



EUROPEAN CENTRAL BANK

EUROSYSTEM

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Lessons learned from NPL resolution in euro area countries*

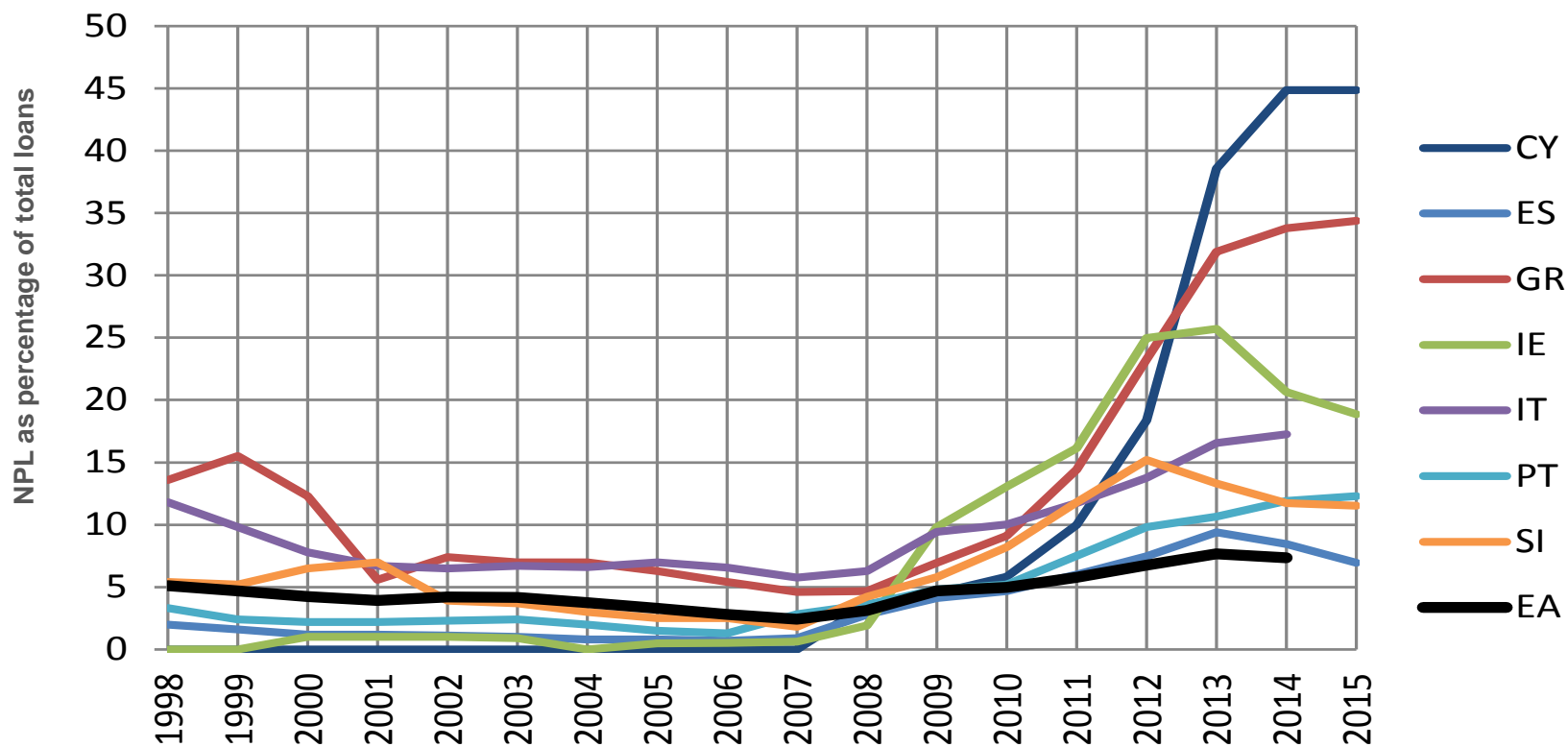
*Financial Stability Seminar on managing
NPLs in Asia and Europe*

Shanghai, PRC, 8-10 November 2016

**The views presented in this paper are exclusively those of
the authors and not necessarily those of the ECB.*

Loan quality developments in the euro area

*Scale of NPL challenge in euro area: for 'significant' SSM banks at end'-2015 EUR 950 billion (9% of GDP)
NPL' ratios vary from less than 2% (FI) to over 50% (CY)*



Source: World Bank, IMF, ECB.

