

# Good Practices for NPL Resolution

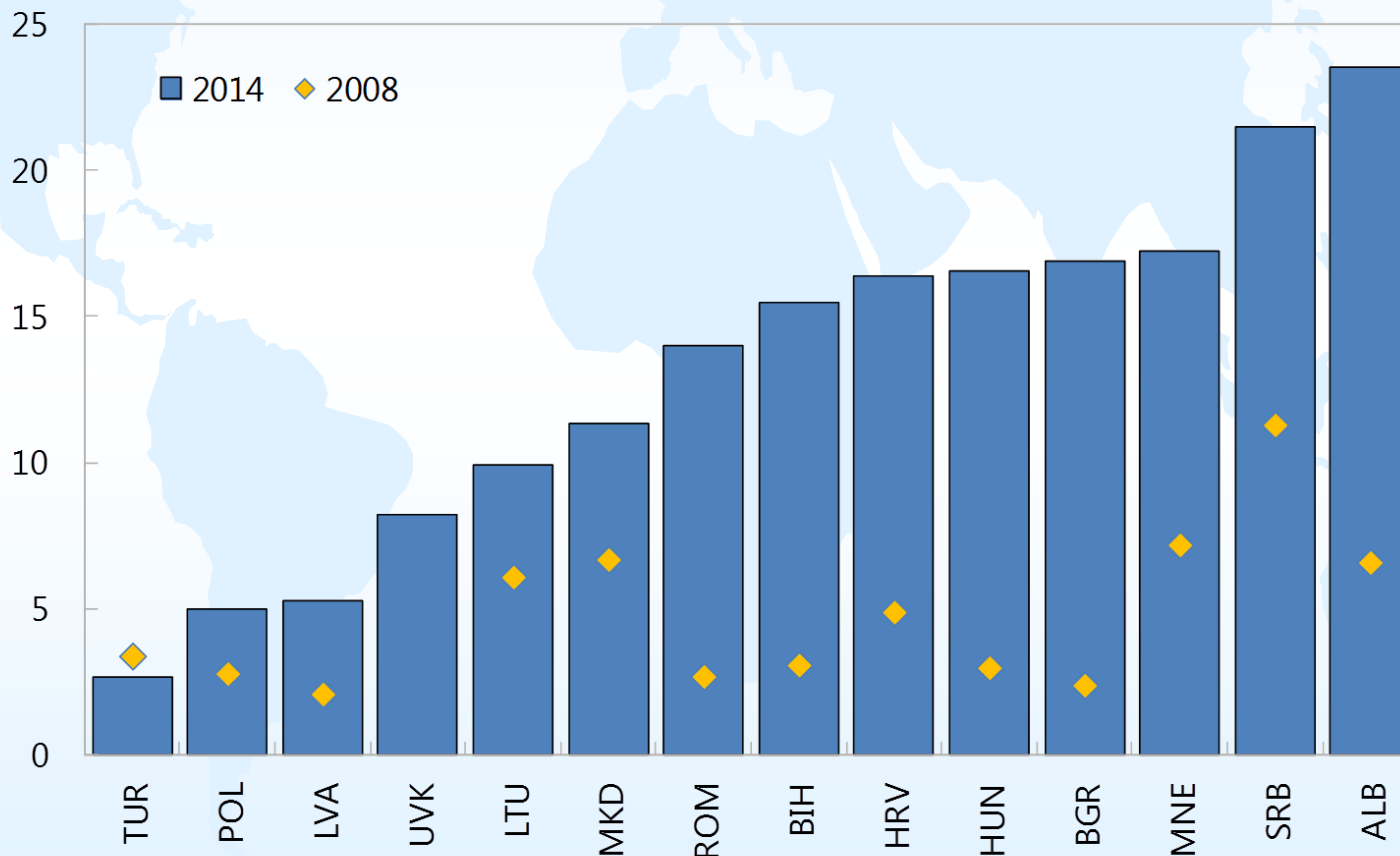


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# Context – why does NPL resolution matter?

