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Deleveraging Europe 2019: Focus on France

October 2019

Financial Advisory

Executive summary

The European loan portfolio market marked a record year with more than €200bn traded in 2018. The contribution of the French market was underwhelming. But why? Healthy economic indicators, a significant market size, regulatory pressure and a robust legal environment along with a scaling loan servicing landscape and progress in data quality make France an attractive market for investing in distressed assets.

Readiness ■■■■□□

Macroeconomic environment

Despite a recent tempering in economic outlook, the French market has seen sustained growth in recent years with confidence returning. While less impacted than other countries following the global financial crisis, France still maintains a high public and private debt level. The macroeconomic outlook is conducive to attracting investors to the distressed assets space.

Readiness ■■■■■□

Market landscape

With the second largest pool of non-performing loans (NPL) in Europe, and despite an NPL ratio below the European average, pressure is mounting on French banks to deleverage. Growing loan activity fueled by low interest rates combined with restrained loan sales positions France to overtake more saturated markets, justifying the challenges faced by investors entering a new market.

Readiness ■■■■■□

Legal and regulatory environment

The legal and regulatory framework in France supports effective NPL resolution. The implementation of macro prudential regulation and supervisory guidance across the banking system, a balanced and efficient legal system and the current political stability favour the French NPL market.

Readiness ■■■□□□

Quality of information

Collection and reporting of key NPL information is a challenging area in France, but it is gradually improving. While the banking system provides for consistent loan classification and NPL identification, key measures on information quality have not been systemically implemented. As NPL sales increase, the quality and volume of information made available to potential investors has improved.

Readiness ■■■■■□

Servicing capacity

Despite historically low NPL sales, the debt servicing infrastructure is relatively developed with the presence of six of the top 10 European credit management players. Until now, most NPL trades have gone to local debt purchasers who service their own assets. Still, a few international distressed asset funds are venturing into the market and larger foreign investors are waiting on the sidelines for the first signs of market growth.

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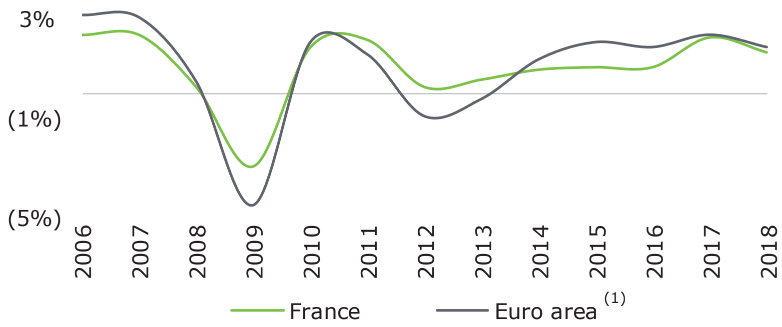
Macroeconomic environment

Notwithstanding a slump in the economic forecast, France is posting GDP growth aligned with the European average and an unemployment rate that declined for the fourth consecutive year. Lending to households and corporates continued to increase at a 6% rate in 2018, and while the French banking supervisory authorities implemented a countercyclical capital buffer (CCyB) to mitigate the risk of recession, the number of individual and corporate bankruptcies decreased. Macroeconomic policies, alongside limited NPL resolution, have produced a significant quantity of distressed assets to spur market development.

French economic indicators

Following real GDP growth of 2.3% in 2017, the highest level in the six previous years, French economic growth was more subdued in 2018 at 1.7%. Social unrest that started at the end of 2018 disrupted economic activities with protests continuing into 2019, resulting in a decreased GDP growth forecast of 1.3% for 2019. An economic slowdown is widespread among European countries as the GDP of the Euro area increased by 1.9% in 2018, compared to 2.4% in 2017.

Nominal GDP growth

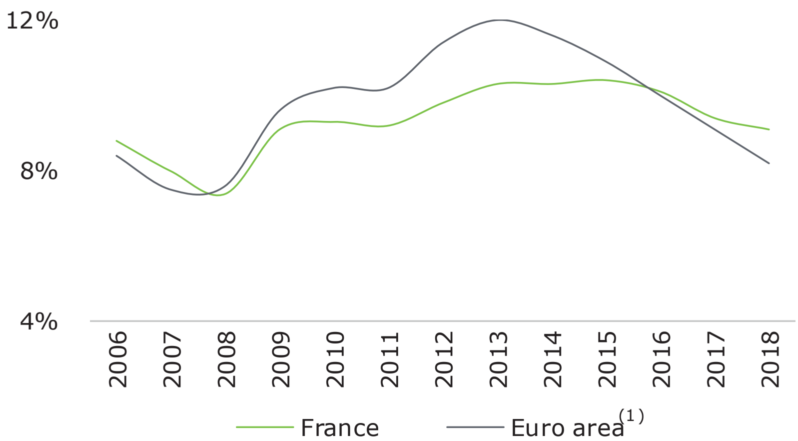


Note: (1) Euro area includes 19 countries

Source: Eurostat

A decreasing trend in the unemployment rate was observed across most European countries with unemployment decreasing from 12% in 2013 to 8.2% in 2018 in the Euro area. The United Kingdom is driving the improvement with levels significantly below that of other European countries. The French unemployment rate declined for the fourth consecutive year, but, at 9.1%, remains above the Euro area average and represents the fourth highest rate in Europe behind Greece, Spain and Italy.

Unemployment rate

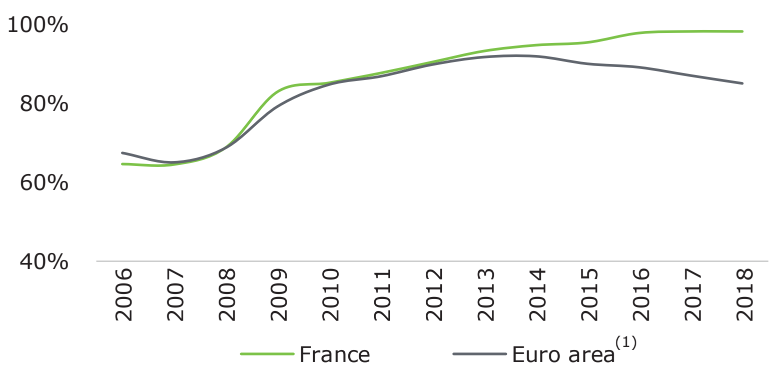


Note: (1) Euro area includes 19 countries

Source: Eurostat

Gross public debt in France reached €2.3 trillion at the end of 2018, representing 98% of GDP. This upward trend since the 2008 financial crisis results in France having the sixth highest gross public debt in Europe. In contrast, levels decreased in the United Kingdom between 2016 and 2018 by 0.6% and in the rest of the Euro area by 2.3%.

Gross public debt level (% GDP)



Note: (1) Euro area includes 19 countries

Source: Eurostat

Dynamic credit conditions and the countercyclical buffer

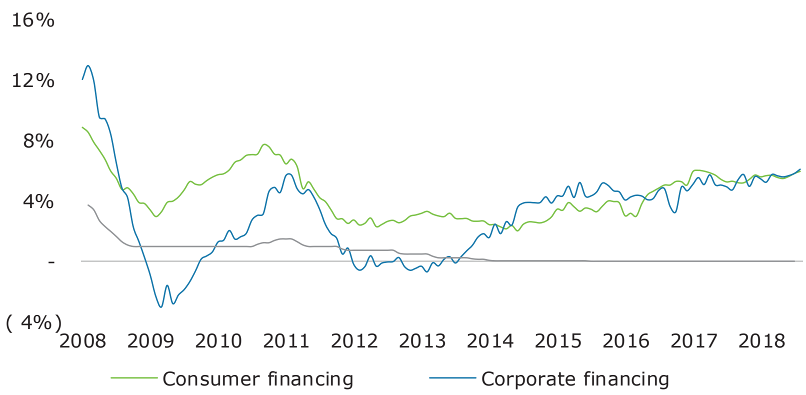
Lending to households and non-financial companies continued to increase in 2018, with an annual growth rate of 6% between Dec-17 and Dec-18, propelled by the low interest rate environment.

The French supervisory authorities first employed a countercyclical capital buffer in Jun-18 when they raised the buffer from zero to 0.25% of Risk Weighted Assets (RWA). As a result of the high credit to GDP gap, the CCyB will be increased to 0.5% from Apr-20.

Other euro area countries introduced similar buffers with Germany announcing a 0.25% buffer, applicable as of Jul-20 in an effort to hedge against recession uncertainty.

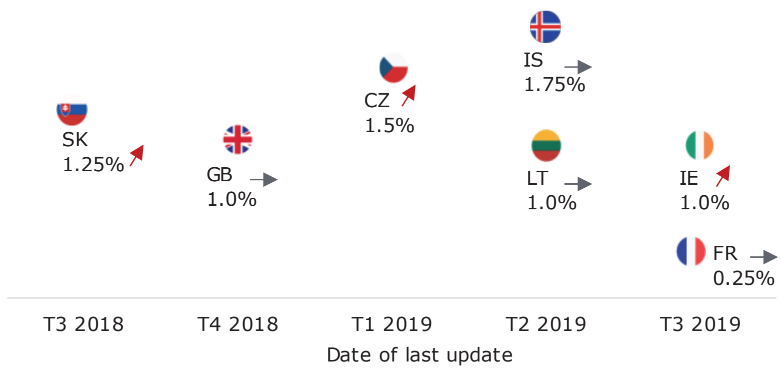
Despite the safeguarding actions, continued growth in consumer and corporate lending in France may slow as an economic downturn could lead to a renewed credit crunch.

Consumer/ Corporate lending and ECB refinancing rate (YoY growth)



Source: Banque de France and ECB

Evolution of CCyB notified to ESRB (Jul-19)



Note: Upward/stable arrow represents increase/stability of the CCyB at the date of last update

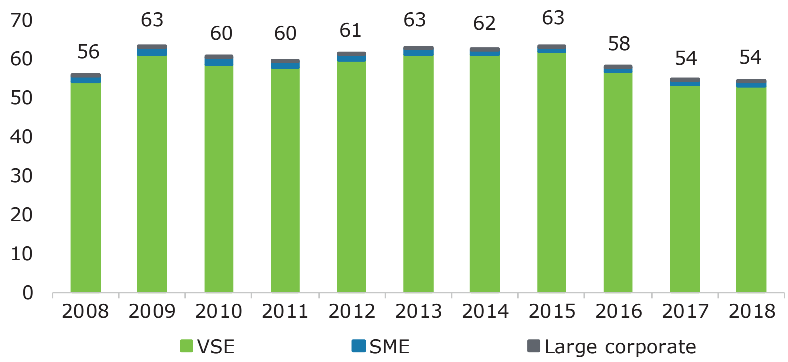
Source: European Systemic Risk Board (ESRB)

Consumer and corporate bankruptcies

The number of corporate bankruptcies in France remained largely stable between 2017 and 2018 at 54,000. Bankruptcies are triggered by micro-enterprises and very small enterprises (VSE), representing on average 98% of total corporate bankruptcies. Small and medium entreprises (SME) and large corporates made up the remainder with 1,149 and 39 bankruptcies, respectively, in 2018. Outstanding loans of companies filing for bankruptcy in 2018 represented 0.3% of total outstanding loans in France.

Despite a downward trend since 2015, the number of bankruptcies is expected to marginally increase in 2019 as the global economy is facing difficulties.

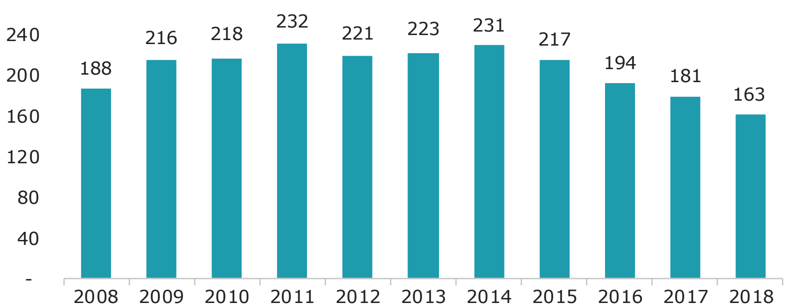
Corporate bankruptcies by company size (000)



Note: Company size is defined according to legal units
Source: Banque de France

The number of households applying to the Banque de France (BDF) overindebtedness plan continued to decrease in 2018 to 163,000, of which 91% were considered eligible for assistance from the household debt commission. This level, which has not been observed since 2003, represents €35 billion of overindebtedness outstanding. The sharp decrease in the last four years is attributable in part to the low interest rate environment and public policies that better protect households against abusive lending practices.

