Hogan Lovells

Loan portfolio transactions and their related financings

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Contents

Introduction

Across Europe, increased regulation, governmental reforms and higher capital requirements have added pressure on banks to divest non-core assets. The last half of 2016 saw considerable activity in Southern Europe in particular which is likely to continue in 2017 and spread to other jurisdictions in Europe. Equally, the rising trend in non-performing loans ("NPLs") in South-East Asia indicates that deleveraging is likely to become more prevalent there as well in the short to medium term.

This Hogan Lovells client note highlights potential structuring and execution techniques and explores key initial considerations for potential investors in a number of jurisdictions in Europe which have been active during 2016 and will continue to be active in 2017, as well as a number of jurisdictions in South-East Asia (namely India, Indonesia, Vietnam and Malaysia).

Market overview

Europe

According to Deloitte's market update at the end of 2016, there were over €103bn of European loan portfolio transactions in 2016, matching the number of completed deals in 2015 which reflected a significant rise on the €91.3bn reported in 2014. These levels are likely to be repeated in 2017, with new markets opening up and more complex portfolios coming to market.

Many transactions were delayed as a result of the economic uncertainty partly caused by the UK's EU Referendum vote, although activity picked up later in the year driven in particular by real estate loan portfolio sales in Southern Europe, and some of those delayed deals are now expected to come to market. That said, in 2017 there is political risk and uncertainty, especially in Europe, with upcoming elections in some jurisdictions.

However, new accounting standards on valuing NPLs*, capital requirements for both banks and insurance companies and increased regulation (see the ECB's supervisory priorities) and the results of the recent European Banking Authority (EBA) stress test[1] continue to drive portfolio sales of non-core assets. Over half of the estimated €2.3trn of non-core assets within the banking system is made up of performing assets, with the UK, Spain and Italy having some of the largest reported volumes. That background, coupled with the fact that many investors are well capitalised in anticipation of investing in loan portfolio transactions across Europe, is likely to drive such transactions.

In the longer term, a decrease in NPL related sale activity is likely as banks focus on deleveraging the books and look to their performing non-core assets to achieve that objective.

"Market expectation is that the number and size of NPLs in South-East Asia will continue to rise over the next 12 to 18 months, as regional economies struggle and delinquent and restructured loans become bad debts."

Shaun Langhorne, Partner, Singapore

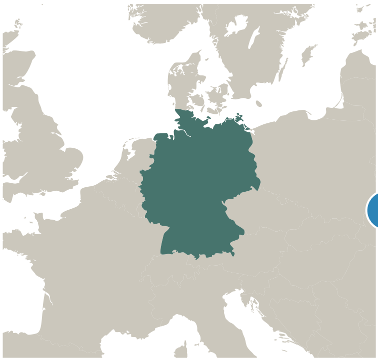
1 Although certain European banks still need to strengthen their capital buffers, the stress tests showed that in general capital ratios for banks in the sample were robust, with some exceptions (although we note the current debates on the use of internal models by some banks).

* To be introduced in 2018 under IFRS 9.

We set out a brief summary of NPL activity below[2]:

Jurisdiction	Summary of NPL activity
 United Kingdom	NPL volumes have fallen over the past year, but both unsecured and secured lending are rising once again with total household debt to income ratio projected to reach 170% by 2020 (although the Bank of England's decision to reduce interests rates post Brexit is helping to mitigate the impact on affordability). Brexit had a considerable impact, slowing UK loan portfolio sales and broader M&A activity, both before and after the referendum, driven by the uncertainty around the UK economic environment and the future direction of interest rates, although the fall in the value of the pound may increase foreign investment. In 2017 a number of delayed trades will come back to market. The trend of sales of residential mortgage loans is likely to continue, and the relative reduction in the number of deals will drive more competition.
 Italy	NPL portfolio sale volumes have increased significantly, aided by the development of the Government guarantee scheme, as well as the creation of the Government backed bank rescue "Atlante" fund. This coupled with the shortening and simplifying of legislative and enforcement proceedings, will help to drive liquidity and investor appetite, although Italian servicing capabilities will be needed to ensure that investors can maximise recoveries. These reforms have meant that Italy is currently one of the most active countries in Europe in respect of loan portfolio sales, in large part because the financial crisis left Italian banks with €360bn of nonperforming loans – equivalent to 20% of Italy's GDP. Deal pipeline in Italy will continue to be driven by the pressing need of Italian banks to deleverage their non-performing loans and, given more realistic pricing expectations and a political commitment to NPL resolution and bank recapitalization, Italy is likely to be one of the strongest loan sale markets in 2017.
 Spain	Aproximately €13bn in completed portfolio sales closed during 2016, and with around €120bn of NPLs (excluding residential real estate owned assets (REOs)) still held by local banks, further sales activity is expected in the coming year against a backdrop of an improving real estate market and a positive economic outlook. Banco Sabadell and CaixaBank were amongst the most active vendors, with disposals by SAREB (the management company for assets arising as a result of the Spanish banking sector reorganization, primarily comprising developer debt, SME/corporate debt and REOs) being reduced at the start of the year because of new accounting requirements and servicing migration issues. The Spanish market has also seen an increase in the number of secondary market trades, supported by the change in ownership of recovery platforms and exiting investors who previously bought into the Spanish loan portfolio market. Like Italy, Spain is likely to be among the strongest loan sale markets in 2017, with more complex assets such as secured SME and corporate exposures forming a larger part of the market.

2 In Ireland the market continues to see large transactions, including from NAMA and Ulster Bank and most deals have involved commercial real estate. Deals involving residential real estate loans (including REO portfolios) are expected to increase this year as the Irish loan sale market matures.

Jurisdiction	Summary of NPL activity
 Netherlands	A significant increase in transaction volumes, with a couple of sizeable transactions. Examples include Van Lanschot selling its commercial real estate loan portfolio to Cerberus Capital Management (which was reported to have an original principal balance of €400m), the sale of Propertize, the Dutch State-owned real estate bad bank, to a joint venture between Lone Star and JP Morgan for €895m, and the acquisition by CarVal Investors and Vesting Finance of a credit portfolio of €1.7bn and a customer database of some 9000 loans of RNHB Hypotheekbank, a subsidiary of Rabobank from FGH Bank. More such transactions are expected in the months to come and the pace of disposals in the Netherlands in 2017 is likely to increase compared to previous years.
 Germany	Although transaction volumes have been relatively muted (with the exception of overseas lenders, local lender Commerzbank and other banks disposing of non-German loans), the second highest level of NPL assets are located in Germany (which, together with other non-core assets, amount to over €240bn). The market expects a steady flow of transactions in the coming years; increasing political and regulatory pressure may even push German institutions to accelerate disposals. In particular, German banks, notably Landesbanken, still have considerable exposure to the shipping sector (some €81bn at the end of 2015), despite a significant reduction of their shipping loan books since 2010. The sale of the first part of a legacy portfolio of €1.64bn of commercial real estate and aviation loans from HSH Nordbank, one of Germany's largest banks, indicates the start of increased sales activity in Germany. Further sales from HSH Nordbank's legacy portfolio totaling €3.2bn are expected by mid-year 2017.
 France	France has seen modest activity in its loan sale marketplace to date, despite there being in excess of €120bn of NPLs in its banking sector, the second highest volume in Europe, with transactions such as Lone Star's acquisition of the debt in relation to Coeur de la Defense being notable exceptions. However, some French banks have low common equity Tier 1 capital ratios and there is likely to be an increasing number of portfolio sale transactions going forward in which debt funds take a more active role. However, the market is picking-up and we note that there is an increase in equity funds and investors gearing-up and investing in this market.
 Poland	In Poland, NPLs have been focused on the consumer debt sector and the investor base has been predominantly domestic to date, with Polish banks selling NPLs to securitization funds (as only the sale of NPLs to a securitization fund allows the selling bank to benefit from advantageous tax treatment by recognition of losses on the sale as tax deductible costs), which funds are exempt from income tax. However, an increase in the number of deals is expected to attract more international investors, especially as Polish banks are considering selling portfolios outside of the consumer debt space.

The techniques used to effect deleveraging in some of the above jurisdictions are likely to be transported cross border and used successfully elsewhere, including where support is given by governments to portfolio sale transactions.

South-East Asia

Since the 2008 credit crisis, South-East Asia has seen a rise in debt levels relative to national incomes. These high loan-to-GDP ratios can result in high debt servicing burdens.

Over the last two years, the on-going economic slowdown and dislocation in commodity prices have affected loan quality across South-East Asia. This effect has been amplified by deliberate devaluation of a number of Asian currencies and will be further exacerbated as interest rates rise further in the U.S. (for those Asian economies which peg their currencies to the dollar), resulting in deterioration of debt-servicing ability among businesses and households. This is resulting in a rise in NPLs in the region. World Bank data shows year-on-year increases in NPLs as a percentage of all loans in Indonesia and Thailand and rising trends across much of ASEAN.

Banks in the region may consider opportunities to reduce these exposures and de-risk, by reference to a specific named borrower, corporate group, industry sector, geography or a combination of these elements. Where more than one such element is involved, a creditor will almost invariably select a portfolio of assets for disposal – potentially offering a "sweetener" to assist in the disposal of a particularly difficult risk or where the sale of a bundle of related risks makes sense from a strategic or balance sheet management perspective.

These conditions and trends will provide potential buyers with varied opportunities for investment in credit across the region and may open possibilities for entry into markets which would not otherwise be open to a given investor. Understanding the structures by which such investments can be made will be crucial to getting the best possible result – particularly where a buyer may wish to dissect the portfolio post-acquisition.

