WHITE & CASE

European NPLs: Market earns welcome breathing room

The ongoing decline in NPL volumes in 2022 and pivot towards smaller disposals leave European lenders well positioned to withstand adverse economic conditions.

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Foreword

Lenders are enjoying the fruits of their labours. Having offloaded their most toxic bad loans, in 2022 banks were instead able to focus on smaller, strategic NPL disposals, even as macroeconomic hardship began to mount.

Europe's banks have been on quite a journey to get their non-performing loans (NPLs) under control through NPL disposal tools including portfolio sales and securitisations. While disposals of toxic debt were interrupted by the COVID-19 crisis, this work has been unrelenting. In last year's edition of this study, we described how NPL sales in Europe in 2021 had bounced back from pandemic disruption; 12 months later, we can report that sales continued in 2022, though at much reduced levels.

That slowdown reflects the extensive progress already made by banks. Most have reached a point where the imperative to further trim their NPL volumes is much diminished—they are free to make disposals according to their strategic and tactical priorities, rather than to avert disaster. That remains true despite the mounting economic and geopolitical volatility that Europe has faced over the past 18 months.

In this year's report, we examine the outlook for Europe's NPL market, including for secondary sales, over the months and years ahead. The first section considers the changing market dynamics, including the latest NPL data and analysis of what is driving activity. The second section offers a deep dive into key markets across Europe.

The future is highly uncertain. There is a case to be made both for a resurgence in NPL volumes and deal activity, and for a continued slowdown. Much will depend on the economic outturn, where uncertainty levels are even more elevated. The good news, however, is that these are precisely the market conditions in which new opportunities abound.

European NPLs: New buyers emerge as disposals shrink

Despite broad economic turmoil, countries across Europe have so far avoided recession. Banks have been able to catch their breath with the NPL market shrinking steadily post-pandemic. But looking forward, Europe is hardly anxiety-free.

European NPL volumes fell by approximately 9 per cent in 2022, as recovery from the COVID-19 crisis continued. But Russia's full-scale invasion of Ukraine, darkening economic clouds and concern about growing geopolitical tensions all cast long shadows.

Against this backdrop, the European Banking Authority (EBA) exhibited considerable caution in its Q4 2022 Risk Dashboard. "Higher interest rates, persistency in inflation and macroeconomic uncertainty could weigh on economic growth and unemployment rates, which in turn could adversely affect banks' asset quality," the EBA warned. It pointed to data from Eurostat revealing that declared bankruptcy numbers had reached an all-time high at year-end.

Nonetheless, the data for 2022 looks relatively benign. Analysis from *Debtwire ABS Europe* shows that, at the end of the year, the largest banks across Europe held approximately €279 billion in stage 3 loans on their books, down from about €305 billion at the end of 2021. As in previous years, NPLs at banks in France, Spain, the UK, Italy and Greece accounted for the lion's share of that total—approximately €190 billion—with France leading the way.

Though hardly insignificant, these figures do represent a continuing downward trend. To put the 2022 data into context, European NPLs eclipsed €1 trillion in 2014.

That decline follows action to address historic NPLs—by banks themselves, as well as by policymakers in countries such as Greece and Italy. But it is also a reflection of the industry's more conservative stance on underwriting in recent years, reducing the risk of non-performance.

Against that, recent increases in capital costs may be prompting banks to take action more quickly to identify under-performing loans. All the more so given that rising levels of profitability—the EBA says banks' return on equity reached 8 per cent by Q4 2022—make it possible to confront losses. Still, the overall picture is of an NPL market that has shrunk steadily.

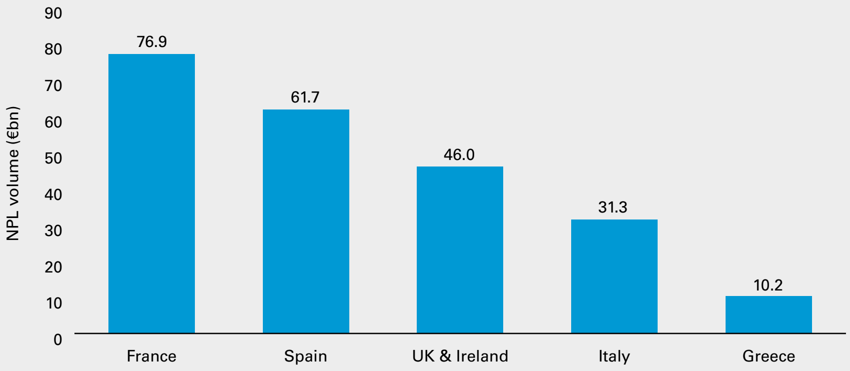
The question now is whether that will continue. The EBA points out that NPL ratios had already begun to widen in certain sectors of the economy last year—notably agriculture, mining and financial services, writing in its Q4 dashboard that "the trend of rising bankruptcies has recently become broader-based among countries."

The economic outlook has, of course, deteriorated. The latest forecast by the International Monetary Fund (IMF) for euro area GDP growth in 2023 is just 0.9 per cent. That compares to a forecast of 1.2 per cent when the previous edition of this study was published a year ago.

Inflation may be moderating in Europe, but it remains elevated by recent standards. Interest rate hikes are taking a toll and may make it challenging for struggling borrowers to refinance debt that was originally sourced at a much lower price. Besides these financial concerns, there appear to be few prospects of an end to the war in Ukraine in the near term.