Impediments to NPE resolution

- Economic impediments
 - Banks may have insufficient capital buffers to realise losses;
 - Crises are periods of heightened economic uncertainty – when is the right time for banks to sell NPEs?
- Inefficient / inadequate legal systems
 - Inadequate enforcement of legal rights due to capacity constraints in legal services;
 - Absence of voluntary ‘out-of-court solutions’, which may help circumventing bottlenecks in the legal system;
 - Weak insolvency regimes may lean towards liquidation;
 - Foreclosure may be expensive / lengthy or de facto non-existent

Impediments to NPE resolution (cont.)

- Inaction bias of policy makers
 - Lack of awareness about macro-financial importance of NPLs;
 - Lack of coordination between authorities;
- Tax or accounting disincentives
 - Transaction taxes on real estate may further depress activity;
 - Tax deductibility of provisions / write-offs.
- Information deficiencies
 - Inadequate or non-existent credit registers;
 - Insufficient exchange of information between banks Data protection rules.

Can AMCs solve the euro area NPL problem?

- A number of AMCs set up in response to systemic crises in euro area countries:
 - NAMA (Ireland)
 - SAREB (Spain)
 - DUTB/BAMC (Slovenia)
- An AMCs can be a “bridge to the future”
 - funding assets outside bank balance sheets over time
 - mitigate capital losses - maximise recovery values
 - reduce upfront capital costs to banks
 - gain from efficiencies and economies of scale
 - limit potential negative fiscal impact

Can AMCs solve the euro area NPL problem (cont)?

- Cost-benefits analysis

Benefits	Costs
Recovered value	Bank losses on transfer
Focussed management	AMC costs, incl. funding & equity
Economies of scale	Contingent liabilities to State
Consolidation, pooling, enforcement	Severed client-bank relationships

- AMCs best suited for relatively low number of large exposures with straightforward collateral (CRE as prime example)
- Retail portfolios a priori less suitable
- Governance structure is key (political interference)
- AMCs still need suitable legal environment
- Constraints as regards EU competition and state aid rules

- On 12 September 2016, the Single Supervisory Mechanism (SSM) launched its draft “Guidance for banks on non-performing loans” for public consultation
<https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/npl.en.html>
- Guidance covers the following main elements:
 1. NPL strategy (*including inter alia the request to establish targets by portfolio*)
 2. NPL governance and operations (*e.g. management oversight and establishment of separate NPL workout units*)
 3. Forbearance (*e.g. assess viability of forbearance options*)
 4. NPL recognition (*e.g. application of EBA definition, alignment of regulatory and accounting definitions as far as possible*)
 5. NPL impairment measurement and write-offs (*e.g. conservatism in collateral / cash flow estimation, going vs. gone concern definition*)
 6. Collateral valuation of immovable property (*e.g. at least annual collateral valuation updates and market value as valuation base*)

- *The European Systemic Risk Board (ESRB) has launched an Expert Group on NPLs, jointly chaired by the ECB and the EBA*
 - *The focus of this Expert Group will be to look in more detail at obstacles for the establishment of a secondary market for NPLs in Europe*
- *The EU's Financial Services Committee (reporting to the Council of Economic and Finance Ministers of the EU) has established a Sub-Group on NPL**The*
 - *Sub-Group mainly consists of representatives of Economics and Finance Ministries and is well placed to look into macro-financial repercussions of NPLs and legal framework conditions.*
- *In sum, work is on-going – and in parts already well advanced – on the elements needed to deal with the NPL problem in the EU and the euro area!*

Thank you for your attention!

Further information:

