



Approaches to NPL resolution in the EU countries

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Outline

(i) Snapshot on non-performing loans (NPL) trends in the EU Member States

(ii) NPL regulatory developments at national and EU level

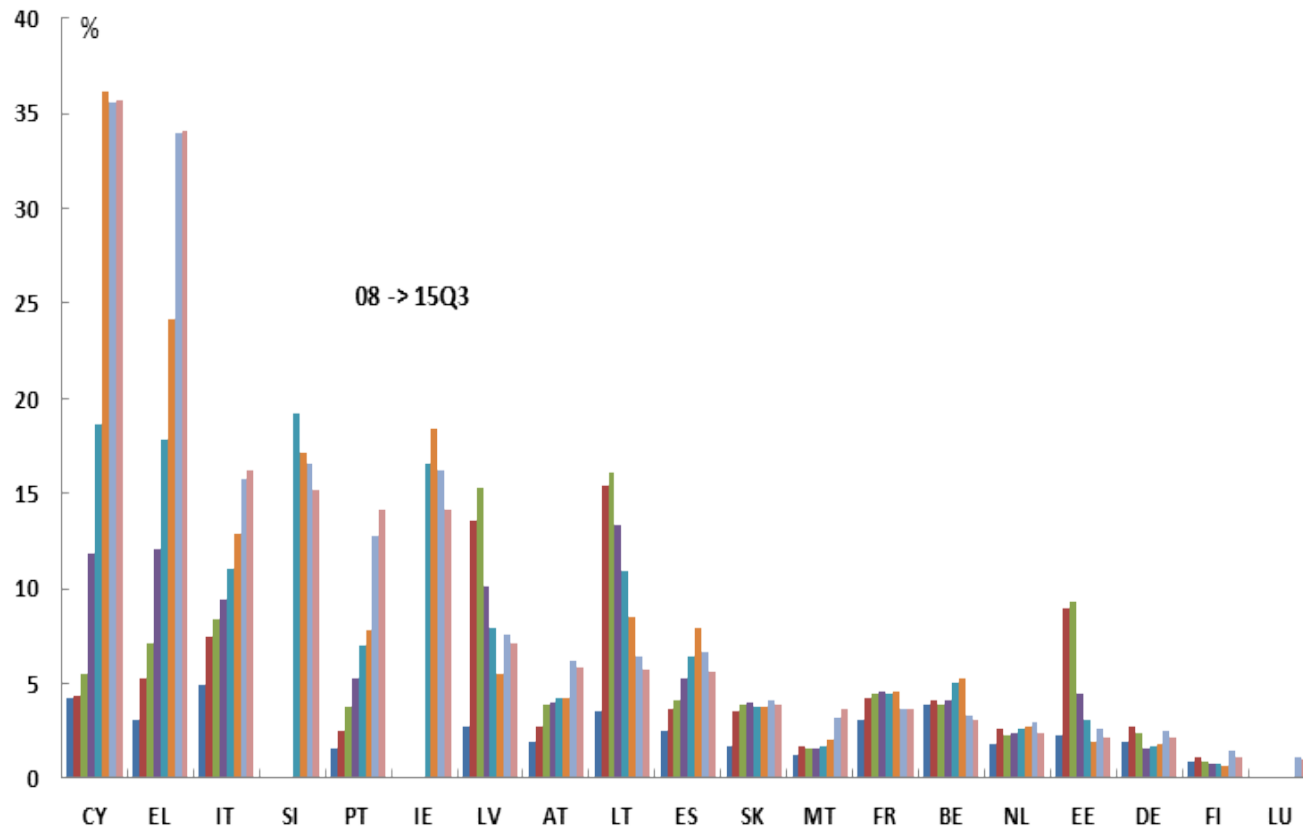
(iii) Balance sheet cleaning-up in euro area countries