In some countries, these pressures already appear to

NPL volumes in Europe at end-2022 (€bn-equivalent)



Source: Debtwire ABS Europe, based on stage 3 loans in financial reports from the largest banks in each jurisdiction

€279 billion

Value of NPLs held by the largest banks in major jurisdictions across Europe at the end of 2022

be feeding through. Several banks have reported significant increases in their volumes of stage 2 loans—those in the early stages of underperformance—particularly in the UK, Germany and the Netherlands. Banking sector stress, exemplified by the crises earlier this year at Silicon Valley Bank and Credit Suisse, adds to the sense of anxiety.

Given all these factors, there is no guarantee that NPL volumes will continue to fall over the course of 2023. Indeed, George Georgakopoulos, Intrum's Global Head of Servicing, emphasised that although there has not been a material increase in delinquency, it is only "a matter of time" until the NPL market becomes "lively" again. The market may have reached a turning point.

NPL disposals slow sharply

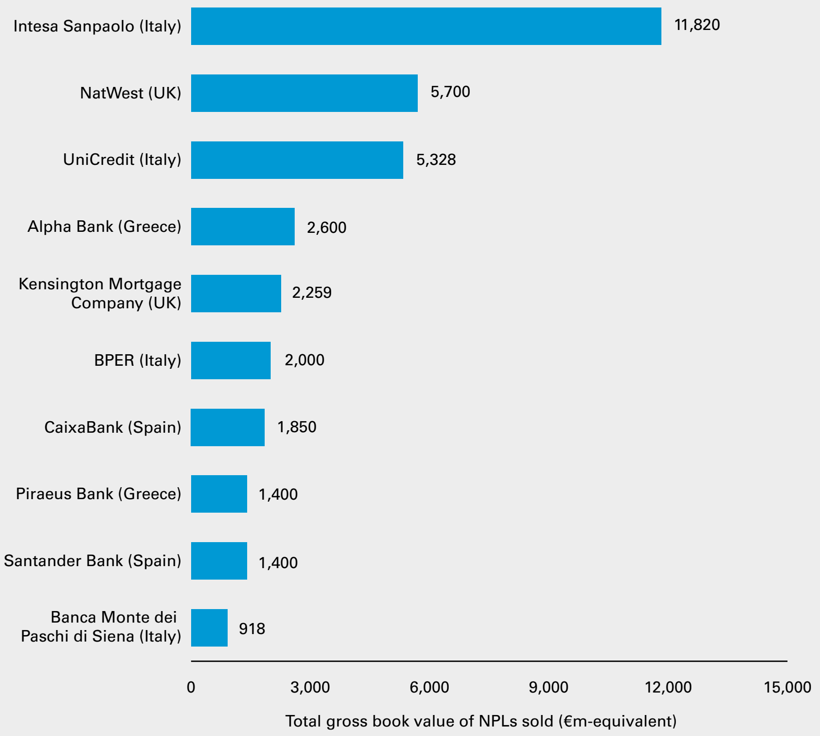
With Europe's banks continuing to shrink their stocks of NPLs, their need to dispose of these assets has naturally diminished. While NPL disposals continued in 2022, particularly in countries such as Italy and the UK, there is no doubt that the market was far quieter than in previous years.

Analysis by *Debtwire ABS Europe* reveals that Europe's leading banks sold just under €49 billion worth of NPLs and non-core loans in 2022. That figure is significantly lower than the €100 billion of NPL sales recorded in 2021, let alone the peak of more than €200 billion seen in 2018.

For now at least, the primary market for NPLs looks flat at best, with preliminary analysis pointing to a further slowdown in sales in H1 2023. In the short term, a return to the volumes seen between 2015 and 2019, when sales topped €100 billion in four out of five years, seems unlikely.

One reason for the potential slowdown in Italian and Greek NPL securitisation is the withdrawal of state support for banks disposing of bad debts. In Italy, the government had secured a preliminary agreement with the European Union (EU) to renew its Garanzia Cartolarizzazione Sofferenze (GACS) initiative, a similar scheme to HAPS that expired in June 2022, but these plans were put on hold in May 2023.

European NPL top sellers in 2022 (€m-equivalent)



Source: Debtwire ABS Europe's European NPLs database

Top European NPL deals signed in 2022 by volume

Seller	Country	Project name	Gross book value (m)	Buyer	Date
Intesa Sanpaolo	Italy	Organa SPV	€8,500	-	May
NatWest	Ireland	Ulster Bank Mortgages	€5,700	AIB	June
UnipolREC	Italy	-	€2,600	AMCO	August
Alpha Bank	Cyprus	Sky	€2,400	Cerberus	February
Kensington Mortgage Company	UK	-	€2,259	Barclays	June
UniCredit	Italy	Panther	€2,000	Christofferson, Robb & Comp	June
Intesa Sanpaolo	Italy	M3	€1,800	Christofferson, Robb & Comp	June
BPER	Italy	-	€1,500	AMCO	November
Intesa Sanpaolo	Italy	-	€1,400	AMCO	July
Hellenic Bank	Cyprus	Starlight	€1,320	Oxalis (Pimco)	April

Source: Debtwire ABS Europe's European NPLs database

In Greece, the two-phase Hercules Asset Protection Scheme (HAPS), through which the government backed securitisations of banks' NPLs, came to an end last autumn.

