

# Conditions for securitisation of Greek non-performing residential mortgages improving

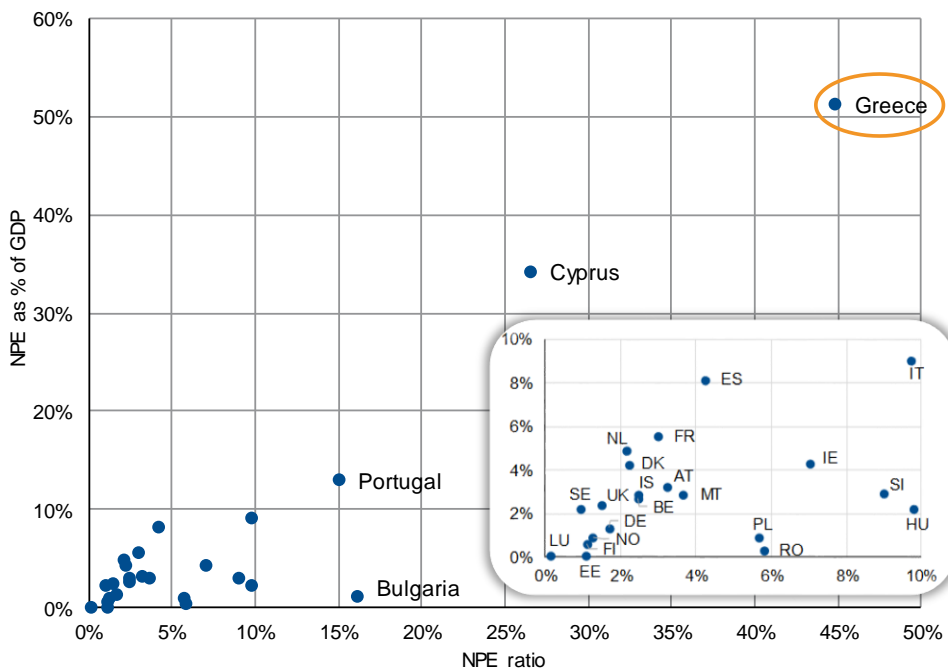


The performance of Greek non-performing residential mortgage-backed securitisations will rely critically on the new public subsidy scheme for debtors, the ability of special servicers to negotiate attractive loan-restructuring solutions, and acceptance by the capital markets of the Hercules asset protection scheme. Economic momentum, supported by a positive feedback loop from the reduction of banks' NPL stock, should support borrower re-performance, but country-specific risk factors remain.

Special servicers should avoid work-out strategies that rely excessively on loan enforcement, as over-supply of collateral, lengthy enforcement procedures, and potential leakage of auction proceeds to preferred and unsecured creditors will strongly erode NPL valuations.

Legal reforms have been implemented to champion the creation of a domestic secondary market for NPLs and reduce the large crisis-induced stock of non-performing exposures (NPE), which is weighing on the banks' profitability and capital adequacy amid an improving liquidity situation and increased depositor confidence.

**Figure 1: The magnitude of the Greek NPE problem**



Source: EBA transparency exercise (2018)

Several measures improved NPL resolution over the course of Greece's European Stability Mechanism (ESM) bail-out programme, including:

- i) the simplification of the complex insolvency regime for small businesses, which specifically targets more problematic SME loans (see Figure 3);
- ii) an acceleration of bank loan sales;
- iii) better work-out solutions through loan servicing agreements and public support schemes.

The market environment and the improved legal framework have led to better conditions for NPL securitisation, especially those backed by residential mortgages. Section 1 of this report highlights the most positive developments. In Section 2 we turn to particular risk drivers that investors in Greek NPL securitisations will face.

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## 1. Better conditions for NPL securitisation

### 1.1. Economic outlook

Greece's economic recovery gaining momentum ...

