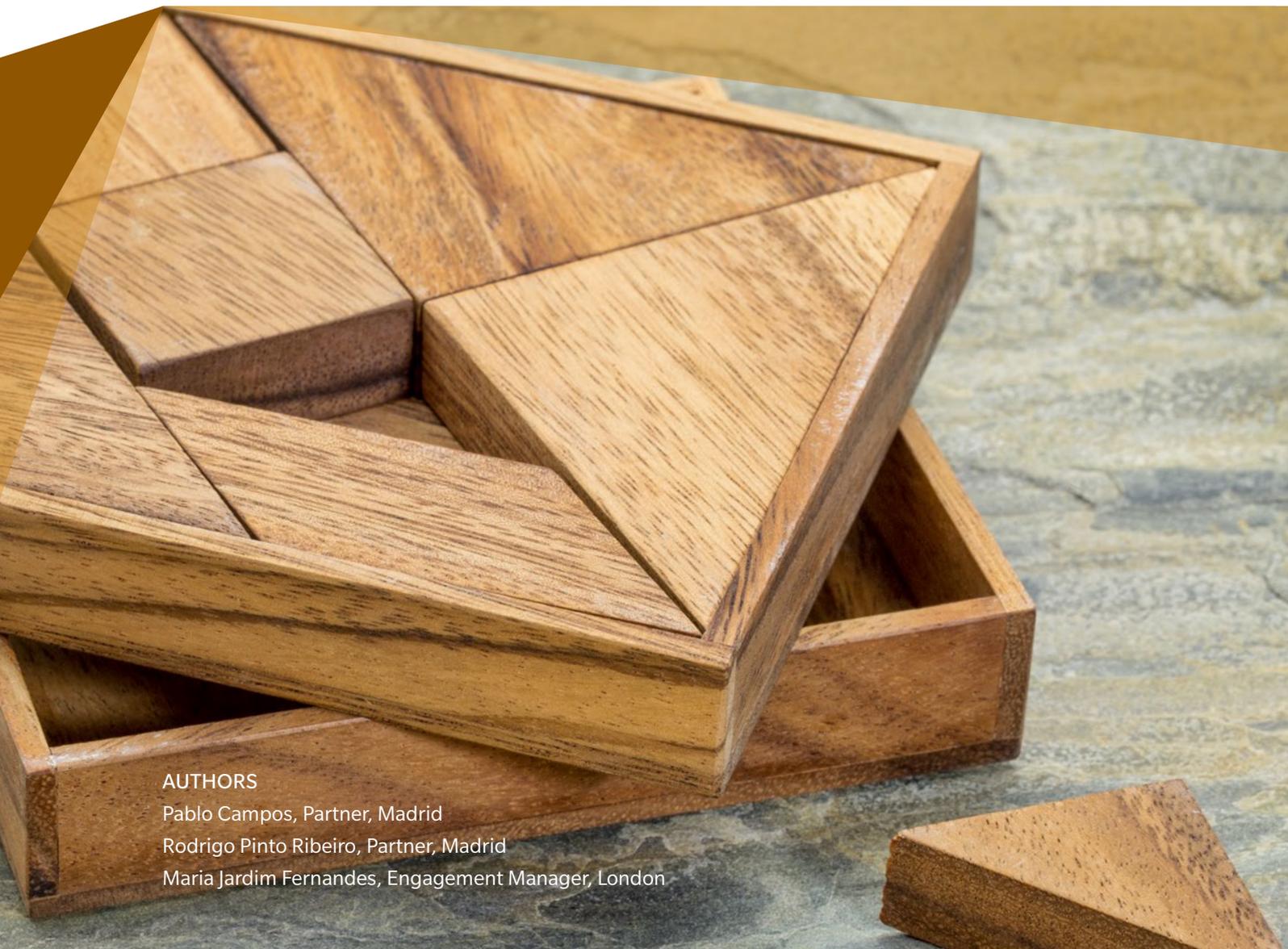


THE NON-PERFORMING LOANS JIGSAW: PIECES STARTING TO FIT?

THE ROAD AHEAD FOR THE NPL ECOSYSTEM



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1 NPLs or NPEs

We refer to non-performing loans (NPLs) or non-performing exposures (NPEs) interchangeably throughout this paper.

With that, we are referring to non-performing exposures or assets in a broad sense: that is, non-performing loans but also any assets resulting from the liquidation of those non-performing loans that are still on balance sheets to be resolved – namely, real estate owned assets.

In terms of magnitude the latter (non-performing) assets are very relevant particularly in countries such as Spain and Ireland, where by now a large part of non-performing loans have been foreclosed, yet many associated real estate assets still remain on balance sheets to be cleaned up.

EXECUTIVE SUMMARY

Despite many improvements, progress in reducing the non-performing loans or exposures (NPLs or NPEs¹) from the financial crisis has been notably slower in Europe than in the US and Japan. NPL ratios remain high in more than 10 European countries. With the banking landscape rapidly changing and economic recovery in sight, the management of NPL is at an inflection point as it moves into its third wave – from a crisis activity towards an NPL ecosystem.

