1. Trends in the European non-performing loan market

1.1 Increasing range of active jurisdictions
The European market for loan portfolio transactions continues to be very active, with 2015 seeing over €100 billion in completed loan disposals across Europe. The United Kingdom and Ireland have led the way with the highest value transactions, such as the sale of UK Asset Resolution’s £13 billion Project Granite and Lloyds Banking Group’s sale of the €4.2 billion Project Poseidon in Ireland.

Other key jurisdictions include Spain, the Netherlands, Germany and Italy, but with highly competitive auction processes in all of these jurisdictions driving up pricing, buyers are looking to an increasing range of opportunities in less familiar jurisdictions, in particular in central and eastern Europe.

1.2 Diverse assets and structures
While loans secured on commercial real estate still form the major part of the European non-performing loan market, portfolio transactions are diverse in range, and can include secured and unsecured consumer or individual borrower loan assets, loans secured on shipping or aviation or other assets, and corporate borrower loans. Portfolios often include far more than just the core loan assets, with transactions that include hedging positions, real estate owned properties, litigation claims, current account overdrafts, agency roles, letters of credit, minority and controlling equity positions, unfunded commitments and employees.

Moving into 2016, a key trend has been the increased number of share transactions where sellers are seeking to sell an entire corporate group structure, containing loan assets and underlying real estate and other assets where security has already been enforced, together with asset management and other employees, an example being the auction of Propertize BV by the government of the Netherlands.

There are also a limited number of secondary portfolio sales in the European market, akin to private equity secondary buyouts, where an investor has acquired portfolios over time and combined loans from different portfolios into a new portfolio, which is then sold in a secondary transaction to a new buyer.

1.3 Continuing buy-side demand and pressure to sell
Buy-side demand and sell-side pressure are expected to lead to a very active loan portfolio market throughout 2016 and beyond. On the sell-side the bad banks and
other state-supported entities are planning continued asset sales and wind-down processes. Changing regulatory and economic circumstances, in particular regulatory capital requirements, mean that European banks and other financial institutions will continue to dispose of non-core assets as they focus on new strategies and priorities. On the buy-side, an increased range of investors are competing in the portfolio auction processes, made up of private equity and special situation funds, investment arms of insurance companies, investment banks with special situation groups and smaller local market participants, all of whom have significant amounts of capital to invest.

While non-performing loan portfolio transactions are increasingly varied in structure, jurisdiction and the nature of the portfolios being sold, the market for loan portfolio transactions has evolved since the financial crisis in such a way that there are certain typical transaction processes and key issues that arise on most deals. These key features and issues are assessed below, together with a consideration of the new themes and issues that are arising as the structure of deals, asset classes, financing and jurisdictions involved continue to broaden.

2. Transaction structure

2.1 Bad banks and private sales
State-sponsored bad banks have been set up in several European countries over the past five years as a key strategy in resolving the issue of non-performing loans on European bank balance sheets. The non-performing loans are transferred to the bad banks and are subsequently being disposed of by the bad banks to private buyers in accordance with the wind-down mandate for each bad bank. Particularly active bad banks have included UKAR in the United Kingdom, NAMA in Ireland and SAREB in Spain. Other bad banks have been established more recently, such as HETA in Austria, and are becoming more active, with HETA expected to push on with the disposal of assets in Slovenia, Hungary, Croatia, Bulgaria and other central and eastern European countries.

Where non-performing loans have not first been transferred to a bad bank, they are typically sold by the relevant originating bank directly to private buyers.

2.2 Basic structure
The seller of a non-performing loan portfolio will typically want an outright sale of the loan assets by means of legal assignment and assumption of liabilities. An outright sale is not always possible though, for example due to borrower consent requirements in the underlying loan documentation, or regulatory issues in a particular jurisdiction, and alternative structures are sometimes used. Alternatives include the use of participation agreements that should remove the need to obtain borrower consents, although these are unpopular with buyers if they are required for longer than an interim period before a subsequent elevation, due to the indirect exercise of voting and other rights in a participation structure. A hive-down of the relevant assets to a special purpose vehicle and subsequent share sale may be an option not requiring borrower consent, but change of control issues will still need to
be considered. Less frequently, other options are seen, including total return swaps and declarations of trust. With all structures, the tax and regulatory implications will need to be carefully considered by both the seller and buyer.

