Non-Performing Loans in CESEE

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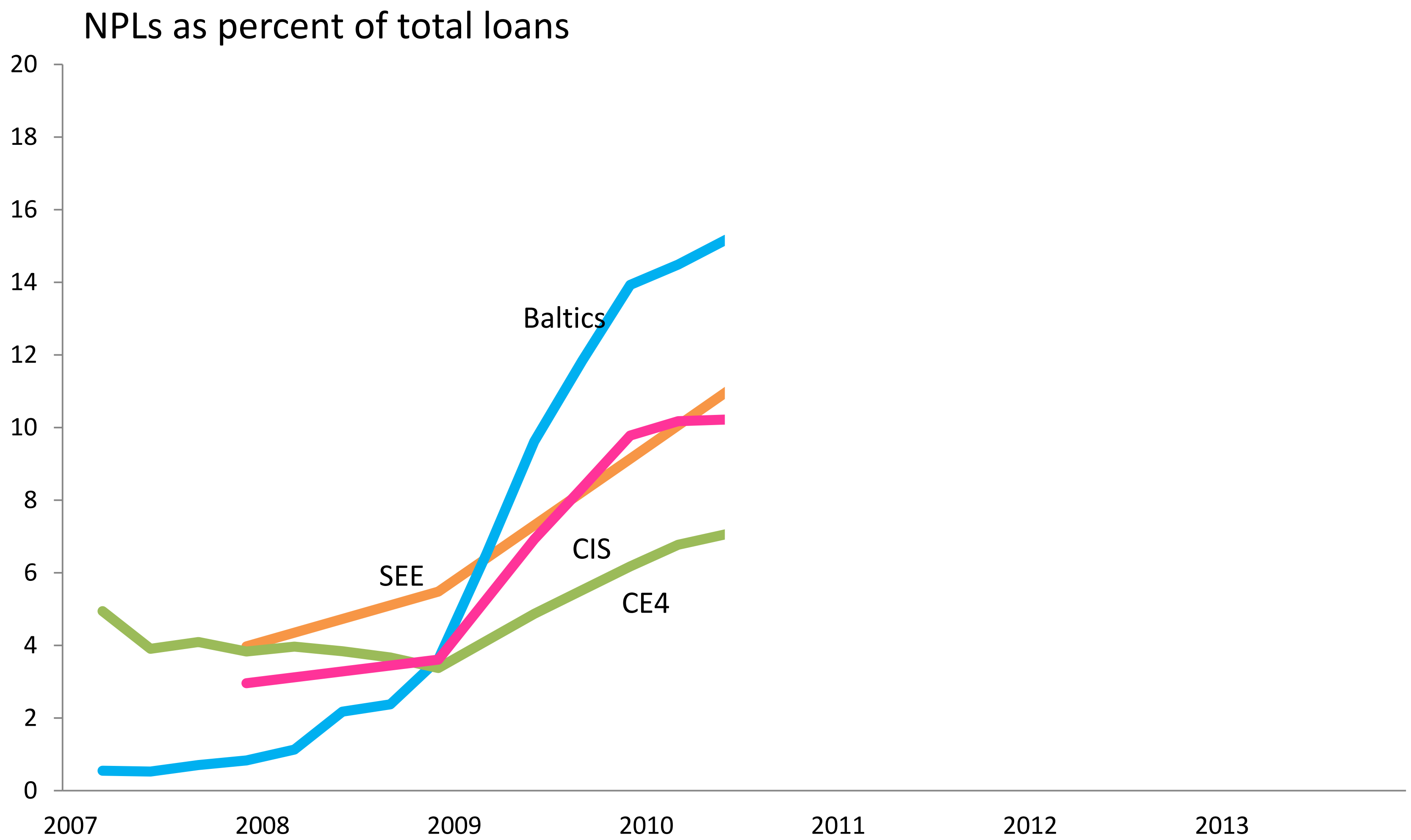
High NPLs ratios need to be addressed

- Boom-bust cycle left a legacy of high NPLs
- Average level of 13 percent, higher in countries with bigger credit cycle
- NPLs still rising in some, in others may have peaked but limited and fragile reduction so far, outside Baltics
- NPLs raise concerns not so much for financial stability as for growth:
  - Impairing banks' ability to resume lending
  - Suppressing activity of overextended borrowers

