NPL Deals In The Spotlight – Romania

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Although the restructuring of non-performing loans ("**NPL**") was slower in Romania than in other EU member states, NPL deals have been of late among the most interesting and challenging transactions in the Romanian market.

Along with other Central and Eastern Europe ("**CEE**") jurisdictions, Romania has been targeted by foreign investors with appetite for investing in deals aimed to acquire, or finance, the acquisition of NPL portfolios.

The NPL Boom

Prior to 2014, banks and financial institutions operating in Romania employed a relatively wide range of solutions for credit recovery, with rather limited efficiency. However, further to the implementation of new prudential regulations brought by Basel III international standards, as well as other reforms for implementing European Union Directive 2013/36/EU and Regulation 575/2013, the National Bank of Romania ("**NBR**") has started to apply pressure on local banks to dispose of their problematic assets and clean–up their balance sheets.

2014-2015

In 2014 and 2015 several large Romanian NPL deals were executed. These transactions benefitted from a tailwind of increasing foreign investor appetite for acquisitions of NPLs as well as financing of NPL acquisitions. For example, in 2014 Volksbank sold a EUR 490 million portfolio of Swiss franc-denominated mortgage loans to a consortium comprising of Deutsche Bank, Anacap and HIG, while BCR (the largest Romanian bank based on assets) sold to Deutsche Bank and APS two NPL portfolios, one with a value exceeding EUR 220 million and another of EUR 400 million.

Following its emergence in 2014 and early 2015, the Romanian NPL market experienced another active period at the end of 2015 and in the first semester of 2016. During this period, two of the largest deals were completed – Projects Tokyo and URSA. In Project Tokyo, BCR sold to APS, Deutsche Bank and IFC a NPLs portfolio with a nominal value of approx. EUR 1.2 billion. In Project "URSA", Bancpost, ERB Retail Services IFN and a Dutch vehicle of Eurobank sold to a consortium comprising of IFC and Kruk three unsecured, consumer credit-backed NPL portfolios with a nominal value of approx. EUR 597 million, for a total purchase price of approx. EUR 46 million.

2016

NPL acquisitions continued throughout 2016, although the completed deals were in relation to portfolios of lower value (Intesa Sanpaolo sold to APS and AnaCap an approx. EUR 287 million NPL portfolio, Bancpost sold to a consortium of investors a retail NPL portfolio with a nominal value of approx. EUR 170 million and Romanian state-owned CEC Bank sold to Kruk an approx. EUR 70 million NPL portfolio).

The main investors in Romanian NPL portfolios have so far been investment funds and debt collection companies. In fact, following the largest deals of 2015 and 2016, debt collection companies such as Kruk (Poland), Kredyt Inkaso (Poland), APS (the Czech Republic) and EOS (Germany) became the most active players on the Romanian NPL market.

This trend could change however, due to the recent changes in legislation.

Challenges of NPL deals

NPL deals can be extremely complex and challenging transactions. Foreign investors need to carefully consider a multitude of legal, financial and tax matters and pay increased care to the structuring of the transaction so that all the specific regulatory requirements applicable in each relevant jurisdiction are complied with.

As a result, there are certain legal matters which require more attention and in-depth analysis in international NPLs deals than in local deals. Qualification of NPLs as "bad debt" and transfer and enforceability of foreign law governed loans and security interests are just two of the matters that we will present below which are particularly challenging in this type of transaction.

Summary of NPL - Specific Deal Challenges in Romania

NPL Determination	Purchase & Transfer Considerations	Other Regulatory Challenges
Qualification of NPLs as "bad debt" under applicable law – under-performing loans do not necessarily qualify as "bad debt"	GEO 52/2016 introduced new rules for transfers of 'bad debt' to non-regulated entities	Enforcement of security interests for cross-national portfolios
"Bad Debt" portfolio composition – specific determination and transfer rules applicable to retail loans, mortgage retails loans and corporate loans	New regulations for the operation of debt collection companies and distressed investors in Romania	Specific regulations for large transactions, such as approval of the National Bank of Romania or clearance of the Competition Counsel

Qualification of NPLs as "bad debt"

In Romania, performing loans may be acquired only by regulated entities (e.g., credit institutions or non-banking financial institutions). Credit institutions or non-banking financial institutions licensed in EU member states may passport their activities in Romania, either directly or by setting up a local branch, and purchase performing loans or NPLs against Romanian debtors in the same conditions as Romanian regulated entities.

Provided that certain conditions are met (please see Section 2.3 below), loans qualified as loss or "bad debt" may be acquired by non-regulated entities.