2.3 Bidco structuring
The bidco entity will usually be a special purpose vehicle, established in a jurisdiction that is tax-efficient for the buyer, taking into account the assets in the portfolio and its upper tier structure, and the necessary governance, financing and regulatory requirements for the transaction. In many cases several special purpose vehicle holding companies will be established, either as part of the buyer’s group or as part of an orphan structure. Key tax considerations in the structuring process will include any potential withholding tax on interest payments to the buyer and possible transfer taxes related to the transfer of security or assets.

Another possibility is the use of a securitisation structure to take advantage of particular regulatory requirements or hurdles. In Italy, for example, the government announced a state guarantee in February 2016 in respect of securitised non-performing loans, with the objective being to assist the removal of non-performing loans from the balance sheets of Italian banks. The government guarantee will apply in respect of the senior notes issued by the securitisation special purpose vehicle. Under a securitisation structure, the non-performing loans would be transferred to a securitisation special purpose vehicle in the relevant jurisdiction. The special purpose vehicle would fund the purchase of the portfolio through the issue of different classes of notes with a different seniority ranking to investors in the securitisation. The cash-flow generated by the non-performing loans is collected by a servicer, on behalf of the special purpose vehicle, and applied to the payment of interest and principal on the notes, as well as the running costs of the special purpose vehicle, in accordance with their terms.

In certain jurisdictions, notably Spain, there are a growing number of large portfolios that contain real estate that is already owned by the seller (real estate owned properties), which have been acquired through the enforcement of security. Each real estate owned property is typically held by a special purpose vehicle (REOCo). Portfolios including real estate-owned properties usually transfer them directly as an asset transfer to the buyer, using separate asset transfer agreements, in addition to the main sale and purchase agreement, to effect the transfer of the real estate-owned properties in each applicable jurisdiction. Note that in certain jurisdictions it may be advantageous for transfer tax or other reasons to transfer the shares in the REOCo itself, rather than make an asset transfer of the real estate-owned property.

2.4 Regulatory issues
In structuring a bid for a non-performing loan portfolio, a buyer will need to consider the regulatory regime applicable to the jurisdiction, the nature of the loans and any underlying assets on which the loans are secured. Certain jurisdictions may require the holder of legal title to the loans to have a licence in order to carry out lending activities. What constitutes lending activities may be interpreted broadly in
a particular jurisdiction to include not just making an advance under a loan facility, but also the restructuring of a loan or acquisition of a loan.

If the portfolio contains consumer loans or regulated mortgages, additional authorisations will almost certainly be required, and the entity that is to hold legal title to the acquired loans will be required to hold the relevant authorisations. Where the buyer is part of a banking group, the holder of legal title for such loans will often be a regulated banking entity within that group. For a buyer that is not part of a banking group or has not teamed up with a bank as a co-investor, the third-party servicer that will be servicing the portfolio from closing will typically have the necessary authorisations and will be able to hold legal title to the regulated mortgages instead of the buyer. The receivables from the loans will then be transferred to the buyer on a rolling basis to reflect the desired economics of the transaction.

Data protection, bank secrecy and confidentiality rules concerning the disclosure of customer information also need to be considered, as this may prevent the transfer to a purchaser of key information about the loans or underlying borrowers prior to completion, which in turn may cause issues for the buyer’s know-your-customer process. However, in many situations there are exemptions to such requirements due to the need to be able to transfer non-performing loan portfolios. In all cases, the scope of the regulatory regime that applies for a particular portfolio transaction should be identified and considered by both the seller and buyer early on in the sale process.

With appropriate structuring, it may be possible for a buyer to team up with a third-party servicer or co-investor in order to meet the relevant regulatory requirements and to ensure it is able to give comfort to the seller on the regulatory compliance matters, which will be one of the priorities for a seller considering opposing bids in an auction process.