In a first wave, the response to the bad debt crisis was led by governments and supervisory authorities. They intervened to restore bank solvency and confidence in the system. Among other measures, they recapitalised insolvent banks and enabled banks to transfer NPLs to “bad banks” or special NPL asset management companies. And they reformed regulation to make banks’ asset quality more transparent and to facilitate the resolution and trading of NPLs.

In a second wave, building on restored stability and improved regulatory conditions, banks upgraded their internal NPL management and workout capabilities, often running these operations as standalone businesses. They also started to outsource workout services. State intervention began to diminish and focus on improvements to the NPL “workout environment”, for example, by changing the rules concerning debt restructuring and debt sales.

During these first two waves, banks were dealing primarily with relatively homogenous and simple mortgage and unsecured retail NPLs. They must now confront the backlog of corporate and SME NPLs (especially in countries where NPLs are the result of a general recession rather than a real estate bubble), which will be more complex to workout.

At the same time, however the post crisis regulatory advances, “lessons learned” since the crisis and new technology are leading to promising advances in NPL management. European banks are entering a third wave of NPL management.

This third wave involves increased knowledge sharing between banks, increased NPL sales, increased NPL securitization, and the emergence of multi-bank restructuring platforms. These developments promise to reduce the cost of NPL management and facilitate the transfer of NPLs’ management and/or ownership from banks to entities better able to bear the capital and operational burdens.

We expect these trends to continue. We will see yet more externalisation of NPL management, with specialist management companies (sometimes spun-off from banks) attracting capital from non-bank investors in NPL portfolios. Advanced analytics will improve NPL management decisions, such as whether to restructure or sell a bad debt. And NPL trading platforms will emerge.

Progress in working out the NPL legacy of the financial crisis has been slow in Europe. But we expect it to speed up significantly. The regulatory, commercial and technological pieces are falling into place.

INTRODUCTION

Ten years after the onset of the financial crisis, the European banking landscape is changing. Some changes are driven by new technology, customer preferences and competition. Others are responses to legacy issues from the crisis itself, attempts to put it firmly behind. And, in some areas, these two forces are coming together. Tackling the still large stock of non-performing loans (NPLs or NPEs, used interchangeably¹) in Europe is one of them.

Progress in reducing non-performing loans has been notably slower than in the US or Japan. As of Q3 2017, the total bank-held NPL stock in Europe stood at ~€ 854 (4.2% of total loans), though concentrated in selected markets (See Exhibit 1.).² Eight European countries still have NPL ratios above 10%. And aggregate NPL data from most sources captures only NPLs still held by banks and not those sold to investors, thus understating the quantity of bad debt that still needs to be dealt with. Furthermore, many of these loans may have been liquidated, with the associated collateral – namely, real estate owned assets – still remaining on banks' balance sheets as non productive assets, though also typically not well captured in aggregate data.

Achieving meaningful progress in offloading and working out these non-performing assets in a broad sense – whether in the form of loans or assets resulting from the liquidation of those loans (see footnote 1 on previous page) – is now imperative in Europe as the economic cycle turns, and has been signalled as a priority by policy-makers.³ But how these non-performing assets will be worked out going forward is on the verge of transformation.

The overall workout environment has improved since the crisis. Regulatory reforms have made banks' loss absorption capacity and asset quality more transparent. They have improved incentives for workout measures, for example, through restructuring schemes, debt enforcement rules, tax incentives, and third-party licensing. And reforms such as IFRS9, guidelines on new NPL provisioning and stricter state aid and BRRD rules have made it less attractive to hold NPLs.

Banks have simultaneously improved their capabilities in NPL management and workout, now often running them as stand-alone businesses. In high NPL countries (like Greece, Cyprus, Italy and Portugal), these are a significant part of ongoing business activity.

But the overall business and competitive environment is rapidly changing, and part of Europe is already moving beyond restructuring. And whilst efforts thus far have focused mostly on real estate-backed and unsecured exposures, the current backlog of heterogeneous, Corporate and SME exposures that still needs addressing will be more complex to resolve.

