OLIVER WYMAN

THE DAWN OF A NEW ERA IN CORPORATE RESTRUCTURING

NEW ALLIANCES TO TURN AROUND NON-PERFORMING LOANS

SURVEY PARTICIPANTS

IN % OF ALL PARTICIPANTS

73%

OF SURVEYED BANKS EXPECT MORE SALES OF NON-PERFORMING LOANS (NPLs) TO INVESTMENT FUNDS

1. Management consultants, lawyers, insolvency administrators, chief restructuring officers (CRO) etc.

INTRODUCTION

Dear Reader,

Has corporate restructuring reached a turning point?

Until recently, banks that provided the financing have been the driving force behind most turnaround and restructuring processes. When a client became distressed, banks would send their "special care" department to solve the problem, while simultaneously reducing or ring-fencing the risk to the bank. In an ideal solution, the debtor would return to "normal" and repay the outstanding loan as scheduled.

But this world is changing. The restructuring of non-performing loans (NPLs) is becoming increasingly difficult for banks, as holding on to the loans places increased pressure on their balance sheet from regulators and supervisors. The changed landscape, however, represents an opportunity for investment funds, which possess a large amount of "dry powder" and an appetite to take over and restructure the loans. In contrast to banks, funds see the upside from turning around these trouble debtors since the value of the recovered non-performing loan (NPL) is usually much greater than the price paid for it.

Dr. Lutz Jaede | Head of Corporate Restructuring

Will this trend intensify in the coming years? What forces will drive investment funds in the eurozone to engage? Are specialized platforms and vehicles needed for speeding NPL transactions and restructuring? And will this lead to a profound shift in the restructuring ecosystem?

We have analyzed these questions in this report. Its insights are based on a survey of restructuring experts and corporates across Europe, complemented by Oliver Wyman analyses and points-of-view. We hope you find it informative and useful.

Sincerely yours,

Lutz Jaede


kN ↔ 23 ↕ 8 8

CONTENTS

EXECUTIVE SUMMARY

WINNING IN COLLABORATION

BANKS ARE BEING FORCED TO SELL MORE NPLs

Economic growth in Europe has been positive in recent years – fueled in part by favorable macroeconomic trends and lower lending costs. Nonetheless, Europe as a whole has not fully recovered from the financial crisis, and NPL ratios in many European countries remain high. Banks in "high-NPL" countries, such as Italy, Greece, Spain, and Portugal, are likely to continue selling NPLs to reduce their risk exposure. Additionally, our survey reveals that NPL sales may increase even in countries with low NPL ratios, such as Germany. The main drivers behind these trends are regulatory requirements, greater expectations for tackling NPLs under the Single Supervisory Mechanism, and new accounting standards (IFRS 9) which make it less favorable to keep an NPL on the bank's balance sheet. But balance sheet considerations are not the only reasons for selling an NPL. The survey participants point out that they would also sell an NPL to an investment fund to accelerate the restructuring process or to focus in-house resources on more strategically relevant areas.

INVESTMENT FUNDS ARE INCREASINGLY WILLING AND ABLE TO TURN AROUND DISTRESSED DEBTORS

The need for banks to sell their NPLs has led to a growing interest among investment funds to buy them. Even funds that previously focused on equity transactions have begun investing in "single-name" corporate NPLs, with the goal of gaining control over the restructuring process and improving the likelihood of a successful turnaround. The participants in the survey also see investment funds as being better positioned to support the debtor in a crisis situation, as compared to banks. The advantages of a fund in restructuring scenarios are speed and flexibility, as well as the great number of restructuring instruments it can bring to bear. Banks in turn can leverage stronger relationships with local stakeholders, which may increase the level of trust among the involved parties and facilitate a consensual solution for the restructuring.

SMARTER TRANSACTION VEHICLES CAN HELP TO CREATE WIN-WIN SITUATIONS

But there is currently a mismatch between demand and supply: Investment funds are seeking corporate NPLs in the early-crisis stage, allowing them more time and leeway to turn around the debtor. Banks, on the other hand, want to keep alive their chance of benefiting from a turnaround of the NPL and thus will sell only when the company is on the verge of insolvency. "Smarter" vehicles for NPL transactions may be able to bridge this demand-supply gap by providing a basis for banks and investment funds to combine their capabilities and share the upside. To date, these "special purpose vehicles" (SPVs) have been applied only in countries with high NPL ratios – but they could also serve as a way for "low-NPL" countries to address their own demand-supply gap in NPL deals.

ALL STAKEHOLDERS WILL BENEFIT IF BANKS AND FUNDS COMBINE THEIR STRENGTHS

The survey's findings show that banks and investment funds possess complementary strengths and a shared interest in a successful turnaround of the NPL, and that collaboration is beneficial to all stakeholders. This is in line with the fact that the majority of participants see investment funds and banks as being equally important for driving future restructuring processes. As a result, restructuring processes may become more entrepreneurial, and we expect that understanding and optimizing the business design of the debtor will become even more important in the future.