3. Due diligence

3.1 Diligence process
In highly competitive non-performing loan auctions, due diligence often remains a buyer’s primary source of comfort with respect to the assets that are being acquired, as sellers typically give very limited contractual protections to the buyer in the sale and purchase agreement (see under heading 4 below for a detailed discussion of terms and conditions in the sale and purchase agreement). The results of the due diligence process are crucial in allowing bidders to determine their pricing assumptions, and will also be very important in the buyer’s structuring of the transaction.

The seller will customarily provide a data tape setting out key information about the loans in the portfolio at a given date (usually the effective date for the economic transfer of the portfolio to the buyer). Key data points will include the amounts outstanding, interest rates, maturity dates and undrawn commitments. The data tape will be the key piece of information used by bidders in determining its bid purchase price. As a result, contractual protections in the form of robust warranties with
respect to the data tape information should be included in the sale and purchase agreement.

Vendor due diligence reports vary in usefulness and scope, and indeed are not even always provided other than in the form of a basic information memorandum. Where full legal vendor due diligence reports are provided, they may be too narrow in scope or subject to low caps on liability to give significant comfort to the buyer. As a result, detailed due diligence by the buyer remains the key due diligence work-stream.

The scope and extent of due diligence carried out by a buyer and its advisers will be driven by:

- the buyer's risk appetite, taking into account the overall level of comfort with the transaction and the seller;
- cost sensitivities;
- attractiveness of the portfolio to a particular buyer and whether they believe they have a good chance of winning the auction;
- the extent and quality of vendor due diligence;
- transaction structure;
- the degree of contractual protections proposed in the seller's draft sale and purchase agreement.

In all cases, the buyer will likely want to ensure it carries out efficient and targeted diligence at an early stage, in order to enable it to determine its appetite with respect to the portfolio and whether its proposed strategies for working out the portfolio post-closing are viable.

Where multiple jurisdictions are involved, it is essential for the buyer's main transaction counsel to take a lead coordinating role, seamlessly integrating advice from leading local counsel in the relevant jurisdictions.

As well as legal due diligence, a buyer will carry out detailed financial and asset-level due diligence, often with external financial advisers and sector specialists, although certain buyers have existing in-house underwriting teams that carry out a large part of this financial and asset diligence work-stream.

3.2 Scope and common red flags to resolve
The scope of due diligence will vary depending on the specific nature of the loans and/or the underlying assets in the portfolio. Set out below are some of the key diligence points and common issues that may arise.

(a) Real estate assets
In respect of real estate assets, due diligence will require:

- a review of title and mortgage status;
- public register searches;
- third-party valuations;
- flagging of cross-collateralisation or cross-guarantees within borrower/obligor groups; and
- a sample review where standard-form documentation is used.
Common issues include:
- security over only a part of a property and/or defects in leasehold title which limit use and therefore value of a property;
- incorrectly executed and/or registered security;
- waiver of some or all enforcement rights;
- inter-creditor arrangements containing gaps so that ranking is not clear or not consistent; and
- missing original documentation.

(b) Shipping/aviation assets
With shipping and aviation assets, due diligence will include:
- physical inspection of the vessel/aeroplane;
- third-party valuations;
- an insurance review; and
- an understanding of corporate holding structures and security.
Common issues include:
- the borrower and vessel jurisdictions and the jurisdiction of operations, which may raise particular issues (such as anti-bribery and corruption and/or sanction issues in certain jurisdictions);
- incorrectly executed and/or registered security;
- waiver of some or all enforcement rights;
- inter-creditor arrangements containing gaps so that ranking not clear or not consistent; and
- missing original documentation.

(c) Consumer/regulated loans
With consumer and other regulated loans, due diligence should encompass:
- confirming relevant documentation exists;
- reviewing standard forms and samples of loan documentation; and
- reviewing compliance practices.
Common issues include:
- evidence of breach of consumer laws or rules which may make the loan unenforceable;
- origination and/or mis-selling issues; and
- where there are issues, understanding the status of discussions with the regulator and the steps required to remedy the situation.