However, on 8 July 2023, the Greek finance minister, Kostis Hatzidakis, noted in his address to the plenary session of the Hellenic Parliament during the debate on the government's policy statements that NPL management remains an important challenge and that "the Hercules programme will be used, so that within the framework of the rules set by the EU institutions, any outstanding issues will be addressed, for the benefit, ultimately, of the health of the banking system." Reportedly, the new Hercules programme will include three pending securitisations amounting to €3 billion.

Still, some deleveraging will continue, even if deals are smaller in scale. One possible driver is the EU's 'backstop' regulation, introduced in 2019, which requires banks to back NPLs with 100 per cent core equity within a set time period following their identification (from three to nine years depending on the type of loan). As more NPLs are impacted by this regulation, its significance as a driver of disposals will grow.

One nuance here is that the UK post-Brexit has distanced itself from this European regulation. In March 2023, the Bank of England announced that UK banks would no longer face the same deduction requirements on non-performing exposures. The change could even encourage UK banks to come into the market as NPL investors.

The changing buyer pool

One impact of the changing dynamics of Europe's NPL market is that it has become less attractive to many of the private equity (PE) investors that were previously prominent buyers when banks deleveraged. The rising cost of capital has given many PE investors pause, particularly considering the time and resources required to extract value from NPL portfolios.

This is not to say PE has exited the buyer pool altogether. Last year's deals included high-profile transactions involving the likes of Bain Capital and Cerberus, for example. However, for PE firms lacking specialist servicing platforms, the economics of NPL investment are less compelling. As a result, their appetite to buy NPL portfolios has diminished, and some are even seeking to liquidate existing positions.

By contrast, many of the larger servicing companies remain acquisitive, as they pursue further growth, both as investors and as servicers. Their expertise and experience provide an edge in terms of evaluating new opportunities, as well as to extract more value through improved recovery rates. Firms such as Intrum, Kruk and Axactor account for a growing number of deals on the buyer side.

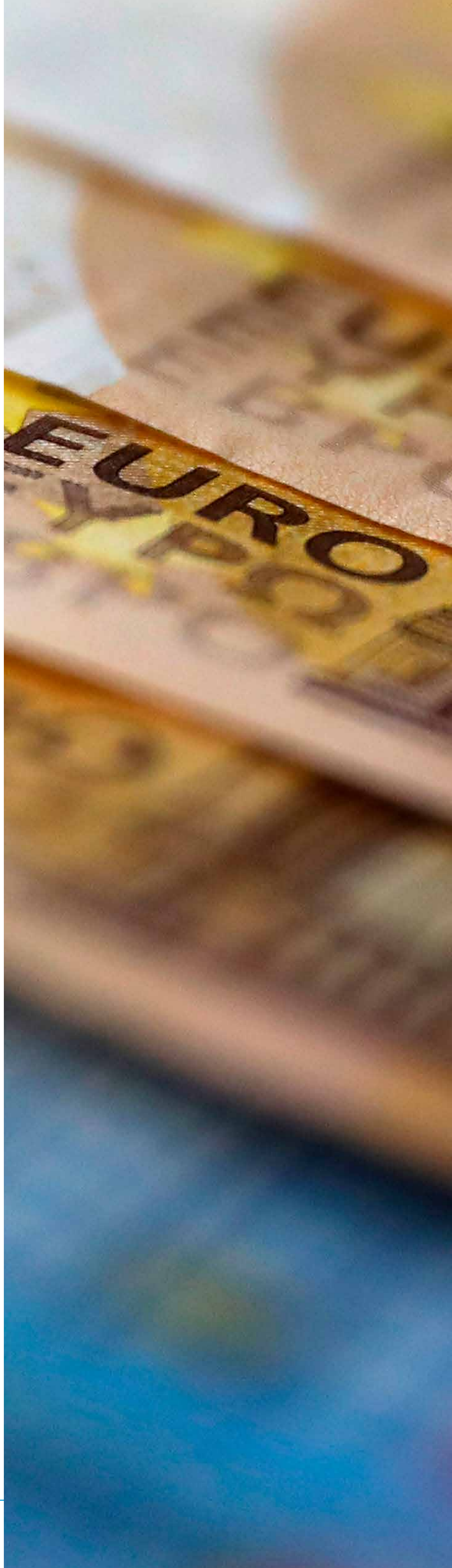
That said, servicing businesses aren't immune from rising capital costs, particularly as they face the need to refinance debt taken on to fund portfolio acquisition. In some cases, this debt is no longer rated as investment-grade. If NPL recoveries become more difficult in light of the current economic backdrop, the pressure on these firms will increase, impacting their ability to make more acquisitions.

More broadly, these factors are also likely to play into ongoing consolidation in the servicing market, which a handful of large firms now dominate. Banks have continued to spin out their servicing units, even where they have chosen to retain NPLs, and smaller-scale players are increasingly rare.

Secondary market growth

Many of these themes are also relevant to the secondary market for NPLs, which already accounts for a larger share of overall dealmaking as bank disposals moderate.

Where, for example, PE firms are seeking to exit existing positions, they must find secondary buyers for their NPLs. For larger players looking to deleverage in order to assuage the concerns of the bond market, disposals on the secondary market are one possible strategy. Larger servicing companies are increasingly seeking new strategic solutions for their NPL portfolio investments in order to achieve



their deleveraging objectives and improve their financial ratios. Such solutions include the securitisation of back books and the formation of capital partnerships or co-operation agreements for the securitisation of front books. In addition to being a core balance sheet management tool, such securitisation transactions enable the debt collection firms to continue servicing the securitised NPL portfolios.

