



# EBRD & THE CENTRAL BANK OF HUNGARY

*NPL WORKSHOP*

Budapest 3 March 2015



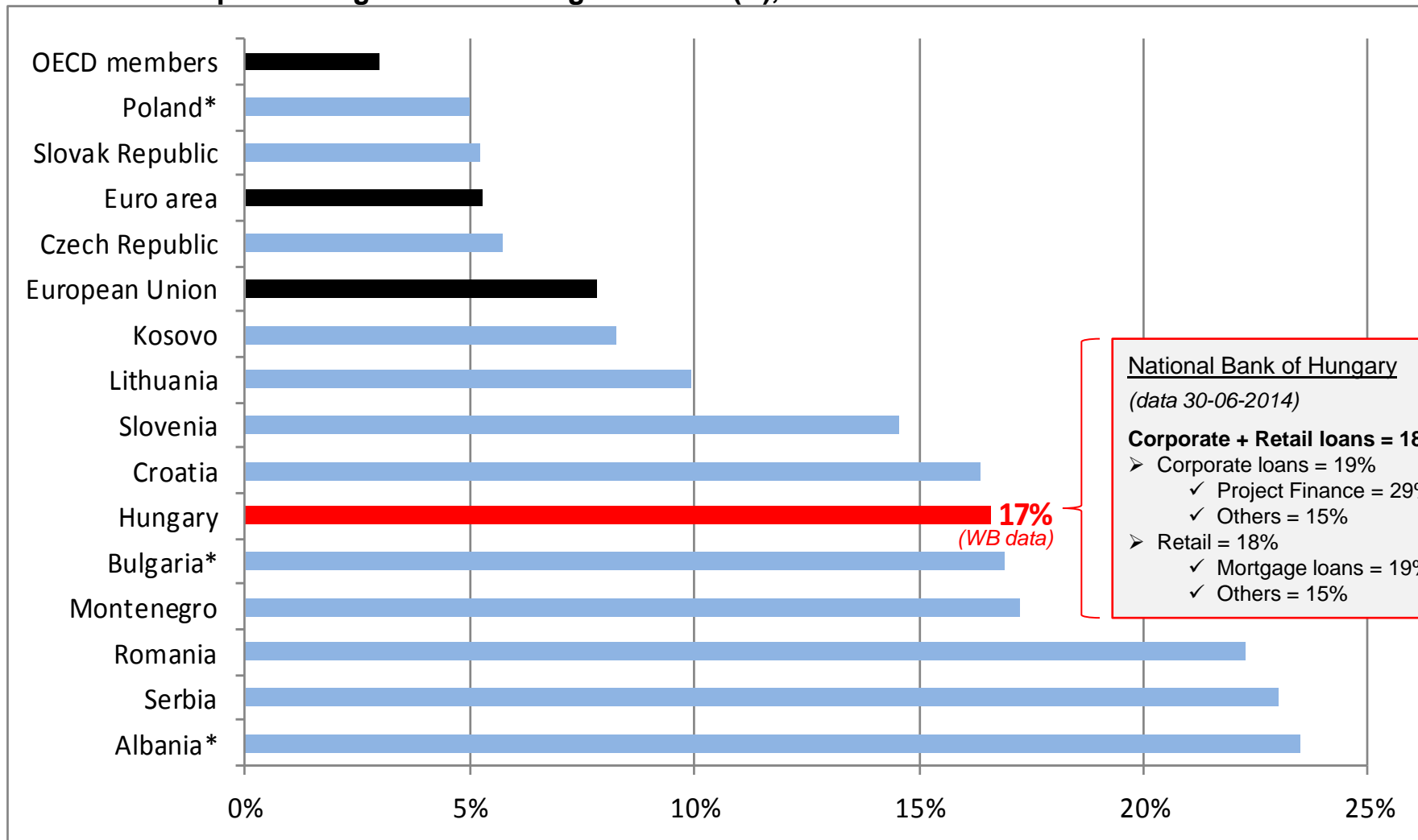
**ALVAREZ & MARSAL**



# HIGH NPLs ARE A REGIONAL ISSUE

## Aggregated Level of Hungarian NPLs in Lower Half of Range For EU and CEE

2014 - Bank nonperforming loans to total gross loans (%), World Bank Data



**National Bank of Hungary**  
(data 30-06-2014)

**Corporate + Retail loans = 18.5%**

- Corporate loans = 19%
  - ✓ Project Finance = 29%
  - ✓ Others = 15%
- Retail = 18%
  - ✓ Mortgage loans = 19%
  - ✓ Others = 15%