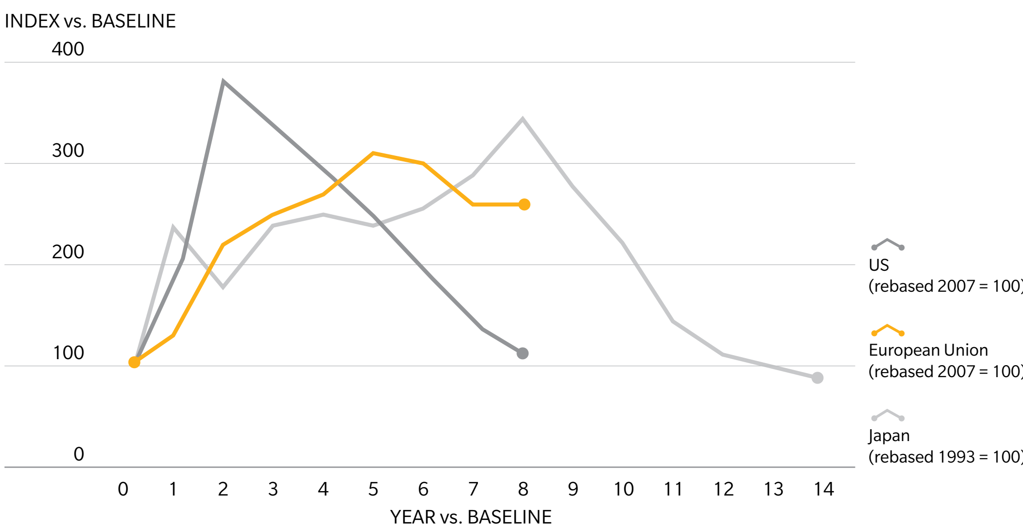
STUDY

BANKS UNDER PRESSURE

NO RECOVERY YET FROM THE FINANCIAL CRISIS

The banking system in the European Union is still recovering from the financial crisis. Compared to crises in the past, such as the banking crisis in the United States in 2008 or the financial crisis in Japan in the late 1990s, the reduction of European Union NPL ratios is much slower. (See Exhibit 1.) As a result, some "high-NPL" countries such as Greece, Portugal, Italy, and Spain still face very high NPL ratios, and banks need to act in order to reduce their risk exposure. (See Exhibit 2.)

Exhibit 1: NPL ratio indexed to start of crisis

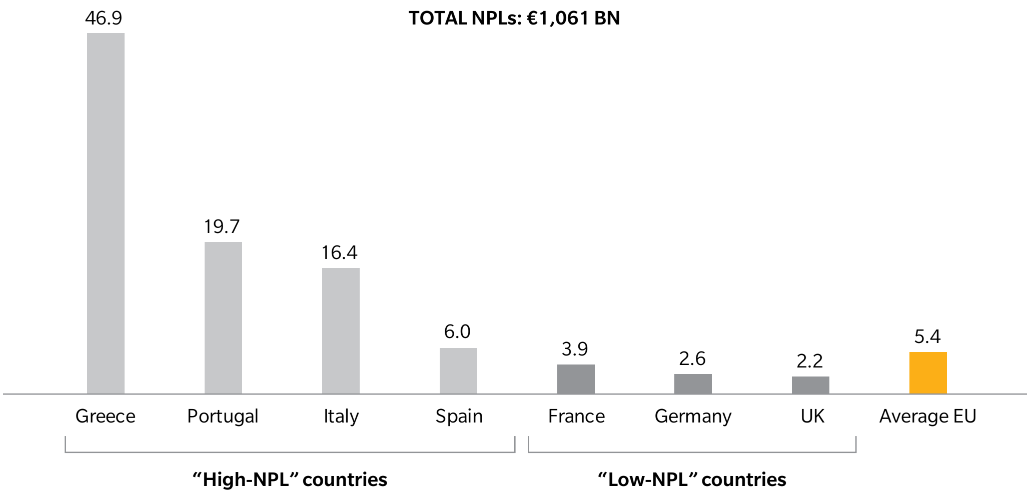


Source: European Banking Authority Report, Regional Development Bank (Q3-2016)

To accelerate the recovery, new regulations and rules have been introduced that impact the way corporate NPLs are treated by banks. The most significant one is the request by the bank supervisor (Single Supervisory Mechanism) for banks to conduct a self-assessment and develop a bottom-up plan for how to tackle their NPLs. This is relevant in particular for banks in countries with high NPL ratios. Basel IV requires banks to cover some NPLs with even more equity. And on top of that, the new accounting standard IFRS 9 introduces the obligation for banks to recognize the expected lifetime loss in the valuation of a loan that turns non-performing.

Exhibit 2: NPL ratios in the EU by country

IN % OF GROSS LOANS



Source: European Banking Authority Report, Regional Development Bank (Q3-2016)