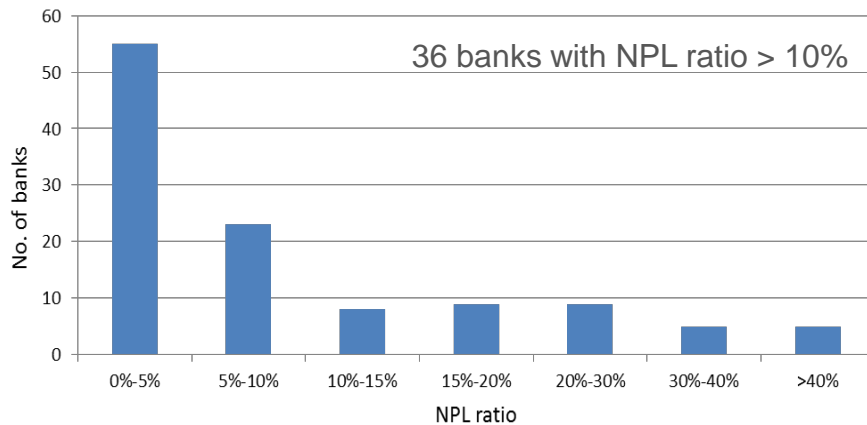
www.ecb.europa.eu

<https://www.bankingsupervision.europa.eu>

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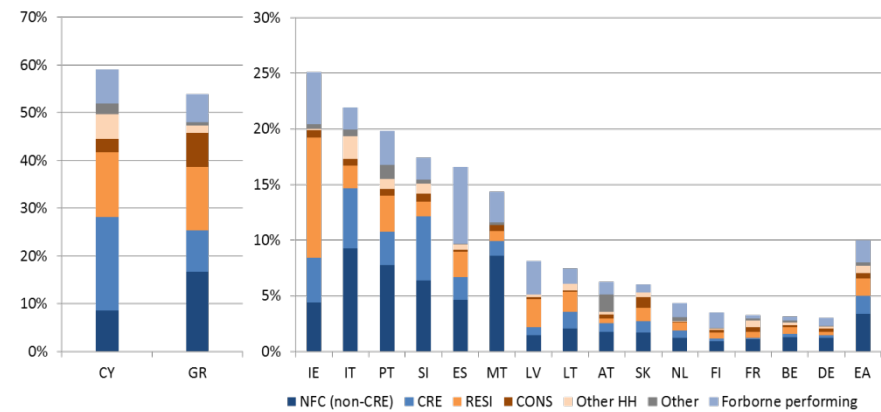
Annex: Loan quality developments in the euro area

NPLs concentrated in some banks and countries but spread across portfolios...



Source: ECB Supervisory Statistics.

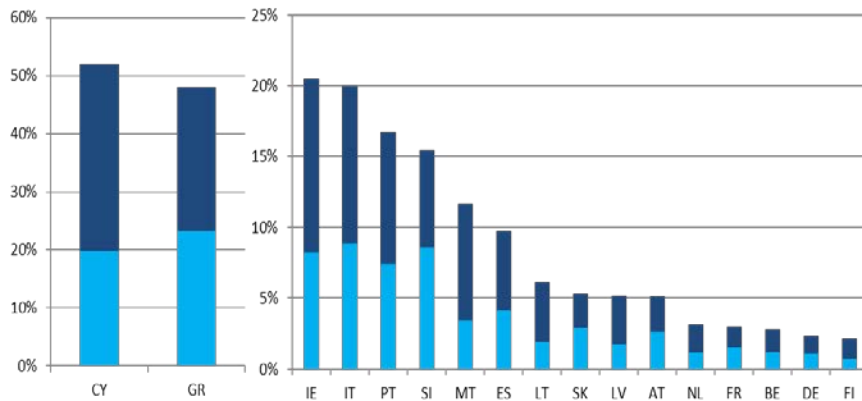
Notes: sample based on 122 Significant Institutions. Q4 2015 data.



Source: ECB Supervisory Statistics.

Note: NPLs on locational basis e.g. ratio for BE includes loans of FI banks in BE. Q4 2015 data.

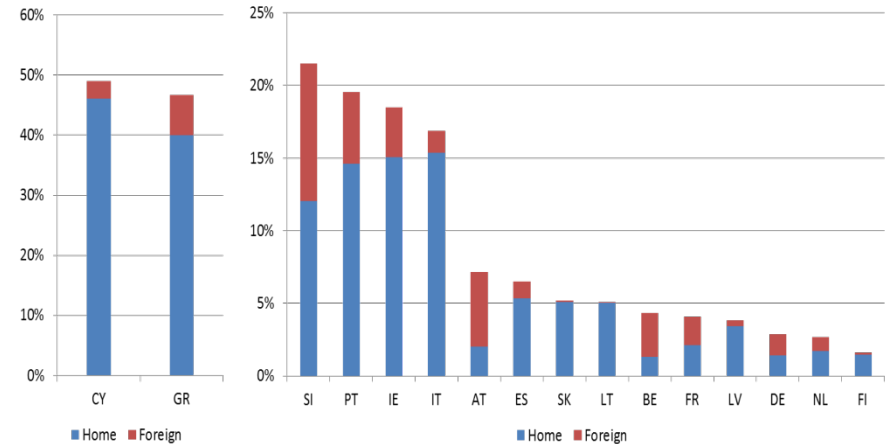
Coverage ratios vary. For some countries, NPL domicile may be important.



Source: ECB Supervisory Statistics.

Note: Light blue bars - provision coverage of NPLs on locational basis e.g., Provisions allocated by FI bank for BE portfolio are included in BE ratio. Dark blue bars - NPLs not covered by provisions. Q4 2015 data.

NPLs in the euro area.