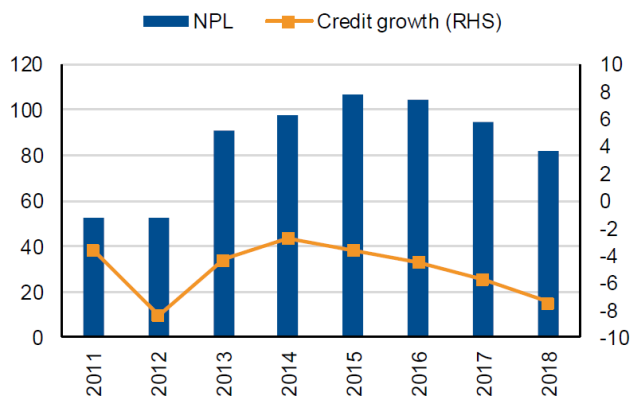
Following eight years of recession resulting in a 44% loss of per capita GDP between 2008 and 2016, Greece's recovery has gained some momentum. Scope expects real GDP growth of 1.9% this year, driven by a) a rebound in investment as financing conditions have improved, b) private consumption supported by employment growth and c) rising exports (in line with global demand for tourism and shipping services), reflecting the country's improved cost competitiveness as a result of structural reforms in the labour market, with more flexible wage bargaining. Growth is set to remain robust over 2020-2022, averaging 2.5% as recent and planned structural reforms have improved the long-term growth outlook.

#### 1.1.1. Addressing NPL-induced credit constraints

... cutting NPLs frees up capital for credit extension

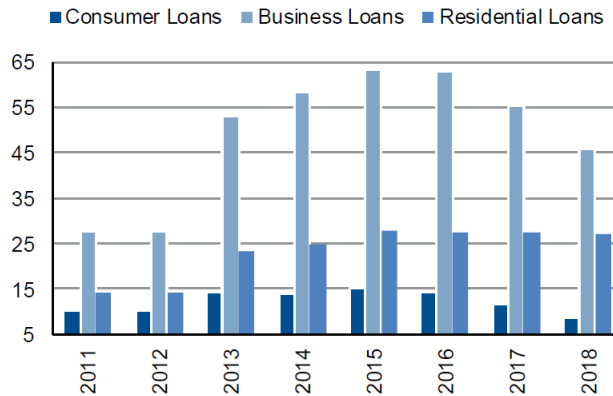
Greek banks have a critical role to play in ensuring the country's continued recovery. First by reducing the high NPL stock; second, by providing the credit necessary to fund productive investments. Greek banks have made substantial progress, reducing their stock of NPLs by 21 percentage points in the past four years through write-offs and individual bank loan sales. But the banking system remains saddled with a substantial stock of NPLs amounting to 45.1% of total loans at the end of first quarter of 2019. This is weighing on credit supply, despite increased depositor confidence. Banks are struggling to meet rising demand for credit as the economy improves. Credit extended to the private sector shrank by around 10% YoY as recently as June 2019.

Figure 2: NPL (EUR bn) and Credit growth (%YoY)



Source: Bank of Greece, Scope Ratings GmbH

Figure 3: NPLs per segment (EUR bn)



Source: Bank of Greece, Scope Ratings GmbH

After years of austerity, Greece faces a significant investment gap – a lack of spending to upgrade equipment, infrastructure and intellectual property – with domestic investment amounting to just 10% of GDP, equivalent to half of pre-crisis levels. This investment gap weighs on Greece's economic potential, particularly given the strong sovereign-bank nexus and crisis-induced burden on Greece's banking sector, which ensures that the real economy is reliant on investment from abroad. A key factor supporting the still-fragile economic recovery will be the reduction of NPL stocks via securitisation, which will relieve the burden on bank balance sheets. The associated capital relief will strengthen the financing capacity of the domestic banking sector and help tackle the crisis-induced investment-gap that weighs on Greece's economic potential.

Approval of HFSF asset protection scheme could accelerate NPL ABS

### 1.1.2. NPL carve-out proposals

Speeding up NPL resolution is a government priority. The government intends to strengthen the NPL resolution framework, based on two complementary NPL carve-out proposals from the Hellenic Financial Stability Fund (HFSF) and the Bank of Greece. The HFSF proposal is an asset-protection scheme; the Bank of Greece backs the creation of an asset management company, or 'bad bank'. The implementation of these systemic NPL resolution measures is being assessed under Greece's post-bailout "enhanced surveillance framework" vis-à-vis European creditors as part of the country's commitment 'to continue to implement reforms aimed at restoring the health of the banking system, including NPL resolution efforts'.

The European Commission approved the asset-protection scheme – named Hercules – on October 10, confirming that it complies with EU restrictions on State aid. Under the scheme, each of the four Greek systemic banks – Alpha Bank, Eurobank, National Bank of Greece and Piraeus Bank – will create a series of SPVs which will purchase NPL portfolios funded by sales of asset-backed securities to private investors. The most senior tranches will have a government guarantee, similar in principle to the Italian GACS scheme, improving the transfer price for NPL portfolios for Greek banks. In September 2019, the Greek government announced it had ring-fenced EUR 9bn of State guarantees to help clean up Greek bank balance sheets.