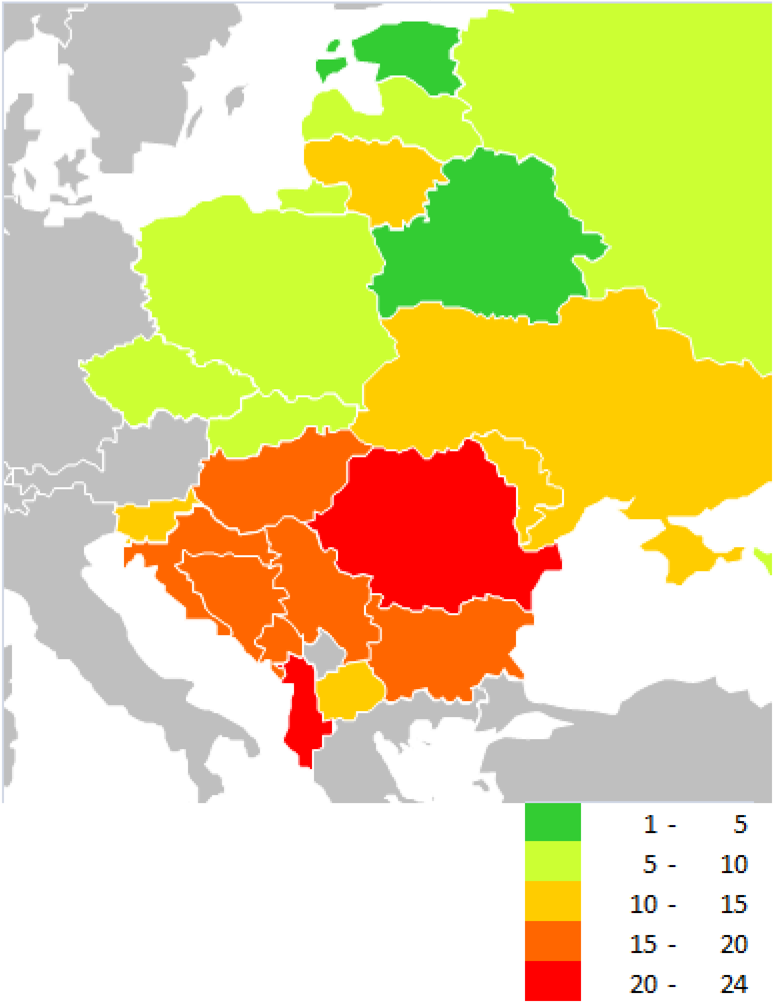
NPLs ratios have yet to stabilize



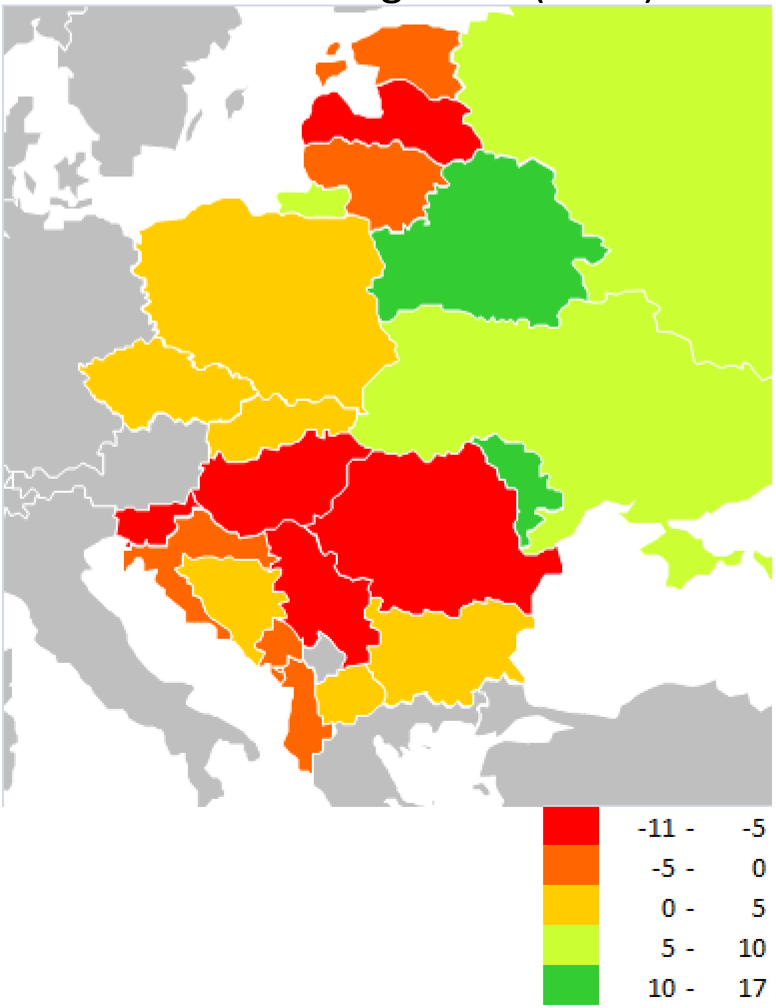