Household overindebtedness (000)



Source: Banque de France

Market landscape

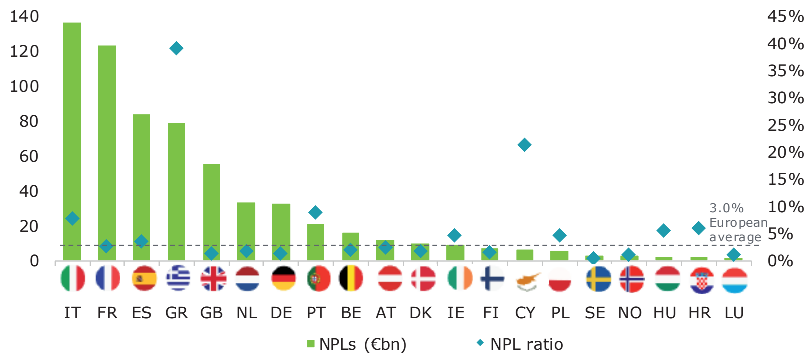
With the second largest NPL pool in Europe and emerging deleveraging activity, France is on course to have the highest NPL stock in Europe. While the large French banking groups that share 85% of the market are decreasing NPL volumes outside of France, the stock of French distressed assets has been stagnant over the past five years.

Coupled with regulatory pressure, profitability underpins banks' reinforced focus on NPL resolution strategies. Meanwhile, run-off banks are continuing the wind-down of their assets, and smaller players, such as consumer captives and Fintechs with growing distressed assets, will bring small and mid-sized portfolios to market.

France in the context of European NPLs

France has consistently maintained an NPL ratio below the European average, decreasing further since Mar-15 to reach 2.6% as at Jun-19. In contrast, the corresponding NPL outstanding held by French banks remains the second largest stock in Europe after Italy. While French banks decreased their NPL exposure to €124 billion as at Jun-19 from €140bn as at Jun-17, this was driven by large NPL sales in other European jurisdictions and, notably, in Italy.

€636bn stock of NPLs held by European banks (Jun-19)

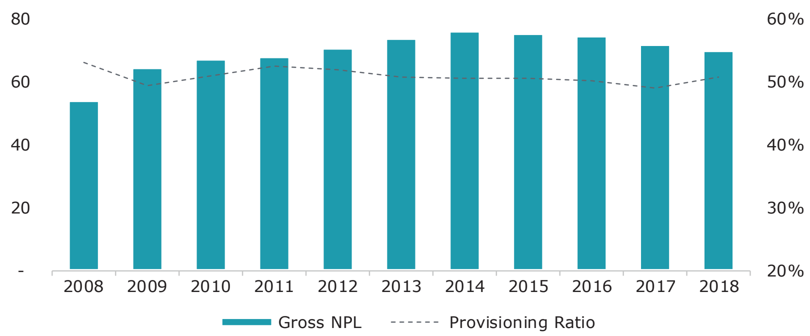


Note: The graph presents only the top 20 European countries in terms of gross NPL stock, whereas the European average includes data for all European countries

Source: European Banking Authority Risk Dashboard 2Q 2019

Contrary to the €124 billion NPLs held by French banks, the stock of non-performing loans owned in France totaled €70 billion as at Dec-18, a level that has remained stable over the last five years. Banks' provisioning ratio, intended to cover prospective losses on NPLs, increased to 51% in 2018, a 2% year-over-year (YoY) variance. Recent EU-wide regulatory guidelines will undoubtedly have an impact on the provisioning ratio as banks are directed to provision unsecured NPLs at 100% three years after default. With NPL resolution strategies targeting a rapid clean-up of banks' balance sheets, an acceleration of NPL disposals is forecast despite the overall low NPL ratio in France.

NPLs and provisioning ratio in France (€bn)



Source: Banque de France

The French banking landscape

The French banking market consists of centralised, mutual and cooperative banking groups, consumer finance companies, foreign and independent banks, Fintech companies and consumer captives. The seemingly fragmented market is in fact dominated by the top six banking groups, which account for over 85% of market share. The level of centralisation is a key factor in NPL disposal maturity, while regional banks are frequent sellers of small portfolios via limited auction processes or bilateral transactions.

+85% of the French banking market

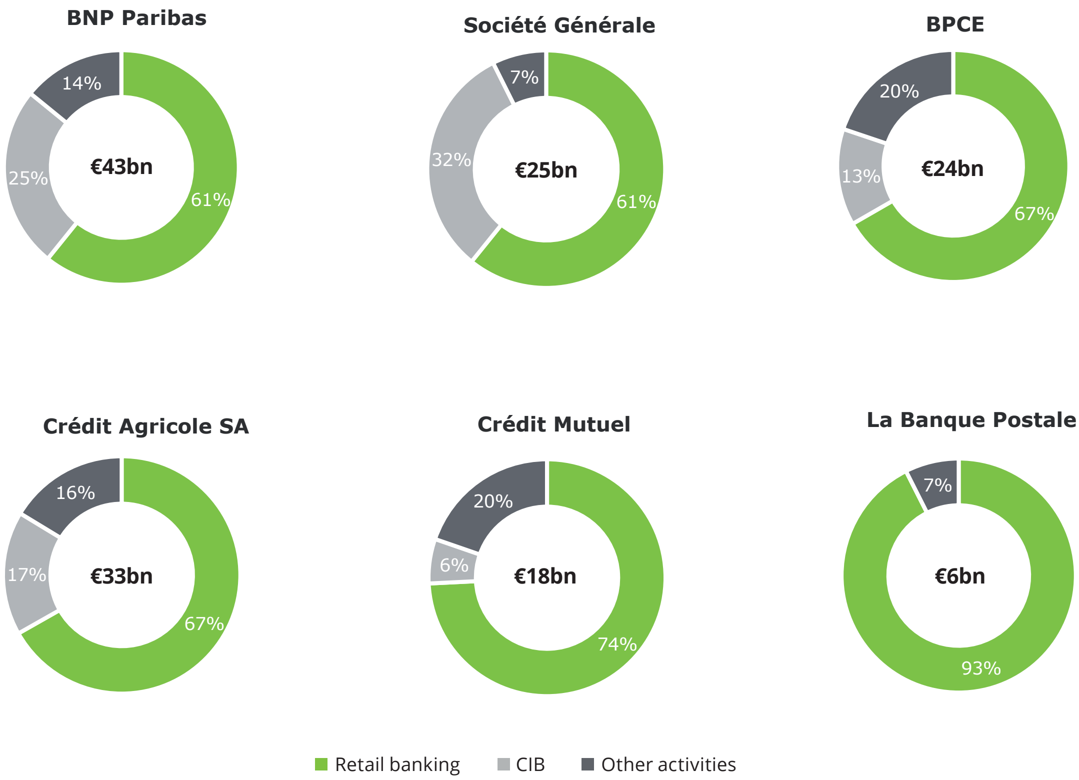
Category	Centralised banking groups	Mutual & cooperative banking groups	Consumer finance companies	Foreign/ independent banks	New players/ Fintechs	Consumer captives
Examples	BNP Paribas La Banque Postale Societe Generale	Groupe BPCE Crédit Agricole Crédit Mutuel	Sofinco Cetelem Cofidis	HSBC Milleis Banque mymoneybank	younited credit. N26 october	PSA Bank Banque Casino Banque RCI Bank and Services
Credit offering	Mortgage Consumer SME Corporate	Mortgage Consumer SME Corporate	Mortgage Consumer SME Corporate	Mortgage Consumer SME Corporate	Mortgage Consumer SME Corporate	Mortgage Consumer SME Corporate
Size	- ○ ○ ○ ○ ● +	- ○ ○ ○ ○ ● +	- ○ ○ ● ○ ○ +	- ○ ● ○ ○ ○ +	- ● ○ ○ ○ ○ +	- ○ ● ○ ○ ○ +
Centralised	- ○ ○ ○ ○ ● +	- ○ ● ○ ○ ○ +	- ○ ○ ○ ○ ● +	- ○ ○ ○ ○ ● +	- ○ ○ ○ ○ ● +	- ○ ○ ○ ● ○ +
NPL sale activity	- ○ ○ ● ○ ○ +	- ○ ● ○ ○ ○ +	- ○ ○ ● ○ ○ +	- ○ ● ○ ○ ○ +	- ● ○ ○ ○ ○ +	- ○ ○ ● ○ ○ +

Source: Deloitte analysis

The six largest French banks dominate the French banking market: BNP Paribas (BNPP), Société Générale (SG), BPCE Group (BPCE), Crédit Agricole Group (CAG), Crédit Mutuel Alliance Fédérale Group (CMG) and La Banque Postale (LBP). Despite disparities between banks, the aggregated Net Banking Income (NBI) of the top six increased by 0.9% between 2017 and 2018 to reach €148bn in 2018. Overall, corporate and investment banking revenue decreased by 6%, while asset management and insurance and retail banking activities increased by 6% and 1%, respectively.

As retail banking represented 63% of aggregated NBI in 2018, NPL monitoring and delinquency resolution are key components of profitability. A significant NPL stock also affects operating performance as both human capital and financial resources are engaged in credit management procedures, thus curtailing new lending activities.

Breakdown of the top six French banks NBI (2018)

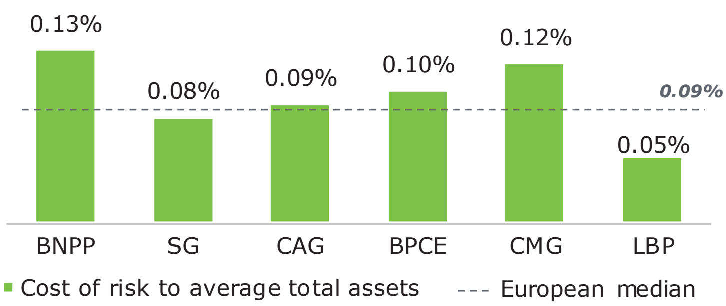


Source: Bank annual reports

Are French banks less profitable than their EU counterparts?

Combined cost of risk (CoR) of the top six French banks decreased by 6.4% between 2017 and 2018, as reductions in levels of non-performing loans led to lower NPL ratios. However, three banks still have a CoR to total balance sheet ratio that is above the 2018 European median of 0.09%.

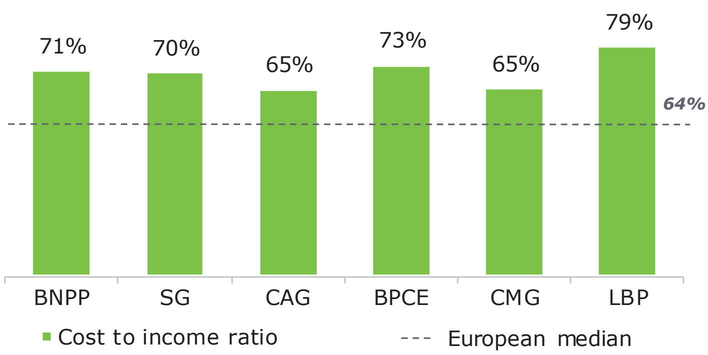
Cost of risk to total assets (2018)



Source: Autorité de contrôle prudentiel et de résolution (ACPR)

The cost to income ratio remains a leading concern as it has continued to increase since 2015. Operating expenses of French banks, mainly under pressure from costly restructuring plans, increased faster than their net income in 2018. This resulted in a 0.8% increase in the average cost to income ratio of French banks to 70.2% in 2018, a level that is on average 6% higher than the European median.