Romanian banking regulations provide various criteria for qualifying a loan as "bad debt." For instance, if after applicable grace periods, the loan has been in arrears for at least 91 days (for debtors included by the credit institution in the category of debtors with highest financial performance) or such other period of time determined by the financial performance category in which the debtor is included, or if the enforcement or bankruptcy proceedings are initiated against the relevant debtor.

However, there are specific categories of NPLs where these criteria vary. For example, in respect of credit agreements for real estate property entered into by consumers after 30 September 2016, when the Government Emergency Ordinance 52/2016 ("**GEO 52/2016**") entered in force, a loan is non-performing when the debtor has delays in payment of principal and/or interest of at least 90 days. Therefore, for the purpose of transferring NPLs under GEO 52/2016, the financial performance category in which the debtor was included by the credit institution would no longer be relevant, since the loans can be qualified as non-performing only after 90 days of delay in payment.

Given the hurdles to the designation of loans in Romania a careful assessment of the NPL portfolio is advisable prior to any acquisition in order to determine whether the portfolio comprises (exclusively) of loans qualified as "bad debt", especially as this will likely impact the conclusion on whether the acquiring entity needs to be a regulated one or not.

What is a "Bad Debt"?

1. The qualification of a loan as a "bad debt" is in some ways analogous to a poor credit rating.
2. Under Romanian law, this analysis is dependent on the number of days since the loan has been in arrears and on whether or not enforcement procedures have been commenced against the debtor.
3. The number of days since the loan has been in arrears is set differently for each category of clients depending on their financial performance initially assessed by the bank.
4. A loan of a client included in category A (the highest financial performance) can be qualified as "bad debt" only if the loan is in arrears for more than 91 days.
5. A loan of a client included in a lower category of financial performance can be declared "bad debt" if the loan is in arrears for a minimum of 15 – 90 days.

When is an NPL not entirely an NPL?

The qualification of NPLs as "bad debt" becomes challenging in an international context, as "performing loans" are sometimes sold as NPLs, although these loans were not qualified as "bad debt" according to Romanian legislation and the applicable EU regulations. In some cases, this may be due to the fact that "performing loans" are actually treated by banks as sub-performing or restructured loans in accordance with their internal regulations, but were never officially qualified as "bad debt" and provisioned accordingly.

Another possible reason is that the criteria used in Romania for classifying a loan as "performing" or "non-performing" sometimes differs from those applicable in other jurisdictions. As a result, there may be cases in which certain loans qualified as "non-performing" according to the legislation of another jurisdiction, could in fact be performing if judged from a Romanian law perspective. A practical example of this case is when "non-performing" or "sub-performing" loans are qualified as "bad debt" by the local branch of a foreign bank which is under the general supervision of its home state regulator and applies different rules for qualification of the loans. The exception, however, in relation to the acquisition of "bad debt" by non-regulated entities will only be available if the criteria for the qualification of "non-performing" loans as "bad debt" are met as per the Romanian legislation and the applicable EU regulations.

Therefore, despite the efforts made by the European Banking Authority to harmonize the qualification of non-performing exposures at the level of the EU states through the amendment of EU Regulation 575/2013, this matter remains sensitive and should be treated as such by foreign investors as this may impact on both the licensing requirements of the purchaser, as well as the manner in which the transfer of the NPLs will be structured (e.g., through transfer of receivables or contracts).

Uncertainty from new rules for transferring NPLs
GEO 52/2016 brought some unexpected changes to the applicable legislation dealing with the transfer of "bad debt".

Prior to its entry into force on 30 September 2016, the general rule was that lending activities performed on a "professional basis" (e.g., in broad terms, as a stand-alone economic activity) could be carried out only by regulated entities (such as credit institutions and non-banking financial institutions) and only such entities could acquire loan portfolios.[1] As an exception, loan portfolios qualified as "bad debt" could be transferred to non-regulated entities. GEO 52/2016 repealed the article stating both the rule and the exception which was applicable regardless of whether the relevant loans were corporate or consumer loans, thus raising the question of whether non-regulated entities may still acquire NPL portfolios.

GEO 52/2016 offers an answer in respect of consumer loans portfolios only, stating that they may be transferred only to credit institutions or non-banking financial institutions authorised to grant this type of loans in Romania, or alternatively, to entities authorised to issue securitized debt instruments.[2] By way of exception, receivables deriving from non-performing loans (i.e., loans due for at least 90 days), or in relation to which the creditor declared the acceleration of the loan or initiated enforcement proceedings against the debtor, can be acquired by debt collection entities having their registered seat, branch or a representative office in Romania.