A related trend is the growing interest in dividing parts of the portfolio for sale to specialist acquirers. Where portfolios were acquired from banks by way of NPL securitisation, this requires taking out single loans or parts of the portfolio from the securitised portfolios. PE investors may no longer be so keen on exposure to NPLs as an asset class in their own right, but a firm with specialist expertise in, say, real estate or the consumer sector, may be interested in buying loans that relate specifically to their area of interest.

Other buyers may also be in this market. For example, Intrum's 2022 sale of Tethys, a portfolio of NPLs relating to Greece's hospitality sector, saw it agree a deal with a consortium of investors including an Israeli hotels company.

These sales of small portfolios, where debt collection firms have organised the NPLs around a particular sectoral or thematic opportunity, conducted some remedial work and built a data room, effectively offer a curated opportunity for specialist buyers. Deals may even include the disposal of single-name debt positions in certain sectors.

Separately, there is also an ebb and flow to NPL transactions. As buyers work through large deals done in the past, they naturally reach the point where a small sub-scale rump of NPLs remains—debt raised to finance the deal may even have been repaid. At that stage, it makes sense to sell to a more specialist investor.

Inevitably, however, buyer demand on the secondary market will be impacted by the performance of NPL portfolios. Here, the data is encouraging—analysis by Morningstar and DBRS suggests

> **One factor that certainly supports deals in both the primary and the secondary market is the significant improvement in data quality in the NPL sector. For banks, the regulatory requirements around data management have increased drastically in recent years—NPLs coming on to the market for the first time are therefore backed with much clearer documentation.**

NPL transactions that have taken place since the outbreak of the COVID-19 pandemic have performed strongly, with recoveries proceeding at a better rate than expected.

Still, as economic headwinds strengthen, particularly in consumer-facing sectors, such progress may be difficult to maintain. That has the potential to act as a brake on secondary NPL sales.

Visibility improves

One factor that certainly supports deals in both the primary and the secondary market is the significant improvement in data quality in the NPL sector. For banks, the regulatory requirements around data management have increased drastically in recent years—NPLs coming on to the market for the first time are therefore backed with much clearer documentation. Errors have been eliminated and information gaps closed.

Similarly, secondary buyers are benefitting from the huge amount of work done by debt servicers—both independents and PE-captive platforms—to clean up portfolio data. As they have serviced these loans, they have built substantial data rooms that provide a consistent and reliable source of information.

Such data provides buyers with far greater visibility of potential purchases. Investors with specialist data analytics tools are increasingly using this expertise to secure an edge in the market, generating actionable insight around pricing and potential recovery rates.

Technological advances will provide further opportunities in this regard. Early adopters of machine learning and artificial intelligence tools in the NPL sector claim to have reduced costs by 90 per cent and increased efficiency 20 times over.

Reperforming loans increase

There is another driver of NPL activity that should not be discounted. In some markets, NPL investors report growing numbers of rehabilitated accounts—loans that are once again performing, with borrowers' payments back on schedule. This debt can be put up for sale, with banks often keen to acquire the potentially profitable customer relationship that comes with it.

Regulatory constraints are a factor here—in most markets, regulators do not allow the sale of a rehabilitated loan back to the original lender. Nevertheless, investors are often keen to sell such loans, both to secure a return and to free up resources to focus on their core activity of managing NPLs. Banks looking to grow the customer base provide a potential buyer pool.

The extent to which reperforming loan sales will accelerate is not clear. Slowing economic growth may be an obstacle to rehabilitation—some loans may even slip back into NPL status—but this theme is attracting interest in several markets. Greek businesses, for example, are now performing far more strongly than during the period when many NPL sales were concluded.

Regional spotlight on NPLs: Italy, the UK, Greece and Spain

Total NPL volumes across Europe are down and ratios remain stable, with countries such as Italy and Greece having worked especially hard to deal with toxic assets. Even with economic growth set to slow, banks have reason to be broadly optimistic about their NPL levels.

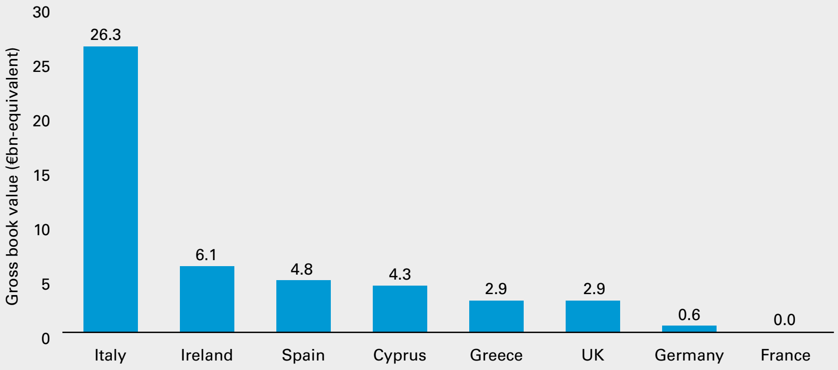
With NPL levels across Europe continuing to fall, the imperative for banks to offload toxic debt has eased. NPL sales fell sharply across much of the continent in 2022, with only Italian banks disposing of more loans than in the preceding 12-month period.