(iv) NPL resolution in non-euro area countries, with focus on CEE countries

(v) Specific elements in the Cypriot approach to tackle NPLs

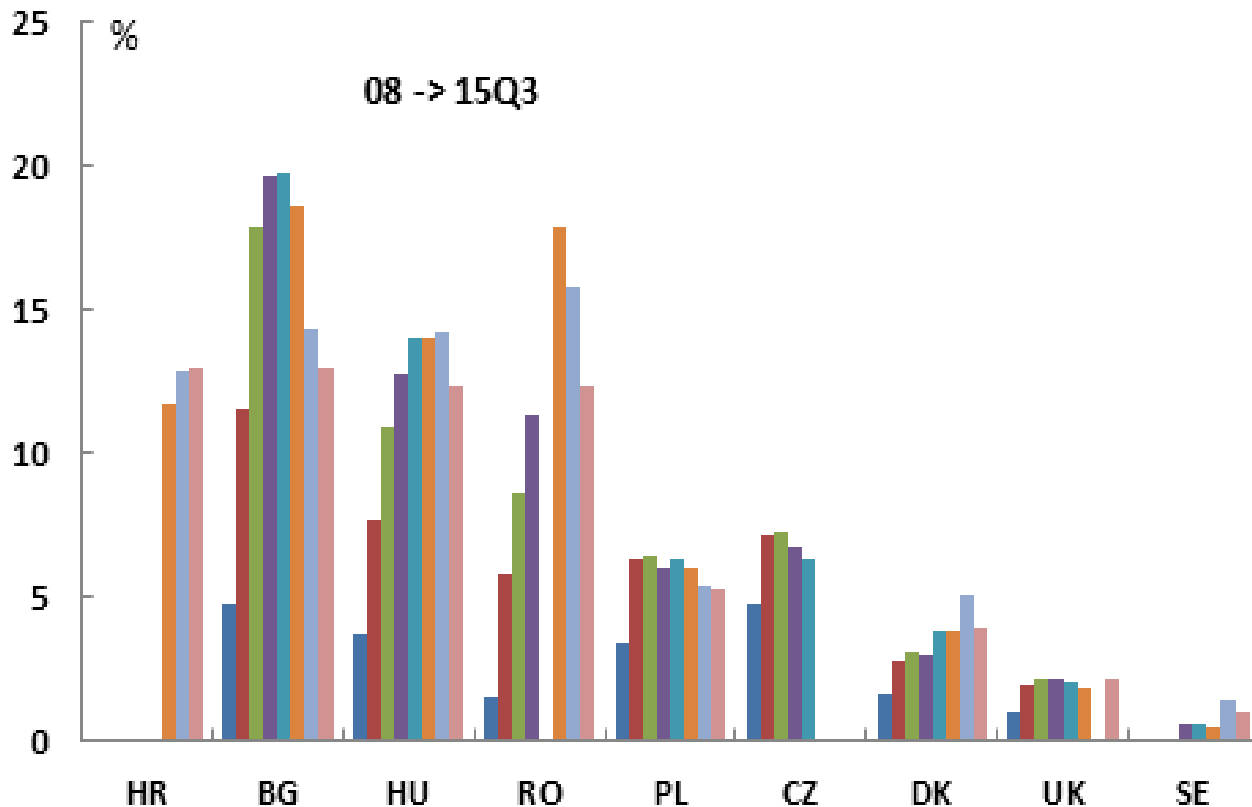
(vi) Concluding remarks

NPLs on a declining trend, but not in a decisive manner in several euro area countries



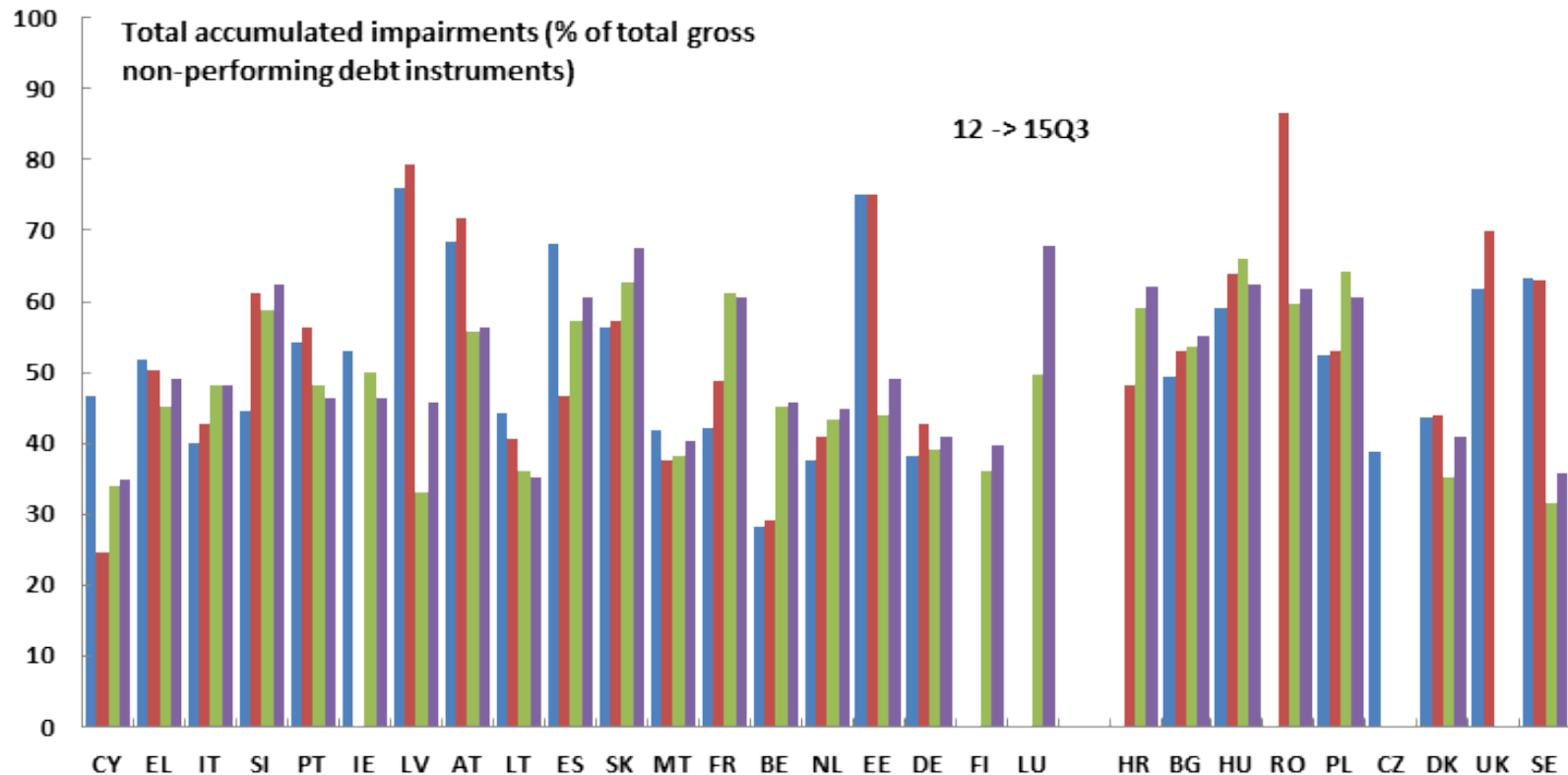
- In most euro area countries, NPLs are well below 10%
- In two euro area countries, NPLs are above 30% and without clear signs of decline: *Cyprus, Greece*
- NPLs are also still very high in *Italy, Slovenia, Portugal and Ireland*

