# NPLs in the CEE/SEE region – investment prospects to watch

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## A look back at the last NPLs sales cycle

In the previous cycle of non-performing loans (NPLs) sales after the global financial crisis of 2008, the region of CEE/SEE attracted **substantial investor interest** and maintained it for several years. Central, Eastern and Southeast Europe gradually gained experience in this regard, ranging from large portfolio tenders in billions of euros, up to bilateral, single digit transactions within banking groups for ring-fencing lucrative assets.

The pace and participants varied. The Austrian and Greek banks were discretely selling. The international funds, which were first attracted by the large volumes in Romania and the high NPL ratios in Hungary and Slovenia, thereafter explored Bulgaria and Serbia, reaching Ukraine whilst continuing to watch for secondary sales in the more mature markets of Austria and Poland. Regional debt servicers stepped-up and started fronting and even sponsoring investments in secured portfolios. For those that faced the first wave, government support was offered through asset management companies and "bad" bank structures, following the trend in Western Europe.[1]

The regulatory measures that were imposed on the banks, the AQR and stress tests, which were carried out even outside of the Eurozone, inevitably crystallised the NPLs and pushed disposals.

This led to a substantial drop in the NPL ratio to 3% in 2019 in EU member states, starting from levels as high as above 15% in some countries in the region of CEE/

1 The government of the Republic of Slovenia established a Bank Asset Management Company to acquire NPLs after the AQR in Slovenia, thus following Western Europe's trend of "bad" bank structures. Another example of government support has been seen in Austria with the establishment of the Heta Asset Resolution (formerly Hypo Alpe-Adria International), which established a new precedent in implementing the new European banking resolution regime.

SEE, while in other parts of the region the high levels continued.[2]

## Where the market is heading

Entering the final quarter of 2021, we are getting a closer look at **some of the factors that the EC anticipated a year ago to define NPL divestments** in the post-pandemic period.[3]

The chart below indicates our assessment of how these drivers have developed and whether during the last year they accelerated or experienced a delay/lack of progress. We also outline other triggers that are worth observing carefully.

acceleration delay/lack of progress

## Expiry of payment moratoria across the region of CEE/SEE:

- While the latest EBA data4 from October 2021 shows a decline in the aggregate NPL ratio to 2.3% at end of Q2, the data further reveals that for the industries vulnerable to the impacts of the pandemic, the NPL ratio is substantially higher, and it continues to rise. For instance, in accommodation and food services, it reached 9.6%.
- For loans under moratoria the statistics are also alarming and indicate an increase in the NPLs ratio[4]. The effect is still expected to transpire beyond the end of 2021, by when the extended maturities of the deferrals through the moratoria are expected to ultimately expire.
- These data cannot however be automatically transposed into NPLs sales, not least because they do not cover banks outside of the supervisory reach of the European authority. Large scale divestments which might be lucrative for funds can be expected to be brought to the market later than in other parts of Europe. Judging from the previous cycle, the regional and local sponsors will use various forms of debt restructuring in the meantime as a last line of defence to maintain control over the assets.

## Harmonisation of the national insolvency framework:

In most EU member states in the region, the implementation of the Restructuring Directive, which aims to prevent insolvency, has been delayed and the July 2021 transposition deadline has not been

2 Pursuant to the EBA report on NPLs progress made and challenges ahead in 2015 the countries from the CEE/SEE region which had the highest NPL ratio in the range between 10% and 20% were Poland, Bulgaria, Croatia, Hungary and Romania while Slovenia exceeded 20%. Per the same report, these countries had significant improvement with the NPL ratio, as it decreased in all of them to below 10% in 2019. 3% weighted average NPL ratio in 2019. https://www.eba.europa.eu/sites/default/documents/files/document_library/Risk%20Analysis%20and%20Data/Risk%20Assessment%20Reports/2019//Final%20EBA%20Report%20on%20NPLs-for%20publication_final.pdf In Ukraine the level of the NPLs in October 2019 was 48,930% pursuant to the data of the National bank of Ukraine https://bank.gov.ua/en/stability/npl

3 Communication from the commission to the european parliament, the council and the european central bank. Tackling non-performing loans in the aftermath of the COVID-19 pandemic. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX-:52020DC0822

4 Pursuant to the Risk Dashboard for the second quarter (Q2) of 2021 published by EBA on 6 October 2021, the NPL ratio increased from 3.9% to 4.5% for loans under current moratoria, from 4.5% to 4.7% for loans under expired ones and from 1.4% to 2.0% for public guarantee scheme (PGS) loans. EBA Risk Dashboard points to stabilising return on equity in EU Banks but challenges remain for those banks with exposures to the sectors most affected by the pandemic | European Banking Authority (europa.eu)

met (*For further details you may check the WT report on the progress before the July 2021 deadline.*)[5] This restricts the implementation of tools for early control of financial distress and decrease the value of the collateral packages in the corporate NPLs due to insolvency risks.

### Access to the secondary market:

Registration or licensing requirements for investors in NPLs and asset managers exist in both EU and Non-EU member states in the region. Market access might be further hindered by AML and GDPR registrations for the purchasers as well as by merger clearance conditions that might apply depending on the thresholds in the NPLs transactions, these being valid in cross-border deals as well.

### Securitisation:

In contrast to the insolvency framework, the legislative skeleton for securitisation is already in place in the EU member states in the region.[6] The harmonisation however did not accelerate the use of securitisation vehicles in NPLs, as it was anticipated to do. To some extent this is due to local and (yet) different regimes that act as strong qualifiers for eligibility of the structures such as the existence of "severe claw-back" provisions or the requirements with respect to the "true sale" concept, which vary substantially in an area that geographically assumes fewer differences.

We nevertheless expect that the advantages of securitisation will be recognised by regulators, sellers and investors in NPLs and will bring life to such structures in more countries in the CEE/SEE region.

*You can follow* ***WT publications*** *for further updates on securitisation.*

### Transparency of data:

The establishment of a data hub on a European level is considered by the EC as a boost to the NPLs secondary market. Such a hub is aimed at collecting and storing anonymised data on some of the "top hidden" information such as: (i) which NPL portfolios were sold; and (ii) what were the workout cash flows that they generated. The establishment of this hub is however in its infancy and the consultations by the EC are ongoing. Questions as to whether it will achieve its target to "raise transparency, and thereby the functioning of secondary markets of NPLs" and how long it will take to do so are therefore still unanswered.[7]

### In addition to the above, three further accelerators should be monitored:

1. Banking M&A in the region, which is on the rise as anticipated as per the latest survey carried out by WT and Merger Market[8];
2. ESG, which is steadily being introduced by the banks as a requirement for new lending and warrants attention as to its potential impact on NPL deals; and
3. the on-going disputes among the banks and

5 https://www.wolftheiss.com/fileadmin/content/6_news/changerecovery/BF-EU-Insolvency-Directive.pdf

6 Through the introduction of Regulation (EU) 2017/2402 of the european parliament and of the council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation.

7 Colsultation document; targeted consultation on improving transparency and efficiency in secondary markets for non-performing loans https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2021-non-performing-loans-consultation-document_en.pdf

8 https://cee-spotlight.wolftheiss.com/business-and-financial-services-m-and-a-in-cee-in-2021-and-beyond#

borrowers over the validity of or scope of performance of Swiss Francs denominated mortgage loans that may primarily impact the Polish NPL market.

With the legacy of substantial haircuts and large "bid-offer" gaps, the region of CEE/SEE is moving to **a more developed market with less hurdles**. NPLs are starting to be perceived as an opportunity for the banks to untie capital that could otherwise be used for investments in new financial services and products.

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