Drivers for buyers and sellers

Sellers

There are a number of drivers for financial institutions who are sellers of loan portfolios, including:

- Regulatory requirements, in particular the cost of holding loans with high regulatory capital requirements under Basel III and liquidity rules, as well as asset quality review and stress test results.
- Pressure on state-supported institutions and bad banks to divest assets (given political pressure arising from EU state aid concerns).
- Profit expectation e.g. expected value in excess of book value.
- Liquidity needs and the reduction of operational costs.
- Strategic withdrawal from certain sectors and markets e.g. Italy.

The size of the non-core pool is likely to increase in the short term as banks in particular continue to re-assess what is central to their strategy in the emerging economic and regulatory landscape.

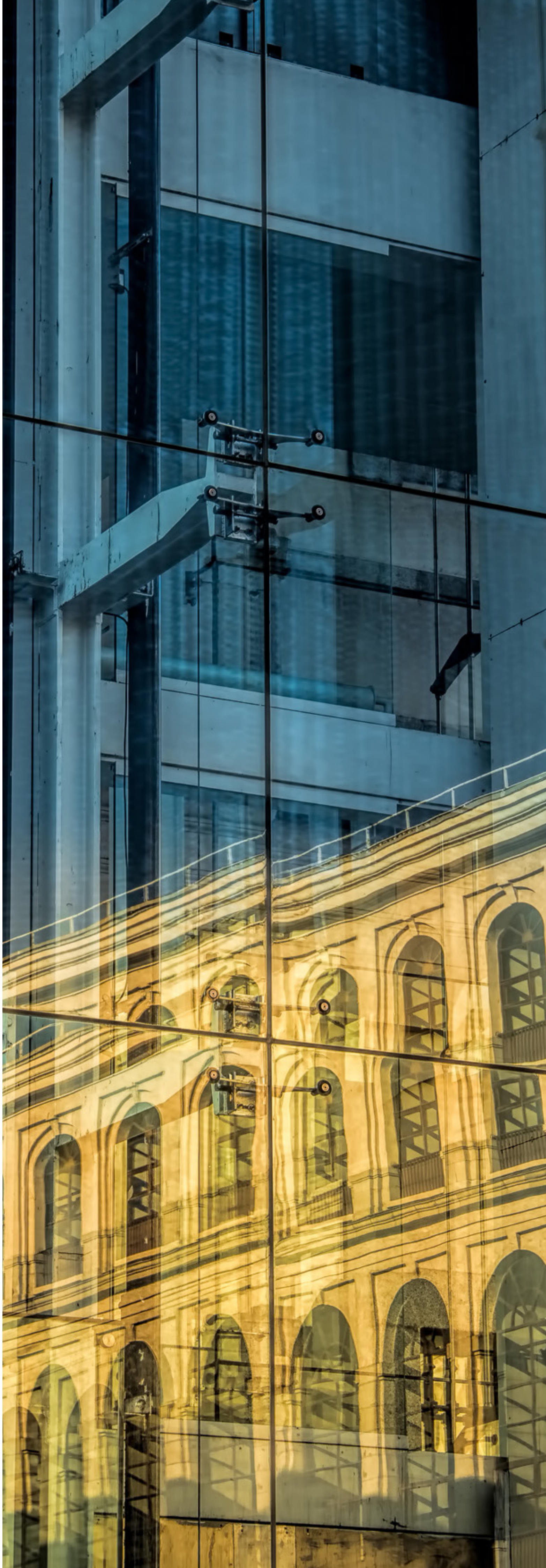
Buyers

For buyers of non-core and distressed assets such as pension funds, insurers, private equity houses, hedge funds, debt funds and some banks doing principal trades, there are a number of key issues that need to be assessed when looking at entering into loan sale portfolio transactions in any given jurisdiction. Assets are commonly sold by way of auctions to maintain pricing tension and buyers need to maximise their bids to maintain competitiveness.

Buyers may also form consortiums with other investors where only some of the assets in a given portfolio appeal to them, often investing via a joint venture vehicle where different bidders have exposure to specific assets in the structure (through the capital structure or otherwise).

Key issues to consider include:

- Undertaking due diligence in respect of the assets to inform both pricing assumptions and deliverability in respect of the buyer's chosen exit plan for the assets (see below).
- The need for banking licences, as the origination or acquisition of loans may be a regulated activity in certain jurisdictions. If the buyer already holds a licence to lend in a European jurisdiction, it may be possible to passport that licence into another European jurisdiction, but (i) additional licences or authorisations are likely to be required if the buyer is acquiring consumer loans and making loans in respect of residential property and (ii) in some European jurisdictions security can only be held by banks or financial institutions. However, we note that certain governments are now acting to relax restrictions that would otherwise apply. For example, since the middle of 2014, Italian securitization SPVs and insurance companies have been permitted to make loans to Italian borrowers without a licence to lend, subject to certain conditions.
- Bank secrecy/confidentiality, as many jurisdictions have rules on disclosing information about customers, including data protection legislation.
- Access to servicing in the relevant jurisdiction: buyers need to decide whether they acquire a servicing platform in the relevant jurisdiction or use a third party servicer to service the loan portfolios they acquire in that jurisdiction.
- Asset quality, credit assessment and collection performance.
- Having access to benchmark data in the relevant jurisdiction, the quality of data relating to the loan portfolio and availability of such data.
- Legal/regulatory framework of the relevant jurisdiction, including in respect of enforcement.
- Competition and exclusivity.



Structure and execution techniques

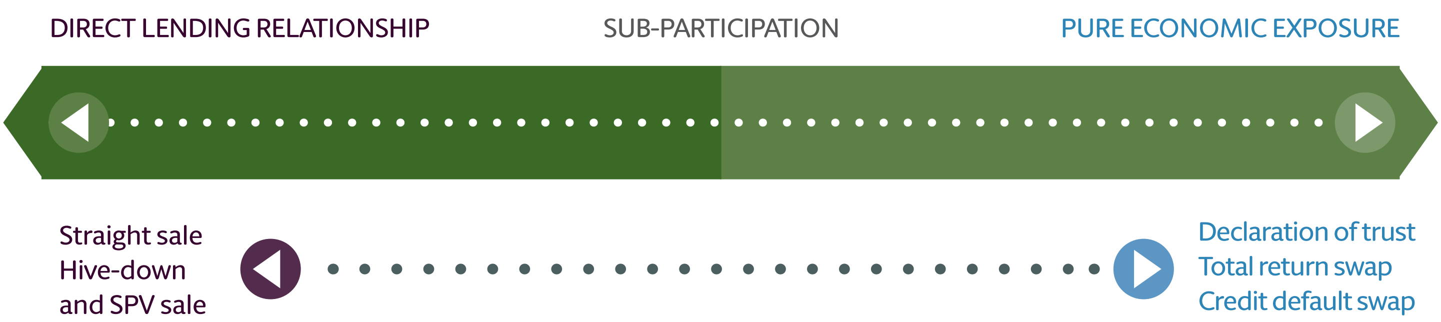
The ability to transfer a loan portfolio, together with the form and method of such transfer, will depend on a number of factors, including the nature of the assets comprising the portfolio, the jurisdictions in which the underlying obligors are based, the nature and location of any secured assets supporting the loans, and the place from where the seller and the buyer deal.

As with any complex financial transaction, tax and regulatory considerations will play a key role in structuring the deal.

Ultimately, the transfer methodology chosen will depend on the commercial objectives of the buyer and the seller, the level of control each wishes to exert over management of the portfolio following completion of the sale, the requirements of the relevant jurisdictions involved and the nature of the relationship each of them wishes to maintain with the ultimate debtors post-closing.

A given loan portfolio transaction may lend itself to one or more execution techniques and the techniques themselves are capable of considerable flexibility, allowing effective counsel to add value by tailoring solutions to the needs of a given transaction. We set out below a general description of those which are most commonly deployed and comment briefly on their pros and cons (noting that specific jurisdiction regimes/ requirements are referred to below).

The diagram below shows how the various methodologies can be grouped, depending on the proposed level of exposure the buyer will have to the portfolio debtors, and summarises their respective protections.



Structures resulting in direct lending relationship for buyer/SPV

Straight sale

Outright disposal of loans and related rights/obligations

PRO

- Allows exit from asset base/jurisdictions/ sectors.
- Assets removed from balance sheet in return for purchase consideration.

CON

- Potential contractual transfer restrictions.
- Significant transfer taxes in certain jurisdictions.
- Loss of any relationship with original customer.
- Potential withholding tax issues depending on location of purchaser.

Structures resulting in direct lending relationship for buyer/SPV (cont'd)

Hive-down and SPV share sale

Transfer of loans to an SPV established in the seller group and sale of shares in SPV

PRO

- Typically consents not required, but careful analysis of change of control provisions in relation to the seller is required.
- May be more tax efficient depending on the jurisdiction.
- Portfolio seller can manage pre-sale preparation, resulting in ease of final execution.

CON

- May trigger stamp duty and negatively impact on ability to make tax-effective use of losses.
- Needs a reasonably sized portfolio to be worthwhile.

Loan repacks/ CLOs

Transfer of loans to an SPV which funds itself by issuing notes which are subscribed for by investors

PRO

- Some investors need to hold notes, and some will need the notes to be listed on a recognised stock exchange to maximise liquidity and mitigate withholding tax exposure.
- Relevant where contractual transfer restrictions prohibit transfer to the purchaser but allow transfer to an SPV.

