Non-Performing Loans And Their Resolution In The European Banking System

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Outline

1. Current situation and historical perspective of NPLs
2. European Council Action Plan and Commission initiatives to reduce NPLs
3. Update on the EBA policy work
4. EBA work on supporting secondary markets – NPL templates
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NPLs in Europe in comparison with other regions

- In Europe the slow pace of NPL provisioning and write-offs in contrast with other countries might be the reason for a slow disposal of NPLs from banks’ balance sheets.

- Other countries dealt quicker with the stock of NPLs. The US needed 3 years to decrease the NPL ratio to before crisis levels, while Japan needed 5 years. This went in parallel with significant re-capitalisation efforts, including through state supported solutions.

- Most vulnerable countries in EU currently are Cyprus, Greece, Portugal and Italy.

Recent developments of NPL ratios across jurisdictions (Q3 2014 = 100).

Source: Supervisory data.

Source: World Bank. (NPL definitions not compatible)

Different reduction of NPLs between countries (NPL ratio rebased to 100 at T-0).

Source: Autonomous.
### Current situation with NPLs in Europe

**Total NPL of EUR 735bn**
(EU, consolidated level)

**Average NPL ratio of 3.6%**
(EU average)

<table>
<thead>
<tr>
<th>Country</th>
<th>NPL Ratio</th>
<th>NPL Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>0.8%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Malta</td>
<td>3.4%</td>
<td>6.4%</td>
</tr>
<tr>
<td><strong>Total NPL of EUR 735bn</strong></td>
<td><strong>Average NPL ratio of 3.6%</strong></td>
<td><strong>(EU average)</strong></td>
</tr>
</tbody>
</table>

**NPL ratios and volumes (EUR bn) as of Q2 2018.**
NPL ratios continue to improve

- NPL ratio reached its lowest level since harmonisation of the definition – 3.6%
- Volume of NPLs has decreased by almost 1/3 over 3 years from EUR 1,100 bn to EUR 735 bn
Secondary markets pick-up and help with reduction

- Gross and net NPL ratio decreased to 3.6% and 1.9% in Q2 2018 compared to 6.5% and 3.7% in 2014, respectively. On average Stage 3 loans represent 95% of NPLs.

- Italy, Spain, the UK and Ireland accounted for 83% of more than EUR 500bn “gross” deals between Q1 2015 and Q1 2018, of which around EUR 130bn in the last quarter.

- On average, the highest difference between the market price and book value of NPLs is seen for household loans.

Assumed prices** for future NPL sales (derived from existing deals)

<table>
<thead>
<tr>
<th>Region</th>
<th>SME</th>
<th>Consumer secured</th>
<th>Consumer unsecured</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>35%</td>
<td>30%</td>
<td>10%</td>
</tr>
<tr>
<td>BeNeLux</td>
<td>30%</td>
<td>30%</td>
<td>9%</td>
</tr>
<tr>
<td>France</td>
<td>25%</td>
<td>25%</td>
<td>5%</td>
</tr>
<tr>
<td>Germany</td>
<td>30%</td>
<td>30%</td>
<td>15%</td>
</tr>
<tr>
<td>Greece &amp; Cyprus</td>
<td>20%</td>
<td>20%</td>
<td>2%</td>
</tr>
<tr>
<td>Italy</td>
<td>30%</td>
<td>30%</td>
<td>4%</td>
</tr>
<tr>
<td>Ireland</td>
<td>25%</td>
<td>40%</td>
<td>7%</td>
</tr>
<tr>
<td>Nordics</td>
<td>40%</td>
<td>35%</td>
<td>15%</td>
</tr>
<tr>
<td>Portugal</td>
<td>25%</td>
<td>20%</td>
<td>5%</td>
</tr>
<tr>
<td>Spain</td>
<td>25%</td>
<td>20%</td>
<td>6%</td>
</tr>
<tr>
<td>UK</td>
<td>25%</td>
<td>30%</td>
<td>11%</td>
</tr>
<tr>
<td>Rest of Europe</td>
<td>20%</td>
<td>20%</td>
<td>4%</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td>27.5%</td>
<td>27.5%</td>
<td>7.75%</td>
</tr>
</tbody>
</table>

Source: BofAML (KPMG data).

Labels show coverage ratio for Q2 2018.

Source: preliminary supervisory reporting data Q2 2018.

NPL transactions* - developments

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*Proxy for 115 banks from the EBA Transparency exercise.

