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COMMUNICATION FROM THE COMMISSION

Guidelines for a best-execution process for sales of non-performing loans on secondary markets

COMMUNICATION FROM THE COMMISSION ON GUIDELINES FOR A BEST-EXECUTION PROCESS FOR SALES OF NON-PERFORMING LOANS ON SECONDARY MARKETS

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Glossary and Definitions

1-Phase-Process	An NPL sales process that only foresees a Binding Offer Phase (*Phase 2*).
2-Phase-Process	An NPL sales process that foresees both a Non-Binding Offer Phase (*Phase 1*) and a Binding-Offer Phase (*Phase 2*).
AML	Money laundering is a type of financial crime. It involves taking criminally obtained proceeds ('dirty money') and disguising their origins so they will appear to be from a legitimate source. *Anti-money laundering (AML)* refers to the activities financial institutions perform to achieve compliance with legal requirements to actively monitor for and report suspicious activities.
Analysis Report	Once the Seller receives the *NBOs* from *Phase 1 Investors*, the Seller will compare and analyse them, which results in an *Analysis Report* of the *NBOs*. This supports the Seller in shortlisting the relevant bidders, which may then move on to *Phase 2*. Once the Seller receives the *BOs* from *Phase 2 Investors*, the Seller will again compare and analyse them, resulting in an *Analysis Report* of the *BOs*.
Auction Types	The Seller can choose an *Auction Type* for the intended *NPL* sale. A list of commonly used *Auction Types* is attached as Annex 4 to these Guidelines.
AUP Report	The *agreed-upon procedures (AUP) Report* is part of the vendor *Due Diligence* that should be provided to investors. *AUP* engagements involve a practitioner performing specified procedures that have been agreed to by the practitioner, the Seller and any appropriate third parties. On the basis of the factual findings of such *Due Diligence* efforts, an *AUP Report* is prepared by the practitioner and shared with those parties that have agreed to the procedures.
BO	The Binding Offer to be submitted by the *Phase 2 Investors*.
BO Date	The deadline set by the Seller for receipt of a BO from the *Phase 2 Investors*.
BO Guidelines	Written guidelines provided by the Seller to *Phase 2 Investors* detailing the form and content of the *BO*.
Broad Auction	A *Broad Auction* is a typical *2-Phase-Process*, whereby a large list of investors is invited to submit an indicative *NBO*. Following this first auction stage, a *Due Diligence* process is run with a restricted shortlist of investors, which is invited to submit a final *BO*. Following this second auction stage, a single *Preferred Bidder* is selected, with whom the Seller enters into the negotiation of the *LSPA* and potentially additional transaction agreements. The Guidelines represent a *Broad Auction* process.
Closing	The date on which the *NPL* transaction is legally closed and customarily the date on which the purchase price is paid and ownership of the *NPLs* is transferred to the *Purchaser*.

Cut-Off Date	Seller customarily determines and communicates to the *Phase 2 Investors* a *Cut-Off-Date* from which onwards the proceeds in respect of the NPLs are due to the *Purchaser*.
Defective NPLs	*NPLs* which either do not fulfil all *Eligibility Criteria* or fulfil at least one *Exclusion Criterion*.
Disclosure Qualifier	Seller can qualify certain Representations and Warranties (*R&Ws*) to disclosure, an example could be: "Seller warrants that all securities are 1st rank mortgages unless as duly disclosed by Seller (in a form that can be evidenced by Seller) to Purchaser until [date of last disclosure]."
Due Diligence and Due Diligence Documentation	In the course of a *Due Diligence*, the Seller customarily provides in a legally compliant manner physical or virtual access to relevant *Due Diligence Documentation* based on which legal and operational experts of the *Phase 2 Investors* can review and verify document quality and availability, validate assumptions made in pricing and assess *R&W* requirements for the *LSPA*.
Exclusion Criteria or Eligibility Criteria	*Eligibility Criteria* are criteria agreed in the *LSPA* all of which have to be fulfilled by each sold *NPL*. *Exclusion Criteria* are criteria agreed in the *LSPA* which none of the sold *NPLs* (should) fulfil.
External Service Providers	*External Service Providers* are service providers offering general support to a Seller for an *NPL* sales process, including Financial Advisors, Technical Advisors, *Transaction Platforms* and VDR providers. More information on specific categories of external service providers can be found in Annex 3.
Information Memorandum	The *Information Memorandum* provides a short presentation of the main features of the *NPLs* to be sold.
Investor LSPA Mark-Up	Mark-up of the draft Loan Sale and Purchase Agreement (*LSPA*) provided by a *Phase 2 Investor* in *Phase 2*, customarily delivered on the *BO Date*.
KYC	The *know your customer* or *know your client* (*KYC*) standards are used within the financial services industry, stipulating requirements to verify the identity, suitability, and risks involved with maintaining a business relationship. The procedures fit within the broader scope of anti-money laundering (AML) policy.
Loan Data Tape	The *Loan Data Tape* denotes an electronic file or set of files that captures lending product data from a financial firm's systems. It can be considered as a one-time snapshot of a subset of a Seller's credit portfolio information. It includes the information provided by the Seller during Phase 2 to the Phase 2 Investors.
LSPA	The Loan Sale and Purchase Agreement, sometimes also referred to as Sale and Purchase Agreement or Debt Sale Agreement. In the Guidelines, the abbreviation *LSPA* will be used.
LSPA Term	A term sheet of no more than 2-4 pages, which includes major terms of

Sheet	the *LSPA* (e.g. envisaged transaction structure, Seller *R&Ws*, liability regime), on which the Seller wants to obtain investors' feedback early on during the process, e.g. in *Phase 1*.
Management Meeting	Meeting(s) offered by the Seller to *Phase 2 Investors* in which *Phase 2 Investors* will receive background information on the NPLs to be sold and explanations of workout or pre-processing activities and where *Phase 2 Investors* can pose questions to employees of the Seller who have profound knowledge of the NPLs to be sold as well as prior workout actions.
Negotiated Sale	The *Negotiated Sale* is a bilateral process involving a single potential investor. Due to the lack of competition, the main steps (with relevant documentation shared) and the outcome of the marketing process vary significantly from the *Broad Auction*.
NBO	The *Non-Binding Offer*, i.e. an indicative offer submitted by a *Phase 1 Investor*, i.e. an offer that is not legally binding on the bidder.
NBO Date	The deadline set by the Seller for receipt of a NBO from the *Phase 1 Investors*.
Non-Disclosure Agreements (NDAs)	A *Non-Disclosure Agreement* is a confidentiality agreement signed by Seller and interested investors. In the *NDA*, the conditions are set out under which the Seller is willing to share confidential information. Investors need to sign the agreement before gaining access to the relevant data and initiating *Due Diligence*.
Non-performing loans (NPLs)	A bank loan is considered non-performing when there are indications that the borrower is unlikely to repay the loan (hence, the sub-category of "unlikely to pay" (UTP)), or more than 90 days pass without the borrower paying the agreed instalments or interest.
Phase 1 = Non-Binding Offer Phase	The phase at the end of which the Seller expects to receive *NBOs* from all *Phase 1 Investors*.
Phase 1 Investor	An investor that was admitted by the Seller to participate in Phase 1 of an NPL sales process.
Phase 2 = Binding Offer Phase	The phase at the end of which the Seller expects to receive *BOs* from all *Phase 2 Investors*.
Phase 2 Investor	An investor that was admitted by the Seller to Phase *2* of an NPL sales process.
Phase 2 Data and Documents	Data and documents prepared during the preparation phase by the Seller to be provided to *Phase 2 Investors* at the beginning of *Phase 2*. Apart from loan-by-loan data in respect of all NPLs, *Phase 2 Data and Documents* customarily contain *Due Diligence Documentation* to be reviewed by *Phase 2 Investors*. *Phase 2 Data and Documents* should also contain any costs or fees that the Seller envisages the *Purchaser* to assume.
Preferred	The investor which submitted in the opinion of the Seller the best *BO*.

Bidder	Ideally and in most cases, the *Preferred Bidder* equals the *Purchaser*.
Process Letter	A *Process Letter* is a document that shows the steps of the sale process and the deadlines to be respected by all actors involved.
Purchaser	The investor with whom the Seller concludes an *LSPA*.
Q&A Process	A process usually conducted in *Phase 2* whereby *Phase 2 Investors* may pose questions to be answered by the Seller.
R&W(s)	*Representations and Warranties* given in an *LSPA* whereas the Seller *R&Ws* can include representations and warranties in respect of the *NPLs*, the underlying securities, pre-processing etc.
Servicing Transition Date	The date on which the *Purchaser* or a servicer acting on behalf of the *Purchaser* takes over the servicing of the acquired *NPLs*. The *Servicing Transition Date* customarily equals *Closing*, but can also be subsequent to *Closing* if so agreed between the Seller and *Purchaser*.
Signing	The signing of the final *LSPA* negotiated between Seller and *Purchaser* and signed by Seller and *Purchaser*. Depending on the complexity of the transaction, *Signing* can either precede or equal *Closing*.
Targeted Auction	A *Targeted Auction* is a competitive process similar to the *Broad Auction*, but involves a shorter list of potential investors (approximately 2 to 8). This option typically allows the Seller to have better control over the process whilst benefitting from a still competitive environment. It is usually a *2-Phase Process*, although under specific circumstances and especially in high time-pressure situations, the first phase may be omitted.
Teaser	A *Teaser* is an anonymous marketing document that contains the key transaction background and summary data on the *NPLs* to be disposed. It summarises the main elements of the investment opportunity.
Transaction platforms	*Transaction platforms* are online marketplaces that connect buyers and sellers of *NPLs* and help organise the sales process. They facilitate *NPL* transactions by providing access to investors and technological support (including a *VDR*). *Transaction platforms* offer to conduct online *NPL* auctions whereas the seller can choose the desired *Auction Type*.
Vendor Due Diligence	A review performed by the seller, the outcome of which is shared with investors. A *Vendor Due Diligence* can e.g. comprise: real estate revaluation, *Loan Data Tape* consistency checks, legal documentation review
VDR	*Virtual Data Room*, which can be used by the Seller to provide information, data and documents to all investors in *Phase 2* (and *Phase 1* unless Seller sets up the *VDR* only for *Phase 2*).
VDR Provider	A (tech) company offering the set-up and organisation of a *VDR* for an *NPL* sale.

EXECUTIVE SUMMARY

As announced in its Action Plan of 16 December 2020, the Commission, in close cooperation with members and observers of the Commission's NPL Advisory Panel, has developed Guidelines on a best-execution process for sales of NPLs on secondary markets. The objective of these Guidelines is to encourage good sell- and buy-side processes for NPL transactions in EU secondary markets and, in particular, to help sellers and buyers that may have less experience with secondary market transactions.

The document is based on best practices and describes the sequence of main activities to be performed within the preparation of the competitive transaction process. The Guidelines outline some practices and conditions considered necessary to achieve a successful outcome. While market participants are not obliged to follow the Guidelines, they provide NPL sellers and buyers with a clear and structured process that should enable them to achieve a successful outcome.

The main structure of the document follows a chronological reasoning. Each main chapter focuses on one of the specific stages that should be followed throughout a sales procedure. By default, a standard market transaction is defined in this document as a Broad Auction process that comprises multiple phases with two main stages: a Non-Binding Offer Phase (Phase 1) and a Binding Offer Phase (Phase 2).

The table below provides a stylised summary of the document, spanning across all phases of the transaction process. It highlights the key activities and key deliverables for each phase. More information on each of these elements can be found in the relevant chapters in the main body of the Guidelines.

Phase	Key activities	Key deliverables
1. Transaction structuring: Portfolio selection	• Assess possible legal/tax/consumer protection restrictions • Review existing IT system to enable optimising the selection process • Definition of the transaction perimeter / selection of the portfolio to sell • Decide upon the use of *External Service Providers* and / or other external advisors • Determine most efficient and effective organisational set-up to run the process (if relevant supported by External *Service Providers*) • Other considerations around servicing, portfolio modelling and setting of the 'reserve price'	• Possible amendments to IT system • Selection of portfolio for sale • Establish organisational structure to manage transaction process • Contracts with *External Service Providers* (if relevant/required)
2. Preparation phase	• Define the number of phases of the process (namely, 2-Phase-Process with *NBOs* and *BOs*, or 1-Phase-Process, directly with *BOs*) • Set the timeline – including internal steps and approach to the market (taking into account involvement of legal and consulting advisors) • Prepare the main marketing documents (mainly *Teaser* and Information Memorandum). A Management Presentation may be required during *Due Diligence* in the *BO Phase*. Preparation of the main process documents (mainly investor *NDA*, Process Letter (if required separately for Phase 1 and Phase 2), *BO Guidelines* and, if relevant, NBO Guidelines) • Prepare *Loan Data Tape* and retrieve documentation • Set up *VDR*[1] (including a detailed VDR index), unless cost-benefit analysis would dissuade use of VDR, especially for small portfolios • Preparation of *LSPA*	• Investor *VDR* (*Phase 1 VDR* ready for opening, *Phase 2 VDR* in preparation) • *Teaser* • Information Memorandum • Early draft of Management Presentation • Early draft of Process Letter • Early draft of *LSPA* • *Loan Data Tape* • Draft *NDA* • *VDR* rules (for Phases 1 and 2)
	• Market sounding • Definition of the best marketing strategy	• Process Letter • Due Diligence material inventory • *LSPA Term Sheet*

[1] The use of *VDR* is advised in general. In some cases, a *VDR* might not be entirely necessary, such as bilateral negotiations for single-name transactions (depending on the specificities of the deal).

3. Pre-marketing phase	• Negotiation of *NDAs* • Preparation of *LSPA Term Sheet* • Continue preparation of the process and marketing materials (e.g. investor presentation) for the *Phase 1* and *Phase 2*	• Signed *NDAs* • Investors long list • Optional: Expressions of Interest
4. Non-binding phase (Phase 1)	• Management of the *Phase 1* investor VDR (incl. opening, user and access management, VDR reporting, etc.) • (Continued) preparation of the *Phase 2 Data and Documents* as well as investor *VDR*, if applicable • Disclosure of the process and marketing materials for *Phase 1* • Disclosure of (meaningful) data tapes to investors (via the VDR) • Management of a (limited) *Q&A* Process if applicable due to the complexity of the perimeter and/or the number of bidders • Analysis of *NBOs* that have been submitted and comments on *LSPA Term Sheets*, if applicable • Selection of a short list of bidders to admit to the Binding Offer Phase • Selection of an *Auction Type* and preparation of auction • Finalisation of the *NPL* portfolio, potentially excluding certain ineligible *NPLs* from the portfolio (i) if they do not match the original selection criteria (anymore) or (ii) based on the reasonable request of investors.	• Investor *VDR* (Phase 2 VDR ready for opening) or other means of sharing data with investors • *Loan Data Tapes* (full set) • Optional: *Vendor Due Diligence* materials prepared (AUP Report, legal Due Diligence, etc.) • *VDR* reporting (e.g. on bidder activity and areas of interest) • Answers to questions based on *Q&A*, if applicable • Analysis Report of *NBOs* and shortlist of bidders • Optional (if not included in the *Process Letter*): Draft Q&A Process guidelines (for *Phase 2*)

5. Binding phase (Phase 2)	• Provision of Phase 2 Data and Documents to Phase 2 Investors • Management of Q&A Process • Optional: Organisation of Management Meeting(s) and summarising / providing outcome to all Phase 2 Investors • Organisation of the auction • Analysis of submitted BO Letters and *Investor LSPA Mark-Ups* • Selection of Preferred Bidder / Purchaser • Optional: KYC Process • Finalisation of the *NPL* portfolio, potentially excluding certain ineligible *NPLs* from the portfolio (i) if they do not match the original selection criteria (anymore) or (ii) based on the reasonable request of investors	• Provision of Process Information to Phase 2 Investors • Provision of draft LSPA to Phase 2 Investors • Provision of BO Guidelines to Phase 2 Investors • Final Management Presentation • New or updated information (including any costs in connection with the NPLs or the transaction that Seller wishes Purchaser to assume) to be provided to investors via the VDR and the Q&A Process • Optional: Vendor Due Diligence reports to be provided to Phase 2 Investors • Optional and if applicable: VDR reporting (e.g. on bidder activity and areas of interest) • BO Analysis Report and selection of Preferred Bidder
6. Signing of the transaction and closing	• Manage a smooth exit from the portfolio once the *NPL* sale is completed, inter alia by defining after-sale activities of Seller and *Purchaser* • Execute *LSPA* and, if applicable, further transaction documentation • Financial closing • Finalise preparation of transfer of data and documents • Negotiate and agree on the transition of the NPL servicing from the currently acting servicer to the *Purchaser* or its servicer • Accounting of the transaction • Upon *Closing*: Migration process: transfer of *NPLs* and relevant information and documentation to the Purchaser to ensure a smooth on-boarding.	• VDR archives • Final LSPA
7. Post-closing	• Conduct and implement post-*Closing* obligations according to the *LSPA*. • Cooperation between seller and *Purchaser* as foreseen in the *LSPA* and, if applicable, on an ad-hoc basis if problems occur or non-foreseen actions become necessary.	

