Grass roots and green shoots

European non-performing loan trends in a post-COVID-19 world

Contents

Foreword

While the overall European non-performing loan (NPL) market has been in decline since its peak in 2018, the ongoing impact of COVID-19 may soon change things.

It has been a tough year for European business and consumers, as waves of COVID-19 lockdown restrictions took their toll. Entire sectors were effectively shut down, with many surviving on government support and employee furlough programmes, as well as tapping liquidity markets and taking advantage of any debt relief measures on offer.

Travel restrictions and economic uncertainty also impacted the NPL market. Though activity shut down in the second quarter of 2020, the final quarter saw a partial recovery, with deals worth €28.6 billion signed in Q4 2020 alone. However, price gaps continued to impact some deals. The first month of 2021 saw deals close that were worth €3.3 billion, as some deals paused due to lockdown conditions managed to compete. Looking to the rest of 2021, Greek NPL deals are keeping the NPL pipeline filled.

The impact of COVID-19 on loan quality has yet to be felt. Many companies have managed to avoid slipping into insolvency thus far, whether through government stimulus measures or agreements with lenders, but once those measures wind down and lenders reassess the creditworthiness of their borrowers, that is likely to change. Provisioning levels at top European banks in the UK, Spain, France, Italy and DACH reflect this reality, almost doubling year-on-year from 2019 to 2020, according to *Debtwire*.

Governments across Europe recognise the challenge they are facing. A spike in NPLs among lenders could spell trouble for those same lenders, prompting the EU to consider regulatory options that will help smooth the process. Standardised templates, securitisation and boosting secondary NPL trading are all on the cards, as regulatory bodies and lenders take a proactive stance to prepare for a potentially rocky road ahead. Taking these steps also opens the door to more buyers entering the market—including some that were once active but may have stepped aside as things cooled, including PE firms, banks and other debt servicers. It may also encourage partnerships to invest in NPL portfolios, which may also drive the speed of portfolio disposals in the coming year.

New market opportunities in sight?

At a regional level, Italy and Greece remain NPL hotspots, as the securitisation of NPL portfolios coupled with state-backed guarantee schemes continue to help reduce NPL stocks among banks. But other markets are now showing signs of activity, and investors are watching very closely.

In Spain, moratoria on mortgage and non-mortgage debts are set to expire, prompting many Spanish banks to prepare for an uptick in NPL stocks—the four top banks in the country put aside provisions of €22 billion in 2020, up from €15 billion in 2019.

Many expected UK banks to move quickly in the event of an expected rise in NPLs, given the high economic fallout of multiple lockdowns. Top UK bank provisions rocketed by 3.1x year-on-year, to €21.2 billion, as banks braced for loan losses.

Ireland, France, Portugal and even typically cautious Germany (where SME loans are expected to be the largest source of NPL stock rise) are all on the radar for investors. But the degree of rise in problem loans still has a large degree of variability, with the speed of economic recovery and the end of huge levels of government support still unclear.

COVID-19 and the state of the European NPL market

Early in 2020, as the pandemic took hold, the European NPL market went into lockdown along with the rest of the economy—but as the market opened up in the second half of the year, NPL sellers jumped back in, setting the stage for a busier 2021.

As COVID-19 vaccination programmes are rolled out across Europe and markets stabilise, NPL assets are back on the agenda for banks and regulators alike. European NPL stocks are expected to increase through the course of 2021 and into 2022 as insolvency moratoria, employment protection schemes and central bank liquidity support measures unwind.

This stands in stark contrast to the position of the market pre-pandemic, when NPL activity in Europe was in steady decline due to lower volumes of NPLs. Of course, Europe's NPL market is not homogenous—some markets have remained busy, such as Italy and Greece—but overall European NPL activity has slowed during the pandemic.

In the decade following the 2008 financial crisis, banks strengthened balance sheets and offloaded unwanted portfolios of loans. In 2019, only €102.8 billion of NPL and non-core deals closed, less than half the €208.2 billion figure for 2018, according to *Debtwire*'s full-year analysis of the European NPL market in 2020.

According to the European Banking Authority's (EBA) 2020 Risk Dashboard, based on data as of Q3 2020, overall European NPL levels stood at a record low of €510.5 billion, less than half the peak level of €1.2 trillion reached in 2014.

The combination of long-term falls in NPL levels and the COVID-19 lockdown saw NPL and non-core loan deal activity for 2020 down 34 per cent year-on-year at €67.7 billion, making the

period the least active since 2016, according to *Debtwire*.

NPL markets regroup

Deal activity started to revive in the second half of the year as market participants, including selling banks, buyers and state-owned asset management companies (AMCs—vehicles set up by governments to consolidate and sell down bad loan books), returned to work on disposals and managing legacy NPLs. In the final three months of 2020, deals worth €28.6 billion were signed, accounting for more than a third of activity for the year.

Most notable deals (by deal size) that have gone through since the summer of 2020 include AMCO, the Italian AMC, buying an €8.1 billion portfolio of NPL and "unlikely to pay" (UTP) loans from Banca Monte dei Paschi di Siena, and debt servicer doValue buying the mezzanine and junior notes of a €7.5 billion non-performing exposure (NPE) securitisation from Eurobank Eragsias as part of Project Cairo in Greece.

In other significant NPE securitisation deals in Greece, Piraeus Bank signed binding agreements with Intrum to sell 30 per cent of the mezzanine notes for the Phoenix portfolio and Vega portfolio, amounting to €1.92 billion and €4.8 billion gross book value respectively, which are intended to benefit from the Greek asset protection scheme Hercules.