BANKS CHANGE THE WAY THEY TREAT THEIR NPLs

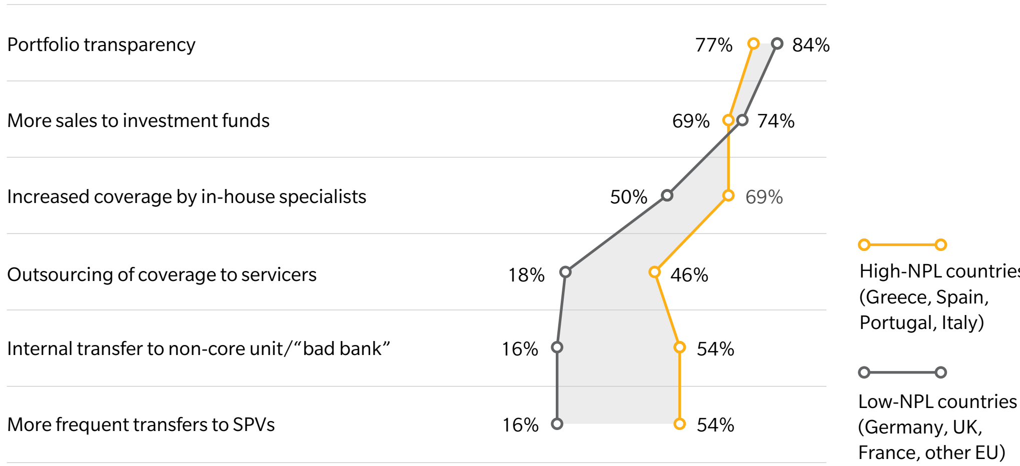
As a response to these drivers, banks have begun to change the way they deal with corporate NPLs. (See Exhibit 3.) Most banks plan to improve their transparency on NPLs on their credit book to fulfill the information requirements of the Single Supervisory Mechanism. The sale of corporate NPLs to investment funds will happen more frequently, even in countries with low NPL ratios. A significant number of banks also plan to professionalize the way they deal with NPLs by handing them over to in-house specialists. The use of servicers, "bad banks", and transfer to special purpose vehicles will also happen more frequently – although these changes are most likely to happen only in "high-NPL" countries.

NPL SALES AS A LEVER TO FACILITATE RESTRUCTURING PROCESSES

Reducing risk exposure is the most important driver to sell NPLs across all countries covered in the survey. (See Exhibit 4.) However, NPL transactions are also used by banks as a lever to increase the efficiency of the restructuring process itself. Banks surveyed stated they use NPL sales to focus in-house resources more on NPLs within core markets and asset classes and that reductions in the NPL portfolio help them reduce the costs of handling NPLs.
In addition, banks see NPL sales as a shortcut to a resolution of the situation, avoiding a lengthy and uncertain restructuring process and benefiting from the workout experience of the buyer.

Exhibit 3: How will you change the way you treat corporate NPLs?

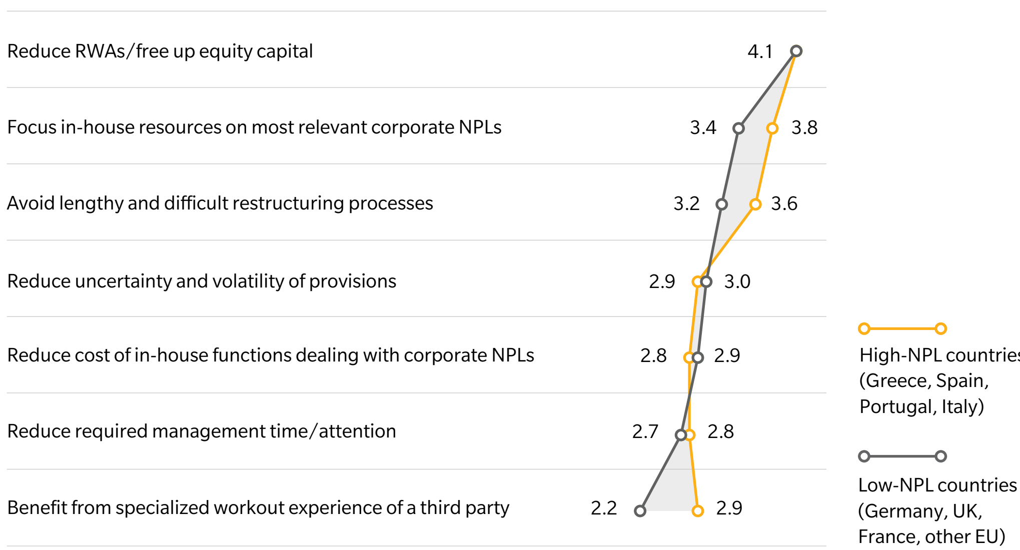
IN % OF RELEVANT PARTICIPANTS (BANKS)



Source: Oliver Wyman Restructuring Survey 2017

Exhibit 4: What could be the reason to sell a corporate NPL?