INTRODUCTION

The COVID-19 pandemic has led to a sharp economic downturn in the EU and worldwide. Despite vast support schemes implemented by governments, banks are exposed to companies and individuals that have become financially more vulnerable, in particular small and medium-sized enterprises (SMEs). Addressing a renewed build-up of NPLs on banks' balance sheets as early as possible is a key lesson from the last economic crisis. In this context, further structural measures are needed to prevent the accumulation of NPLs on banks' balance sheets as a result of the ongoing pandemic and related effects.

In order to provide banks with a further tool to face challenges to credit risk due to the COVID-19 pandemic, the Commission has outlined targeted action to improve secondary markets for NPLs in its December 2020 Action Plan on "Tackling NPLs in the aftermath of the COVID-19 pandemic". The further development of secondary markets for distressed debt is one of the key policy areas in this regard. A deep and liquid secondary market for distressed assets across the EU would better allow banks to reduce their NPLs by selling them to third-party investors. If banks are better able to off-load non-performing assets from their balance sheet via secondary markets, this would help banks focus on their lending activities, free up space in their balance sheets for new lending and hence enable them to fund the economic recovery.[2] Easier market entry and participation should be encouraged, especially for smaller sellers and purchasers who may be crucial for local-level NPL resolution.

As the economic repercussions of the COVID-19 pandemic have set in, NPL trading activity initially declined markedly, but has recently picked up pace again. When national support measures are phased out, it is likely that insolvencies may rise and the balance sheets of banks may be impacted by this stress. Banks need to be ready to identify debtor distress early, engage proactively with their borrowers in a timely manner and consider appropriate restructuring when needed.[3] In the event that a sale of (portfolios of) NPLs to third-party investors is considered a suitable approach, banks should be ready to conduct an efficient and effective transaction process, leading to the best possible outcome. This would result in a better price for the NPLs, sold to a reputable purchaser that ensures compliance with laws including consumer protections.

To this end, the Commission announced in its Action Plan that it would develop guidance for sellers of NPLs, in cooperation with the European Banking Authority (EBA) and relevant stakeholders. The Commission therefore publishes the Guidelines on a best-execution process for sales of NPLs on secondary markets. The objective of these Guidelines is to encourage good sell- and buy-side processes for NPL transactions in EU secondary markets and, in particular, to help sellers and buyers that may have less

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[2] Off-loading NPL exposures may be the most suitable solution, especially when the work-out of NPLs exceeds the capacity of a bank. On the other hand, restructuring and work-out are also core activities of banks and need to be maintained when this would be the most fitting approach, depending on the situation of the bank and the borrower.

[3] When it comes to companies in particular, banks should have the capacity to assess changes in their debt servicing abilities and differentiate between liquidity and solvency needs.

experience with secondary market transactions. The Guidelines could lead to a number of benefits for EU secondary markets, by enabling more standardisation of processes, increasing efficiency and transparency of the timeline of transactions, and improving market practices in Member States, in particular where secondary markets are less developed.

This document summarises the best practices following the sequence of main activities to be performed within the preparation of the competitive transaction process. Throughout all of the different phases, the Guidelines provide clear suggestions on what would constitute an efficient and effective approach. The document illustrates in detail the main process and materials that are provided to external investors in standard market transactions. Considering the significant importance of sharing relevant data and information, the Guidelines include suggestions specifically on the scope of disclosure in the respective phases.

The Guidelines outline some practices and conditions considered necessary to achieve a successful outcome. Banks (as sellers of NPLs) are the main target audience and in particular smaller institutions that have less experience with offloading NPLs on secondary markets. However, the Guidelines also reflect the perspective of bigger banks, as this document could become a market practice standard for all sellers of NPLs. Beyond the banking sector, the Guidelines could also provide a reference document for other institutions that engage in sales of NPLs.

Market participants are not obliged to follow the Guidelines. These are rather meant to support NPL sellers and buyers in following a clear and structured process description that would enable arriving at a successful outcome. In particular, the Guidelines include indications on specific steps that the seller and buyer could take to improve the efficiency and effectiveness of the process. The Guidelines also point to certain steps that are more important for a specific type (and in certain cases a specific size) of transaction and/or asset class.

As regards the types of transactions, the Guidelines cover outright sales of (large) *NPL* portfolios and make reference to (large) single-name transactions.[4] Both unsecured and secured loans are considered, including the following NPL categories:

- Residential real estate (RRE) secured: requires many checks and proper documentation is essential.
- Commercial real estate (CRE) secured: very heterogeneous in nature, with characteristics differing according to location, size, industry, use, etc.
- Small and Medium Enterprise (SME) exposures: need strong focus on collateral valuation, cash flow analysis and the use of statistical methods and sampling.
- Consumer unsecured: portfolios are typically made up of small exposures.
- Corporate unsecured: implies heavier Due Diligence.
- Leasing: has particular characteristics and specialisation[5].

[4] 'Large' in this context refers to the magnitude of the portfolio in terms of overall (gross) value.

[5] Note that leasing *NPLs* include VAT and that the Seller must previously clarify (if needed, in cooperation with external tax consultants) what the implications of the *NPL* sale are in respect of the "VAT portion" of the *NPL* claim.

The above implies that *NPLs* are a 'special' product. *NPL* sales are often highly portfolio-specific. Standardising the process entirely would therefore not be possible and is not the objective of the Guidelines.

The main structure of the document follows a chronological reasoning. Each main chapter focuses on one of the specific steps that should be followed throughout a sales procedure. The two main alternative standard strategies for setting up a competitive process are a *Targeted Auction* and a *Negotiated Sale*. The Guidelines elaborate on these two alternative strategies as relevant and their possible implications if chosen. The Guidelines represent a *Broad Auction* process, which is a typical *2-Phase-Process*.

This document was developed by the Commission, in close cooperation with members and observers of the Commission's NPL Advisory Panel. The latter's membership can be found in Annex 1.

1. TRANSACTION STRUCTURING: PORTFOLIO SELECTION

1.1. KEY ACTIVITIES

The portfolio selection lays the foundation for a successful transaction. It is essential to select a marketable portfolio that complies with internal strategic targets and attracts investor demand. An early involvement of senior management during the portfolio selection process increases execution certainty, which is important for Seller as well as *Purchaser*. A marketable and well-selected portfolio reduces the execution risk, thus avoiding inefficient use of resources from all involved parties.

The key activities in this first phase are as follows:

- Assessment of legal/tax/consumer protection restrictions.
- Review existing IT system to enable optimising the selection process.
- Definition of the transaction perimeter / selection of the portfolio to sell.
- Decision upon (i) the use of internal resources vs *External Service Providers*, provided that a certain level of internal resources will always be needed[6]; and (ii) Definition of the most efficient and effective organisational set-up to run the process.
- Fine-tuning of other considerations around servicing, portfolio modelling and setting of the 'reserve price'.

In order to optimise the selection process and to avoid high costs for data validation, data reconciliation and time-consuming manual changes, the existing IT system should be reviewed and adjusted, if necessary. The more complex a transaction is, the more likely that the design of a Seller's internal organisational set-up as a project is advised, insofar that it allows a better alignment of all internal stakeholders in a transaction and closer monitoring of the transaction progress.

[6] In particular, the Seller should foresee one main contact person who communicates with the *External Service Provider* and who is responsible for the NPL transaction within the Seller's organisation.

Portfolio selection plays an important role in any transaction as the right choice of a portfolio is key to a successful execution. The portfolio selection process needs to reflect the requirements and strategic targets of the Seller and simultaneously to attract investor demands, which might not necessarily be aligned to the Seller. The Seller's goals may be driven by changes in strategy, regulatory pressure, and/or changes in risk appetite. While the Seller might have the expectations to sell more complex exposures at a high price, these goals may need to be adjusted because investors have a different yield expectation and cost calculation for work-out strategies for the *NPLs* offered. Decision to sell or to keep/retain to benefit from further upside is mainly driven by internal views within the Seller organisation (recovery value net of enforcement costs combined with P&L effect for different customer business segments) vs perceived market view (applicable for portfolio or single ticket).

The portfolio selection process may also need to exclude assets, which might be difficult to enforce against a borrower and/or to assign to a third party or which are specifically marked within the portfolio. A good example are exposures with third-party rights, or those that are otherwise encumbered, like guarantees. In such cases, it is often hard or unlikely to obtain the needed consent to transfer the asset from the beneficiary. This could lead to situations where, for example, some exposure of the borrower, like term loans, might be transferred to the *Purchaser* while the most labour-intensive exposures will remain with the bank. This also shows how important it is that the transaction team (if separate from the work-out team) maintains an open dialogue with the respective work-out officers.

It is worth noting that the portfolio may still undergo changes later in the process, i.a. reasonable ineligible claims will be excluded upon detection. During *Phase 1* and *Phase 2*, the Seller continues to check the *NPLs*, verifying whether certain loans should be excluded from the final portfolio, in line with the *Eligibility Criteria* and *Exclusion Criteria*. The *Preferred Bidder* (which eventually/ideally is also the *Purchaser* in most cases) might equally ask to exclude some *NPLs*. On this basis, the portfolio is finalised. Chronologically, this approach entails the following steps:

- Application of the main selection criteria (type, counterparty, status, size, geography, etc.);
- Exclusion of non-transferrable loans;[7] and
- Exclusion of loans according to the negotiation between the Seller and the *Purchaser*.

1.2. Assess legal/tax/consumer protection restrictions

Before composing and selling an *NPL* portfolio, there are several legal checks to be clarified varying in different countries:

- Is it allowed to sell the loans to a third party (e.g. banking secrecy, special loan conditions etc.) and what are the requirements to the third party (as prescribed by

[7] Such *NPLs* should have been filtered out when preparing the *NPL* Portfolio, but if this only becomes obvious later in the process, such NPLs should then be excluded with a relevant explanation towards the investors.

the local law implementing the Directive on credit servicers and credit purchasers[8])?

- Is it allowed to share data with third parties and what data can be shared and which ones not or only with a Data Processing Agreement[9]?
- Is it necessary to request authorisation from any regulatory bodies, taking into account the specifics of the envisioned transaction (as well as the stipulations of the local law implementing the Directive on credit servicers and credit purchasers)?
- Are there any liabilities on the portfolio from a contract with a current loan servicer/lawyer (e.g. legal fees, penalties etc.) when selling it to a third party?
- Are the loans subject to restrictions or do they include publicly traded companies with special restrictions (e.g. inside information, employees of the Seller, assignment restrictions stipulated by law)?
- Is the consent of a public/state-owned development bank (e.g. Finnreva, KfW) necessary when selling to a third party?
- What are the tax implications according to the Seller's jurisdiction?

If the contracts underlying the NPLs have been terminated ('denounced loans'), usually the whole exposure is on demand and fully due upfront, making direct sale possible. However, for the *NPL* sub-category of 'unlikely to pay' (UTP) exposures, the situation is more complicated because the underlying contracts are still valid, and both the receivables and contracts should be considered in order to perform the disposal.[10]

In terms of ensuring appropriate consumer protection, where relevant, there are certain local/national legal information duties towards consumers that need to be verified and complied with.

1.3. OBJECTIVES OF THE PORTFOLIO SELECTION PROCESS

The selection of the portfolio plays a key role in reducing the execution risk. Mitigating this risk is key to an efficient and effective *NPL* portfolio sale and is one of the most important factors in transactions for Sellers as well as for *Purchasers*. The potential of failure of a transaction, especially when Seller and *Purchaser* have invested substantial time and resources, should not be underestimated, and might also lead to reputational issues for the Seller and/or the *Purchaser*. When a Seller is unable to execute a transaction, depending on the specific causes, investors might not participate again in future transactions organised by the same Seller. Sellers who cancelled transactions in the past might not be considered as attractive/dependable as others as they might be associated with more uncertainty and the risk of abandoning transactions once more. Investors prefer to allocate their limited resources, personnel and capital to transactions in the market where they expect to have the highest likelihood of execution and not to

[8] Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and Directive 2014/17/EU.

[9] General data protection stipulations are usually contained in the *NDA*.

[10] Specific information on UTP NPLs can be found in Annex 5 to these Guidelines.

waste a potentially substantial amount of financial as well as other (internal) resources on *Due Diligence*. On the other hand, *Phase 1 Investors* that withdraw from the process after submitting unrealistic *NBOs*, might not be invited by the Seller in any future transactions.

It is crucial to use the portfolio selection as a means to balance the various and often conflicting interests of all interested parties. A portfolio disposal transaction often requires involvement of many different internal stakeholders, including, at a minimum, the *NPL* relationship management team as well as representatives from Finance, Risk, IT, Legal, and Compliance. Internal expectation management is therefore important to get the approvals needed to execute a trade. However, considering the various internal departments involved, even a well-designed and well-executed process can result in the consumption of large amounts of resources of the Seller organisation. In addition, it might be necessary to enhance internal IT systems, which generates additional costs. In cases where external support for data advisory and validation, indicative pricings, etc. is needed, total direct and indirect costs can become material. Therefore, the Seller should recognise that there may be substantial costs regardless of whether the transaction is successfully completed.

Examples of factors that may result in transactions not completing include:

- Failure to obtain the necessary internal approval, (among other reasons) due to:
    - Submitted prices being well below price expectations;
    - Missing and/or inadequate involvement of senior management; and/or
    - Emergence of unexpected factors (for example, adverse press coverage, change of legislation, etc.)
- Poor market timing due to a lack of interest by investors and/or no market for the portfolio offered.
- Technical reasons, e.g. transfer restrictions materialising during the transaction process. Usually, such restrictions would be foreseeable and the chosen perimeter should not include *NPLs* where such risk exists.
- Data gaps and/or data quality issues, adversely impacting pricing and/or transfer.
- Legal/tax constraints for *NPL* sales in certain jurisdictions, e.g. specific license requirements for *Purchasers* (which should cease to exist once the Directive on credit servicers and credit purchasers has been implemented), pre-condition of legal recovery before any sale, taxation that makes the transaction commercially unviable, etc.[11]

Most of these factors can be mitigated with a well-considered portfolio selection and a well-researched/planned sale process before launching a transaction. A portfolio selection based on a confirmed strategic decision by senior management will typically obtain relevant approvals as it is usually already aligned with management goals and the

[11] The Seller's internal Legal department's work should be coordinated with the Tax department in each jurisdiction as relevant. A general understanding of which taxes would occur on both Seller and *Purchaser* side, is relevant to a successful transaction.

bank's strategic *NPL* disposal plan. Reasons and possible goals for conducting a transaction are covered in Annex 2.

Even if there is no pre-defined or comprehensive strategy for an active *NPL* sales program, a portfolio selection should always be based on the overall internal goals and KPIs and comply with internal guidelines. It is important to note that internal strategic targets do not necessarily need to be met on a case-by-case basis. It is possible that adding exposures not meeting the criteria on a single-name basis might still add value to the overall marketability of the portfolio. For example, assets for which there is a clear interest in the market could be added to the portfolio, even if they would not fulfil all transaction goals. Such an addition might increase the offer's attractiveness in absolute terms as well as widen the investor base, leading to a higher price.

Selecting a portfolio that meets the Seller's expectation is certainly a prerequisite, albeit just one part of a successful transaction. The portfolio must also attract the investors' interest and should allow them to achieve their expectations as well. Market intelligence and soundings are key to mitigating this risk factor. Evidently, selecting a portfolio that meets the requirements/considerations of the Seller, but would not find any demand in the market, is futile. The art of portfolio selection balances the market demand with internal Seller objectives in the selection process.