(d) Current account overdrafts
Where borrowers hold current accounts with a selling bank, the outstanding balance will often be turned into a term loan by the seller prior to completion, and the interest in that loan transferred to the buyer. A buyer may want to discuss the impact of the removal of an overdraft facility with the relevant borrower as well as the seller, as it may have a negative impact on the borrower's business that is not helpful for the borrower or buyer.
(e) **Set-off and cross-collateral**
In a situation where security for a loan is transferred, but other facilities or interests are retained by a seller, this may complicate steps to work out the relevant connection, as there will likely be conflicting interests between the seller and buyer. In addition, where a seller intends to retain certain facilities that are secured by the same assets as the main loan being sold to a buyer, inter-creditor issues will arise that are unlikely to be provided for in existing documentation.

(f) **Unfunded commitments**
Unfunded commitments raise increased potential problems for the buyer of a non-performing loans portfolio. In particular, it is more likely that the buyer will need a banking licence to hold and fund the commitment.

(g) **Hedging**
In many non-performing loan portfolios, certain loans may be hedged by an interest rate and/or currency swap. In such cases, the seller will typically want to transfer the swap as part of the overall portfolio. The swap counterparty's consent will usually be necessary in order to enable an outright transfer of the hedging transaction, and so pass-through swap confirmations are usually used to transfer the economic risk and reward of the swap prior to an outright transfer of the hedging transaction.

A buyer will need to consider the regulatory requirements of acquiring and being party to a swap, in particular under the European Market Infrastructure Regulation. This requires swap counterparties periodically to reconcile their positions under the swap documentation, and to set out specified dispute-resolution procedures should any disputes arise from such reconciliation processes. The swap counterparties will also be required to report specified data in respect of the transaction to a trade depositary, either directly or through a delegate.

(h) **Secured loans**
If any of the loans in a portfolio are secured, key issues to confirm are whether the security has been effectively created over the whole of the relevant asset, whether the security has the correct ranking with relevant inter-creditor provisions, how the security will be transferred to the buyer, and whether and how the security is enforceable. The answer to these questions will be vital in helping the buyer determine whether its investment strategy is viable.

A frequent issue in non-performing loan transactions relating to secured loans is missing original documentation. The consequences of this vary by jurisdiction – in England for example copy documents should be sufficient, but in Germany an absence of original documents may hinder a buyer’s ability to enforce certain types of security.

Where security documents have not been registered correctly, it may be void against certain persons. For example in England with respect to a mortgage granted by a corporate borrower, although this may be registered at the Land Registry, if it has not been registered at Companies House within the applicable time period, while the loan remains enforceable against the borrower entity, the security will be void against an administrator, liquidator or other creditor.
The nature of the secured assets and the relevant jurisdiction will determine the technical steps to transfer the security to the buyer. If the security is held by a security agent or trustee, the transfer will need to comply with the express mechanics in the relevant documents for the benefit of the security to transfer to the buyer. If the role of security agent or trustee is held by the seller and will transfer to the buyer, then the direct security rights will need to be transferred to the new buyer and technical steps taken to perfect that transfer. The transfer of direct security rights may be relatively expensive and require new registrations or the taking of new security. The latter may require borrower consent, and may also trigger insolvency hardening periods.

Where a non-performing loan portfolio contains secured loans, a buyer will need to understand the options available to it for enforcement, so that it can determine its optimal strategy with respect to working out the portfolio. Security enforcement ranges from relatively complicated court proceedings or public auctions, through to a private sale or straightforward transfer of the secured asset.

(i) Active restructurings/insolvency proceedings

Where a borrower is in an active restructuring or settlement discussions with the seller in the period prior to closing, it is essential for the buyer to understand the status of the negotiations taking place, and any initial agreements reached or term sheets signed in respect of a restructuring. Typically a sale and purchase agreement will include express provisions relating to active negotiations and restructurings that will bind the buyer into a particular course of action with the borrower following closing.

It is also essential to understand whether any borrowers in the portfolio are insolvent and whether any insolvency proceedings have been commenced or threatened in the relevant jurisdiction, as this can directly affect the enforcement rights of the buyer. In Spain, for example, where a borrower becomes insolvent, a court-appointed Receiver is required to obtain a valuation of the underlying real estate held by the borrower, and the outstanding loan is then revised to the applicable fair value based on the new valuation.

4. The auction

The majority of non-performing loan portfolios are sold through a competitive auction process, similar in style to those used in private mergers and acquisitions auction transactions.

