Prerequisites for developing markets for distressed assets

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Introduction

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Key challenges in the European Banking Sector

NPL / Non core

- NPLs continue to be a burden on bank's earnings, capital, costs and focus
- Many banks still have an overly complex set of products and markets that they seek to exit

Data Quality & Analytics

- The ability of banks to produce data with the quality required by the market in an efficient and cost effective manner is still lacking
- Huge investment is required to optimise pricing, funding terms and to generate useful MI

Business model & structural changes

- Bank business models are being undermined from challenger banks, consumer platforms and tech savvy operators
- Banks are considering how they shift to a lighter footprint, lower cost base and lower capital/RWA business models

Regulations

- These include: the Single Supervisory Mechanism, accounting rules (e.g. IFRS 9), minimum liquidity requirements, data protection, and governance structures
- New initiatives / laws impacting NPL markets being introduced across the region (both positive and cumbersome)

Increase in NIM / Cost Reduction

- Cost to income ratios are a focus for sufficiently liquid and well capitalised banks, given the historically low IR levels
- This is driving a shift to increasing outsourcing and carve-outs from banks

Digital

- Digital mediums are providing improved customer experience, better targeting, enhanced underwriting processes and lower costs.
- Digital innovation and change is a critical strategic issue

What are the "blockers & challenges?

Internal	Structural	Regulatory
Unwillingness to recognise additional losses leading to price gap	No centralised asset pledge registry (real estate other pledges)	Uncertainty over court protection of creditors' rights through enforcement
Lack of experienced workout specialists, Banks have mostly Relationship /Credit skills	Limited borrower credit information (negative only, bank only)	Continued debtor protection
Belief value can be created for NPLs simply through prolongation (but instead value erosion)	Limited trust and cooperation between creditors	Lack of clarity on application of new regulation
Data quality & quantity	Costly to transfer asset ownership	Slow process for approving new market entrants

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What drives investor return requirements?

	15%	Return requirements	30%
Seller Driven	Realistic timetable, experienced advisor	**Open & Transparent Sale Process** *(Is the seller committed?)*	Short timetable, unclear requirements
Seller Driven	High quality data	**Data Quality** *(Loan, Borrower, Collateral & Historical view)*	Limited / low quality data
Market Driven	Clearly defined, protected by courts	**Creditor rights** *(Legal support of creditor rights)*	Unclear, costly to protect
Market Driven	Court processes efficient and reliable	**Court processes** *(Speed, transparent, reliable, resourced)*	Uncertain outcome of court procedures, expensive
Market Driven	Clear pursuit of NPL resolution, supportive of FDI	**Regulator** *(Proactive, transparent, decisive)*	Mixed messages, unclear regulation
Market Driven	No or limited tax on transfer	**Tax Framework** *(VAT, stamp duty, withholding)*	Vague / unclear tax treatment
Market Driven	Positive short to medium term economic outlook	**Economic outlook** *(GDP, FDI, Real estate prices, etc)*	Poor medium term economic outlook

International PE buyers / Debt servicing platforms

- Sankaty Advisors
- Fortress
- CarVal Investors
- Apollo
- DavidsonKempner Capital Management LP
- KKR
- Blackstone
- Lone Star Funds
- Centerbridge
- TPG
- The Baupost Group
- Oaktree Capital Management, LLC
- Bain Capital Credit
- APS Holding
- B2 Holding
- intrum
- PRA Group
- EOS
- LINK
- KRUK International
- ddm

Investment Banks

- Bank of America Merrill Lynch
- citi
- HSBC
- J.P.Morgan Asset Management
- Deutsche Bank
- Goldman Sachs

Banks (other)

- IFC
- European Bank for Reconstruction and Development

Assessing different strategic options

Delta between NBV and MV

Delta > 20% — **Delta < 20% >10%** — **Delta < 10%**

As the delta between the NBV and MV increases, the number of options to manage the NPL exposure reduce

1 Outsourcing/ Insourcing

— Workout loans to enhance value
— Loans still under bank ownership
— No profit share mechanism

1a In-house optimization
1b LTSA

1-2 years

2 Joint Ventures / AMCs

— Loans moved to a Newco / AMC
— Partner with investor
— Shared ownership with investor