It is advised to compose a homogeneous portfolio targeting specific investor groups. Additionally, in the composition of the portfolio, although there are some mixed portfolios sales, it should be avoided to mix up too many different asset classes as investors are mostly specialized on specific asset classes. In most of the cases, investors are deciding between:

- Consumers OR Corporates OR Public;
- Secured with hard assets (e.g. real estates, airplanes, cars etc.) OR Unsecured; and
- Bankrupted OR Not bankrupted

It is further advised to compose a homogeneous *NPL* portfolio with regard to jurisdiction, i.e. selecting *NPLs* (and ideally, also real-estate collateral) from only **one** jurisdiction. The number of investors will decrease for portfolios that include *NPLs* from different jurisdictions and cross-country portfolios increase complexity regarding various parameters of the planned transaction for both Seller and *Purchaser* (legal, tax, servicing). When looking at jurisdiction, the Seller should take into account:

- Where is the *NPL* effectively "booked", i.e. in which jurisdiction is the seller located?
- The laws of which country apply to the underlying loan contracts?
- Where do the borrowers reside / have their seat or registered office (at the time when the loan was granted and currently)?
- Where is the (real-estate) collateral located?

Another relevant criterion to consider is the size and potential purchase price of the portfolio. Investors need to invest time and resources in the *Due Diligence* process, which has to be included in the calculation of their potential return on investment.

Moreover, such investment might not be recovered at all in the case that a different party wins the deal. If the portfolio is too small in terms of investable funds and the expected return too low, the potential *Due Diligence* cost might be higher than the expected return on the offered portfolio or, the Seller might have to consider to provide for comprehensive *R&Ws* in the *LSPA* to outweigh the risk of not enabling *Due Diligence* and/or to provide a chance to get familiar with a portfolio. In this case, there is a high risk that nobody would join the process or submit a bid. As *Due Diligence* cost is a significant sunk cost in the event of not being selected as the *Preferred Bidder* and a function of complexity, the right balance must be found between size, R&Ws and price/return of the portfolio to create interest in the market.

1.4. TECHNICAL ASPECTS OF THE PORTFOLIO SELECTION PROCESS

It is important to take into account the more technical aspects of a portfolio selection process. IT systems in banks are often not specifically designed for portfolio divestment as such systems are usually designed to support the in-house work-out process and the work-out officer in their daily tasks. A bank offers various products to its clients and needs to disclose a material amount of accounting and regulatory information predominantly on an overall exposure level. However, the business model of a bank in the context of the banking book is usually not aimed at frequently buying and selling assets. The IT system of a bank is not designed for frequent transactions. It usually reflects the exposure view as this is important for the bank. They do not necessarily reflect a more legal or contract view, which can be critical from a transaction perspective. Providing information to potential investors in an adequate way might therefore be challenging for a bank, and the information used to prepare *Loan Data Tapes* usually requires validation (the preparation of a *Loan Data Tape* is highlighted in section 2).

For one-off transactions, the validation and, where applicable, the remediation of data might often be done manually. In cases where more regular transactions are planned, it makes sense to improve the IT system to enable a more efficient process. This may involve a review of the existing IT system and amending and/or creating a number of (additional) fields for transaction purposes. The improvements to the IT system should enable the Seller to provide relevant data on all of the positions in a timely manner throughout the transaction process. This would decrease *Due Diligence* costs for the investors and would reduce overall transaction costs, thereby improving pricing.

An innovative approach in support of efficient transactions is the implementation of a specific field in the front office system that allows the loan officer (or workout officer) to classify an exposure as suitable for transaction purposes. As the loan managers should have the best overview about the value of an exposure, they may be in a better position to recommend an in-house work-out strategy or a sale strategy. This field, therefore, allows loan managers to classify specific loans as disposable and enables them to focus on loans to which they might be able to add more value.

In addition, the transaction management team should be able to filter specific management targets and to include *NPLs* that meet the management targets. The

inclusion of these *NPLs* usually requires the approval of the respective loan manager. Such approach also allows the transaction team to better steer the timing of a transaction, which might be useful in case too many other sellers are currently active in the market. It is a very simple and powerful tool to establish an internal warehousing function. Given that this field is actively used by the loan manager, it would also enable closer alignment between the responsible loan officer and the transaction team.

When the transaction team concludes that a sufficient size has been reached and the timing to go to market is considered attractive, relevant data from the front office system may be uploaded to a system used (and in certain cases specially developed) by the transaction team. The software allows for detailed analysis of the portfolio, displays stratification tables, fills the relevant fields, and eventually produces the *Loan Data Tape*. Based on the data, a first assessment of a possible purchase price will be provided to senior management. Following the latter's approval, the transaction process could be initiated. In the context of a 'plain' portfolio, with full and complete datasets and LSPA, the process described above works well and could give swift insights into a potential portfolio and the relevant impact of a sale. In case of larger or specific transactions that do not follow a clear rationale (reason for sale) and portfolios assembled unstructured, mixing across asset classes, a detailed case-by-case analysis is inevitable. Additional efforts especially would be required, especially with respect to organisational issues.

1.5. Reflecting upon the necessary use of internal resources and potential additional need for external support

Before preparing the portfolio composition and sale, the Seller should reflect upon the available internal resources for the planned sales activities and the potential need to engage an *External Service Provider*, such as a *transaction platform* (see also Annex 3).

The following questions would help in the decision process:

- Does the Seller have internal experts that are experienced in executing a sales process?
- Does the Seller have access to a wide investor database to select the most proper and competitive investors for the transaction?
- Does the Seller know what investors expect in the *Due Diligence Process*?
- Does the Seller need support in data preparation?
- Does the Seller have a dedicated internal lawyer or is support needed in terms of legal/tax advice for the documentation (*NDA*, *LSPA*)
- Does the Seller have its own technical capacities for sharing the data or is a *VDR* provider or *transaction platform* needed?

1.6. Organisational issues

When planning a transaction, a dedicated internal team and/or an *External Service Provider* are resources worth considering. In this section, the main focus lies on internal aspects and considerations. Planning and executing a successful transaction cannot be left just to the Loan/Workout Manager, but rather, as previously mentioned, it requires a

set of skills from many departments and might benefit from the facilitating role of an advisor. The amount of work involved should not be underestimated. Similarly, the value of an existing network of *Purchasers* and the experience of conducting multiple transactions is very important.

Another important consideration is whether the personal objectives of a loan/workout manager might (or appear to) conflict with the overall management target regarding the transaction. It can be complicated to align the individual aims of a loan/workout manager with the aims that would be achieved by selling the *NPL* in the market, thereby reducing his/her workload. It could also be the case that loan/workout managers face personal concerns that selling their exposures in the market could render their role redundant. One option to mitigate this issue could be, similar to the possibility of including a field for marketable assets in the IT system (see previous section), to adjust the annual goals for loan/workout managers to encourage the loan/workout officer to 'tick the box'. This has demonstrated to be a successful method to incentivise the appropriate and effective identification of loans for a sales programme.

The establishment of a dedicated (and ideally independent) transaction team/department could be advised for many sellers (if economically efficient) and would further ameliorate the organisational set-up to facilitate and run effective *NPL* transactions. Such a specialised team could build knowledge about *NPL* markets and experience with market dynamics (in different countries/jurisdictions). This would enable the team to advise on *NPL* portfolio selection, possible market prices and the economic benefits of selling a specific portfolio. In turn, this facilitates the required (pre-) approval and support from the (senior) management to engage in *NPL* transactions.

For larger transactions, it could be advised to set up the transaction as a (separate) project. The project should be run by the internal transaction team (potentially supported by *External Service Providers*) for the reasons outlined above.

In the case of larger selling institutions, it could be advised for the transaction team to establish a project management office (PMO), which would coordinate the various work streams, set up shared folders to exchange information between the various work streams, and organise the communication with the steering committee. The steering committee should include all relevant senior managers to ensure that they are consistently informed about the progress on the transaction and to align them with the appropriate outcome. This helps in mitigating the risk that the approval for selling would be refused. As regards the set-up and implementation of different work streams, sellers generally have quite some flexibility. However, major workflows need to be able to fulfil their functions and should not be disrupted by an overly complex structure. Such processes include *Loan Data Tape* validation/remediation/enrichment; Data/*Due Diligence* (which should be led by the loan/workout manager), Finance, Marketing (led by transaction manager) and Legal.

Such a set-up, including a PMO, might not be viable for a smaller seller that wants to sell an *NPL* portfolio that is considered to be small by the market, yet is of a considerable size for the Seller. Internal analysis by the (smaller) Seller should reflect

upon the most effective and cost-efficient organizational set-up, taking into account the size and complexity of the *NPLs* to be sold.

2. PREPARATION PHASE

2.1. KEY ACTIVITIES

Building on the actions and reflections described above, the Seller should take care of the following key activities during the preparation phase:

- Define the number of phases of the process (namely, *2-Phase-Process* with *NBOs* and *BOs*, or *1-Phase-Process*, directly with *BOs*)
- Set the timeline – including internal steps and approach to the market (taking into account involvement of legal and consulting advisors as well as timing to take care of requests that investors can have)
- Prepare the main marketing documents (mainly *Teaser* and *Information Memorandum*). A Management Presentation may be required during *Due Diligence* in *Phase 2*. Preparation of the main process documents (mainly investor *NDAs*, *Process Letter* (if required separately for *Phase 1* and *Phase 2*), *BO Guidelines* and, if relevant, *NBO Guidelines*)
- Prepare *Loan Data Tape* and retrieve documentation
- Set up *VDR*[12] (including a detailed *VDR* index)
- Preparation of the *LSPA*

2.2. NUMBER OF PHASES OF THE PROCESS AND TIMELINE

First of all, a decision should be taken on whether to conduct a *2-Phase* or a *1-Phase-Process* according to the type of portfolio to be brought to the market and expected deadlines (e.g. if the asset type is well known with good understanding of expected prices, a *1-Phase-Process* could be preferred to shorten the timeline). A timeline, including all of the relevant internal steps and milestones to approach the market should be defined, taking into consideration:

1. Consistency of approval path, stemming from Board of Directors' delegation of powers and signatory powers[13];
2. Identification of list of possible investors to be invited. In case of disposal, all the internal compliance requirements (e.g. *KYC*) need to be addressed;
3. Identification of list of possible servicers to be invited for any investor potentially interested in the acquisition, but without currently having access to a servicer);
4. Set up of competitive tender context to achieve sufficient price tension, as appropriate; however, in case of a small *NPL* portfolio or single-name transaction,

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[12] The use of *VDR* is advised in general. In some cases, a *VDR* might not be entirely necessary, such as bilateral negotiations for single-name transactions (depending on the specificities of the deal).

[13] Delegation of powers is intended as a subdivision and sub-allocation of powers to subordinates in order to achieve effective results.

the seller should also weigh increased transaction costs and efforts against the possibility of a bilateral negotiation approach;

5. Definition of transaction documentation – the *NDA*, *LSPA* and potentially additional transaction documents have to be agreed upon by the relevant internal legal functions, eventually supported by external legal advisor; the *LSPA* should in addition be signed off by the tax department and by the auditors.
6. Consideration of the time needed to perform vendor *Due Diligence* / data remediation, to prepare *Teaser* and *Information Memorandum* and *Loan Data Tape*.

2.3. Preparation of main documents

The institution should then prepare the documentation related to the *NPLs* and the commercial materials. A *Teaser* contains the key transaction background and summary data on the *NPLs* to be disposed, a *Process Letter* with all relevant transaction steps and timing (see also section 3.4) and an *Information Memorandum* with further information on the transaction structure and the *NPL* portfolio. The *Information Memorandum* provides a detailed description of the target *NPL* portfolio/single exposure that serves as the primary marketing document in the tender process. It also contains an executive summary, investment considerations, sale structure, bidding method, estimated recoveries etc.

Within these documents, all the engagement rules of the process, including timeline, conditions, etc. should be clearly stated. The importance of clear and transparent communication in the initial phase should be stressed, to explain to potential investors why the transaction is taking place and what are the rules of engagement. This could otherwise lead to misunderstandings and ultimately jeopardise the deal. These soft facts should not be overlooked by sellers, as they can motivate an investor to consider a deal.

2.4. Loan data tape preparation and documentation retrieving

During this phase, the selling institution should start collecting the data on the *NPLs* (and collaterals, if applicable) of the portfolio, in order to create the *Loan Data Tapes* that would be made available to investors. The Seller should prepare a *Loan Data Tape* covering, as a minimum, information in the following key main areas:

- total outstanding amount and breakdown into principal claim, interest, fees and costs
- date of origination
- nature of borrowers
- status of claim / borrower (e.g. insolvent)
- date of default and information on actions taken to avoid statute-barring
- historical payments, ideally on a loan-by-loan basis
- status of recovery procedures and projected recoveries (business plan), if available

- legal status of the debt (e.g. pre-legal, currently in-court proceedings, already titled and in enforcement actions[14])
- if the loan is secured, additionally: key information on collateral, including rank of the lien, register facts (registered amounts), third-party rights, open market values available, personal guarantees, etc. For CRE loans, more disclosure may be needed on tenancy/occupancy status, yield, gross market rent. In case of corporate loans, it may be necessary to add financial statements of the borrowers, etc.

In order to obtain a more accurate pricing of credit portfolios, it is advised to strive to not only take a snapshot of the data, but also provide some historical performance data, especially on recovery rates. Historical performance data should include the actual gross collection cash flows (including detailed interim collection and cash in court information) on the portfolio at loan or borrower level plus procedural costs and legal expenses. The historical performance data might include aggregated recovery curves reflecting the general workout experience of the selling institution. Due to the disordered relationship with the borrower, information about the legal status is very helpful as well. It is advised to also perform an internal vendor *Due Diligence* to check completeness and correctness of stored information and eventually improve the data quality via ad hoc remediation. Vendor *Due Diligence* can be performed internally or with the support of a (specialised) *External Service Provider*, which may offer an additional neutral (and potentially clearer) view regarding the key relevant information to be disclosed, mainly affecting the prices.

It is important to note that the EBA standardised *NPL* data templates, which were first developed in 2017 to help facilitating financial *Due Diligence* and the valuation of *NPL* transactions, will play an increasingly important role in the future. At the request of the Commission and following the adoption of the Directive on credit servicers and credit purchasers, the EBA is currently carrying out a review of the data templates, streamlining them to help banks better prepare as part of their *NPL* management strategies in the aftermath of the COVID-19 pandemic. Use of the templates has been voluntary so far, yet the Directive on credit servicers and credit purchasers[15] mandates the EBA to further develop them into implementing technical standards for credit institutions. In line with the conditions as set out in the Directive, credit institutions will in future be required to use the templates for transfers of non-performing credit agreements (including transfers to other credit institutions). Taking into account the experience of market participants on the buyer and seller side, the revised templates should become simpler, more proportionate and more effective, which would enable price discovery in a consistent way across the single market.

The Seller can perform completeness, accuracy and other data quality checks and create a *Loan Data Tape* in the specific format required for transaction or regulatory purposes. In this respect, it is advised to employ the *NPL* data template of the European Banking

[14] If enforcement actions have been taken, it would ideally be clarified which measures.

[15] Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and Directive 2014/17/EU.

Authority, which is to become mandatory in the future. An *External Service Provider* can also support the determination of an expected price for the specific portfolio.

Preparation of the documentation should include the actual loan files, or a sample thereof, as those will be required by the investors during the *Due Diligence*. In any case, availability of documentation will become a topic during the *BO* Phase as investors usually request *R&Ws* with respect to documentation being available. Documentation in a transferable form needs to be ready before signing / closing. Knowledge of what data and documentation can be provided in which form is a prerequisite when starting an *NPL* sales process.

The collection of physical documentation might not be a trivial formality. Lack of quality of documentation can pull down the price. Depending on the loan contract, it might include a variety of documents and records:

- Loan documentation:
    - Contracts or deeds with debtors
    - Judicial documentation
    - Insolvency documentation
- Addendums in longer term loans
- Collateral documentation
- Correspondence with the client or the courts
- Correspondence with lawyers

Should the Seller decide to share a sample of documents with investors only, then the sample creation process should be well explained and all borrowers belonging to the sample should be clearly marked in the *Loan Data Tape*. The seller should prepare sample documentation for a (statistically) random sample. If the chosen *NPLs* do not (seem to) represent a random sample, analysts on investor level will point this out and investors are likely to request additional documentation, which can delay the overall process or, if the seller does not fulfil the request, can lead to lower prices offered as investors fear that data quality is not uniform for the *NPLs* in the portfolio.