Hercules scheme is credit-positive

While the approval by the European Commission's competition authorities' of the Hercules scheme is credit-positive, the Bank of Greece's proposed resolution scheme should be seen as a potential complement rather than a substituting proposal. The proposal, which was first disclosed in autumn 2018, consists of supplementary transfers of a significant share of NPLs along with deferred tax credits booked on banks' balance sheets to a common SPV, funded by the issuance of securitised notes, comprising three classes of notes.

According to the Bank of Greece proposal, it was also anticipated that legislation would be introduced to turn transferred deferred tax credits into irrevocable claims of the SPV on the Greek State (with a pre-determined repayment schedule). According to the proposed scheme, the lowest-quality tranches would be purchased by the Greek banks and the State; the other tranches would be absorbed by private investors.

The benefits of securitisation are strong in a small and inter-linked economy as Greece

Both proposals – relying on portfolio sales and securitisations – will shift large stocks of NPLs into legally-separate entities, thereby freeing up funds for new lending. In particular, the benefits of securitisation in facilitating debt restructuring by bringing more flexibility into NPL-reduction plans are strong in a small and inter-linked economy such as Greece's, in which bank lending is the key source of corporate and household financing.

### 1.2. New borrower support scheme

Greek law allows borrowers evidencing permanent and general inability to repay their debts to apply for court debt settlement plans. Under law 3869/2010, the Katseli law, debtors can apply for a three-year settlement of all of their debts though the liquidation of their assets. The law used to provide the borrowers with the option of applying for an enforcement exemption of their primary residency (and for the restructuring of related mortgage debt), but this provision was abolished on 28 February 2019.

### Online debt restructuring platform up and running

On 1 April 2019, the Greek parliament passed a new law (L.4605/2019), which allows individuals in financial difficulties to apply for the restructuring of all of their debts<sup>1</sup> through a single online platform. The new law also allows eligible debtors<sup>2</sup> to apply for the protection of their main residence following abolition of the corresponding provisions under the Katseli law. Debtors wishing to preserve their main residences only have the option of applying for a settlement plan under law 4605/2019. Debtors who wish to become debt-free after a three-year period but have no owned primary residence or are willing to lose that ownership, can still apply under the Katseli law.

The new law provides that any borrower who had filed a settlement application under law 3869/2010, can file a new application under law 4605/2019, if they withdraw the prior application. The provisions under the new law are temporary, until December 31<sup>st</sup>, 2019<sup>3</sup>.

### Law 4605/2019 introduces credit-positive novelties

The new law introduces three credit-positive novelties:

- It allows eligible borrowers to apply for a State subsidy of 20%-50% of the settlement plan's monthly instalments<sup>4</sup>, subject to the household's annual income<sup>5</sup>.
- The new law is subject to more concise eligibility criteria, in an attempt by the regulator to exclude strategic defaulters.
- The new law also provides for standardisation of mortgage loan restructuring plans and State subsidy amounts, in an attempt to clear the court backlog generated by the large number of applications under the Katseli law.

#### 1.2.1. State settlement plan subsidies

The introduction of State subsidy amounts will primarily benefit NPL creditors, because they imply lower loan settlement plan haircuts relative to those experienced under the Katseli law.

The Katseli law established that debt settlement plans must provide for payments by debtors in accordance with their ability to repay, which resulted in court-ruled haircuts often above 40% of outstanding loan balances. By contrast, the standardised restructuring plan under the new law only provides for a haircut of outstanding loan amounts which exceed 120% of the market value of the collateral, if any. After accounting for the State subsidy, Scope's believes that instalment amounts to be paid by borrowers will be fairly similar under the two schemes.

Regarding borrowers who had already applied for restructuring and protection of their primary residence under the Katseli law, it remains to be seen if they will have sufficient incentives to switch from the old scheme to the new one. The main upside of switching is increased certainty about the outcome of the procedure, which is no longer subject to the discretion of the judge but based on objective eligibility criteria.

### State subsidy amounts will benefit NPL creditors

<sup>1</sup> With specific exceptions regarding debts guaranteed by the State and debts already restructured, or for which a relevant application is pending under a different legal debt restructuring process.

