TMA Europe Round Table develops a unified voice on financial services turnaround

Around thirty of Spain's leading experts on financial services turnaround met for the inaugural Madrid TMA Europe Round Table on 28 May.
The main aim of the Round Tables is to break down barriers between stakeholders in Europe' banking industry, in order to develop a coherent guiding voice for regulators.

The need is urgent; the challenge huge. Non Performing Loans (NPLs) represent almost one third of the entire banking market in Europe.
If the continent's banks are ever to break free from the paralysing hold on these NPLs and return to their vital function in the economy, lending to business, then something urgently has to change.
With the theme 'How can Madrid continue to build big opportunities in post AQR Europe?' over 30 key figures in the turnaround profession came together to debate how best to tackle these NPLs – and how to smooth their way from the banks into the hands of new owners.
The NPL secondary market is mature and relatively smooth flowing in the US. In Europe by contrast it is still relatively new, finding its feet.
At this delicate stage of its growth, it is vital that Regulators do not strangle new growth.
At the same time, it is vital that regulators keep a firm hand to prevent abuses, abuses that could damage the reputation of the market at its birth.
That is where the TMA Europe Financial Services Round Tables come in.
The first was held in London this January, the second in Madrid. The next will be in Milan **(????add names)**
The aim; to develop a unified voice to regulators to smooth the transfer of these NPLs from the banks to the alternative financing market; that is, from the regulated market to the unregulated.

How the Round Tables work
The Round Tables are a quarterly series of business events connecting the Continent's leaders in Financial Services turnaround.
TMA Europe invites a panel of four speakers to suggest how best to restructure the European financial services sector, and debate these ideas in a confidential environment with figures drawn from central and commercial banks, regulators, law firms and financial advisors.
The idea is to promote innovation and 'blue sky thinking', based on the real world experiences of a wide range of people who are working at the sharp end of financial sector restructuring.
The discussions and main conclusions are then summarised by a coordinator

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Findings from the Round Table in Madrid on 29 May, 2015

These are the findings from the discussions and comments of the key stakeholders held in Madrid. There are no attributions, as the ability to speak freely by market participants is key to creating a useful set of conclusions.

The financial crisis has, above all, been a banking crisis, and remains so, even after strenuous efforts by the European Central Bank (ECB) to draw a line under it last year with its AQRs and stress tests.

Banks in Greece, for instance, remain shackled by the ongoing sovereign debt standoff
While there is a growing banking crisis in Austria

However, out of challenge arises opportunity.
In his presidential year at TMA Europe Lukas Fecker recognised this was an opportunity for TMA Europe
The aim of the Round Tables is to break down boundaries between turnaround managers, lawyers, accountants, bankers and regulators; to develop a voice for the turnaround industry.
This will be a voice that will have credibility with regulators, and that can guide them in this developing industry.
In this way TMA Europe can give a lobbying voice to institutions such as banks that might feel vulnerable if they raised their own concerns in public.

A thought for the future
At TMA Europe it is important not to try to run before we can walk - after all, this is the first year of the Round Tables. Next year we should aim to sharpen our focus -what should our agenda be?
One obvious target for the future should be to engage with the European Central Bank (ECB).

A 1.3 trillion euro problem: Non Performing Loans (NPLs)

The conviction behind these Round Tables is that we need to tackle the problem of non-performing loans (NPL).
NPLs make up one third of the entire European banking market. Much if not all of these NPLs are destined to be sold by the originator banks into the secondary market, to unregulated funds in the shadow banking sector.

Hundreds of billions of euros of loans are migrating from the regulated to the unregulated market.

This migration process is unprecedented in Europe and cries out for a structure or environment in order to make it work properly. The US has enjoyed such a structure for many years, for instance.

It is vital that regulators strike the right balance; both in enabling this migration, and in regulating the acquiring parties.

It is important that they do not act too heavy-handedly; for instance, they must allow buy side funds to recover value.

They must also help banks to refocus on their original, vital function in the economy - lending to businesses. Lending to business is the main reason why taxpayers provided a backstop to the banks in the first place.

The NPL hotspots

There is a big future for alternative capital coming in to work out NPLs. This year three very active markets are;

- Italy
- Cyprus
- Greece

Despite the headlines on Greece understandably concentrating on the sovereign debt crisis, Greek legislators have recently passed new laws that will allow alternative finance funds to enter Cyprus. These funds in turn will be able to buy NPLs, and enable banks to re-allocate resources from spent to growing businesses.

How regulation is driving banks' behaviour

Regulation, such as Basel III and the ECB's new supervisory regime, is driving banks' behaviour. One effect of this is to provide more depth to the loan market. How does this work?

Banks are driven by regulation of capital costs. They have to hold a certain ratio of assets to loans, and this ratio has been tightened significantly by regulators all over the world since the global financial crisis broke.

This means that if they hold too many loans that are classed as non-performing, their capital base is reduced. This means they are forced to either sell some of these risky, non-performing assets, or reducing lending.

Regulators and governments are of course urging banks to lend more to businesses, for the wider good of the economy.

One big problem is that banks tend to be penalised for lending to small business, as lending to small business is some of the riskiest of all. Small firms often lead to the most non-performing loans.

This creates a contradiction for banks: How can they shrink and lend more at the same time?

Regulators are telling bankers to make their business less risky, and at the same time to make their business more risky. This makes no sense.

Banks selling loans; a learning curve
One participant, speaking from experience, said something very striking:
"Banks no longer think; they rely on systems."

Banks have difficulty dealing with loans. Selling loans is simply not in the DNA of many large, traditional banks.