2.5. DECISION ON VDR SET-UP

In order to share information, for larger transactions with mostly digitally available information, it is advised to use a *VDR* (internal *VDR* solution and/or *External Service Provider* offering *VDR solutions*). This enables tracking downloads of documents and the activity of each potential investor in a manner that is easily auditable. In addition, *VDR* usually allows for *Q&A* sessions and might also enable sharing any request of additional information to every investor, which facilitates a fair and transparent process. A *VDR* can be set up internally by the Seller or in cooperation with an *External Service Provider* (see also Annex 3 for more details).

If the Seller chooses to make use of a *VDR*, then all (electronically available) data and documents are shared via the *VDR*. If the Seller does not make use of a *VDR*, the Seller chooses another secure medium of data transfer.

The decision to set up and use a *VDR* should be determined on a case-by-case basis to meet the interests of all participating parties. Especially for small portfolios or single-name transactions, a cost-benefit analysis should be conducted, which might deter using a *VDR* and may suggest using alternative solutions that could be more cost-efficient under such circumstances.

When using a *VDR*, guidelines in a specific document should set the rules to be followed by the investors in using the *VDR* (access to the *VDR* and use of the information disclosed therein). The document typically contains the list of persons to be given access to the *VDR*, data room rules and permission rights (e.g. permission levels of downloads, printing possibilities etc.). *VDR* rules should be balanced and should state that agreements in the *NDA* prevail in case of conflict. It can create a significant delay if *VDR* rules contain stricture stipulations than the *NDA* including potentially personal liability of persons entering the *VDR*. If investor analysts refuse to enter the *VDR* based on e.g. personal liability clauses, this is not in the interest of the seller or the process in general.

Documents uploaded in the *VDR* need to comply with the applicable personal data protection and banking secrecy legislation. Therefore, if applicable, personal data information (i.e. personal identification number, name/surname, etc.) and/or sensitive information must be black-lined following the advice of internal/external transactional counsel.

On the other side, during this phase, the Seller gives investors access to essential information in the form of the *Loan Data Tapes* to allow portfolio analysis. The more relevant the information, the more likely the Seller will obtain realistic non-binding price offers. Relevant information should at least include the following: total outstanding amount, segment of debtors (private individuals, small businesses, large corporates, etc.), date of default, historical payments, legal status of the debt, details regarding collateral (in case the loan is secured). In case of large portfolios, the *VDR* might not include full documentation during *Phase 1*. A sample of loan documentation may then be provided during *Phase 2*. Scope of the loan documentation disclosure could be provided to *Phase 1 Investors* during *Phase 1*, so that they factor this in for their *NBOs*. Sampling criteria may need to be properly disclosed to the investors as such could be included in the *LSPA* in the form of *R&Ws*. If *External Service Providers* are engaged, it is advised that they check and endorse the sampling criteria.

2.6. Preparation of the Loan Sale and Purchase Agreement

Apart from data and documentation, the terms included in the *LSPA* will affect the price. The process around the *LSPA* should thus already be started in the preparation phase and be part of the documentation to be shared with investors via *VDR* before the *BO* is submitted and constitute a key element to be considered for the *BO* itself.

The Seller should decide on the process regarding the *LSPA*:

- In which language is the *LSPA* to be provided to investors? It is considered standard market practice that English is the preferred language, provided that

specific legal terms should also reference the respective legal term in the local language. However, where targeted investors are (solely) local, the local language is likely to be acceptable.

- Will it be drafted by in-house lawyers or would external legal counsel be mandated?
- Are *LSPA* templates available from industry associations or *transaction platforms*?
- What information do the lawyers need to be able to customise the *LSPA* to the portfolio?
- Which *R&Ws* can the Seller give? Input from the work-out team is imperative here.
- Who needs to sign off on the *LSPA* internally before it is provided to the investors[16]?
- Define a reasonable timeline for investors to prepare a mark-up and thereby taking into account additional time that might be needed if the *LSPA* language is not English, but international corporations / funds are among the investors.
- Set internal timelines: what needs to be done and when, to be able to meet the delivery timeline?
- When would the draft *LSPA* be delivered to investors?

The draft *LSPA* should be further developed during the next phase (see also section 3.4).

3. PRE-MARKETING PHASE

3.1. KEY ACTIVITIES

The Pre-Marketing Phase entails the preliminary assessment of the market appetite to receive feedback on a transaction. The output of this phase is the final selection of the transaction structure and perimeter, the *Process Letter* describing the transaction's rules and timeline, and a *Due Diligence Material Inventory* detailing at what point in the process key material will be released to potential investors.

The key activities are the following:

- Market sounding
- Definition of the best marketing strategy
- Continue preparation of the process and marketing materials for the *NBO* and *BO* Phase.

The scope and depth of pre-marketing is defined by often-conflicting requirements within which the Seller is operating. The Seller must balance:

- its need for transaction transparency as demanded by its stakeholders (e.g. regulators, shareholders, etc.); and

[16] The *LSPA* should inter alia be reviewed by the seller's auditors under an accounting perspective to verify compliance with IFRS requirements in order to assess the derecognition of the portfolio.

- the general objective (e.g. maximizing recoveries/value, speed and costs, minimizing disruption, discretion, deliver towards customers in distressed situation etc.)

3.2. Market sounding

During this phase, the Seller may perform a 'market sounding', based on the features of the projected transaction and prepare a long list of potential investors to assess their interest in the transaction. External restrictions on the process may not allow an open invitation to as many investors as possible and/or the Seller may not have knowledge of the most likely investors. Therefore, it is important to have access to and maintain the widest possible investor pool with no limitation. In this regard, for certain sellers, in a number of jurisdictions, *External Service Providers* can help addressing the right investors through their investor databases.

As part of the Market Sounding, the Seller may issue the *Teaser* presenting the envisaged process (with a general timeline), the rules to access information, and the bidding procedure. It is important to clarify the expectations and to outline the process as detailed as possible. It is therefore key to provide a concrete timeline, to indicate when the Seller deliverables will be provided, when the bids are expected and on which basis, etc.

The *Teaser* is an anonymous marketing document, which summarises the main elements of the proposed *NPL* sale. It can be provided to potential investors before the signing of an *NDA* (and provides a first indication on when the *NDA* has to be signed/executed). Particularly for *NPL* sales involving real estate collateral, it is important that such *Teaser* be prepared with a set of visuals, maps, etc. that is as comprehensive as possible. To the extent possible without disclosing confidential material, the *Teaser*, at a minimum, should address key property facts, property location, investments highlights, borrower overview, current stage within the legal process of the loan, key financial indicators, picture[17], and contact information.[18]

The *Teaser* is distributed to target investors to introduce them to the key characteristics of the envisaged transaction. The Seller collects expressions of interest from potential investors. Following the receipt of the written expressions of interest, the Seller may consider inviting further investors to the sales process.

The Seller's internal/external legal advisor needs to negotiate *NDAs* with the potential investors and their respective legal counsels. At the end of this phase, potential investors are required to sign these *NDAs*. Following execution of the *NDA*, the Seller will be able to distribute an initial *Process Letter* and *Information Memorandum* to *Phase 1 Investors*.

As *NDAs* present a complex topic of their own, it might take a long time to negotiate an *NDA* with experienced investors that have their own internal rules and guidelines to

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[17] It is not always possible to provide pictures of e.g. property. This is especially the case for RRE.

[18] In general, compliance with the requirements of the EU General Data Protection Regulation (GDPR – Regulation (EU) 2016/679) needs to be ensured.

adhere to. This needs to be reflected in the timeline. It is possible that an investor is ready to sign swiftly and that the process is still held up for weeks because the *NDA* needs to be negotiated with another investor. It is advised to centralise the on-boarding of interested investors, using strict team responsibilities and modern technologies (via internal systems or via e.g. *transaction platforms*).

Elements to consider when marketing/advertising a sale:

The selection of the investors' residence and the language of the marketing material is very important. As a rule of thumb, transactions with a possible cash price (net proceeds) below EUR 5 to 20 million (depending on the country and the specificities of the NPL portfolio) may only be attractive to local investors; larger transactions should be marketed to both local and international investors. International investors will typically expect that the transaction incorporates generally accepted market documents and processes (e.g. LMA *NDA*) and need an English documentation for the transaction process. Also for smaller transactions, English documentation should be considered, as "local investors" may be affiliated to bigger corporations with their seat abroad and where committee approval needs to be obtained.

It is also important to elaborate on the selection of investors based on the preference in the specific asset category. Investors in the *NPL* market mostly divide their interest according to a number of factors (see also section 1.3). Willingness to buy might also be demonstrated via a financial commitment (e.g. refundable deposit). With respect to the latter option, the Seller should weigh the level of security a deposit offers, against the additional efforts arising from the necessity to negotiate another document and to handle the financial deposits from various investors, which in the end will have to be reimbursed (except for the *Purchaser* for which the deposited amount could be deducted from the purchase price payment).

3.3. DEFINITION OF THE BEST MARKETING STRATEGY

As noted above, a choice needs to be made between a *1-Phase-Process* and a *2-Phase-Process*. The latter is characterised by two levels of disclosure: first, bidders are provided with high-level disclosure during the *NBO* phase. Subsequently selected investors are provided access to a second level of disclosure during the *BO* phase, which generally includes more detailed *Due Diligence* materials (*AUP Report*, re-valuations, servicing review etc.). Conversely, in a *1-Phase-Process* all bidders are provided with the same level of disclosure at once.

There are a number of advantages in having an *NBO* Phase:

(i) Increases competition as the initial pool of bidders is larger;

(ii) Investors are selected for the following phase based on their *NBO* letters so that the more work-intensive binding phase and *Due Diligence* is only conducted with a restricted group of investors, making the overall process more efficient and easier to manage;

(iii) Investors have the chance to ask for additional data during the *NBO* phase, which the Seller can prepare and then provide in the binding phase. Necessary

disclosures regarding the quality of the portfolio can increase the pricing of the portfolio (leading to more accurate pricing) and make discussions on the *LSPA* easier;

(iv) Price discovery may be more important for unlikely-to-pay portfolios, which could become more common in the aftermath of the COVID-19 crisis than it was for the legacy *NPLs* transacted in the last 10 years;

(v) More sensitive data/information (such as private contractual and judicial information related with the borrower itself, property revaluations, full servicer review etc.) is only provided to shortlisted bidders in *Phase 2*.

On the other hand, the disadvantages of an *NBO* phase include:

(i) Transaction may take longer given the *2-Phase* nature of the process;

(ii) Two sets of data must be prepared. Nevertheless, the second *Loan Data Tape* should benefit from the partial work done in the first one adding a higher degree of completion; and

(iii) Wider investor outreach may reduce transaction confidentiality.

In general, a *2-Phase-Process* could be advised in case the number of potential investors has not yet been reduced to e.g. 5 or less. In case a Seller already knows that the number of investors would be limited and competition might even be counterproductive, the Seller could certainly consider a faster (and probably more profitable) short-list process.

Length of the disclosure phases: on average, *Phase 1* lasts up to ca. 4 weeks and the second phase 4 to 12 weeks (depending on whether the portfolio is secured or not and depending on whether the Seller will comply with its own delivery deadlines). However, given the heterogeneity of portfolios and bespoke nature of these transactions, the exact duration depends on each portfolio and investor base.

Once the decision to opt for either a *1-Phase-Process* or *2-Phase-Process* has been taken, based on market practices, the three standard strategies for setting up a competitive process are a *Broad Auction*, a *Targeted Auction* and a *Negotiated Sale*. Below is an overview of these three options and indications on what constitutes the best marketing strategy in different scenarios.

Broad Auction:

A *Broad Auction* is a typical *2-Phase-Process*, whereby a large list of investors is invited to submit an indicative *NBO*. Following this first auction stage, a *Due Diligence* process is run with a restricted short list of investors which is invited to submit a final *BO*. Following this second auction stage, a single *Preferred Bidder* is selected, with whom the Seller enters into the negotiation of the *LSPA* and potentially additional transaction agreements.

Building on the advantages mentioned above, the main benefit of this process lies in the bigger base of potential investors:

- More competition leading to higher sales results;

- Investors will be treated in a more transparent selection process based on the price and not on personal relationships; and
- From compliance perspective, a more representative market price and pricing comparable are available.

The main disadvantages are additional resources required to manage the transaction, sharing confidential information with more participants, sellers' reputational risks and possible risk of failed execution with new investors. Regarding longlists of investors, the risk of having an excessively long list is that those investors that have a real interest in the transaction could be more reluctant to spend time and resources on *Due Diligence* in such a situation, due to the very high competition and the perception of the process being less focused.

For transactions attempting to reach a broad audience, for certain sellers in a number of jurisdictions, *transaction platforms* could offer an efficient manner to minimise the disadvantage of dealing with a large number of investors. *Transaction platforms* are designed to shift the complexity of interacting with multiple possible investors from the Seller to a purpose-built platform.

Targeted Auction:

A *Targeted Auction* is a competitive process similar to the *Broad Auction*, but involves a shorter list of potential investors (approximately 2 to 8). This option typically allows the Seller to have better control over the process whilst benefitting from a still competitive environment. It is usually a *2-Phase-Process*, although under specific circumstances and especially in high time-pressure situations, the first phase may be omitted.

The main advantages are linked to the narrower base of potential investors:

- Less complexity (fewer interactions, less Due Diligence efforts needed at this stage);
- Participants are well known, which fastens the timeline and the rate of success. It also allows to get a better commitment from every participant, as they believe they stand a better chance to be selected as the *Preferred Bidder*, spurring them to spend more resources, focus more efforts on *Due Diligence*, which can have a positive impact on price and the *LSPA*;
- *Q&A Process* with investors is more manageable by the bank's team; and
- Containment of potential issues with confidentiality of information and limited reputation risks.

The main disadvantages of a narrow marketing disclosure are limited competition, in particular the possible exclusion of newcomers that could have been interested in the transaction. This could lead to lower sale proceeds and, in a worst case, regulatory review later on.

Negotiated Sale:

The *Negotiated Sale* is a bilateral process involving a single potential investor. Due to the lack of competition, the main steps (with relevant documentation shared) and the outcome of the marketing process vary significantly from the *Broad Auction*. The strategy is more likely to be adopted in scenarios where speed and confidentiality related to the transaction are critical for the Seller, or in the following cases:

- In the preliminary market assessment, only a limited number of investors (one or two) showed interests in the transaction.
- Negotiation between the Seller and the potential *Purchaser* have been made beforehand or this is a repeat/follow-up transaction, therefore there may be no need to start a competitive process.

The main advantages would be linked to special knowledge/interest on the Debtor/Creditor:

- Investors that are already invested in a specific Debtor (Corporate) would be able to pay a premium due to reduced *Due Diligence* effort and risk.
- Investors/servicers that already perform servicing for the Creditor have developed specific know-how/procedures over time to pay a Premium and give Execution certainty.
- The effort on sharing *Due Diligence* documents is very low.

The main disadvantages are the possible collection of limited reference prices and narrow market feedback.

Depending on the choice among the three options above, the following timelines could be envisioned:

Process	**Preparatory Phases**	**Non-Binding Offer Phase (*Phase 1*)**	**Binding Offer Phase (*Phase 2*)**	**Negotiation and Signing**
Broad Auction – *2-Phase-Process*	8 - 12 weeks	4 - 6 weeks	6 - 10 weeks	2 - 4 weeks
Targeted Auction – *2-Phase-Process*	6 - 10 weeks	4 - 6 weeks	6 - 10 weeks	2 - 4 weeks
Targeted Auction – *1-Phase-Process*	6 - 8 weeks	N/A	6 - 10 weeks	2 - 4 weeks
Negotiated Sale – *1-Phase-Process*	4 - 8 weeks	N/A	6 - 8 weeks	2 - 4 weeks[19]

[19] Depending on the level of preparation on the side of the seller, the complexity of the sale, etc., this could also take longer (possibly over 2 months).

3.4. PREPARATION OF THE PROCESS AND MARKETING MATERIALS FOR THE NON-BINDING AND BINDING PHASE

Preparation of the process and marketing materials for the *NBO Phase:*

The final objective of the pre-marketing phase is to prepare the process and marketing materials that are appropriate to the marketing strategy chosen (e.g., Broad, Targeted, Negotiated). The output is a *Process Letter*[20], which is shared with investors who have signed an *NDA*. The *Process Letter* document defines:

(i) the procedure and rules to which participants in the sale will adhere; and

(ii) the *Due Diligence Material Inventory*, which will detail what material prepared in the previous stages (e.g. *Teaser*, *Loan Data Tapes*, loan documents, appraisals, *AUP Report*, legal *Due Diligence* report, *LSPAs*, etc.) will be included in the *NBO* and the *BO* phase (if a decision has been made to have a split process).