The legal framework remains unclear with respect to the possibility to transfer corporate NPLs to non-regulated entities. In light of the rule that lending activities may be carried-out on a professional basis only by regulated entities, determining whether a purchaser would be regarded as carrying-out a lending activity on a professional basis as a result of the NPL acquisition becomes essential.

As per the law, the NBR is the only authority competent to decide whether an activity is professional lending or not. It has therefore been helpful to see that it has recently taken a stance (albeit only in the form of a press release) and clarified that the acquisition of corporate or retail loan portfolios qualified as "bad debt" according to the applicable regulations, as well as debt collection activities carried out by non-regulated entities, do not represent lending activity on a professional basis.

The position expressed by the NBR leads to a change in the legal assessment that a potential buyer of an NPL portfolio needs to make on whether it needs a regulated vehicle for the acquisition or not. It is not only the non-performing status of the loans that is relevant, but even more so, its work-out approach to it. For example, it could be argued that the acceleration of loans and the commencement of enforcement proceedings against debtors by the purchaser do not represent professional lending activities. However, if after the acquisition of the NPL portfolio the buyer reschedules the loans or continues to collect instalments, interest and other fees on their due dates in accordance with the terms of the loan agreements, then it may be argued that it does carry out professional lending and should therefore be a regulated entity.

The prudent approach given this change in legislation would be for potential buyers to obtain official confirmations from the NBR regarding the possibility for a non-regulated entity

to acquire the respective NPL portfolio. This approach is fairly common in Romania when it is not clear whether certain activities represent professional lending activities. The NBR is usually very responsive and an official answer can take up to 30 days to obtain. However, in practice this may not be desirable or achievable due to, for example, time constraints which are particularly relevant in competitive processes.

New rules for debt collection companies
The recent GEO 52/2016 has also introduced new rules for debt collection companies managing retail loan portfolios. For example, they need to have a share capital of at least RON 500,000 (approx. EUR 111,000), register with the Romanian National Authority for Consumer Protection and have their registered seat, a branch or a representative office in Romania.

In principle, these requirements should apply only to debt collection companies, which include distressed purchasers and collection agencies, acquiring consumer loans for real estate property granted after 30 September 2016 and other consumer loans not regulated by GEO 52/2016. However, the new rules are not very clear and in practice, all debt collection companies may in fact be required, for example, to register with the Romanian National Authority for Consumer Protection in order to avoid consumer complaints.

Other challenges

Transfer and enforceability of foreign law governed loans and security interests
It is not uncommon for NPL portfolios sold by Romanian banks or with Romanian debtors to comprise loans and related security interests governed by various laws other than Romanian law or for the governing laws of the loan to differ from that of the security documentation.

The fact that certain loans and/or security interests are governed by different laws may also impact on the approach that the purchaser intends to implement on a post-closing basis. For example, a loan governed by foreign law may prove difficult to enforce directly in Romania without first obtaining in the relevant foreign jurisdiction a court decision against the debtors under the respective foreign law governed loan. To the extent such court decision was issued in a member state of the European Union, the creditor can seek its recognition in Romania under the Regulation (EU) no. 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, or its enforcement under Regulation (EC) no. 805/2004 creating an European Enforcement Order for uncontested claims. This may delay the enforcement procedures in Romania with the period necessary to obtain the foreign court decision or may even trigger the cancelation in court of enforcement proceedings initiated prior to having obtained the foreign court decision.

Similarly, where a loan is governed by Romanian law and the related security interests are governed by foreign laws, the risk is that the creditor may not be able to commence a direct enforcement of the security interests in the foreign jurisdiction, without first obtaining a court decision in Romania against the debtors under the respective Romanian law governed loan and afterwards seeking the recognition of such court decision in the foreign jurisdiction.

The transfer of certain security interests (e.g., real estate mortgages) governed by Romanian law would typically require authenticated documentation, even if the receivable that they secure is governed by the law of another jurisdiction and could be transferred on the basis of a deed under private signature. This needs to be accounted for in relation to transaction structuring, preparation of the relevant transaction documentation and with regards to notary costs.

Particular challenges may also appear where loans are subject to multiple co-existing sub-participations or syndication rules of international banks. The sub-participation or syndication of certain loan exposures would allow the seller to transfer only its share of the loan and the acquirer may not necessarily control enforcement of the security on its own. Therefore, the purchaser should carefully assess sub-participation and/or syndication rules as these may influence the legal regime applicable to the transfer of the loans, e.g., what part of the loan receivable may be transferred, in what conditions and subject to what restrictions or consents.