A similar downward trend in NPLs is visible in non-euro area countries

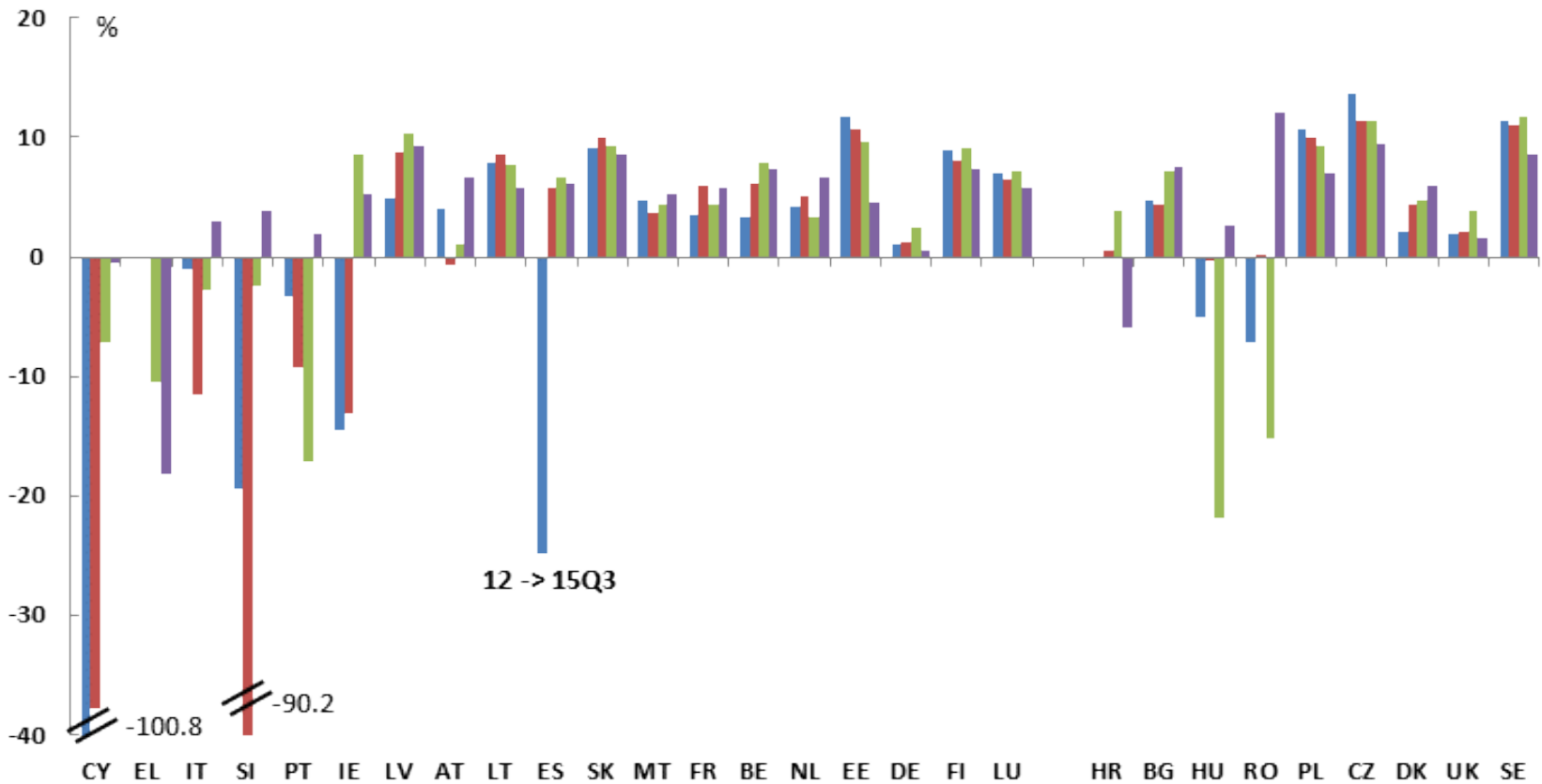


- NPLs have increased during the crisis period most markedly in *Croatia, Bulgaria, Hungary and Romania*
- *UK and the Nordic countries* have been less impacted
- Most significant progress regarding NPL reduction has been done in *Bulgaria and Romania*