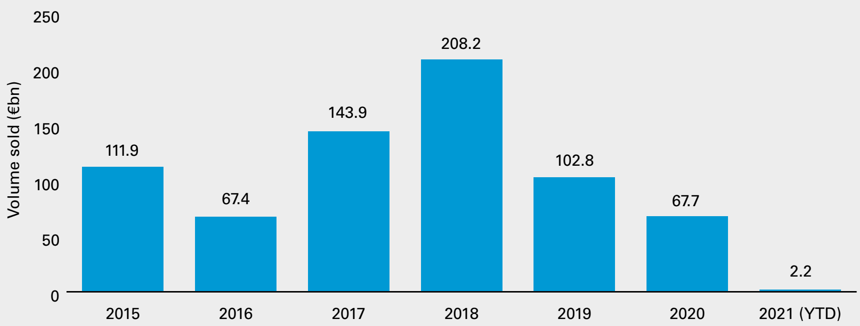
Deal pipelines for pending deals have also been replenished, with *Debtwire* tracking €51.6 billion in live deals at the start of 2021. Top live deals being tracked in Greece include Project Frontier, a €6 billion disposal ongoing from the National Bank of Greece. Piraeus Bank also submitted an application for a new €7 billion NPE securitisation, Sunrise 1, under the HAPS scheme.

Project Galaxy, an Alpha Bank securitisation with a portfolio worth €10.8 billion, closed in February 2021. Davidson Kempner signed an agreement to acquire 51 per cent of the mezzanine and junior notes.

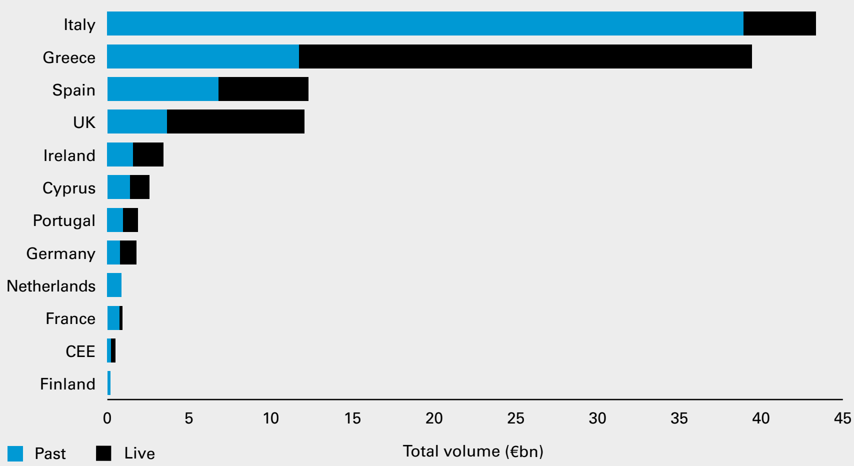
COVID-19 will drive European NPLs

In addition to the pipeline of current live deals, banks and buyers are also preparing for an influx of new NPL

NPL and non-core loan deals in Europe by year

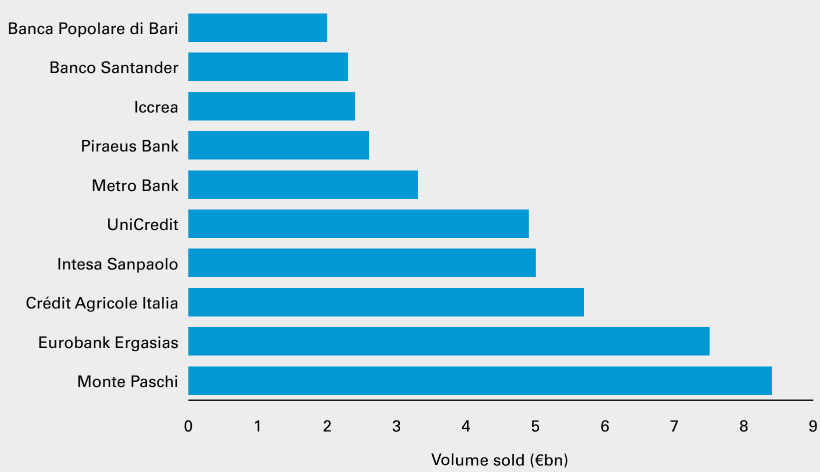


European NPLs: Closed and live deals by country in 2020*



*Covers deals to the end of 2020—some live deas have since closed.

European NPL top sellers in 2020



stock prompted by COVID-19 and its impact on financial performance and creditworthiness.

Total provisioning levels at top European banks in the UK, Spain, France, Italy and DACH have almost doubled year-on-year, according to *Debtwire*, rising from €35.7 billion in 2019 to €71.8 billion in 2020, as institutions prepare for anticipated future losses.

While these provisions suggest a significant increase in NPL stock is expected, the scale remains uncertain. Many banks are still assessing which borrowers will be unable to repay loans when economies reopen and which may be able to recover fully in time.

For example, lenders may decide that companies in industries such as leisure, aviation and commercial real estate—which were trading strongly pre-COVID-19 but were hit particularly hard by lockdown restrictions—will be able to rebound as economies recover and service outstanding debts as their earnings improve.

Proactivity is key for regulators

While regulators are equally uncertain about the ultimate size of European bank NPL exposure, the chair of the European Central Bank's supervisory arm warned in October 2020 that—in a severe but entirely plausible scenario—NPLs at European banks could rise as high as €1.4 trillion.

The European Commission (EC) is considering various measures and changes to regulations to proactively address any pending spikes in bank exposure to NPL loans.

Regulators want to support Europe's NPL secondary market by making it easier and quicker to get deals to market. The EBA already has data templates in place to help investors analyse NPLs, but uptake has been limited. There is now a push to make templates mandatory for market participants—they were initially only required for new NPLs, i.e., for loans that become non-performing after a specific cut-off date—and to create a central database of NPL information that market participants can access.

The regulators have also indicated that banks should not be penalised if they do not have non-essential data and will be allowed to use a no-data option.

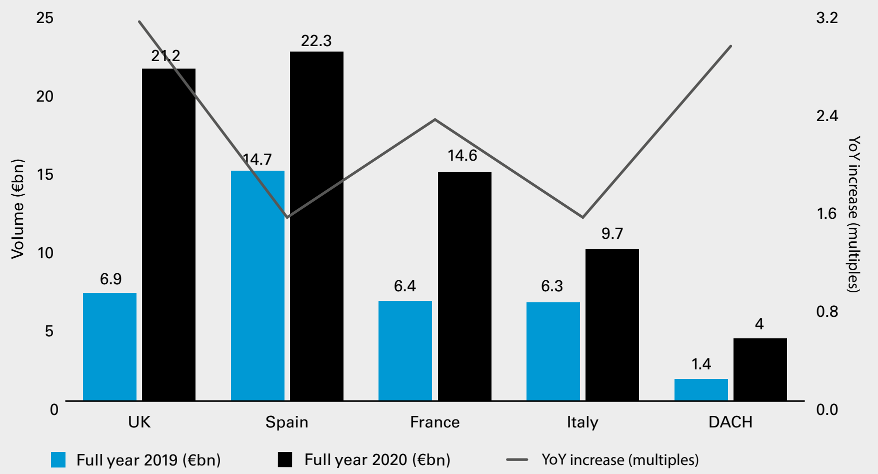
While Europe has a functioning NPL secondary market, it has typically been characterised by smaller tickets and local buyers. Standardising information and data is seen as a crucial step to increase the volume of secondary NPLs.