<sup>2</sup> The eligibility criteria under l. 4605/2019 are the following: (a) the applicant must be a natural person who has ownership rights over his primary residence (b) no final decision has been issued or exists that rejects the respective application of l. 3869/2010, on the grounds of fraudulent behaviour of the applicant, regarding its inability to repay its debt, or on the grounds of existence of adequate assets for the payment of the loans, or that accepts the said application, (c) the value of the property under (a) does not exceed the amount of EUR 175,000, if business loans are included in the application, or, the amount of EUR 250,000 in any other case, (d) the yearly family income of the applicant, during the last fiscal year does not exceed EUR 12,500 (plus EUR 8,500 if the applicant is married, plus EUR 5,000 for any dependent member of the family – maximum of three dependent members), (e) the total amount of debt exceeds EUR 20,000, while value of household's other real estate assets and means of transportation does not exceed EUR 80,000, (f) the value of the household's deposits, financial products and precious metals does not exceed EUR 15,000, (g) the total amount of debt does not exceed EUR 130,000 or, should the loans in question be business loans, EUR 100,000 per creditor.

<sup>3</sup> Applications could be submitted as of 1 July, the date on with the e-platform started operating, until 31 December 2019. According to the press, banks and the Greek government have requested the Commission to allow an extension of the termination date of the law. Market rumours are that the termination date will be extended for a period of three to six months.

<sup>4</sup> Or a flat 30% in the case of SME loans backed by first residencies.

<sup>5</sup> The State subsidy must be paid in special blocked accounts that are exempted from seizure and held in the name of the debtor to pay the specific debt of the credit institution that owns the receivables. Implementation of the blocked-account scheme in cases where receivables have been securitised has not yet been tested in practice. It could be argued that such an account should still be held with the originator but should be opened in the name of the SPV (on behalf of the debtor) in order to serve exclusively the purposes of payment of the State aid in respect of the receivables that are owed by the SPV and have been subject to the provisions of law 4605/2019. It is Scope's view that this account should be a separate account in relation to the collection account held for the purposes of the securitisation. The matter has not yet been tested into practice, thus only assumptions can be made on its implementation.

However, two key limitations to the State subsidy have to be considered: First, the subsidy is not guaranteed over the entire term of the settlement plan. At the end of each fiscal year, the conditions governing the basis of which the subsidy was granted (family status, family yearly income, etc.), are reviewed, to determine whether the applicant still meets the eligibility criteria. Second, under the provisions of the law, it would appear that the State can reduce or even abolish the subsidy, in the case of a budget crisis <sup>6</sup>.

### 1.2.2. Strategic defaulters

The new legal provisions may help reduce the number of strategic defaulters, as the new eligibility criteria more accurately depicts the true economic situation of the applicant.

According to some market participants, more than 25% of applicants under law 3869/2010 were strategic defaulters primarily seeking to have their main residence exempted from any enforcement proceedings. Prior to the expiry of the exemption provisions in February 2019, enforcement measures against the borrowers' main residence were prohibited during the length of the proceedings, provided inter alia that the value of the property did not exceed certain thresholds <sup>7</sup>.

Assumptions on the number of strategic defaulters can be derived from the number of petitions withdrawn or waived in the last quarter of 2018, due to the establishment, from 14 June, of provisions related to the lifting of banking secrecy for applicants under law 3689/2010 <sup>8</sup>. The number of applicants increased from 6,435 in the second quarter and 5,365 in the third quarter to 12,500 in the fourth quarter due to the imminent expiry of the shielding legislative provisions regarding the protection of the primary residence. The number of withdrawn cases spiked even more strongly from 268 in the second quarter and 1,200 in the third quarter to 3,200 for the October–December period.

### 1.2.3. Settlement plan standardisation

New legal provisions may mitigate court backlog issues. According to data published in the media, by the end January 2019 the total number of individuals under the protection of law 3869/2010 i.e. prior to the introduction of law 4605/2019 totalled 200,000<sup>9</sup>, of which 135,000 corresponded to pending petitions and 65,000 to resolved cases.

The new law provides for standardised mortgage loan restructuring plans and State subsidy amounts based on a) borrower eligibility criteria, and b) household income. This standardised approach applies write-offs horizontally. It is designed to allow for many restructurings in a limited period. Borrowers must apply through the online platform. The online platform connects directly to the tax office and the bank system to collect the necessary information regarding borrower eligibility. Applications have been eligible for submission since 1 July.