The NPL market looks set to remain flat, particularly now that state-backed securitisation schemes in Italy and Greece have run their course. However, any increase in NPL volumes—perhaps as a result of the cost-of-living crisis and the still-challenged macroeconomic landscape—could presage an increase in activity. In that context, it is notable that banks in much of Europe have increased their provisions compared to 2021.

For now, however, NPLs remain at low levels. The average European Economic Area bank's NPL ratio stood at just 1.8 per cent at end-2022 according to the EBA, unchanged from the previous year.

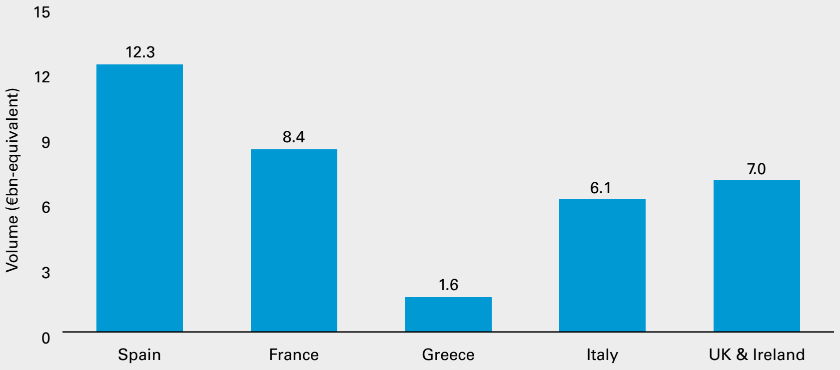
> **The NPL market looks set to remain flat, particularly now that state-backed securitisation schemes in Italy and Greece have run their course.**

European NPLs: Total deals signed in 2022 by country



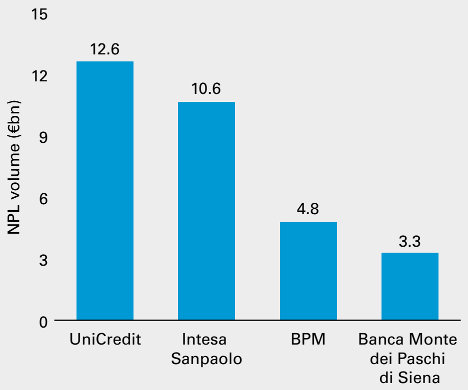
Source: Debtwire ABS Europe's European NPLs database

Provisions taken by top European banks by country in 2022



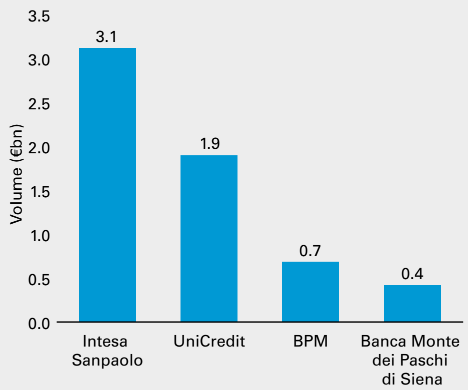
Source: Debtwire ABS Europe, based on provisions outlined in financial reports

NPL volume in top Italian banks at end-2022 (€bn)



Source: Debtwire ABS Europe, based on stage 3 loans in financial reports

Provisions taken by top Italian banks in 2022 (€bn)



Source: Debtwire ABS Europe, based on provisions outlined in financial reports

ITALY:

Toxic assets offloaded

Italy's banks made further reductions to their stock of NPLs over the course of 2022, disposing of more loans than their counterparts in any other European country. NPL sales in Italy totalled just over €26 billion in 2022, up from €19.5 billion the year prior. Indeed, Italy was the only country in Europe to record a year-on-year increase in NPL sales in 2022.

Almost a third of that total came from the largest deal of the year, Intesa Sanpaolo's €8.5 billion securitisation. That transaction was one of the final deals conducted under the state-backed GACS scheme, which came to a close in June 2022. While the Italian government subsequently reached a preliminary agreement with the EU to extend GACS, plans to do so were put on hold.

Nevertheless, the impact of GACS has been substantial. Banks have completed more than 40 securitisations through the scheme over the past five years, offloading more than €100 billion of toxic assets from their collective balance sheets.

Against that backdrop, and with Italy's NPL ratio down to 2.4 per cent at end-2022 according to the EBA, NPL sales now look set to slow dramatically. Indeed, remaining NPL volumes at leading Italian banks totalled only €31.3 billion by the end of 2022, leaving little room for further substantial disposals.

Instead, Italy's secondary market is beginning to move to centre stage, albeit with much smaller transactions. Some purchasers of NPL portfolios report disappointing collection rates, particularly as they move towards the tail of loans, and are therefore looking to exit. Others are looking to package loans in areas such as real estate to sell to specialist investors.

Looking forward, Italy's slowing economy—the IMF is predicting GDP growth of 1.1 per cent for 2023—could see NPLs spike higher once again. Certainly, three of the four biggest banks in the country increased their provisions in 2022 compared to a year prior.

However, while the Italian Banking Association has already asked banks to take a sympathetic approach to customers struggling with debt, there is little sign as yet of a wave of new NPLs. Indeed, stage 2 loan volumes in Italian banks fell by double-digit percentages in 2022.