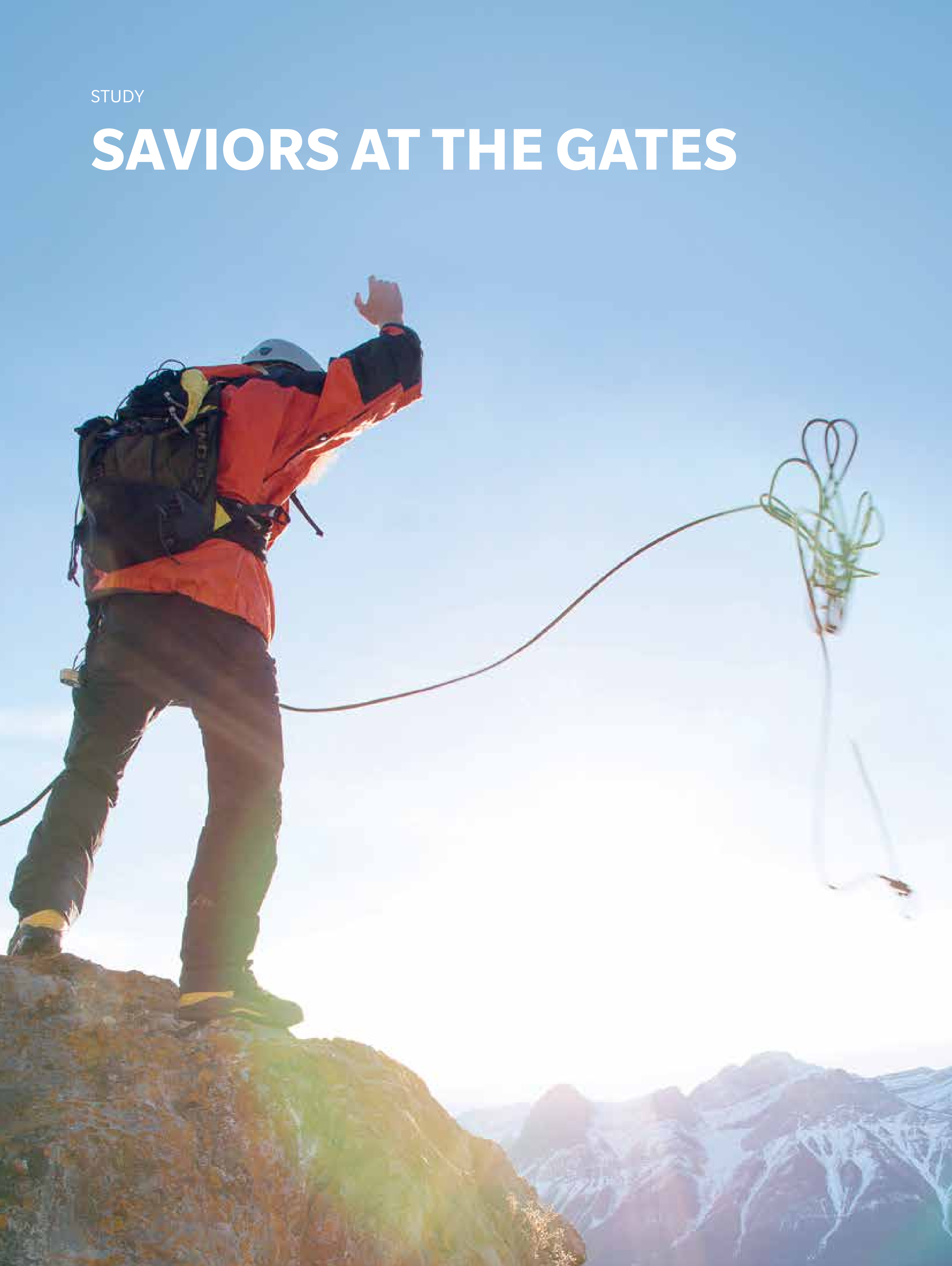
AVERAGE OF RESPONSES FROM 1 = NOT RELEVANT TO 5 = VERY RELEVANT



Source: Oliver Wyman Restructuring Survey 2017

STUDY

SAVIORS AT THE GATES



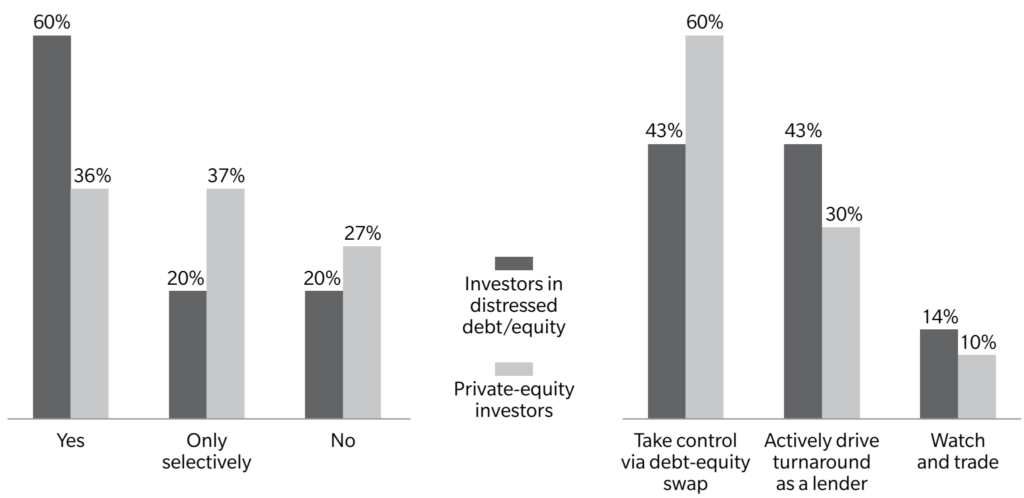
A NEW TYPE OF NPL INVESTOR

The landscape of NPL investors is becoming more diverse. (See Exhibit 5.) While past NPL transactions often involved specialized debt funds, our survey shows that already more than one-third of the surveyed private-equity investors plan to invest in NPLs. A similar number said they would invest selectively in NPLs if the upside is visible and the crisis can be solved. Consequently, the clear majority of private-equity firms that invest in NPLs seek to get into an equity position or drive the turnaround actively as a lender.

Exhibit 5: The landscape of NPL investors is becoming more diverse

Do you currently plan to invest in corporate NPLs? What is your NPL investment strategy?