The standardisation process relieves a lot of the workload associated with the proceeding schemes. However, while the application process has been digitalised, the loan settlement process is still too slow, and creditor input is still necessary to move the process forward. According to data published in the media, out of 26,197 applicants, the first successful settlement plan along with the State subsidy granted by virtue of law 4609/2019, was achieved on 16 October (the State contribution was approved for 40% of the total restructuring amount). The process is expected to become more efficient in time, as the legislator is examining ways to make it not only more appealing to borrowers but also faster to examine.

New eligibility criteria designed to cut strategic defaulting

Standardised settlement plans and State subsidy amounts

<sup>6</sup> An argument to the contrary would be that creditors agreed to the settlement in view of the expectation of the subsidy and therefore it should be constitutionally protected.

<sup>7</sup> Borrower that have applied for the protection of their property under law 3869/2010 prior 28.02.2019, still enjoy the protection of such law regardless of the time of hearing of his application and issuance of the respective court decision.

<sup>8</sup> Debtors who apply for insolvency are now obliged to withdraw from bank secrecy and submit a solemn declaration that they are not eligible for commercial bankruptcy.

<sup>9</sup> While the amount of relevant debt was reaching EUR 17bn.

### Law 4354/2015 a milestone in secondary NPL market

### 1.3. Specialised servicers' work-out strategies

A key milestone in the creation of a secondary NPL market was the introduction of Law 4354/2015, the so-called NPL law. The main pillar of this law is the ability of licensed loan servicers to service bank credits and loans, which until then had remained a privilege of licensed credit institutions. Licensed servicers are also permitted to act as servicers under the Greek Securitisation law (L.3156). At an operational level, Greek banks have finalised the segmentation of NPLs and set up specialised units for the management of NPLs, which has resulted in the creation of systemic servicers. The Bank of Greece has licensed up to 20 servicers and various others are awaiting approval.<sup>10</sup>

A servicer's ability to extract value through arrears management and out-of-court settlements is crucial to Greek NPL transactions. Servicers with local expertise, management team and staff, and with a proven track-record in Greece may have a competitive advantage.

But investors should also carefully assess the servicer's incentives, as well as the credibility and soundness of their business plans. Another key element concerns portfolio management systems and software solutions. Ideally, all aspects of the servicing performed on each loan are electronically recorded and regularly monitored by senior management.

In any case, servicers should demonstrate willingness and capacity to add value through restructuring work-out solutions. In the context of restructuring strategies under law 4605/2019, where borrowers must voluntarily enter the process via the online platform, it is critical that servicers proactively approach debtors to guide them through the application process. Servicers may leverage, for instance, a clear communication and outreach plan, call centres operators, physical assistance channels (e.g. through bank branches), and dedicated relationship managers.

### NPL recoveries poor owing to deep negative equity

## 2. Particular risk factors faced by investors in Greek NPLs

Recovery prospects on Greek NPLs are poor mainly because debtors are in deep negative equity. House prices declined in Greece by 43% between 2008 and 2017. By Scope estimates, the median current loan to-value on NPL loans lies between 115% and 120%.

Collateral liquidation strategies are likely to yield poorer results than even very generous haircuts under restructuring agreements, because collateral liquidation has severe drawbacks that will strongly erode the present value of NPLs. Firstly, massive over-supply of stock, as evidenced by the amount of residential mortgage NPLs in relation to the size of the economy (about 15% of GDP), would demand particularly high disposal discounts (see section 2.1). Secondly, lengthy enforcement procedures further impair recovery prospects (section 2.2). Finally, enforcement costs may exacerbate leakage of auction proceeds to non-first-ranking secured creditors (section 2.3).

### Mortgage NPLs would overwhelm enforcement route

### 2.1. Massive over-supply of stock

The mortgage NPL exposure of the four systemic Greek banks amounts to about EUR 26.5bn, which represents almost 15% of GDP. The property market would need to absorb hundreds of thousands of underlying properties if enforcement of collateral becomes the main work-out route.

<sup>10</sup> The list of credit servicing firms can be found at <https://www.bankofgreece.gr/en/main-tasks/supervision/supervised-institutions>.

Against this backdrop, the early signs of recovery shown by property price indices offer little comfort. As of Q1 2019, average house prices have grown by about 9.5% from 2017 trough levels. The recovery was mainly driven by foreign demand, supported by government incentives such as the Golden Visa programme, and was concentrated in Athens and other tourist areas. In a bid to boost the property market, tax incentives for new construction and modernising old buildings via the elimination of value-added taxes for three years are also planned.