The importance of this phase cannot be underestimated. Investors build confidence in a process based on the professional spirit of the 'rules of the game' as defined by the Seller in the *Process Letter*. Investors typically prefer to invest *Due Diligence* costs in processes where they have high confidence in the timeline and goals of the Seller. Conversely, sales processes that appear to have sliding timelines, changing rules, etc. damage not only the prospects for that individual sale process, but also the Seller's prospects at conducting further sales. Sellers should take this into account when launching an *NPL* sales process and consider that investors are less likely to take part in processes again if they observed either of the following:

- the Seller seems to be merely interested in cross-checking the book value of its *NPLs*;
- the Seller launches a transaction process for the same (or similar) portfolio on a regular basis, yet does not sell on account of its price expectations not being met, while never revealing its reserve price.

Similarly, investment in this phase reduces the risk of legal costs, regulatory scrutiny, and liability later. The *Process Letter* determines investors' expectations as to the process, timeline, and format of the bidding process. It allows them to allocate resources and sets their strategy.

The *Process Letter*, at a minimum, should address:

- Restrictions on what type of entities can bid: Based on advice from in-house or external legal (regulatory) counsel, the Seller should specify license or other requirements applying to the *Purchaser*. Even if legally it is predominantly a *Purchaser* obligation to ensure such compliance, the seller does not want to risk a process delay or admitting investors who cannot fulfil the requirements to *Phase 2*.

[20] Terms of sale.

- Means by which a bidder acknowledges and agrees to the *Process Letter*: For example, written acknowledgement prior to bid, through the action of submitting a bid, etc.
- All deadlines applicable to the relevant transaction phase, including seller deliverables such as data, sample loan documentation and *LSPA*.
- *KYC*: At what stage a prospective bidder will have to provide *KYC* material.
- Bid Procedure:
    - How will *Due Diligence* be performed, and at what stages different levels of material will be released. For example, an anonymized *Loan Data Tape* will be made available during the *NBO* phase; a detailed *Loan Data Tape* will be made available during the *BO* phase.
    - How will questions related to *Due Diligence* be addressed? Submission process, targeted turnaround time, etc.
    - Deposit: Will a deposit be required to submit a bid and what are the instructions for submitting the deposit, if required?
    - How bids should be submitted: For example, email, electronic platform, phone, physical, etc.
    - Bidding type: Whether the sale will be conducted as a sealed bid, English auction, Dutch auction, or some hybrid model (see also Annex 4 for more information).
    - What a valid bid will constitute: For example, whether partial bids will be considered, whether bids contingent on changes to the *LSPA* will be considered, etc.
    - For what timespan bids have to be binding (e.g. during 72 hours), if during Phase 2.
- Cut-Off Date: For loans where interest is being accrued, what will be the calculation date? How will payments of principal and interest received after this date be addressed.
- Bid Deadline: When do bids have to be submitted by and whether late bids are considered.
- Bid Nomenclature. Should bids be submitted as a percentage of outstanding principal balance or gross book value or as an amount in the bid currency, etc.?
- Bid Confirmation: How the Seller will confirm the receipt of the bid and what the bidder should do if they fail to receive a confirmation
- How Bids will be Assessed: For example, what will the process be if identical bids are received, is the Seller committed to selling regardless of the value of the highest bid, is the Seller constrained to selling to the highest bidder, etc.
- Bid Award: How will the winning and losing bidders be informed?
- Closing Process: For the winning bidder, process and timeline to closing, e.g.:
    - Good faith deposit. If a deposit is required, how is it calculated, what is the deadline, and under what circumstances will it be returned.
    - Execution of the *LSPA*. When is signing intended?

- Other: Other factors that the Seller envisages. Examples of this include will the Seller offer finance, is regulatory approval required, etc.

Previous stages of the preparation process have created all the documents and material that will be made available to the investor. The *Due Diligence Material Inventory* will set out for the Seller team and potential investors at what stage material will be released. The release of the data is driven by:

- Data Protection Laws: The Seller wants to safeguard and minimise the risk of violating data protection laws.
- Competition Issues: Sellers may want to restrict data being seen by competitors that might give their competitors an advantage over them.
- Maximizing Proceeds and Transparency: As a general rule, the sooner potential investors have access to the full *Due Diligence* material (good or bad), the higher the participation and the bids.

Preparation of the process and marketing materials for the *BO Phase*

In a *2-Phase-Process*, the *BO* phase will make use of the documentation prepared in the previous *NBO* phase, in particular the *Process Letter* with the terms of sale therein. The *VDR* may give greater permission levels for downloading detailed information within the limits of data protection and bank secrecy.

The draft *LSPA* is the final main documentation to be prepared and to be released at the beginning of the *BO Phase.* Main topics to be covered in the LSPA are listed in Annex 6.

4. Non-binding Offer Phase (Phase 1)

4.1. Key activities

The overall objective for the Seller is to receive *NBOs* from all *Phase 1 Investors* on the *NBO Date* in the form requested by the Seller.

When the decision has been made to follow a *2-Phase-Process*, the Seller first asks for *NBOs* and then for *BOs*. As a critical part of the preparation phase, the Seller has selected an appropriate group of prospective investors and compiled corresponding contact information. The Seller (potentially supported by *External Service Providers*) identifies and puts together a list of appropriate *Phase 1 Investors*.

At the beginning of *Phase 1*, the Seller is to provide each *Phase 1 Investor* with (i) the information that such investor was admitted to *Phase 1*; and (ii) a specific/detailed timeline setting out each major step, including any data, documents or information to be provided by the Seller.

The key activities are as follows:

- If a *VDR* is employed: Management of the *Phase 1 Investor VDR* (incl. opening, user and access management, *VDR* reporting, etc.)
- (Continued) preparation of the *Phase 2 Investor VDR*

- Disclosure of the process and marketing materials for the *Phase 1*
- Disclosure of (meaningful) data tapes to *Phase 1 Investors*
- Management of a (limited) *Q&A Process* if applicable due to the complexity of the perimeter and/or the number of bidders
- Selection of an *Auction Type* for *Phase 2*
- Optional: provision of an *LSPA Term Sheet* to *Phase 1 Investors*
- Analysis of the *NBOs* that have been submitted
- Selection of a short list of bidders to admit to *Phase 2*
- Finalisation of the portfolio potentially excluding certain ineligible *NPLs* from the portfolio (i) if they do not match the original selection criteria (anymore) or (ii) based on the reasonable request of investors.

4.2. LAUNCH OF THE BIDDING PROCESS AND DISTRIBUTION OF THE INFORMATION PACK

Marketing materials represent the first formal introduction of the *NPL* portfolio/single exposure to investors. They are essential for sparking investor interest and creating a favourable first impression. Together with the *Teaser*, the main additional marketing documents for a first-round *NBO* phase are the *Information Memorandum*, a (meaningful) *Loan Data Tape* [21] and the *Process Letter*.

The *Phase 1 Process Letter* sets out the rules of the *NBO* phase. The Seller can already share the *LSPA* draft in *Phase 1*, but it is not customary to ask investors to prepare an *Investor LSPA Mark-up* in *Phase 1* as (i) investors might be reluctant to spend money (external legal counsel) and resources on this in *Phase 1* and (ii) the Seller does not want to review *Investor LSPA Mark-ups* of all *Phase 1 Investors*. However, if the Seller wants to use comments on contractual topics as selection criterion, the Seller can choose to distribute a (concise) *LSPA Term Sheet* stipulating the main parameters that will be contained in the *LSPA*. On this basis, *Phase 1 Investors* can be asked to submit a statement on these parameters, together with their *NBO*. This enables the Seller to take into account the preferences of *Phase 1 Investors* before moving on to *Phase 2*, supporting the Seller to further develop and finalise the *LSPA* draft. In addition, the seller would be made aware if the *LSPA Term Sheet* contains contractual arrangements which all or the majority of investors reject.

If a professionally prepared *LSPA* is not released for comment as early as possible in the process, the Seller exposes itself to the risk of 're-trading' (the *Purchaser's* negotiating strategy of using the negotiating of the *LSPA* as an opportunity to claw back economic value after committing to a purchase price during the bidding process). It is therefore advised that:

- an *LSPA Term Sheet* is shared with investors during Phase 1,
- the *LSPA* be prepared in the preparation phase and finalised in *Phase 1*, to be released latest at the beginning of *Phase 2*, and

[21] The full set of *Loan Data Tapes* should be prepared and ready by the end of *Phase 1*.

- investors should be required to submit *Investor LSPA Mark-ups* to the as part of their *BOs*.

Together with the *Process Letter*, the materials to be received by the *Phase 1 Investors* will also contain detailed portfolio data on a line-by-line basis, and where applicable further detailed information regarding all or the largest loans. The *Process Letter* or another part of the *Phase 1* materials shared by the Seller sets out, inter alia:

- the detailed timeline for *Phase 1* and ideally already the rough timeline for *Phase 2*. In case of any delay on the Seller's side, the Seller actively communicates this immediately to all *Phase 1 Investors* including information about postponement of deadlines which were originally communicated by the Seller. The timeline initially communicated to the *Phase 1 Investors* should be realistic and changes should be made transparent for the Seller to retain a reputation of reliability;
- the information on the Seller's requirements for format and contents of the *NBO*. It is advisable for the Seller to request from *Phase 1 Investors* to specify e.g. any information and *Due Diligence* requests they would have for *Phase 2*, as well as the assumptions their *NBO* is based on, to enable the Seller to take this into account for *Phase 2* planning and to determine a realistic *Phase 2* timeline.

To the extent that the Seller has undergone any *Vendor Due Diligence* work (e.g. real estate revaluation, *loan data tape* consistency checks, legal documentation review), it might be helpful to disclose the scope of such *Vendor Due Diligence* in *Phase 1*. This would enable investors to scope the potential *Due Diligence* work required in *Phase 2* and factor this in as part of their *NBO*.

4.3. BIDDERS UNDERTAKING INITIAL DUE DILIGENCE

After receiving the *Phase 1* materials from the Seller, the *Phase 1 Investors* carry out an initial *Due Diligence* based on the available information. They might also submit a limited number of questions to clarify certain aspects regarding the *NPLs* (and their underlying collateral, if applicable) to the Seller. There would also be the option to allow for limited *Q&A* with *Phase 1 Investors*, which might already pose (limited) questions to the Seller. This could be due to the potential complexity of the sale perimeter and/or the number of bidders. Furthermore, the Seller could develop guidelines for the more detailed *Q&A Process* in *Phase 2*. During this first round, the Seller (potentially supported by *External Service Providers*) will manage investors' questions in a centralised file and subsequently prepare answers to these questions or provide supporting material to address investors' initial concerns. In parallel, the Seller will continue the preparation of the relevant (additional) material for the second round.

4.4. SUBMISSION OF NON-BINDING OFFERS BY BIDDERS AND SELECTION OF SHORTLISTED BIDDERS TO BE ADVANCED TO SECOND ROUND

Depending on the type of transaction or portfolio structure, the Seller (potentially supported by *External Service Providers*) will request from the *Phase 1 Investors* an *NBO* within the time period as set out by the Seller in the *Process Letter* or other materials. Once the *NBOs* are received, the Seller will compare and analyse them, which

results in an *Analysis Report of NBOs*. If necessary, brief follow-up discussions may be conducted with individual investors to clarify some aspects of their respective *NBOs*.

The outcome of *Phase 1* is to allow the Seller to shortlist the chosen *Phase 1 Investors* and to continue the sales process by providing access to more detailed confidential data and information about the *NPL* portfolio to the chosen *Phase 2 Investors*. Finally, investors that are not selected to proceed to *Phase 2* are to be notified as soon as possible to strengthen the Seller's reputation as a reliable and transparent market participant.

5. BINDING OFFER PHASE (PHASE 2)

5.1. KEY ACTIVITIES

The objective for the Seller is to receive *BOs* from all *Phase 2 Investors* on the *BO Date* in the form requested by the Seller in the *BO Guidelines*.

Key activities include the following:

- Provision of *Process Letter* to *Phase 2 Investors*
- Provision of *BO Guidelines* to *Phase 2 Investors*
- Provision of *Phase 2 Data and Documents* to *Phase 2 Investors*
- Provision of draft *LSPA* to *Phase 2 Investors*
- Management of *Q&A Process*
- Optional: Organisation of *Management Meeting(s)* and summarising / providing outcome to all *Phase 2 Investors*
- Organisation of the auction
- Analysis of submitted *BO Letters* and *Investor LSPA Mark-Ups*
- Selection of *Preferred Bidder / Purchaser*
- Optional: *KYC* Process
- Finalisation of the portfolio (continuation from non-binding phase)

5.2. SELLER DELIVERABLES

Process Information

At the beginning of *Phase 2*, the Seller provides each *Phase 2 Investor* with:

(i) the information that such investor was admitted to *Phase 2*;

(ii) a specific/detailed timeline setting out each major step, including any data, document or information to be provided by the Seller. This timeline should be realistic and any changes that were made should be as transparent as possible, in order to preserve the Seller's reputation of reliability; and

(iii) information on the Seller's requirements for format and contents of the *BO*. It is advisable for the Seller to request from *Phase 2 Investors* to specify e.g. the assumptions their *BO* is based on.

The information on process can be given by an electronically signed *Process Letter*.

BO Guidelines

At the beginning of *Phase 2* (and often as part of the process information): the Seller provides each *Phase 2 Investor* with the *BO Guidelines* setting out the Seller's requirements in respect of the format and contents of the *BO*.

Phase 2 Data and Documents

At the beginning of *Phase 2*: *Phase 2 Data and Documents* are provided to all *Phase 2 Investors*. Any costs, which, based on the draft *LSPA* are borne by the *Purchaser*, are communicated as part of this.

Due Diligence (Documentation)

At the beginning of *Phase 2*: communication of physical *Due Diligence* time slots or provision of virtual *Due Diligence Documentation* to all *Phase 2 Investors*.

LSPA Draft

At the beginning or *Phase 2* or shortly thereafter: draft *LSPA* to be provided to the *Phase 2 Investors*.

Additional Phase 2 Data and Documents

Ongoing: potentially, at the request of one or more *Phase 2 Investor(s)*, or as updated information becomes available, the Seller to provide additional / updated information to all *Phase 2 Investors*.

Answers in Q&A Process

Ongoing: Seller to provide timely answers to questions posed in the *Q&A Process*.

Optional: Presentation for and Findings from Management Meeting

After *Management Meeting*: If the Seller organizes one or more *Management Meetings* where a presentation is shared, such presentation and relevant findings from the *Management Meeting(s)* are to be shared with all *Phase 2 Investors*.

Optional: Snapshot of Final VDR

If the Seller uses a *VDR* and wishes to link certain *R&Ws* to a *Disclosure Qualifier*, the Seller could save a "snapshot" of all information included in the *VDR*, which can be provided electronically to the *Purchaser* upon *Signing*.

5.3. BEST PRACTICES

Process Information and Timing

The process information that the Seller provides to the *Phase 2 Investors* should at least include:

(i) dates on which certain data, documents or information is expected to be made available to the *Phase 2 Investors* (including the *Phase 2 Data and Documents* as well as the draft *LSPA*),
(ii) dates on which *Phase 2 Investors* are expected to provide certain deliverables (including the *BO Date* and the date on which the *Investor LSPA Mark-up* would be submitted by *Phase 2 Investors*);
(iii) further information: e.g. language(s) of the draft *LSPA*, specific contents the *BO* should include and form in which the *BO* is to be submitted, (if applicable) specific format which questions in a *Q&A Process* should have, etc.
(iv) if, when and in which form (a) *Management Meeting(s)* is / are planned, e.g. would there be one meeting for all *Phase 2 Investors* or individual meetings for the *Phase 2 Investors*, would the *Management Meeting(s)* take place physically or virtually, who would take part from the Seller and what are the persons' roles and expertise, etc.

To lead an efficient, transparent and reliable process, the Seller should:
(i) carefully plan and set an overall reasonable *Phase 2* timeline;
(ii) determine the timing communicated to *Phase 2 Investors* in a way which allows a certain "buffer" for unexpected delays;
(iii) actively inform *Phase 2 Investors* in case any Seller deliverables would be delayed;
(iv) adapt the deadlines for *Phase 2 Investor* deliverables (mainly *BO* and *Investor LSPA Mark-Up*) in case of a delay of Seller deliverables;
(v) extend deadlines for all *Phase 2 Investors* and not for single *Phase 2 Investors*.