\*2013 data









(1) NBH Financial Stability Report, data 30-06-2014 (Excl. Financial Enterprises for retail)

# IMPEDIMENTS TO NPL RESTRUCTURING AND RECOVERY

## Number of common obstacles to effective NPL resolution across CEE

FINANCIAL/TAX	LEGAL/REGULATORY	ORGANISATIONAL
<ul style="list-style-type: none"> <li>⬆️ Lack of adequate and realistic provision levels and lack of capital to absorb credit losses</li> <li>⬆️ Illiquid and under-developed NPL secondary markets</li> <li>⬆️ Tax write-offs on credit losses require bankruptcy</li> <li>⬆️ Debt write-offs or debt-to-equity swaps create borrower tax liabilities</li> <li>⬆️ Difficult to access up-to-date and accurate data / information on borrowers</li> </ul>	<ul style="list-style-type: none"> <li>⬆️ Require license to buy/trade debt claims</li> <li>⬆️ Lack of clarity with enforcement/repossession legislation</li> <li>⬆️ Insolvency regulation promotes liquidation over rehabilitation</li> <li>⬆️ Ability of creditors to influence selection of bankruptcy administrator</li> <li>⬆️ Slow bankruptcy process and court backlogs</li> <li>⬆️ Lack of commercial acumen/experience of bankruptcy courts</li> </ul>	<ul style="list-style-type: none"> <li>⬆️ Need to separate management of NPLs from management of performing (good) loans</li> <li>⬆️ Lack of restructuring tool kit, restructuring skills and expertise within banks</li> <li>⬆️ Predominance of bilateral lending over syndicated leads to lack of co-ordination, co-operation (e.g. London, Vienna 2, and Budapest Approaches)</li> </ul>

# MULTIPLE NPL INITIATIVES HAVE BEEN USED IN COMBINATION

Country	AMC	Resolution (Bridge Bank / P&A/ Liquidation)	Nationalisation	Consolidation	Internal Good Bank / Bad Bank Split	Insurance / Guarantee Scheme
 Ireland	✓	✓	✓	✓	✓	✓
 UK	✓	✓	✓	✓	✓	✓
 Spain	✓	✓	✓	✓	✓	
 Greece		✓	✓	✓	✓	
 Cyprus		✓		✓	✓	
 Germany	✓	✓	✓	✓	✓	✓
 Italy				✓	✓	
 Portugal		✓	✓		✓	



# EXAMPLES OF STRUCTURAL NPL PORTFOLIO SOLUTIONS

Depending on the strategy agreed, multiple solutions exist internally and externally to manage and/or resolve NPLs and assets owned.

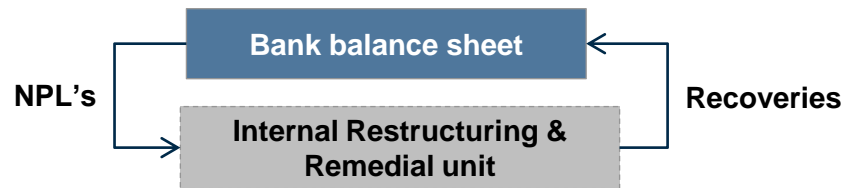
## Public Support Options

### Asset Purchase Scheme

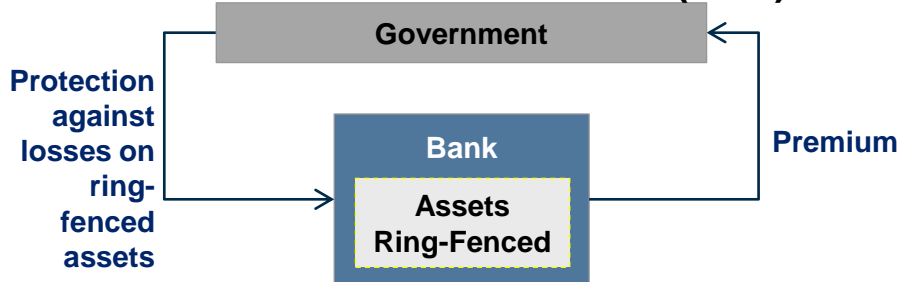


## Private Sector Options

### Strengthen Existing Restructuring and Remediation Procedures



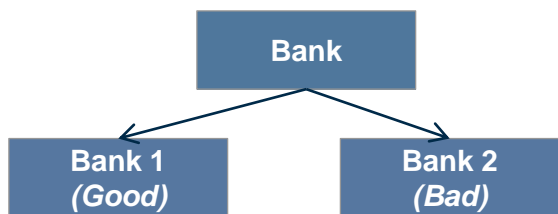
### Asset Protection Scheme (APS)



