# EXPERT Q&A

*The European NPL market opportunity set is growing for those with experience and established bank relationships, says Paul Burdell, co-founder and CEO of LCM Partners*

# The value of a steady hand

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**Q What is the current status of the European non-performing loan market?**

The market itself is quite stable today and defaults remain at relatively low levels. There was strong support provided by central banks and treasuries during covid, which meant we didn't get the huge tsunami effect driven by rising unemployment that many feared. In aggregate, we estimate the stock of European non-performing loans (NPLs) stands at approximately €400 billion and it's been around that level for the last couple of years.

In terms of the underlying borrowers, or customers as we call them, we haven't experienced any material change in behaviour. Average payment amounts have come down a little in certain portfolios or geographies as living costs have increased but nothing more than that. Remember, we don't charge our customers fees or interest.

In the main, we are acquiring portfolios from prime originators, so these are good customers who are often going through some sort of life event, like a divorce or a redundancy, and we want their journey with us to be a rehabilitation story. If a customer finds themselves in a hole, we should give them a ladder.

**Q What does that mean for your credit opportunities strategy?**

Last year was record-breaking for our credit opportunities strategy (COPS), which deployed €1.1 billion, and we have seen no slowdown in activity at the start of this year. In fact, we've never been busier.

What's interesting is the breadth of opportunities we see at the granular end of the European consumer and SME market that we target. We're not only acquiring NPLs, but increasingly attractive performing loan portfolios are coming to market as banks and other financial institutions look to exit subscale product lines or geographies.

We like these investments because typically there's a good deal of operational complexity, and through utilising our proprietary software and our in-house servicing capabilities, it provides us with a competitive edge.

We're also seeing new markets opening up – places such as France, Germany and the Nordics. There weren't many opportunities for us previously because spreads were so tight, but pricing is much improved today.

### Q What's behind this heightened activity?

It's a few things. Regulation continues to provide a tailwind to our deployment with the implementation of the final Basel III revised standards for bank capital requirements. The results of the latest mandatory Basel III capital monitoring exercise showed that minimum Tier 1 capital requirements for European banks will increase by 9 percent at the full implementation date. Based on our calculations, that equates to approximately €150 billion. That's a lot of additional capital if the European banks want to maintain their current capital buffers.

Further deleveraging seems inevitable, and the value of our franchise is in how we ingrain ourselves in the financial community in which we operate. The more solutions we can provide, the better our relationships and the better the returns we can generate for our investors.

The competitive landscape has also changed. We took the position very early on that we don't use leverage when acquiring NPL portfolios. We also don't have any debt on our balance sheet. By contrast, many of our competitors are leveraged balance sheet buyers.

These firms have more than €8.5 billion of capital markets debt to refinance between now and the end of 2026 at a time when their cost of borrowing has increased materially, and this also doesn't include either revolving or working capital facilities. The higher interest rate environment is forcing them to focus on balance sheet management, and that's leading to both reduced deployment and, in some cases, asset sales.

On the flip side, we closed COPS 4 with €4.1 billion, so we have one of the largest pools of long-term capital in this space. By design, and by strength, we're seen as a trusted counterparty by the banks, which explains why almost half of our annual deployment is in long-term exclusive contracts.

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*"If a customer finds themselves in a hole, we should give them a ladder"*

Finally, over the last decade there has been in excess of €1.2 trillion of European loan sales, which is driving the creation of a growing secondaries market. These transactions play to our strengths as these tails are typically more granular in nature and have a track record of payment history that can be diligenced.

Going forward, none of these trends are going away, and there's a huge amount of optionality if the market turns down. If we can do what we are doing today in a relatively static environment, then I am optimistic about what will happen if the market turns.

### Q What about competition from other funds?

In the consumer NPL space post-GFC, banks have become hyper-sensitive about who they sell their portfolios to. It's now a lengthy process to make it onto a bank's approved panel of buyers and you've got to have the in-house servicing capability. In the past, it was possible for other investors to participate with just a cheque book, but today that is much more difficult.

Also, do not underestimate the value of long-term relationships. We have been regularly dealing with more than 110 banks across Europe for almost 25 years. The banks increasingly want to interact with people that buy from them regularly and understand the process. So many of our competitors have built up and left this market – our job is to build up and stay. We aren't going anywhere, and we see plenty of opportunities for more growth.

### Q What are your priorities for 2024?

Driving efficiencies in our servicing business is always a priority, and the advent of AI and other related technologies is really helping in that regard. We are doing some really cool things in robotic process automation for example, with 32 bots now functioning across our operations. We estimate they do work that is equivalent to 106 full-time employees.

Sourcing attractive transactions is obviously another perpetual priority, but don't underestimate the impact of the final Basel III revised standards. The banks are still working out what to do but the opportunities being shared with us today are very significant, not just in Europe but globally. We're going to start fundraising for the latest vintage of the COPS strategy later this year and it certainly feels like good timing. ■