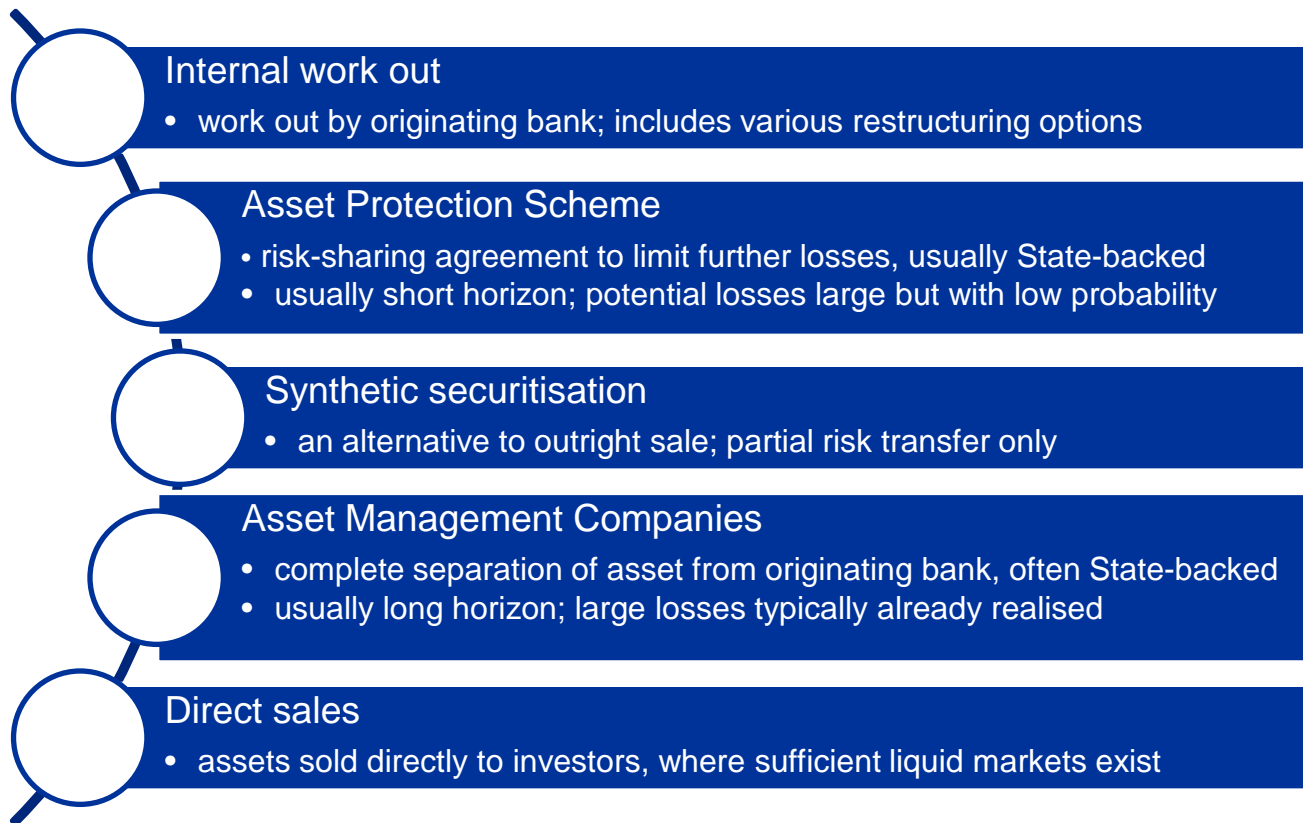
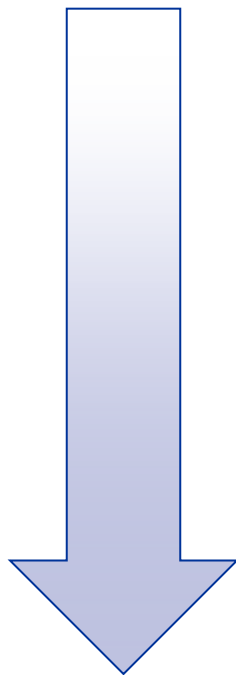
Source: ECB Supervisory Statistics.

Notes: NPL ratios by home country of reporting banks – consolidated e.g., NPL ratio for BE banks include all loans of BE banks in all jurisdictions. Q4 2015 data.

Annex: NPL resolution – a brief taxonomy of policy options

Wide range of policy responses to address large NPL stocks: a very brief overview of frequently-employed options...

On-balance sheet



Off-balance sheet

Public support may be required for some of these schemes; internal work-out will always feature in NPL resolution.

Novel solutions may be required - especially for corporate and SME portfolios

Clearing Houses

A sales hub that brings together data and documentation for available-for-sale assets, thereby reducing investors shoe-leather costs and the costs of due diligence. Can deliver some AMC benefits without state involvement.

Corporate debt restructuring (possibly State supported)

Resolving corporate / SME NPLs may have substantial adverse impacts on the real economy. Schemes which facilitate viability assessments, debt restructurings, joint ventures with private investors, etc may be helpful in this context.