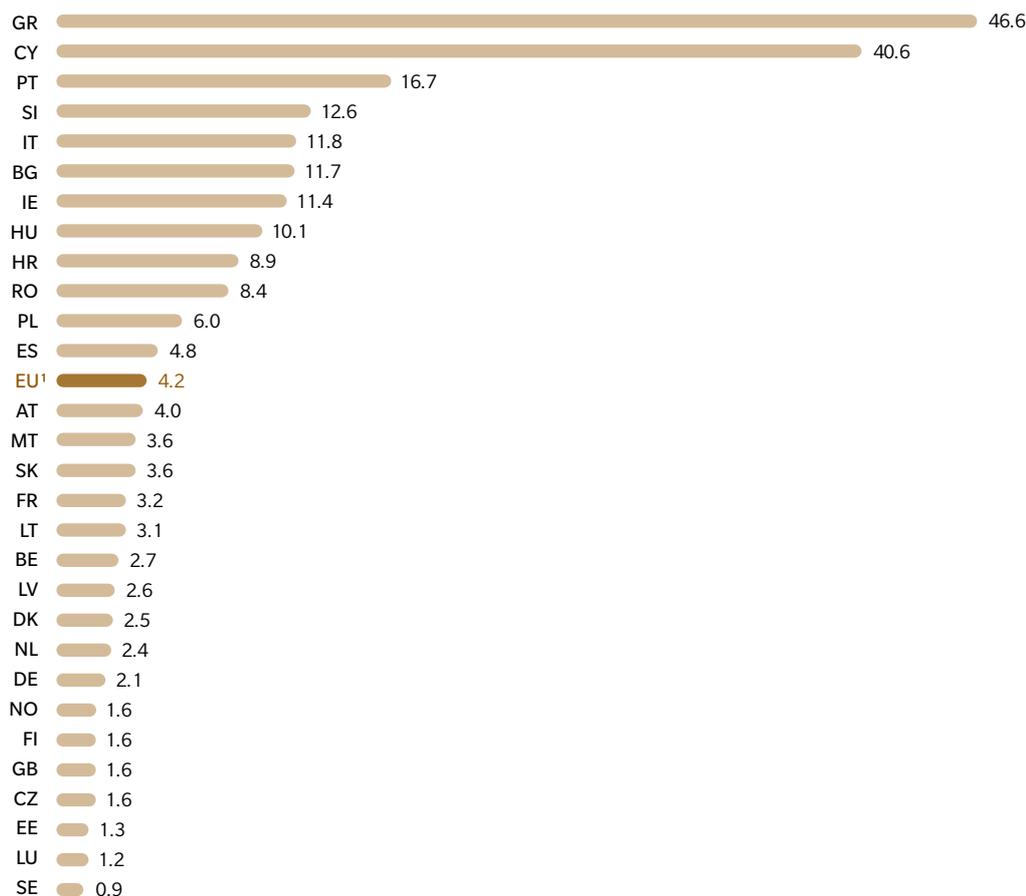
2 Based on EBA Risk Dashboard regular publication (<http://www.eba.europa.eu/risk-analysis-and-data/risk-dashboard>). Note this is based on a sample of 189 European banks, thus a slightly smaller perimeter than collected in ECB's Consolidated Banking Data warehouse.

3 ["Council conclusions on Action plan to tackle non-performing loans in Europe, 11 July 2017"](#)

In this new world post-crisis, solving the NPL problem in Europe will need new, innovative and collaborative approaches. We are already seeing some emerging in the market, and being considered by policy-makers. These will, to a greater extent, increase transparency in NPL workouts, use partnership structures, and leverage on digitalisation and platform businesses. We expect to see the NPL solution set expanding further and much faster than it has since the crisis, towards NPL “ecosystems”. It will fundamentally change not only how current NPLs are worked out but also how future accumulations of NPLs are managed and, ideally, prevented.

It’s a good moment to take stock of the various approaches taken so far for lessons learned. Could this be the inflection point for NPL workouts? Are the various pieces from different NPL experiences across Europe finally coming together?

Exhibit 1: Gross NPL ratio per EU country held by banks, Q3 2017



*1 EU figure calculated as weighted average

Source: EBA Risk Dashboard 2017 Q3. NPL ratio defined as non-performing loans and advances/total gross loans and advances

THE EVOLUTION OF NPL WORKOUT

Since the onset of the crisis, most European governments reformed their NPL workout environments, changing restructuring and insolvency schemes, debt enforcement rights and tax incentives. At a European level, enhancements to the supervisory framework, such as issuing common EBA NPL definitions and introducing the ECB Comprehensive Assessment, helped to make asset quality more transparent and cross-country comparisons more meaningful.⁴

The solution set for NPL workout structures has expanded over time, advancing in three waves:

- In a first wave of crisis response, problems worsened as banks' internal efforts to manage NPLs were ramping-up, and NPL accumulation posed a serious threat to financial stability. Governments intervened to restore solvency and confidence in the system, and authorities started rethinking the regulatory and supervisory framework around NPLs
- In the second wave, private solutions came to the fore as public and regulatory reforms restored stability and some confidence in asset quality and banks' management of NPLs. Many banks built up internal capabilities significantly and started to externalize services and seek partnerships. State intervention began to diminish or focus on improvements to the NPL workout environment, such as changes to restructuring schemes or debt sales rules
- A (current) third wave is changing the landscape around NPLs, with new, privately-led and collaborative approaches emerging. Many banks have developed NPL management structures and capabilities as businesses in their own right. The legislative and regulatory framework has facilitated NPL transactions, third party licensing and workout. Partnerships and pooled solutions among private stakeholders, data standardization and transparency, and the use of technology are giving rise to new NPL ecosystems.