2 LTSA

12-18 years

3 Structured Credit

— Portfolio with variety of credit qualities
— Tranches created to target buyers
— Part of portfolio retained by bank

3a Structured credit
3b Securitizati on

12 - 18 months

4 Asset sale

— Complete transfer of ownership to buyer
— Bank provisions determine profitability of sale

4a Out right portfolio sale/
4b Single asset sale
4c Asset swap
Centralized Sales platform

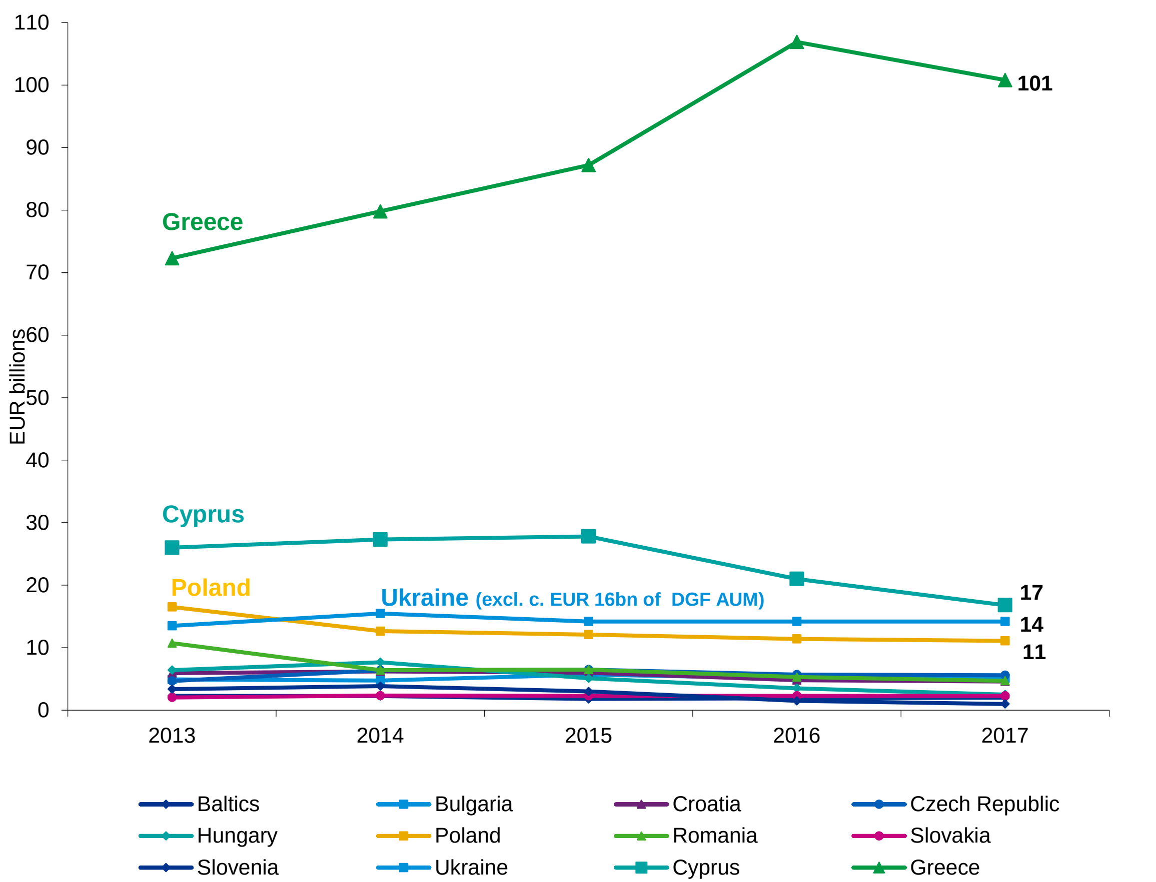
9 - 12months

Prerequisites for developing markets for distressed assets

Non-performing loans trends in CEESEE

NPLs in the CEESEE region continues to decline, partly as a result of improvements in regulatory framework facilitating NPL resolutions and sales. New leading markets joins the scene, Greece and Cyprus…