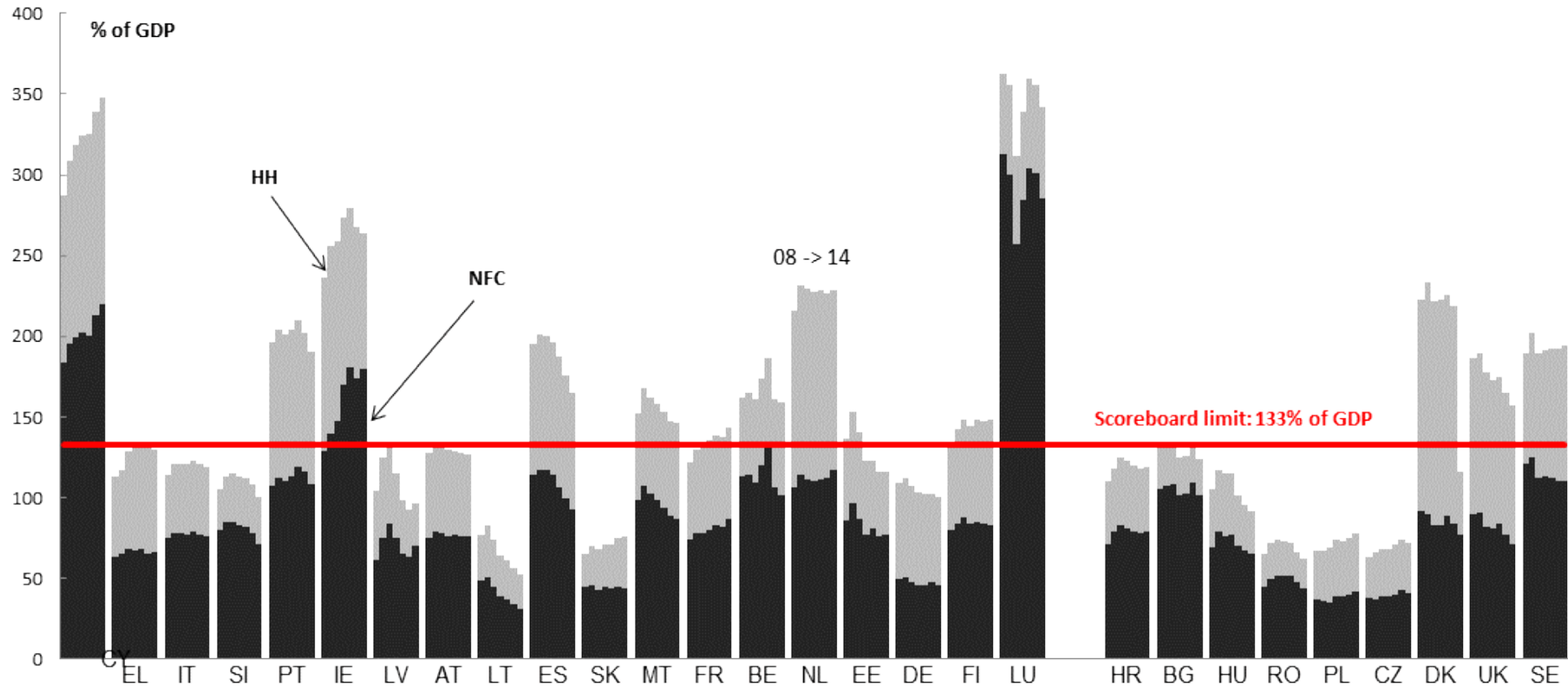
NPL coverage ratios decreased in 2013, but have rebounded afterwards in most EU countries...



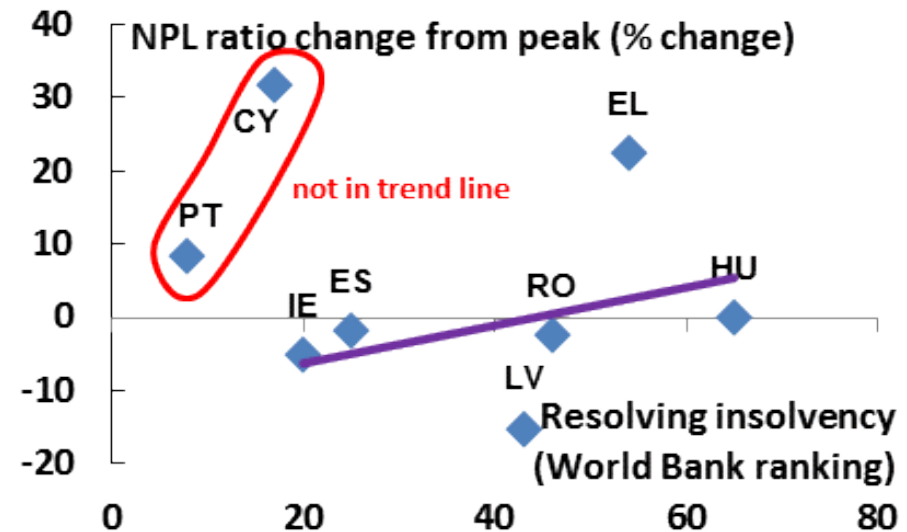
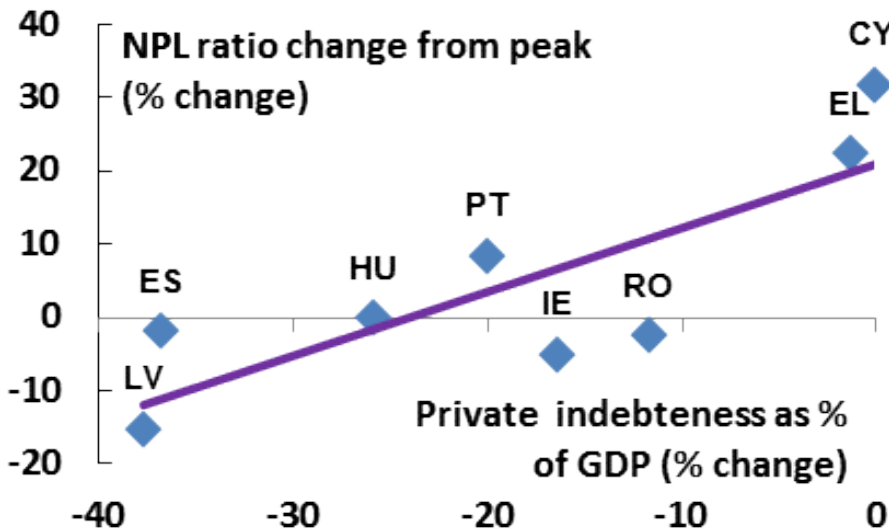
...however, provisioning efforts have also put strain on profitability



Private indebtedness in several EU countries needs to decline further



Private indebtedness – developments in programme countries



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NPL regulatory environment has evolved both at national and EU level in recent years

- **More stringent NPL definitions and disclosure in several countries (e.g. in *Portugal, Cyprus*)**
- **Guidelines on restructured/renegotiated loans (e.g. in *Ireland, Spain*)**
- **CRR (Capital Requirements Regulation) 90 days past due definition of a defaulted obligor**
- **Harmonization of NPL definitions at EU level: EBA definitions of non-performing exposure (NPE) and forbearance (FBE)**
- **Use of prudential filters on loan-loss provisions (e.g. in *Romania*)**
- **Introduction of immediate tax deductibility of loan-loss provisions (most recently in *Italy*)**

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Policy actions supporting NPL work-out and disposal adopted in euro area countries