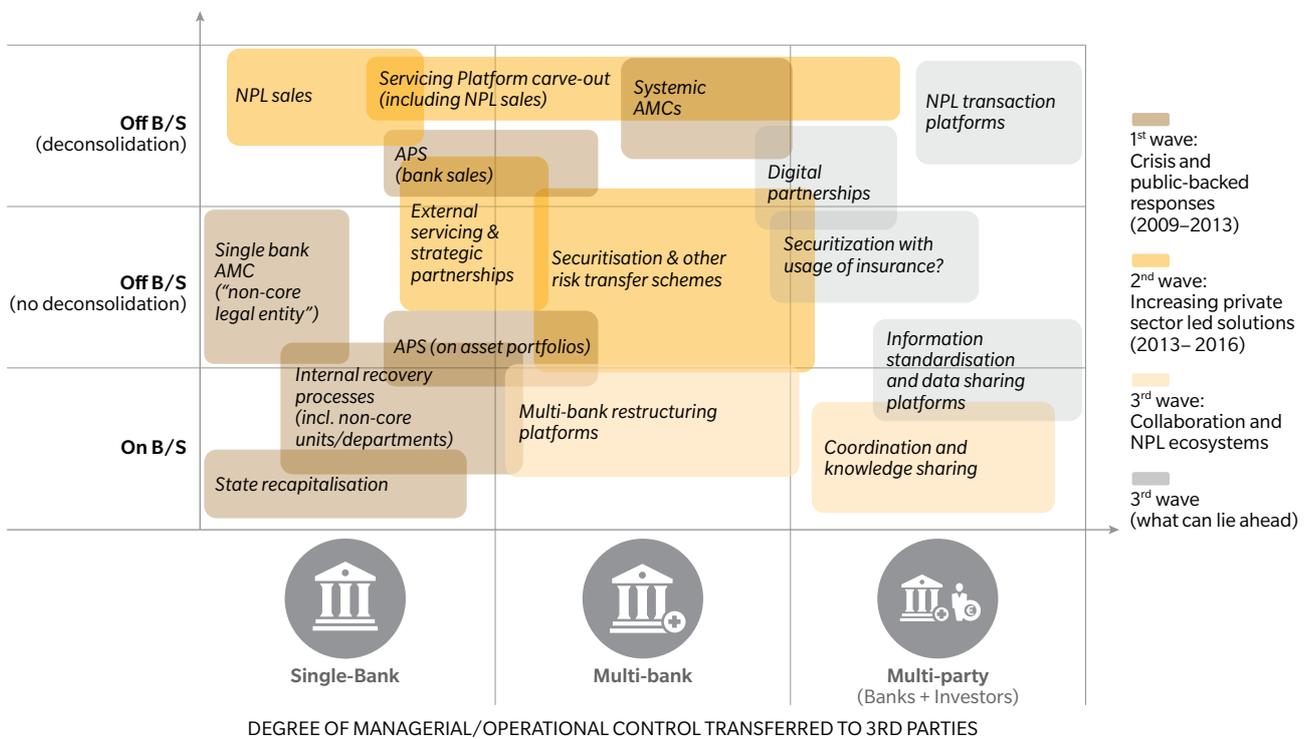
Within this general development path, there's been considerable national variation, not only in progress but in the particulars of the workout structures that have emerged and the instruments governments have used. This depended on the stage in the economic and restructuring cycle, and on the specifics of the underlying assets. For instance, in Spain and Ireland, NPLs accumulated predominantly as a consequence of real-estate bubbles, resulting in homogeneous stocks of NPLs, largely real-estate backed. These have proven easier to deal with than NPLs from corporates or small and medium-sized enterprises (SMEs) in economies struggling for competitiveness.

⁴ Oliver Wyman supported the ECB in 2014 in conducting the Comprehensive Assessment exercise performed on the Eurozone banking system ahead of establishment of the SSM.

We characterize these different workout structures along two dimensions (See Exhibit 2.): the degree to which risk and rewards are transferred to 3rd parties, and the degree of managerial or operational control over those assets that is transferred to 3rd parties.

Exhibit 2: Expansion of NPL solution set – from crisis onset to present day

DEGREE OF RISK & REWARD PROFILE TRANSFERRED TO 3RD PARTIES



*1 Deconsolidation is obtained from selling servicing capabilities along with NPLs, not the servicing carve-out itself
 Notes: AMC – Asset Management Company; JV – Joint-Venture; SPV – Special Purpose Vehicle; APS – Asset Protection Scheme
 Source: Oliver Wyman analysis

FIRST WAVE: CRISIS AND STATE-BACKED RESPONSES (2009–2013)

A first post-crisis period was dominated by governmental interventions aimed at restoring financial stability and confidence in the system. These interventions took a variety of forms, including direct capital injections, bank restructurings and liquidations, asset protection schemes, and state supported asset management companies (“AMCs” or “bad banks” – whether for the system or for individual banks). In most cases, state aid was tied to a key restructuring principle of separating “core” from “non-core” assets. Three commonly observed approaches are discussed below.

INTERNAL RECOVERY UNITS AND SINGLE-BANK AMCS

Many banks established internal units dedicated to managing “non-core” assets (largely NPLs). Most did so as a condition for receiving state aid, but some did so voluntarily. These internal non-core units were sometimes further ring-fenced into separate legal entities within the banking group, with a separate P&L and funding – a “single- bank asset management company”. Such a good-bank, bad-bank split was often part of a government bailout mechanism where the bad bank was isolated and managed for run-down over a given time frame, usually of many years. These were often directly supervised by national regulatory authorities or dedicated asset management companies established for that purpose, such as in Germany and the UK.