Nonperforming loans to total loans  
(Percent)



Source: IMF Financial Stability Indicators



# Context – why does NPL resolution matter?

- NPL overhang holding back recovery
  - ◆ Banks with higher NPLs tend to be less prone to lend...
  - ◆ ...due to higher funding costs, elevated provisioning expenses and/or risk aversion
  - ◆ Debt overhang negatively affects corporate investment, causing further drag on growth
- Reducing NPLs expeditiously is crucial to ensure financial stability and support credit growth



# Structural obstacles impede timely resolution of NPL

- Multiple factors, including
  - ◆ Economic and political uncertainties
  - ◆ Insufficient loss absorbing capacity of banks
  - ◆ Weak bank strategies, poor operations and lack of loan restructuring tools
  - ◆ Data gaps, hindering affordability assessments
  - ◆ Weak enforcement, insolvency and out-of-court frameworks
  - ◆ Accounting valuations often exceed market and long-term economic values



# Structural obstacles impede timely resolution of NPL – cont'd

- Multiple factors, including
  - ◆ Weak prudential rules and passive supervision
  - ◆ Poor debtor awareness and lack of counseling services – impacting confidence
  - ◆ Tax disincentives
  - ◆ Restrictive rules and excessive set-up costs discourage foreign investment and expertise
  - ◆ Shallow market for NPLs



# IMF Survey of obstacles to NPL resolution

## Country survey:

18 countries, EA and non-EA, with peak NPL ratio > 10 percent (2008-14)

## Bank survey:

10 banking groups

## Results:

Impediments to NPL resolution spanning across five key areas, over which participants were asked to rank concerns on a 3-point scale:

"3" = High,

"2" = Medium;

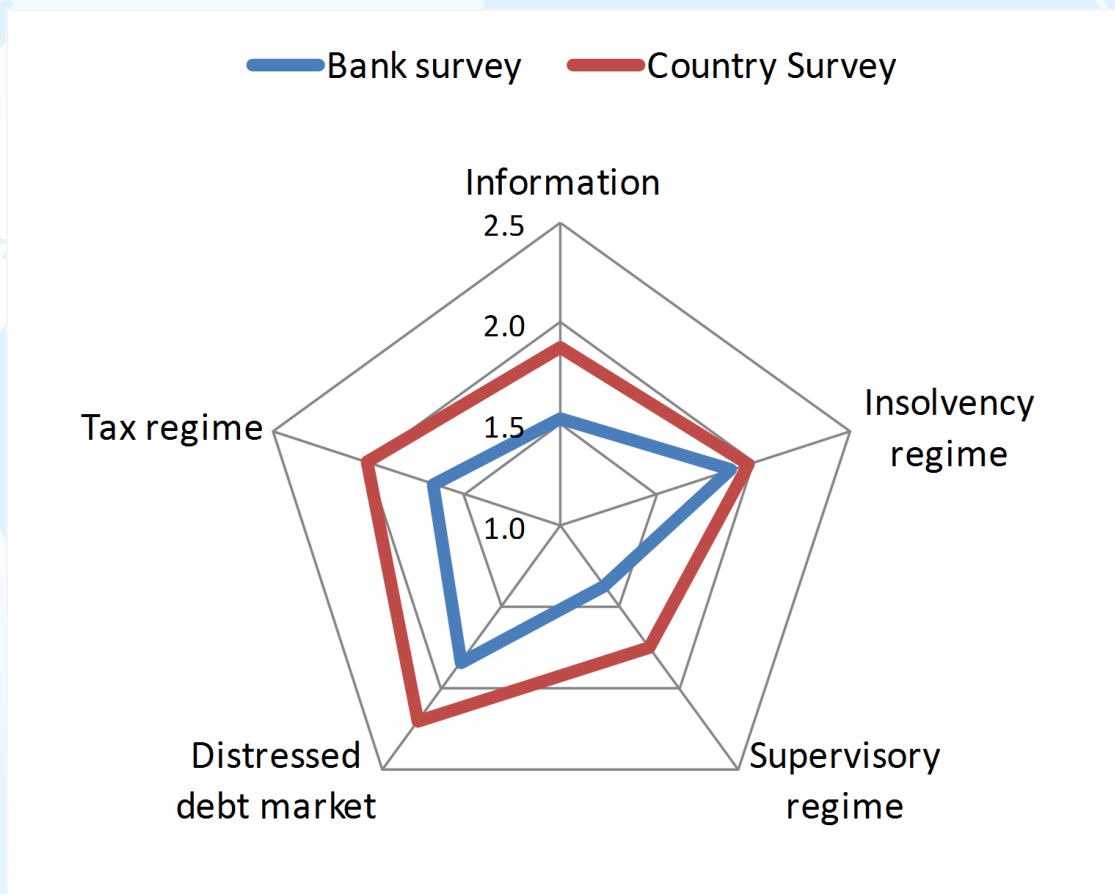
"1" = no concern

Degree of concern abt impediments in the areas of	Average score
<b>Information</b> --max (country, bank)	1.8
<b>Legal framework</b> --max (country, bank)	2.1
<b>Supervisory framework</b> --max (country, bank)	1.8
<b>Distressed debt market</b> --max (country, bank)	2.3
<b>Tax regime</b> --max (country, bank)	1.9