- **Legislation to remove barriers to NPL sales to facilitate the development of the distressed assets market (most recent cases are Cyprus and Greece)**
- **Removal of legal/administrative disincentives to NPL resolution (e.g. restrictions regarding impaired assets servicing companies)**
- **Introduction of or strengthening of existing out-of-court settlement frameworks**
- **Revamp of corporate insolvency frameworks to *inter alia* shorten recovery periods of collateral – most of the recent reforms were undertaken in countries under multilateral assistance programmes**
- **Reform of personal insolvency and foreclosure frameworks**
- **Enhancement of credit registries**

Both on- and off- balance sheet approaches for NPL resolution were used in the euro area countries

On balance sheet approaches:

- **Increase in loan-loss provisions and NPL coverage ratios to facilitate NPL work-out and write-off: requires also adequate capital buffers to absorb losses**
- **Introduction of NPL resolution targets (for instance, in Ireland, Cyprus and more recently in Greece)**
- **Measures to improve internal arrears management capacities of banks: upgrading of organisational processes and IT systems, investment in specialised human resources**

Off balance sheet approaches:

- **Setting-up of asset management companies for distressed assets, special purpose vehicles (SPVs), outright sales of NPLs**

Off balance sheet solutions (I)

Asset management companies (AMCs)/("bad banks"):

- Enabled the cleaning-up of balance sheets in an environment of depressed market prices
- Setting-up of system-wide AMCs entailed complex decisions (on asset perimeter, ownership structure, funding, governance/accountability, pricing of distressed assets)
- System-wide AMCs established in the euro area countries so far (in Ireland, Spain, Slovenia) benefitted from state support (transfer price of assets at real economic value, state guarantees on funding)
- Establishment of AMCs facilitated by the existence of homogeneous impaired assets (e.g. real estate and construction sector)

Off balance sheet solutions (II)

Special purpose vehicles (SPVs) for NPL securitisation:

- **Alternative solution to system-wide AMCs, especially taking into account the current EU legal framework on bank resolution**
- **Requires adequate securitisation legislation**
- **Difficulties to secure funding - attract buyers for the junior bonds/notes issued by SPVs**
- **Limited experience in the post-crisis period with NPL securitisation (e.g. the IT scheme for NPL securitisation adopted in February 2016)**

Outright sale of impaired assets

- **Sales of NPLs by banks increased more markedly since 2014**

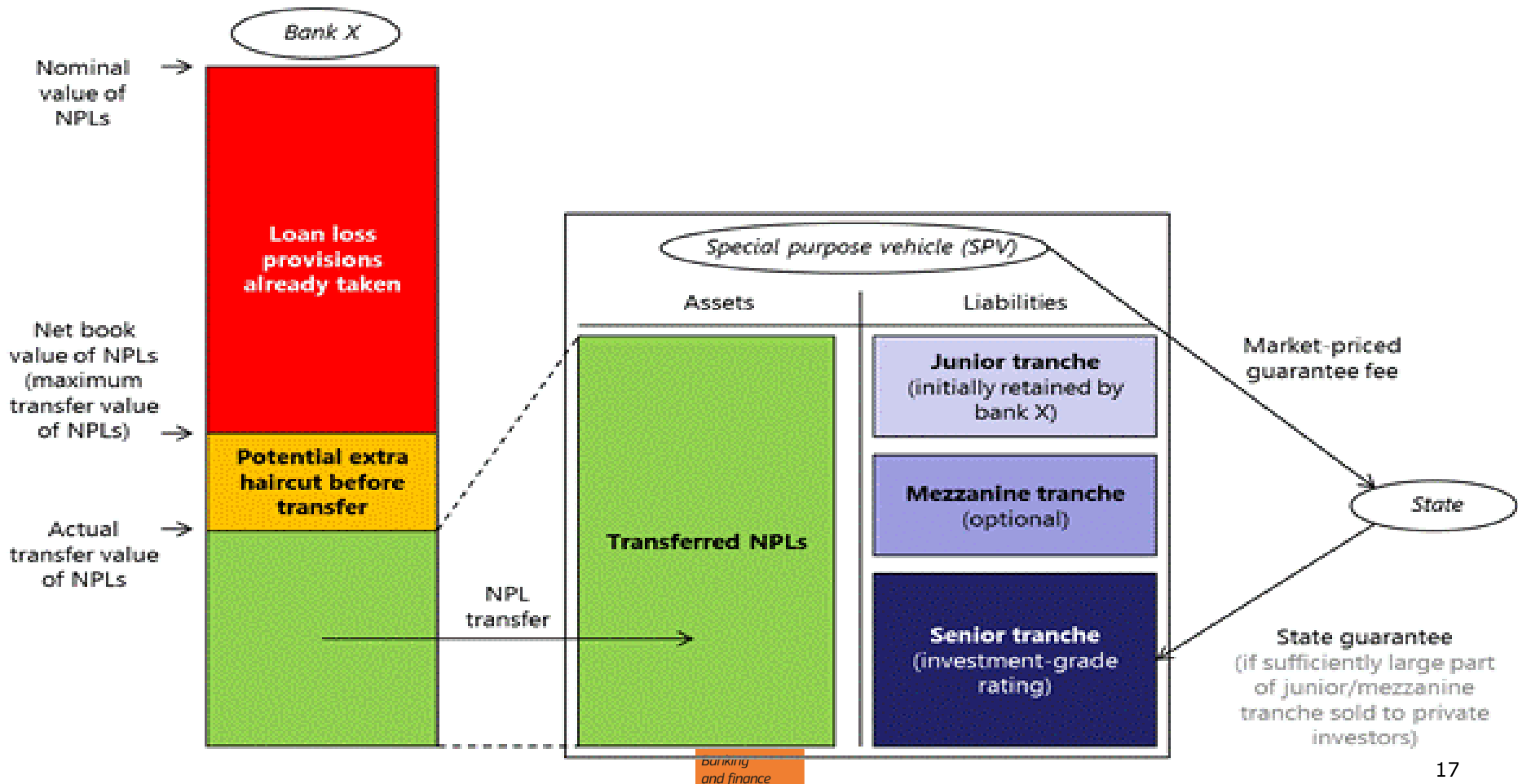
Overview on Asset Management Companies (AMCs) and NPL securitisation vehicles (SPVs)