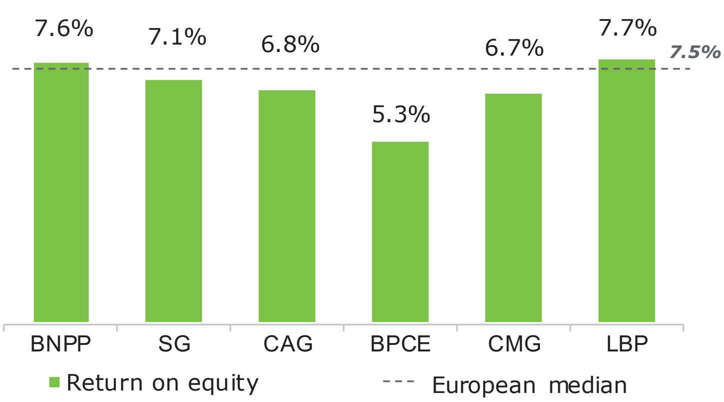
Cost to income ratio (2018)



Source: ACPR

The profitability of the top French banks, measured by their Return on Equity (RoE), increased to 6.7% in 2018 from 6.3% in 2017; however, French banks on the whole remain less profitable than their European counterparts. Similarly, the average Return on Assets (RoA) of the same French sample reached 0.38% in 2018, below the European median of 0.51%.

Return on equity (2018)

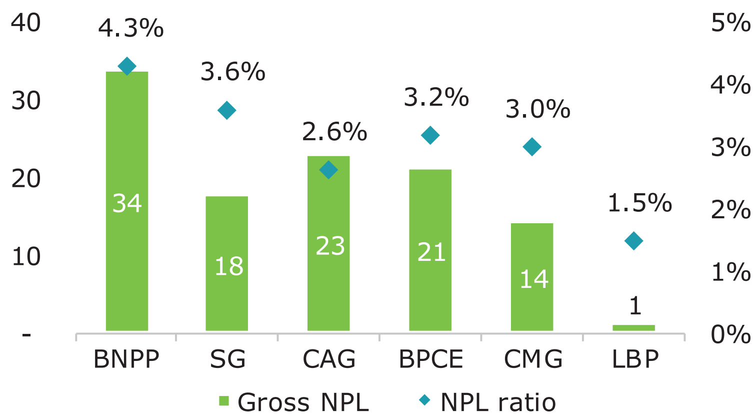


Source: ACPR

Gross NPL exposure held by top French banks

The cumulative NPLs of the six largest French banks totaled €112 billion as at Dec-18 with a corresponding average NPL ratio of 3%, varying among the French groups from 1.5% to 4.3%. BNPP was the most exposed to credit risk with €34 billion of NPL outstanding in 2018, and La Banque Postale had the lowest level with NPLs of just €1 billion.
The overall level of NPLs decreased further for French banks as at Jun-19, which should be reflected in the individual bank's exposure once the results of the 2019 EU-wide transparency exercise are published.

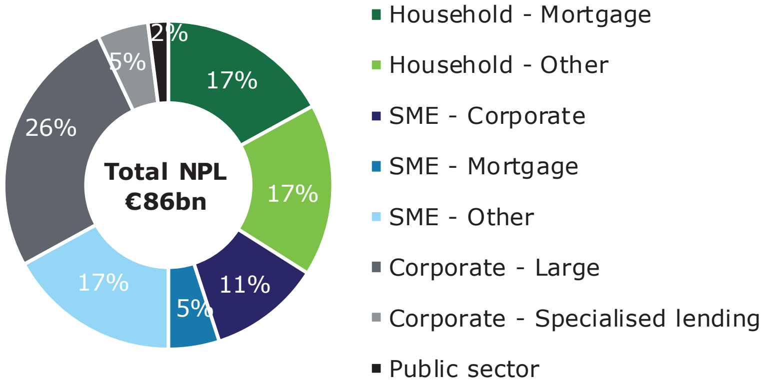
Gross NPLs and NPL ratio[(1)] (€bn, Dec-18)



Note: [(1)] Gross NPLs of French banks held in France and abroad
Source: Company annual reports and financial statements

Non-performing exposures are composed of residential mortgages and consumer loans, and SME and corporate loans in equal proportions. The only comparable measure of this breakdown for the top five French banks is based on the Internal Rating-Based (IRB) reporting published by the EBA annually. Defaulted exposures using this approach totaled €86 billion as at Jun-18 and were distributed evenly between household loans (34%), SME loans (33%) and corporate loans (32%).

NPLs by loan type[(1)] (Jun-18)

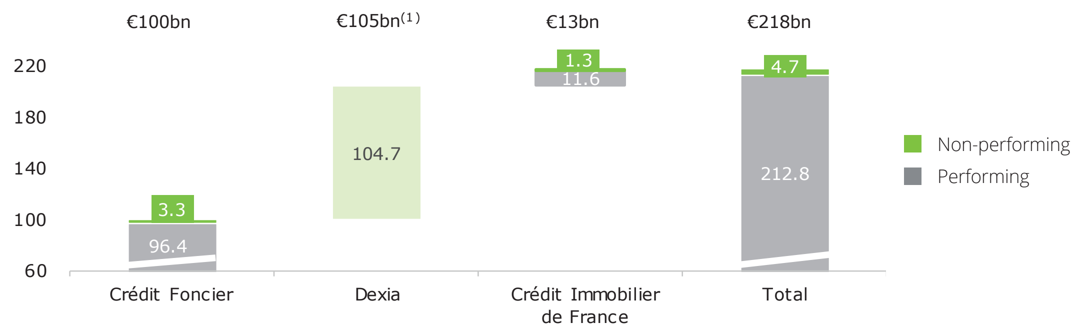


Note: [(1)] NPLs of BNPP, CAG, BPCE, SG and CMG owned in France and abroad, based on the IRB approach i.e. banks' own calculation model
Source: 2018 EU-wide transparency exercises - EBA

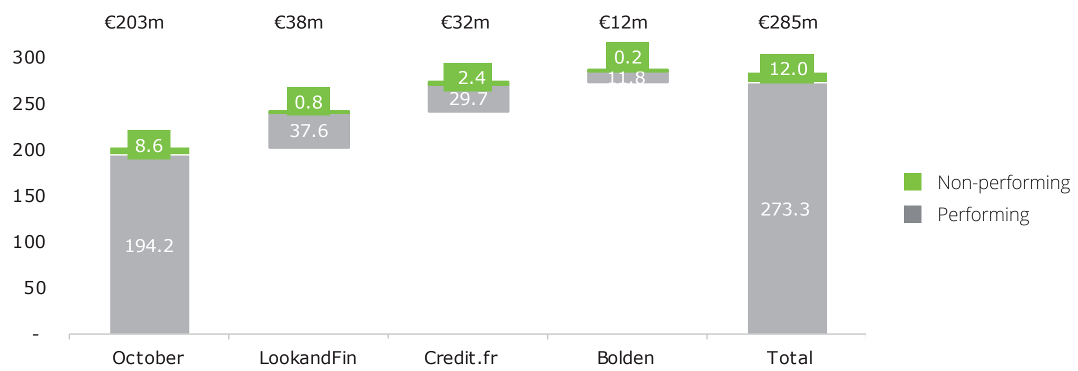
A closer look at NPL stock beyond the top banking groups

Selected consumer captives – Gross outstanding in France (€bn, 2018)

Banks in run-off – Gross outstanding in France (€bn, 2018)



Selected Fintechs – Gross outstanding in France (€m, 2018)



Note: [1] The credit risk exposure of Dexia is displayed as gross loans, and NPL data were not available
Source: 2018 annual reports and company websites

Private debt in the French market and the breakdown of NPLs by asset type

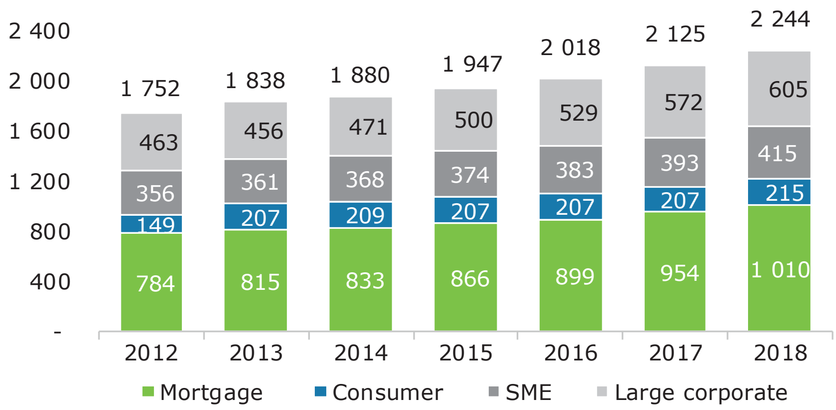
Outstanding retail and corporate loans (including SME) in France totaled €2.2 trillion as at Dec-18 and are mainly comprised of retail mortgages (45%), whose growth is stimulated by historically low interest rates. The large corporate segment showed an increase in corporate loans over the last five years, while consumer loans have remained stable in light of more stringent regulation.

Retail and corporate NPL outstanding in France, a different measure than the total NPLs held by French banks across Europe, totaled €68bn as at Dec-18.

Nearly half of this amount belongs to corporates (including SME) resulting in an NPL ratio of 3% for this asset class. Consumer loans, which are generally unsecured, make up 33% of bad debt and have the highest NPL ratio at 11% (compared to 1.3% for retail mortgages).

The share of NPL stock has slightly decreased since 2014 and is driven almost entirely by consumer loans, as the quality of debtors has improved and NPL sales have been focused on this asset class.

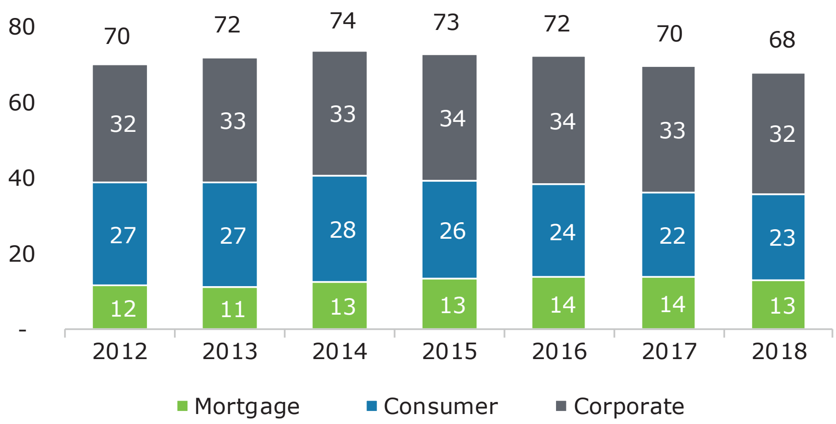
Retail and corporate loans outstanding (€bn)



Note: Consumer includes non-real estate loans to individuals; Large corporate includes only non-financial companies

Source: Banque de France

Retail and corporate NPL outstanding (€bn)



Note: Consumer includes non-real estate loans to individuals; Corporate includes SME and large corporate exposure

Source: Banque de France

Legal and regulatory

New guidelines issued by the EBA in June 2019 require EU banks to define an NPL strategy to sustainably reduce NPL levels. French banks' adherence to these guidelines, as well as the new Pillar 1 and Pillar 2 guidance backing full NPL provisioning, should incentivise deleveraging. At the broadest level, the French legal framework enables loan activity as well as debt recovery and asset resolution. The mortgage financial guarantee system, insolvency regimes (including the overindebtedness scheme), collateral enforcement and amicable or judicial procedures facilitate effective, albeit lengthy, NPL resolution.

Impact of the EBA's new NPL guidance

The EBA's new guidelines on the management of non-performing and forborne loans came into effect on June 30, 2019 and impacted more than 6,000 banks in the European Union. The guidance introduces new requirements for banks to define an NPL strategy and to implement operational structures to sustainably reduce NPLs. In line with these guidelines, European banks will have to design new projects to adapt IT systems, adjust risk models, review business models, improve credit management practices and adapt NPL procedures and tools.