Source: Financial Soundness Indicators

NPLs inhibit credit growth

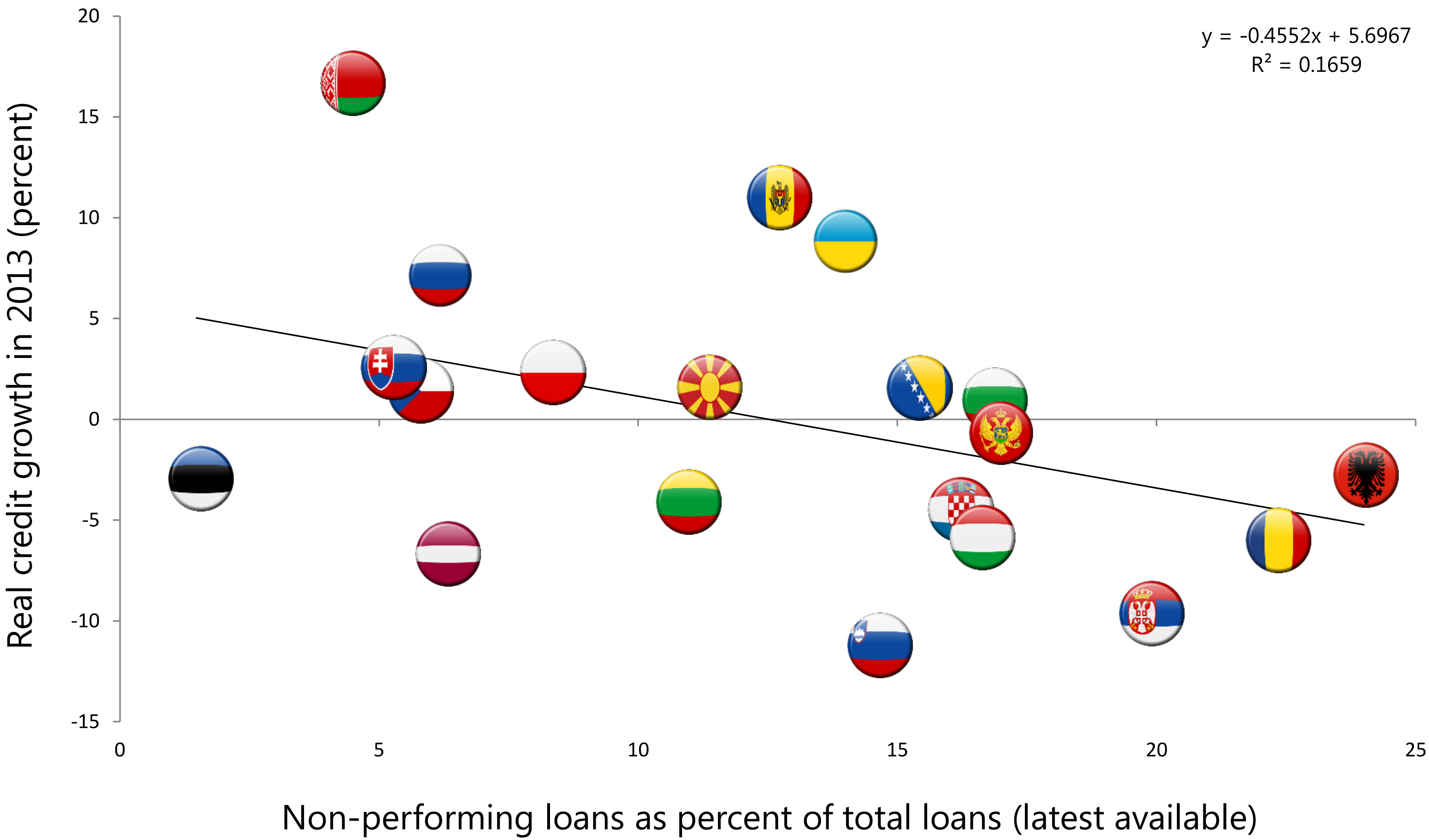
NPLs levels (2013)