CON

- Cost.
- Complexity.

"The European debt portfolio market is becoming more competitive, with an increasing number of market participants chasing the same deals, squeezing the economics for buyers. Efficiency and experience are increasingly valued as a result."

Tauhid Ijaz, Partner, London

Structures resulting in pure economic exposure

Declaration of trust

Seller declares a trust in favour of the purchaser in respect of beneficial rights in assets being sold

PRO

- Legal title will remain with the seller.
- May be relevant to consider where contractual restrictions apply but careful analysis is needed.

CON

- Many jurisdictions do not recognise the concept of a trust.
- Ring-fences assets away from the insolvent estate of the seller but insolvency of seller may delay recovery of trust assets.
- Detailed negotiations may be required in respect of conduct of portfolio post-closing.

Total return swap ("TRS")

TRS purchaser receives income and any capital gains (i.e. total return) from the underlying loans in exchange for making periodic payments, either fixed or floating, to TRS seller

PRO

- Allows TRS buyer to gain economic exposure to, and benefit from, the assets without having actually to own them.
- Option to import the underlying contractual restrictions.
- Ownership of assets may remain with TRS seller, depending on settlement method.
- May avoid transfer tax issues.

CON

- From TRS seller's perspective, TRS may not result in a clean exit from portfolio.
- Collateral may be required to support payment obligation.

Credit default swap ("CDS")

CDS purchaser makes agreed periodic payments to CDS seller up to the maturity of the CDS and in the event the debt issuer or borrower of the Reference Obligations defaults (i.e. a "Credit Event" has occurred), CDS seller will pay CDS purchaser the market value of that debt obligation

PRO

- Transfers the credit exposure of the portfolio to the CDS seller without any funding obligation.
- Option to import contractual restrictions.
- Maintains confidentiality in relation to loans.
- Gives exposure to particular borrower types, jurisdictions and sectors.
- May avoid transfer tax issues.

CON

- Risks bought must qualify as "Reference Obligations" for settlement purposes.
- Collateral may be required to support payment obligation.
- Option of cash or physical settlement of TRS or CDS depending on the market (i.e. to replicate exposure to loan synthetically or to physically "sell" the loan).

Sub-participation

The attraction of sub-participation is its flexibility: it may be deployed either on a "disclosed" or "undisclosed" basis, depending on whether the parties wish the debtor to be aware of the risk transfer. Equally, a sub-participation can be structured on a "funded" or "unfunded" basis – the former being akin to a loan purchase on the date of completion and the latter typically resulting in an obligation on the risk buyer to contribute funding only following default by the debtor. In all cases, the legal title to the risk will remain with the original creditor and so this methodology is not appropriate where it is imperative that the original creditor should be released as a party to the underlying transaction and the assets be removed from its balance sheet. Absent an "elevation" where the buyer becomes lender of record, the buyer will continue to take credit risk on the seller in these structures. Accordingly, protections need to be included to ensure the buyer's credit risk on the seller is mitigated and which regulate the seller's ability to take decisions that may impact on the rights of the buyer as economic owner of the loan so the seller acts in accordance with the buyer's instructions to prosecute its rights (which can be controversial if there are commercial sensitivities, reputational or regulatory concerns for the seller).

Initial key issues

We set out below a number of key issues that the buyer and seller of a portfolio will need to consider. The relative importance of each will depend on the commercial aims of the parties.

Due diligence

The key purpose of any due diligence exercise is to allow a buyer to understand and model the loan assets and to assess features which will impact cashflows and the repayment of the loans in the relevant portfolio.

Often the seller may produce vendor due diligence in the initial bidding round, which would include a data tape and vendor legal due diligence report, the latter of which in practice is likely to be limited in scope (especially where demand for the particular loan assets is higher) and subject to low liability caps. Buyers will often "top-up" the vendor due diligence with their own additional due diligence exercises, depending on their risk appetite, sometimes on a sampling basis.

Due diligence is also often phased to take into account the different rounds of bidding, with focused key commercial questions being asked in initial rounds to flush out issues that might go to pricing and the buyer's strategy for the assets and, if relevant, to inform later discussions on contractual protections needed to mitigate any key due diligence gaps. Efficient and targeted due diligence appropriate for the relevant bidding phase is therefore key.

Examples of early due diligence issues include:

- Borrower population.
- Amounts outstanding and any funding obligations if loans undrawn.
- Interest rates/PIK provisions.
- Secured/unsecured, guarantees and cross collateralisation, perfection of security interests.
- Asset classes.
- Repayment profile, maturity and extension options.
- Reserve accounts and conditions for use.
- Yield protection and fees payable to lenders.
- Financial covenants, cures and duration.
- Cash traps, cash sweeps and payment waterfalls.
- Nature of any outstanding defaults and consents/waivers already given.
- Voting control for waiver, amendments and enforcement.
- Applicable transfer restrictions.
- Restrictions on disclosure.
- Intercreditor issues, including in respect of other creditors (e.g. the ranking of amounts due to any swap counterparty, ability to close out of the swap) and entrenched rights.
- Post-closing steps required to perfect transfer of portfolio. Can borrower(s) be compelled to assist? Who bears costs?
- Withholding tax treatment especially if buyer in different jurisdiction from seller.

Contractual protections in sale documentation

Whether LMA trade confirmations or bespoke sale and purchase agreements are used to document the sale, key issues for consideration include:

- Clarity on assets and liabilities to be transferred/excluded and limitations on liability (both quantum and time-based).
- Clarity on percentage of outstanding loan being sold (i.e. will purchaser achieve a voting quorum under a given financing?).
- Protections around accuracy of data tape, including price adjustments and indemnities.
- Coverage for regulatory/mis-selling issues.
- Process and mechanics for regulatory, anti-trust and third party consents.
- Migration and integration and the use of transitional servicing arrangements.
- Allocation of risk on shortcomings of the assets/portfolios.
- Decision-making processes and rights surrounding portfolio and enforcement between exchange and completion.
- Transfer of swaps, restrictions and use of pass-through swaps and credit support annexes.
- Transfer of agency and trustee roles.

Hedging

- If the loans in the portfolio are hedged, then parties will need to consider what happens to the swaps (which are generally either interest rate or currency swaps in this context).
- The seller is unlikely to wish to keep the swap once the loan has been transferred, especially if the swap relied on the seller's right as lender in terms of protections on the basis that both would always be stapled. Indeed, contractual provisions may staple the swap to the loan, preventing the loan from being transferred without the swap.
- If the buyer is willing and able to acquire the swap, the consent of the borrower is likely to be required where the swaps are to be novated to the buyer. If it is commercially difficult for the seller to obtain such consent, the seller may enter into a pass-through swap with the buyer, and parties may seek to enter into collateralisation arrangements/obtain the benefit of guarantees in respect of the pass-through swap arrangements to mitigate against the on-going credit risk they will have.
- The buyer will need to consider whether it must comply with any licensing/authorisation requirements.
- Parties will need to consider the impact of EMIR, and the reconciliation and reporting obligations under that regime as a minimum.

Security

- A buyer's valuation of the loans being sold in any portfolio sale will take into account the security for such loans, including whether it has been created effectively, how it may be transferred and what enforcement options are available in relation to the secured assets (especially if a "loan to own" strategy is being adopted).
- Early due diligence will be required by the buyer to establish:
  - The assets secured and their location.
  - Whether the documentation is complete (as if it is not, this can create difficulties when seeking to enforce security in some jurisdictions).
  - The governing law of the relevant security documents.
  - Whether security registrations were made to perfect the security.
  - Due diligence of enforcement options.
- Consideration will also be required as to whether the security is held by a trustee or agent on behalf of secured parties, bilaterally or granted directly to the individual lenders (which is sometimes the case in some European jurisdictions using parallel debt structures) and whether the loan will be novated as this can result in the loan becoming unsecured. Where the security is held by a security trustee/agent who is not being replaced, the loan can be transferred if the contractual requirements in the loan documentation are satisfied and the security for such loan will continue to be held by such security trustee/agent. Where the security trustee/agent role is being transferred, this may trigger necessary formalities and perfection requirements and the time and cost for doing so will need to be considered.
- The above considerations will impact on the buyer's valuation of the loans, and so its pricing of the loan portfolio.

Tax and regulatory considerations

- Is buyer authorised locally to enter into a debtor/creditor relationship with the borrowers? Some jurisdictions require an entity to have a licence to lend, in particular in respect of origination. Passporting of such a licence may be possible within the EU. Consumer lending (whether secured or unsecured) is likely to require additional authorisations and licencing, including in respect of data protection, in certain jurisdictions.
- Will payments at closing or cashflows in the portfolio post-closing trigger unforeseen taxes?
- Are there any stamp or transfer taxes on the transaction?
- Will disposal trigger tax consequences for seller and, if so, will any tax losses on sale be capable of being used effectively?
- Withholding tax considerations on interest payments may dictate the jurisdiction in which the acquiring entity is established.
- Will transaction achieve the desired regulatory capital and accounting treatment for each of buyer and seller?
- Disclosure requirements to regulators/government authorities in the jurisdiction of the buyer and seller.
- Restrictions on the trading of or mark-to-market valuation of CDS or TRS.
- Currency controls applicable to TRS or CDS, if cash-settled.