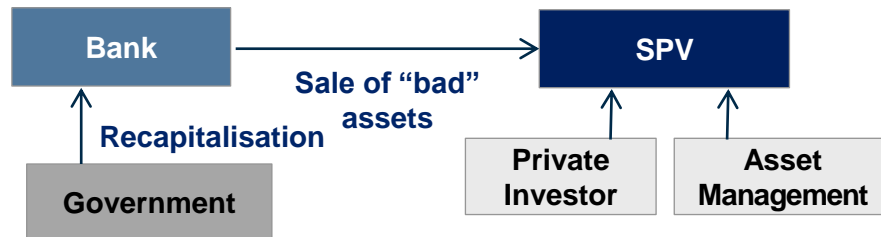
### Corporate Restructuring Vehicle (CRV)



### Good/Bad bank split



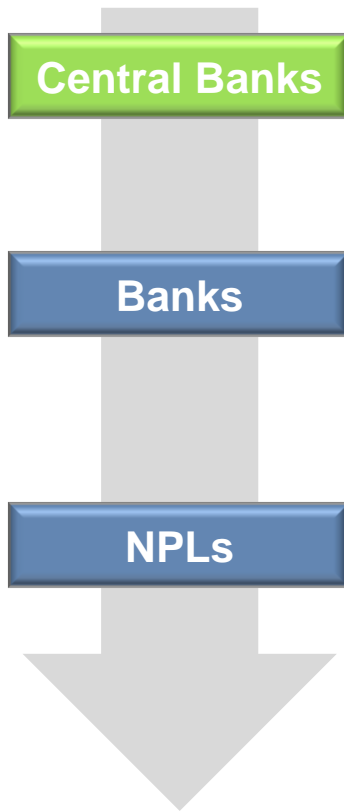
### Carve-out and Sale (NPLs and Assets)





# RANGE OF CENTRAL BANK STRATEGIES

Central banks need to select their strategic approach to NPLs: e.g. voluntary vs. coercive, keeping NPL management within banks or carving-out NPLs, or both.

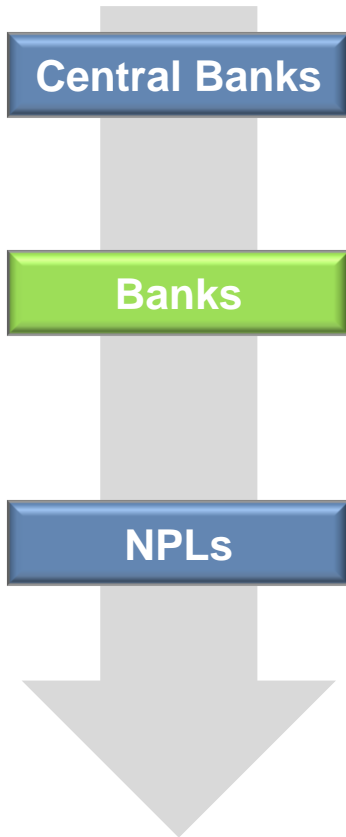


- Central banks need to decide on how much of a role it will take in:
  - Defining NPL framework;
  - Monitoring and pushing the banks for measurable results
  - Auditing banks' NPL operations
  - Developing code of conduct



# WHAT STRATEGIC STANCE SHOULD BANKS TAKE?

Banks need to develop a strategy for managing NPLs and put in place the necessary organisation and staffing resources

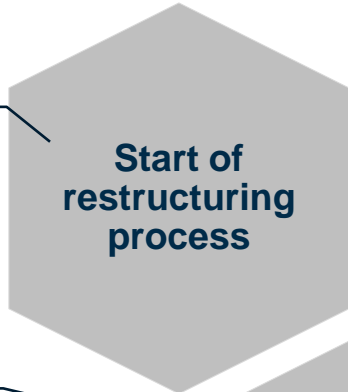


- Set a clear strategy – internal or external NPL unit
- Use decision trees to categorise and segment different types of NPL customers
- Define range of restructuring solutions:
  - Short term forbearance: e.g interest only;
  - Medium term: e.g. capitalisation of interest arrears, repayment extension;
  - Long Term: e.g. debt-for-equity, split mortgage
- Build target operating model
- Establish measurement and periodic reporting framework