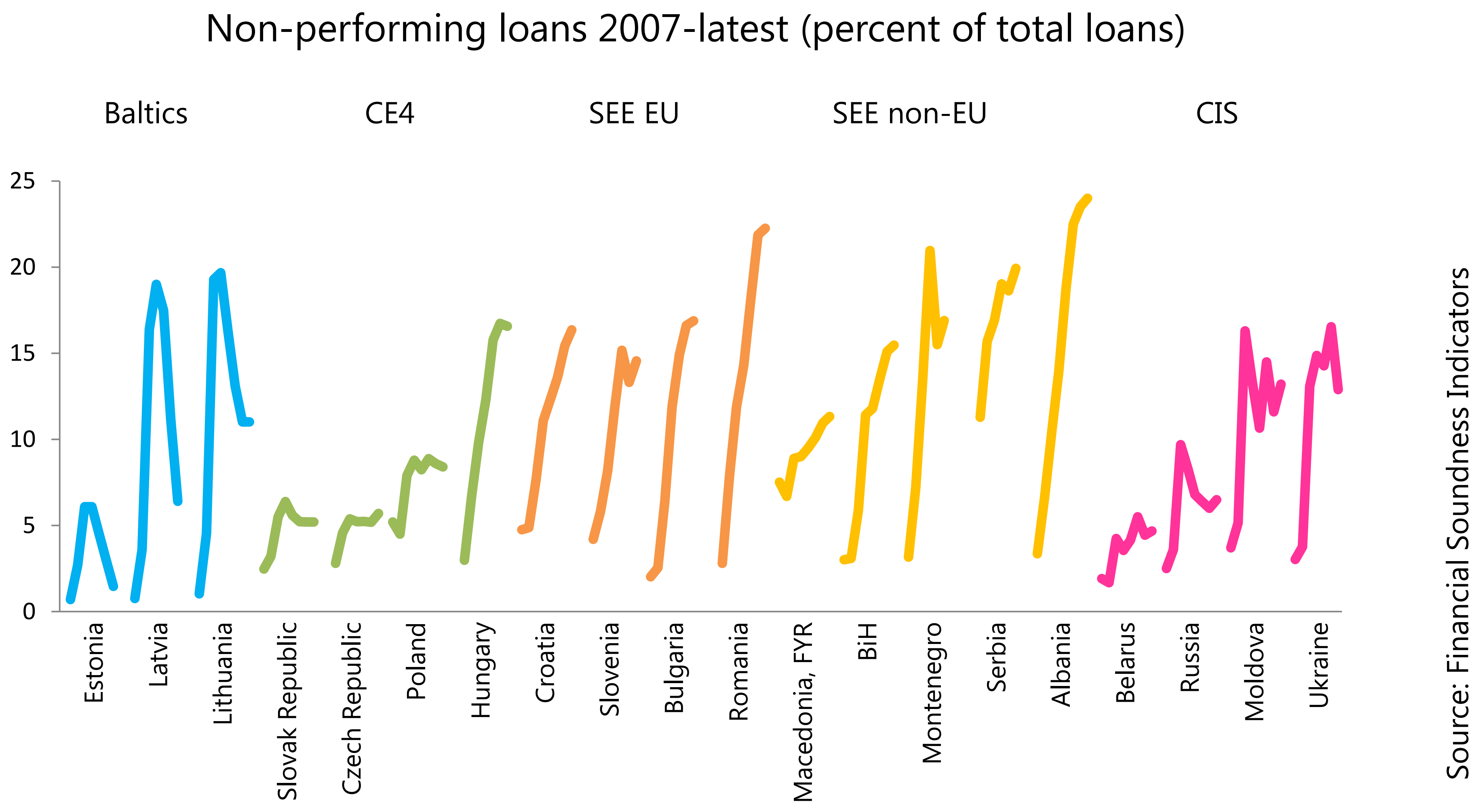
Real credit growth (2013)