Financing

Buyers may need leverage to boost their international rates of return and the availability of leverage has increased on average as a percentage of deals over the last few years (albeit against "right-sized" assets). There may be a preference for the buyer of the portfolio to raise leverage against the portfolio post acquisition, but equally there are a number of deals which are leveraged at the time of acquisition.

There are an increased range of debt funding options now available, ranging from direct bank loans, loan on loans, vendor finance, private placements and securitizations. The debt provided will typically be sized by reference to a maximum loan to value based on a market valuation of the portfolio, with funders typically funding at the 65% to 70% level, although on certain securitization deals the leverage levels may be higher.

Debt will typically be sized as a percentage of the purchase price for the loan portfolio and the maximum loan to value based on a market valuation of the portfolio at the time of financing, with the remainder of the funding being sourced from equity (and often structured as subordinated debt or quasi-debt). Pricing for the debt is often driven by regulatory capital treatment, which may determine which type of debt product is used. In many transactions, the buyer will be a bankruptcy remote special purpose company (whether orphaned or within the buyer's group) which then raises finance to fund the acquisition, securing such borrowing on the rights it has in the underlying portfolio of loans and swaps.

Key issues that often arise on financing transactions include:

- Diligence on the underlying debt portfolio and in particular patchy documentation/opinions on the underlying assets, the extent to which vendor due diligence reports are available and the ability of buyers to rely on such reports and/or the need to undertake top up diligence by the buyer (often on a phased basis depending on bid phase).
- Seller warranties, their scope and any related limitations.
- Underlying obligors can be distressed and in default, so the transaction may need to accommodate the buyer as lender under the underlying loans and also as owner of the underlying assets post-enforcement (such as REO portfolios).
- Level of discretion to be retained by buyer, who will wish to operate its business with minimal lender control, whereas the lenders will want to introduce protections to protect their interests.
- Financial covenants and events of default.
- Cash sweeps and early amortization events.
- Volcker rule – the buyer will represent and undertake that it is not and will not be a "covered fund" under Section 13 of the U.S. Bank Holding Company Act of 1956, as amended, or consider if it can fall under an applicable exception (such as for loan securitizations).
- Risk retention requirements in the context of a transaction that will qualify as a "securitization" for the purposes of Art 4(61) of the CRR[3], an EU-regulated credit institution/investment firm may currently only provide debt finance to the transaction if the "originator, sponsor or original lender" undertakes to retain a minimum 5% "material net economic interest" for the transaction's life using one of five permitted methods.
- Assessment of U.S. risk retention rules to determine if an exemption is available or the transaction will need to be structured to meet U.S. risk retention requirements which differ significantly from the EU risk retention requirements.

3 I.e. a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranched, having both of the following characteristics: (i) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures; and (ii) the subordination of tranches determines the distribution of losses during the on-going life of the transaction or scheme.

Overview of jurisdiction specific considerations

Europe

France

Transfer regime/requirements

Methods for transfer of receivables:

- Common civil law transfer. The regime has been relaxed since 1 October 2016. Only a written agreement is needed between the assignor and the assignee. The assignment is enforceable against third parties as from the date of the assignment, but it is enforceable against the debtor as from the date it is notified of, or acknowledges, such transfer. A bailiff service is no longer required.
- Transfer to a securitization entity is carried out by way of a simplified transfer document (*bordereau*).
- Transfer of commercial receivables (*cession Dailly*) is carried out by way of a simplified transfer document (*bordereau*) but the assignee must be a credit institution.
- Subrogation is also a simplified way to transfer receivables as it only requires the payment of an amount from the transferor to the transferee. However, subrogation occurs up to the paid amount and is therefore not adequate in relation to NPL sale transactions as the transfer price is usually below par.
- Novation should also be avoided as this requires the consent of the debtor and the security must be reserved in order to be maintained.
- There are also corporate means to transfer receivables as part of the transfer of business (*cession partielle d'actifs, cession de fonds de commerce*), but this may trigger a tax on the transfer.
- As a matter of principle, security (being an ancillary right) automatically follows the transfer of the receivables. However, in the context of NPLs or disputed receivables, in order to ensure a seamless enforcement, it would be advisable to register or complete any formalities in respect of such security interests.

- In relation to disputed receivables, in the event that such receivables are transferred at a price below the nominal value, the debtor has the ability (*retrait litigieux*) to discharge its obligations by reimbursing the purchase price together with expenses and justified costs and any interest which has accrued from the payment date of the purchase price.

As long as the debtor has not been notified of the assignment (or has not acknowledged it), it can still raise any defence relating to the underlying contract (such as any grace or remedy period, rescheduling, write-off and set-off of any claims). Following such notification (or acknowledgement), the debtor may still raise exceptions that are directly linked to the existence of the receivables (e.g. connected claims, nullity, cancellation and non-performance).

Regulatory licences or consents required to undertake any secondary lending activities

- Under French law, the purchase of performing or unmatured loans on a regular basis (i.e. more than a one-off transaction) is a credit activity and is regulated. This means that only credit institutions licenced in France or passported in France and, subject to certain conditions, insurance companies and funds may purchase performing or unmatured loans.
- By way of exception, the purchase of non-performing/ matured loans/receivables is not a credit activity, and hence is not subject to regulatory licence.
- Moreover, debt funds such as the French securitization entities benefit from a statutory carve-out and can purchase loans/receivables (whether performing or not).
- A loan servicer (other than the originator) which collects debts will have to declare to the Prosecutor (*Procureur de la République*) that it carries out debt collection activities.

Consequences from a regulatory perspective if the lender were to trade the loans it acquires or the equity it may receive in conjunction with that debt?

As a practical matter and for some years, given the regulatory constraints on the secondary trading of performing/non matured receivables, secondary lending activities have been carried on offshore from France whereby non-French entities buy and sell participations in loans to borrowers. Although this is current market practice, the French banking regulator has not, to our knowledge, confirmed it agrees with this view and as such from a strictly French law viewpoint, we cannot unequivocally confirm it is permitted.

In relation to secondary trading of non-performing/ matured loans/receivables, there are no regulatory consequences.

Bank secrecy/duty of confidentiality

Banking secrecy rules also apply in relation to information held by credit institutions. However, the French Financial and Monetary Code provides for a carve-out in relation to the assignment of receivables.

Data protection

The assignor and the assignee must also comply with the personal data protection law which sets out requirements as to how personal data must be treated (i.e. in a loyal and licit way) and collected.

Germany

Transfer regime/requirements

Under German law, there are three main transaction structures for loan portfolio transactions:

- Asset Deal: Transfer of loan receivables and collateral to the buyer by way of (i) assignment (*Abtretung*), or (ii) assumption of contract (*Vertragsübernahme*). The assignee/transferee acquires legal ownership of the assets as a result of an asset deal. The debtor has to consent in case of a transfer by way of assumption of contract (*Vertragsübernahme*). In general, the debtor's consent is not required for an assignment of receivables (*Abtretung*), unless contractually stipulated otherwise. Receivables may be assigned either with notice to the debtor (disclosed assignment – *offene Zession*) or without notice to the debtor (silent assignment – *stille Zession*). In case of a silent assignment (*stille Zession*), the assignor generally continues to service the assets for the assignee.
- Share Deal: A share deal typically involves the establishment of an SPV, the demerger of the loan portfolio to be transferred to the SPV, and the acquisition of the SPV by the buyer. A share deal enables the seller/transferor to transfer the entire loan portfolio to the buyer in one go. Furthermore, the consent of the debtors is not required. As in the case of an asset deal, the buyer becomes the legal owner of the assets via its shareholding in the SPV. However, a share deal requires the implementation of a complex transaction structure (establishment of an SPV, demerger, commercial register etc.) and also entails certain challenges (e.g. reciprocal continuing liability (*Nachhaftung*), recognition of the demerger in a cross-border context).
- Sub-Participation: Under a sub-participation, the seller/transferor remains the legal owner of the loan portfolio and only economic ownership is transferred to the buyer/transferee. This requires the creation of a trusteeship (*Treuhandverhältnis*) between the seller/transferor and the buyer/transferee (amongst other reasons) for tax purposes. In general, the consent of the debtor is not required. Similar to a silent assignment (*stille Zession*), the servicing of the assets remains with the seller/transferor.

In principle, two types of collateral exist under German law:

– Accessory collateral (*akzessorische Sicherheiten*), such as suretyships (*Bürgschaften*), share pledges (*Anteilsverpfändungen*) and account pledges (*Kontoverpfändungen*). Generally, accessory collateral (*akzessorische Sicherheiten*), by operation of law, automatically follows the respective secured receivables upon their transfer. By operation of law, ancillary rights (*Nebenrechte*) generally pass to the buyer/transferee together with the respective secured receivables. Note that the transfer of certain types of accessory collateral (*akzessorische Sicherheiten*), e.g. ship mortgages (*Schiffshypotheken*), may need to comply with additional form requirements (such as registration).

– Non-accessory collateral (*nicht-akzessorische Sicherheiten*), such as land charges (*Grundschulden*), security assignments (*Sicherungsabtretungen*) and security transfers (*Sicherungsübereignungen*), must be transferred separately (i.e. apart from and in addition to the secured receivables), by way of assignment (*Abtretung*), assumption of contract (*Vertragsübernhame*) or a combination thereof. In the absence of a contractual consent requirement, the consent of the security grantor is typically not required for the transfer of non-accessory collateral (*nicht-akzessorische Sicherheiten*). With respect to the transfer of registered land charges (*Buchgrundschulden*), the registration of the transfer in the land registry (*Grundbuch*) is required to complete the transfer (note that proper (re-)registration is essential with respect to enforcement scenarios). In any event, the transfer of land charges (*Grundschulden*) involves additional costs (e.g. notarial and registration fees).