Supporting the securitisation of NPL portfolios—which has proven successful in Italy and Greece, where banks had the largest NPL exposures in Europe—will also expedite NPL transactions (see "Is securitisation an essential ingredient for success?"

€71.8 billion

Total provisioning levels in 2020 at top European banks in the UK, Spain, France, Italy and DACH

Provisions for top European banks, 2019 versus 2020 (€bn)



Source: Financial reports from the top four banks in each region

Top-five European NPL deals closed in 2020

Seller	Country	Project name	Gross book value	Buyer	Type	Closed
Banca Monte dei Paschi di Siena	Italy	n/a	€8.1 billion	AMCO	Secured	30/06/2020
Eurobank Ergasias	Greece	Cairo	€7.5 billion	doValue	HAPS Secured (Securitisation)	05/06/2020
Intesa Sanpaolo	Italy	Yoda	€4.3 billion	n/a	GACS Mixed Secured and Unsecured (Securitisation)	18/12/2020
Crédit Agricole Italia	Italy	Pelican	€5.7 billion	Goldman Sachs with LCM Partners, and Elliott	Unsecured	23/07/2020
Metro Bank	UK	n/a	€3.3 billion	NatWest	Secured—Residential (performing)	20/12/2020

Source: *Debtwire NPL Database*

on page 6). The legislators have completed the process of implementing targeted improvements to the securitisation framework to account for the special characteristics of NPL securitisations. The amended framework will enable wider use of securitisation as a tool by banks to free their balance sheets from NPLs.

Calling all new buyers

It is hoped that facilitating securitisation and boosting secondary NPL trading will bring a broader pool of buyers into the market, creating deeper liquidity and reducing the time it takes to dispose of NPL portfolios.

From 2015 to 2019, private equity (PE) managers Cerberus, Blackstone and Lone Star dominated NPL transaction activity, accounting for more than €160 billion in NPL deals between them. In 2020, however, with the exception of a few deals closed by Cerberus, none of these firms were particularly active in NPL transactions.

In 2020, Italy's "bad bank" AMCO was the most active NPL investor, buying up €11.7 billion of NPLs. Other asset managers and banks—including LCM, Goldman Sachs and fixed-income specialist PIMCO—were active buyers last year, with debt servicing platform doValue also ranking among the top-ten buyers.

PE firms, banks and other debt servicers, including CarVal and Intrum, that were more active buyers of NPL assets prior to 2020, will likely once again become key buyers of NPL portfolios as levels increase through 2021. Banks will also be looking to other distressed debt funds, family offices, activist investors and pension funds to come into the market and provide potential exit routes as NPL stocks increase.

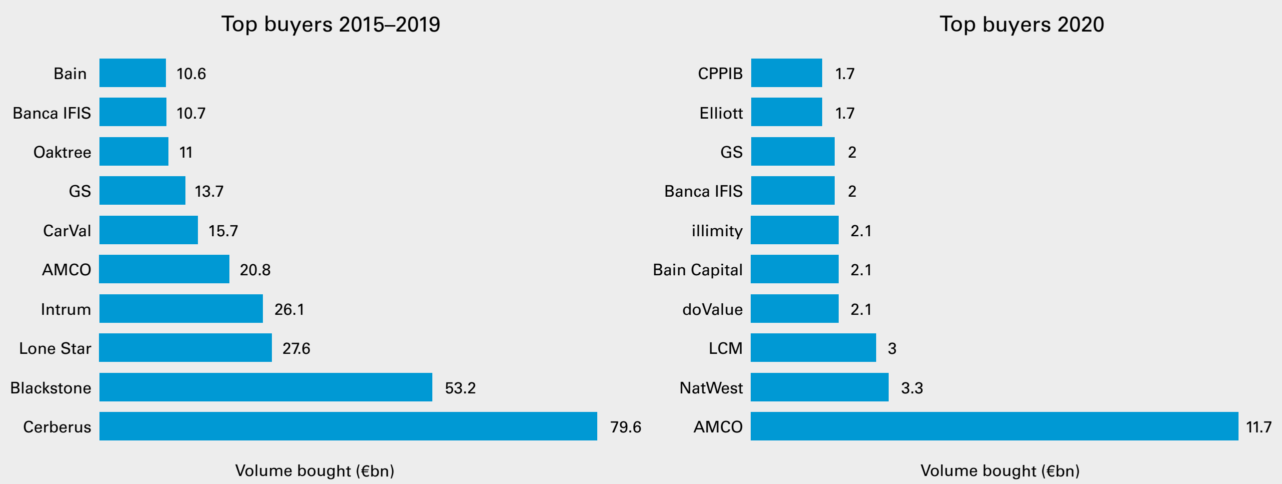
In 2020, activist investor Elliott bought a €1.7 billion NPL portfolio from Crédit Agricole Italia. Canadian pension fund CCPIB's €1.6 billion acquisition of a Spanish secured residential loan portfolio from Santander in March 2020 is another example of the European NPL market holding appeal for a broad range of institutions.

Investors are also exploring partnerships as a way to invest in NPL portfolios. Swedish debt purchasing firm Hoist Finance, for example, has agreed to a deal with structured credit fund Magnetar Capital Management. The deal will allow Hoist to buy up NPL portfolios, hold the senior debt and sell down the mezzanine and junior securitised note portions to Magnetar. As a result, Hoist—which is a bank, unlike most of its investor competitors—can invest up to €1 billion in NPLs while benefitting from the preferential capital treatment by achieving significant risk transfer. Other investors, such as buyers aiming to repurpose real estate by taking ownership of properties via purchases of real estate NPLs, could also deepen the buyer universe.