Property recovery driven by foreign demand; tax incentives will help

But the number of real estate transactions remain muted relative to pre-crisis levels. The number of transactions, including all types of assets, was 70,000 in 2017 vs 168,000 in 2007 (source: Hellenic Statistical Authority), while the number of e-auctions announced as of Q3 2019 was about 15,000. Moreover, the lack of buying interest continues, forcing banks to bid most of the time. Going forward, we expect that local demand will remain particularly constrained by low mortgage credit supply and weak housing affordability. As of Q2 2019, outstanding mortgage credit continued to decrease year-on-year by 4.5%. And while household disposable income is slowly recovering, it remains substantially below pre-crisis levels.

According to the Hellenic Statistical Authority, Greece's housing cost over-burden rate, i.e. the share of population for which housing costs (net of housing allowances) exceed 40% of household disposable income, stood at 40% in 2018. Based on this metric, the share of households that are at risk of being unable to pay for their housing is also 40%, by far the highest metric in euro area countries<sup>11</sup>. In addition, the fact that private consumption still contracted in H1 2019 – despite higher household disposable incomes – is a clear signal that the deleveraging process of private households will need to continue for an extended period.

Spanish real-estate crisis offers key clues

It is difficult to estimate the time and liquidation discounts that would be required to dispose of NPL collateral. Some assumptions may be drawn from the experience from countries that have recently experienced a real estate crisis, such as Spain, which offers interesting parallels:

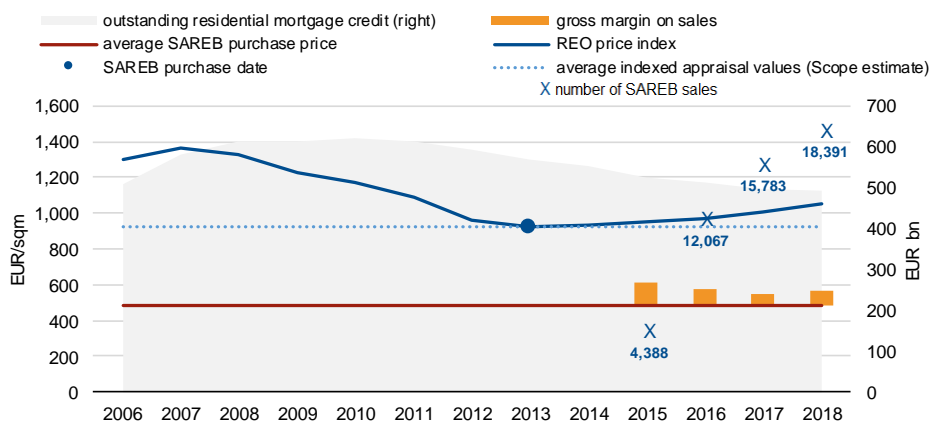
Between Q4 2012 and Q1 2013, SAREB, the Spanish asset management company, acquired about one third of the Spanish banking system's exposure to repossessed residential assets and residential-backed mortgages (equivalent to 11% of GDP). The purchase consisted of over 100,000 units of finished properties at an estimated gross book value of about EUR 37bn<sup>12</sup>. These assets were acquired at a discount of 55% over collateral appraisal values, equivalent to a discount of about 47% over indexed appraisal values, Scope estimates. The time of the acquisition was close to the property price trough, which occurred in 2014.

In the first year after the acquisitions, Spanish house prices continued to drop by about 4%, but then recovered by about 15% from trough levels, as of the end of 2018. In aggregate house price indices recovered by about 10% between acquisition date and end-2018, although credit volumes remained muted. By contrast, SAREB's sales volumes have accelerated since 2015, but gross margins remained subdued at about 17% of average purchase prices. This is equivalent to an average sales price discount of about 35% relative to indexed property valuations as of acquisition date (see Figure 4).

<sup>11</sup> Second highest is Denmark at 14.7%

<sup>12</sup> The SAREB also acquired other bad assets, mainly other developer loans and non-residential repossessed assets, for a total transaction volume of EUR106bn.

