



GARRIGUES

**NPLs portfolios and REOs
deals: an update at July
2021**

LatAm & Iberia – NPLs Task Force
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July 2021

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NPLs portfolios and REOs deals: an update at July 2021

Transactions with non-performing loans (NPLs) started to take off in the second quarter of 2021, especially in Spain and Portugal. The gradual fading in continental Europe of the health impact of COVID 19, combined with the progress made in vaccinations, have allowed various “sleeping” transactions to be brought back into motion and new transactions to be closed between the first and second quarters of 2021. Meanwhile, in the global arena, there have now been numerous alerts from regulators over the deteriorating quality of financial institutions’ loan assets. The coming to an end of governmental relief or forbearance measures, combined with the heightened impact of COVID-19 on very specific business sectors, are likely to hasten the pace of NPL transactions over coming months.

Resumption of competitive processes with NPL portfolios

According to data published by the European Banking Authority, the aggregate stock of NPLs is in excess of €510.5 billion. Of this amount, 125.4 billion are held in France, making it the country with the highest NPL figure in the EU. Italy comes second, with NPLs totaling €98 billion and accounting for 5.4% of the aggregate stock of loans. **Spain** takes third place with NPLs amounting to €76.9 billion and a 3% share of the total. Followed by Greece (€62.2 billion), the Netherlands (€37.3 billion), Germany (€33.3 billion), Belgium (€16.9 billion) and **Portugal** (€13.4 billion).

In the second quarter of 2021, NPL transactions took off worldwide, following very modest levels in 2020. Although an immediate return to previous activity levels is not expected, the outlook for the third and fourth quarters of 2021 is reasonably better than the way things looked at the beginning of 2021.

Alerts from regulators concerning the quality of assets

Globally, regulators have warned of latent and very considerable risks in the non-performing assets of financial institutions. Although the NPL ratio has not increased in aggregate terms, it has risen in specific sectors such as retail, consumer spending and for the companies or industries that have been hardest hit by the restrictions (mainly hotels, airlines, manufacturing, tourism ancillary businesses, leisure and entertainment).

Impact of COVID-19 on corporate debt and new challenges for corporate debt workouts

More than a year after COVID-19 burst onto the scene, it is clearly apparent that the pandemic’s effects on the NPL market will be very different from those caused by the worldwide economic crisis related to property development, construction and associated financial products (subprime mortgages, credit default swaps, and derivatives, among others). The economic crisis caused by the pandemic has already brought important new changes to the NPL market, such as: (i) the change to the classes of debtors for non-performing loans and credit facilities; (ii) the modification of underlying assets and of personal guarantees for non-performing positions and (iii) the design, creation and implementation of different workout processes for the transferred loans.

Elsewhere, guarantee facility mechanisms provided by the governments of various countries have brought new question marks which will have an impact on transfers of NPLs, related obviously to the ability to transfer –without restrictions, subject to conditions or even without the option of transferring – the security associated with secured loans.

In the previous crisis, delinquent debtors –especially corporate debtors connected with the real estate industry– could “hibernate” and even halt their operations, which, at a specific time, made it easier to repossess the assets underlying the transferred debt in NPL portfolios. However, this time there will be a much higher number of non-performing loan and credit facility debtors than in the previous crisis, companies that have places of business operating as going concerns, workers, clients, and additional funding needs. In anticipation of the additional liquidity that the transferred debtors are going to need to return to the performing route, there are already several players in the market who are creating, or developing their direct lending platforms even further, to support an operational or financial restructuring that will enable recovery of the non-performing loan or credit facility plus an extra sum in respect of credit facilities to be used to support a turnaround.

New legislation

So, what main trends are already visible in the main LatAm, Spanish and Portuguese markets? What transactions are being performed in these jurisdictions and which have yet to come?

Garrigues is pleased to share our view of the main trends in these debt markets, drawing from our on-the-ground network of offices in Brazil, Chile, Colombia, Spain, Mexico, Peru and Portugal.