IN % OF RELEVANT PARTICIPANTS (FUNDS)



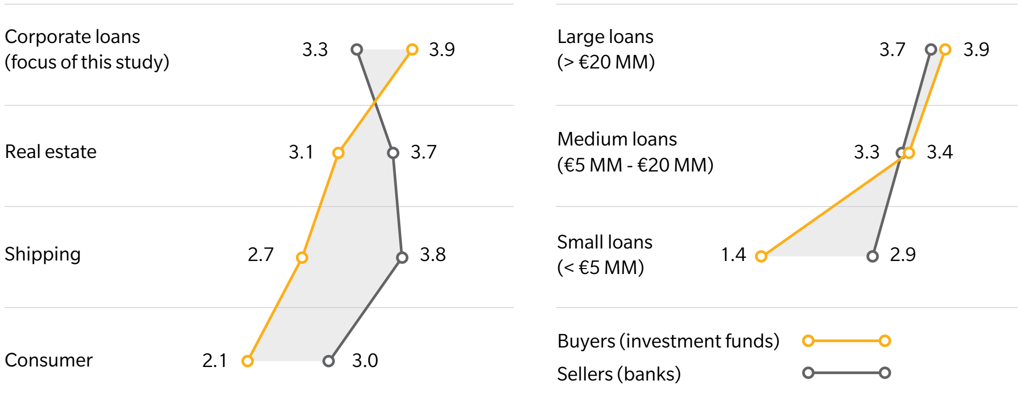
Source: Oliver Wyman Restructuring Survey 2017

But also "distressed investors", who may be suspected to just "hold out" on their loans, clearly strive for an active role in any turnaround. As a result, the differentiation between distressed-debt and private-equity investors is likely to become more and more blurred. Instead, the market will see a set of "special situation" investors who earn their returns from supporting a company in overcoming a crisis – no matter if the entry point is an equity investment or an NPL purchase.

Such a strategy, however, works only for single-name corporate loans, which allow investors greater active involvement in the turnaround process. Moreover, the loans will need to be fairly sizable so that returns justify investors' efforts. (See Exhibit 6.)

Exhibit 6: What kind of NPL do you prefer to buy or sell?

FROM 1 = VERY UNLIKELY TO 5 = VERY LIKELY



Source: Oliver Wyman Restructuring Survey 2017

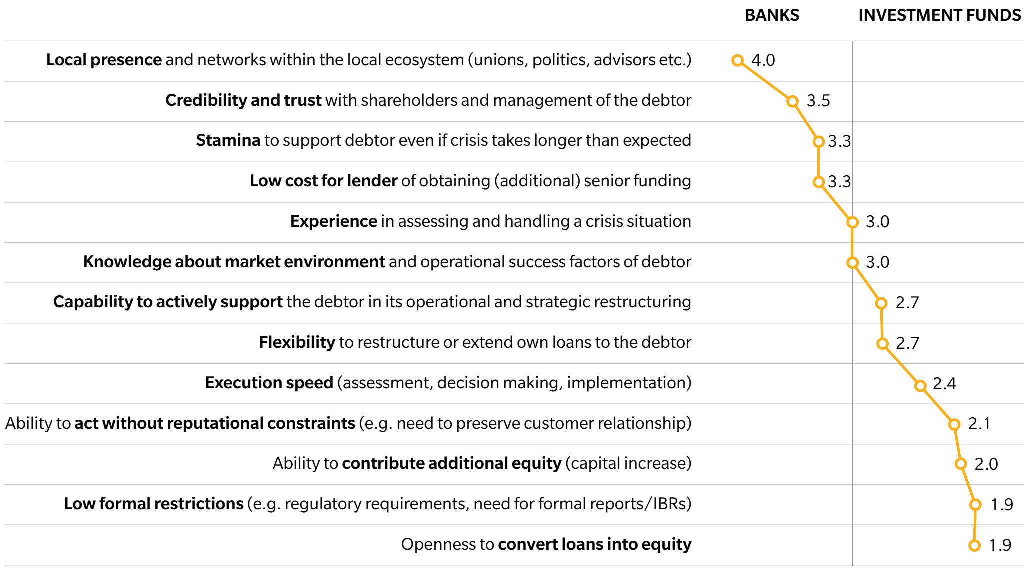
FUNDS SEEK TO MAXIMIZE RETURNS RATHER THAN MINIMIZE RISKS

Investment funds have a different attitude than banks towards a turnaround situation. Banks usually do not expect a debtor to get into distress when making a loan. Hence, they always perceive a turnaround situation as a downside and try to reduce their risk exposure or minimize losses via the restructuring process. An investment fund buying the NPL, on the other hand, already knows about the crisis situation and therefore will only invest if there is a chance to turn around the company and realize a recovery of the loan that is higher than what has been paid for it. In addition, the option to take control as an equity holder and then realize value growth via add-on acquisitions or further investments is a playing field that is familiar to investment funds but impossible for most banks to pursue.

These different approaches also translate into specific strengths and weaknesses for banks and investment funds. (See Exhibit 7.) The survey participants see investment funds as being much more capable than banks in bringing about a restructuring. They are able and willing to contribute additional equity or to turn their loans into shares. Additionally, they have fewer restrictions due to regulatory requirements or reputational constraints. Finally, they can move faster and more nimbly than banks, which are often slowed by complex and lengthy internal decision-making processes.

Exhibit 7: What (dis-)advantages do funds have vs. banks in restructuring a corporate NPL?