Separating the good and bad banks allowed NPL management to be separated from the core banking business, while retaining any upside from recoveries and control over workouts in full. Banks started to improve their internal management capabilities, including data and reporting. But it placed considerable demands on internal resources and operations, and success varied widely. Some units developed into stand-alone businesses and were effective precursors for subsequent sales, as in Spain; others still manage a significant quantity of NPLs today.⁵

ASSET PROTECTION SCHEMES

Internal workout can be slow to deliver benefits. Asset protection schemes (APS) acted as insurance on a pool of non-core assets, with state-backed institutions covering part of the losses on the agreed pool (up to a certain limit and conditional on specific triggers) in exchange for a fee. This allowed banks to keep assets on their balance sheets but benefit from a lower risk weight on covered assets. The improved risk profile could then give banks better access to funding and capital.

⁵ In Spain, a royal decree (RLD 18/2012) introduced the requirement to establish asset management companies for real estate repossessed assets related to Real Estate developer loans. Many banks concentrated capabilities in these units that were later on sold along with portfolios of NPLs, realising value.

Examples include a £300BN APS scheme for RBS in the UK in 2009-2012, and a €7BN public second-loss guarantee for the German HSH Nordbank, extended to €10BN in 2013. In Spain, state-backed APSs were also used to facilitate sales of distressed banks as a whole: for example, the sale of CAM to Sabadell in 2011, and of Banco de Valencia to Caixabank in 2012.

However, these are costly transactions, and governance is difficult. Because risk is (partially) transferred away from the bank, these schemes can also reduce incentives to restructure the underlying assets. Publicly-backed APS are also increasingly difficult under new state aid and BRRD rules.

SYSTEMIC ASSET MANAGEMENT COMPANIES (“AMC”)

State-backed AMCs were established to purchase NPLs from banks, allowing them to clean up their balance sheets. They bought large volumes of NPLs at above-fire sale prices, though still below booked values and in line with state aid rules. Their dedicated mandate and size not only gave them the benefits of specialization and economies of scale, but allowed them to maximise the value of the assets over an appropriately long timeframe.

Recently established system-wide AMCs include those established in Ireland (NAMA, 2010), Spain (SAREB, 2012) and Slovenia (DUTB, 2013), with varying proportions of public and private funds: for example, SAREB was set-up with less than 50% of its equity coming from the state. They played a crucial role in relieving bank balance sheets and contributing to market liquidity and price discovery, thereby increasing investor appetite for NPLs and stimulating the development of third-party servicers. However, establishing an AMC is complex and costly (infrastructure, processes, people), requiring significant capital upfront and continued active management on the trade-offs around returns, liquidity and operating costs. They proved more effective for large stocks of homogeneous assets, such as real estate-backed loans or foreclosed real estate owned assets, which were the majority of NPLs in Spain and Ireland.

SECOND WAVE: INCREASING PRIVATE SECTOR-LED SOLUTIONS (2013–2016)

Improved NPL management capabilities and the availability of more and better data has enabled private sector-led solutions to play a larger role in the management of NPLs. Over the past three to four years, we have seen the rise of third-party servicing and (unsubsidized) sales of NPL portfolios or NPL units (“servicing platforms”). Strategic partnerships between servicers and investors have also started to emerge.

EXTERNAL SERVICING AND STRATEGIC PARTNERSHIPS

Third party servicing can complement internal bank processes by providing superior or cheaper expertise than is available in-house, and allowing management teams to focus on their core activities. Outsourcing has been a common market practice in auxiliary activities such as debt collections, such as call centres, in real estate appraisals or legal services. But in recent years, the offer and sophistication of specialized servicers has expanded. This has allowed banks to outsource larger parts of their NPL value chain, and allowed non-bank investors to purchase NPL portfolios without developing these capabilities themselves. In Spain, we estimate that about 70% of retail mortgages and real estate-backed loans are already managed by external servicers. We expect to see similar increases in outsourcing and servicing businesses in other markets; it is already picking up in Italy and Portugal. As competition for this business increases, it will raise the bar on the design and governance of these partnerships to ensure they are value-additive.

Though less widespread, relationships with third parties can be extended to strategic partnerships in joint venture (“JVs”) or single purpose vehicle (“SPV”) structures. For example, SAREB (Spain’s systemic AMC) divests considerable amounts of its portfolio through special JVs. It transfers NPLs in exchange for shares, while a special real estate manager monetizes the vehicle, for example, by renting or selling the underlying assets. More strategic partnerships are also emerging in the form of “restructuring joint ventures” with distressed debt specialists or other investors. For example, in 2016, investment firm KKR announced such a structure with its Pillarstone platform and Greek banks Alphabank and Eurobank; it has similar ventures in Italy. The investor acts as a strategic partner that can bring expert knowledge and new money for devising corporate turnaround strategies and overseeing restructuring commitments.

NPL SALES AND CARVE-OUT OF SERVICING PLATFORMS

NPL sales allow banks to permanently remove them from balance sheets, avoiding any further cost and capital impacts. A one-off loss is incurred at the moment of sale, when prices offered may not fully cover the net book value of NPLs held.