> **Italy was the only country in Europe to record a year-on-year increase in NPL sales in 2022.**

Top NPL deals signed in Italy in 2022 by volume

Seller	Project name	Gross book value (€m)	Buyer	Type	Date
Intesa Sanpaolo	Organa SPV	€8,500	-	GACS securitisation	May
UnipolREC	-	€2,600	AMCO	Corporate*	August
UniCredit	Panther	€2,000	Christofferson, Robb & Co	Securitisation	June
Intesa Sanpaolo	M3	€1,800	Christofferson, Robb & Co	-	June
BPER	-	€1,500	AMCO	-	November

Source: Debtwire ABS Europe's European NPLs database

**Granular corporate, secured and unsecured*

UK AND IRELAND: Economic ill-health

NPL volumes in the UK and Ireland bucked the European trend in 2022, rising slightly to €46 billion by year's end, compared to €44.4 billion at end-2021. That largely reflected higher volumes at two banks, HSBC and Barclays.

That increase is somewhat surprising in light of IMF analysis that suggests the UK was Europe's fastest-growing major economy in 2022, though the fund also warns that 2023 will see it slow more markedly than any of its rivals. Still, UK banks in particular did record a marked increase in provisions in 2022.

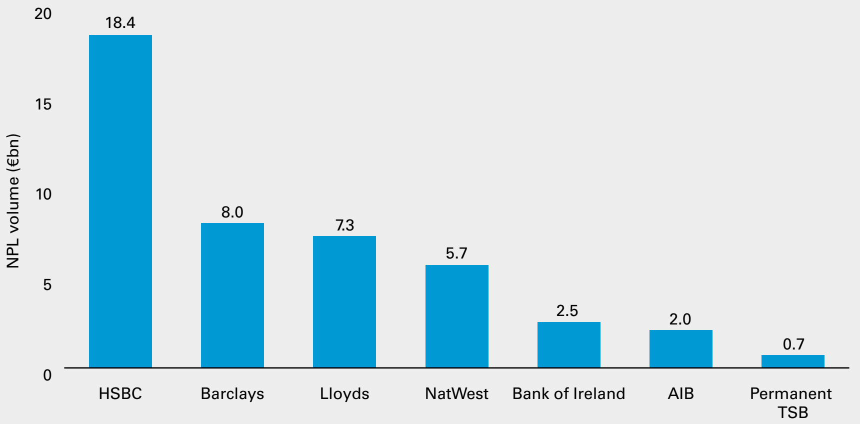
The absence of significant NPL disposals is certainly part of this story, with only five transactions announced by banks in the UK and Ireland in 2022, worth €9 billion in aggregate. While that looks like only a modest decline from the €10 billion of sales recorded in 2021, it is worth noting that more than half of the 2022 total was contributed by a single transaction, the €5.7 billion of NatWest's Ulster Bank NPLs.

Overall, however, NPL exposures look modest. In Ireland, the EBA says the banking sector's NPL ratio fell to 1.8 per cent by the end of 2022, in line with the average across the EU as a whole. In the UK, the comparable figure was 1 per cent, unchanged from a year prior.

Secondary market activity has also been relatively modest, though deals continue to be announced, particularly as PE houses and larger debt servicing companies trade portfolios or individual loans.

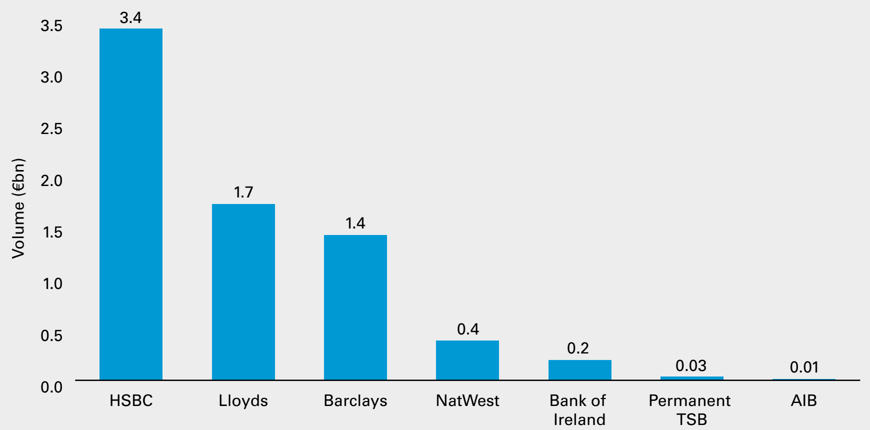
Looking forward, the UK's economic difficulties appear particularly pronounced, with core inflation remaining stubbornly high despite more than a year of consecutive interest rate hikes. Capital Economics, the independent think tank, is predicting a surge in business insolvencies over the next 12 to 18 months, potentially hitting a record high by Q2 2024. It will also be important to monitor NPL levels at some of the UK's smaller banks, which are particularly exposed to sectors such as buy-to-let and SME lending.