FROM 1 = CLEAR ADVANTAGE OF FUNDS TO 5 = CLEAR ADVANTAGE OF BANKS



Source: Oliver Wyman Restructuring Survey 2017

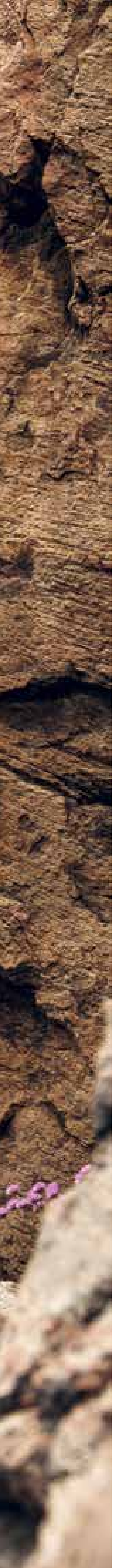
Banks in turn have a stronger network within their local ecosystem. They can often build upon well established and trust-based relationships with other banks and with other key stakeholders, such as unions or politicians. Plus, they usually have a long-standing business relationship with the debtor and an established level of credibility and trust, which in turn can help in building consensus in the restructuring process.

These relative strengths are not competing but complementary. Furthermore, banks and funds are deemed by the study participants as being equally capable of understanding the debtor's business, assessing the need for action, and handling the crisis situation. This suggests that both banks and funds can contribute important skills to a restructuring, and that there is a strong basis for collaboration if both sides can establish an effective platform to work together.

STUDY

JOINT SUCCESS REQUIRES SHARING

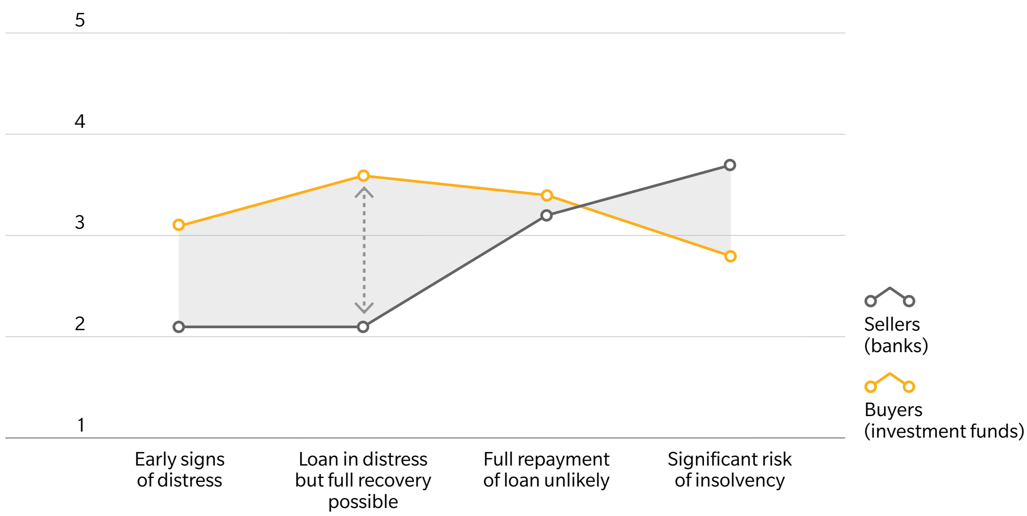
BANKS ARE HESITANT TO SELL NPLs AT AN EARLY STAGE OF THE CRISIS



If investment funds are to utilize their capabilities, they need to be involved as early as possible. The sooner they can drive a restructuring, the more freedom they will have to act and achieve a successful turnaround. But comparing the interest of funds to buy with the willingness of banks to sell an NPL along the typical stages of the crisis shows a clear mismatch of demand and supply. (See Exhibit 8.) Funds prefer to get involved at an early stage of the crisis that still may allow a full recovery of the loan. Banks, however, mostly sell if they think a write-off is unavoidable or insolvency is looming.

Exhibit 8: At which stage of the crisis do you want to buy or sell an NPL?

AVERAGE OF RESPONSES FROM 1 = VERY UNLIKELY TO 5 = VERY LIKELY



Source: Oliver Wyman Restructuring Survey 2017

This mismatch, most likely, is due to the banks' fear of losing the possible upside in the event of a recovery. What they fail to take into account is that involving funds increases the likelihood of success, given their capabilities in driving and supporting a turnaround.

"SMART" VEHICLES ARE REQUIRED TO ALLOW EFFECTIVE COLLABORATION

The way around this dilemma would seem to be to establish transaction vehicles that allow the seller to participate in the upside of a successful turnaround even after selling the NPL. This solution is supported by the requirements that survey participants find most important for different types of NPL transactions. (See Exhibit 9.) When banks sell a non-core NPL, efficiency is most important to them. In such a case, they require well-established, flexible transaction frameworks and a seamless interaction between buyers and sellers.

Exhibit 9: What are the most important requirements for NPL transactions?

IN % OF RESPONDENTS

Requirement	Disposal of non-core NPL	Sale of NPL with core segment
Framework that allows to structure deals on a case-by-case basis	73	35
Efficient platform to involve a large group of sellers and potential buyers	72	22
Low complexity of transaction (few sellers and few buyers involved)	70	39
Platform to pool resources needed for management of corporate NPLs	49	34
Ability to involve additional investors beyond buyer to support turnaround	54	47
Buyer can take an **active role in turnaround** of the debtor using own advisers	50	47
Financing mechanism that allows buyers and sellers to **share upside**	70	57
Seller can continue to **service corporate NPL with own resources**	30	67
Option for the seller to **take corporate NPL back into own credit book**	15	72
Continued control over the loan for the seller (to the extent possible)	17	82

Type of transaction: Disposal of non-core NPL; Sale of NPL with core segment

Source: Oliver Wyman Restructuring Survey 2017

When they are forced to sell an NPL that has good prospects or strategic importance, "smarter" transaction platforms are required. Such vehicles allow the seller to stay involved in the turnaround, get a share in the upside, or even take back the loan into own credit book when the turnaround is successful.