Compliance with these new requirements will prompt significant additional costs, further reducing banks' operational and execution capacity. This is expected to lead to an increase in banks' refinancing costs, a reduction of their profitability and will ultimately weigh on their regulatory capital needs. The potential impacts of the EBA's guidelines are outlined below.

		Data and IT device	Internal organisation and process	System monitoring
NPL strategy	• Based on internal and external operating environment analyses • Defines time-bound reduction targets • Studies all strategic options to reduce NPLs			
NPL governance and operations	• Decision making • NPL operating model • Internal control framework • NPL monitoring and early warning processes			
Forbearance	• Prevents borrower delinquency due to deterioration of economic situation • Extends exposure terms and postpones payments			
NPL recognition	• Updated EBA NPL definition • Classification according to forbearance status • Implementation of mechanism for days past due determination			
NPL impairment and write-offs	• Defines clear internal guidelines for: - Irrecoverable loans and write-offs - Adequate valuation of loan portfolios impairments - Robust risk provisioning methods			
Collateral valuation	• Independent, up-to-date and coherent value assessments of collateral associated with NPLs • Regular back-testing • Sale of foreclosed assets			

New supervisory directives on NPL provisioning

New definition of default (Jan-17)		The EBA's new definition of default will come into application by January 2021 with adjusted criteria that should significantly affect the NPL stock and their expected behaviour
ECB NPL guidance (Mar-17)	Pillar 2	The ECB guidance defines supervisory expectations for NPL management. It requires banks with large NPL stocks to develop appropriate strategies to reduce their level.
Addendum to the ECB NPL Guidance (Mar-18)	Pillar 2	The addendum clarifies the ECB's supervisory expectations for prudential provisioning of new NPLs (i.e. loans classified as NPL on or after April 1, 2018).
ECB press release (Jul-18)	Pillar 2	This press release established further steps in the supervisory approach to reducing NPLs and provides coverage expectations for banks' NPL stock (i.e. loans classified as NPL before April 1, 2018).
Official Journal of the EU (Apr-19)	Pillar 1	The European Parliament and the Council of 17 April 2019 amends the CRR minimum loss coverage for NPLs and sets out the prudential treatment under Pillar 1 for NPLs arising from loans originated on or after April 26, 2019.
ECB communication (Aug-19)	Pillar 1	The most recent communication clarifies previous NPL guidance and provides some adjustments to the ECB's supervisory expectations for new NPLs (under the Pillar 2 Addendum) to allow a consistent and simple approach to reducing NPLs.

Communication from the ECB on coverage expectations, published in Aug-19, attempted to clarify and simplify previously published NPL guidance. The text (i) addresses the overlap in scope between the addenda of Pillars 1 and 2, (ii) specifies the relevant coverage expectations for NPLs based on the date of loan origination and the date of the NPL status and (iii) provides some adjustments to the Pillar 2 Addendum:

- Pillar 2 as per the ECB press release still applies to NPL stock, i.e. loans classified as NPL before April 1, 2018; and
- Pillar 1 and Pillar 2 Addenda have been harmonised so that coverage expectations are consistent for loans classified as NPLs on or after April 1, 2018.

Loans classified as NPL before April 1, 2018		Pillar 2 – ECB press release
Loans classified as NPL after April 1, 2018	*Loans originated before April 26, 2019*	Pillar 2 Addendum – Adjusted calibration
Loans classified as NPL after April 1, 2018	*Loans originated on or after April 26, 2019*	Pillar 1 – Backstop

Pillar 2, as described in the ECB press release of Jul-18, applies to loans classified as NPL before April 1, 2018 (the NPL stock). It provides three different paths to full coverage –or 100% provisioning rate– based on the specific characteristics of each bank:

- banks with net NPL ratios <5%;
- banks with net NPL ratios >5% and <12.5%; and
- banks with net NPL ratios >12.5%.

French banks are generally viewed as having low NPL ratios as they are, overall, below 5%. The initial provisioning rate, to be applied in Dec-20 for banks with net NPL ratios below 5%, is 60% for secured loans classified as NPL for more than seven years and 70% for unsecured loans classified as NPL for more than two years. An additional 10% increase in the provisioning rate is expected every year.

Provision for banks according to NPL ratio

	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24	Dec-25	Dec-26
				Net NPL ratio <5%			
Unsecured NPL	70%	80%	90%	**100%**	**100%**		
Secured NPL	60%	70%	80%	90%	**100%**		
				Net NPL ratio >5% and <12.5%			
Unsecured NPL	60%	70%	80%	90%	**100%**	**100%**	
Secured NPL	50%	60%	70%	80%	90%	**100%**	
				Net NPL ratio >12.5%			
Unsecured NPL	50%	60%	70%	80%	90%	**100%**	**100%**
Secured NPL	40%	50%	60%	70%	80%	90%	**100%**

Source: ECB press release (Jul-18)

Both the Pillar 1 and Pillar 2 Addenda are applicable to new NPLs:

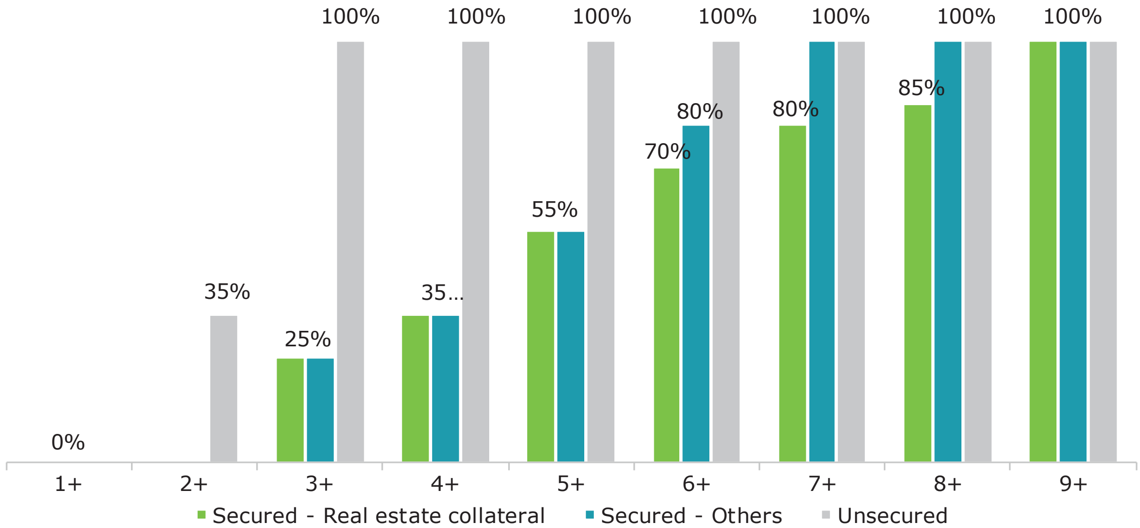
- Pillar 1 applies to NPLs from loans originated on or after April 26, 2019; and
- The Pillar 2 Addendum applies to NPLs from loans originated on or after April 1, 2018.

This overlap initially resulted in two different approaches being used for new NPLs classified from April 26, 2019 onwards, and has been addressed in the Aug-19 communication of the ECB. The communication provides some adjustments so that the Pillar 2 Addendum only applies to NPLs not subject to Pillar 1. Additionally, the coverage expectations for new NPLs are consistent under both Pillar 1 and Pillar 2 Addendum: a 100% provisioning rate for new NPLs should be reached by the 3rd, 7th, or 9th years depending on attached guarantees.

Simultaneously, the EBA's new definition of default should create "new compartments" of NPLs that might enhance both NPL stocks and expectations for innovative financial solutions.

The impact of these directives could be significant and should create opportunities for NPL disposals.

Provisions on new NPLs by year after default[1]



Note: [1]On or after April 2018

Source: ECB communication (Aug-19)

Potential impact on NPL disposals

Portfolio type	Definition	Potential impact on NPL transactions	
Fully provisioned *Pillar 1 – Backstop*	• Unsecured: three years post NPL status • Secured: nine years post NPL status if guaranteed by a real estate collateral, or seven years otherwise		• Portfolios are too expensive to maintain on balance sheet despite relatively high quality of underlying assets (especially for secured loans)
Restructured (probation period) *EBA new definition of default*	• Minimum one-year probation period • Required conditions for reclassification: - Min. 12 months of regular payments; - No past due credit obligations; and - No signs of unlikeliness to pay		• A default provision rate is applied to loans that may no longer be delinquent (if sufficient new payments have been collected), making them costly to hold
Defaulted by contagion *EBA new definition of default*	• Default status applies at the customer-level (borrower's total exposure) regardless of the actual status of each individual loan		• Borrower level default provision rate applied to loans that may not be delinquent individually and may still have good recovery chances
Overindebted customers (BDF) *EBA new definition of default*	• BDF can require banks to restructure loans of overindebted customers • Loans are reclassified as restructured and subject to the 12-month probation		• Upon completion of the probation period, these loans are reclassified as “performing overindebted” and can only be acquired by regulated entities
Non-restructured (probation period) *EBA new definition of default*	• Minimum 3-month probation period • Clear assessment of unlikeliness to pay triggers must be made before reclassification to performing		• A default provision rate is applied to loans that may no longer be delinquent (if new payments have been collected), making them costly to hold

Recent updates to accounting and regulatory frameworks issued by European regulators have created significant opportunities for the French NPL disposal market. These regulations result in increased incentives for NPL holders to deleverage their balance sheets as NPL stocks are becoming more expensive to retain. In particular, the Pillar 1– backstop implies that five years after NPL classification, secured loans must already be provisioned up to 70%. In France, where the judicial process for debt recovery is lengthy, applying a high provisioning rate is incompatible with optimistic recovery chances. The increased cost is a clear incentive for portfolio disposals.

Banque de France overindebtedness plans, a French market specificity

The Banque de France established a plan for households that cannot reimburse their loans and cannot reimburse their loans while paying their current expenses. It offers a remediation plan to restructure or partially write-off debt. In 2018, 163,000 applications were submitted to BDF under this scheme, of which 91% were considered eligible, either directly by the commission or following a district court appeal. The number of applications submitted decreased by 10% YoY and by 27% compared to 2013.

Among the total number of applicants in 2018, there were 92,000 were first-time applicants, a 4% decrease YoY and a level comparable to 1990. Of eligible applicants, 45% were oriented toward a recovery plan without judicial liquidation, which represents a total debt of €1.3 billion. BDF plans can extend expected recovery time significantly as the instruction period takes up to two years and plans can last up to seven years.