The start of the auction will see the seller and/or its financial adviser approaching potential bidders and inviting them to participate in the first phase of the auction on the basis set out in an initial process letter and subject to the potential bidder first entering into a non-disclosure agreement with the seller. Bidders agreeing to take part and who have entered into the required non-disclosure agreement will be provided with basic information on the portfolio, usually in the form of an information memorandum. The bidders are invited to submit non-binding indications of interest based on the information disclosed to them in that first phase.

Several bidders will typically then progress to a second phase, the formalities for
which will be set out in a second phase process letter, and during which they may be
provided with a vendor due diligence report, but in any case will be provided with
access to a virtual data room in which more detailed information on the portfolio
and the underlying assets will be available, typically covering the following areas:

- relevant underlying loan documentation;
- communications with/from borrowers and/or regulators;
- other material information relating to the portfolio;
- a form of sale and purchase agreement for the acquisition of the portfolio;
- a pricing template with certain inbuilt assumptions for use in calculating the
  second round bid.

The bidders carry out a detailed diligence process during this second phase (see the
due diligence section above for more information on the diligence process) and
produce a mark-up of the sale and purchase agreement and possibly related transaction
agreements to submit with their binding second phase bid (see the section on the
acquisition agreements below for an overview of the key terms in these agreements).
In certain well run auctions the sellers will seek an interim mark-up of the acquisition
agreements from the bidders prior to submission of the binding bids, and will give
feedback on these initial mark-ups in advance of the phase two bid date, in order that
the mark-ups are as advanced as far as possible at the point the bids are made.

The seller and its financial adviser will take numerous factors into account in
assessing the competing bids including:

- compliance with the structure and terms of the proposed transaction set out
  in the process letters;
- completion certainty;
- the identity of the bidder, their co-investors and third-party servicers (if
  applicable), and their reputation and experience in acquiring and working
  out previous portfolios;
- the proposed purchase price and mark-up of the transaction documents;
- the source of financing/commitments in respect of the bid;
- the ability and/or willingness of the bidder to become lenders of record under
  the terms of the loans included in the portfolio, to take on agency roles
  related to the loans in the portfolio, and to acquire hedging transactions
  related to the loans in the portfolio; and
- any other assumptions on which the bid is based.

The third and final phase of the auction sees the seller seeking to negotiate and
exchange contracts with a preferred bidder as quickly as possible, while keeping in
touch with the other bidders in case a deal with the preferred bidder is not reached.
In this phase the sale and purchase agreement, all related transaction agreements
and, in certain transactions, detailed transfer procedures in respect of the loans, are
all negotiated and agreed. Where there may be a significant time-period prior to
signing or conditions to signing, the seller and preferred bidder will often enter into
exclusivity arrangements to give themselves time to negotiate and commit resources
to the execution of the transaction.
While transactions vary greatly depending on the specifics of the portfolio, transaction and seller, a typical timetable for an auction might be as follows:

<table>
<thead>
<tr>
<th>Step</th>
<th>Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invitations to potential bidders to participate in first phase, and entering into a non-disclosure agreement</td>
<td>Between one and four weeks</td>
</tr>
<tr>
<td>First phase of auction process: initial due diligence and submission of non-binding indications of interest</td>
<td>Between two and six weeks</td>
</tr>
<tr>
<td>Second phase of auction process: detailed due diligence, mark-ups of transaction documents, meetings with seller/management teams and submission of binding bid</td>
<td>Between four and 10 weeks</td>
</tr>
<tr>
<td>Final phase of auction process: selection of preferred bidder, possible period of exclusivity, negotiation of final form transaction documents and signing of sale and purchase agreement</td>
<td>Between one and four weeks</td>
</tr>
<tr>
<td>Completion of transaction following satisfaction of conditions precedent</td>
<td>Between one and 12 weeks</td>
</tr>
<tr>
<td>Elevation of assets (if applicable) following satisfaction of transfer requirements</td>
<td>Between two and 12 weeks</td>
</tr>
</tbody>
</table>

5. **The sale and purchase agreement**

The main agreement setting out the terms and conditions for the acquisition of the portfolio will be a sale and purchase agreement. Some or all of the following ancillary agreements, depending on the nature of the portfolio, the assets contained in it, the time frame and structure for the transaction and the parties involved, may also be used to implement the transaction:

- funded or risk participation agreements;
- pass-through swap confirmations;
- hedging transaction transfer agreements;
- forms of transfer instruments to transfer legal title; and
- transitional services agreements, in particular where the migration of consumer loan portfolios will take place following completion.