Measures to further develop the secondary and securitisation markets will encourage more investors like these to consider NPL deals seriously.

> “**It is hoped that facilitating securitisation and boosting secondary NPL trading will bring a broader pool of buyers into the market, creating deeper liquidity and reducing the time it takes to dispose of NPL portfolios**

Top buyers of European NPL volumes (2015–2019 versus 2020)



Source: *Debtwire NPL Database*

Is securitisation an essential ingredient for success?

The securitisation of NPL portfolios in Greece and Italy has proven an invaluable tool for reducing bank NPL stocks in these jurisdictions.

Both the Garanzia Cartolarizzazione Sofferenze (GACS) scheme in Italy, launched in 2016, and Greece's Hercules Hellenic Asset Protection Scheme (HAPS), introduced in 2019, provide state-backed guarantees for senior tranches of NPLs that are bundled together into special purpose vehicles and sold.

Italy was the largest European market for NPL deals in 2020, with the sale of €38.9 billion of loans, followed by Greece with deals totalling €11.7 billion. The portion of GACS- and HAPS-supported transactions in 2020 represented a third of all European NPL activity that year.

Although the mechanisms for NPL securitisations in Europe have been in place as early as 2003, and there were a number of NPL securitisations that took place prior to the 2008 financial crisis, their use was effectively shut down on the continent after the financial crisis. It was only when governments in Italy and Greece stepped in to create securitisation frameworks that deal activity revived using these mechanisms. State-backed guarantee schemes have been particularly successful in these jurisdictions.

Although the tool has helped both Italian and Greek banks to accelerate the pace of their NPL sell-downs, other European governments have yet to step in and create similar state-backed NPL securitisation programmes. There have been a few isolated examples of non-state-backed NPL securitisations in Spain, Ireland, Portugal and Greece, where Eurobank Ergasias completed a €2 billion market NPL securitisation in 2019, but these deals are rare and account for a fraction of overall NPL volumes.

EU NPL securitisation regulation, which came into force in 2019, has put a uniform set of rules in place for all European governments to follow should they choose to do so. The adoption of government guarantee schemes by other European countries under this framework could provide a timely boost for clearing out NPL portfolios following the increased pressure on loan books as a result of COVID-19.

The legislative process for amending the current NPL securitisation framework, so that non-rated NPL securitisations are no longer subject to materially higher capital charges, has been completed and was included in the level I text on 9 April, 2021. These changes are certain to encourage more NPL securitisation deal flow.

Legislators have also placed emphasis on expediting the enactment of law governing credit servicers and credit purchasers in order to further develop a secondary market for distressed assets.

Another legislative initiative that is key for the NPL market is the minimum harmonisation rules on accelerated extrajudicial collateral enforcement. The European Commission has also extended its support to national AMCs in such banking sectors where it is needed, while maintaining that involvement of state aid must not be seen as the default solution.

Key figures: At a glance

NPL activity in Europe

NPL and non-core loan deal activity for 2020 fell by more than a third year-on-year while provisioning among top banks in the UK, Spain, France, Italy and DACH have almost doubled during the same period, setting the stage for what is expected to be a very busy 2021.

34%

The drop in European NPL and non-core loan deal activity, year-on-year, from €102.8 billion in 2019 to €67.7 billion in 2020, making the period the least active since 2016, according to *Debtwire*.

€28.6 billion

Total value of European NPL deals signed the final three months of 2020, accounting for more than a third of activity for the year.

€71.8 billion

Total provisioning levels in 2020 at top banks in the UK, Spain, France, Italy and DACH, with the majority put aside for expected losses due to loan deterioration, suggesting that NPL levels are expected to rise.

€51.6 billion

Total value of live NPL deals in the pipeline tracked by *Debtwire* at the start of 2021.

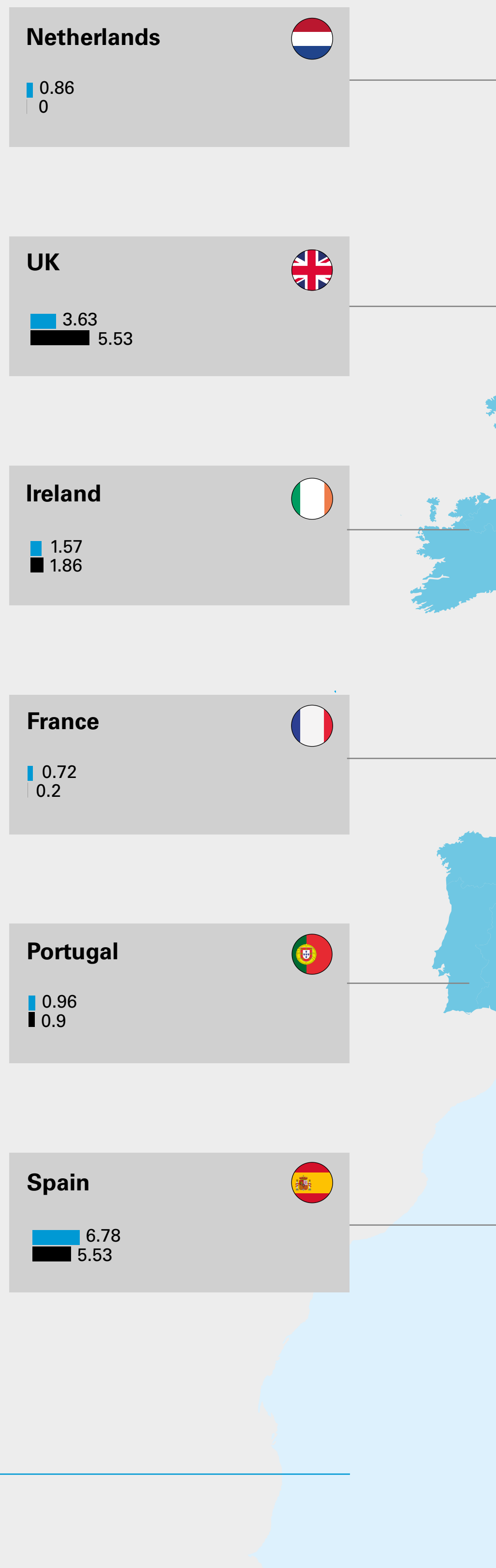
Top deals in Europe

€8.1 billion

Total value of the portfolio of NPL and "unlikely to pay" (UTP) loans bought by AMCO, the Italian AMC, from Banca Monte dei Paschi di Siena–one of the biggest deals of 2020.

