

Credit Portfolio Advisory

Critical challenges ahead for bank and non-bank lenders in the UK and Europe



MARCH 2020

As the financial and operational disruption brought on by the outbreak of COVID-19 continues to spread across the world, Alantra's Credit Portfolio Advisory (CPA) team considers the current and expected impact on UK and European lenders, beyond operational business continuity.

In a fast moving environment with government and central bank actions evolving daily, Alantra's CPA team specifically discusses how the challenges of tougher capital market conditions and the inevitable stresses on asset quality and funding will affect bank and non-bank (NBFI) lenders' business models.

Volatility in capital markets



- Equity indices have seen significant sell-off with the U.S. S&P500 now officially seeing its first "bear market" for over 10 years.
- Debt markets have seen credit spreads widen to levels not experienced since the 2008 Global Financial Crisis (GFC), with a particular stress in sub-IG corporate credit.
- Wide-ranging monetary and fiscal stimulus packages are very welcomed and may lead to near-term stabilisation in equity and debt markets, but profit warnings and weak earnings numbers will inevitably cloud H1 2020 market sentiment.
- Levered NBFIs (ABS and/or HY bonds) seeking refinancing in H1 2020 should expect considerable cost increases further pressuring lending spreads and profitability—wholesale funded business models and acquisition structures will come under intense pressure.

Stresses in asset quality



- Corporates and SMEs will experience considerable short-term stresses as government 'lock-downs' take effect across Europe and globally—drawing of credit lines are being reported, albeit banks are so far suggesting immaterial movements.
- Consumer finance and auto finance are also likely to see performance stresses in the short-medium term.
- Borrowers (both corporate and consumer) may benefit from 'borrower mortgage breaks' and 'insolvency suspensions' taking effect in the UK and parts of Europe.
- All lenders should expect deterioration in asset quality, an uptick in NPLs/NPEs, an increase in portfolio impairments (see IFRS 9 box) as loans migrate to 2/3, and capital erosion.
- Lenders who are not prepared for a down-cycle will need to quickly prepare operationally to support and restructure borrowers—third party servicing support may be required.

Impact of IFRS 9 pro-cyclicality



- Generally, asset quality stresses will result in increased migration of exposures from Stages 1-2 to later Stages 2-3.
- Banks are expected to provide against Stage 2 exposures on a lifetime expected credit loss (ECL) basis and Stage 3 exposures on a full amortised cost basis, hence overall provisioning levels are expected to increase considerably.
- Bank of England has already announced that it does not expect recent 'mortgage break' measures to automatically result in migration to Stage 2, which will be helpful for banks—and EBA/NCAs likely to follow suit across Europe.
- Implementation of the new EBA Definition of Default guidelines through 2020 was already expected to increase the quantum of defaulted loans.
- Capital measures (including CCyB release—see Regulatory box) will provide some relief.

Central bank & regulatory actions



- Significant measures have been taken by central bankers to support lending into the 'real economy', including the renewal of the bond purchasing programmes (ECB ABSPP & TFSME) focussed on ensuring liquidity reaches businesses.
- Certain central banks (e.g. UK, Ireland) have also moved to enact a reduction in the counter-cyclical buffer (CCyB) from 1% to 0% which should serve to off-set some of the IFRS 9 impact on bank balance sheets.
- Europe-wide bank "stress tests" are delayed until 2021 although asset quality will remain a concern particularly against the back-drop of continue COVID-19 uncertainty—it is likely that bank recovery plans drawn up in recent years will need to be reviewed.
- Lenders will need to continue to monitor and adapt to support measures made available to both borrowers and institutions.