NPLs portfolios and REOs deals:
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Brazil



NPLs portfolios and REOs deals: an update at July 2021 in Brazil*

*contents created by Brazilian law firm NBF|A

1. Market update

The mood in Brazil is one of cautious optimism. One reason for this is that, after the progress made in vaccinating the population, it appears to have left the most critical phase of the health crisis behind and, from an economic angle, the country is starting to show clearer signs of recovery. Another is because the actual effects the health crisis has had on the economy, and in particular on financial debt levels, are still hard to estimate due to the calming effect of the access to deferred payment granted by both public and private banks, and also due to the government's official aid measures for the most vulnerable members of the population.

In any event, a considerable increase in debt levels may reasonably be expected over coming months, as a result of the gradual reduction in access to deferred payments and aid. Indeed, the analysts are saying that the current debt ratios do not reflect actual market conditions, and there is a clear upward trend in the short and medium term.

This scenario of increasing debt levels accompanied by clear signs of economic recovery tends to be very positive for the NPL market, because at the same time as the numbers of NPL portfolios available for sale are multiplying, expectations of improvement in the economy have the positive effect of stimulating and reactivating the market. Legislative and regulatory initiatives have also appeared on the scene (such as the reform of the Brazilian Insolvency Law and the agenda for financial modernization that is being implemented by Banco Central de Brasil) which are likely to bring greater legal certainty and innovation to this market.

This scenario has prompted expectations that maybe even in 2021, and especially in 2022, the NPL market will gain momentum in Brazil not only due to the greater number of portfolios available, but also because of the entry of new players on the scene from inside and outside Brazil, seeking to take advantage of the climate described above, which is certain to contribute to the diversification of this market which continues to be highly concentrated among the large Brazilian banks

2. Key trends

- A combination of a **rise in financial debt levels** in Brazil, and an **expectation of gradual economic recovery** will tend to strengthen the distressed deals market generally and the NPL market in particular.
- The **strong devaluation of the Brazilian currency** throughout 2020 and 2021, together with **historically low interest rates** in Brazil, favor the market for alternative investments (including NPLs), as well as the participation of foreign investors in this market.
- The **most recent legislative initiatives** (such as the reform of the Brazilian Insolvency Law) will have positive effects on the distressed assets market, by increasing companies' recovery alternatives and bringing greater legal certainty to the market.
- There is a **strong move towards digitalization in the debt collection market**, which will contribute to its sophistication and to the entry of new players with a technological profile.

- Banco Central de Brasil has been implementing an agenda for modernizing the Brazilian financial market, including implementation of open banking, with the goal of creating an **ecosystem more open to competition** and to **financial innovation**, by giving impetus to the fintech market among others and multiplying the supply of products and services.

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Chile



NPLs portfolios and REOs deals: an update at July 2021 in Chile

1. Market update

There have been no major changes in the Chilean NPL market since our [latest report](#).

On January 4, 2021, a law was published (Law no 21.299) allowing financial institutions to grant deferral credit facilities to mortgage borrowers, which are only for refinancing up to six monthly mortgage payments. The deferred loans will be secured by FOGAPE (Guarantee Fund for Small and Medium Sized Businesses) and their only purpose will be to pay the deferred installments of the mortgage loan. Those loans will not be subject to stamp tax and their interest rate will not be greater than the rate on the original mortgages concerned.

In May 2021, a syndicate of nine banks sold to a local investment fund all of their NPLs owed by Grupo Graneles, operating primarily in logistics. The deal was concluded for 40% of their nominal value, USD 290 million, namely USD 116 million.

2. Key trends

- Due to the implementation of emergency income for households in response to the pandemic, banks' **NPL portfolios are not expected to rise**. Indeed, between January and March 2021 they stayed relatively stable, only increasing by 1.55%.
- If their NPL ratio remains stable, banks will be less inclined to embark on **large-scale NPL sale programs**.
- In the opposite scenario, if inflation continues to rise, Banco Central de Chile raises interest rates and incentives for businesses and individuals are phased out, **an increase in the NPL ratio is likely**. This may also happen if, after the current health protection restrictions in response to the pandemic have been eased, unemployment remains stable or increases (currently it is 10%).

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Colombia



NPLs portfolios and REOs deals: an update at July 2021 in Colombia

1. Market update

The Colombian economy has been hit hard by the COVID-19 crisis and its impact has been seen in an increase in the NPL ratio. In 2020 the Colombian economy contracted by 6.8%, the largest fall since 1975. GDP grew in the first quarter of 2021, however.