| | In operation | | | | In preparation |
|-------------------------------------|-----------------------------|----------------------------|------------------------------|---|---|
| | Ireland NAMA Dec 2009 | Spain Sareb Nov 2012 | Slovenia BAMC Mar 2013 | Hungary MARK Nov 2014 (Dec 2014) | Italy GACS (securitisation) Feb 2016 (June 2015) |
| NPL, bn EUR | 138.1 | 203.4 | 8.5 | 6.7 (Dec 2014) | 337 (June 2015) |
| Gross value, bn EUR | 74.4 | 97.5 | 5.0 | | |
| % of GDP | 44% | 9% | 14% | | |
| Transfer value, bn EUR | 31.8 | 50.7 | 1.6 | | |
| discount | 57.3% | 48.0% | 68.0% | small | small |
| Nature of transfer | obligatory | obligatory | obligatory | voluntary | voluntary |
| Cover of bank losses | | public capital injection | | | bank provisions |
| Public debt as % of GDP, start date | 61.8% | 85.4% | 70.8% | 76.2% | |
| peak | 120.2% (2012) | 100.8% (2015) | 83.5% 2015 | 80.8% (2011) | 133.0% (2015) |
| 2015 | 99.8% | 100.8% | 83.5% | 75.8% | 133.0% |
| Sovereign rating (S&P), start date | AA | BBB- | A- | BB | |
| trough | BBB+ (2011/14) | BBB- (2013/14) | A- (2013/15) | BB (2013/14) | BBB- (2015) |
| Dec 2015 | A+ | BBB+ | A- | BB+ | BBB- |
| Funding | State guaranteed bonds | Government bonds | Central Bank | Senior (state guaranteed)/junior bonds | |
| Eligible collateral | yes | yes | yes | | |

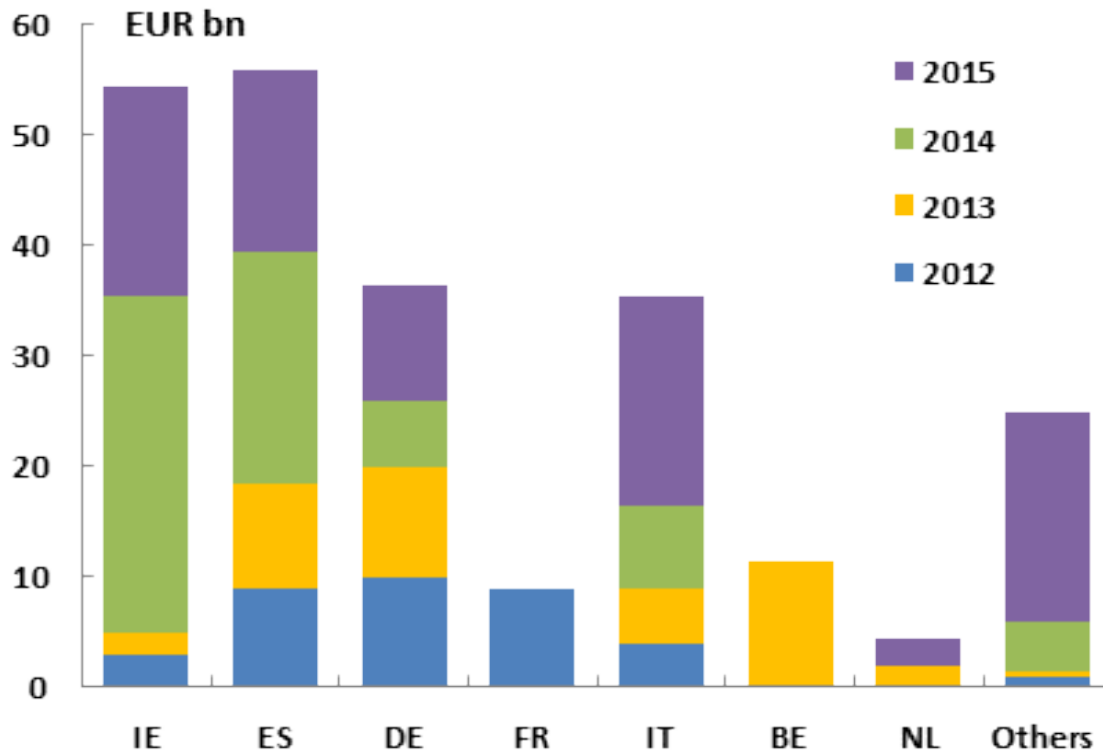


European
Commission

Italian scheme – structure of a special purpose vehicle (SPV) for NPL securitisation



Sale of impaired assets in euro area countries



- Total sales of NPLs reached roughly EUR 86 bn in 2015, up from EUR 69.5 bn in 2014

- Most buoyant markets are in *Ireland* and *Spain*, with sales of impaired assets also increasing in *Italy*

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Cleaning-up of balance sheets has proceeded at low speed in the CEE region in recent years ...