Key themes for lenders (banks and NBFIs) & how Alantra can help

Key themes likely to prevail

How Alantra can help

Liquidity optimisation	Banks	<ul style="list-style-type: none"> With UK TFS (2016) winding down, accessing TFSME/Repos/ECB ABSPP to supplement existing liquidity will be an increasingly important tool Additionally, banks will need to carefully consider the eligibility of collateral vs. market liquidity 	<ul style="list-style-type: none"> Collateral eligibility preparation Private placement securitisations
	NBFIs	<ul style="list-style-type: none"> Access to capital markets may no longer be optimal or indeed possible for some lenders Considering a broader funding arrangement will be necessary at these times, with private capital likely to play an important role 	<ul style="list-style-type: none"> Senior & Mezzanine capital raising Evaluating all funding arrangement options
Asset quality reviews	Banks	<ul style="list-style-type: none"> All lending sectors (corporate, consumer, etc.) are likely to see increases in delinquency rates Understanding portfolio stresses and the present market-value of certain assets will be an important regulatory capital management tool 	<ul style="list-style-type: none"> Loan portfolio market pricing Options for releasing capital/liquidity
	NBFIs	<ul style="list-style-type: none"> A number of NBFIs will be facing their first negative credit cycle, with limited insight into likely performance and recovery levels Those in specialist/complex finance and off-prime lending segments are most likely to see pressures 	<ul style="list-style-type: none"> Portfolio analytics for financing support Asset cashflow stress modelling
Capital raising & de-risking	Banks	<ul style="list-style-type: none"> Whilst CET1 ratios across Europe are at record high levels, the impact of IFRS 9 and rising impairments generally is likely to cause downwards pressures Releasing capital (via asset de-risking) or raising capital (e.g. Tier 2) remain viable options for banks 	<ul style="list-style-type: none"> Loan portfolio sales and capital relief trades Bank capital raising
	NBFIs	<ul style="list-style-type: none"> Private capital (equity or preferred) injections are likely to be necessary for a number of NBFIs seeking to manage rising impairment levels and borrower forbearance measures Business planning and viability will be critical 	<ul style="list-style-type: none"> Equity capital raising Business plan assessments
Business models, Restructuring & M&A	Banks	<ul style="list-style-type: none"> Profitability through scale is likely to be ever more critical given long-term interest rate projections There are likely to be situations where banks can access assets that would enhance/complement existing business models leveraging cheaper funding 	<ul style="list-style-type: none"> Acquisition target identification & support Business & operating model review
	NBFIs	<ul style="list-style-type: none"> Enhancing existing platforms through diversification and/or scale will be necessary, particularly as shareholders assess viability of short-/medium-term exit plans Consolidation and M&A opportunities are expected 	<ul style="list-style-type: none"> Sourcing equity partners Debt capital financing & restructuring

Helping you access the right capital and liquidity during unprecedented market conditions

Institutional capital & banks

Insurance &
Pension funds

Asset
managers

Banks



Project Landmark

Senior facility for a bridging & development lender



Lead financial advisor to PropFin, a provider of residential development and bridging loans on the execution of a senior financing facility

£100 million
2019



Project Arthur

Portfolio sale of ERM & home reversion exposures

Confidential

Lead sell-side advisor to a UK bank on the sale of a portfolio performing equity release mortgages (ERM) and home reversionary plans

Confidential
ongoing



Project Juniper

Portfolio sale & forward flow of SME asset finance

Confidential

Lead financial advisor to a specialist SME asset finance lender on the sale of a performing asset finance portfolio and forward flow structuring

Confidential
2019

Private capital

Private equity

Credit funds

Hedge funds



Project Nata I & II

Portfolio sales of corporate and consumer NPLs & NPEs

Confidential

Lead sell-side advisor to a large Portuguese banking group on the sales of two portfolios of non-performing consumer/SME (secured and unsecured) and corporate single-name exposures to a US hedge fund

€3.5 billion
2019



Project Union

Sale of interests in a specialist development lender



Lead financial advisor to Pollen Street Capital on the sale of its debt and equity interests in Castlehaven Finance to Avenue Capital

£250 million
2019



Project Pillar

Structuring and placement of an SRT transaction for NPLs



Sole arranger and financial advisor to Eurobank on the structuring of a cash securitisation allowing de-recognition of non-performing exposures

€2 billion
2019

Alantra CPA

Alantra CPA is the leading credit advisory team globally



150+

Professionals



>30

Countries where CPA is currently advising clients



8

Offices on three continents



25

Nationalities



6

Partners



35

Pricing & analytics professionals



38

PropTech professionals (uDA)



>250

Deals advised since 2014



Loan Solutions

- We have unrivalled experience in advising on loan portfolio transactions globally advising on the sell- and buy-side
- As the leading credit portfolio advisor in Europe, we provide clients with unique investor access, tailored deal structures and a in-depth knowledge of all credit asset classes

Funding

- Our funding advisory team works to structure efficient solutions tailored to our clients' individual funding and capital needs
- The team has deep knowledge of the structured credit, Asset Backed Securities (ABS) markets and debt capital markets

Banking M&A

- We intimately understand the UK and European banking landscape and have led a number of high-profile banking M&A transactions
- The team provides a unique perspective to M&A strategies covering clients in the bank, non-bank and asset originator space

Real Estate & Technology

- We specialise in the sale and acquisition of distressed real estate portfolios across Europe
- CPA acquired urbanData Analytics ("uDA") in 2019, a machine learning-driven PropTech company
- uDA specialises in providing efficient and automated data-driven real estate value estimates

Pricing & Analytics (P&A)

- Our unique P&A team underpins all of our advisory capabilities across Europe
- P&A has deep expertise in portfolio valuations, data set analysis, cash flow analysis, business plan builds and ABS structuring
- We provide 'real-time' market pricing on credit assets

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ALANTRA

POSSIBILITY IS IN THE ASCENT

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United Kingdom
United States

Alantra is a global investment banking, credit portfolio advisory and alternative asset management firm focusing on the mid-market with offices across Europe, the US, Latin America and Asia.