NPLs volumes in CEE/SEE from 2013 to 2017



Source: Vienna initiative, IMF, National Banks

- NPL sales, better collections and economic recovery, particularly in Romania, Hungary, Serbia and Slovenia have triggered a decline NPL ratios across CEE
- Romania has continued to be one the leaders of NPL closed transactions in the region during both 2016 and 2017, however due to introduction of new legislative changes NPL trades have staggered at the beginning of 2018
- Secondary market sales comparably at low levels but expected to pick up
- With Greece and Cyprus opening up with sizable and “queuing” pipeline, these two new markets have quickly attracted the interest of all major investors
- Poland has been the largest country in terms of NPL volumes so far, however still it is primarily focused on “industrialized” small scale NPL sale processes and local/regional investors
- Ukraine has also been surfacing the regional NPL scene with its above EUR 30bn of NPLs. Several reforms have been recently introduced aiming to improve enforcement landscape and open up NPL market for international investors

Prerequisites for developing markets for distressed assets

Romania - NPL market life cycle

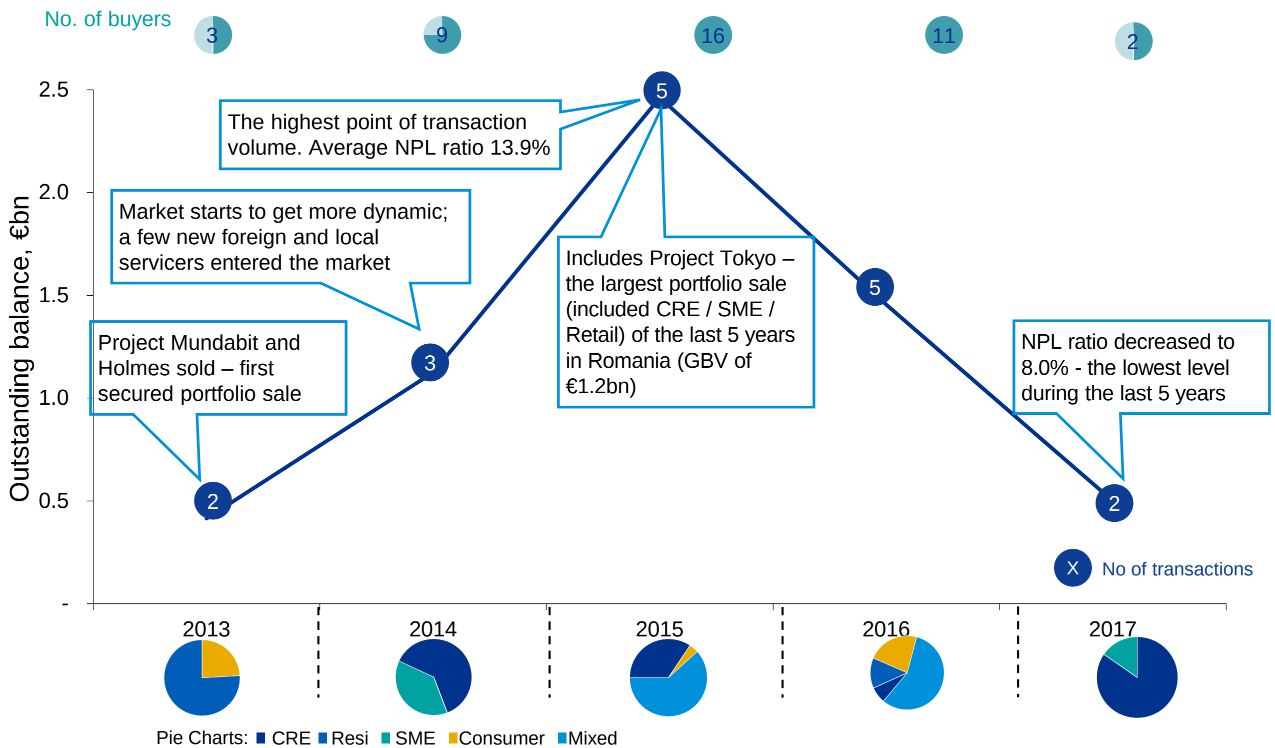
Timeline

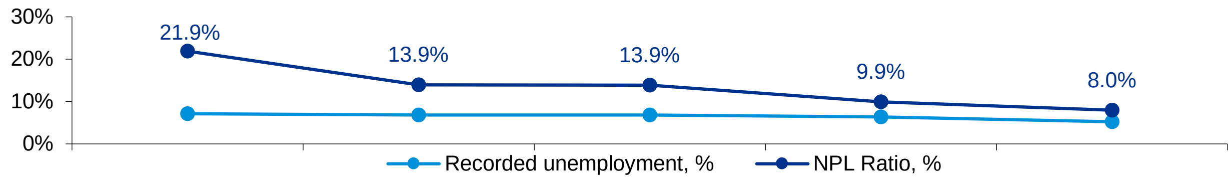
2013: Market opens with the 1st successful secured loan portfolio transaction in Romania – Projects Mundabit and Holmes – sold by RBS as part of their market exit

2014: The National Bank of Romania strengthens oversight over banks and starts to encourage them to decrease NPLs levels

2015-2017: Romania remains the most active market in the CEE/SEE for both secured and unsecured NPL sales