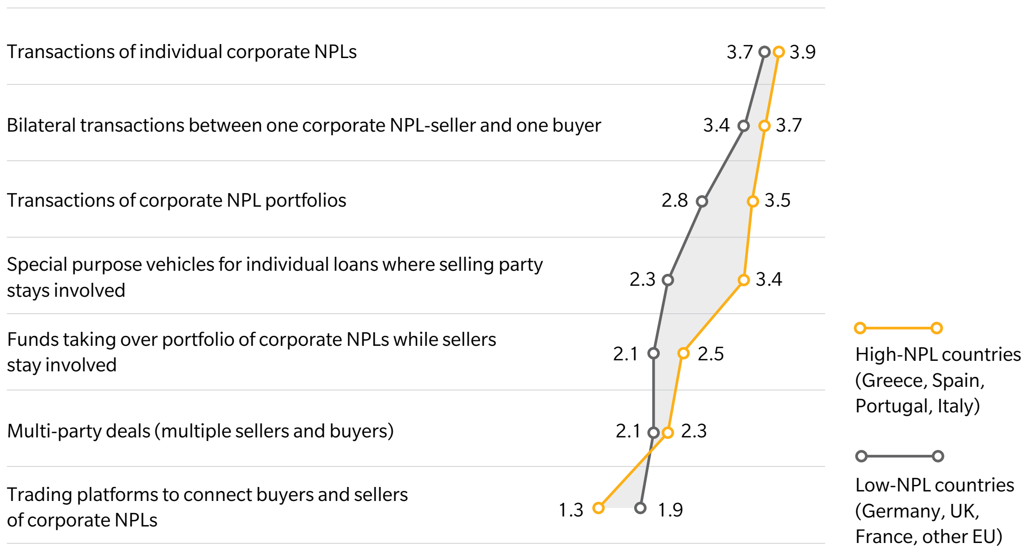
If such "smarter" vehicles are available, banks may become less reluctant to sell NPLs at an earlier stage of the crisis, as they would still have a stake in the restructuring process and participate in any upside.

ADVANCED TRANSACTION VEHICLES ALREADY USED IN “HIGH-NPL” COUNTRIES

Looking at the type of NPL transactions that have been observed by the experts recently, it becomes clear that the most common type of NPL transaction is an outright sale of an individual NPL or an NPL portfolio that involves two parties only. (See Exhibit 10.) Other types of transactions have been observed only seldom.

Exhibit 10: Which types of transactions have you observed recently?

AVERAGE OF RESPONSES FROM 1 = NEVER OBSERVED TO 5 = VERY FREQUENTLY OBSERVED



Source: Oliver Wyman Restructuring Survey 2017

In countries with high NPL ratios, however, survey participants report they have seen NPL transactions based on special purpose vehicles, which allow sellers to stay involved and share in the upside with buyers. In countries with low NPL ratios, such transactions have not been observed to date.

This may be due to the fact that banks with healthy balance sheets can afford to hold on to strategically important NPLs, and therefore have no need for special purpose vehicles. If, however, the bank’s balance sheet were to come under pressure, it could be forced to sell an NPL that it might otherwise want to keep. In such a situation, a vehicle that allows the bank to stay involved would be an attractive solution. But special purpose vehicles could also serve as a model for those banks with lower NPL quotes that are looking to benefit from the capabilities of an investment fund in a restructuring process.

CONCLUSION

IF YOU WANT TO GO FAR, GO TOGETHER

The restructuring landscape in Europe is rapidly changing. Increasingly, banks will need to sell their NPLs to investment funds as a result of tougher regulatory and capital requirements and new accounting rules. Currently, NPL transactions happen at a late stage of a crisis, and sellers usually do not stay involved once the NPL is off their balance sheet.

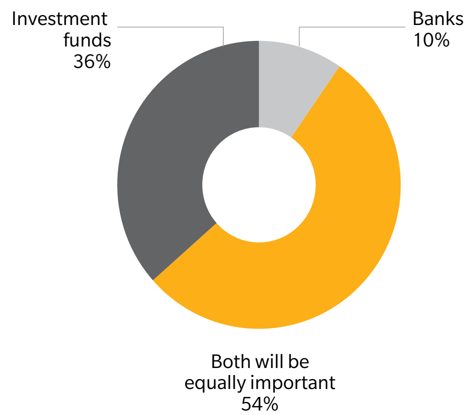
But the participants in our survey believe that investment funds can achieve more than just serving as a place to dispose of doomed loans. They feel they can bring to the table key capabilities to drive and support a turnaround process that banks cannot match. Involving investment funds at an earlier stage may increase the likelihood of a successful recovery. A solution benefiting all stakeholders becomes even more feasible if funds act in collaboration with banks, which can leverage established, trust-based relationships with the struggling company and other involved parties.

Such a symbiosis, however, requires an alignment of interests and a platform for banks and investment funds to work together. Examples of this kind of platform have been seen already in high-NPL countries, allowing sellers to remain involved and share in the bounty of a successful turnaround. We believe these kinds of platforms can also add value in situations where banks are looking for an effective way to profit from the capabilities of investment funds to facilitate a turnaround process and maximize the benefit for all stakeholders.