# Survey results (preliminary)

Average scores on impediments to NPL Resolution:  
Country survey vs bank survey

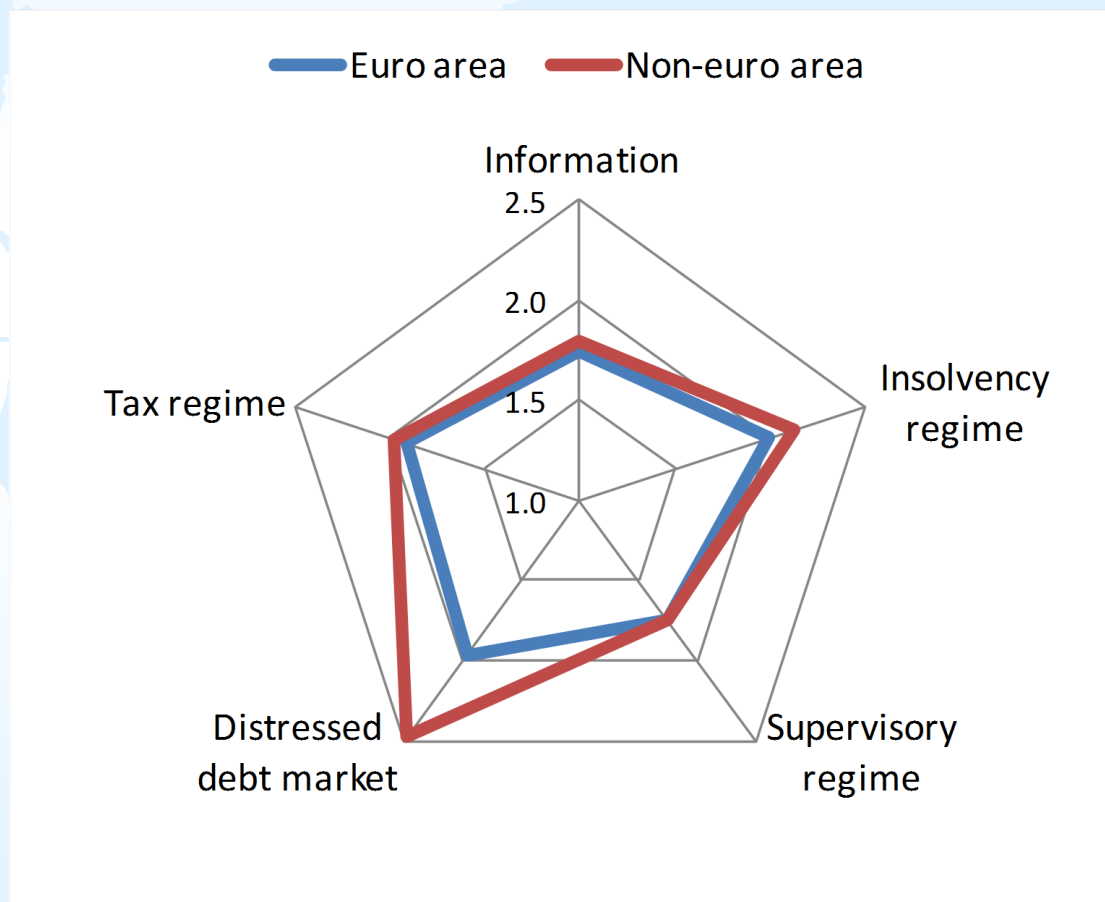


**Degree of concern:** "3" = High, "2" = Medium; "1" = no concern



# Survey results (preliminary) – cont'd

Average scores on impediments to NPL Resolution:  
Euro area vs non-euro area countries