NPL volume in top UK & Ireland banks at end-2022 (€bn)



Source: Debtwire ABS Europe, based on stage 3 loans in financial reports

Provisions taken by top UK & Ireland banks in 2022 (€bn)



Source: Debtwire ABS Europe, based on provisions outlined in financial reports

** 2022 provisions in large part related to Chinese real estate*

Top NPL deals signed in UK & Ireland in 2022 by volume

Seller	Project name	Gross book value (€m)	Buyer	Type	Date
NatWest	Ulster Bank Mort's	€5,700	AIB	Mortgages	June
Kensington Mortgage	-	€2,259	Barclays	Mortgages	June
Permanent TSB	Glenbeigh 4	€770	Pimco	BTL mortgage*	September
Bank of Ireland	Temple Quay	€678	-	Mortgage*	November
AIB	-	€400	Everyday Finance	Mixed	June

Source: Debtwire ABS Europe's European NPLs database

**Securitisation*

GREECE:
Secondary market potential

Greece's recovery from financial crisis continues, with the help of the HAPS scheme, which saw the Greek state guarantee senior notes on NPLs while investors took on mezzanine and junior debt and came to an end in October 2022. The Greek government is now discussing the renewal of the HAPS scheme on different terms to the previous programmes (i.e., Hercules I and Hercules II).

The unwinding of HAPS did see a flurry of deals conducted under the scheme over the course of 2022, including the National Bank of Greece's €1 billion Frontier II project, the single largest NPL portfolio sale in the country during the year.

Overall, however, the Greek market was very quiet in 2022, with banks disposing of just €2.9 billion worth of NPLs. That compared with more than €40 billion of transactions in 2021, a year in which Greece saw twice as much NPL deal activity as any other country in Europe.

The implication is that the work to right-size Greece's NPL exposure is now more or less complete. NPL volumes at the country's leading banks stood at €10.2 billion at end-2022, down from more than €16 billion a year prior. Alpha Bank and Piraeus Bank have more or less halved their exposure.

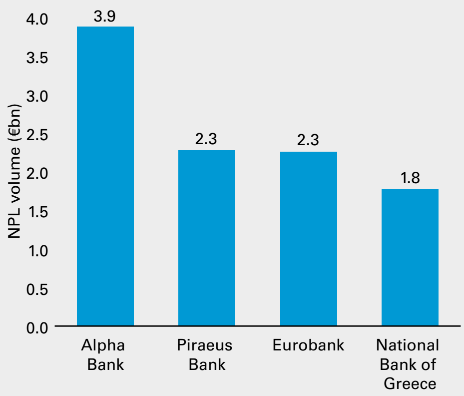
There is still some room for improvement—the EBA reported that Greece's NPL ratio stood at 4.6 per cent at end-2022, but that compares favourably to a figure of 7 per cent in December 2021. It is worth remembering that in 2016 the Greek NPL ratio peaked at close to 50 per cent.

The outlook also feels positive. Greek banks took net provisions of €1.6 billion at the end of 2022, compared to €6.2 billion a year prior.

In that context, NPL deal activity is more likely to be focused on the secondary market going forward, at least in the short term. As investors work through the substantial portfolios acquired over the past few years, there is significant potential for secondary sales, particularly of smaller portfolios or packages of loans. That will include increasing sales of reperforming loans, with Greek borrowers now recovering strongly.

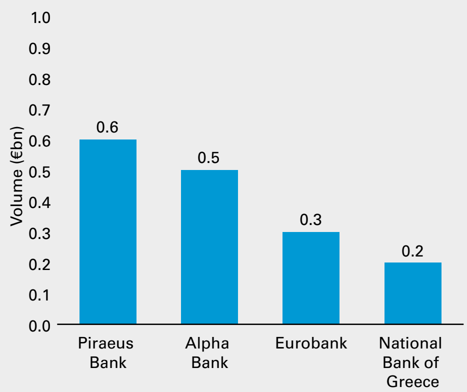
> **The Greek market was very quiet in 2022, with banks disposing of just €2.9 billion worth of NPLs.**

NPL volume in top Greek banks at end-2022 (€bn)



Source: Debtwire ABS Europe, based on stage 3 loans in financial reports

Provisions taken by top Greek banks in 2022 (€bn)



Source: Debtwire ABS Europe, based on provisions outlined in financial reports

Top NPL deals signed in Greece in 2022 by volume

Seller	Project name	Gross book value (€m)	Buyer	Type	Date
Nat'l Bank of Greece	Frontier II	€1,000	Bracebridge	HAPS securitisation	January
Piraeus Bank	Sunrise III	€500	Intrum, Waterwheel	HAPS securitisation	November
Piraeus Bank	Sunshine	€500	Bain Capital Credit	Leasing	December
Piraeus Bank	Dory	€400	Davidson Kempner	Shipping	January
Intrum	Tethys	€285	Various*	Secondary, hospitality	September

Source: Debtwire ABS Europe's European NPLs database

**SMERemediumCap, Latonia Enerprises—Athanasios Laskaridis family office, WHG Europe—Brown Hotels*

SPAIN:
Provisions security

In Spain, NPL volumes at leading banks stood at just under €62 billion at end-2022, down from close to €69 billion a year prior. The decline is partly explained by the fact that Spanish banks disposed of NPLs worth €4.8 billion, though that figure was down from the €7 billion worth of deals seen over the course of 2021.

Two banks dominated proceedings in 2022. Santander completed three disposals worth €1.4 billion combined, and CaixaBank undertook two amounting to €1.85 billion.

Despite these deals, however, Spain still has one of the largest NPL stockpiles in Europe, with only France recording larger totals. The EBA put the average NPL ratio in the Spanish banking sector at 2.8 per cent for end-2022, a modest improvement on the 3 per cent recorded a year prior.