€10.8 billion

Total value of Project Galaxy in Greece, an Alpha Bank securitisation that closed in February 2021.



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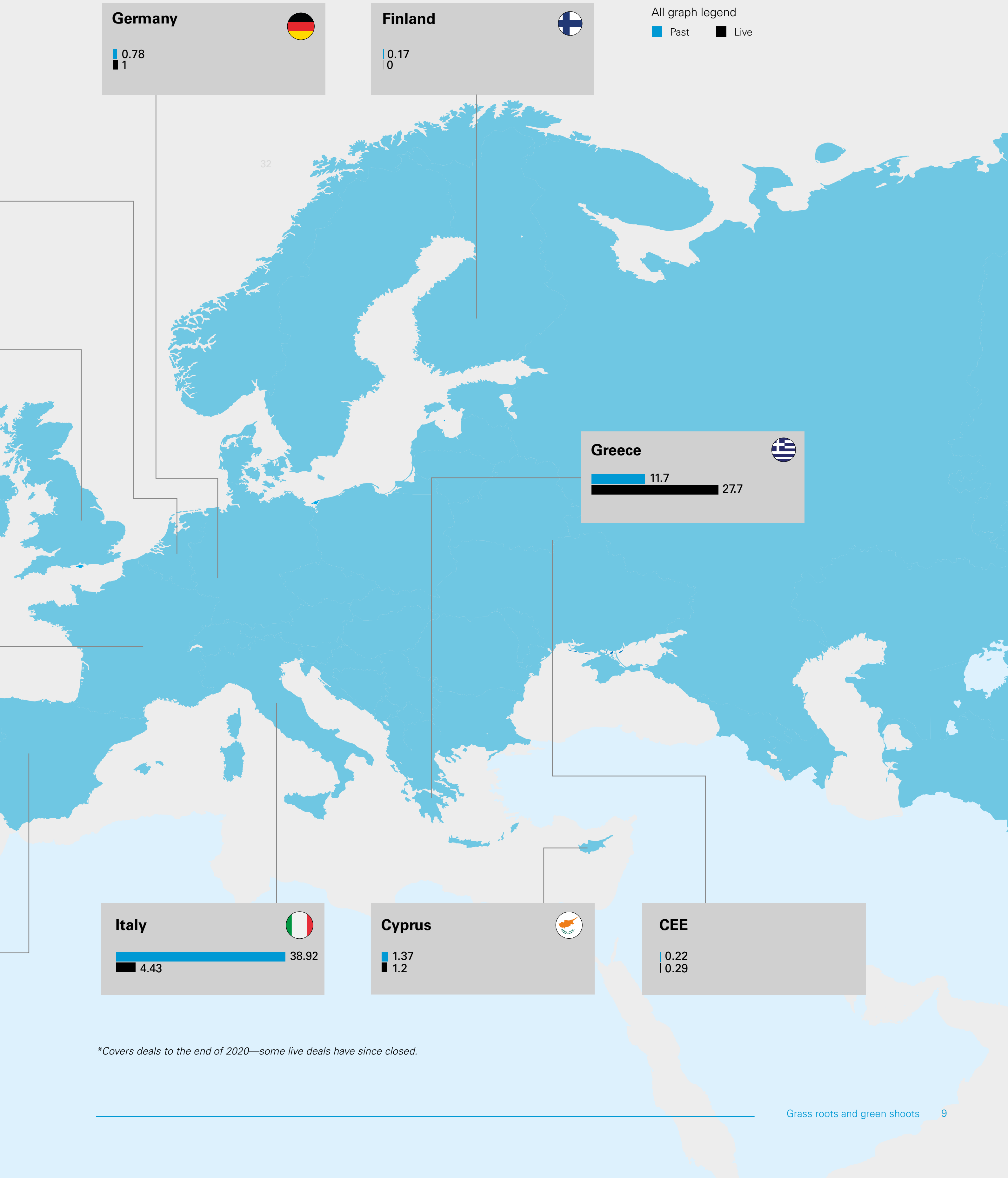


**Covers deals to the end of 2020—some live deals have since closed.*

Regional spotlight: NPLs in France, Germany, Spain, UK and Ireland

Opportunities for NPL investors are presenting themselves in European jurisdictions outside of the largest markets: Italy and Greece. Here is an assessment of markets where new opportunities for NPL deal flow are emerging.

Europe's two largest non-performing loan (NPL) markets—Italy and Greece—accounted for the majority of European NPL deal activity in 2020 and absorbed most investor attention. Government-supported NPL securitisations and high levels of legacy NPL stocks will see these countries continue to take the spotlight when it comes to NPL deal flow.

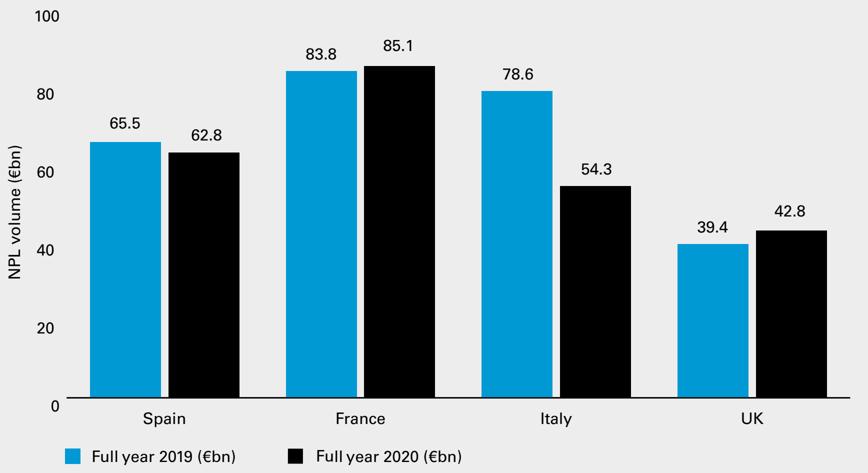
At the same time, other European countries are showing signs of activity that point to more dealmaking in the months ahead. Provisioning levels at major banks in France increased in 2020, as did those in Germany, Austria and Switzerland (DACH) as well as Spain.