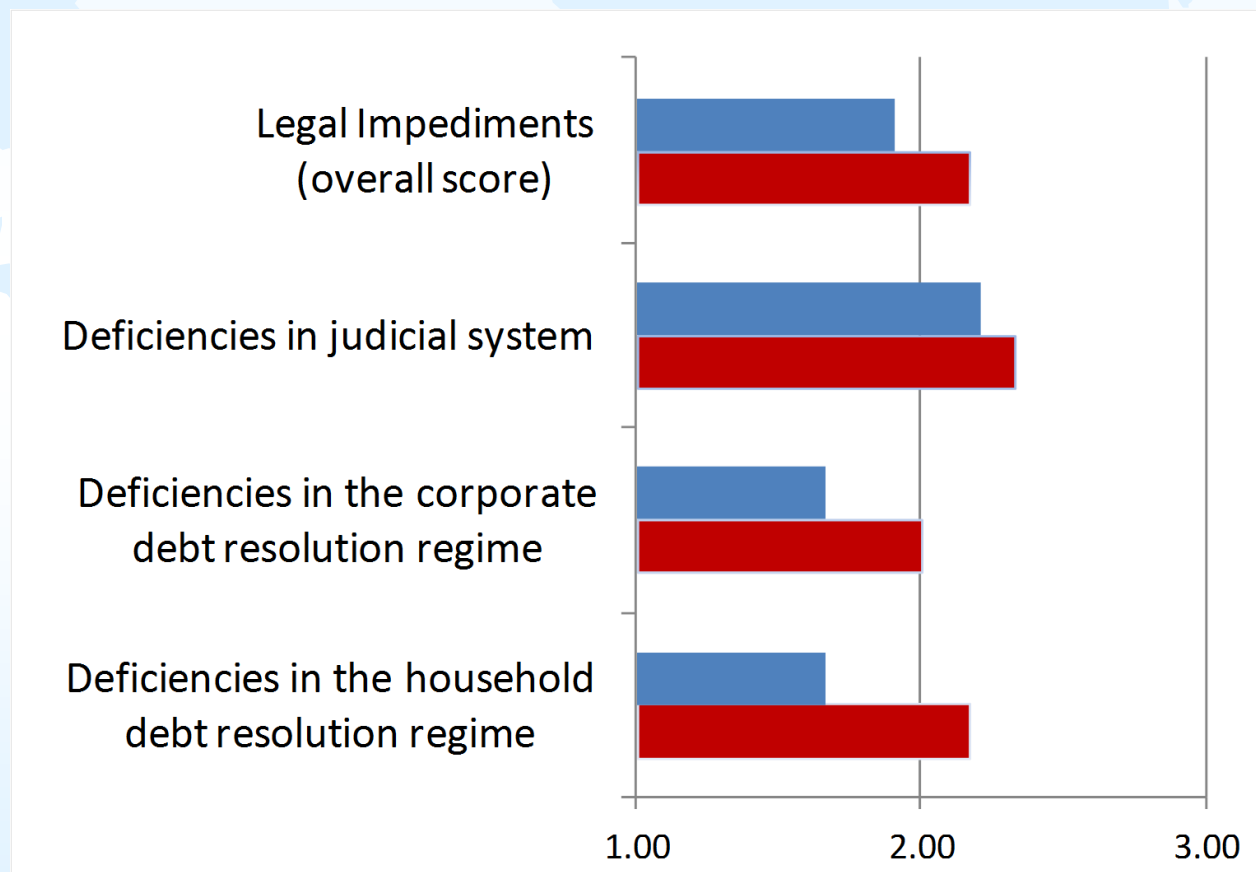






# Survey results (preliminary) – cont'd

Legal impediments: overall score and sub-components  
Euro area average = blue, non-euro area average = red