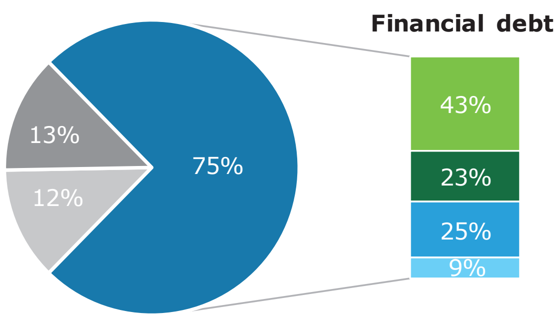
BDF plan activity by stage (2018)

163 000	applications submitted	• Individuals initiate process by submitting a BDF plan application. Upon application, the individual is registered to the national payment incident database (FICP)
148 000	eligible applications	• BDF examines the application to assess the eligibility of a plan
66 000	standard procedures	• BDF defines a solution tailored to the applicant's economic situation (new repayment schedule, moratorium and/or partial write-off)
12 000	personal recovery procedures	• For highly deteriorated financial situations, BDF can implement a total write-off (FICP registration continues for five to seven years)
14 000	procedures terminated	• BDF plan is closed (full repayment or total write-off)

Source: Banque de France

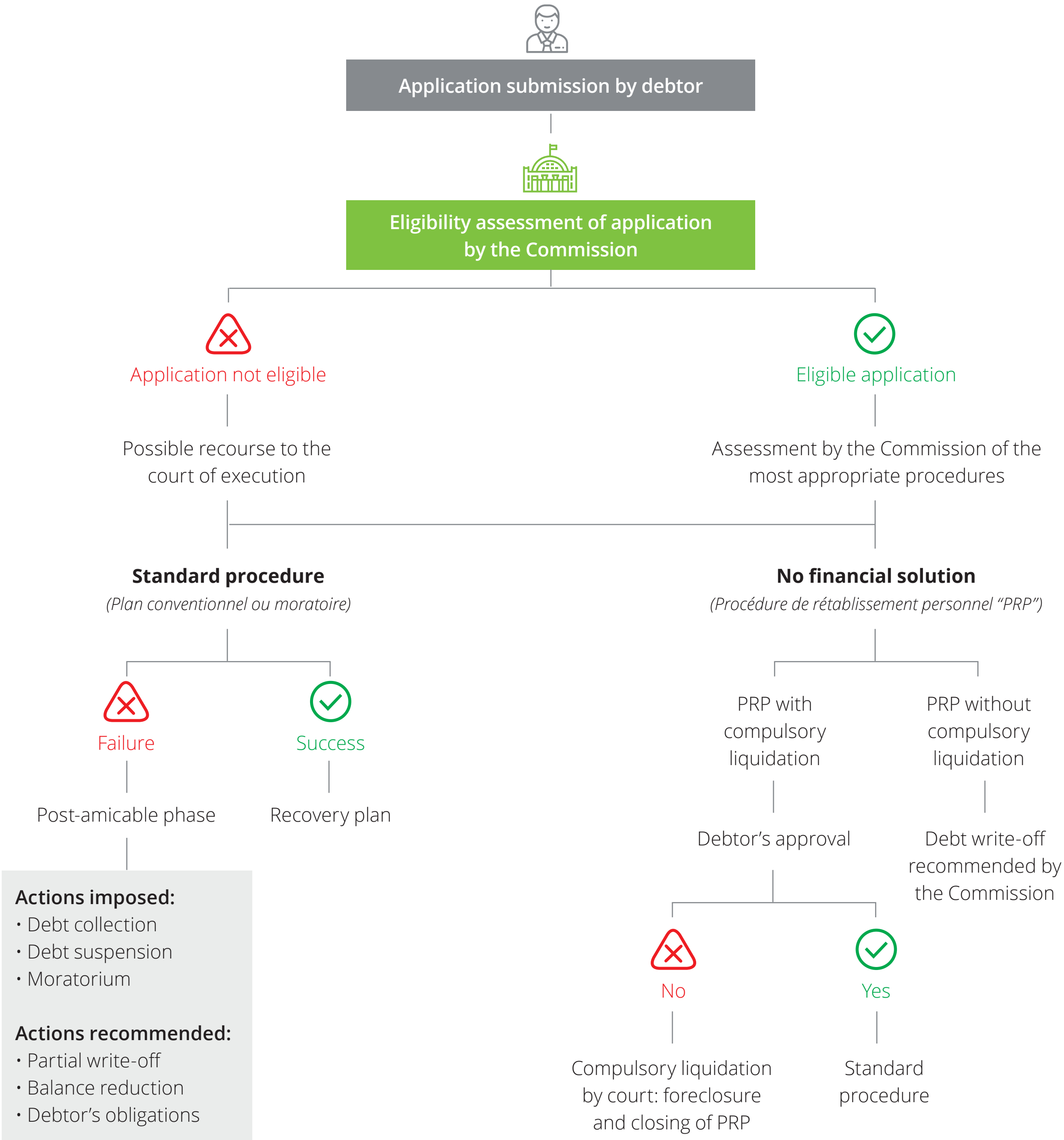
The total debt of eligible applicants totaled €6.6 billion as at Dec-18, of which €3.5 billion relates to eligible first time applicants. The debt of eligible applicants is composed mainly of financial debt, of which 42% is related to mortgage loans with the remainder divided between personal and revolving loans. Arrears represented 12% of the total debt and the debt write-off rate in 2018 was 30%, up 3% from 2017.

Total debt of eligible applicants (Dec-18)



Source: Banque de France

Simplified BDF plan application cycle



Source: Banque de France

French mortgage market guarantees

Financial guarantees in the mortgage loan market are an alternative to registered mortgages (*hypotheque*). In practice, when an individual requests a mortgage loan in France, the lender submits an application for a financial guarantee from its affiliated subsidiary. If the individual is not eligible, the bank will then register a first ranking mortgage with the *Conservateur des hypothèques*. Most financial guarantee providers, including Crédit Logement, manage the recovery process. In the event of default, resolution procedures are initiated by the guarantee providers. These could include loan restructuring or loan consolidation. In case of failure, they proceed to the sale of the assets.

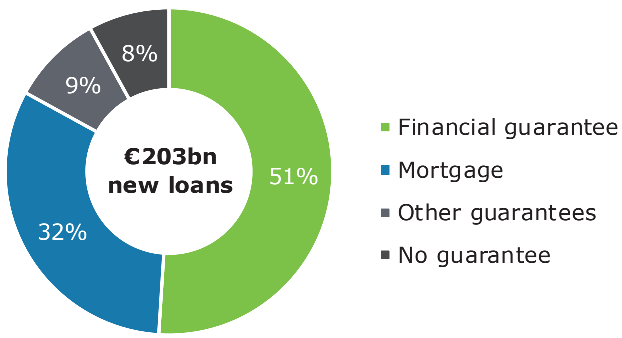
Of the €203 billion new individual mortgage loans in 2018, 51% were secured using financial guarantees.

Crédit Logement is the leading French specialist in mortgage loan guarantees with €346 billion of total loans outstanding guaranteed as at Dec-2018, more than half of outstanding secured by financial guarantees. In 2018, it guaranteed more than 575,000 loans.

Banks also have their own mortgage loan guarantee subsidiaries such as CEGC, part of the BPCE group, which has 15% market share, and SOCAMI, also a BPCE entity, distributing through Banque Populaire branches only.

Other non-banking players are also present in this sector, include CNP Caution, a subsidiary of CNP Assurances, and MNH and MGEN, which are mutual insurance companies. Their market share is less than 20% combined.

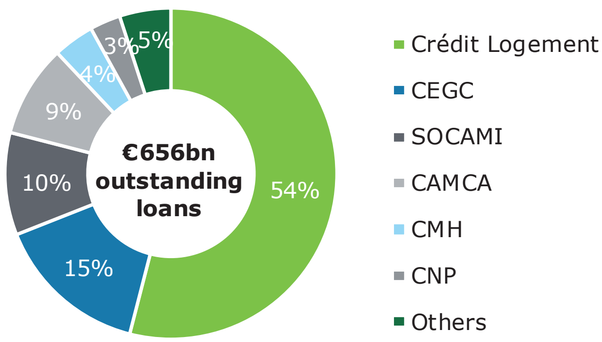
Mortgage loans by guarantee (2018)



Note: As a % of loan production

Source: Crédit Logement Observatoire

Outstanding by financial guarantee (2018)



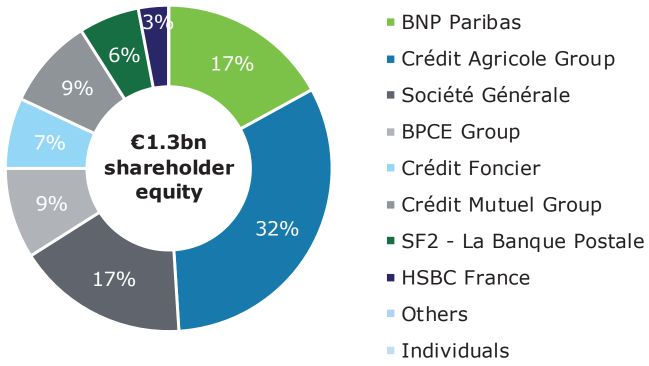
Note: As a % of loan outstanding

Source: Xerfi

This guarantee system allows a credit risk pooling between banks and financial guarantee providers. Crédit Logement is a joint subsidiary of the main French banking groups. To benefit from the guarantee scheme, banks have to be shareholders of Crédit Logement and must be committed to increasing the Mutual Guarantee Fund, a credit risk sharing mechanism. Shareholders contribute to the fund (*Fonds Mutuel de Garantie*), a risk pooling tool used by Crédit Logement in case of unrecoverable loans.

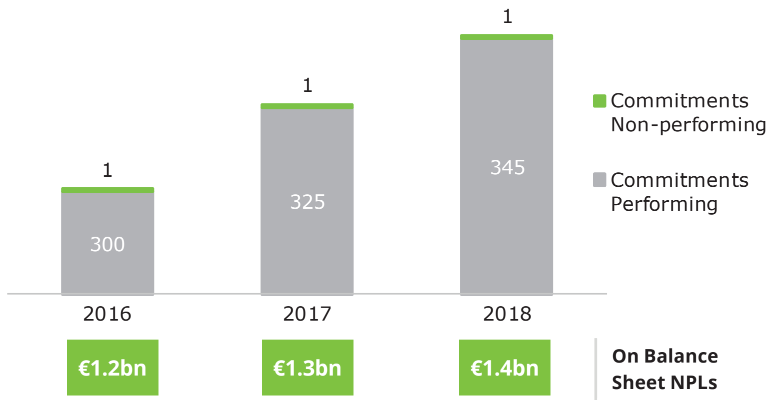
Crédit Logement has a low NPL ratio over total exposure of 0.22% in 2018 related to the granted guarantees (off balance sheet). The NPL outstanding on its balance sheet totals €1.4 billion.

Crédit Logement – shareholding structure (Dec-18)



Source: Company annual report

Crédit Logement exposure [1] (€bn)

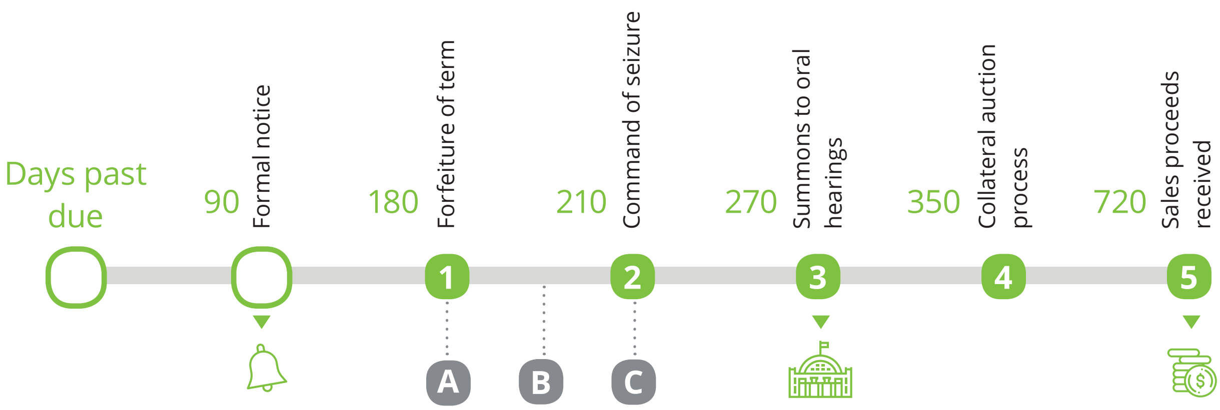


Note: [1] Off balance sheet guarantees related to loans guaranteed by Credit Logement

Source: Company annual report

Standard recovery process for mortgage NPLs

Standard mortgage recovery procedure



Note: Time estimates outline a standard recovery procedure of a mortgage without a financial guarantee

Source: Deloitte estimates

For mortgages, default is usually declared after 90 days past due, and the recovery procedure is relatively straightforward and lender friendly:

1. When the debtor is not able to meet the payment due date, the term is forfeited (*déchéance du terme*). This enables the bank to ask for the immediate full reimbursement of the loan.
2. Following the forfeiture of the term, through the command of seizure (*assignation des débiteurs*), debt holders can put in force the requirement for debtors to pay the amounts due.
3. Debtors and guarantors are then summoned to a court hearing *(convocations pour audience).*
4. The Court usually decides to sell the collateral through an auction process (*ordre de mise en vente).*
5. Proceeds from the sale of the asset pledged are distributed to debt holders (*distribution des fonds*).