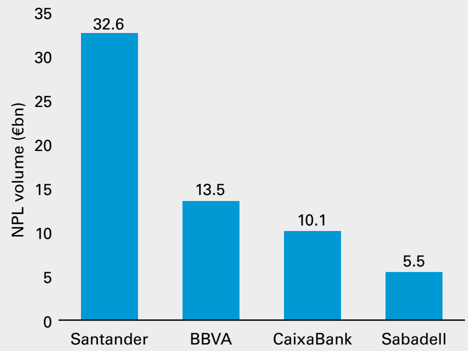
It is also worth noting that Spanish banks are consistently reporting more significant levels of provisions than their peers elsewhere in Europe. At end-2022, provisions at Spain's largest banks totalled €12.3 billion, down only marginally from €12.4 billion figure reported 12 months earlier. That context suggests progress on toxic assets in Spain is slowing, albeit with the country's exposures transformed positively compared to, say, five years ago.

It was reported towards the end of August 2023 that three Spanish banks—CaixaBank, Santander and BBVA—intended to sell a swathe of NPLs worth €1.4 billion in aggregate after the summer. These are composed largely of residential NPLs, with those that BBVA and Santander intend to sell each possessing reported gross book values of at least €400 million, while the portfolio that CaixaBank is looking to move has an unpaid principal balance of €485 million. Disposals such as these will certainly help to keep Spain's average NPL ratio at a modest level.

There is potential, too, for further activity in the secondary market, particularly in sectors such as hotels and leisure, where specialist investors are circling. Reforms to Spain's pre-insolvency regulation, widely perceived as supportive of creditors, as well as plans to streamline the country's insolvency processes, also provide incentives for secondary buyers to focus on the Spanish NPL market.

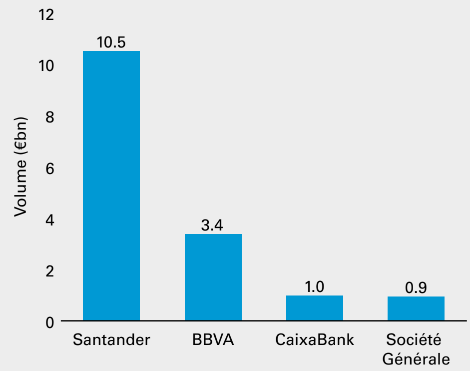
Still, at a macro level, there are concerns about Spanish economic performance over the course of 2023. The IMF expects GDP growth of 1.1 per cent for the year—down from an estimated 5.2 per cent in 2022—though it points to resilience in the tourism sector as one potential point of optimism.

NPL volume in top Spanish banks at end-2022 (€bn)



Source: Debtwire ABS Europe, based on stage 3 loans in financial reports

Provisions taken by top Spanish banks in 2022 (€bn)



Source: Debtwire ABS Europe, based on provisions outlined in financial reports

Top NPL deals signed in Spain in 2022 by volume

Seller	Project name	Gross book value (€m)	Buyer	Type	Date
CaixaBank	Ordesa	€1,100	Axactor, Kruk, EOS	SME, consumer	September
Banco Sabadell	Austro	€832	Zolva	Unsecured	June
CaixaBank	Yellowstone	€750	Cerberus	Mortgages	August
BBVA	Neira	£720	Link, Kruk	SME, consumer, credit cards	December
Santander	Macondo	€700	Morgan Stanley, Ellington	Mortgages	July

Source: Debtwire ABS Europe's European NPLs database

Subdued headline figures belie nuanced NPL market

Declining NPL ratios have put banks in a somewhat more comfortable position than they were this time last year, but the threat of macroeconomic hardship looms over borrowers.

In the previous edition of this study, we painted two possible pictures for European NPL sales in 2022. One possibility was that the aftereffect of the COVID-19 pandemic, combined with new shocks such as the outbreak of war in Ukraine, would see NPL volumes increase, and banks come under pressure to step up disposals of their toxic assets. Alternatively, we suggested, the heavy lifting done by banks over a number of years to get NPL exposures under control would diminish both the scope and the imperative for further sales, even amid a deteriorating macroeconomic climate.

In actuality, the second of these scenarios dominated. NPL sales were sharply down in 2022, and there has, in any case, been little sign so far of a new wave of bad debts at European banks. NPL volumes have continued to fall, with even modest levels of sales sufficient to counteract the income of debt newly designated as non-performing.

Where will the market go from here? In many respects, the possibilities are little changed compared to 12 months ago. The sharp economic slowdown now expected across much of Europe may see NPL volumes increase; certainly banks have, in aggregate, increased their provisions. Equally, however, NPL ratios have fallen to comfortable levels, providing banks with some degree of comfort even if more borrowers do begin to struggle. In the short term at least, the level of NPLs remaining on banks' balance sheets is not sufficient to drive a significant increase in sales. The end of guarantee schemes in Greece and Italy also mitigate against a sharp spike.

This is not to suggest that the NPL market lacks opportunities. Some investors are looking further afield, with new deals completed in the Nordics in recent months, and even signs of a new market emerging in the Middle East. The secondary NPL market is also seeing significant levels of actively, as a broad range of market participants trade in and out of portfolios according to their changing appetites.

The headline numbers, in other words, may be misleading. On the surface, the NPL market looks calm—underneath, however, there is plenty of activity.

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