA's focus on measures to prevent future build-ups of stressed assets. Just this week Hoist Finance completed a purchase of French non-performing mortgage loans - the first time a non-performing mortgage portfolio of this size has been sold in France. Several large secured transactions currently ongoing in France are some of the largest in the country in recent years, and suggest a changing attitude from French banks to take advantage of investors' demand in the market, Deloitte said.

Nordic banks are meanwhile expected to bring an increasing number of non-core deals to market, as well as non-performing and sub-performing consumer and residential loan portfolios. Direct sales of larger, single-name, corporate NPLs are already under way, including the sale of individual ships and fleets.