Note that *NPL* investors are customarily experienced investors who can adapt to different processes. A very important or even the most important feature of the bidding process for the investors would be that the process is led in an efficient, transparent and reliable manner where all investors are treated fairly.

Phase 2 Data and Documents / Due Diligence Documentation

General: All *Phase 2 Data and Documents* should have been prepared either in the preparation phase or latest during *Phase 1*. In a *2-Phase-Process*, the Seller might have received data / information / documentation requests during *Phase 1* and if the Seller can and wants to provide such data / information / documentation, these should be prepared before *Phase 2* starts. Especially in a *1-Phase-Process*, (an unexperienced) Seller must be prepared that data / information / documentation requests come up during the *Binding Offer Phase* and the Seller must determine how to deal with these, e.g. plan for relevant in-house persons to be available to prepare additional data and information during all of the *Binding Offer Phase*.

Due Diligence Documentation: The Seller should provide information on the selection criteria or reasons as per data and documents to be provided in the *Due Diligence* as well as potential inclusions or exclusions with respect to the object of sale in the process. The Seller should be prepared for the possibility that *Phase 2 Investors*

additionally request *Due Diligence Documentation* for cases they have chosen if the selection of the Seller does not seem to cover a random statistical sample of relevant size. Additional *Vendor Due Diligence* that could be provided to *Phase 2 Investors* includes property revaluations, *AUP Report*, Legal *Due Diligence*, etc.

Due Diligence Timing: Access to physical *Due Diligence* should be arranged at the appropriate time in *Phase 2* – "neither too early nor too late": The *Phase 2 Investors* should have a chance to get an overview of the *NPLs* and respective data before conducting the *Due Diligence*. Access to physical *Due Diligence* should be provided in the first half of *Phase 2*. If *Due Diligence Documentation* is provided virtually to the *Phase 2 Investors*, it should be provided as early as possible during *Phase 2*.

LSPA Draft

Apart from *Phase 2 Data and Documents* also the stipulations of the *LSPA* (e.g. *R&Ws*) could influence the prices at which *Phase 2 Investors* will bid. The Seller should plan the process around the *LSPA* already in the preparation phase. A draft should be provided to *Phase 2 Investors* no later than 3 weeks before the deadline (customarily the *BO Date)* which the Seller wishes to set for the *Investor LSPA Mark-Up*. Ideally, especially if the Seller has not shared an *LSPA Term Sheet* in *Phase 1*, the draft *LSPA* should be provided to *Phase 2* Investors at the very beginning of *Phase 2.*

Q&A Process

In order to organize a *Q&A Process* in an efficient, reliable and transparent manner, the Seller can take the following steps:

(i) determine the format in which questions are to be posed.

(ii) set deadlines for both questions and answers, e.g. questions always to be posed until Friday and answers to be given by the following Wednesday during *Phase 2*.

(iii) set a reasonable maximum number of questions to be posed by each *Phase 2 Investor*.

(iv) share answers (and maybe corresponding questions) with *all Phase 2 Investors*. Inform *Phase 2 Investors* about this before starting the *Q&A Process* so that *Phase 2 Investors* will not include own confidential information in their questions.

Optional: Organisation of Management Meeting(s)

Both timing and contents of (a) *Management Meeting(s)* should be prepared either in the preparation phase or during *Phase 1*. Important features of a *Management Meeting* can be:

(i) a presentation providing background on the *NPLs* to be sold, underlying securities, workout / pre-processing activities, etc.

(ii) access to one or more employees of the Seller who have profound knowledge of the *NPLs* to be sold including loan granting requirements at the time of origination of the *NPLs*, underlying securities as well as prior workout actions, etc.

From a timing perspective, for the *Management Meeting(s)* to be most effective, they should take place "neither too early nor too late":

(i) The *Management Meeting(s)* should be scheduled at a time when the *Phase 2 Investors* already had the chance to familiarize themselves with the data and documents including the securities in case of real-estate secured *NPLs*;

(ii) The *Management Meeting(s)* should take place no less than two weeks before the *BO Date* to give *Phase 2 Investors* the opportunity to include information gathered during the *Management Meeting* into their valuation of the *NPLs*.

In order to lead an efficient and transparent process, the Seller should summarise main results and information from the *Management Meeting(s)* and distribute them to all *Phase 2 Investors*. As a practical example: if in one *Management Meeting* with a *Phase 2 Investor* it comes to light that a security, which was flagged as "1st rank mortgage", is in reality a "2nd rank mortgage", the Seller should disclose this information to all *Phase 2 Investors*.

BO Guidelines and Format

The Seller needs to determine ideally before the beginning of *Phase 2* specifications regarding the *BO* that the Seller wishes *Phase 2 Investors* to comply with. The *BO Guidelines* are ideally provided at the beginning of *Phase 2* together with other information on process and timing. Specifications regarding the *BO* can refer to:

(i) format, e.g. signed pdf format,

(ii) delivery, e.g. to be delivered by e-mail on the *BO Date* to person(s) XYZ,

(iii) contents, e.g. *Phase 2 Investor* to name purchasing entity, intended servicing entity; whether the *BO* is subject to funding, any conditions or any internal approvals; which assumptions the *BO* is based on; for how long the *BO* will be valid, etc.

(iv) pricing, e.g. if an *NPL* portfolio is divided into sub-portfolios: if *Phase 2 Investors* are to provide prices on the overall portfolio as well as on sub-portfolios.

(v) gross / net pricing , e.g. the *BO* specifies if the offered purchase price is the final amount which would be payable to the Seller ("net") or if it is the gross price, i.e. in case a *Cut-Off Date* in the past has been determined by the Seller, such gross price would be decreased by the proceeds received in respect of the *NPLs* since the *Cut-Off Date*; to mention the net price in respect of *NPLs* to which a *Cut-Off Date* has been assigned is in practice not possible as neither the *Phase 2 Investor* nor the Seller can know the proceeds which will be received between the *BO Date* and the *Signing* / closing of the transaction.

(vi) bidding rounds and Auction Type, e.g. Seller can request a qualifying sealed-bid *BO*, timed auction or a combination.

Note that not all *Phase 2 Investors* may fulfil all specifications requested by the Seller, e.g. if a *Phase 2 Investor* would only be interested in purchasing the entire portfolio, they might not be willing to specify pricing per sub-portfolio. Also, especially for secured *NPLs*, *Phase 2 Investors* may be reluctant to provide per-item pricing as this

would disclose the value which they allocate to each *NPL* (and / or the corresponding collateral) and since the *Phase 2 Investor* cannot be certain to become the *Preferred Bidder*, they might not disclose this information which they see as being a very specific result of their (costly) *Due Diligence*.

Optional: Auction Types

The "default auction type" that the Seller can employ easily is the so-called sealed-bid approach whereby the Seller requests all *Phase 2 Investors* to provide their *BO* on the *BO Date* to the Seller. The latter then reviews and decides on the *Preferred Bidder*. There are other auction types like English, Dutch or Japanese auctions offered by auction or *transaction platforms*. An overview of main auction types can be found in Annex 4.

It might be easier for sellers with little or no track record in *NPL* sales to choose the sealed-bid approach which gives the Seller the opportunity to review in detail all *BOs* before committing to a *Preferred Bidder*. In general, a sealed-bid is advisable when the terms of the *BOs* can differ between *Phase 2 Investors* other than by price (e.g. terms in the *LSPA* and *R&Ws*, financing conditions, or perceived execution certainty). However, in the sealed-bid the *Phase 2 Investors* have no information about the other *Phase 2 Investor's* prices and may be afraid they bid too much.

An English auction might achieve optimal results for smaller homogeneous pools of unsecured consumer *NPL* where the cost of *Due Diligence* is modest and many investors are ready to participate.

Optional: Partial Bid

For larger heterogeneous *NPL* portfolios, which can be divided into more homogeneous sub-portfolios, an auction structure may be optimal where *Phase 2 Investors* price the sub-portfolios individually. The Seller (potentially with the support of *External Service Providers*) can then match each *NPL* sub-portfolio with the highest price. This so-called partial bid can increase the total sale price and may lower the barriers for investors to participate. However, dealing with more than one *Preferred Bidder* and *Purchaser* increases the complexity for the Seller in closing and settling the transaction and might thus increase the Seller's cost and internal resources necessary to complete the transaction. Sellers should be aware that not all *Phase 2 Investors* might be willing to make bids on *NPL* sub-portfolios: *Phase 2 Investors* looking to acquire a potentially big *NPL* portfolio might drop out of the process when asked to bid on smaller sub-portfolios. *Phase 2 Investors* take into account *Due Diligence* and other transaction costs (e.g., external legal counsel, purchasing structure set-up) when deciding which *NPL* portfolio size to invest in.

Some sellers request per-item prices (PIP) as part of the *BO* with the intention to allocate the loans to the respective highest bidder. A PIP *BO* is common for sales of large syndicated loans and less common in granular portfolios where the Seller intends to select one *Preferred Bidder* only. *External Service Providers* can help finding the optimal portfolio allocation in a PIP *BO* while respecting investor conditions such as minimum allocation amounts and target portfolio compositions. Sellers should be aware

that *Phase 2 Investors* may be reluctant to provide per-item pricing as this would disclose the value which they allocate to each *NPL* (and / or the corresponding collateral in case of secured *NPLs*) and since the *Phase 2 Investor* cannot be certain to become the *Preferred Bidder*, they might not disclose this information which they see as being a very specific result of their (costly) *Due Diligence*. Furthermore, since investors are cost-sensitive, a split into smaller units can discourage investors as they will incur the same or similar costs for transaction closing (e.g. external legal counsel) as they would for the whole *NPL* portfolio.

Optional: KYC Process

The Seller can start the *KYC* process of all *Phase 2 Investors* during *Phase 2* with the objective of having finalised *KYC* checks by the *BO Date*. The Seller can alternatively decide to conduct a *KYC* check only of the *Preferred Bidder*.[22]

Pro *KYC* of all *Phase 2 Investors* before the *BO Date*: When analysing the *BOs*, the Seller will have certainty that all *Phase 2 Investors* fulfil the Seller's *KYC* requirements. This can be helpful if the Seller has a fixed date (e.g. business year-end) until which the transaction must be finalized insofar that there would be insufficient time to review the *Preferred Bidd*er's *KYC* documentation after the *Preferred* Bidder has been selected.

Contra *KYC* of all *Phase 2 Investors* before the *BO Date*: Seller's compliance department will have to review *KYC* documentation provided by several investors. If the Seller only starts the *KYC* check once the *Preferred Bidder* has been chosen, only one set of *KYC* documentation needs to be reviewed. If *Phase 2 Investors* are known and assumedly reputable market participants, the Seller can decide to postpone the *KYC* check to start once the *Preferred Bidder* has been selected. This also benefits the unselected *Phase 2 Investors*, as they do not spend resources on a fruitless *KYC* process.

Analysis of submitted BO Letters

Before receiving the *BOs*, the Seller should determine the decisive factor(s) for the decision on the *Preferred Bidder*, e.g.:

(i) will the focus be mainly / purely on the best price?

(ii) if and how will other factors be taken into account, such as track-record regarding closing of similar transactions, (internal or external) servicing capabilities, reputation of *Phase 2 Investor* as well as intended *NPL* servicer, availability of funding, etc.

The Seller then compares and analyses the different bids of *Phase 2 Investors*, resulting in the *Analysis Report* of the *BOs*. Should the Seller need any clarification in respect of any *BO*, it is customary for the Seller to reach out to the specific *Phase 2 Investor*. However, in the interest of confidentiality, reliability and transparency, the Seller should not share any information regarding *BOs* of other *Phase 2 Investors* and the Seller should only use such direct contact for clarifications (e.g., no asking for a price

[22] As *KYC* processes can be time-consuming, the Seller might opt for initiating a *KYC* process only for the *Preferred Bidder* / *Purchaser* and to execute the transaction subject to *KYC* approval.

increase to give only one *Phase 2 Investor* the chance to surpass the prices of the other *Phase 2 Investors*).

Decision on Preferred Bidder / Purchaser

As soon as the Seller has decided upon a *Preferred Bidder*, such *Phase 2 Investor* will be informed customarily in writing and final negotiations start on the *LSPA*, including practical topics to be handled (e.g., format and timing regarding provision of data and documents both electronically and in paper format, sending of notification letters to borrowers after sale, etc.). Unless major hurdles occur, which were not foreseen by the Seller, the *Preferred Bidder* becomes the *Purchaser*.

Sellers customarily inform unsuccessful *Phase 2 Investors* soon after the *Preferred Bidder* is chosen. The other *Phase 2 Investors* will realise eventually that they were not chosen as *Preferred Bidder.* However, in the interest of transparency and not to alienate *Phase 2 Investors* for future transactions, the Seller should consider a direct communication. In addition, in the unlikely event that the transaction with the *Preferred Bidder* falls through, the Seller might want to contact the *Phase 2 Investor* who submitted the second-best *BO*.

6. SIGNING OF THE TRANSACTION AND CLOSING

6.1. KEY ACTIVITIES

The key activities for this phase are as follows:

- Deliver a clean exit from the portfolio once the *NPL* sale is completed
- Execute the *LSPA* and, if applicable, further transaction documentation
- Financial closing
- Finalise preparation of transfer of data and documents
- Negotiate and agree on transition of the *NPL* servicing from the currently acting servicer to the *Purchaser* or its servicer
- Accounting of the transaction
- Upon *Closing*: Migration process: transfer of *NPLs* and relevant information and documentation to the *Purchaser* to ensure a smooth on-boarding

More concretely, the following steps need to be taken care of, divided by area:

Legal

- Communicate with the *Preferred Bidder(s)* on all matters including receiving confirmation that the purchasing vehicle(s) are established and that the required funds are available
- Negotiation of the *Investor LSPA Mark-Ups* with the *Preferred Bidder*
- Finalisation and signing of the *LSPA*
- Commence/finalise reconciliation on practical topics and requirements with the credit servicer (to be mandated by the *Preferred Bidder*), if necessary, for post-*Closing* period

Financial close

- Refresh portfolio information and/or provide updated collection data as required
- Financial closing: ensure that responsibility and timing is shared among the parties
- Implement closing arrangements (for instance, in case of deferred purchase price)
- Seller to invoice the *Preferred Bidder* with the cost of the servicing and/or recovery costs supported since *Cut-Off-Date* (if so agreed in the *LSPA*)

Operational

- If applicable: Continued management of the *VDR* (incl. removal of non-preferred bidders), closing and preparation of *VDR* archives
- Commence making the necessary internal arrangements for how the Seller will deliver on its obligations under the *LSPA* to the *Purchaser* post-*Closing*
- Envisage the electronic and physical transfer of information and loan documentation (based on the final perimeter)
- Continued management of the *Q&A Process* (if necessary) and/or direct communication, including resolution of open issues and transmission of any information supporting the transition of the servicing of the *NPLs* to the *Purchaser* or a servicer acting on behalf of the *Purchaser*.
- If needed in accordance with each national law to get the transfer publicised, provide contact information of (i) borrowers and (ii) lawyers/bailiffs for each loan to make sure the *Preferred Bidder* has all necessary information to notify them about the disposal if such notifications are conducted by the *Purchaser* as, either set out under statutory law or in the *LSPA* (hello/goodbye letter for borrowers and notification letter for the lawyers/bailiffs) and reconcile the hello/goodbye letter and notification letter with the *Preferred Bidder*
- Continued servicing of the *NPLs* until the agreed *Servicing Transition Date*
- If applicable: Finalise interim servicing arrangements of the portfolio up and until an agreed *Servicing Transition Date*
- Set up and prepare guidelines for the support to be provided by the Seller post-*Closing* (if applicable), incoming documents received by the Seller and interim collections received by the Seller in accordance with the stipulations of the *LSPA*

Accounting and internal

- Ensure that the sale of the portfolio is correctly represented according to the Seller applicable accounting rules: termination of customer account, cancellation of provisions, set the accounting loss/profit with allocation of the purchase price
- Obtain necessary internal approvals and consents including *KYC* checks, regulatory treatment (including CRR as the case may be), validation of the acquisition structure

6.2. KEY RISK CONSIDERATIONS

This critical phase requires strategic and commercial focus, as value may be eroded during the negotiation phase to financial close. It is important to design an efficient

execution process for the transaction to limit the period between signing and closing of the transaction, considering that potential complexities and delays – pre agreement / negotiation – could be critical. During this phase, the *Preferred Bidder* and Seller have significant steps to take and this may be managed through agreed transition plan structures with an agreed timeline in place. Assistance and involvement of internal and/or external financial and legal advisors is key.