The recovery process varies for the lender when financial guarantees have been granted for residential loans.

A. Once the debt is forfeited by the bank, the financial guarantee (e.g. Crédit Logement) can be activated to cover the unpaid amounts.

B. If the request is deemed compliant, the financial guarantor repays the lender and receives a subrogation notice (*quittance subrogative*) that is used to take legal action against the debtor.

C. The provider of the financial guarantee exercises its subrogation action (*recours subrogatoire*) against the debtor by command of seizure.

Real and non-real estate guarantees that back SME loans

Type of guarantee	Real estate pledge	Personal guarantee	Financial guarantee (BPI, SIAGI etc.)	Company's undertaking pledge
What it is?	• Real property pledged to loan by debtor • Considered as a real security (linked directly to loan)	• Unsecured written promise from an individual, owner or management guaranteeing payment of loan in the event of payment default • Not tied to a specific asset	• Counter-guarantee provided by French Public Investment Bank, which offers funding and guarantees to SMEs, Micro-enterprises and self-employed individuals • Guarantees range from 40% to 70% of loan amount	• Pledge of the business (and its assets) to the benefit of the creditor to protect it against the risk of payment default by the debtor
How can it be triggered?	• Property must be registered (for a given value and duration) for benefit of the lender • Once default has been declared, the lender launches property foreclosure procedures	• Guarantor must sign a written document, which lender holds as security • Can be revoked in several cases (physical loss of the guarantee, mandatory information missing, disproportion between the guarantor patrimony and his commitment, etc.)	• Intended as guarantee for financial institutions to cover part of the debt in the event of borrower default • Will only settle the lender's final loss after all other securities have been activated	• Contract should be signed between debtor and lender • Eight days after a unsolved order to pay, lender can request to the commercial court to order the public auction of the company's assets. This gives priority to pledge holder in proceeds disbursement
Requisite	• Mortgage registration document	• Signed promise with complete information	• BPI's signed approval	• Registered deed deposited at the clerk (*greffe*)
Valuation strength and transparency	- ○ ○ ○ ● ○ + • One of the most solid types of guarantees • Property can be valued according to market index	- ○ ● ○ ○ ○ + • Value assessment more complex as value impacted by solvency and holding of guarantor (property, liquid assets, etc.)	- ○ ○ ● ○ ○ + • After collections from other securities, BPI will reimburse a portion (40% to 70%) of lender final loss	- ○ ● ○ ○ ○ + • Difficult to assess recoverability amount as value of assets will depend on the liquidation of company holdings

Source: Deloitte analysis

Overview of restructuring and insolvency proceedings for French companies

Simplified restructuring and judicial procedures

In case of financial difficulties, a French company can use amicable out-of-court proceedings or judicial proceedings.

Amicable proceedings

A company can enter into amicable negotiations with creditors prior to insolvency[1]:

1. **Ad hoc proceedings** (*Mandat ad hoc*): An out-of-court and confidential proceeding, a solvent debtor facing financial difficulties can request the appointment of an ad hoc agent, whose role is to facilitate negotiations with creditors.
2. **Conciliation**: An out-of-court and generally confidential proceeding, available to all private entities and individuals acting as merchants, artisans or independent professionals in commercial or artisanal activities (except farming) facing legal or financial difficulties and insolvent for less than 45 days. The court appoints a conciliator to facilitate negotiations with creditors and reach a workout agreement.

Failure of out-of-court proceedings or direct recourse to judicial proceedings

Judicial proceedings

Available to solvent companies, safeguard proceedings can only be petitioned by the debtor and allow a restructuring under court supervision.

1. **Safeguard proceedings** (*sauvegarde*)
   - Safeguard
   - Accelerated financial safeguard
   - Accelerated safeguard

   ▶ Safeguard plan

In the case of insolvency (*cessation de paiements*), two judicial proceedings exist to rehabilitate the company or liquidate its assets.

2. **Receivership** (*redressement judiciaire*)
   - Aim to protect a company's activity and employment

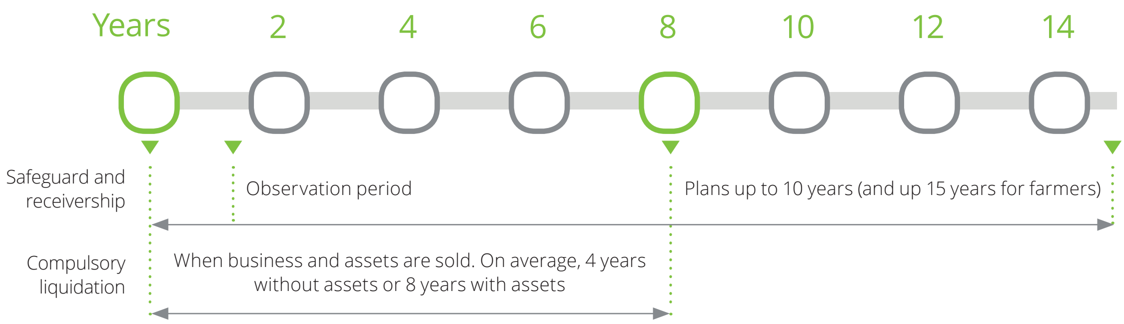
   ▶ Receivership plan
   ▶ Disposal of assets

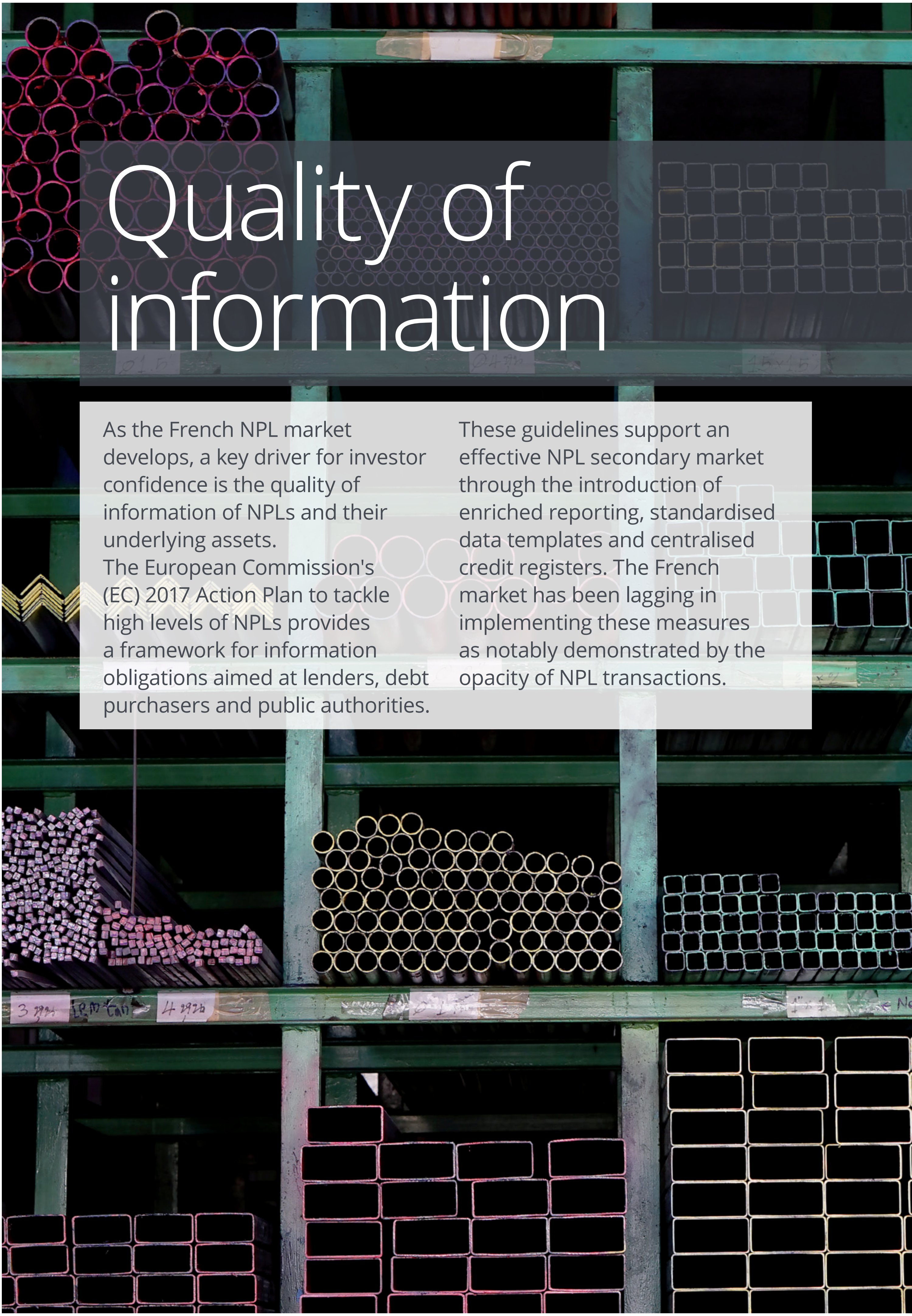
3. **Compulsory liquidation** (*liquidation judiciaire*)
   - Liquidation of a company when rehabilitation is not possible

   ▶ Liquidation of company assets

Note: [1] A French company is insolvent if it is not able to meet its payment obligations with its available assets when payments are due
Source: Deloitte analysis

Average length of legal procedures





Quality of information

As the French NPL market develops, a key driver for investor confidence is the quality of information of NPLs and their underlying assets.

The European Commission's (EC) 2017 Action Plan to tackle high levels of NPLs provides a framework for information obligations aimed at lenders, debt purchasers and public authorities.

These guidelines support an effective NPL secondary market through the introduction of enriched reporting, standardised data templates and centralised credit registers. The French market has been lagging in implementing these measures as notably demonstrated by the opacity of NPL transactions.

An Action Plan aimed at improving information quality across Europe

The European Commission introduced an Action Plan to tackle NPLs in Europe in Jul-17. It addressed various aspects of the NPL market and presented a comprehensive set of measures to improve the quality of information. Key actions and progress on implementation are outlined in the EC's fourth progress report on the reduction of NPLs in the Banking Union. While positive on average, tangible progress in France is not readily apparent.

The most impactful action for enhancing data quality would be the use of a loan reporting template that would improve the consistency and comparability of NPL portfolios, increasing potential investors' trust in the provided information. The lack of transparency of traded portfolios also puts France at a disadvantage as it underestimates the depth of the market and decelerates NPL resolution.

Key measures from the Action Plan related to information quality

Measures	Progress
Create an NPL reporting template to improve loan information provided by banks and facilitate NPL disposals	Completed
Enhance disclosure requirements on asset quality and NPLs	Completed
Strengthen NPL data infrastructure, including implementation of potential transaction platforms and the development of credit registers	Completed
Develop an NPL secondary market to support NPL reduction efforts	Completed
Issue new guidelines on bank loan origination, monitoring and internal governance	In progress

Completed In progress

Note: Progress includes the implementation of the Action Plan in Europe

Source: European Commission (Jun-19)

Availability and quality of information on value drivers

Compared to more mature NPL markets, France is still considered a new market. This is noticeable in terms of availability and homogeneity of information, whether obtained from lending institutions, public or private sources creating high barriers to entry. Still, the French market is rich with information on macroeconomic indicators, accurate financial and legal information on debtors and credit scoring. Combined with comprehensive data provided by NPL sellers, it is possible to estimate recoverability potential and forecast possible scenarios. The preparation of NPL reporting using EBA templates would help reduce information asymmetries between sellers and acquirers and increase access and quality of loan information. Improvements in key areas of data management could further enhance NPL information quality in France.

Credit bureaus

The absence of credit bureaus makes it difficult to access consumer credit information. Specialised companies provide credit scoring for individuals and companies. Extensive customer information is available via private sources, including solvency reports and legal proceedings. Civil investigation companies can find missing debtors and data on the solvency of a company or individual.