In most European countries, NPL markets are illiquid because information asymmetries create large bid-ask spreads between buyers and sellers.⁶ However, as banks have increased their loss-absorption capacity and relevant legislation has improved, sales of NPL portfolios to private investors have picked up significantly across Europe, especially in the more tradeable asset classes, such as real estate owned, real estate-backed loans and unsecured loans. Estimates of NPL market sizes vary. They generally describe a significant increase in NPL transactions over the past three years, with Italy as the largest market. The availability of third party servicers has further stimulated NPL sales by expanding the investor pool. In Spain, it has been common for banks to carve out pools of NPLs along with their servicing units, selling them jointly to private equity funds. These transactions allow banks not only to deleverage their balance sheets but to shed the costs associated with the staff and other resources used for NPL management.

This recent pick-up is expected to signal significant growth in NPL markets, since the volume of transactions today is still small relative to the total stock of NPLs and purchases are still concentrated in fairly similar investor profiles (large-sized, high investor rates of return).

⁶ See Fell, J., M. Grodzicki, R. Martin and E. O'Brien (2016), "Addressing market failures in the resolution of non-performing loans in the euro area", Special Feature B in Financial Stability Review, ECB, November 2016.

THIRD WAVE: COLLABORATION AND NPL ECOSYSTEMS

The regulatory and operational workout environment has improved significantly since the crisis onset in these two waves, and so have banks' NPL management capabilities. But the landscape around NPL workouts is changing as the restructuring cycle progresses.

New challenges include:

- Most NPL reduction efforts have focused on homogeneous and simple pools of assets, largely retail, real estate-backed and unsecured. The residual backlog of heterogeneous and often multi-creditor corporate and SME NPLs will be more complex to work out, harder to sell, and more heavily reliant on national restructuring and insolvency frameworks.
- Banks face increasingly difficult decisions between retaining and restructuring NPLs or ending their exposure through write-offs, sales or liquidations. The new IFRS9 accounting standard makes it less attractive to hold NPLs. However, the alternative of selling them is still constrained by wide bid-ask spreads in NPL transactions between banks and investors.
- New state aid and BRRD rules limit the circumstances in which governments can support banks dealing with NPLs, and the amounts that can be provided.
- While banks have generally improved their capabilities for working out NPLs, these advances have been uneven across banks and jurisdictions. Many banks have not yet reached the required scale or flexibility in their NPL management. As the economy recovers and a new competitive and business environment unfolds, NPL reduction will be increasingly challenging for late reformers.

New privately-led solutions are emerging in response to this new landscape, increasing knowledge sharing, collaboration and transparency in NPL markets.

COORDINATION AND KNOWLEDGE SHARING

The Vienna Initiative is a good example of increased cooperation. This forum was established to promote knowledge sharing and coordinated decision-making on crisis response across CESEE countries and multilateral organizations, such as the EBRD, EC, EIB, IMF and World Bank. The forum recently launched an NPL-specific effort to promote best practice and transparency targeted at industry professionals, policy-makers and international investors. In parallel, industry sponsored conferences and discussion forums have proliferated across Europe, improving coordination and knowledge sharing.

SECURITIZATION AND OTHER RISK TRANSFER SCHEMES

While securitization has been common market practice for low risk, relatively easily understood performing loans, investor appetite for securitized NPLs has only recently picked up. Italy is a front-runner. A Government supported scheme launched in 2016 (GACS) facilitates transactions by making it possible to buy a state guarantee on the senior tranche, provided that senior notes are rated as investment grade. The scheme has already supported at least three small banks – Popolare di Bari, Carige and Creval, with a total volume of about €3 BN – and is currently planned to expire in September 2018. The public guarantee meant sale prices have been higher than in unprotected NPL sales, for which private investors usually require higher rates of return and relatively short payback times. Larger banks have also signalled their interest in securitization, for larger deal sizes (UniCredit completed a €18 BN deal and Intesa San Paolo announced a tender for a €1.35 BN deal), though outside the GACS at time of writing.

Private insurance is a potential alternative to state guarantees. Insurers have longer investment horizons and require lower investor rates of return than distressed debt specialists and other investors that traditionally purchase NPL portfolios. Banks could purchase insurance on the notes of securitisation vehicles, allowing them to be sold to third parties at better prices and possibly enabling asset derecognition if the seller transfers all risks and rewards to the insurer.