A special feature under German law is the possibility to register certain collateral (e.g. land charges (*Grundschulden*)) in the so-called refinancing registry (*Refinanzierungsregister*) of the seller/transferor. In the event of an insolvency of the seller/transferor, the beneficiary of the respective entry in the register is equipped with an insolvency-remote (*insolvenzfest*) right of segregation (*Aussonderungsrecht*) regarding the collateral registered in the refinancing registry (*Refinanzierungsregister*). Employing the refinancing registry (*Refinanzierungsregister*) yields certain benefits, e.g. by saving the costs and time associated with the actual transfer of the collateral, especially in the context of (but not limited to) securitisation transactions. Note that, in case of a financial institution/bank, the beneficiary of a registration must be an institution located in the European Economic Area (EEA).

Protection of the debtor with respect to assignments (*Abtretungen*): As long as the debtor has not been notified of an assignment (*Abtretung*), it may repay its debt to the seller/assignor with discharging effect. Even where the debtor is notified of an assignment (*Abtretung*), it may raise the defences it was entitled to vis-á-vis the seller/assignor at the time of the assignment (*Abtretung*) also against the buyer/assignee (note that, typically, this is also true with respect to defences of the grantor of a land charge (*Grundschuld*) arising from the respective security purpose agreement (*Sicherungsvertrag*)). Further, the debtor may, in principle, set-off (*aufrechnen*) a claim against the buyer/assignee if it was entitled to set-off (*aufrechnen*) such claim against the seller/assignor.

Regulatory licences or consents required to undertake any secondary lending activities

Under German law, the mere sale/transfer (by the seller/transferor) or acquisition (by the buyer/transferee) of loans does not require a banking licence. However, a banking licence is necessary for lending activities, e.g. in case of financial restructurings (including the extension of maturities), the provision of further loans, or the taking of undrawn commitments or revolving credit facilities. With regard to the latter, the acquisition of terminated revolving credit facilities is permitted without a banking licence (i.e. the respective facilities would have to be converted into term loans before the transfer).

Where lending activities are required, e.g. in refinancing scenarios, particularly in situations where fresh money is needed, fronting bank structures may be and are used.

Regulatory issues or restrictions on the lender owning shares in a Borrower (for example, as a result of any debt for equity swap)

Not applicable as long as the lender does not have a German banking licence. Note, however, that holding an equity stake in the borrower/debtor may entail grave consequences for the lender in an insolvency of such borrower/debtor by potentially triggering a so called "equitable subordination" of the respective loans.

Consequences from a regulatory perspective if the lender were to trade the loans it acquires or the equity it may receive in conjunction with that debt?

No regulatory consequences assuming that the lender does not have a German banking licence.

Banking secrecy/duty of confidentiality and data protection

There is no statutory banking secrecy (*Bankgeheimnis*) in Germany. However, the unwritten banking secrecy (*Bankgeheimnis*) rules apply to all bank clients, irrespective of whether individuals or legal entities are concerned.

Under German law, there are detailed statutory provisions dealing with data protection, e.g. the German Federal Data Protection Act (*Bundesdatenschutzgesetz*). However, data protection rules apply to personal data of individuals only.

In more detail:

- These restrictions apply to the disclosure of data in connection with: (i) due diligence processes; (ii) loan portfolio transfers; and (iii) the post-closing servicing of loan portfolios.
- The banking secrecy (*Bankgeheimnis*) and data protection rules are typically not at issue where the debtor has consented to the disclosure of its data or where the lender's interests regarding the disclosure of the data prevail over the debtor's interests of keeping it confidential. The lender's interests generally prevail in the context of NPL transactions. At this juncture, the debtor usually is in breach of contract, and, consequently, its (personal) data is not considered to be deserving of protection via the banking secrecy (*Bankgeheimnis*) and/or data protection rules. Note that the disclosure of data is generally not permitted with respect to performing loans.
- In case of a breach of the banking secrecy (*Bankgeheimnis*) and/or data protection rules, the validity of the transfer (by way of assignment (*Abtretung*) or assumption of contract (*Vertragsübernhame*)) of the respective receivables remains unaffected. Note, however, that a breach of: (i) data protection rules constitutes an administrative offence, potentially triggering fines and (ii) the banking secrecy rules (*Bankgeheimnis*) may, for example, allow the debtor to terminate the loan agreement without any prepayment penalties (a significant risk considering current interest rates, plausibly providing a certain incentive for debtors to seek a refinancing). In addition, an institution may also face substantial reputational risks in connection with the aforementioned breaches.
- Against this background, the debtors' data is generally disseminated in connection with NPL transactions, as the disclosure of the data is permitted for due diligence purposes (to the extent required for evaluating the loan portfolio).
- In case of a performing loan transaction, only limited disclosure of data is permitted (e.g. for due diligence purposes). Therefore, performing loan transactions are often structured as undisclosed transactions, i.e. an assignment (*Abtretung*) of receivables without sharing the relevant debtor's data with the buyer/assignee (which is possible under German law), or as demergers combined with a share deal. In addition, certain workarounds may be employed, e.g. establishment of a data trustee holding a data key, redaction of documents or synthetic transfers.

Italy

Transfer regime/requirements

Disposal of NPLs in Italy are generally carried out by way of:

- A direct transfer of the relevant NPL portfolio to the relevant buyer/investor pursuant to Article 58 of the Italian Banking Act (i.e. Legislative Decree No. 385 of 1 September 1993) ("**Article 58**").
- A securitization regulated by the Italian Securitization Law (i.e. Law No. 130 of 30 April 1999) ("**Law 130**") under which the relevant NPL portfolio is transferred to a special purpose vehicle established under Law 130 ("**SPV**") which funds the relevant purchase price through the issue of asset-backed notes to be subscribed by the relevant buyer/investor.

In addition, a state guarantee for payment obligations arising from senior tranches of asset-backed notes issued in the context of securitization under Law 130 ("**GACS**") may be obtained.

Key features in respect of the transfer of assets pursuant to Article 58 and Law 130 and of the GACS can be summarised as follows:

Transfer of assets pursuant to Article 58

- Subject of the transfer: assets, legal relationships (including claims and receivables), going concerns and operating asset units. The entire loan is transferred to the buyer.
- Buyers: 1) banks and other entities which are subject to consolidated supervision according to the Italian Banking Act; and 2) financial intermediaries (enrolled in the public special register held pursuant to Article 106 of the Italian Banking Act).
- Legal benefits: 1) Transfer as a block; and 2) automatic transfer of the security interests.
- Eligibility criteria: block criteria (i.e. assets and/or legal relationships need to be identifiable "as a pool").

- Formalities: the relevant assignment is perfected upon (i) publication in the Italian Official Gazette; and (ii) registration of the assets' assignment in the assignee's Companies Register (respectively, the "**Publication**" and the "**Registration**").
- Early termination right: during the three months following completion of the Publication and Registration, the other parties to the transferred agreements can terminate such agreements if a justified reason (*giusta causa*) exists, save in respect of the liability of the transferor.
- Bank of Italy ("**BOI**") authorisations: certain transfers of claims/assets need to be authorised by the BOI or notified to it.

Transfer of assets pursuant to Law 130

- Subject of the transfer: receivables. The seller remains party to the loan agreement and, therefore, it retains certain regulatory liabilities and duties.
- Buyers: SPVs established in accordance with Law 130.
- Legal benefits: 1) transfer as a block; 2) automatic transfer of the security interests; 3) pursuant to Law 130 the portfolio is segregated for the benefit of the noteholders; and 4) a favourable insolvency claw-back regime is provided.
- Eligibility criteria: block criteria (i.e. assets and/or legal relationships need to be identifiable "as a pool").[4]
- Formalities: Publication and Registration pursuant to Article 58.
- Early termination right: not applicable.
- Servicing: the servicing activities must be provided by banks or financial intermediaries enrolled in the public special register held pursuant to Article 106 of the Italian Banking Act.
- BOI authorisations: no specific authorisation is required.

Italian state guarantee for senior tranches of NPLs asset backed securities ("GACS")

- The GACS is granted by the Italian Ministry of Economics and Finance ("**MEF**") and exclusively covers the senior tranches of notes (i.e. the lower-risk notes) issued in the context of securitization transactions under Law 130.
- It is designed as an unconditional, irrevocable and first demand guarantee for the benefit of the senior noteholders of any payment obligations contractually provided in respect of interests and capital.
- The GACS may be granted by the MEF upon specific request in connection with Italian Law 130 securitization transactions of non-performing receivables originated by Italian banks and certain Italian financial intermediaries[5].
- The aim of the GACS is to: (i) increase credit worthiness of the senior ABS, hence attracting investors, (ii) reduce the funding costs of the SPV, (iii) incentivise the sale of non-performing receivables and improve their liquidity.

Regulatory licences or consents required to undertake any secondary lending activities

- Under Italian law, lending activities, including the purchase of performing or unmatured loans on regular basis (i.e. more than a one-off transaction) are regulated activities that can be carried out mainly by banks and financial intermediaries duly authorised/passported in Italy.
- Certain exemptions may apply. For example, since the middle of 2014, Italian securitization SPVs and insurance companies have been permitted to make loans to Italian borrowers without a licence to lend, subject to certain condition.
- The purchase of non-performing/matured loans is not a credit activity, but certain regulatory restrictions apply.