This recovery may be affected by a number of social protests and blockades in various cities in the country to show the discontentment of several sectors of society with the steps taken by central government and local governments in relation to kick-starting the economy. Although the trigger for the demonstrations was the proposed tax reform presented by central government, which was withdrawn a few days after the protests started, other sectors joined the movement claiming various types of aid or reforms. The protests hit trading in several cities, as well as the transport of goods between different areas of the country. The central government and representatives of the demonstrators have started talks and although the number of demonstrations has declined, there have been lower-scale blockades which could affect the recovery process.

The overall economic situation, combined with the events that took place in the first half of 2021 have increased the portfolio of NPLs. Although the portfolio of past-due loans in December 2019 had been 4.3%, it reached 5.2% in 2021. The increase in the NPL ratio in the portfolio has made it necessary for banks to increase their provisions, resulting in greater numbers of NPL sale transactions being negotiated and signed.

Another significant factor for the Colombian economy was the downgrade of Colombia's rating by S&P Global Ratings in May, to BB+ with a stable outlook. Fitch changed its rating in the same way during the first week of July, leading to lose its investment grade credit rating, which is likely to raise the cost of borrowing and could increase the pressure to sell non-performing assets, including NPL portfolios.

In the second quarter of 2021, the Colombian government expanded its aid programs for the most vulnerable sectors of the population and has provided a number of government guarantee facilities to give companies access to credit. Similarly, it has been strengthening guarantee programs for corporate bond issues on the Colombian market.

2. Key trends

- **Internal specialization of teams:** teams at financial institutions have been specializing with a view to carrying out better-structured NPL sale transactions, with the aim to promote sales to international investors.
- **Increase in transactions:** several large financial institutions have been bringing loan portfolio sale processes forward, for both performing and non-performing loans.
- **Structuring:** there are signs of a clear preference for using fiduciary arrangements for servicing and purchasing loan portfolios.

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Spain



NPLs portfolios and REOs deals: an update at July 2021 in Spain

1. Market update

In line with reports by a few credit rating agencies in 2020, the European Commission and the European Central Bank, in their new surveillance report on the Spanish financial industry, said that a deterioration in asset quality at financial institutions is “likely” after the relief measures for the COVID-19 health crisis have been phased out. More specifically, the two institutions consider that “Spanish banks continue to have some of the lowest capital ratios in the European Union” and that “The bulk of these loan moratoria will expire in May and June 2021. While no significant cliff-edge effects are expected when moratoria expire, a more marked deterioration in asset quality is likely to emerge in 2022”.

In its latest Financial Stability Review ([Financial Stability Review](#) May 2021), the European Central Bank reported that in 2020 the aggregate NPL ratio for euro area reached its lowest level (2.7%), although the normalization may prove temporary because indicators of deteriorating asset quality are starting to appear, particularly in countries where lengthy and costly insolvency processes inhibit loan enforcement (Spain, however, has a good position in the classification of these countries, due to having better ratios than Portugal, Cyprus, Greece, Italy or Slovakia in terms of the lengths and costs of insolvency processes).

Activity is gradually recovering in the Spanish NPL portfolio market and there are already a number of projects launched in 2020 which have continued into the second quarter of 2021: Cacao (seller: Unicaja), Wave-Zenith (seller: Chenavari) and MoMa (seller: Caixabank). Banco Sabadell eventually completed the Higgs project in 2021 (purchaser: Lone Star). Banco Santander has continued to be one of the most active players in the NPL portfolio market in the second half of 2021, with its Talos and Sun projects.

2. Key trends

2.1 European directive on credit services and credit purchasers

Confirmation was given on June 28, 2021 to the provisional agreement reached between the Presidency of the European Council and the European Parliament: on the new directive harmonizing rules for credit servicers and credit purchasers of non-performing loans issued by credit institutions. According to the [press release](#) issued by the Council, the directive is expected to be adopted after legal-linguistic revision.

After it has been signed and published in the Official Journal, the directive will have to be transposed into national law within 24 months.

As we reported in our [previous newsletter](#) it now seems that finally in 2021 the wording of the directive on credit servicers and credit purchasers will be revealed, after the first versions appeared in 2018. Although the final wording is not yet known, it has been advanced that the main matters that the Council and the Parliament have discussed were the “fair and diligent” treatment that should be received by the borrowers and the nature (indicative or imperative, it is not yet known) of the “restructuring measures” for the transferred loan as a prior step before triggering enforcement proceeding against the transferred debtor.