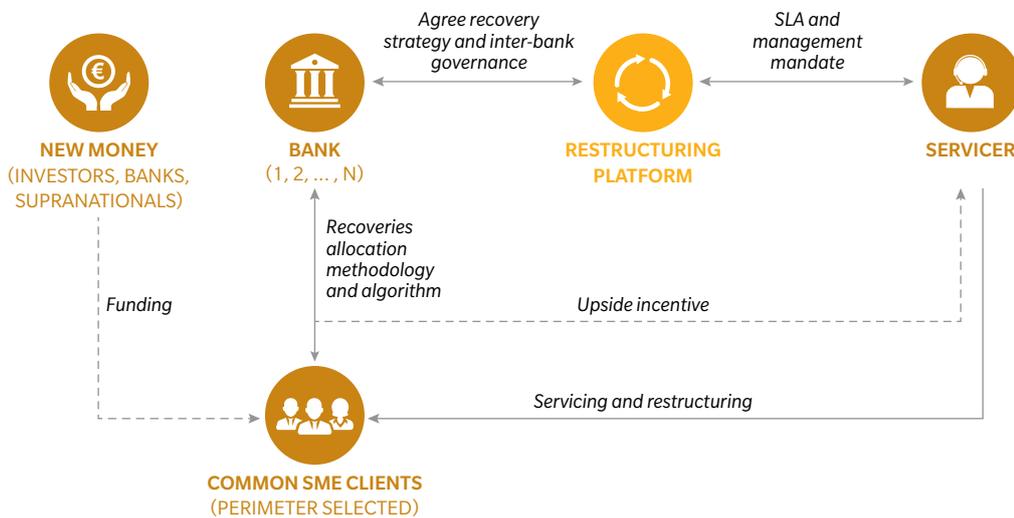
MULTI-BANK RESTRUCTURING PLATFORMS

Multi-bank corporate and SME NPLs are more complex to work out. They require creditor coordination and expert assessments of the borrower’s viability, debt affordability and turnaround potential. Yet many banks and third-party servicers lack these capabilities at the necessary scale.

Platforms aimed at working out these heterogeneous exposures are emerging. They aim to coordinate restructuring actions across the participating banks with a view to maximizing overall recoveries. Exposures may remain on bank balance sheets, but the platform is mandated by the banks to restructure the exposures under a delegated authority framework which covers the types of agreements that the platform can enter into on behalf of the banks.

Ideally, it would be able to pool loan exposures across banks to acquire dominant positions across different debtors and more decision power, speeding up agreements over restructuring measures. It could also pool data and borrower information across banks and act as the single point of contact for the borrower, ensuring coordination and better, faster decisions. The platform’s large scale can also provide cost-sharing across banks and improve negotiations with third parties, such as external servicers. As with platforms referred below, robust data standards and governance would need to be put in place to avoid misuses from data sharing. The creation of multi-bank restructuring platforms has been announced in Greece and, most recently, in Portugal. Exhibit 3 illustrates how such a platform could work.

Exhibit 3: Illustrative structure for a restructuring platform



Source: Oliver Wyman analysis

WHAT LIES AHEAD?

Solving the ongoing NPL problem in Europe will need new, innovative and collaborative approaches. We are already seeing some emerge, and we expect to see the NPL solution set expanding further towards tighter NPL ecosystems. Such developments are likely to include:

1 – INCREASED PRIVATE SECTOR PARTNERSHIPS

More collaboration with third-party players – taking advantage of external restructuring expertise, servicing capabilities and access to capital – can complement banks' internal capabilities, reducing costs and sharing risks. It may also facilitate or complement NPL transactions, especially in corporate and SME exposures that have been less attractive for investors.

In our recent study "[The Dawn of a New Era in Corporate Restructuring](#)", we explore how combining capabilities across investors and banks can be mutually beneficial despite an inherent mismatch in when banks are keen to sell NPLs (late stage, to minimise forgone upside) and when investors are keen to buy (early-stage, to maximise the value of turnaround expertise).

2 – DIGITALIZATION AND PLATFORM BUSINESSES

New customer preferences, digital interfaces and platform businesses are transforming mainstream banking, and they will surely extend to NPLs. We expect to see increasing use of digital tools and technology in the NPL space, both to enhance NPL capabilities and to drive platform businesses and "open innovation" in the industry. We already see some of these utility-like solutions being considered in the market and by policy-makers.

ENHANCED NPL DECISION-MAKING CAPABILITIES

Digital tools can help banks or NPL investors decide between restructuring, write-offs, sales or liquidations. They can also be used to derive segmented workout strategies and to assess internal and external workout efficiency. Some specialists are already building AI capabilities to improve NPL portfolio management or are hiring Chief Data Officers.

INFORMATION SHARING PLATFORMS

Information sharing platforms could consolidate data across banks in a standardised format and perform independent validation, thereby facilitating due diligence and improving market liquidity. At present information held on NPLs varies widely in format and detail across jurisdictions, banks and types of exposures. This makes comparison difficult and increases costs of validation, due diligence and analysis by third parties, making a case for information standardisation. In December 2017 the EBA published standardised data templates for NPLs that can be a first step in this direction. Nevertheless, as standardised information spurs increasing activity and usage in the market, careful governance and usage standards will need to be put in place to ensure data protection and avoid misuse by interested players.

One similar platform has been successfully set-up for asset-backed securities (ABS); the European Data Warehouse standardises and warehouses loan-level data underlying ABS and their transactions. Though initially sponsored by the ECB, it is a privately-owned and operated utility serving the industry.