In the UK and Ireland, meanwhile, several larger deals that were put on hold due to COVID-19 are now set to go ahead, while the UK's largest banks are reporting an increase in loans at risk, suggesting an active 2021 for NPLs.

Elsewhere, there are signs of potential activity in the months to come. For example, bank loans worth approximately €23.2 billion in total are currently subject to COVID-19-inspired moratoria in Spain, Portugal and Greece. These could turn into NPLs in the months ahead. The issue is particularly serious for Portugal, which could see its NPL level increase by more than 50 per cent after the programme expires in September 2021.

Drilling down into the data reveals substantial NPL activity just under the surface waiting to break across Europe—and buyers and sellers alike will not hesitate to take advantage of the opportunity.

Impaired loan volume in top European banks (€bn)



Source: Financial reports (impaired loan volumes come from the top four banks in each region; the UK bank totals represent Stage 3 loans)

> **Drilling down into the data reveals substantial NPL activity just under the surface waiting to break across Europe**

FRANCE: On the rise

France is positioned for a busier year of NPL activity in 2021. The country's banks have been slower to deal with NPL exposures than their counterparts in Italy and Greece, given that the NPL ratio of the system has remained low. As a consequence, by the end of the year, France was holding the highest volume of NPL assets in Europe. France's four main banks—BNP Paribas, Société Générale, Groupe BPCE and Crédit Agricole—saw their NPL holdings increase from €83.8 billion in 2019 to €85.1 billion in 2020.

French banks also provisioned €14.6 billion that year to cover anticipated distressed loans emerging from the disruption caused by COVID-19—more than double the €6.4 billion set aside in 2019.

France's banks will be under pressure to offload these loans as pandemic volatility subsides, and some lenders have already moved to reduce their NPL exposure.

In August 2020, for example, Société Générale sold its €550 million Project Gaya—a primarily secured SME loan portfolio—to CarVal and iQera, a debt purchaser and servicer owned by BC Partners. This was the largest French NPL portfolio deal since 2015.

NPL sales momentum is expected to carry through 2021 with Société Générale bringing forward Project Orsay, a €200 million secured NPL portfolio deal, at the end of 2020.

GERMANY: Cautious but well prepared

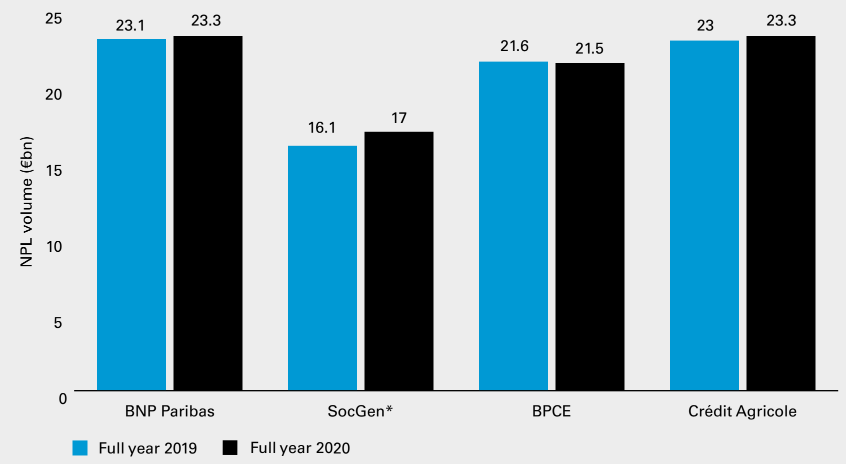
The German NPL market has not been as active as other jurisdictions, having already made sales earlier in the NPL cycle. The market will remain of interest as German banks continue to pay close attention to capital adequacy requirements, controlling leverage and analysing the impact of COVID-19 on the performance of existing loan portfolios.

Provisions at DACH banks—although much lower than levels in the UK, France, Spain and Italy—almost tripled year-on-year in 2020, to €4 billion. German SME loans are expected to be the largest source of NPL stock rises in Germany, accounting for almost two-thirds of increases in NPL ratios, according to publicly released analysis from PwC. On a sector basis, retail credit is expected to be the largest contributor of new NPLs in Germany, accounting for approximately 30 per cent of the NPL ratio rise.

Although provisions are rising, NPL transaction volume in Germany was limited to a handful of deals in 2020. Cerberus sold a portfolio of shipping loans with a gross book value (GBV) of €250 million to LCM Partners, which also acquired a pool of unsecured loans from Hamburg Commercial Bank with GBV of €360 million. Hamburg Commercial Bank, meanwhile, offloaded a €700 million wind farm loan portfolio to Unicredit. It has been reported that a number of affected German banks have become more vigilant when reviewing their workout options, including disposals and/or structures to take ownership of the underlying collateral, thereby avoiding market losses and allowing them to wait for recovery.

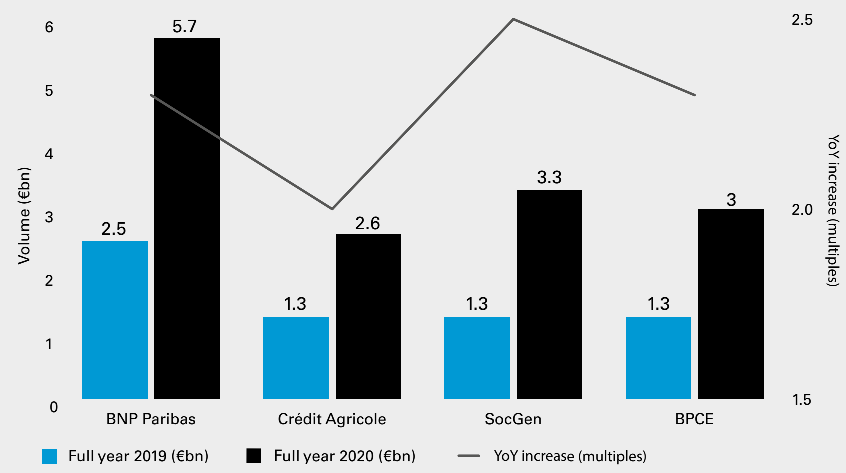
Some German banks are also considering risk transfer transactions for still-performing loan portfolio assets that are at risk of NPE status, in order to avoid negative accounting

NPL volume in top French banks (€bn)



*Source: Bank earnings reports; *SocGen only provides a volume for Stage 3/"doubtful" loans*

Provisions for top French banks (€bn)



consequences. It generally remains to be seen whether higher levels of provisioning actually leads to real NPL activity in Germany, where lenders have historically sought to manage troubled credits internally.