- **Obstacles to faster NPL resolution and disposal:**
 - **Limited work-out expertise and arrears management capacity, in particular for smaller banks**
 - **Inefficient pre-insolvency/insolvency procedures leading to lengthy recovery periods and low recovery values of collateral**
 - **Lack of forceful supervisory action aimed at incentivising banks to clean up balance sheets**
 - **Underdeveloped markets for distressed assets (in some countries, quasi non-existent for corporate debt)**

....but, has gained momentum since 2014

- **Developments supporting NPL resolution:**
 - **Overhaul of insolvency procedures and introduction of out-of-court workouts**
 - **Enhanced focus on loan provisioning requirements to facilitate write-offs and sales of distressed assets**
 - **Loan portfolio reviews/asset quality reviews and stress tests at national and EU level**
 - **Elimination of legal and fiscal barriers hindering swift NPL disposal**
 - **Increased interest of foreign investors in distressed assets in CEE countries**

Sales of distressed assets have picked up in several CEE countries (I)

- **Increased demand of foreign equity funds for distressed assets in these countries:**
 - **In 2015, roughly EUR 4.5 billion of impaired assets were sold (EUR 1.9 billion) or planned to be sold (EUR 2.6 billion) in the CEE countries**
 - **Romania was the most active market both in terms of volume and number of completed transactions in 2015:**
 - **banks sold mainly corporate and consumer loans**
 - **most active sellers are still the largest banks**
 - **Ongoing transactions were reported in Bulgaria, Croatia, Hungary and Poland**

Sales of distressed assets have picked up in several CEE countries (II)

- **Key factors driving decisions to engage in debt sales transactions in these countries:**
 - **Data quality and availability**
 - **Perceived pricing gap (*bid-ask spread*) of impaired assets**
 - **Access to asset servicing companies on local markets**
 - **Availability of a "critical mass" of distressed assets and of certain asset classes**
 - **Predictability of the legal and regulatory framework**
 - **Debt collection and recovery performance**

AMCs – a solution for non-euro zone countries? (I)

- **Limited experience and incentives so far with the setting-up of AMCs in these countries:**
 - **Only relevant case so far is the Hungarian AMC (MARK)**
- **Appetite to establish AMCs has been dampened by:**
 - **Concerns regarding potential impact on public finances (in case of full/majority state ownership)**
 - **Difficulties to secure private ownership to avoid consolidation of AMCs in the general government sector (relevant especially for countries with high public debt)**
 - **Unavailability of high volumes of sufficiently homogeneous impaired assets**

AMCs - a solution for non-euro zone countries? (II)

- **Local vs. foreign ownership in the banking sector – less incentives for authorities with high foreign ownership to set up such vehicles**
- **State-aid considerations related to the transfer price of assets and funding of such vehicles:**
 - **After the entering into force of the BRRD, the setting up of AMCs with public support has become more difficult**
- **Difficulties to ensure from inception an appropriate operational capacity to manage impaired assets**

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Specific elements in the Cypriot approach to tackle NPLs (I)

Targets:

- **In 2014: Introduction of key performance indicators (including medium-term targets for loans 90 days past due and provisions) for Bank of Cyprus (BoC) and Cooperatives, which were subject to ELA or restructuring plans**
- **Since mid-2015: Debt restructuring targets for all banks, recalibrated and checked against performance on a quarterly basis with publication of aggregate numbers**

Overall targets for banks under restructuring

| Key performance indicators | | Bank of Cyprus (BoC) | | | Cooperative Group | | |
|----------------------------|--|----------------------|----------|--------------------|-------------------|----------|--------------------|
| | | Dec 2014 | Dec 2015 | Medium-term (2017) | Dec 2014 | Sep 2015 | Medium-term (2017) |
| Asset quality | 90 days past due coverage | 41% | 48% | 40 - 50% | 44.3% | 49.9% | > 45% |
| | Provisioning charge | 3.6% | 4.3% | <1.0% | 1.3% | 3.8% | < 2.0% |
| | 90 days past due loans (EUR bn) | 12.65 | 11.30 | < 10 | 6.2 | 6.0 | < 4.5 |
| Funding | LTD | 141% | 121% | < 150% | 81.6% | 74.3% | < 85.0% |
| Capital | CET 1 ratio | 14.0% | 14.0% | > 10% | 13.6% | 12.0% | > 15% |
| | Leverage ratio (assets/equity) | 7.7x | 7.5x | < 12x | 11.3x | 13.6 | < 10x |
| Efficiency | Net interest margin (NIM) | 3.9% | 3.8% | > 2.5% | 2.7% | 2.5% | > 2.5% |
| | Cost-to-income ratio | 37.0% | 40.0% | < 45% | 37.4% | 41.2% | < 42% |
| | Number of branches (target for Dec 2015) | 130 | 129 | 125 | 292 | 253 | 258 |
| | Number of employees | 4,334 | 4,341 | < 4 100 | 2,703 | 2,659 | 2,580 |

Debt restructuring targets for banks

| Indicators | Jun-15 | Sep-15 | | Dec-15 | | | Mar-16 | | Jun-16 |
|---|--------|-------------|--------|-------------|-------------|--------|-------------|------------|--------|
| | result | June target | result | June target | Sept target | result | Sept target | Dec target | target |
| (1) Proposed solutions (%) (non-cumulative) | 6.1 | 9.4 | 6.3 | 11.5 | 12.5 | 13.3 | 11.1 | 11.6 | 14.4 |
| (2) Concluded solutions (%) (non-cumulative) | 4.7 | 7.5 | 6.5 | 10.1 | 11.6 | 13.0 | 10.7 | 11.1 | 14.9 |
| (3) Terms-being-met (%) (cumulative since Jan 2014) | 65.8 | 66.5 | 68.2 | 70.7 | 72.9 | 69.9 | 71.7 | 71.7 | 71.6 |
| (4) Early-arrears cured (%) (non-cumulative) | 28.1 | 27.8 | 31.2 | 40.0 | 40.0 | 38.6 | 43.1 | 40.0 | 43.8 |

Specific elements in the Cypriot approach to tackle NPLs (II)