Real estate valuation

Limited public information on properties and valuations. Availability of cadastral information via restricted sources and a multitude of traditional and Fintech firms offering property valuations, including automated, desktop and drive-by assessments.

Regulatory action

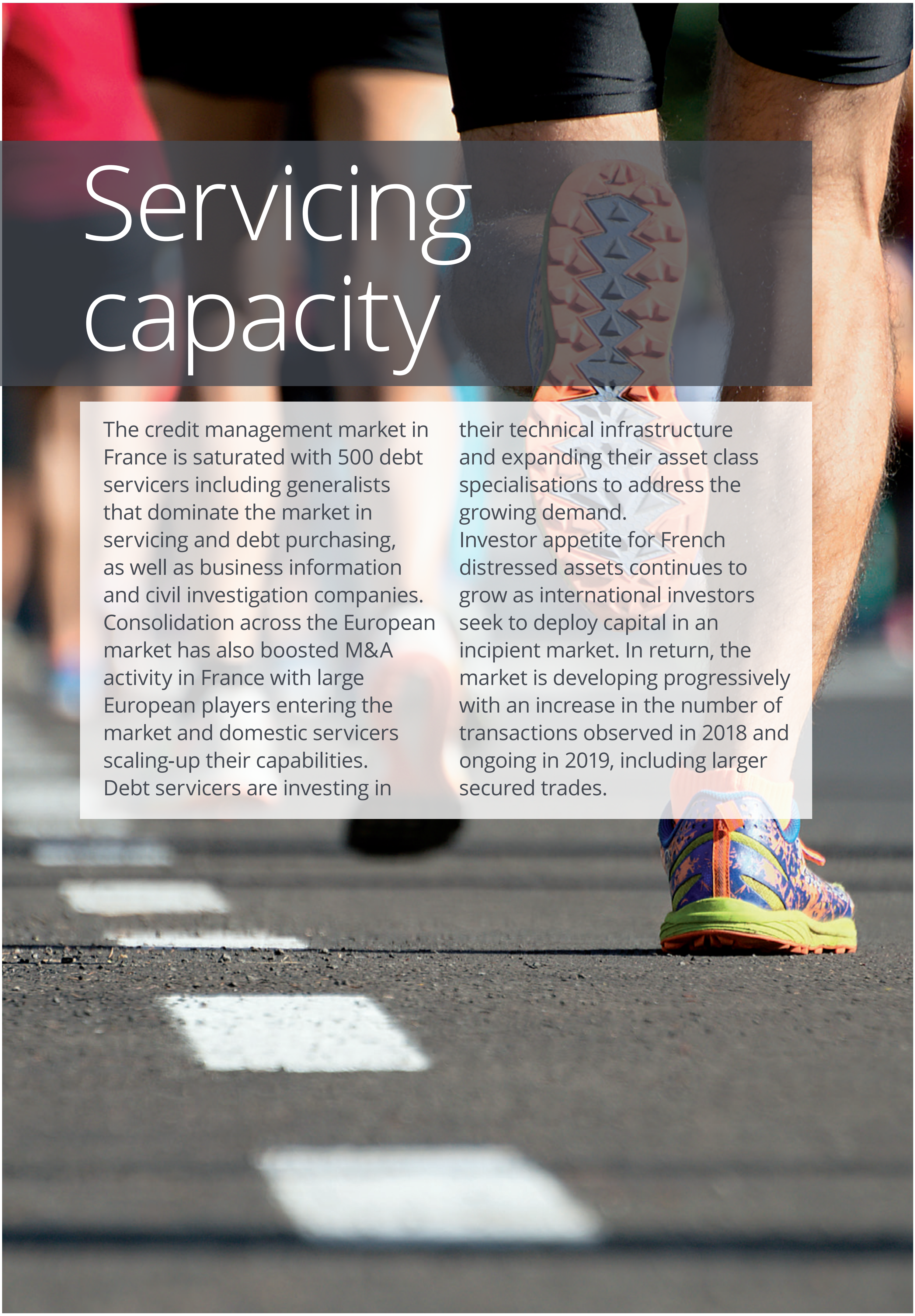
Supervisory guidance providing for comparable and standardised NPL information to meet investor needs increases awareness of data quality limitations and and drives a remediation exercise to improve quantity and quality of information available.

Benchmarks

Debt servicers have valuable collections and pricing information. Limited public benchmarks, but prior data can also be sourced through business information companies and consulting firms.

Digitalisation

French banks are investing in digitalisation, but availability of electronic credit files varies greatly between lenders. Debt servicers are also investing in innovation, notably IT and digital tools, to improve servicing capacity.



Servicing capacity

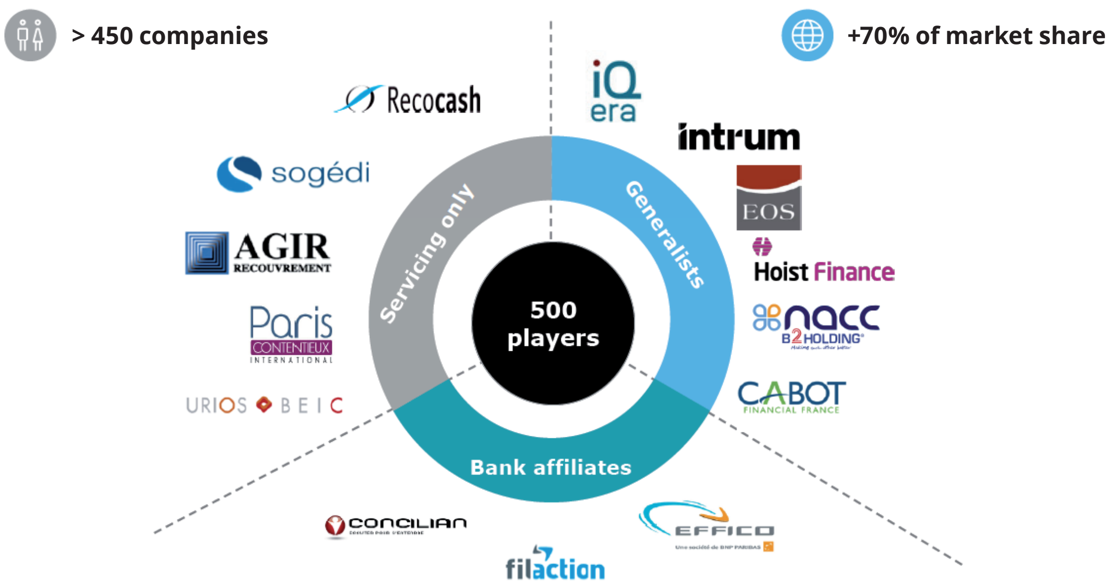
The credit management market in France is saturated with 500 debt servicers including generalists that dominate the market in servicing and debt purchasing, as well as business information and civil investigation companies. Consolidation across the European market has also boosted M&A activity in France with large European players entering the market and domestic servicers scaling-up their capabilities. Debt servicers are investing in their technical infrastructure and expanding their asset class specialisations to address the growing demand.

Investor appetite for French distressed assets continues to grow as international investors seek to deploy capital in an incipient market. In return, the market is developing progressively with an increase in the number of transactions observed in 2018 and ongoing in 2019, including larger secured trades.

French loan servicing landscape

The credit management market in France is mature, but concentrated around a handful of key players that dominate debt collection/ servicing and debt purchasing activities. A long tail of 450 smaller players compete for the remaining circa 25% of market share. Their main activities include third party debt collection (FIG and non-FIG), debt purchase and debt servicing for their own account (mainly FIG), civil investigation and business information. Large generalists are active in both debt servicing and debt purchasing activities, bank subsidiaries perform collections and servicing predominantly for related party assets, and the remainder are largely independent smaller players active in servicing and information/ investigation.
Debt purchasing activities account for approximately 30% of the total market revenues, but given the lack of public information and acquisition vehicles located outside of France, it is difficult to estimate the magnitude.
Following the trend in more mature markets such as Italy and Spain, the credit management market is expected to develop further as international distressed funds invest in NPL portfolios in France. These positive indicators make international banks and funds eager to capture this market growth as they are actively looking at the French market.

Credit management market players



Note: Graph split is not indicative of market share
Source: Deloitte analysis

	Revenues in France (€m)	FTEs (#)	Shareholders	Avg. ticket size	Years of exp.	Activity: Debt purchase	Activity: Debt servicing
iQera	211	1,800	BC Partners/ Montefiore Investment	>€20k	30	PL/ NPL	PL/ NPL
EOS	92	500	Otto Group	€10-20k	15	PL/ NPL	PL/ NPL
intrum	85[1]	652[1]	Public	€10-20k	25	PL/ NPL	PL/ NPL
Hoist Finance	60	130	Public	€10-20k	18	PL/ NPL	NPL
nacc B2HOLDING	31	102	B2Holding	>€20k	26	PL/ NPL	PL/ NPL
CABOT FINANCIAL FRANCE	18	145	Encore Capital Group	<€10k	15	NPL	PL/ NPL
CONCILIAN	13	217[1]	Société Générale	n/a	15	n/a	NPL
Recocash	13	140	IK Investment Partners	n/a	14	n/a	NPL
LINK FINANCIAL	n/a	20	Brookfield AM (Minority)	<€10k	4	PL/NPL	NPL
URIOS BEIC	10	90	AEGIR	n/a	25	n/a	NPL
sogédi	8	147	Management	n/a	18	n/a	NPL
AGIR RECOUVREMENT	8	96	Management	n/a	27	n/a	NPL
FINREC	7	74	Management	<€10k	50	NPL	NPL
filaction	6	75	Crédit Mutuel Alliance Fédérale	n/a	25	n/a	NPL
1640 finance	4	30	Management	<€10k	11	PL/ NPL	NPL

>€20k   €10-20k   <€10k

Note: [1] Figures are as of 2017 where indicated and otherwise as of 2018

Source: Xerfi, Diane, Mergermarket and company information

The presence of Europe's largest debt servicers in France

Six of the top 10 largest European players are already present in France with significant market shares or have recently entered through M&A or greenfield investments. They look to benefit from the expected growth in the NPL secondary market and are able to leverage their expertise in debt purchasing and servicing.

Revenues have increased overall as banks across Europe sell distressed assets and outsource servicing. Valuation indicators weakened in 2018 in line with the decline in the equities market, but have been rebounding in 2019.

Top 10 European debt servicing and purchasing companies

Company	Presence in France	120-month gross ERC[1]	Revenues	Price / Revenues	EV / ERC
Intrum	✓	€5.1bn	€1.3bn	2.0x	1.3x
Lowell		€3.4bn	€754m	n/a	n/a
Hoist Finance	✓	€3.0bn	€259m	1.5x	0.9x
Cabot Credit Management	✓	€3.0bn	€436m	n/a	n/a
B2Holding	✓	€2.2bn	€292m	1.7x	0.7x
Arrow Global		€2.1bn	€402m	1.0x	0.7x
PRA Group		€2.2bn	€791m[2]	1.7x	1.3x
Link Financial	✓	€2.0bn	€383m	n/a	n/a
EOS	✓	€1.9bn	€765m	n/a	n/a
Kruk		€1.7bn	€271m	2.5x	0.8x

Note: KPIs for European activities (2018). [1] Estimated Remaining Collections. [2] PRA Group global revenues

Sources: Company annual reports and Deloitte estimates

Consolidation of the credit management market

The credit management landscape has been consolidating as local players reinforced their position and European competitors acquired credit management companies to enter the French market. The most recent transaction saw European PE firm IK Investment Partners acquire Recocash, a large independent debt servicing company. French players are also starting to expand outside of France: iQera (formerly known as MCS-DSOgroup) has been actively expanding into the Italian market with the acquisition of Serfin in 2018 and Sistemia in 2019.