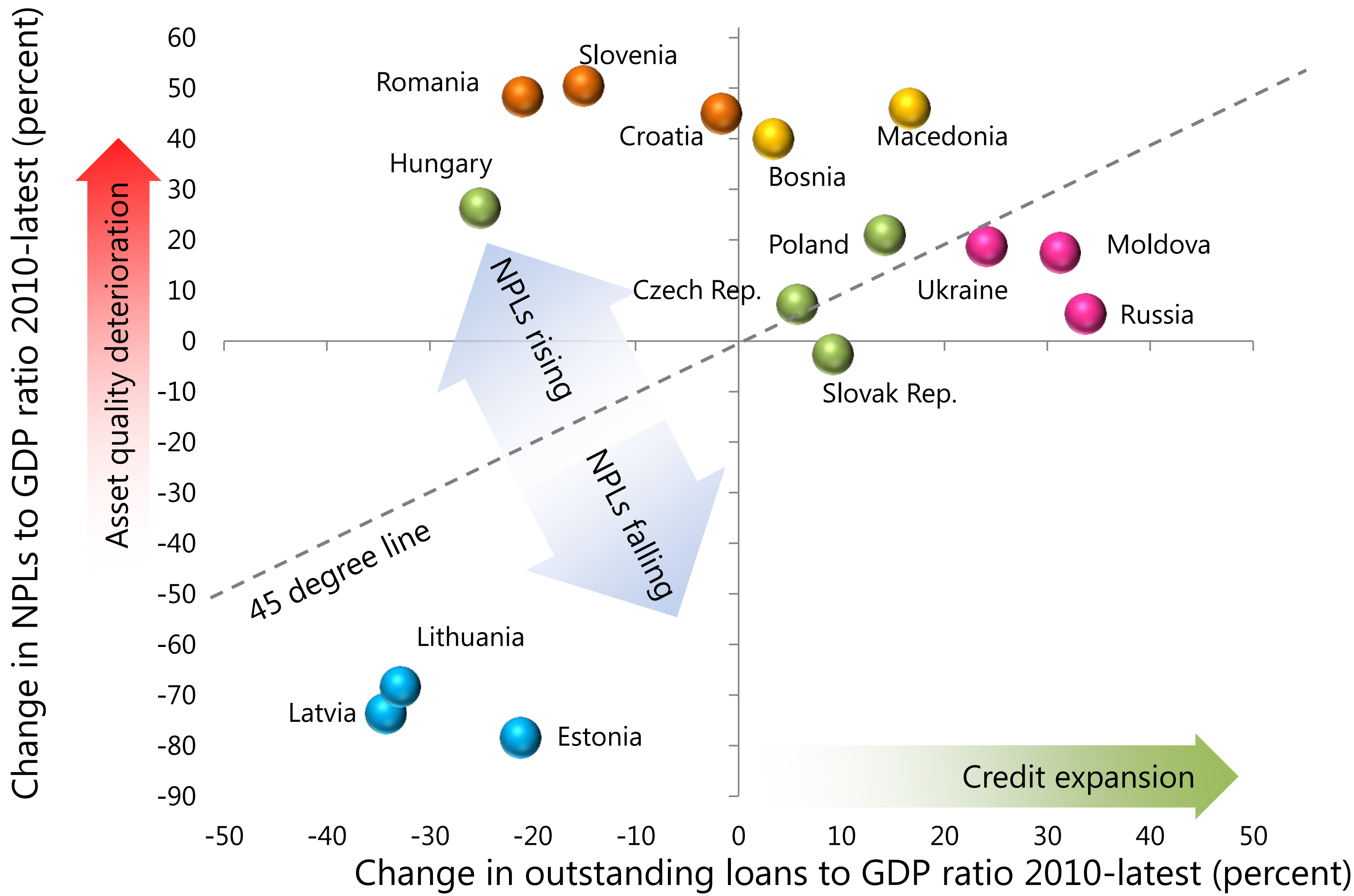
NPLs inhibit credit growth



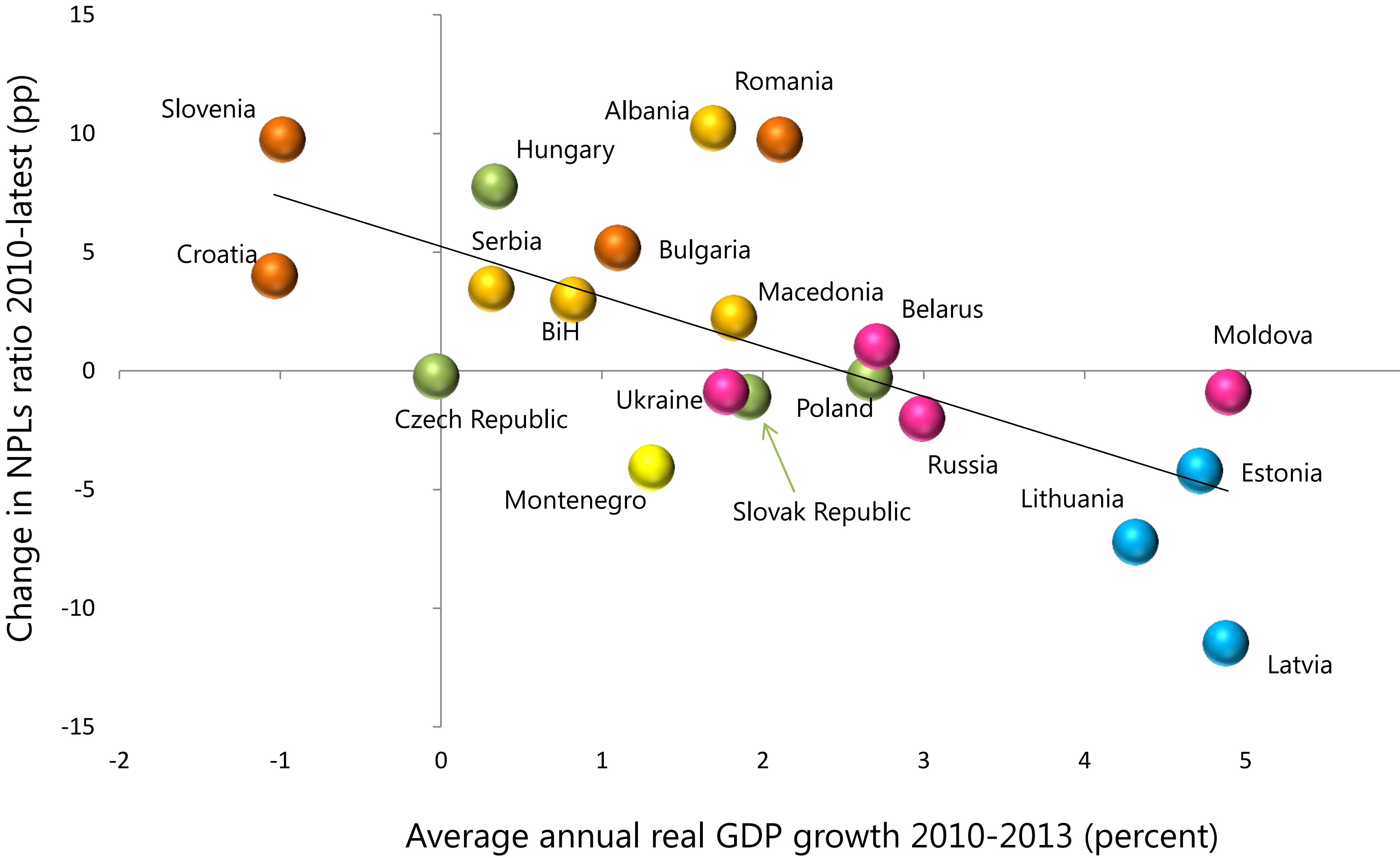
Regional differences are significant



Credit contraction exacerbates the problem

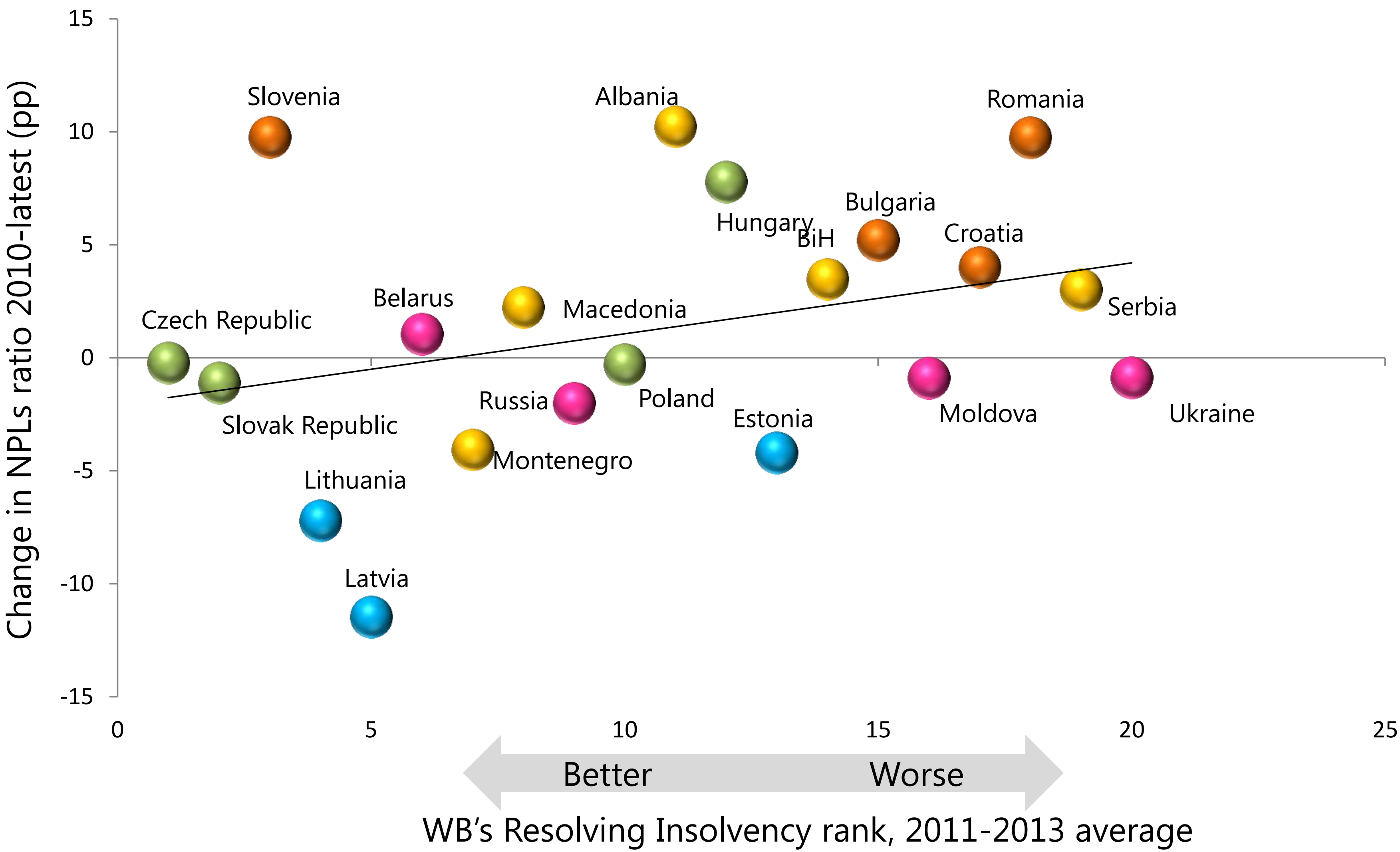


Growth is a main facilitating factor



Source: Financial Soundness Indicators, WB Doing Business, WEO database

Suppotive legal framework is important



Source: Financial Soundness Indicators, WB Doing Business, WEO database

What are the factors behind slow pace of NPL disposal in CESEE?

Limited incentives

Tax disincentives

Reliance on collateral