The following key provisions will typically be covered in the sale and purchase agreement.
5.1 Effective date for transfer of economic risk/reward
The sale and purchase agreement is typically structured with the economic risk and
reward transferring to the buyer on a pricing date in advance of signing, similar to
the effective date in a ‘locked-box’ sale and purchase agreement.

5.2 Conditions
Regulatory conditions, in particular antitrust conditions, may be required,
depending on the assets being acquired or where the bidder entity is a formal joint
venture between bidders.

5.3 Interim covenants
Interim covenants are particularly important where there are ongoing live
restructurings or negotiations with borrowers or where a portfolio is already in an
ongoing wind-down plan. The bidder will want as much influence as possible over
the operation of the business and in particular live restructurings and negotiations
with material borrowers, while the seller will want to maintain limits on the freedom
of the bidder in such a scenario, often due to the seller’s concerns about its
reputation with its customer and in case the transaction fails to complete.

5.4 Transfer procedures and participations
The seller and buyer will need to consider both the specific steps needed to transfer
each debt, equity or hedge asset and any relevant security in the portfolio. Such steps
and additional instruments are typically set out in a detailed transfer procedures
document. Where third-party consents or notifications are required to allow the
transfer of full legal title, participations are frequently used so as not to delay
completion, with elevation to full legal title at a later date once the relevant consent
has been obtained or the notice period has expired.

5.5 Warranties and limitations on liabilities
Auction processes are typically extremely competitive and, due to the distressed
nature of the portfolios and/or the status of the seller entity, often being a bad bank,
the warranties provided are usually very limited in scope (frequently being pared back
from the Loan Market Association distressed trade warranties) and are subject to
relatively seller-friendly private mergers and acquisitions style limitations of liability.

Key warranties include:
- clean ownership/title;
- the accuracy of the most important line items in the data tape provided to
  the buyer, which forms the initial basis for pricing the portfolio;
- the provision and accuracy of information contained in the virtual data
  room;
- that there are no litigation proceedings ongoing or threatened that might
  affect the loan assets; and
- that there are no funding obligations, no bad acts, no connected parties, no
  impairment and no default in each case in respect of the loan assets, other
  than as disclosed to the buyer.
Key elements of the limitations on seller liability include:

- a relatively short time period in which to bring claims against the seller – typically between 12 and 18 months from signing or closing;
- a customary minimum threshold and aggregate or basket threshold;
- a maximum cap on liability, with a relatively low maximum cap for non-fundamental warranties of between 10% and 30% of the purchase price, and for fundamental warranties (the scope of which will be heavily negotiated but should include ownership/title warranties) a maximum cap of 100% of the purchase price;
- customary limitations relating to a buyer's recovery from insurance, requiring a buyer to mitigate any loss suffered and placing the risk of matters arising after signing on the buyer;
- a take-back right for the seller, whereby the seller has the right to take back an asset from the portfolio and return the purchase price for that asset instead of resisting or paying out under a claim in respect of that asset (if applicable); and
- a relatively broad limitation for buyer knowledge and disclosed information, which the seller will seek, to include the knowledge of the buyer's advisers and also the findings of searches that a prudent buyer should have sought and undertaken (all of which a buyer will strongly resist).

5.6 Indemnities

It is typical for the seller to indemnify the buyer in respect of excluded liabilities – principally covering liabilities of the seller with respect to acts or omissions of the seller before the pricing date – and for the buyer to indemnify the seller in respect of the liabilities relating to the assets that it assumes under the sale and purchase agreement. Additional specific indemnities may be negotiated, such as transfer of undertakings (TUPE) indemnities, environmental indemnities and indemnities relating to specific regulatory investigations or litigation, which will be based on the specific red flags raised through the due diligence of the portfolio.