**Figure 4. Spanish experience**



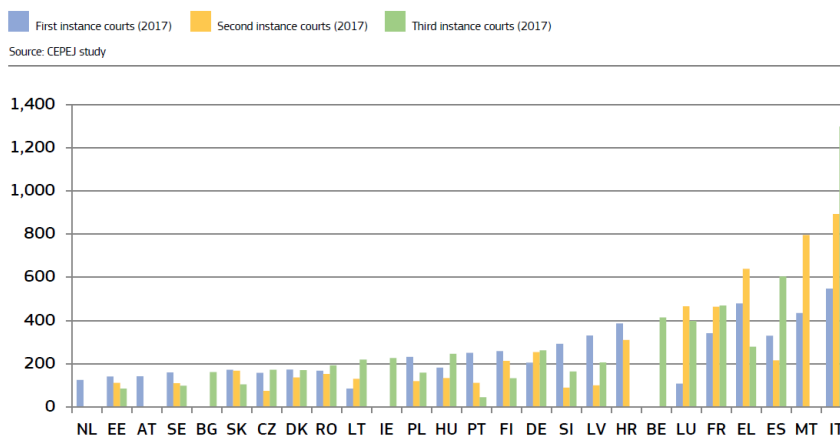
Source: Scope, based on data from SAREB annual accounts and investor presentations. The REO price index has been derived from blended Bank of Spain house price indices, adjusted by a factor of 67% to reflect the below average quality of REO assets.

## 2.2. Length of enforcement proceedings

Greece's court timeframes among longest in Europe

According to the findings of the 2019 EU Justice Scoreboard, Greece is one of the European countries where it takes longest to resolve litigious civil and commercial cases, after Italy, Malta and Spain.

**Figure 5. Time needed to resolve litigious civil and commercial cases at all court instances in 2017 (in days)**



Source: EU Justice Scoreboard (2019)

Enforcement in Greece is a long, court-driven process. Liquidation of security is effected through a public auction. Until recently, the estimated average duration of mortgage foreclosures on individual borrowers was about seven years, because the defendant was entitled to raise counter-claims during all stages of the process. In addition, between 2010 and 2015, enforcement proceedings and auction processes were totally or partially suspended, pursuant to laws 3858/2010, 4224/2013, and following the imposition of the capital control regime (which has now been lifted).

Law 4335/2015 revised the entire Greek Code of Civil Procedure (GCCP) with effect from January 2016 with the aim of reducing litigation time to one year; for instance, through the observance of strict deadlines for the hearing of relevant annulment petitions and the issuance of decisions by the courts of first instance. By virtue of Law 1412/2018 all enforcement auctions are now conducted solely via the electronic platform by a public notary without physical presence of the participants, in an attempt to speed up the



### Revised civil code limits debtor objections

liquidation process. However, the new regime remains largely untested and the reforms do not seem to have yielded the expected results so far.

The new GCCP limits the stages during which the debtor may raise objections against enforcement proceedings to a maximum of three; two before the auction and one after the auction. However, in case borrowers use all legal avenues available to them, the enforcement process can be delayed to about six years, considering persistent court backlog issues, in conjunction with technical legal defects and the still low penetration of IT in the Greek judicial system.

The most relevant borrower opposition avenues that could result in significant enforcement delays are under Law 3869/2010 and Law 4605/2019. Furthermore, under the provisions of the GCCP, the borrower is entitled to file an opposition against the enforcement title. If this is rejected, the borrower is entitled to file an appeal and also a petition aimed at ceasing enforcement proceedings.

The Consumer Protection law (2251/1994 Law) also applies to banking transactions. Furthermore, the grounds of the borrower's opposition may concern the invalidity of "the general terms and conditions" contained in the contract, the termination of which was the cause of the initiation of enforcement. In light of the above, the invalidity of a general term under law 2251/1994 could impact the enforcement process, since it may lead to the cancellation of the enforcement title.

The debtor may also seek postponement of the auction by alleging that the auction price has been under-estimated. In reference to e-auctions, out of the roughly 15,000 auctions announced as Q3 2019, many were delayed or postponed. The main reason for their postponement is down to debtors challenging the starting price. Once the allocation of proceeds has been determined, creditors may dispute the allocation. This can further delay the time before creditors finally receive the proceeds of the enforcement against the relevant property.

### Limits on auction proceeds could cap allocations to first-ranking secured creditors

#### 2.3. Leakage of auction proceeds

Allocation rules for the distribution of auction proceeds under Greek law may constrain the amounts received by first ranking secured creditors to up to 65%. The average leakage to preferred and unsecured creditors represents around 10% of auction proceeds, Scope estimates. A recent change in the allocation rules has improved the position of first-lien secured creditors for any claims arising after January 2018, but NPL creditors are still better off under restructuring solutions in most cases.