Until the final wording of the directive is known, there are a number of other important unknown factors (i) how many notifications the transferred debtors should receive and what contents they will have, (ii) whether the directive will introduce additional guarantees for the transferred debtors that will impact the workout of non-performing loans or (iii) the guidance in the directive on transfers of loans secured with the debtor's principal residence.

2.2 Servicers do not have to be registered with the Bank of Spain

The Real Estate Loan Contracts Law (LCCI) required real estate lenders and real estate loan intermediaries in Spain to be registered with the Bank of Spain. The LCCI contained a few ambiguities that set alarm bells ringing for players in the NPL market. In particular, they caused unease in the debt servicing industry over the potential regulatory risk if they were required to apply for their registration (separate from that specified in the European directive being produced).

On May 27, 2021, the Treasury General Secretary, in reply to a prior request from the main Spanish servicers advised by Garrigues, clarified that the role of servicer does not fall within the categories of lender or loan intermediary, therefore they do not have to be entered on the registers held by the Bank of Spain.

Further information [here](#).

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Mexico



NPLs portfolios and REOs deals: an update at July 2021 in Mexico

1. Market update

According to information reported by the National Securities and Banking Commission, in March 2021 the NPL ratio for the aggregate portfolio of all banks was 2.57%, 0.25% higher than in March 2020. The adjusted non-performing loans ratio ("IMORA", which includes defaults by individuals, the portfolio of past-due loans and the reduced amounts of payments on loans) was 5.32%, 0.75% higher than the level recorded a year earlier before the pandemic started. At the end of May 2021, IMOR was 2.52% (0.11 percentage points above the level in May 2020) and IMORA was 5.33% (0.62 percentage points higher than in 2020).

The figures reported by the National Securities and Banking Commission show that the segments that have the highest NPL ratios in the aggregate portfolio of past-due loans are credit cards, personal loans and payday loans.

Analysts and participants estimate that the non-performing financial loan ratios of banking customers will return to their traditional levels, after the increase caused by the pandemic. Moreover, the increase in IMOR is believed to be lower than in earlier crises. This may be due to a number of factors, including: (i) the fall in demand for lending caused by the pandemic; (ii) the contraction in the provision of credit and (iii) the measures made available by the Mexican financial authorities and banks in relation to personal loans and to small and medium sized businesses, such as extending due dates for the payment of loans and write-offs or reductions.

A few analysts believe, however, that the effects of the pandemic are not over yet, and therefore, default ratios may rise over the coming months. Also, the results of the restructuring arrangements and extensions granted to banking customers remain to be seen.

2. Key trends

- A **constant stream of non-performing loan sale transactions** has been observed, which will probably be maintained over the remainder of 2021.
- The industry continues to embrace change with the creation of **digital platforms for online auctions of non-performing loan portfolios** in competitive processes and in a range of formats. Various participants have taken an interest in the development of those platforms and new options are expected in the near future which will be added those already in the market.
- Mexico continues **to be in the sights of the main players in** the NPL industry, which remain active.

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Peru



NPLs portfolios and REOs deals: an update at July 2021 in Peru

1. Market update

As in all emerging countries and especially those in the region, the COVID-19 pandemic has The timely measures adopted by the Peruvian authorities in response to the COVID-19 outbreak in an effort to contain the effects of the contraction of the economy appear to have made sure that banks were prepared to support consumers and corporate borrowers.

This was confirmed by [Moody's](#) in March 2021, when it changed the outlook for the Peruvian banking system from negative to stable, reflecting its opinion that the expected rebound in GDP growth and the broad packages of support measures would help the quality of assets of Peruvian and drive profitability. The improved outlook for these institutions is based also on their high reserves, the recovery of profitability and their capital levels.

Similarly, and even though the NPL ratio at these financial institutions has increased by 82 basis points in the portfolio of past-due loans, reaching 3.43% in January 2021 (with respect to the same period for 2020), Moody's considers that financial institutions' reserves place them in a better position in relation to preventing an impairment of their assets for the remaining part of 2021 and 2022.