SPAIN: Expectations rise

NPL deal activity fell to a five-year low in Spain in 2020 as NPL transactions were put on hold due to tight COVID-19 restrictions. Banco Santander's Project Prometeo, a €2.1 billion NPL sale that was on track to go to M&G, was one example of a large NPL transaction that stalled following the pandemic. Pricing gaps also added to deal delays.

The tally for closed NPL deals in Spain reached €6.8 billion in 2020, less than half the €16.1 billion recorded in 2019 and 88 per cent down from the €54.9 billion in transactions posted in 2017 when the market was at its peak.

Falling NPL volumes in the country's four largest banks—down from €65.5 billion at the end of 2019 to €62.9 billion in 2020—also meant there was slightly less urgency to offload NPL portfolios.

Spanish banks are, however, preparing for NPL stocks to start climbing once again, as moratoria on mortgage and non-mortgage debts expire. These limited the deterioration of credit quality through the pandemic and, without them acting as a buffer, many of these loans may fall into distress.

Between them, Santander, BBVA, Sabadell and Caixabank put aside provisions of €22 billion in 2020 to cover potential losses, up almost 50 per cent on the €14.7 billion set aside in 2019.

NPL deal activity in the country showed initial signs of recovery in the second half of the year, as COVID-19 restrictions eased and markets reopened. This rebound saw eight deals close in the second half of 2020 worth €4.4 billion, including Project Saona, a €1.6 billion unsecured mortgage portfolio sold by Sareb (Spain's state-backed "bad bank") to distressed investor Procobro.

UK & IRELAND:
Credit risk on the rise

COVID-19 saw NPL deals in both the UK and Ireland put on hold through 2020. The UK only saw €3.6 billion in sales, less than a third of 2019 figures and the lowest level of transaction volumes since 2015, according to *Debtwire*. There was only one sale closed in Ireland in 2020, worth €1.4 billion—down from €9 billion in 2019 and €14.4 billion in 2018.

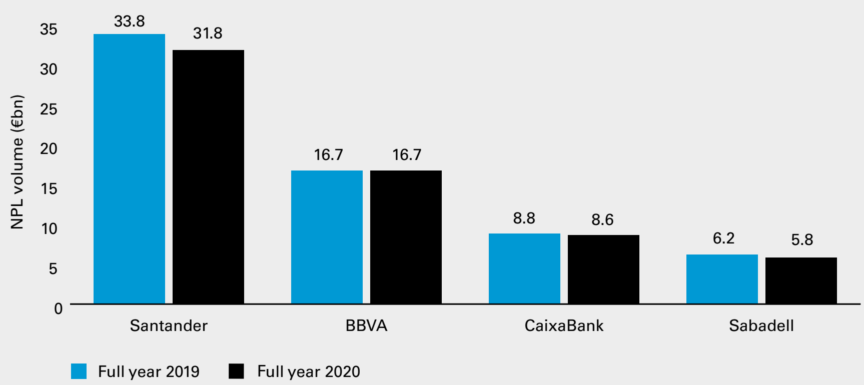
NPL activity in both jurisdictions, however, is expected to revive as the volume of NPLs on bank books starts to increase in the aftermath of the pandemic. NPL volumes in four of the UK's top banks reached €42.8 billion by the end of 2020, up from €39.4 billion the year before.

The UK market started to pick up at the end of 2020, with the largest deal of the year, Metro Bank's sale of a residential mortgage portfolio for €3.3 billion to NatWest, crossing the line in December.

€22 billion

Total provisions put aside by Santander, BBVA, Sabadell and Caixabank in Spain in 2020

NPL volume in top Spanish banks (€bn)



Source: Bank earnings reports

Top closed deals in Spain in 2020

Seller	Project name	Gross book value	Buyer	Type	Closed
Banco Santander	Atlas	€1,672 million	CPPIB	Secured—Residential	11/03/20
Sareb	Saona	€1,600 million	Procobro	Unsecured	18/12/20
Sabadell	Higgs	€600 million	Lone Star	Secured—Residential	31/12/20
Unicaja	Encina	€563 million	Cerberus	Unsecured—Consumer and SME	12/12/20
Sabadell	Aurora (CAM loans)	€550 million	KKR	Mixed Secured and Unsecured (NPL, Performing and REO)	21/12/20

Source: Debtwire NPL Database

Metro Bank, which is changing tack after acquiring peer-to-peer lending platform RateSetter, was also involved in the sale of the latter's £167 million property development portfolio to Shawbrook Bank. Natwest, meanwhile, hired advisers early in 2021 to run the sale of a £550 million distressed commercial property loan portfolio.

A 10 per cent increase in impaired loans across the UK's largest banks and a doubling of loans with significantly increased credit risk could also see NPL deal volumes increase.

Loan loss provisions at Ireland's pillar banks, meanwhile, also increased through the pandemic. DBRS Morningstar figures show that Irish banks increased their loan loss provisions more than tenfold in 2020, rising to €2.74 billion from €241 million in 2019.

In addition to a rise in anticipated deal flow from increasing NPL exposures, deals halted through lockdowns could also come back to market. Allied Irish Bank's mortgage NPL portfolio deal, meanwhile, was relaunched and sold to Apollo.