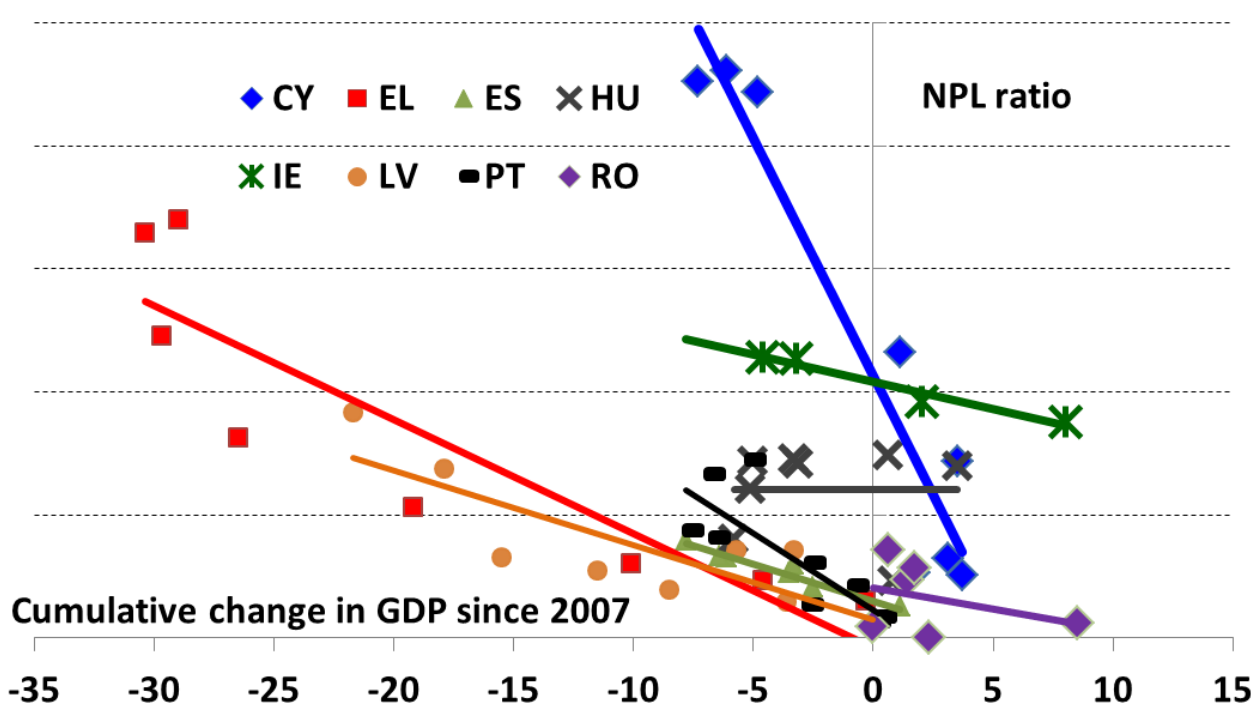
- **Reform of personal and corporate insolvency framework – adopted in April 2015**
 - **The new personal insolvency framework includes a *personal repayment plan*, which establishes a procedure whereby an insolvent debtor can, with the mandatory help of an insolvency practitioner, propose a restructuring plan which, where possible, should avoid the sale of the debtor's primary residence; in case of failure, a *compulsory element* allows the debtor to apply to the court for the imposition, subject to certain criteria, of a restructuring plan on creditors**
 - **Further aspects addressed: debt discharge and relief, establishment of an *Insolvency Service*, development of guidelines on reasonable living expenses, regulation of insolvency practitioners**
 - **Reform of the corporate insolvency regime to enable the swift liquidation of unviable companies or their rescue with the support of insolvency practitioners**

Specific elements in the Cypriot approach to tackle NPLs (III)

- **Foreclosure law – adopted in September 2014, but entered into force once the insolvency framework was adopted in April 2015**
 - **It became applicable when the regulation on the procedural rules for sale by auction was adopted in May 2015 and will become fully effective when the auction locations are selected and become operational in the 5 districts**
 - **Banks intend to pursue about 40 first cases at foreclosure; compared with the outstanding amount of NPLs (EUR 27.4 bn or 160% of GDP), the NPLs backed by collateral to be auctioned, represent only a small amount (roughly EUR 100 million); the signal is to strengthen payment discipline rather than collect outstanding debts**

Specific elements in the Cypriot approach to tackle NPLs (IV)

- Need to address strategic defaults



- Particularly rapid increase in NPLs not justified entirely by GDP contraction
- Following a study on access of information on financial assets and earnings of delinquent borrowers, the Civil Procedure Code and Court Rules were amended at the end of 2015, but further progress may be needed to enhance the availability of financial information to courts and enforcement agents

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Concluding remarks (I)

- **The cleaning-up of bank balance sheets in both euro area and non-euro area countries is ongoing, but further efforts are needed in several countries**
- **Structural reforms adopted in several countries in recent years to support NPL work-out and disposal have not produced their full effect yet**
- **In several countries, further efforts are needed to address strategic defaults and safeguard payment discipline in the banking sector**
- **The increase in the outright sales of NPLs is a positive development and such market solutions for cleaning up balance sheets should be further supported**
- **A multi-dimensional approach is needed to tackle NPLs – *"there is no one measure that fits all"***

Concluding remarks (II)

- **In several countries, a more aggressive increase in loan-loss provisions is hampered by low bank profitability**
- **The setting-up of system-wide AMC's involving large losses for banks has bail-in consequences (i.e. bail-in of creditors in line with BRRD provisions) if private resources for the recapitalisation are not available**
- **SPVs (for NPL securitisation) with the support of state guarantees limited to a part of their liabilities (senior tranche) and acquiring well provisioned NPLs avoids some of the drawbacks of an AMC, but need to remain attractive for banks**
- **Countries which have made progress with NPL reduction should refrain from adopting policy measures/legislation which may generate the opposite effect**

Thank you very much for your attention!