5.7 Further assurance provisions

A general further assurance clause to give the buyer the benefit of the terms and conditions of the sale and purchase agreement will be included, but this should be supplemented by specific post-completion undertakings where there are practical issues to resolve that have not been dealt with as pre-completion conditions or undertakings. A frequent issue in non-performing loan transactions is that of missing original documents that relate to assets in the portfolio, which could cause issues enforcing security on the asset (see the section above on issues related to security). Where relevant, the bidder should seek undertakings from the seller to search for any such missing original documents and to assist the bidder in obtaining replacement originals and/or taking other steps to rectify any issues resulting from the missing original documents to ensure that the security is fully enforceable.
5.8 Transitional arrangements and notices to borrowers

A particular issue with portfolios in respect of which there are consumer or individual borrowers is the process to migrate the borrowers at or following completion, together with transitional arrangements between the seller and buyer if migration takes place after completion. Customary ‘hello and goodbye’ letters will be used to inform the borrowers of the transfer that is taking place, together with any formal notices of assignment that are required to perfect the transfer of legal title. Examples of post-completion transitional services that may be required include:

- collection of payments;
- cash management and account maintenance;
- handling and responding to customer queries;
- implementation of instructions from the buyer on an execution-only basis;
- customer payments processing and reconciliations; and
- management of cash sweeps to the buyer.

Terms and conditions will also need to be agreed to deal with data protection prior to migration.

5.9 Succession to litigation proceedings

Where a portfolio includes litigation claims of the seller relating to loan assets that are being transferred in the portfolio, there will typically be a separate agreement dealing with the assignment and procedural substitution or succession to the relevant claim. The specific mechanics for such substitution will be determined by the relevant jurisdiction, but will include interim covenant provisions, information undertakings and the relevant formal mechanics to be substituted as claimant. In addition, provisions will need to be included for the seller to provide and preserve evidence, and to assist with disclosure in connection with any acquired claims following completion. In the event that an assignment of a claim or a related substitution is blocked, it is typical to provide that the relevant claim will be repurchased by the seller and therefore effectively removed from the portfolio sale.

6. Servicing

A bidder has three main options with respect to servicing a portfolio following completion, and the choice will be driven largely by the nature of the assets in the portfolio and the regulatory requirements for servicing such a portfolio.

In many cases a third-party servicer will be retained by a bidder both to help underwrite aspects of the portfolio and to manage the assets from completion. Where a portfolio contains regulated loans or consumers, a servicer holding the necessary regulatory authorisations can also take legal ownership of the loans in the portfolio, with the beneficial interest or receivables being transferred to the bidder's bidco on an ongoing basis.

A second option is to service the portfolio in-house or to set up a new servicing platform, potentially in conjunction with a joint bidder if there is one. This is only likely to be a practical option where the portfolio is very concentrated, such as with
corporate portfolios with a limited number of corporate borrowers, unless a bidder has an existing large in-house asset-management team.

A third option is to acquire an existing asset manager in a relevant jurisdiction, often at the same time as an initial large portfolio. In most cases where a portfolio is contained within a corporate group that is being sold in an equity transaction, the assets will inevitably come complete with an existing asset-management team. This may be useful for a bidder without an asset-management team, but it can also raise problems where the existing employees will be surplus to requirements after completion.

7. **Equity transactions**

While the majority of non-performing loan portfolio transactions are still structured as an asset sale, in certain circumstances sellers are structuring the transactions as a share sale or a transfer of debt instruments at the level of a parent holding company. The reasons for this vary. For example there have been secondary transactions where an existing collection of non-performing loans is held through subsidiaries under a parent holding company structure, where all or part of the existing holding structure is transferred directly to the buyer. This can be achieved through a transfer of shares in the parent company or, where the parent company is an orphan special purpose vehicle, by a transfer of the profit-participating notes or other capital instrument through which the seller holds its economic interest in the orphan special purpose vehicle.

In other situations, a seller may want to transfer existing employees that manage the portfolio and the companies holding the non-performing loans. This has been seen where banks have sold off whole distressed debt divisions, or where governments have nationalised asset management companies or sold bad banks.