**Prices paid as a percent of gross value of NPLs.
Notable decrease of SME NPLs in Q2 2018

- Since 2014 the highest decrease of the NPL ratio was observed for SMEs, from 18.8% to 10.1% in Q2 2018. The highest decrease took place in Q2 2018 (110 bps decrease). Total volume of gross SME NPLs stands at EUR 211bn.

- In absolute terms, the highest decrease of gross NPLs was observed for Large corporates, decreasing from EUR 400bn in 2014 to EUR 206bn in Q2 2018 (-53%). NPL ratio for Large corporates stands at 5.1% in Q2 2018.

- The NPL ratio for Households was 5.4% in 2014 and decreased to 3.7% in Q2 2018. The trend of NPLs decrease was the slowest for Households among all the borrower types.

- NPLs in the above 90 days and below 1 year past due time band decreased by 53% since 2014 until Q2 2018 (the highest decrease across past due time bands). In the same period, the above 1 year past due and UtP (not past due or past due below 90 days) NPLs decreased by 36% to 29%, respectively.

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EU Council conclusions relevant to the EBA (July 2017)

The EBA mandates

- Issue Guidelines on NPE/FBE Management, to apply to all EU banks
- Issue Guidelines on banks’ loan origination, monitoring and internal governance
- Implement, together with ESMA and CAs, enhanced disclosure requirements on asset quality and NPLs
- Issue Guidance on loan tapes monitoring, specifying information required on banks’ credit exposures / data templates

The EBA to work with the ECB and the Commission

- Propose initiatives to strengthen the data infrastructure with uniform and standardised data for NPLs and consider setting-up platforms

Mandates where the EBA is not in the lead

- Blueprint of AMCs
- Structural reforms of insolvency and debt recovery frameworks
- Fostering restructuring of the banking system
EU Council conclusions less relevant to the EBA

Further conclusions without involvement of the EBA:

The ESRB to:

- Develop macro-prudential approaches to prevent emergence of system-wide NPL problems

The Commission to:

- Consider prudential backstops addressing potential under provisioning which would apply to newly originated loans
- Publish the results of benchmarking exercise on the efficiency of national loan enforcement regimes

The SSM to:

- Extend relevant guidance to banks on Non-Performing Loans to Less Significant Institutions

Member States to:

- Carry out dedicated peer-reviews on insolvency regimes across the EU
EU Commission proposals relevant to the EBA (March 2018)

Furthermore:

• The Council conclusions invites the Commission to consider prudential backstops addressing potential under provisioning which would apply to newly originated loans → The EBA was mandated to provide advice, mainly in the form of impact assessment

• The Commission proposes the EBA to develop ITS that specify the format of the information for the screening, financial due diligence and valuation of the credit agreements → link to the guidance on loan tapes monitoring and EBA work on NPL templates

• The EBA published (in March 2018) its advice on the Commission's proposal for statutory prudential backstops on banks' provisioning practices for new loans that turn non-performing:
  • The EBA notes that the backstop complements the existing prudential set of measures and the new accounting provisions under IFRS9 and the advice aims at providing some qualitative considerations as well as a conservative impact analysis of the proposed measures
Statutory backstop measure: EBA impact assessment

- Around **56-bp RWA** weighted average cumulative reduction in CET1 capital ratio 7 years after implementation
- Around 205-bsp after 20 years of implementation, corresponding to around 55% of cumulative retained earnings
- Annually: between 22-bps (baseline) and 26-bps (linear) reduction in CET1 ratio 8 years after implementation

Cumulative impact on CET1 capital ratio (in basis points):

- Year 7: 56-bsp
- Year 17-20: 205-bsp

Average CET1 ratio: 17.52%

Cumulative impact on CET1 capital ratio in basis points

Source: EBA (March 2018)
Secondary Markets - Asset Management Companies ‘Blueprint’

• The Council has mandated the Commission to develop, in cooperation with all relevant institutions, a ‘blueprint’ for the potential set-up of national asset management companies (AMCs)

• The ‘blueprint’ would set out common principles for the relevant asset and participation perimeters, asset-size thresholds, asset valuation rules, appropriate capital structures, the governance and operational features, both private and public

• It should also clarify the permissible design, consistent with the EU legislative framework (BRRD, State Aid Rules and Regulation (EU) No 806/2014 (SRMR))

• Contributors of the Commission AMC ‘Blueprint’ along with the EBA are the ECB, ECB Banking Supervision, SRB and Eurostat

• Feedback from the EBA AMC workshop has been a valuable input in the AMC ‘Blueprint’

• The Commission published the AMC ‘Blueprint’ in March 2018
Secondary Markets - EU NPL Platform

• As part of the proposed initiatives to strengthen the data infrastructure, EBA is working with other official sector agencies on a paper for NPL Platform