"It's like selling your relationship – it's not what you were there to do," said the participant.

Portfolios consist of massive sets of expensive assets, and banks find them very expensive to hold under the new rules. Any portfolio will represent anything from 1,000 to 10,000 different corporate relationship issues for a bank lending officer. Dealing with such large amounts of difficult corporate relationships is just not practical for the bank. This creates a strong incentive for the bank to sell NPLs.
One obvious conclusion is that there will be many more NPL sales.

Will new owners be the right owners?

There are pitfalls as well as benefits to the process of NPLs emigrating from banks to funds; the funds are unregulated, and some may not be not interested in the underlying businesses these loans have been made to. In the absence of regulation, this may result in these businesses being neglected or poorly treated, with bad consequences for society.
Should regulation be extended to the alternative finance sector? This is a debate that will not go away.

Banks face more consumer safety rules

The global financial crisis has prompted governments all over the world to toughen rules aimed at protecting consumers.
In Spain the crisis has hit 2 areas:

1. Mortgage contracts
2. Investment contracts

Foreclosures in Spain doubled between 2007 and 2008. By 2013 foreclosures reached a peak by number of 93,000, and then fell back to 80,000 last year.
This has alarmed politicians and legislators, and it is inevitable that there will be more consumer safety rules to constrain banks in the future.

Case law has also changed banking practice in Spain hugely. For instance, for mortgage law, the impact has been enormous.

A warning from Germany

There is another potential obstacle to the smooth migration of NPLs from banks to funds. German banks might have worries on reputational damage if they were seen to be the selling loans made to a 'Mittelstand' company of long standing.
It is one thing for a German bank to have a debt trading desk in London's Canary Wharf, quite another to be seen ditching local champions in the German domestic market. The very concept of selling NPLs is still relatively new in Europe, compared to the US, and certainly the further East you go.
Political and cultural sensibilities have to be taken into account, to prevent a backlash.

One key takeaway for Spain:
The need for speed

TMA Europe, like the name implies, is all about turnaround. But often an insolvency process will either be used to implement part of a restructuring, or brandished as a bargaining tool by banks to prompt debtors to restructure.
It is a big problem for turnaround in Spain therefore if the insolvency process is slow.
Insolvency, or the 'I' word, was therefore surprisingly prominent in a discussion centred on turnaround.
Some insolvency cases in Spain can take two, three or even four years.
During this time the value of assets will probably be withering away. Auctioneers of distressed assets can only sit mutely on the sidelines as they see potentially healthy recoveries shrink- for no good reason.
One participant said that they had recently closed 2 deals in France, in the aerospace sector, that took 2 months to complete. In Spain it would take two years.
Spain has no monopoly on judicial slowness, however. In Spain you can sometimes get first instance judgments in 15 months, where in France it can take up to 6 years.

A legal problem – or a court problem?
So is it a problem with the law, or with the courts?
After all, the best laws in the world won't help without an adequate court system to implement them.
Spain has a problem with both company rescue laws and courts. The Spanish insolvency court system has been notoriously overloaded for many years now.
The trouble is, to make any meaningful improvements in the court system would take huge amounts of time, money, and political will.
could you justify this by creating value? Vote winner?

A time limit for insolvency proceedings
There is one suggestion that draws support from auctioneers and insolvency practitioners alike; place a time limit on insolvency proceedings. This might at the very least prevent the most egregious forms of procrastination.

Who decides who is 'out of the money'?
There is a specific challenge in Spanish law regarding valuation.

There is too much litigation by parties that are 'out of the money' which could easily be blocked at the start of insolvency proceedings, if Spain had a bankruptcy court to decide on valuation matters as the US does.
In Spain valuation does not have importance it should have in company restructurings.
At start of company rescue proceedings, should someone decide who is out of the money? And then stop them bringing proceedings?
This of course brings it's own challenges. Valuation is not a simple binary process, and deciding "where the value breaks" is often very subjective.
Spanish corporate rescue legislation has improved enormously over the last 3 years. Valuation however remains a challenge.

Who choses the administrator?
In Spain the question of who decides the identity of the insolvency administrator has been under debate, with big implications for the turnaround market.
There are proposals that the insolvency administrator should be chosen not by the judge, and not by creditors; but instead should be drawn from a list. This measure has been introduced to prevent corrupt collusion between judges and administrators.
One problem with this new system is that it may not provide the most appropriately experienced practitioner for a job. Simply the next name on the list.
In Spain anyone can be an insolvency practitioner. There is no licensing system as there is in the UK. Experienced people can't pull rank.
Who regulates who goes on the list?
There is also 'the law of unintended consequences'. A practitioner with a lot of experience and resources may end up with a small and inconsequential case on the list, and then immediately move to the back of the list – hardly an attractive business model.
In Spain, social security is usually the first and most secured creditor.
Debtors have been scared away from the company rescue market by accusations of corruption so don't attend TMA meetings any more.

Beware reform fatigue
Spain has introduced six significant changes to its insolvency law since 2004.
Turnaround advisers complain of 'reform fatigue'. Why not have a proper review and do one comprehensive reform?
The recently introduced Spanish version of the English Scheme of Arrangement has been welcomed. On the other hand, international investors fear change.
Another challenge for Spain is that it has seven different legislations representing seven autonomous regions.

Conclusion
These are the thoughts and opinions of the group of company rescue and turnaround specialists assembled by TMA Europe in Madrid. By presenting their ideas, the idea is to prompt debate and form a credible voice to influence the market, and especially regulators.

We look forward to seeing you at the next TMA Europe Round Table!

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