Where a portfolio sale is structured through a share sale, the buyer needs to approach the due diligence process aware of the differences between asset and share deals. The key issue being that the historic liabilities of the target group will remain in the target group and are therefore essentially allocated to the buyer, unless contractual provisions are included in the sale and purchase agreement allocating risk to the seller. Note that in share deals it is often the case that indemnities for potential historic liabilities are only rarely given, and usually only in specific areas where there is a known liability that has not or cannot be factored into the purchase price. This contrasts with the market approach to asset transactions, reflected in typical loan sale and purchase agreements, where there will be a broad indemnity given by the seller to the buyer for historic liabilities arising prior to the pricing date.

As a result, the due diligence process for share sales needs to focus far more on possible liabilities within the target group, seeking to understand known liabilities and to identify possible unknown liabilities, as well as examining the assets in the group to verify the value attributed to them. Warranties will be used to flush out information and allocate risk for unknown liabilities.

Where a target group is acquired, a key post-completion step will be an audit of the target group business and activities against the warranties and indemnities received from the seller in the sale and purchase agreement. It is important to carry
this out within the applicable time limitation periods in the sale and purchase agreement. In addition, the target group employees will need to be onboarded and internal processes vetted, in particular to align anti-corruption and compliance policies with the buyer’s requirements.

8. **Co-investors**

With respect to larger loan portfolio transactions, it is not unusual to see bidders partnering for a particular bid, often at the start of the second phase of the auction process. This has obvious pricing and risk advantages, but can also be a practical and competitive advantage in a bid, by removing a potential competitor and, where the partner is a bank or holds particular regulatory permissions, can be a useful way to overcome regulatory issues in certain jurisdictions. Such a bidder may also be able to take on agent roles or hedging positions more easily. In addition, co-investors may have different appetites for different parts or assets in a particular portfolio, particularly if part of a portfolio is performing and part non-performing, and, as noted in the financing section below, one bidder may also provide senior debt financing to the other.

It is relatively rare for co-investors to form a formal joint venture entity for the purposes of a bid, although this does happen in certain situations, especially where the joint bidders are setting up a platform to manage the acquired assets. More frequently, contractual arrangements such as relationship or co-investor agreements will be used to set out the terms between the joint bidders.

The key terms and conditions to be agreed between the bidders will include:

- the allocation of the assets in the portfolio;
- sharing of purchase price and other buyer liabilities under the acquisition agreements; and
- most importantly, mechanics by which the bidders can bring a claim in respect of an asset against the seller.

In many cases, however, one joint bidder will not be a counterparty directly with the seller, and instead there will need to be a purely back-to-back structure between the two joint bidders, with only one bidder fronting the transaction. A key issue to resolve with wholly back-to-back structures is how the other bidder has contractual recourse in the event that a claim for breach of warranty, undertaking or indemnity needs to be brought. Consideration will also have to be given as to how any seller liability cap is apportioned between claims by each bidder, and who has control over the conduct of any such claims. The best solution for the non-counterparty bidder is to have direct recourse against the seller through the sale and purchase agreement as a named beneficiary of the seller warranties, indemnities and undertakings in respect of the assets it will acquire. While this may not be possible where the non-counterparty bidder wishes to conceal its identity, it removes issues that can arise with back-to-back warranties or an assignment of rights to bring a claim. Where this is not possible, other options to protect the interests of the non-counterparty bidder are available, and will be influenced by the jurisdiction of the bidders and the governing law of the sale and purchase agreement.
9. **Financing**

In order to achieve a higher return on the portfolios being acquired, certain buyers are increasingly seeking debt finance and aiming for a higher level of leverage. In certain situations, a co-investor will both provide debt finance and take a share of the equity in the acquisition (see above for further information on co-investment structures).

The nature of any financing used varies widely for each particular transaction, ranging from relatively vanilla senior secured loans where a special purpose vehicle bidco is the borrower and security is provided over the assets, through to bespoke structured securitisations or other bespoke special purpose vehicle structures where total return notes or profit-participating loans are used. Such arrangements, particularly where the finance provider is also an equity co-investor, often reflect the close relationship between the parties, and will be on very different terms to what might be available through typical third-party bank finance.

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