(need to wait until end of foreclosure procedure to write off)

Lack of "forcing mechanism"
(regulatory disincentives/obstacles)

Limited options

Slow bankruptcy process

Lack of mechanisms to overcome collective action problem

Underdeveloped private market for distressed assets
(large pricing gap, etc)

Findings of 2012 NPLs Report: Policy

Factors behind slow resolution of NPLs include:

- Delays and weaknesses in enforcement of collateral
- Underdeveloped frameworks for going-concern or out-of-court restructurings lead to lengthy and inefficient liquidations
- Absence of insolvency frameworks for natural persons leaves debt lingering on bank books
- Weakness in legal institutional frameworks delay resolution and overload court systems
- Tax systems provide incentives for delay in loss recognition
- Lax banking supervision provides disincentives for NPL resolution
- Underdeveloped markets for distressed assets
- Collective action problems

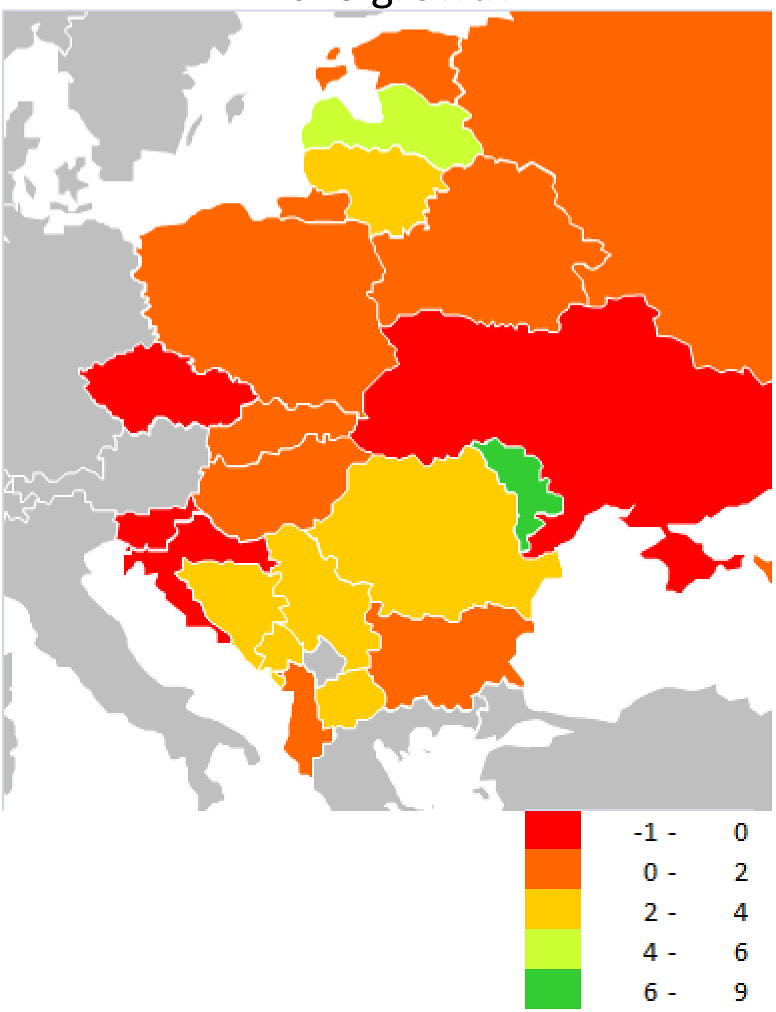
➢ *Need comprehensive, tailored, coordinated approach*
➢ *Avoid direct government intervention/subsidy*
➢ *Improve NPL transparency and data consistency*

