AN INVESTIGATIVE APPROACH TO NON-PERFORMING LOAN RECOVERY:

THE WOOD, THE TREES AND THE LOW-HANGING FRUIT

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Across global markets, there is an ever-increasing focus on the need for financial institutions and debt issuers to both recognize the extent of their non-performing loan (NPL) exposure and to understand options for recovery. At the same time, the secondary market for NPL portfolios is presenting an increasingly attractive investment opportunity.

NPL portfolios are often seen as a sum of their parts. To take the old saying, "you can't see the wood for the trees," sometimes when considering recovery options for NPL portfolios, the problem can be the opposite. To run with the analogy, by focusing on the portfolio as a whole, or "the wood," it is easy to overlook the facts surrounding individual loans, or "the trees." By getting into the detail, a closer examination of individual loans can in the right circumstances yield valuable returns.

Not all NPL portfolios are created equal. There is a mature market and approach for the resolution and sale of unsecured debt, asset-backed and retail NPL portfolios. However, when it comes to NPLs issued to, or guaranteed by, high-net-worth individuals and cross-border business groupings, these NPLs can present a number of challenges when it comes to considering recovery options vs. portfolios of other NPLs.

Adopting an investigative approach to these classes of NPLs is becoming an increasingly attractive option for debt holders to develop an efficient and cost-effective recovery strategy, including by strengthening negotiation positions, and to enhance the potential sale value of a portfolio.

The Investigative Approach

At its core, an investigative approach looks beyond the immediate borrower to understand the international asset profile of related parties, ultimate beneficial owners (UBOs) and guarantors. It is a deep dive into the loan, the borrower and the related parties in order to identify viable routes for recovering value.

This approach utilizes all available sources of internal information within the lender combined with public record and open-source information gathering to efficiently establish the asset profile of subjects of interest in order to formulate an effective strategy for recovery.

The investigative approach typically involves the following phases:

- Defining the population of relevant loans, borrowers, guarantors and related parties
- Conducting a triage process to identify the highest priority loans for recovery. This is achieved through an enhanced review of internal and external information with a view to:
    - Identify jurisdictions in which the subjects have an asset profile, for example, where the subjects reside, are incorporated, operate or have other relevant connections

   - Identify likely assets and assets holding structures
- Developing a targeted recovery strategy focused on:
   - Assets with the greatest value
   - Assets with the greatest strategic significance for settlement or recovery
   - Jurisdictions where the likelihood of recovery is the highest

The first step in any approach is to identify the relevant population of loans, guarantors and related entities. What is often overlooked when taking a portfolio view is identifying connections between the guarantors and related entities. Analysis of internal datasets alongside public record searches can often help identify undeclared or previously unknown connections between subjects of interest. This often allows for further consolidation of loans and related parties and the streamlining of subsequent investigation and recovery efforts.

Low-Hanging Fruit to Fund the More Complex Work

One additional, and important, advantage of adopting an investigative approach to NPL portfolio management is the ability to create a self-funding model, whereby recovery of the "low-hanging fruit," those assets which are most easily recoverable, can fund more complex cases in the portfolio. By utilizing an efficient triage process, the minimum of resources can be deployed in the initial stage to fund recovery of the highest priority assets. This can create a win-win scenario for debt holders – a reduction in NPLs and the freeing up of capital for other uses.

Overcoming Internal Barriers

Knowledge of specific NPLs and related parties as well as the historical recovery efforts can be fragmented across various internal stakeholders and geographies within an organization. Bankers, credit committees, internal audit, general counsel and legal teams, and recovery teams amongst others can all be involved at some point in the NPL process. Commonly, each of these stakeholders approach the issue in a slightly different way, may have different priorities and utilize various internal and external data.

Adopting a centralized approach drawing upon all the existing information held by the various stakeholders and combining it with open-source analysis can prove immensely effective. Beyond the obvious, such as account statements, internal information such as know your customer (KYC) files, compliance records and customer communications across all accounts linked to the subject of interest can yield a tremendous amount of actionable intelligence. This intelligence can then inform an investigation strategy, harnessing open-source and public records to identify and trace assets of the subjects.

Identifying Worldwide Assets

Taking a worldwide view when assessing the assets of guarantors and borrowers is critical for success in recovering NPLs of this nature. This process goes beyond identifying specific assets such as companies, real estate, financial assets and other liquid and illiquid assets; it is equally important to develop an understanding of how assets are held. Establishing a subject's asset-holding structure can reveal easier routes to recovery than may be apparent from an initial view of the loan. For example, real estate held through an offshore company can open up possibilities for enforcement against the shares in the offshore company rather than the underlying property asset.

Having established the asset classes, where they are located and, crucially, how and where the assets are owned, a legal strategy can be devised prioritizing those assets that are of most interest. This allows for a debt issuer's legal counsel to focus their efforts on those jurisdictions in which any debt judgments can be enforced. Decisions can then be made on the viability of pursuing other resolution methods where enforcement of the debt judgment is not possible. Subsequent investigations can then focus on assets and holding structures in the preferrable jurisdictions to gather admissible evidence to support the claims.

Fraud

No matter how robust a debt issuer's underwriting framework is, there will always be instances where loans are issued based on false or misleading information provided by the customer. By adopting an investigative approach, the likelihood of uncovering this activity is increased, and once the activity is identified, it opens up potential options for related fraud claims that move beyond enforcement of any debt order.

An investigative approach is not going to be the right option for all types of NPLs. But sometimes if you are lost in the woods, it can be worthwhile looking at the trees around you to find your way out.