• An NPL data platform is envisaged that will increase the investor base for NPLs

• The main feature is to provide standardised, up-to-date and reliable data to supervisors and market participants

• The NPL platform will act as a tool for pooling NPL data from different regions and across asset classes for building portfolios and therefore attracting more investors, also to smaller regions

• Also provide synergies across AMCs for collecting, storing, analysing and disseminating data
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Status update on the EBA’s policy work on NPLs

- **Guidelines on management of non-performing and forborne exposures**: Aiming to achieve a sustainable reduction of NPEs in credit institutions’ balance sheets.
- **Guidelines on disclosures of non-performing and forborne exposures**: Specifying a common content and uniform disclosure formats on information on NPEs, forborne exposures and foreclosed assets that credit institutions should disclose.
- **Consultation on draft Guidelines on loan origination and monitoring**: Addressing in particular issues such as transparency and borrower affordability assessment and where relevant will leverage on existing national experiences.
- **Amendments to reporting requirements**: Amend reporting (FINREP) of non-performing and forborne exposures to strengthen supervisors’ ability to assess and monitor non-performing portfolios and NPE strategies.
Draft GL on NPE and FBE management

• Sound risk management practices for managing NPE and FBE, looking at the governance and operations of a NPE workout framework, the internal control framework and NPE monitoring, and warning processes

• The aim is to achieve a sustainable reduction of NPEs in credit institutions’ balance sheets → NPE strategies and their operationalisation is at the core

• The GL focus on prudential aspects, but consumer protection perspective is also important

• Proportionality → application of the GL is proportionate to the magnitude of NPLs and reflects size and complexity of the institutions

• Annex 1 - Sample criteria for grouping NPE in retail
• Annex 2 - Benchmark for NPE monitoring metrics
• Annex 3 – Sample of early warning indicators
• Annex 4 – Common NPE-related policies
• Annex 5 - Possible forbearance measures
Work on enhanced disclosure requirements for NPE and FBE

• Implementing, together with ESMA and competent authorities, enhanced disclosure requirements for non-performing and forborne exposures → draft GL on disclosure of NPE and FBE

• The draft GL specify a common content and uniform disclosure formats on information on NPEs, forborne exposures and foreclosed assets that credit institutions should disclose

• The aim is to foster transparency and provide meaningful information to market participants and to address any potential asymmetries of information

• Under the principle of proportionality, the guidelines include a set of additional disclosure templates applicable to significant institutions with a high level of non-performing loans

• The EBA will also be amending reporting (FINREP) of NPEs and FBEs
The draft GL aim to tackle issues around loans at the origination phase and before they become non-performing.

These draft GL in particular address issues such as transparency and borrower affordability assessment and where relevant will leverage on existing national experiences.

Whilst focusing on prudential aspects, these draft GL also account for consumer protection issues.
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EBA standardised NPL templates

The main objective of these templates is first to improve consistency and transparency and widen investor base by lower barriers to entry, secondly, to improve data quality and availability

- **Loan-by-loan data for transactions**, including information on counterparties related to the loan and collateral, and screening templates for aggregating data for market sounding

- **Asset class specific**: templates for 7 asset classes

- Accompanied by clear and precise instructions, data dictionary, references to existing regulatory requirements and validation rules

- Are fundamental to help develop secondary markets, addressing asymmetric information issue in the market -> AMC blueprint refers to the NPL templates

- EBA NPL templates are also used by ESMA in the securitisation disclosure templates

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The EBA NPL templates consist of the transaction and portfolio screening templates.

- **EBA NPL transaction template**: This corresponds to a market sounding exercise where loans with similar characteristics are aggregated into cohorts.

- **EBA NPL portfolio screening template**: The data is at the most granular level and with unique identifiers and relationship mappings to link all the elements together (e.g. counterparty, loans and collateral).

**EBA NPL transaction template**

- **EBA NPL portfolio screening template**

**Granular loan level**

**Asset class specific**

**Critical fields**

**Stratified data level**
Current status of the EBA NPL templates

- The EBA published first version of the NPL templates in December 2017 → Updated version was published in September 2018
- The main objective of these templates is first to improve consistency and transparency and widen investor base by lower barriers to entry, second, to improve data quality and availability, and finally, to support price discovery and facilitate transactions
- By design the templates are evolving based on the received feedback from their practical use

In line with the Council Action Plan and in order to improve secondary markets for NPLs, the EBA in together with the EC and the ECB is working on a draft proposal for an EU transaction platform. The EBA NPL templates will be also used as the basis for this platform.
Conclusion – or a question mark

When will Europe be able to close the gap?

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