2018: Total pipeline for the currently alive or soon to be launched transactions in 2018 amounts to about €1.5 billion





Buyers	Due to improving macro and RE market conditions, comparably good legal enforcement environment and sizeable NPL stock Romania was one of the first CEE/SEE markets to attract the interest of both international and regional players
Financing	Investors use for transactions in Romania primarily funds raised and rarely need leveraged financing due to the size of transactions.
Servicers	Collection agencies do not have licensing requirements, but are subject to authorisation by the NB. Buyers have established relationships with the largest servicers or have acquired local servicers. Key servicers' capabilities are in unsecured space, but largest have established capabilities in secured space during the last 3-4 yrs.
Legal/ Enforcement	Good legal enforcement landscape compared with other SEE countries. New law on debt discharge entered into force in 2016 allowing natural persons in exceptional circumstances (hardship) to discharge residual debt following enforcement secured by a mortgage (applicable only for loans<€250k). A new tax law implemented in 2018 allows for 30% of the difference between the consideration received and the nominal value of the receivable to be deductible for income tax purposes.
Sellers	Sellers predominantly have been international banks as 8 of Top 10 banks in Romania are owned by international banks.
Economy	One of fastest growing economies in the EU. GDP grew by 4.9% in 2016, by 7.0% in 2017 and is expected to grow by 5.1% in 2018. It will be supported by increasing wages and decrease in unemployment.

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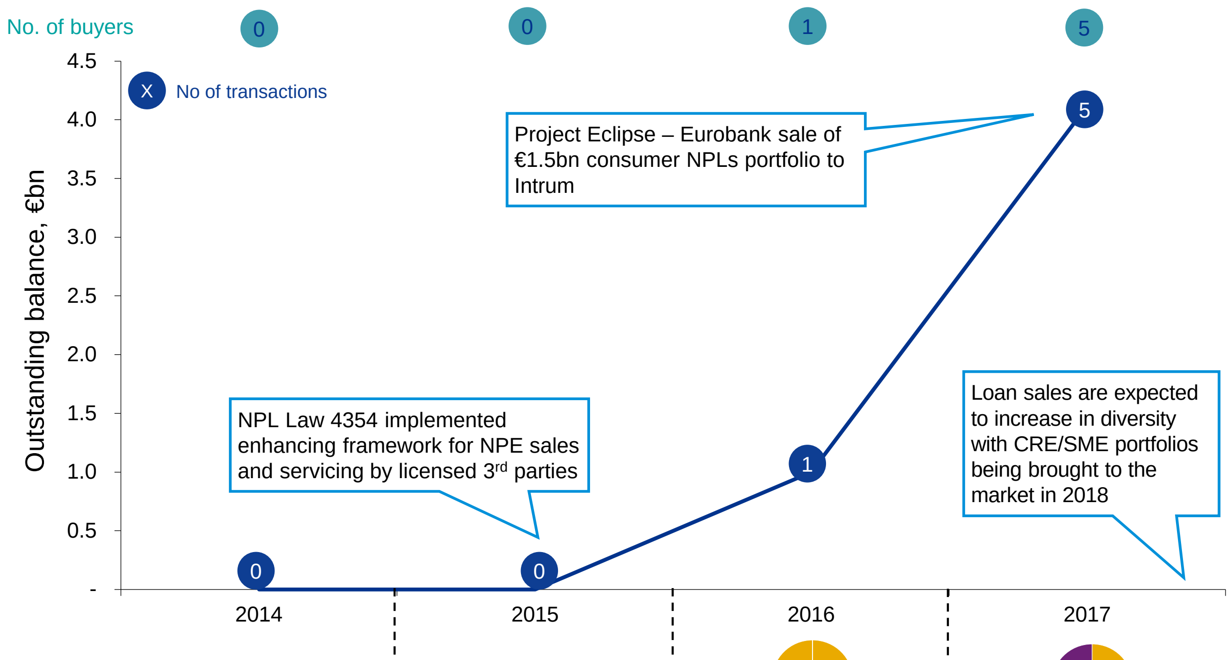
Greece - NPL market life cycle