##### 2.3.1. Applicable rules for claims arising prior to 17 January 2018

There are three classes of creditors under the GCCP: preferred creditors (this refers mainly to State claims on tax liabilities), secured creditors and unsecured creditors.

In the case of concurrence of all three types of creditors, auction proceeds (after deduction of all enforcement expenses) are allocated based on the following rules: up to 65% to secured creditors and any collection exceeding the secured claimed amounts, first to preferred and then to unsecured creditors; up to 25% to preferred creditors and any collections exceeding the preferred claimed amounts, first to secured and then to unsecured creditors; up to 10% to unsecured creditors and of any collections exceeding the unsecured claimed amounts, 2/3 to distributed to secured and 1/3 distributed to preferred creditors.<sup>13</sup>

<sup>13</sup> In the case of concurrence of secured and preferred creditors (i.e. no unsecured creditors): up to 2/3 to the secured creditors and any collections exceeding the secured claimed amount, to preferred creditors; up to 1/3 to the preferred creditors and any collections exceeding the preferred claimed amounts, to secured creditors. In the case of concurrence of secured and unsecured creditors (i.e. no preferred creditors): Up to 90% to the secured creditors and any collections exceeding the

**Figure 6: Example of allocation of proceeds under two different scenarios**

**Assumed debtor liability structure (EUR)**

Liabilities	
Secured creditors	80
Preferred creditors	15
Unsecured creditors	5
<b>Total</b>	<b>100</b>

Case A	
<b>Auction proceeds:</b>	<b>50</b>
<b>Allocation of proceeds:</b>	
1. 65% to secured	32.5
2. 25% to preferred	12.5
3. 10% to unsecured	5
<b>Recovery analysis:</b>	
Recovery rate (RR) on total liabilities	50%
RR on secured claims	38%
RR on preferred claims	83%
RR on unsecured claims	100%
Leakage to preferred and unsecured	35%

Case B	
<b>Auction proceeds:</b>	<b>75</b>
<b>Allocation of proceeds:</b>	
1. 65% to secured	48.75
2. Maximum allocation to preferred	15
3. Excess amount (up to 25%) not allocated to preferred, to secured	3.75
4. Maximum allocation to unsecured	5
5. Remainder to secured	2.5
<b>Recovery analysis:</b>	
Recovery rate on total liabilities	75%
RR on secured claims	69%
RR on preferred claims	100%
RR on unsecured claims	100%
Leakage to preferred and unsecured	27%

Source: Scope Ratings GmbH

**Unsecured creditors arguably in better position than junior secured creditors**

A peculiarity of auction allocation rules is that they would appear to place unsecured creditors in a better position than junior-lien secured creditors, because junior liens are fully subordinated to senior liens within the 65% bucket allocated to secured creditors. Also, under quite plausible borrower liability structures, unsecured creditors could achieve recovery rates higher than those of secured creditors, because the 10% bucket allocated to unsecured creditors is quite large relative to the likely amount of unsecured liabilities.

In practice, several notaries consider junior secured creditors, who are not satisfied via the waterfall, as unsecured creditors too. In addition, unsecured creditors rarely appear in auctions as there is no automatic process informing creditors of borrower auctions.

secured claimed amounts, to unsecured creditors; Up to 10% to the unsecured creditors and any collections exceeding the unsecured claimed amounts, to secured creditors.

### 2.3.2. Applicable rules for claims arising after to 17 January 2018

A purely sequential allocation waterfall applies for claims on credit agreements entered into after 17 January 2018. The objective of this latest reform of the GCCP is to expedite the process and to improve the ranking of the secured creditors.

#### **Figure 7: Simplified auction proceeds allocation waterfall**

1. Employee claims up to six months salaries (subject to certain caps)
2. Secured claims
3. Preferred claims
4. Unsecured claims

An important consideration is that purely sequential allocation rules would also apply to loan agreements executed before 17 January 2018, provided that a novation contract has been entered after 17 January 2018 and that pledge or mortgage over an asset which was not previously encumbered is granted. This legal interpretation provides creditors with a strong incentive to pursue loan restructurings, provided that a relevant clause is included in the agreement provided that the “restructuring” has the meaning of novation of debt.



## Conditions for Greek residential mortgage NPL securitisation improving, but country-specific risk factors remain

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