TRANSACTION PLATFORMS

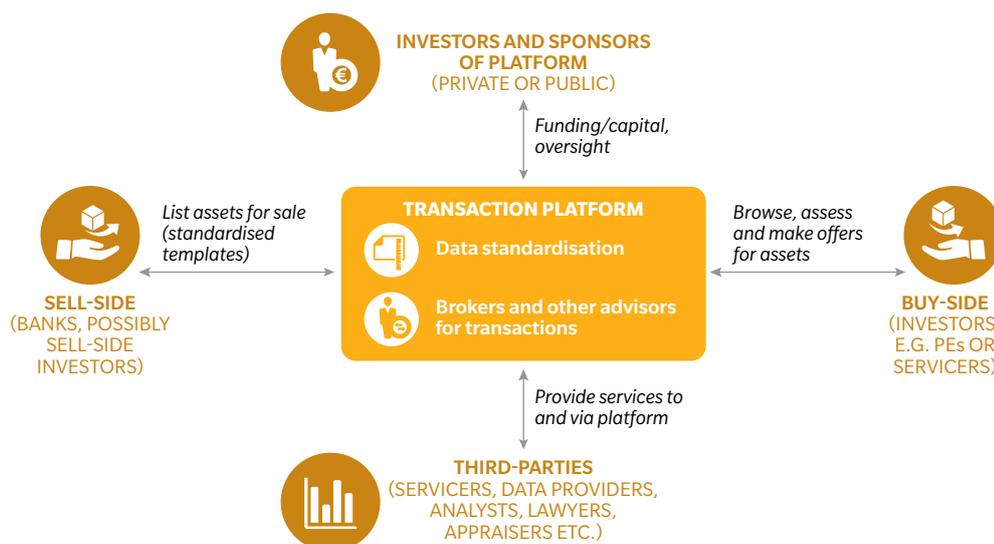
A transaction platform acts as a technology-enabled marketplace for trading assets. This would confer the benefits of an information platform, as well as bringing buyers and sellers together in one place and standardising the transaction process. Banks would voluntarily list assets for sale in the platform's standardised data and format. Investors could browse assets according to their preferences and investor rates of return, and bundle assets from multiple sellers. This would reduce intermediation costs, shorten transaction times and make NPL transactions accessible to a wider base of investors and banks. Robust governance standards and secure technology would be required to protect consumers, banks and investors, ensure data protection and its adequate use, and create trust in the platform, for which it is also important that the platform be run by an independent player.

Such large-scale utility-like solutions would have positive spill-overs by stimulating a broader NPL ecosystem of third party servicers and ancillary services. This phenomenon is already observed in markets with system AMCs, such as Spain. And it would help banks apply to NPLs the new operations based digital technology that have improved service quality and efficiency in performing assets. Exhibits 4 illustrates how an NPL marketplace could work.

The concept of NPL transaction platforms is increasingly being explored by private players and policy makers, including the ECB, which published a paper on the topic in November 2017.⁷

⁷ Financial Stability Review - November 2017, Special Feature: "Overcoming non-performing loan market failures with transaction platforms" by Fell, Grodzicki, Krušec, Martin, and O'Brien

Exhibit 4: Illustrative structure for an NPL transaction platform



Source: Oliver Wyman analysis

3 – THE STATE AS A STRATEGIC PARTNER

Despite the importance of the private sector in leading NPL workouts, we see an important role for public bodies in promoting solutions and overseeing the NPL ecosystem. This can be achieved by:

- Acting as a facilitator by pursuing reforms for a supportive NPL workout environment. These could include improvements to restructuring and insolvency schemes, tax incentives, promoting debt to equity swap instruments, and improved credit bureaus. The announced benchmarking exercise by the European Commission on the efficiency of national loan enforcement regimes will be an important contribution to this.
- Sponsoring privately-led initiatives, such as the transaction restructuring platforms discussed above, by helping mediate dialogue and coordinate action between stakeholders. This can also be done at a debtor level, since the state is often a creditor (being owed tax by the debtor), particularly in SMEs and corporate NPLs. Public bodies can “sit at the table” alongside private creditors for negotiation processes, promoting creditor agreement, debtor compliance with agreed restructuring measures, and revisiting the (senior) treatment of public or other privileged creditors.
- Investing directly in NPL solutions on market terms, consistent with state aid and BRRD rules. There have recently been concrete proposals for co-investment strategies made on market terms, including direct financing of purchase prices and guarantees on securitizations.⁸ Investment could also be made by setting up or co-investing in corporate restructuring funds with private investors with mandates for NPL workout.

⁸ ECB special feature (Financial Stability Review May 2017), “Resolving non-performing loans: a role for securitization and other financial structures?”

CONCLUSION

The workout environment has improved dramatically since the crisis. But progress in actual workouts has been less impressive. NPL ratios remain very high in more than 10 European countries. With the banking landscape rapidly changing and economic recovery in sight, we believe the NPL workout space is at the verge of transformation – from a crisis activity towards NPL ecosystems.

This is an enticing situation for the various stakeholders. Banks, investors, servicers, data managers, and technology developers should be on the lookout for opportunities in NPL businesses and markets, some of them collaborative. These should include increasing partnerships, making use of digital tools, and platform businesses. And public institutions can still play an important sponsoring role. The painfully slow post-crisis clean-up process should start to accelerate now that the pieces of the NPL jigsaw have started falling onto place.

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