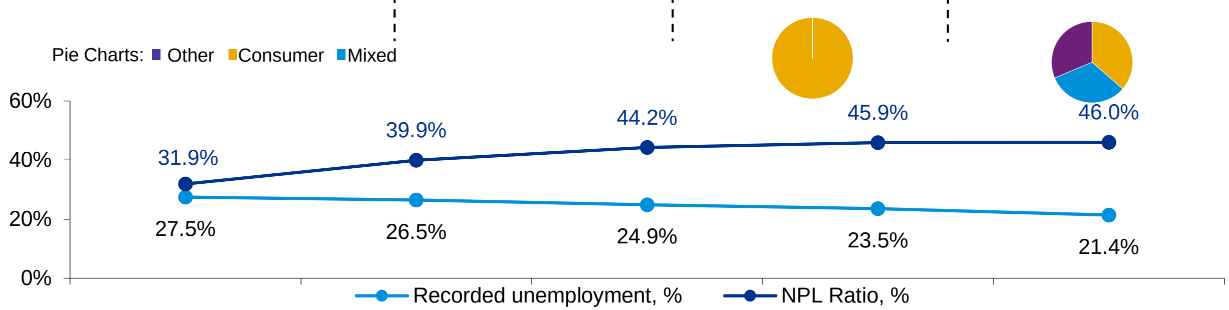
Timeline

2015: Memorandum of Understanding (MoU) signed under European Stability Mechanism (ESM) with reduction of NPLs in banking sector as one of key components

2017: Market opens with Project Eclipse – 1st successful unsecured loan portfolio transaction in Greece

2018: Project Venus – sale of the 2nd unsecured loan portfolio in Greece. Total pipeline for the currently ongoing or soon to be launched transactions in the 2nd half of 2018 amounts to about €14.2 billion





Buyers	Include regional and European debt collection agencies as well as private equity funds. Number of interested investors has been increasing as pipeline has continues to grow rapidly
Financing	For the first closed transactions in the market no leveraged financed been used, however as the size of transactions brought to the market are sizable it is expected that leveraged financing will be used for secured portfolios
Servicers	After Law 4354/2015 was introduced in 2015, 3rd party servicing market has been rapidly developing with 10 debt management companies (Cepal, FPS, Pillarstone, Goddess Artemis, Independent portfolio Management, Resolute Asset management, UCI, B2 Kapital, DV01 Asset Management, QQuant Master Servicer) currently licenced to operate in Greece.
Legal/ Enforcement	Major banking sector reforms recently legislated in order to facilitate NPL transactions. Recently introduced Law 4354/2015 allows sale of loan portfolios through direct sales. It also set up the framework for licencing and supervision of debt management companies by the Central Bank of Greece.
Sellers	Mainly four systemic banks (Piraeus, Eurobank, Alpha Bank, National Bank of Greece) which target to reduce their NPE volume from €105bn (as at 30 Sept 2017) to €43bn by 2019 in line with SSM/Bank of Greece targets
Economy	Stabilized economy with GDP growth of 1.8% in 2017 and forecast of 2.6% in 2018. Supported by reducing unemployment rate (decreased to 21.4% in 2017) and improving private consumption (0.9% growth in 2017 and expected 1.3% growth in 2018)

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Ukraine – surfacing NPL market