4 Trade receivables falling within the scope of Law No. 52 of 21 February 1991 ("Law 52") (i.e. the receivables arising out of contracts entered into by an assignor in the course of its business) do not need to be identifiable "as a pool".

5 Financial intermediaries enrolled in the register set out under article 106 of the Legislative Decree No. 385 of 1 September1993.

Regulatory issues or restrictions on the lender owning shares in a Borrower (for example, as a result of any debt for equity swap)

None. Specific prudential requirements may apply if the lender is a credit institution.

Consequences from a regulatory perspective if the lender were to trade the loans it acquires or the equity it may receive in conjunction with that debt?

Please refer to the previous section.

Bank secrecy/duty of confidentiality

In Italy the expression "banking secrecy" refers to the general duty of the banks to keep confidential the transactions, the accounts and the positions of their clients. It is in some ways similar to the duty of confidentiality of professionals (e.g. lawyers and doctors) and prevents those who work for a bank providing information to third parties.

Bank secrecy/confidentiality is also relevant in the context of the Italian privacy legislation. The Italian privacy authority has established principles and general rules that are applicable also to banking activities. Complying with such principles and general rules ensures in most cases compliance with the banking secrecy principles, and prevents the banks from incurring severe sanctions, and liability for damage.

Data protection

Italian data protection laws should not be directly applicable if personal data of debtors is not processed or made available. Data protection laws may be applicable if data in relation to debtors being natural persons (*persone fisiche*) is processed or made available.

Netherlands

Transfer regime/requirements

In Dutch loan portfolio transactions, two methods exist for a direct legal transfer of the loans, namely: (i) loans can be transferred (in bulk) by way of legal assignment (*cessie*) of rights; or (ii) loans can be transferred (in bulk) as part of the transfer of the entire contractual relationship (i.e. consisting of the rights and obligations under a contract) by way of contract transfer (*contractsoverneming*) with the cooperation of the underlying debtor.

Key features in respect of the transfer of assets can be summarised as follows:

– Legal assignment is the most common method to transfer loan receivables. The reason for this is that for an assignment to be valid, no consent or cooperation of the debtor of the loan receivables is usually required, unless the parties have agreed otherwise. It should be noted though that if the underlying contract explicitly prohibits a transfer or sale and such prohibition is intended to have proprietary effect, any purported transfer will be null and void.

– A transfer of a loan portfolio by way of assignment (*cessie*) can take the form of either a disclosed assignment (*openbare cessie*) or, provided that the loans in the loan portfolio exist or arise from a legal relationship existing at the time of such transfer, undisclosed assignment (*stille cessie*). A disclosed assignment, in order to be effective, must be notified to the debtor of the loan. For an undisclosed assignment to be effective, the deed of assignment should either be included in a notarial deed or registered with the Dutch tax authorities. Pursuant to an assignment of a loan portfolio, the assignee would acquire and become entitled to the assigned loans contained in the loan portfolio (and accessory and ancillary rights relating thereto, such as security rights) but would not assume the obligations of the assignor in respect of the loans (e.g. further advance commitments, etc.). The assignment itself would not have an effect on the debtor, other than that the debtor can only discharge its debt by paying to the assignee in case of a disclosed right of assignment.

– As an alternative to assignment, loan portfolios can be transferred by way of contract transfer (*contractsoverneming*). A party can transfer its contractual relationship (consisting of its rights and obligations (in whole or in part)) to a third party by way of a contract transfer agreement between the transferor, the debtor and the transferee. The debtor must compensate and consent to the transfer for it to become effective, which compensation and consent can be given in advance. If advance compensation and consent is given, the debtor must be notified of the transfer for such transfer to become effective. Pursuant to such contract transfer, all rights and obligations of the relevant contract will transfer to the transferee, except as otherwise agreed.

– Accessory rights (*afhankelijke rechten*) are rights which are connected to another right in such a manner that they cannot exist without the other right, such as security rights. Accessory rights connected to a receivable are also ancillary rights (*nevenrechten*). Ancillary rights include, without limitation, security rights, sureties, privileges, the right of enforcement and the right to stipulated interest or a penalty. Accessory rights follow the right with which they are connected. Consequently, if a loan is transferred, in principle, the accessory rights and the ancillary rights pass by operation of law to the assignee, except if the relevant right by its nature is, or has been construed by the parties as, a purely personal right of the assignor.

– Under Dutch law, a debt provider financing the assignee or transferee of a loan portfolio on a “loan on loan” basis may benefit from the security rights securing the loan portfolio by way of a so called ‘security chain’. The Dutch Supreme Court has recently confirmed that a pledgee (for example, a third party debt provider who has been granted a right of pledge on the acquired loan portfolio) collecting a claim is not only entitled to enforce its own pledge on the loan portfolio itself, but is also entitled to exercise the accessory rights and the ancillary rights (such as mortgage rights and rights of pledge connected to the underlying loan portfolio which was transferred to an assignee) that are connected to such claims.

- Of course, one may also: (i) acquire loan portfolios via a legal acquisition of the share capital of the relevant legal entity which is the creditor of the loan portfolio, legal (de)merger or split-off; or (ii) obtain an economic interest in a loan portfolio via a total return swap or sub-participation.

Regulatory licences or consents required to undertake any secondary lending activities

- Permitted.
- No regulatory licence or consent required.[6]

Regulatory issues or restrictions on the lender owning shares in a Borrower (for example, as a result of any debt for equity swap)

Not applicable as long as the borrower is not a licensed bank or (other) regulated entity.

Consequences from a regulatory perspective if the lender were to trade the loans it acquires or the equity it may receive in conjunction with that debt?

Loans can be traded in amounts of at least €100,000 (see above). Securities offering laws may apply depending on the type of instruments and manner of trading.

Bank secrecy/duty of confidentiality

In The Netherlands, banking secrecy is not expressly regulated in Dutch statute law. The same results from the nature of the contractual relationship between the lender and borrower and a general duty of care (based on general banking terms applicable to the relationship, or otherwise). The starting point is that the lender may only disclose information concerning the debtor if it is legally required to do so or if the debtor has consented thereto.

Data protection

The Dutch Data Protection Act ("Act"), which is the Dutch implementation of the European Data Protection Directive ("Directive"), requires a legal basis and a legitimate purpose for all 'processing' (e.g. collecting, storing, making available, transferring or deleting) of information relating to natural persons (e.g. debtors). These data protection requirements therefore apply when personal data are disclosed, for instance:

- During a due diligence process (i.e. only limited disclosure of personal data is allowed).
- In connection with the portfolio transfer.
- In connection with the post-closing servicing of portfolios.

Individuals must be sufficiently informed about the processing of their personal data prior to the collection of their data. This is usually done at the moment of collection of the personal data from the individual, by means of the inclusion of a data protection clause in the relevant loan agreement.

Personal data must be protected by appropriate technical and organizational measures against any loss or unlawful processing and the rights of individuals must be respected. Furthermore, in order to ensure an adequate protection of personal data outside the EU, there are specific rules for the international transfer of personal data.

As of May 2018, the European General Data Protection Regulation ("GDPR") will repeal the Directive and the Act. The above general obligations remain in force, however the GDPR will have a broader scope than the Directive and Act (as it will also apply to non-EU companies offering goods and services on the European market), strengthen the rights of individuals and allow for stronger enforcement of the rules (fines of up to €20m or 4% of the annual worldwide turnover, whichever is higher).

6 Assuming that the nominal value of the transferred loan amount is at least €100,000 unless the transferee qualifies as a credit institution.

Poland

Transfer regime/requirements

In Poland loans are transferred by way of assignment regulated under the Polish Civil Code. Generally, all loans are assignable unless an underlying loan agreement provides otherwise. An assignment agreement does not require any specific form. The assignment is effective upon the execution of an assignment agreement, except where the loan is secured over a real property, where the assignment is only effective upon the disclosure of the assignee in the relevant mortgage registry. Generally, all security interests are transferred to the assignee together with the assigned loan automatically, although some may require the registration of the assignee in relevant registers. Polish law does not require notification to the debtor, so an assignment is effective without the notification. However, the lack of notification may cause negative consequences to the assignee, in particular the debtor may effectively make payments under the loan to the original creditor. A securitization scheme, where the loans are assigned to a special purpose vehicle is possible in Poland and several loan receivables securitizations have been successfully completed so far.

The NPL market in Poland is still developing and did not exist before 2004, when a new tax law was introduced which allowed Polish banks to recognise losses on the sale of NPL as tax deductible costs, after which major Polish banks sold their NPL portfolios which they had grown before 2004.

Banks now regularly dispose of their NPL portfolios. However, the market is rather fragmented with many small and medium-sized debt buyers. The typical buyers of bad loans are debt collection Polish companies, who then also act as servicers of acquired loans.

Some key features of NPL portfolio market in Poland include:

– There are two methods of transfer of NPL portfolios available under Polish law: a sale and a sub-participation. All NPL transactions executed in Poland to date were done through regular sale.