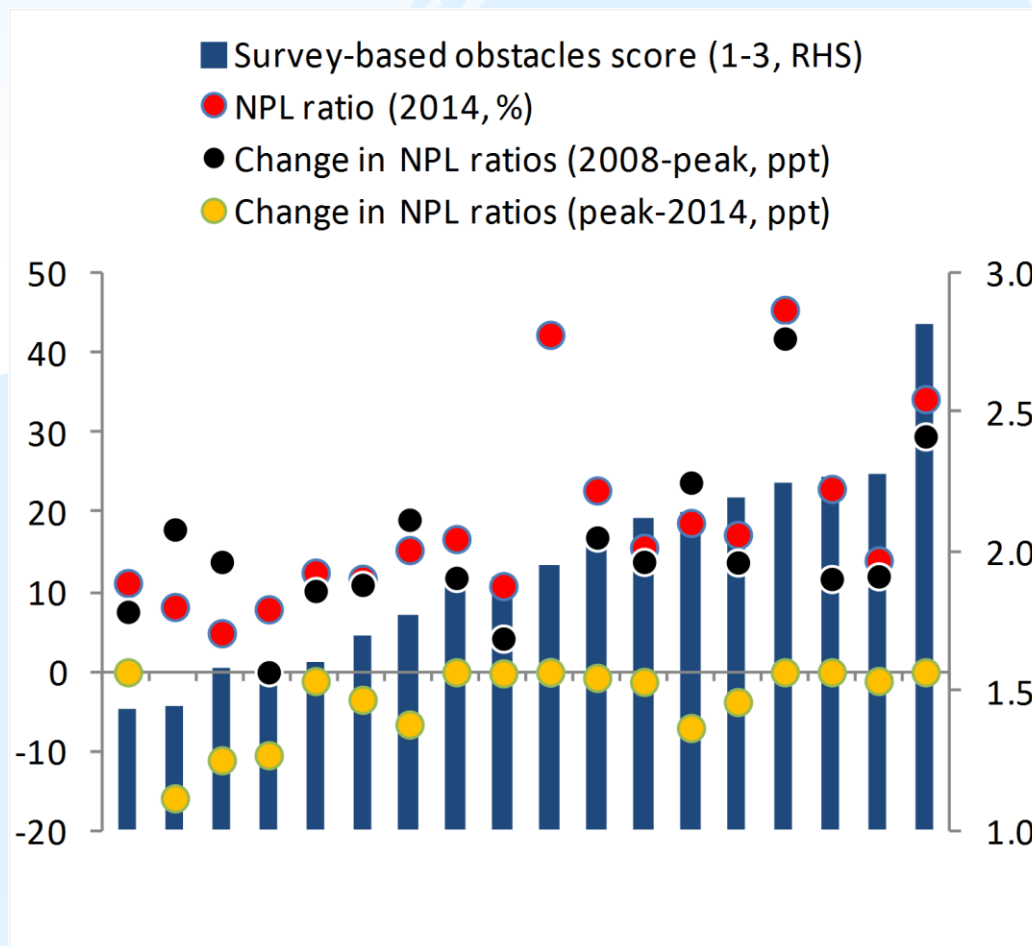


**Degree of concern:** "3" = High, "2" = Medium; "1" = no concern



# Survey results (preliminary) – cont'd

## Survey-based scores on impediments to NPL Resolution and NPL Outcomes



**Degree of concern:** "3" = High, "2" = Medium; "1" = no concern; max (country, bank)



# Multifaceted strategy needed to overcome inertia

- Assertive prudential oversight to ensure banks build NPL resolution capacity
- In-court and out-of-court reforms to facilitate rapid asset recovery
- Amend tax legislation to incentivize (remove disincentives for) NPL resolution
- Develop distressed debt markets to support balance sheet clean-up



# Prudential oversight

- Adequate forward-looking capital buffers
  - ◆ Robust and consistent loan classification
  - ◆ Conservative collateral valuations
- Enhanced supervisory understanding
  - ◆ Independent expert assessment of banks' capacity (e.g. Greece, Ireland, Portugal)
  - ◆ Introduce detailed NPL reporting framework (e.g. Greece)
  - ◆ Hire NPL specialists as part of on-site capability (e.g. Ireland)



# Prudential oversight – cont'd

- Assertive oversight
  - ◆ Require comprehensive NPL strategies
    - With time-bound capacity-building plans
    - Including operational targets for case management
  - ◆ Guidance and regulations on NPL management
    - Code of conduct (e.g. Ireland, Cyprus, Greece)
  - ◆ Conservative accounting treatment and prudent write-off.
    - Guidance on IFRS provisioning (e.g. Ireland, Portugal, Spain)
    - Ensure income recognition is not excessive



# Legal reforms

- Effective and predictable debt enforcement
- Enable rapid exit of non-viable firms and restructuring of viable firms
  - ◆ in-court approval of settlements negotiated out-of-court (“pre-pack”)
  - ◆ debtor-in-possession financing
  - ◆ menu of restructuring tools
  - ◆ inclusive restructuring, involving all creditors
- Strengthened judicial framework
- Out-of-court restructuring procedures



# Tax considerations

- Remove disincentives for NPL resolution
  - ◆ non-deductibility of provisions
  - ◆ income recognition in case of concessions granted to individuals facing financial distress
  - ◆ tax treatment of NPL sales
- Involve public creditors in debt restructuring
  - ◆ need for clear “rules of engagement”
- Balance tax incentives with fiscal costs
  - ◆ annual fiscal costs carefully estimated
  - ◆ consider time limitations on amendments?



# Distressed debt markets

- Identify and remove impediments to NPL sales
- Address information gaps
  - ◆ Public registries, credit bureaus
  - ◆ Improve banks' internal data quality
- Decrease "pricing gap" via conservative provisioning
- AMCs can help kick-start NPL market...
  - ◆ ...but need to be carefully designed





# Asset management companies: some aspects to consider

- Clear mandate
  - ◆ exclusive focus on value maximization
  - ◆ limit amounts of assets to be acquired
  - ◆ "sunset clause"
- Independent and robust governance
  - ◆ knowledgeable and reputable management
  - ◆ strong risk control standards
  - ◆ published, externally audited financial reports
- Sound financial structure
  - ◆ acquire assets at market price
  - ◆ where possible, attract market-based funding<sup>17</sup>



Thank you for your attention

Questions? Comments?