Timeline

2014/2015: Geopolitical tension, armed clashes in Eastern Ukraine followed by commodities price decline and depreciation of hryvnia a year later.
2014/2016: Banking sector clean up by the National Bank ("NBU") resulting in 85 banks in liquidation & 7 temporary administration. Deposit Guarantee Fund ("DGF") assumes the management of these banks.
2016, Oct: Structural reforms and international financial aid drive initiatives to address existing challenges.
2016, Nov: Fitch upgrades Ukraine's Long-Term Foreign and Local Currency Issuer Default Ratings to 'B-' from 'CCC'
2016, Dec: Ukraine's biggest lender PrivatBank gets nationalized
2017, Mar: The IMF reaches agreement with the Ukrainian government on an updated Memorandum of Economic and Financial Policies. This decision will lead to continuation of the structural reforms and disbursement of additional USD 1bn package of financial aid from IMF.

Banking sector and NPL built up

- In 2014 /16 the NPL levels surged to c. 30% and severe capital adequacy and liquidity issues arose. NBU undertook to clean up the banking system which resulted in decrease of operating banks from 180 to 93.
- While the banking system is still in the process of recovery with low capitalization and abnormal level of NPL, the results of NBU clean up policies are already evident in stabilization of the banking sector and gradual recovery of trust to the financial institutions.
- The banking sector concentration has now increased with top 20 banks holding 90% (USD 46.0bn) of total managed by DGF. banking assets and 94% (USD 13.9bn) of the distressed assets in addition to the assets

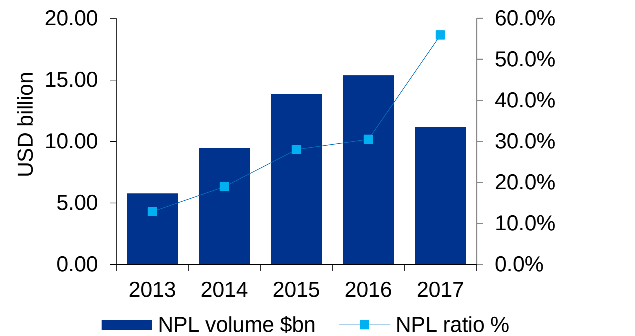
Deposit Guarantee Fund

- DGF is now one of the largest distressed assets holders in Ukraine with the total portfolio of USD 20bn under its management (the appraised value of which is c. USD 3.6bn) and which is comprised of:
  - c.79% of GBV (USD 16.1bn) of loans to individual, SME and corporate borrowers; and
  - c.21% of GBV (USD 3.9bn) of physical property, including RE and movable property.
- o far DGF has been selling assets primarily through single asset sales using Prozorro platform. As of the end of 2017 DGF has commenced sale of the assets through Dutch auction approach and anticipate to bring to the market several portfolios

NPL market landscape/ Recent developments

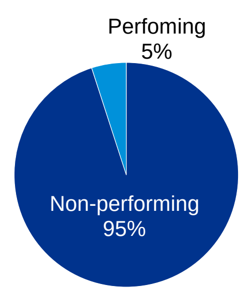
- Debt collection market in Ukraine is focused on servicing unsecured debt and consolidated within the top-10 companies (holds more than 70%), some of which also invest in NPLs.
- In order to reform the enforcement system in Ukraine and increase protection of creditor's rights a set of new initiatives have been introduced in Oct 2016:
  - Introduction of the Unified Register of Debtors;
  - Introduction of Private Enforcement Officers;
  - Enhancement of the Electronic System for the Enforcement Proceedings, in which all legal proceedings documents will be registered and stored;
  - Extension of the term for initiation of enforcement proceedings
  - Bailiff direct access to official state databases and registers to obtain information on debtors' assets, income and funds and shall have the right to register the imposition and removal of arrests.

Dynamics of non-performing loans (at operating banks only, excludes DGF assets under management)

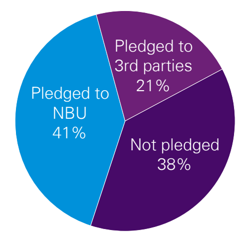


Source: NBU

DGF portfolio: NPL vs. PL by GBV



DGF portfolio: Third party pledge status by appraisal value



Source: DGF

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