- All sales of NPL portfolios in Poland use a Polish securitization fund as buyer, as only the sale of NPL portfolios to a securitization fund allows the selling bank to benefit from an advantageous tax treatment. A securitization fund is a type of closed-end investment fund regulated under the Polish Investment Funds Act. Securitization funds invest mainly in specified receivables or pools of receivables. A securitization fund may be established and managed only by a fund manager, which is a joint stock company set up under Polish law and licensed by the Polish finance regulator (as noted below). Each fund manager may establish and manage more than one investment fund.
- Securitization funds are financed mainly through the issue of a specific type of securities called investment certificates. Securitization funds are financed mainly through issue specific type of securities named investment certificates. Investment certificates are securities having mixed debt and equity nature, giving their holders rights of participation in the securitization fund's net profits, including the ability to exercise voting rights. Investment certificates can be offered both publicly and privately. Investment certificates can be offered both publicly and privately.
- The distribution of profits by a securitization fund to its investors can be done in one of two ways: (i) by distribution in exchange for lowering the number of investment certificates owned by investors which are repurchased by the fund and then annulled; or (ii) without the repurchase of investment certificates by the fund but with lowering the value of all investment certificates. In either case, the method of distribution of the fund's profits is regulated in the fund's statutes.
- NPLs purchased by a securitization fund are usually serviced by Polish debt collection firms although it is possible for the originating bank to act as the servicer. In each case the servicer of NPLs acquired by a securitization fund must hold a licence granted by Polish regulator.
- Usually, sales of NPL's are carried out by a tender process which is established and conducted by the selling bank. There are no specific regulations for such tenders and each bank has its own standards. Invitations to participate in the tender are usually sent to investors who, in the opinion of the selling bank, may be interested in acquiring NPLs.[7] Please note that one of the main conditions to finalise the sale is that the investor must have a securitization fund which will purchase the NPL. For any non-Polish investor that would mean a cooperation with one of the fund managers.

Regulatory licences or consents required to undertake any secondary lending activities

The establishment of a securitization fund requires the consent of the Polish regulator and offering of investment certificates requires the preparation of the prospectus and its approval by the regulator. In the event a securitization fund offers its investment certificates only by way of private placement, no approval is required for its establishment but only a notification to the regulator. In addition to investment certificates, some types of securitization funds may issue bonds.

Regulatory issues or restrictions on the lender owning shares in a Borrower (for example, as a result of any debt for equity swap)

In general there are no such restrictions, except for special cases (listed companies, banks, insurers etc.). Transactions between affiliated companies should meet the arm's length principle and transfer pricing documentation may be required. Also, financial assistance regulations apply to joint-stock companies.

7 The tender procedure usually provides for (i) the delivery of preliminary, non-binding offers from the invited investors to the bank, (ii) due diligence of the loan documentation for investors who were qualified for that by the bank on the basis of evaluating of their preliminary offers (usually all documents relating to the NPL portfolio which is to be sold are disclosed in electronic form); and (iii) final offer and negotiations of the sale documentation with one or more investors.

Consequences from a regulatory perspective if the lender were to trade the loans it acquires or the equity it may receive in conjunction with that debt?

As outlined above. The usual requirements concerning assignment of receivables (regarding transfer of loans) or trading in shares (regarding transfer of equity) apply.

Bank secrecy/duty of confidentiality

Polish Banking Law includes regulations concerning banking secrecy which applies to both Polish banks and foreign credit institutions (and their branches) operating in Poland. The Law prohibits the disclosure of certain client information but it also provides some exceptions, including the possibility to disclose information required for the execution of securitisation contracts and the performing obligations arising under them. Information can also be disclosed to rating agencies in order to provide a rating for receivables that are subject to a securitization.

Data protection

The Polish Data Protection Act regulates the issue of processing data which includes any kind of act connected with the use of personal data, such as collecting, recording, storing, processing, changing, making available and deleting such data. However, if there are other legal acts that grant a higher degree of protection than that granted under the Polish Data Protection Act, then the provisions of other legal acts, such as the Polish Banking Law, will apply. Although the banking secrecy principle covers the issue of transferring the data connected to the agreements entered into by banks and their clients, the regulations included in the Polish Data Protection Act are applicable to other issues connected to personal data processing i.e. requirements in relation to processing of personal data, information obligations imposed on data administrator, registration of personal data and security of personal data.

Spain

Transfer regime/requirements

Transfer/assignments of NPLs in Spain are generally carried out by way of:

- Transfer of contractual position (*cesión de posición contractual*). This method entails the replacement of an existing lender by a new one, which will have the rights and obligations previously held by the seller. Moreover, the consent of the borrower is needed (although the borrower usually gives its consent to future assignments/transfers of contractual positions in the original loan agreement under certain conditions – i.e., the new lender is a bank, etc.).
- Assignment of credit rights (*cesión de créditos*). The assignment of credit rights is generally regulated in the Spanish Civil Code and entails only the assignment of the credit rights of the lender under a loan agreement (but not the obligations).

Key features in respect of the assignments of credit rights (NPLs) (*cesión de créditos*) can be summarised as follows:

- Public document: The transfer/assignment may be carried out by virtue of a private or public document. The common practice in Spain is to notarise the transfer of credit rights (otherwise the effectiveness of the assignment vis-à-vis third parties could not be assured).
- Borrower's consent: Assignment of credit rights is not subject to the consent of the borrower. It shall be noted that whether or not the borrower consents may have an impact on its set-off rights.
- Notice to the debtors: Although it is not required for the perfection of the transaction, it is advisable because such notification ensures that the borrower will not be released of its obligations under the assigned loan by making payments to the original lender, i.e. the seller.
- The sale of the relevant loan shall entail the sale of the ancillary rights/security interests related thereto (please note that this also applies to the transfer of contractual position). Registration of the relevant transfer with the competent public registry is only required in the case of Spanish loans secured by mortgages or non-possessory pledges.

Moreover, there are certain peculiarities in relation to the assignment of loans to securitization funds, since Article 17 of Spanish Act 5/2015 on promoting business financing, establishes that the assignment of receivables to a securitization fund is subject to certain requirements, including, among others: (i) that the assignor shall have audited its annual accounts for the last two financial years; and (ii) the assignment shall be executed in a written document.

In relation to consumer loans,according to Spanish regulation on consumer loans (article 31 of Ley 16/2011 *de contratos de crédito al consumo*) the assignment must be notified to the borrowers unless the assignor continues to act as servicer of the loans.

Regulatory licences or consents required to undertake any secondary lending activities

As a general rule, lending activities or acquisition of existing loans are not regulated activities in Spain. However, securitization funds incorporated in Spain and their managing companies (*sociedades gestoras*) are subject to the Spanish capital markets regulation, to the prior administrative authorisation of the Spanish Securities Market Commission (*Comisión Nacional del Mercado de Valores*) and to the oversight of such commission.

Regulatory issues or restrictions on the lender owning shares in a Borrower (for example, as a result of any debt for equity swap)

As a rule of thumb, there are no restrictions.

Consequences from a regulatory perspective if the lender were to trade the loans it acquires or the equity it may receive in conjunction with that debt?

Please refer to the previous two sections.

Bank secrecy/duty of confidentiality

Many Spanish law governed facility agreements do not contain confidentiality clauses. However, Spanish credit entities are generally subject to stringent confidentiality duties that do not allow them to disclose the finance documents to third parties. Potential buyers are normally requested to enter into a non-disclosure agreement.

Data protection

The assignor and the assignee must comply with the relevant requirements and obligations under the Spanish data protection laws and regulations (i.e. Spanish Act 15/1999, of 13 December, on Data Protection ("**DPL**") and in the Regulation developing the DPL, approved by the Spanish Royal Decree 1720/2007, of 21 December ("**RDPL**")) in relation to the collection and subsequent processing and disclosure of the personal data pertaining to the affected data subjects (e.g. borrowers).

From a Spanish data protection standpoint (i.e. for the Spanish entity), and assuming that Spanish laws apply, the data subject would need to grant its informed consent prior to the collection and subsequent disclosure of its personal data, after being provided with information regarding, amongst other things, (i) the existence of a data file; (ii) the purpose of collecting the data; (iii) the identity and address of the controller; (iv) the proposed recipients of the data; (v) the reasons for disclosure of the data; and (vi) the ability to access, rectify, cancel and/or object to the further processing of his/her personal data.

This is usually done at the moment of collection of the personal data from the data subject, by means of the inclusion of a data protection clause in the relevant loan agreement. Otherwise, a specific communication providing the required information in the context of the potential disclosure of the personal data has to be provided before the transfer takes place. In principle, there is no problem in doing so through an online platform provided that: (i) communications with borrowers usually take place via such online platform; and (ii) evidence proving that such communication has been effectively made is duly recorded.

Moreover, note that generally, according to the DPL and RDPL, international transfers of personal data to recipients located in third countries which are not considered as guaranteeing a level of protection equivalent to the one afforded under EU or Spanish legislations, are subject to prior authorization by the Director of the Spanish Data Protection Agency ("DPA"). The authorization may be granted on the basis of a data transfer agreement containing the relevant set of standard contractual clauses approved by the European Commission. Please note that this is not a straightforward procedure and may take up to three (3) months until the DPA issues a final decision regarding the transfer request.