A majority of experts believe that in the future banks and investment funds will be equally important in driving restructuring processes. (See Exhibit 11.) Furthermore, they expect investment funds will place greater emphasis on achieving a sustainable strategic and operational turnaround of the debtor, rather than seeking a short-term solution.

Exhibit 11: Who will be the future driver of corporate restructurings on the lender side?

IN % OF ALL PARTICIPANTS



Source: Oliver Wyman Restructuring Survey 2017

So in thinking about the future of restructuring, you may want to think about a new era, one that takes an entrepreneurial approach towards restructuring – driven by players whose goal is to realize the upside in a crisis alongside players who are taking a prudent look at potential risks.

We find this thought an exciting one!

RESTRUCTURING WITH OLIVER WYMAN

Backed by years of experience, Oliver Wyman acts as a trusted advisor to banks, investment funds, and distressed corporates as they take on the challenges of strategic, operational, and financial restructuring.

We support commercial banks by providing solutions for their book of NPL, leveraging our deep understanding on the financial services industry and world-leading expertise in finance and risk. At the same time, we work with the world's biggest investment funds and advise them on investments into distressed debt and equity.

When working with distressed corporates, we place a priority on developing sustainable restructuring concepts that address the market and the competitive environment, as well as specific factors for achieving operational excellence. Oliver Wyman acts as a coordinator for restructuring processes, an objective expert, and a neutral third party who provides quantitatively supported advice to address the interests of management, shareholders, lenders, and other stakeholders.

OLIVER WYMAN CAPABILITIES	
INDUSTRY EXPERTISE	Deep knowledge on market trends and operational success factors through specialized sector teams
KNOW-HOW	Broad range of capabilities covering NPL transactions, distressed M&A, and corporate restructuring
NETWORK	Excellent network to commercial banks, investment funds (equity and debt), and other restructuring advisers (lawyers, CRO, etc.)
EXECUTION MINDSET	DNA of a "value growth" consultant, aiming at sustainable success

CONTRIBUTION TO RESTRUCTURING PROCESS

FOR BANKS

- Portfolio transparency
- In-house solutions for NPL management
- Outsourcing and sales

FOR INVESTMENT FUNDS

- Due diligence and valuation
- Transaction support

FOR CORPORATES

- Independent business reviews
- Restructuring concepts
- Implementation support

CONTACTS

Dr. Lutz Jaede
Partner, Head of Corporate Restructuring
Munich
+49 89 93949 440
Lutz.Jaede@oliverwyman.com

Rodrigo Pinto Ribeiro
Partner, Head of Bank Restructuring
Madrid
+34 91 2126 305
Rodrigo.Pintoribeiro@oliverwyman.com

Pablo Campos
Partner, Head of Corporate Finance and Advisory
Madrid
+34 91 432 8441
Pablo.Campos@oliverwyman.com

Enno Behrens
Principal
Berlin
+49 30 399 945 0
Enno.Behrens@oliverwyman.com

Thomas Kautzsch
Partner
Munich
+49 89 93949 460
Thomas.Kautzsch@oliverwyman.com

Dr. Romed Kelp
Partner
Munich
+49 89 93949 485
Romed.Kelp@oliverwyman.com

Dr. Daniel Kronenwett
Principal
Munich
+49 89 93949 591
Daniel.Kronenwett@oliverwyman.com

Dr. Joachim Krotz
Partner
Munich
+49 89 93949 462
Joachim.Krotz@oliverwyman.com

Alexander Lis
Partner
New York
+1 646 364 8408
Alexander.Lis@oliverwyman.com

Dr. Markus Mentz
Partner
Munich
+49 89 93949 548
Markus.Mentz@oliverwyman.com

Dimitrios Psarris
Partner
London/Athens
+44 20 7852 7818
Dimitrios.Psarris@oliverwyman.com

Martin Rauchenwald
Partner
Zurich
+41 44 55335 26
Martin.Rauchenwald@oliverwyman.com

Martin Sanchez
Partner
London
+44 20 7852 7625
Martin.Sanchez@oliverwyman.com

Michael Smith
Partner
London
+44 20 7852 7587
Michael.Smith@oliverwyman.com

Henning Tielker
Principal
Munich
+49 89 93949 776
Henning.Tielker@oliverwyman.com

Robert Urtheil
Partner
Frankfurt
+49 69 971735 03
Robert.Urtheil@oliverwyman.com

Vicente Vazquez Bouza
Partner
Madrid
+34 91 432 8456
Vicente.VazquezBouza@oliverwyman.com

Giovanni Viani
Partner
Milan
+39 02 3057 7504
Giovanni.Viani@oliverwyman.com

Oliver Wyman is a global leader in management consulting. With offices in 50+ cities across nearly 30 countries, Oliver Wyman combines deep industry knowledge with specialized expertise in strategy, operations, risk management, restructuring and organization transformation. The firm has about 4,500 professionals around the world who help clients optimize their business, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is a wholly owned subsidiary of Marsh & McLennan Companies [NYSE: MMC]. For more information, visit www.oliverwyman.com. Follow Oliver Wyman on Twitter @OliverWyman.

CONTACT

sustainable.restructuring@oliverwyman.com

+49 89 939 49 780

+49 89 939 49 501

www.oliverwyman.com

OLIVER WYMAN