6.3. LSPA Considerations

Once the transaction has been internally approved and the terms of the transaction have been finalised, the Seller and the *Purchaser* (selected *Preferred Bidder*) will sign the *LSPA* to achieve a proper settlement and post-*Closing* agreements. The *Signing* and *Closing* often occur at two different dates; however, they may occur at the same time. An appropriate period between *Signing Date* and *Closing* of the transaction should be agreed in the *LSPA* having regard to the complexities of the transaction, the steps needed to be completed in advance of *Closing* and the risk of delays.

In advance of signing of the *LSPA*, it is important to ensure that the *LSPA* appropriately reflects the legal and economic understanding as agreed between *Purchaser* and Seller. The *LSPA* should be drafted by the appointed legal advisors and be clear as to the obligations of both the Seller and the *Purchaser*.[23] As part of *LSPA*, all **post-*Closing* commitments** should be agreed upon, including which party will send notification letters to the borrowers (if applicable), in which form this will be done and which party will bear the costs. The notification should also encompass the involved legal advisors servicing *NPLs* pertaining to the portfolio and institutions (lawyers, bailiffs, courts, etc.) to ensure an efficient transition of *NPL* servicing. This is usually stipulated in the *LSPA*. The specificities of how the borrower is notified of the sale depend on the requirements set out by national law.

6.4. Other Considerations

It is important to align all necessary internal departments with the *Closing* procedures in the *LSPA*. This will include agreeing the interim servicing of the *NPL* portfolio between *Signing* and *Closing* with the *Preferred Bidder*. The agreed interim servicing arrangements are customarily part of the *LSPA*, but may alternatively be documented in a transitional service agreement (TSA) where the Seller agrees to provide certain services for a certain period to the *Purchaser* at an agreed price. In general, interim servicing of the *NPL* portfolio should be carried out by the Seller with the same degree of diligence and care that was applied pre-signing of the *LSPA*.

Another area to consider relates to a specific risk in terms of compliance with anti-money laundering (AML) legislation. EU Member States have implemented the AML Directives differently within the EU, resulting in that only in a few Member States, Credit Servicers are defined as obliged entities and subject to local AML laws. Hence, the obligation to share and subsequently hand over AML-related customer information to a purchaser/credit servicer is only relevant if local AML laws require that KYC

[23] More details on the main content of an LSPA can be found in Annex 6.

requirements are applicable for consumers managed by the purchaser/credit servicer. If such AML obligation does not exist, the legal ground is lacking to share such personal data according to GDPR. The KYC data can be both confidential and sensitive (above all the suspicious transactions) and cannot be publicly shared.[24] It could hence prove beneficial to define an agreement between the compliance departments of the *Seller* and the *Purchaser* to transfer such information, while respecting the perimeter allowed by regulation and guaranteeing appropriate confidentiality measures. In particular, it could be interesting to highlight the elements classified as:

- "high risk", as per reference through dedicated databases (i.e. World-check)
- "high risk", reporting ongoing payments by third persons.
- suspicious transactions, already evaluated by the relevant regulator's relevant division and not to be considered as such.
- politically exposed persons.

6.5. PRICE ALLOCATION

There are jurisdictions that, for legal safety, may require a specific allocation of the price against each exposure included in the *NPL* portfolio or this might be advisable based on the *R&W*s and damages compensation structures as agreed in the *LSPA*:

- for a – rather homogeneous – unsecured consumer *NPL* portfolio, the allocated purchase price is usually determined to equal ["purchase price" divided by "sum of outstanding amounts"] multiplied with "outstanding amount of the specific *NPLs*", or in other words: purchase price quota multiplied with the outstanding amount of the specific *NPLs*.

- in case of more heterogeneous *NPL* portfolios, e.g. real-estate consumer secured (RRE) or even corporate secured (CRE) *NPLs*, a statistical approach is not suitable and hence investors often allocate prices to the single *NPLs* (based on the underlying collaterals), which the seller can request to receive. However, investors are often not willing to share this breakdown of the purchase price for different reasons, including the possibility of the Seller asking to exclude at the last minute certain *NPLs*, for which Seller and *Purchaser* have allocated a different value. The solution can be that the *Purchaser* provides the allocation sheet per loan to a third-party depository (e.g. a notary), which may only disclose single purchase prices based on certain reasons, pre-agreed in the *LSPA*, like a claim of the *Purchaser* regarding a *Defective NPL*.

7. POST-CLOSING

7.1. KEY ACTIVITIES

Once a sale has taken place, the post-*Closing* phase includes a series of activities that require the cooperation of and coordination between Seller and *Purchaser*. A successful

[24] It is not possible to share all kinds of data, i.e. in particular suspicious transactions under investigation by relevant authorities.

post-closing phase will strengthen the Seller's reputation in the market, avoid conflicts and attract further investors resulting in an efficient relation with investors and better conditions in potential future deals. The success of a sale process is therefore determined not only by the closing price, but also by the way the post-*Closing* activities are conducted. A strained post-*Closing* phase would certainly create a precedent and might decrease the chances of successful *NPL* sales in the future.

The key activities are as follows:

- Conduct and implement post-*Closing* obligations according to the *LSPA*.
- Cooperation between Seller and *Purchaser* as foreseen in the *LSPA* and, if applicable, on an ad-hoc basis if problems occur or non-foreseen actions become necessary.

7.2. Migration process

During this phase of the process, the Seller transfers the *NPLs* (as well as the related guarantees, if any) and the related information as well as documentation to the *Purchaser* or an *NPL* servicer designated by the *Purchaser*. This phase should be carefully planned since it is key for the successful on-boarding of the *NPL* portfolio for the *Purchaser* and involves many different and sizeable sources of information and documentation, both information from the Seller's IT system as well as scanned and (sometimes) large volumes in hardcopies. The *Purchaser* should be able to start the IT on-boarding with full cooperation from the Seller in order to properly register the relevant credit files within its own IT system.

1. Communication to the borrowers

Subject to the compliance with the local laws[25], Seller and/or *Purchaser* are expected to communicate the sale, the identity and contact details of the new creditor and the *NPL* servicer that may act on the *Purchaser's* behalf and that the personal information will be passed on within the legitimacy of the sale. It is advisable for Seller and *Purchaser* to agree in the *LSPA* on who would send the notification(s), what the contents would be (insofar as this is not already regulated by statutory law) and how the costs would be allocated between the parties. In the interest of efficiency and partly also based on statutory law, the notification letter to the borrower can/should additionally contain the exact amount of outstanding debt (split into principal amount, interest and fees, as determined by applicable law) as well as the bank account to which the borrower should pay in the future, i.e. provide the bank account information of the *Purchaser* or its designated *NPL* servicer.

2. Information handover

After the sale has been executed, the Seller hands over all of the relevant information regarding the *NPLs*. In addition to the *Loan Data Tape*, this transfer could include the following sets of information:

- Personal data of borrowers;

[25] I.e. the jurisdiction of the borrower.

- Management information, including contacts, tracing activity and previous conversations and potential payment agreements with the borrowers from the past, as well as ongoing conversations;
- Payment information specifying date of payment, amount and currency, source of payment (e.g. received from borrower or third party, cash-in-court, etc.) for each *NPL* (specified by a unique identifier like loan number) from the *Cut-Off-Date* until *Closing*;
- Legal claims, including information of courts, lawyers, amounts, dates and history of legal milestones (as this resides on the management platform of the Seller); and
- Any information on collateral securing any of the sold *NPLs* that is not included in the *Loan Data Tape* or the above.
- All information provided and used for the *Due Diligence* process.

3. Documentation

Documentation is key to the *Purchaser's* capacity to immediately start managing the *NPLs* in the most efficient manner. The quality and speed of delivery of the information is key to a successful post-closing process.

In *NPL* portfolios with a limited number of loans, full documentation is typically available and is usually handed over to the *Purchaser* or its designated credit servicer directly on *Closing*. However, in more granular portfolios, where large numbers of *NPLs* (often thousands) are being transmitted, the *LSPA* can contain a clause with guidelines for the submission of documentation related to *NPLs*. In particular, the following aspects should be taken into consideration:

- Given the volume of documentation and information generated in the *NPLs* and the cost incurred by the Seller in its preparation, the Seller could opt to restrict its commitment to submit documentation, although this is crucial to the successful on-boarding by the *Purchaser*. The Seller should clearly communicate during *Phase 2* what documentation it is able and willing to deliver to the *Purchaser*. Missing documentation can negatively affect pricing of investors, so the Seller should weigh the "cost" for the different scenarios. One option can be to determine "crucial or core" documentation (e.g. any documentation the *Purchaser* needs in order to comply with applicable laws, documentation necessary under local law to prove the existence and amount of the outstanding claim, necessary documentation for the *Purchaser* to obtain a legal title before a court or start enforcement proceedings, etc.) for which the Seller gives a clear representation in the *LSPA* and "other" documentation for which the Seller merely promises to provide documentation on a best efforts basis.
- If relevant costs are associated with delivery of files from seller to *Purchaser*: a mechanism to regulate delivery of files and cost-bearing in this respect should be agreed with the *Purchaser*. The envisaged mechanism should be communicated to the *Phase 2 Investors* via the *LSPA* (or otherwise, if no *LSPA* is provided in *Phase 2* by the Seller) to facilitate a smooth signing/closing process. Any costs the Seller expects to be borne by the *Purchaser* should not come as a surprise after the *BO* has been submitted.

- A reasonable timeframe after the execution of the sale should be established for the delivery of certain documentation (e.g. in some countries, for granting the public deed to proceed with the delivery of information on the updated balance due date of each loan).
- Based on availability and cost associated with making documentation available to the *Purchaser*, the Seller can consider limiting its liability regarding quality and completeness of documentation. This is relevant commercial information for the *Phase 2 Investors* and would be part of the draft *LSPA* so that *Phase 2 Investors* are aware of this before submitting their *BOs*.

7.3. SELLER'S RESPONSIBILITIES

In case the Seller breaches any of the Seller's *R&Ws* or obligations under the *LSPA*, the Seller would be required to compensate the *Purchaser* in accordance with the *LSPA*. The *Purchaser* is entitled to customary remedies if the Seller fails to comply with the *R&Ws* relating to the *NPLs*, one of which can be the Seller's obligation to repurchase or replace *Defective NPLs*. Where the repurchase of *NPLs* is generally legally forbidden, based on relevant legal advice potentially a monetary compensation to the *Purchaser* can be agreed upon.

7.4. AFTER-SALE ACTIVITIES

Once the *Purchaser* or its designated credit servicer has all the information/documentation and can start managing the *NPL* portfolio, there are still several coordination tasks and other duties that have to be taken into account. This includes:

- The Seller should forward to the *Purchaser* or its designated credit servicer:
  - payments received in regard to the sold *NPLs*.
  - communication received from borrowers or borrower representatives in regard to the sold *NPLs*.
- Supplementing documentation and records on exposures.
- Reconciliation of data and specific information on a case-by-case basis.
- Cooperation on the transition of court cases from Seller to *Purchaser*. For legal claims that have already been initiated, procedural succession needs to be conducted according to the procedural rules of the jurisdiction in question. It may be useful to agree on a specific writing model to be followed when submitting to the courts. Seller and *Purchaser* should also agree in the *LSPA* if the Seller terminates all mandates given to any third parties (e.g. external counsel in currently ongoing legal proceedings) in respect of the sold *NPLs* or if the Seller expects the *Purchaser* to take over any such mandates and from which moment onwards fees and costs incurred by such third parties would be borne by the *Purchaser*. Fee schemes, lump sum cost amounts, etc. should have been disclosed to the *Phase 2 Investors* in *Phase 2* so that they can take this into account before they submit their *BOs*.

In addition, the *LSPA* should describe which party will bear the costs, fees and expenses of counsel and solicitor, as well as those arising from the withdrawal of the *Purchaser*, in case the *Purchaser* decides that proceedings will not continue. If the Seller plans for the *Purchaser* to assume costs which are or will be incurred by counsel mandated by the Seller, the latter should inform the *Purchaser* about agreed fees, amounts of costs/fees already incurred and which should be assumed by the *Purchaser* etc. Again, costs, fees etc. to be borne by the *Purchaser* must be communicated before the *BO Date* to all *Phase 2 Investors* to avoid the risk of being unable to execute the transaction based on omitted cost information.

- Communication with regulatory bodies: in every transaction, it should be confirmed whether it is necessary to carry out communication or request authorisation from any regulatory bodies.
- Coordination with legal consulting and other involved areas: the Seller's internal legal department's work should be coordinated with the tax department in each jurisdiction.
- Rectifying misleading or false official records by Seller providing history of official documents.

In some cases, there could be additional services that may be provided post-*Closing* either by the Seller or via a specialised entity. If Seller and *Purchaser* agree that the Seller would provide post-*Closing* servicing, then such service delivered to a third party may require specific fees being charged by the Seller. The level of such servicing fees could be determined based on cost allocation of the relevant work-out unit for the sold NPLs against the portfolio volume or the expected recovery level.[26]

It is advised that sellers provide a certain (minimum) level of service to *Purchasers* even if they are legally not obliged to this, for the duration of the 'full lifespan' of the sold *NPLs*. This would prevent problems with borrowers and courts and would ensure efficient operations for both Seller and *Purchaser*.

[26] The cost attributable to the sold *NPL* portfolio, which in this scenario would still be serviced by the Seller (for a certain period), could be determined on the basis of: (i) the outstanding amount of the overall sum of *NPLs* serviced by the recovery unit; or (ii) the recoveries generated for the *NPLs* serviced by the recovery unit. The recovery level is based on expected cash flows calculated at individual or portfolio level over agreed period of time and determines the performance of the after sale servicing as basis for charging a servicing fee percentage.

EN

ANNEXES

ANNEX 1

Contributors to the Guidelines

The Guidelines were developed by the Commission, in close cooperation with the Commission's NPL Advisory Panel, which consists of the following Members and Observers:

Members

Organisation
AMCO
ASUFIN (Asociación Usuarios Financieros)
Banco Santander
BBVA
BEUC (Bureau européen des unions de consommateurs)
Commerzbank
Debitos
Alpine Tremont
DECO (Associação Portuguesa para a Defesa do Consumidor)
EACB (European Association of Co-operative Banks)
EBF (European Banking Federation)
EOS
Erste Group Bank
European DataWarehouse
Fédération Bancaire Française
Guber Banca
Hoist Finance
Intrum
KPMG
Morgan Stanley
NAMA
NPL Markets
Prometeia
Raiffeisen Bank International
UniCredit

Observers

Organisation
European Banking Authority (EBA)
European Central Bank (ECB)

ANNEX 2

Considerations and steps before the start of the sales process

Is it worth selling?

When dealing with the resolution of bad debts, it is common to think that the organic approach is the most cost-effective way of resolution. However, the organic approach, albeit effective, can lead to an accumulation of judicial processes and real estate assets. At a certain point, this could become difficult to manage organically.

In markets where a secondary market for *NPLs* has sufficiently developed, a significant specialisation in the recovery has likely taken place, which could lead to the conclusion that specialised (third-party) market players are more capable and efficient than the Seller/bank that owns the assets in question. In such markets, sellers usually sell the forward flow on a recurring basis, especially in certain asset classes.

The cost-benefit analysis facilitates the comparison between a retention strategy (*keep the asset and perform the work-out, or carry out a restructuring*) and an exit strategy. Such analysis is key to a well-designed long-term sales vision. However, it should be noted that the strategic perspective, including the cost-benefit analysis of holding positions versus selling them, is extremely complex to carry out. Its complexity derives from the extraordinary difficulty of monitoring the performance related to the organic approach. The time and costs involved in such a process are not negligible and neither are the tail cases that are never resolved.

It is also possible that sellers need to adhere to reaching specific target *NPL* ratios within a defined timeline (as negotiated with competent authorities). This could increase the attractiveness of offloading *NPLs* vs the organic approach of managing them internally.

The following presents an indicative overview of the potential reasons for selling, as well as the caveats and considerations to be taken into account before entering into any portfolio transaction.