Year	Target	Buyer	Share	Consideration
2019	Recocash	IK Investment Partners	100%	Confidential
2019	Sistemia	iQera	100%	Confidential
2018	Serfin	iQera	100%	Confidential
2018	DSOgroup	MCS	100%	Confidential
2018	NACC	B2Holding	100%	€90m
2017	Ijcof	Intrum	100%	Confidential
2017	Crédit Immobilier de France	MCS	Servicing platform	Confidential
2017	Effico	DSOgroup	75.5%	Confidential
2016	Lindorf	Intrum	100%	c.€4bn
2016	Contentia	EOS Group	100%	Confidential
2016	Nemo Recouvrement	Cabot Credit Management	50.1%	c.€1.2m
2015	NACC	Pragma Capital	70%	Confidential
2015	Teotys	DSOgroup	100%	Confidential
2015	DSOgroup	Montefiore Investment	Majority	Confidential
2014	MCS	Cerberus European Investment	Majority	Confidential
2014	Sedree	DSOgroup	100%	Confidential
2014	Aktiv Capital	PRA Group	100%	c.€950m

Note: The list of transactions above is not exhaustive

Source: Company information, Mergermarket and Deloitte estimates

The developing market for French NPL disposals

French NPL portfolios represent an attractive investment opportunity as banks face regulatory and profitability pressure to deleverage non-performing and non-core assets. While the pool of local and international investors that are interested in this market continues to expand, most portfolio acquisitions are completed by generalist debt purchasers. This, combined with sellers' confidentiality constraints and sizeable volumes being traded on a bilateral or limited auction basis, results in a market that is opaque for foreign investors. Still, based on observable transactions, there is a noticeable upward trend in both volume traded and quality of underlying assets.

Ongoing 2019 transactions

Asset class	Type	Seller	Buyer	Size (€m)
SME secured loans	NPL	Retail bank	n/a	250
Mortgage loans	PL/NPL	Retail bank	n/a	500
Mortgage and CRE[(1)] loans	NPL	Foreign bank	n/a	115
Overdrafts	NPL	Retail bank	n/a	300

2019 completed transactions

Asset class	Type	Seller	Buyer	Size (€m)
Consumer loans	NPL	Consumer finance	Debt purchaser	350
Consumer loans	NPL	Consumer finance	Debt purchaser	150
Mortgage loans	NPL	Mortgage bank	Debt purchaser	60
Consumer loans	NPL	Consumer finance	Debt purchaser	60
Mortgage loans	NPL	CIF	EOS	125

Note: [(1)] CRE: Corporate Real Estate. The list of transactions above is not exhaustive and includes approximate nominal amounts

Source: Company information, Mergermarket, Debtwire and Deloitte estimates

2018 completed transactions

Asset class	Type	Seller	Buyer	Size (€m)
Consumer loans	NPL	Consumer finance	Debt purchaser	1,500
Consumer loans	NPL	Retail bank	Debt purchaser	25
Mortgage loans	NPL	Mortgage bank	Debt purchaser	150
Consumer and mortgage loans	NPL	Retail bank	Debt purchaser	40
Consumer and mortgage loans	NPL	Retail bank	Debt purchaser	25
Consumer and mortgage loans	NPL	Retail bank	NACC	30
Consumer loans	NPL	Consumer finance	Debt purchaser	35
Overdrafts and instalment loans	NPL	Retail bank	Hoist Finance	45
Consumer and mortgage loans	PL/ NPL	Retail bank	NACC	45
Auto loans	NPL	Consumer captive	Debt purchaser	105
Mortgage loans	PL/ NPL	Mortgage bank	Hoist Finance	95
Consumer loans	NPL	Retail bank	Confidential	135

Note: The list of transactions above is not exhaustive and includes approximate nominal amounts
Source: Company information, Mergermarket, Debtwire and Deloitte estimates

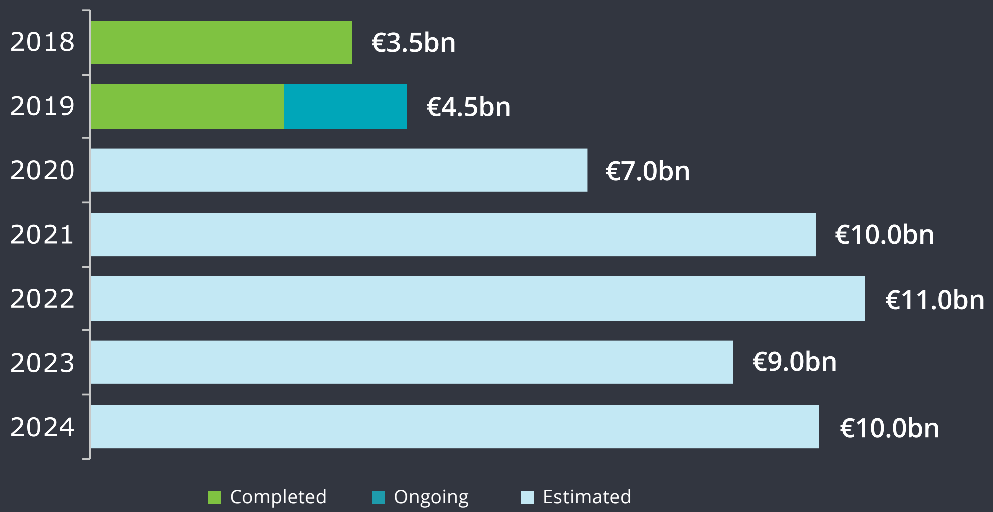
How can we expect the French market to evolve over the next few years?

The latest regulatory publications amplify the focus on NPL reduction in Europe and expectations for NPL management. This is echoed by the push to simplify legal processes for mortgages and to develop a standardised framework for a secondary NPL market. Are French banks concerned by this? Are they gaining momentum to react to these measures?

Holding the second largest NPL stock in Europe, French banks are starting to feel the pressure irrespective of the health of their balance sheets. NPL outstanding and observed transactions remained constant in 2018, which shows that the "wait and see" trend continued. Yet, as the second half of 2019 approached, large French banks launched sizeable portfolio sales marketed to a wide audience beyond local investors. Purchasing and servicing capacity in the market has kept up the pace until now, but with deals ramping up, local players may need to partner with international investors and reinforce their servicing capacity to meet market needs.

The context is favourable for increased transaction flow both from traditional retail banks and from consumer captives, run-off banks and, eventually, Fintechs.

NPL sales activity by year (nominal value)



Note: Completed and ongoing activity is based on observed transactions, extrapolated to take into account bi-lateral trades. Forecast is estimated based on linear regression using historical NPL data, as well as historical and forecast macroeconomic data including real GDP growth, unemployment rate and gross public debt as a percentage of GDP

Source: Deloitte analysis

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Deloitte Portfolio Lead Advisory Services

We have advised on loan portfolio transactions and completed deleveraging projects covering over €560bn of assets globally; we are the most active loan portfolio advisor in the market.

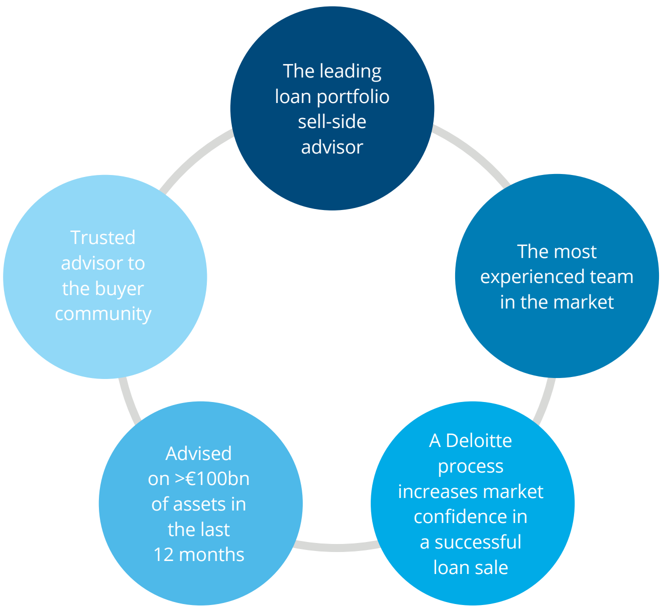
The Deloitte Portfolio Lead Advisory Services (PLAS) teams are recognised leaders in UK, in European and global loan portfolio advisory projects. They cover deleveraging, specialised loan portfolio servicing, and buy and sell side mandates. The core senior team has advised governments, financial institutions, regulatory authorities and global private equity firms on deleveraging and loan portfolio transactions across every major asset class covering over €560bn of assets. PLAS comprises a core team of 40 professionals with experience in advisory, principal investment and banking, together with a dedicated network of 150 professionals across Europe. This is in addition to extensive resource and expertise available from Deloitte's global network of member firms. The PLAS team are active in nearly every country in Europe and many emerging NPL markets, buying and selling loan portfolios as well as advising financial institutions on non-core exposures.

Strategic Advisory
Full strategic advisory services including deleveraging strategy and non-core asset reduction, credit risk, contingency planning, operational wind-down, carve-out advisory and bad bank establishment.

Sell-Side Advisory
Full service advisory to vendors of loan portfolios from strategy and preparation to sales execution.

Buy-Side Advisory
Assisting buyers in portfolio acquisitions in analysing, understanding and pricing loan portfolios. We help them to develop a strategy and understand the risk profile of the portfolios.

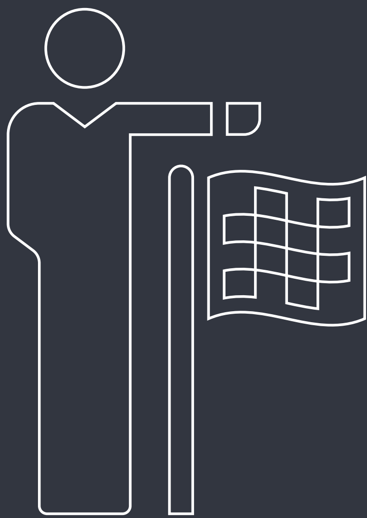
Advising holders, buyers and sellers of performing, distressed and non-core debt in deleveraging planning, loan portfolio management and strategy.



We advise **holders, buyers** and **sellers** of performing, distressed and non-core debt in deleveraging planning, loan portfolio management and strategy

Completed deleveraging strategy plans on

€250bn

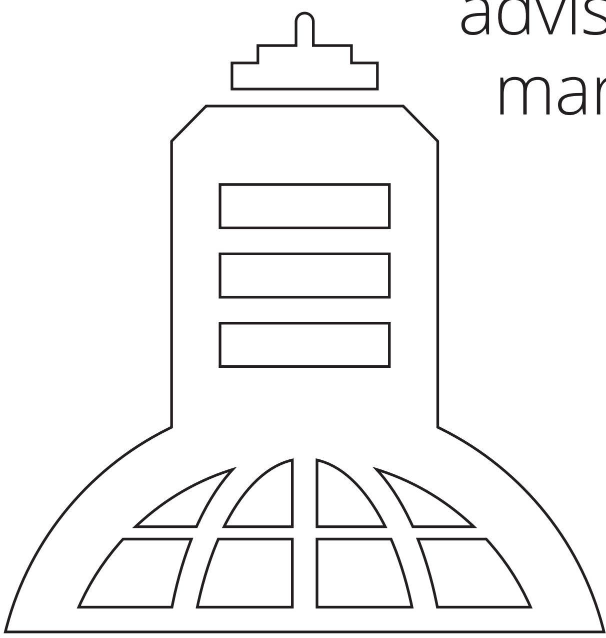


Unparalleled understanding

of the buyer community – we know which buyers are the most active in the market, their preferred asset types and pricing parameters

Global leader

in the loan portfolio advisory market



Lead sale advisor
on over
€120bn
of loan portfolio sales

Buy-side advisor
on over:

€150 bn

Global approach, local insight,

100+

strong team

worldwide, spanning every active market

Deloitte.

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Deloitte France brings together diverse expertise to meet the challenges of clients of all sizes from all industries. Backed by the skills of its 6,900 employees and partners and a multidisciplinary offering, Deloitte France is a leading player. Committed to making an impact that matters on our society, Deloitte has set up an ambitious sustainable development and civic commitment action plan.