Specific regulatory requirements for large NPL deals
Depending on the volume and structure of the NPLs portfolio, other specific challenges can be faced by potential investors. For example, large NPLs deals may trigger regulatory requirements to obtain clearance from the NBR, if the transaction results in a total or a substantial transfer of the patrimony of the respective bank. The law is not clear with respect to the meaning of "substantial transfer of patrimony". Therefore, it may be argued that an NBR authorization may also apply in case of disposal of a large NPLs portfolio when such portfolio represents a substantial part of the assets of the bank. This legal requirement does not apply to the disposal of NPL portfolios by the local branches of foreign credit institutions or other credit institutions incorporated in EU member states which are directly active in the Romanian market, but may still be relevant in such case from the perspective of a buyer, if it is a Romanian bank.

Certain antitrust requirements may also become applicable. In previous cases when notifications have been made to the Romanian Competition Council in relation to the acquisition of NPL portfolios, the authority looked at the relevant markets of the target assets: (i) portfolio of non-performing loans; (ii) portfolio of loans which are not classified as "loss" category (either sub-performing loans or performing loans); and (iii) real estate assets. The geographical relevant market was determined as the Romanian market. As regards the ancillary real estate assets, the geographical relevant market where such assets were located was deemed the local market (the city where the real estate asset is located and its proximities).

According to the Romanian Competition Council, the loans classified as "loss" category will be converted into receivables, leaving the market of finance-banking services and entering the market of debt collection services. If the acquirer is not a credit institution, the market should be determined by reference to the debt collection services and the computation method applicable to a service provider's turnover. The loan portfolio which cannot be classified as "loss" will continue to remain on the market of financial-banking services, on the lending services segment.

An operation will need to be notified to the antitrust authority in Romania, if the following conditions are cumulatively met: (i) the transaction is an economic concentration (there is a long lasting change of control); and (ii) the following turnover thresholds are met: (a) the aggregate turnover of all undertakings involved in the economic concentration (i.e., on the one hand, the acquirer and its group and, on the other hand, the target and its subsidiaries, if any) exceeds EUR 10 million in the last financial year; and (ii) each of at least two of the undertakings concerned achieved a turnover that exceeded EUR 4 million in Romania in the last financial year. From our expertise, simpler transactions carried out between a seller and a recovery agency have not been notified, but they may have been under the above-mentioned threshold.

Transfer of undertaking requirements provided by the Directive 2001/23/EC on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (TUPE Directive) and related regulations may also become applicable to large NPLs deals and need to be observed depending on the specifics of the NPL transfers. This may be the case when, for example,

the NPL portfolio is so large that the seller is in a position to actually transfer a substantial part of its business, together with the relevant employees.

Costs applicable to the transfer of the NPLs portfolio
NPL deals trigger specific costs, such as those related to the transfer of the portfolio of NPLs and the taking of financing security (as the case may be) which in some cases could be quite substantial when the loans are secured by real estate mortgages.

Concerning registration costs, the transfer is not subject to any stamp tax in Romania, transfer taxes or costs, save for administrative cost (e.g., related to the notification of the assigned debtors) and the costs in respect of the registration of the transfer with the Electronic Archive for Movables Security Interests in Romania, the Land Book or other specific registries. If a real estate mortgage or other security right which is subject to registration with the Land Book is being transferred as part of the NPLs portfolio, the transfer agreement must be concluded in an authenticated form and executed in front of a competent Romanian notary public. The authentication costs are sizeable (i.e., 0.3% of the value of the assigned receivables) and are in most cases, an important factor in structuring NPL deals.

Glimpse into the future

Despite the recent changes in legislation which brought a certain degree of ambiguity, the Romanian market continues to show potential for NPL deals at least for the next couple of years. Some of the largest banks in Romania are still struggling with an NPL rate above 10% and we expect that there will be several transactions in the sector in the coming period. ■

1. Lending operations can be performed in Romania on a professional basis only by regulated entities authorized to perform such operations, and the NBR is the only authority able to decide whether an activity represents lending on a professional basis or not. In principle, when deciding whether an activity qualifies as "professional", NBR takes into consideration certain criteria, including whether the lending activities are performed as stand-alone economic activities.
2. This refers to entities which are governed by specific regulations and which are allowed under Romanian law to issue financial instruments, secured by portfolios of receivables, such as mortgage bonds.

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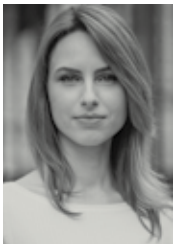

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