Potential reasons to sell

- To not exceed the internal workout capacity and to speed up the disposal of non-performing assets vs the organic approach. Banks usually take longer to achieve resolution, compared with a highly specialised investor and a narrower range of possible solutions mostly aimed at judicial recovery. Considering this, together with the rapid deterioration of the recovery curve from default over time, an early sell decision in mature markets is usually the right one.
- To optimise the NPE management process and workloads. Internal capacity (which can be scarce resource) and efforts are thereby focused on positions that render an organic approach worthwhile.
- To meet an NPL reduction plan and avoid surpassing a certain level of the NPL ratio (e.g. 5%) or to meet an NPL reduction plan as agreed with the supervisor.
- To generate economic value, when the price exceeds the bank's internal economic valuation. The Seller then seeks a better price compared to the expected recoveries that would be achievable via internal workout. This means that the loss upfront should be

lower than the overall costs to be paid in a hold scenario. It is important to note that a certain budget for losses would be required to conduct *NPL* transfers.

- For capital optimisation: better use of capital, avoid future regulatory burdens, etc. By selling, the high weighted risk affecting NPL positions could be cleared, thereby releasing allocated capital allocated to better uses. The deadlines of supervisory commitments and certain regulatory constraints can have an influence on when to sell (e.g. the NPL prudential backstop's provisioning calendars, the rules of forbearance classification).
- Other reasons could be the closure of activity in a company or country.

Warnings and considerations

Selecting the portfolio

This is a crucial phase of the process in order to maximize the target goal (e.g. *NPL* ratio target, optimisation of the internal capacity, etc.) and to minimize the impact on P&L and capital.

Defining the *Loan Data Tape*

The information and documentation gathering and cleansing is absolutely critical and it is without any doubt one of the most important phases of a portfolio selling. Portfolios require a very high depth of very detailed and accurate information on each individual position in the portfolio. The same applies to documentation. It is absolutely fundamental (and not straightforward) to gather the contractual documentation and appraisals and registry excerpts for all of the collateralised positions before launching the *Teaser*.

Typical difficulties with this are

- Gathering the documentation that is not yet stored in an electronic way. It is sometimes necessary to rely on branch searches, causing considerable lag times or even making the operation unfeasible.
- Loan and client remunerations that occur because of branch closings and/or mergers.
- Different repositories that exist as a result of mergers or substitution of IT systems, migrations, etc. In such cases, the original information and documentation may have been lost or be inaccurate.
- Data, while already stored in IT systems, is only available in various formats and individual data field definitions may differ from system to system.
- Unlocalised or inexistent collaterals.
- Charges written off economically, but not registered or updated in the bank's systems. In this respect, the bank's supervisory policy on updating with external recovery agencies is very relevant. It is absolutely mandatory to have a previous review of each guarantee position in the portfolio to ensure that the guarantee still exists.

  The process of data quality, remediation and sorting of documentation is necessary and intensive and is the main reason for hiring an advisor, which could help with a dedicated back-office and a project PMO.
- Restrictions on transferability. When reviewing documentation, it cannot be ruled out finding transferability restrictions in some form, like some policies, syndicate loans, or loans involving elements of State aid. Such cases need to be identified and removed

from the portfolio. Thus, a legal *Due Diligence* on the contracts has to be performed to verify if transferability constraints are present and to comply with the defined notification process.

Assessing the economic impact of the transaction

The risks of 'guessing' the final price: it is important to assess how the Seller could best be protected from undesirable impacts. Before engaging in a sale, it is therefore important, for a specific portfolio, to have an idea of:

1. Whether there is investor interest in that particular asset class;
2. The indicative price at which that portfolio could be traded; and
3. The potential cost for the Seller to keep the portfolio.

This can be achieved either by creating an internal intelligence or by mandating an *External Service Provider* that is actively involved in such transactions. In most cases, a combination of both options is most common. There is a wide variety of available advisors offering their services, but it is important to distinguish between advisors who are actually involved in transactions on a regular basis and those who have only been involved in some small parts of the *Due Diligence*.

Based on this knowledge, the following aspects of internal analysis are highly advised:

- P&L impact based on the estimated price +/-15% (deeper analysis can involve APR release and future burdens *-provisions and capital- savings*).
- Economic-value-added analysis: how well does the internal economic valuation compare with the estimated selling price.

In any case, the best way to protect the Seller from undesirable variations in the final price is often a *2-Phase-Process* in which the Seller may reserve the right to stop the process if *NBOs* do not meet the expectations. It is important to manage this (with maximum transparency) before entering the *BO* phase. At this stage, investors tend to spend more resources on *Due Diligence*.

Defining the contracts and assessing the derecognition test according to IFRS9 principle

In order to derecognise the transferred portfolio, sellers have to demonstrate that they have substantially transferred all risks and rewards arising from the transferred portfolio. To this end, any clauses in the contracts that give back risks/rewards to the Seller must be avoided.

ANNEX 3

External Service Providers

Before defining the transaction structure and perimeter, it is necessary to determine whether *External Service Providers* would need to support the process. Still, a number of tasks should in any case be fulfilled by in-house experts as they require knowledge of: (i) in-house processes, (ii) the *NPLs* to be sold, (iii) the potentially underlying securities, (iv) the work-out of the *NPLs*, and (v) decision on which Seller *R&Ws* can factually be given, etc.

External Service Providers could support the Seller throughout the process of a standard market transaction. The main function of the *External Service Providers* is to help the Seller with the preparation phase and provide guidance along the entire selling process. They can also liaise with bidders, mediate the interaction between Seller and bidders, assist with modelling/pricing of the portfolio to set the 'reserve' price, strategise different financing options, etc. Such services can be particularly helpful in non-mature markets.

The following main categories can be identified:

i. Financial advisors[1, 2]:
   - Deal structuring and identification of best marketing approach as well as target investors list
   - Preparation of marketing materials
   - Management of the marketing process (including advertising and *Purchaser* vetting) , management of the bidding process and the *Q&A* with bidders, support in the modelling/pricing of the portfolio to set a 'reserve' price
   - Evaluation of *NBOs* and evaluation of non-binding proposals
   - *Due Diligence* and completion of transaction
   - Strategise on different financing structures (i.e. securitisation vs outright sale)

ii. Legal and tax advisors:
   - Legal advice including regulatory
   - Deal structuring
   - Preparation of the legal documentation
   - Tax advice on overall transaction (structure, taxes on sale, servicing fee, etc.)

iii. Technical advisors:
   - Project management and assist in negotiations with bidders
   - *VDR* and *Q&A* management
   - Preparation of *loan data tapes*
   - Impact analysis
   - IFRS9 test

iv. *VDR* providers:
   - Technical set-up and administration of the *VDR*
   - Technical support

v. *Transaction platforms*:
   - Deal structuring, portfolio selection, and indicative pricing

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[1] Investment banks can play the role of financial advisors and technical advisors.

[2] Financial advisors are predominantly providers of services related to the marketing process.

- *Loan data tape* preparation, standardization and validation
- Preparation of marketing materials
- Management of the marketing process (including advertising and *Purchaser* vetting)
- *VDR* and *Q&A* management
- Online management of transaction process and document management
- Online management of bids and *Due Diligence process*
- Facilitate NPL auction processes with different *Auction Types*
- Conduct the NPL auction based on the instructions of the Seller.

ANNEX 4

Major auction types

English debt auction (ascending)

Is probably the most popular auction. This is an auction with the classical system, when the Seller sets the initial price for the *NPLs* and the *Phase 2 Investors* bid, thereby raising this price. The highest bid wins. Sometimes, the *Phase 2 Investors* are not very active and the closing price does not differ significantly from the initial one. In this case, the Seller can cancel the auction or move it to another day. Usually, the English auction lasts no more than an hour, which is enough time for everyone who is interested in the *NPLs* to bid.

Dutch debt auction (descending)

The English auction is very prevalent, yet there are other types, such as the Dutch auction, in which everything works the other way around. At the beginning of the bidding, the Seller sets the desired price for which he is willing to sell the *NPLs*. As a rule, this is a fairly high price. During the course of the auction, the price begins to go down until one of the *Phase 2 Investors* makes a bid. At this point, the auction can be considered to be over. Generally, this type of auction is used when the Seller assumes that the *NPLs* are in high demand. The duration of such auction can be anything from a few seconds to several days.

Sealed-bid NPL auction (hidden bids)

The third type of auction that is used when selling *NPLs* is called a sealed-bid auction. In this type of auction, all bidders simultaneously submit sealed bids so that no bidder knows the bid of any other participant. The highest bidder pays the price that was submitted. Sealed-bid auction is based on the English auction, the only difference being that the bids are not public.

Hybrid NPL auction

This is an advanced version of the classic auction. In most cases, the English auction is used. However, there are situations in which other types of auction work better. Sometimes, an *NPL* portfolio is sold in two rounds. For example, the first round is a sealed-bid auction and the second round is the English auction. It is also possible to use a combination of Dutch and English auction for *NPL* portfolio sales.

Japanese auction

In a Japanese auction, the *Phase 2 Investors* do not see their position, but they will need to either accept or decline the 'current bid' within a given time limit. After which, if a *Phase 2 Investor* has accepted the 'current bid', it will proceed to the next round where it will be asked the same question. The auction continues until only one *Phase 2 Investor* remains in the auction room. This auction is typically used when there are only limited number of possible *Purchasers* and the Seller wants to make the most of the Seller's offer.

ANNEX 5

Subcategory of "unlikely to pay" (UTP) NPLs

If the loan falls under the category "unlikely to pay" and the underlying loan contract has not been terminated at the envisaged time of sale, the loan contracts might still include valid Seller obligations, so that a direct sale may not be possible and/or faces strict limitations.

The Seller has two options: a) only sell the receivable; or b) sell the receivable and the contract liabilities:

a) If only the receivable can be disposed of, then the liabilities linked to the continuously existing contract remain with the Seller.
b) Regarding contractual liabilities, there are some options, depending on local legislation and vehicle possibilities:
    - Transferring the contracts: this is often the preferred option, as it would be suboptimal to keep a contract with a borrower against whom the institution does not have a monetary claim anymore. In determining the transferability of the contracts, it needs to be duly analysed:
        (i) whether the *Purchaser* can legally purchase the contract: in some jurisdictions, securitisation vehicles are typically the *Purchasers* and are sometimes legally not able to purchase the contracts. Hence, another bank/financial intermediary would have to enter into the scheme.[3]
        (ii) how to deal with potentially required borrower consent: in many legislations, a creditor substitution is not possible without the debtor's consent.
    - The Seller remains the lender of record and keeps the duties arising from the contractual position.
    - The Seller remains the lender of record and a more complicated structure must be put in place to dispose of the receivables and to entrust a third party with the obligations arising from the contractual position.[4]

[3] Note that such a structure will be costly to set up and the portfolio must be of a big enough size to still make the transaction commercially viable for all parties involved.

[4] Note that such a structure will be costly to set up and the portfolio must be of a big enough size to still make the transaction commercially viable for all parties involved.

ANNEX 6

LSPA – main contents

An *LSPA* suitable to sell a specific *NPL* portfolio usually requires customisation to reflect inter alia the particularities of the *NPLs*, the data quality and the existence and availability of electronic / paper documentation.

The following topics are customarily dealt with in *LSPAs* provided that the specification of relevant clauses depends on the particularities of the transaction itself[5], the *NPLs*[6], national law as well as on the desired level of balancing rights and obligations of seller and *Purchaser*.

1) **Identification of the Seller and the *Purchaser*.**
2) **Specification of the *NPLs* as the object of purchase and assignment**, e.g.
   a) in the main body of the *LSPA*: nature of the *NPLs*, number of *NPLs*, total outstanding amount under the *NPLs*, sum of purchase price
   b) in an (MS Excel) annex: list of single *NPLs* to be sold
3) Statement that the ***NPLs* are sold and assigned** to the *Purchaser* by way of the *LSPA* (including a transfer of the collateral and including corresponding registration for mortgages, if applicable); if applicable depending on the jurisdiction: additionally so-called short form transfer agreements will be signed for each (secured) *NPL*
4) **Timeline for the transaction**, e.g. specification of *Cut-Off Date*, *Signing Date*, *Closing*, payment of purchase price, handing over of data and documentation; optional: *Servicing Transition Date*, optional: interim servicing of the *NPLs* by the seller after *Closing*.
5) If a ***Cut-Off Date*** is determined,
   a) customarily the specification of the *NPLs* refers to the *Cut-Off Date*,
   b) a specification is needed if all monies received in respect of the *NPLs* from the *Cut-Off Date* onwards are due to the *Purchaser* or if any costs or fees should be deducted.
6) **Purchase price and terms of payment** including
   a) How is the purchase price determined and what is the exact payable amount in which currency (e.g. are collections between *Cut-Off Date* and *Signing Date* deducted when the *Purchaser* makes the payment?)
   b) On which date is the purchase price payable?
   c) To which bank account is the purchase price payable?
   d) If applicable: specify costs / fees arising due to the sale (e.g. stamp duty, taxes, notification/registration costs) and which party will bear them
   e) Optional (depending on national law): conclusion of a written payment protocol recommended?
   f) Optional: if a deposit was paid, is the amount deducted from the purchase price?

[5] Note that the sale of *NPLs* on a forward flow basis (where future *NPLs* are sold) would require additional stipulations compared to the sale of an existing stock of *NPLs*. It is advised that inexperienced sellers start with an *NPL* stock sale.

[6] Note that secured *NPLs* usually require additional stipulations which are only generally mentioned, but not covered in detail in the following list.

7) Regarding the **notification letters to the borrowers**, the *LSPA* should regulate:
   a) Which party is responsible for sending out the notification letters?
   b) Is there a deadline for sending the letters?
   c) How are the costs allocated between the parties?
   d) Would the wording of the letter need to be agreed between the parties?

8) Seller *R&Ws*
   a) institutional R&Ws relating to the seller as an entity
   b) R&Ws relating to the NPLs including the data / (electronic and paper) documentation, origination and prior handling of the NPLs, seller being the owner of the NPLs; if applicable: R&Ws relating to underlying collateral, the legal status, etc.

9) **Seller obligations**, e.g. Purchaser compensation in case of breach of seller R&Ws; forwarding monies and communication; optional: further post-Closing support obligations of seller as agreed with the Purchaser

10) **Purchaser R&Ws**
   a) institutional *R&Ws* relating to the Purchaser as an entity
   b) additional Purchaser *R&Ws* if required by the seller;

11) **Purchaser obligations**, e.g. future servicing of the NPLs in accordance with applicable laws; mandate of an authorised NPL servicer, if applicable under national law[7]

12) **Post-Closing cooperation** between seller and *Purchaser*, e.g.
   a) Handling of *NPLs* which are in in legal / enforcement stage at *Closing*
   b) Process for repurchase / replacement of *Defective NPLs*
   c) Handling of any necessary actions post-*Closing*, e.g. regarding provision of evidence, regarding re-registration of mortgages, if applicable
   d) Handling of severe disputes / litigation brought forward by borrowers after *Closing*

13) Liability Regime, e.g.
   a) What would be the remedy / compensation mechanism for *Defective NPLs, e.g.* repurchase / replacement of *Defective NPLs*, monetary compensation?
   b) Would the liability of one or both parties be limited? If so, would the limitation cover the breach of all *R&Ws* or would certain *R&Ws* not be covered?
   c) Limitation of liability can include: (i) *de minimis* amount, (ii) (tipping / spilling) liability basket[8], (iii) liability cap amount, (iv) liability period.

14) If applicable: **Conditions Precedent to *Closing***, *e.g.* necessary approvals, check of documentation by *Purchaser*,

[7] After national implementation of the Directive on credit servicers and credit purchasers: Unless the *Purchaser* is authorised as credit servicer itself or an exception applies, the *Purchaser* needs to mandate an authorised credit servicer.

[8] A liability basket means that a liability claim below a certain threshold will not be compensated by the liable party. Under a "spilling basket" only liability claims exceeding the threshold will be compensated whereas a "tipping basket" means that, once the threshold is reached, also the amount up to the threshold amount will be compensated.

15) Transfer of **Data and Documentation**
   a) The extent and format of data and documentation
   b) The practical process of transferring data and documentation (including the recipient(s), e.g. *Purchaser* and / or credit servicer) should be clearly stipulated
   c) **Notices Section** including bank account details of the parties
   d) **Law and Jurisdiction**
   a) **Confidentiality**, taking into account that a credit servicer needs to obtain data and information and that communication with the borrowers, courts, potentially subcontractors should be covered.