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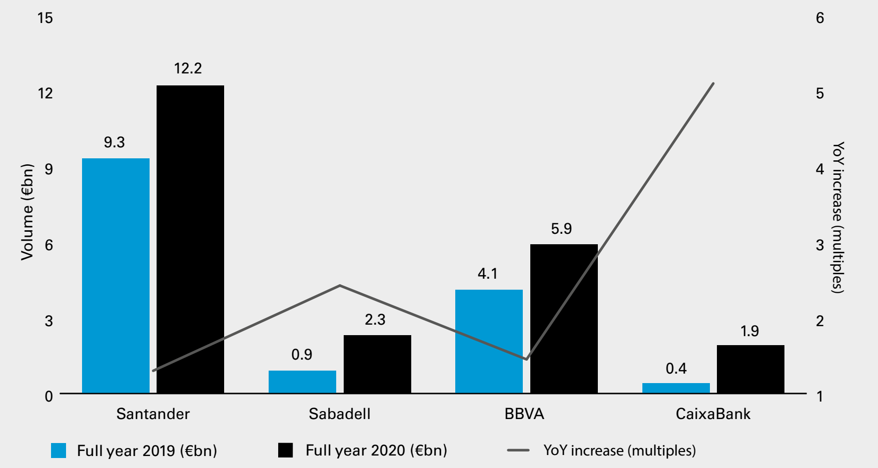
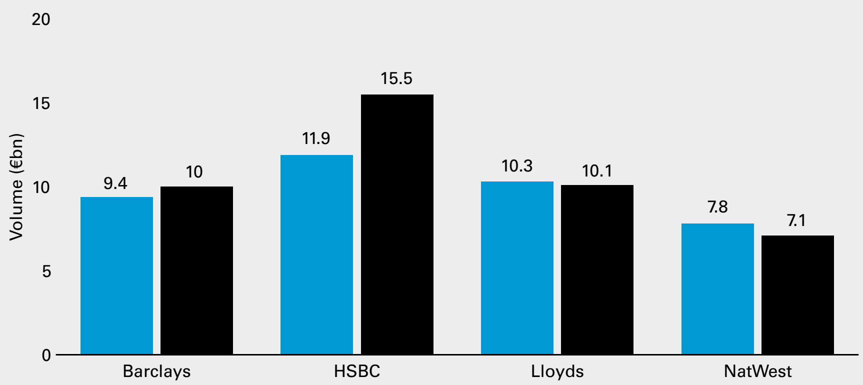
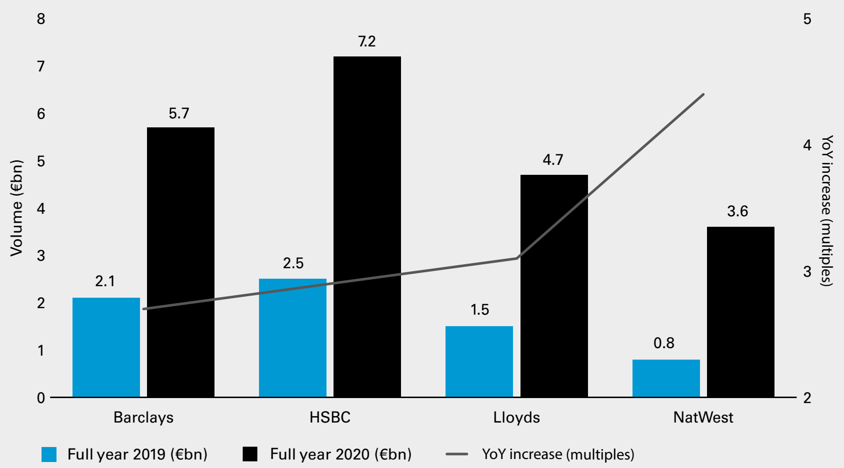
Provisions for top Spanish banks (€bn)



Impaired loan volume in top UK banks (€bn)*



Provisions for top UK banks (€bn)



*Source: Bank earnings reports - *Impaired loan volumes (Stage 3 loans) from the top four banks in the UK*

Conclusion

Where will the European NPL market go from here? A lot depends on vaccine rollouts and the end of debt relief measures. For many, that will be their first chance to assess the damage and plan ahead.

In a poll of audience members watching Fitch Ratings' Credit Outlook conference, held in January 2021, nearly 70 per cent said they expected a rise in European NPL sales in the year ahead, driven by capital management in banks holding the loans as well as non-bank financial institutions improving their handling of NPLs.

While a rise in NPLs is likely on the cards, the scale and timing of such developments remain largely unknown. Government-led relief measures have made it almost impossible to assess how some businesses have performed during the pandemic.

And as the EU's Economic Governance Support Unit pointed out in its analysis of the EU's regulatory and supervisory response to addressing NPLs, published in February 2021, the situation for lenders is not particularly transparent: "The COVID-19 crisis and the policy reactions to avert its damaging economic and social effects have exposed banks to further deterioration of their assets. Effects on banks' balance sheets are yet to be felt and quantified."

Then there are other unknowns to consider. For example, the current economic situation is not the result of a "credit crunch." The impact of COVID-19 was sudden and has lasted longer than many anticipated, but liquidity has not necessarily been an issue. Lending paused in the second quarter of 2020, as did virtually everything, but activity picked up significantly in the second half of the year. Interest rates remain low and, by and large, companies needing to address any debt repayment concerns have had the opportunity to do so.

Post-COVID-19, many businesses that were forced to close their doors for the duration will also remain viable—albeit with weakened balance sheets—and their recovery is entirely possible. Sectors hit particularly hard by the pandemic, from leisure and hospitality to airlines, are likely to struggle more than most, but even they will see recovery once the public is free to take advantage.

At the same time, consumer habits and preferences may have been changed entirely by this experience, to say nothing of people's work habits, and time will tell how this plays out. Many supply chains will also have been altered and may not return to pre-COVID-19 levels, changing the business landscape significantly.

What all of these unknowns mean for the future of NPLs is not yet clear. But the resurgent waves of COVID-19 across Europe, coupled with delays in vaccine deliveries and rollouts, suggest that European NPL volumes are likely to increase in the months ahead, as businesses are forced to make increasingly tough decisions about their future. Increases in bank provisioning certainly points to an uptick in NPL activity. As such, borrowers, lenders and investors alike will need to keep a close eye on how the story plays out once the dust begins to settle.

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