South-east Asia

India

- The Reserve Bank of India (the "**RBI**") has not, at the date of this guidance, issued any regulations or framework which permit sales of Rupee denominated loans (non-performing or not) between Indian residents and offshore investors;
- However, Indian resident entities may sell loan portfolios to each other. In addition, in respect of foreign currency debt (including foreign currency loans or bonds and Rupee denominated loans or bonds) held by offshore lenders, transfers can be made between offshore lenders.
- Foreign exchange laws govern transactions between residents and non-residents. Loans can be made by non-resident entities to resident entities, but the criteria may be different to the domestic loans sought to be sold and therefore whole loan sales may not be practicable or at the least need to be considered carefully. Transfers of loan portfolios where the loans are already made by non-residents to residents (therefore resulting solely in a change to the non-resident lender) may be possible but will need to be reviewed on a case by case basis. If a foreign lender holds a foreign portfolio registration, then they may invest and purchase Rupee denominated bonds (commonly known as non-convertible debentures).
- Banks, financial institutions and non-banking financing companies are permitted to sell their NPL portfolios to asset reconstruction companies ("**ARCs**") and securitization companies set up in India for distressed debt management (subject to certain conditions prescribed by the RBI). A foreign entity can invest equity up to 100% in ARCs without any prior approval of the Foreign Investment Promotion Board of India, provided that total shareholding of individual foreign portfolio and institutional investors remains below 10% and any other investment limits for sponsors' shareholding in asset reconstructions companies as stipulated by other legislations, from time to time, are maintained.
- Another form of offshore investment in ARCs is by way of investments in security receipts (similar to a securitization note) issued by such ARCs, where the Government has permitted foreign investors to invest up to 100% of any issuance, but such investment is subject to directions or guidelines laid down by the Reserve Bank of India and within relevant regulatory caps, as applicable.
- There may be other vehicles like non-banking financial companies that foreign investors can also consider establishing and using to purchase whole loans.
- Domestic synthetic structures are not customarily used by foreign entities looking to invest in Indian loan transactions. However, some similar techniques can be used for cross border financings.

Indonesia

- A lack of specific regulation on debt sale and purchase within the financial regulatory environment means that rehabilitation of NPLs is largely subject to contractual principles set out in the Indonesian Civil Code and, if the debt is secured by Indonesian security documents, the recovery of NPLs may also be through enforcement of the security in accordance with the laws governing the relevant security.
- The concept of trust is not recognized and synthetic structures may be subject to liberal interpretation by the Courts. Documentation should allow for alternative dispute resolution and flexibility in the execution process.
- The on-going development of legal process in the provinces means that ownership and security registration, as well as powers of attorney issued to perfect security within these areas, continue to require rigorous verification.
- External debt may be subject to the required hedging and liquidity ratios comparing foreign currency assets of the obligor to its foreign currency liabilities against specific maturity periods. External debt is also subject to the credit rating requirement

as stipulated by Bank Indonesia (the Indonesian Central Bank). Also, the Indonesian obligor must submit offshore loan reports to Bank Indonesia, the Ministry of Finance, the Foreign Commercial Loan Coordinating (PKLN) Team and the Directorate General of Tax.

– Under the current controlled foreign investment regime, regulatory approval for the transfer of shares in an Indonesian company to a foreign buyer may be subject to foreign investment and industry specific regulatory process and approval as well as the prevailing Negative Investment List.

Vietnam

– The highly administered nature of the jurisdiction means that, notwithstanding apparently permissive debt documentation, compliance with certain procedures and forms of transfer set out in State Bank regulations on "debt sale and purchase" may be required.

– Stringent foreign exchange controls set out in ambiguous terms in the regulations mean that the "exporting" of a local NPL from a Vietnamese credit institution or foreign bank branch operating in Vietnam to a foreign lender may require an ad hoc confirmation from the State Bank of Vietnam that registration is not required; the repatriation of interest payments and repayments of principal through an " authorised credit institution" may otherwise be compromised.

– Participation by an offshore lender in security packages may, particularly if real estate is concerned, be problematic.

– Synthetic structures for risk participation are not supported by Vietnamese law, and are therefore in practice typically established outside Vietnam and governed by a law other than Vietnamese law.

Malaysia

– Banking institutions may sell NPLs to: (i) domestic banking institutions or locally-incorporated foreign banking institutions in Malaysia; (ii) domestic investors; or (iii) foreign investors.

– Cases (ii) and (iii) must be conducted through a Malaysian incorporated and tax-resident SPV where the foreign equity participation is capped at 49% (note that this limit does not apply to locally-incorporated foreign banking institutions);

– Bank Negara Malaysia approval is required before disclosure of any confidential information relating to borrowers, including in a due diligence exercise.[8]

We would like to thank Skrine and Cyril Amarchand Mangaldas, with whom we regularly work on deals involving Malaysia and India respectively, for collaborating with us in the production of this note.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

8 The disposal of NPLs in Malaysia is currently governed by the 2006 Guidelines on the Disposal/Purchase of Non-Performing Loans by Banking Institutions.

Examples of recent experience

- **GE** on the sale of its real estate loan portfolio. The portfolio holds approximately US$23bn worth of investments in office buildings, apartment complexes, and other commercial property worldwide.
- **NAMA** on the disposal of its Northern Ireland book with a face value of c.€5bn to Cerberus (Project Eagle).
- A **major UK clearing bank** in relation to the sale and transfer of a portfolio of loans with a face value of circa £280m and related security (Project Cooper).
- A **major UK clearing bank** on the disposal of part of its Irish loan book. We acted as international counsel on the transaction (Project Pegasus).
- A **major UK clearing bank** in relation to the sale and transfer of loans with a value of circa €500m and backed by a large portfolio of German commercial real estate assets (Project Indie).
- **Kennedy Wilson** on a number of CRE debt portfolio acquisitions and their related financings, including its acquisition of a circa £770m portfolio of UK nonperforming real estate backed loans and related swaps.
- **Starwood Capital** in relation to its bid for RBS's £1.5bn property loan and related swap portfolio.
- **NAMA** as seller of the Maybourne hotels debt of circa £660m to entities controlled by the Barclay brothers.
- An **international debt fund** in relation to its investment in a joint venture loan portfolio acquisition platform and the first acquisition and issuance made by that platform.
- **Bank of America Merrill Lynch** as arranger on a £161m debt on debt financing involving the financing of a pan European CRE loan pool in seven European jurisdictions (including the Netherlands and Germany) acquired by a Luxembourg Securitization Company (which was established by a fund).
- **Bank of America Merrill Lynch** as arranger on a debt on debt financing involving the financing of a Dutch Loan and REO commercial property portfolio.
- **Deutsche Bank** as arranger on the financing of a portfolio of Irish REO residential properties acquired by a debt fund.
- A **major international bank** as senior lender under a £1bn term loan facility to finance the acquisition of a portfolio of UK residential mortgage loans.
- A **major U.S. financial institution** on the proposed acquisition and re-leveraging of the debt provided to a debt origination and acquisition platform established by a U.S. debt fund.
- **GE Capital** on NPL portfolios acquisition tender proceedings.
- **Euler Hermes** on acquisition of NPL portfolio; Euler Hermes acts as intermediary and servicer for UBS in acquisition of NPL in Poland.
- **Santander Global Banking & Markets** and **Citibank Internationa**l as Arrangers and Joint Lead Managers in relation to a PLN 1,367bn Polish auto loan securitization.
- **Kreditech** on the securitization of consumer loan receivables resulting from the financial activity of Kreditech Polska.
- **Unicredit Bank** (as arranger and investor) on the PLN 1bn securitization of Polish loan receivables originated by Santander Consumer Bank S.A.
- **Getin Noble Bank S.A.** on the securitization of receivables resulting from auto loans granted by Getin Noble Bank S.A.
- **Crédit Agricole Corporate & Investment Bank** in connection with the acquisition of several portfolios of non-performing mortgage loans, originated by Italian banks or financial intermediaries.

- **FMS Wertmanagement (FMS-WM) (the "bad bank" established for Hypo Real Estate Group)** on the acquisition of a portfolio consisting of risk assets and non-strategic business units of Hypo Real Estate Group in the total amount of €173bn, on the organizational set-up of FMS-WM and on the disposal of various non-performing assets.
- **Barclays Bank Plc** (acting through its Barclaycard division) in connection with two principal finance transactions involving the sale of non-performing portfolios of credit cards loans and consumer loans, both originated by the Italian branch of Barclays.
- **Barclays Bank Plc**, as seller, on the sale of several portfolios of Italian non-performing loans (originated by the Italian branch), also through auction procedures.
- **Pirelli Real Estate**, as buyer, in connection with the acquisition of portfolios of non-performing mortgage loans from Italian banks.
- **BNP Paribas** in connection with the drafting and negotiation of an asset management agreement with Italfondiario S.p.A. for managing the recovery of non-performing mortgage loans.
- **Nomura** in connection with an auction sale of portfolio of non-performing mortgage loans originated by Meliorbanca.
- **Morgan Stanley** in connection with the restructuring and refinancing of a structured finance deal regarding loans originated by a number of Italian banks.
- **Cassa di Risparmio di Parma e Piacenza** in connection with an auction sale of a portfolio of non-performing loans originated by the bank.
- A **significant investor** on a €2.7bn Spanish residential mortgage certificate and REO residential property financing and note repackaging.
- **Bank of America Merrill Lynch** as arranger on a £161m debt on debt financing involving the financing of a pan European CRE loan pool in seven European jurisdictions (including the Netherlands and Germany) acquired by a Luxembourg Securitization Company (which was established by a fund).
- On the acquisition by a **consortium** of a portfolio of non-performing loans in Indonesia.
- An **international bank** on the disposal of the economic rights in a portfolio of defaulted loans across South-East Asia.
- A **German bank** on the sale of a €1.64bn loan portfolio to financial investors.
- Advising **Aviva** on the formation and seeding of new infrastructure and real estate debt funds with capital raised in excess of £600m and on subsequent due diligence and debt acquisitions in the secondary market.

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