An important piece of news in this new period is the Peruvian government's new program: Capital Strengthening at Institutions that Specialize in Microfinance. The goal is to protect people's savings, preserve macroeconomic stability and maintain the payment chain by strengthening capital or performing corporate reorganizations at the companies in the financial system that specialize in microfinance.

The program was added to a number of other government programs such as Reactiva Perú, FAE-MYPE and the Business Support Program for Small and Medium Sized Businesses (PAE-MYPE), which have been geared towards avoiding an interruption in the payment chain by providing working capital loans, to small and medium sized businesses, mainly.

Although loans (financial and non-financial) with a high default risk continue to exist, loan portfolios continue to be one of the major sources of liquidity.

2. Key trends

- **Securitization structures:** public and private offerings of securitized debt have become a an alternative source of funding in the Peruvian market. The transfer of receivables and the income flows arising from them without recourse to local funds held in trust is often analyzed, to seek the most tax-efficient arrangements for the originator's business model.
- **Sales of loan portfolios:** foreign banks, mainly, are seeking to structure purchases of collection rights or invoices of local entities, by signing sale and purchase documents subject to foreign laws. The set of documents subject to foreign laws is more sophisticated and implies that transactions are structured to include the final debtor's risks or risks of the person acting as customer in the contractual relationship.
- **Businesses with customers using microfinance services:** an interesting point to consider is that securitization processes are currently being encouraged in which the debtors of the

transferred receivables are individuals or companies which are usually served by local microfinance companies, meaning that the non-performing loan risk could be greater.

- **Variety of companies involved in lending transactions:** another interesting new feature is the entry of entities from the public service sector in the market for financing with collection rights. These entities have been transferring income flows or collection rights in a specific portfolio to obtain immediate liquidity.

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Portugal



NPLs portfolios and REOs deals: an update at July 2021 in Portugal

1. Market update

After a lukewarm start to the second quarter of 2021, in which a large hotel portfolio garnered the attention of the key players active in the Portuguese market, the markets picked up in June, when several sale processes were initiated by Portugal's largest banks. As expected, the secondary market has also been active, mostly with sales of single-name positions that had been previously acquired by investors in the NPL transactions which closed in 2018/2019.

As of April 1, 2021, the forbearance regime approved by the Portuguese government in March 2020 in response to the COVID-19 pandemic ceased to be applicable to interest payments, but will still cover principal payments until September 30, 2021. Although there has been some activity from Parliament to approve a new extension, that extension is only expected to be effective if it is in line with the guidelines and recommendations of the European Banking Authority.

The Portuguese government has announced that it will approve new measures to support the hardest hit economic sectors, in particular hospitality/tourism, cultural activities and retail. These measures are expected to come in the form of (i) direct equity/quasi-equity investment by government or public entities or (ii) state guarantees for restructured loans in which banks accept to give an additional forbearance period to the borrower and to extend the maturity dates/repayment schedules. These measures may provide additional relief to entities operating in these sectors, thereby having the effect of reducing NPL ratios on the balance sheets of banks in the last quarter of 2021 and first semester of 2022 (or at least keeping them under control).

2. Key trends

- **Uncertainty:** uncertainty surrounding the impact of the end of the forbearance regime and its possible extension is playing an important role in how players are perceiving the market going forward. This issue has additional importance for investors from the standpoint that certain portfolios may include restructured loans subject to the forbearance regime and therefore have an impact on their pricing models.
- **Workout strategies:** government COVID-19 pandemic relief measures have also had a significant impact on the NPL portfolio workout strategies in place, especially because the measures involved the suspension of time periods for parties to carry out certain steps in judicial enforcement proceedings and, as a result, had the effect of lengthening the collection periods originally foreseen by investors. The majority of these restrictions have now been lifted as of April 2021, although the judicial sale and eviction of properties that are household residences (casa de morada de família) are still suspended, thereby impacting the workout of residential NPL portfolios.
- **Mid-size portfolios:** the general expectation in the market is that, with some exceptions, the aggregate UPB of the NPL portfolios to be placed in the market by Portuguese banks will not reach the levels of Project Atlantic (CGD), Project Nata I or Nata II (Novo Banco), in 2018 and 2019, but rather focusing on the mid-size portfolios on the market, ranging from €100Mn to €300Mn. This was already a trend that we witnessed in 2020.

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