Thank you

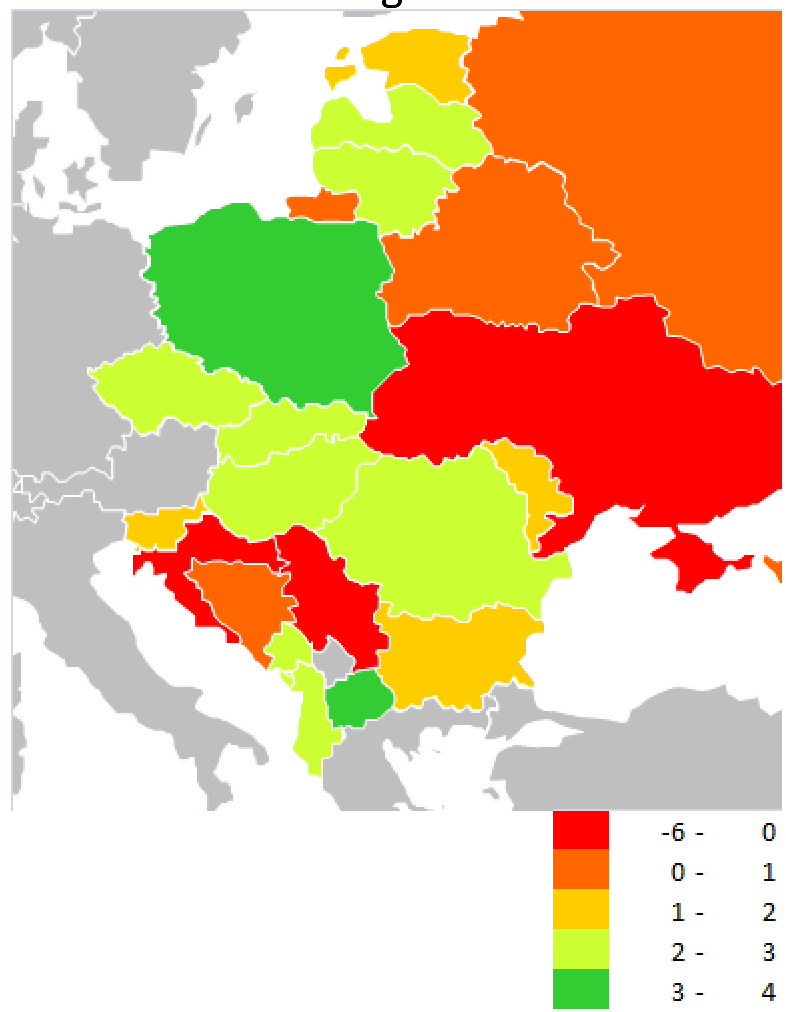
Questions to consider for CESEE

- Have tax (and other) disincentives been removed?
- Is the current institutional and legal framework sufficiently supportive?
- What are the key obstacles for using "optimal" tools to deal with specific NPL problem (HH, NFC, SME, real estate loans)?
- What are the key obstacles for a well functioning distressed asset market and how to overcome them? How to overcome pricing gap (can harmonized NPL/collateral rules, AQRs help)?
- What are pros and cons of using a market-based solution for managing distressed assets (in each specific case)?
- What should be the role of the public sector? How to limit moral hazard risk?

2013 growth



2014 growth



Approach tailored to country specifics

Public asset management companies	In systemic banking crisis, for example, in Korea, Japan, Sweden, US, and more recently in Ireland and Spain
Corporate restructuring, incl. out-of-court	Rehabilitation of non-performing assets, both in and outside crisis; requires well-functioning insolvency system
Private market for distressed assets	Outside of a banking crisis; requires a solid framework , proper incentives, players, and history.