# RESTRUCTURING NPLs DEPENDS ON SEVERAL KEY FACTORS

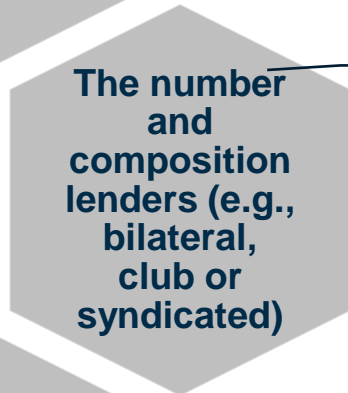
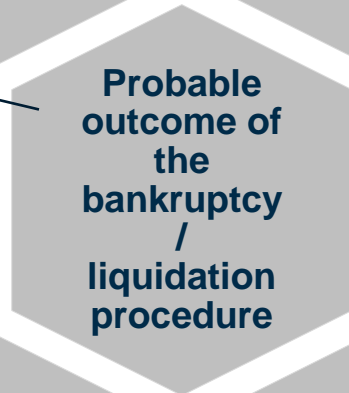
While each individual restructuring is unique, analyzing the situation and reducing it to standard "units" facilitates identification and implementation of an optimal solution

- Greater chance of a successful restructuring the more time there is to prepare before a default or cash runs out



- New money contributions from shareholders to stimulate and finance restructuring process and demonstrate good faith. Availability of new money from new investors/lenders

- Lenders assess pros and cons of the most realistic restructuring alternatives, including bankruptcy



- The larger the number of lenders the more complex it is to coordinate the restructuring process and negotiations.

- Lenders' willingness to enter into a restructuring highly dependent upon level of openness and cooperation of management and shareholders.



- Risk of lenders with small or insignificant loan exposures holding-up restructuring by demanding preferential treatment

- Restructuring consultant can act as an "honest broker" between lenders and the borrower

- Banking regulations impose limitations on lenders, which can impact how they handle their distressed and NPL exposures





# START OF RESTRUCTURING: WHEN AND HOW?

Sooner the better - provides more time to assess alternatives before cash runs out

## Common actions of the borrower or the lenders

## Consequences for restructuring

## A&M's Observations

**When to start restructuring?**

**What happens before restructuring?**

**How to notify the lenders?**

Borrowers and lenders tend to leave a restructuring too late waiting until a payment default, a covenant breach or business runs of cash

Before restructuring, borrowers often resort to solutions detrimental to its existing lenders (e.g. costly third party fundraising / debt refinancing, pledging of unencumbered assets)

Requirements for the format, content and deadlines for regular financial reporting by borrower to lenders should be a key term of a loan agreement

Lenders do not like last minute surprises and may take harder stance opting for foreclosure and bankruptcy rather than a consensual restructuring

“New” lenders complicate a restructuring as they are usually reluctant to compromise so soon after closing.

Less security available and/or cross guarantees of businesses complicates restructuring

Failure to provide timely and accurate financial information usually results in borrower losing control of the situation and creditability with lenders



Borrowers typically inform lenders too late about distress and inability to meet financial obligations

Borrowers do not prepare adequately before notifying the lenders and initiating restructuring - they have a problem but have not identified potential solutions

Lenders should encourage borrowers to act early and proactively when facing distress, prepare comprehensive and realistic business plans, provide full transparency on their financial situation and work cooperatively with lenders to find an optimal solution

# HOW TO DEAL WITH THE DISTRUST OF THE LENDERS?

A&M recommends distressed borrowers engage professional restructuring consultants to help overcome the lenders' loss of confidence in management and shareholders caused by the borrower's financial difficulties

Typical problems of the lender	Comment	Possible role of the consultant
<b>Are borrower's plans realistic &amp; achievable?</b>	<ul style="list-style-type: none"> <li>Often banks lack independent third party expertise to assess the achievability of new borrower's plans, particularly if previous plans failed</li> </ul>	<ul style="list-style-type: none"> <li>The restructuring consultant can participate in the development of the borrower's business plan or provide expertise in challenging the proposal and assessing its viability</li> </ul>
<b>What is the borrower's consolidated performance?</b>	<ul style="list-style-type: none"> <li>Many banks are only lending to one legal entity within in a larger group or conglomerate and have no visibility or control on the overall group situation</li> </ul>	<ul style="list-style-type: none"> <li>Restructuring requires understanding and assessing the entire business of the Group, based on industry insights. Lenders will expect to see a consolidated model which can be stressed for different forecasts</li> </ul>
<b>What is current liquidity &amp; solvency of borrower?</b>	<ul style="list-style-type: none"> <li>In good times management at best focusses on operating profit or EBITDA. It becomes critical in a crisis to manage to cash flow targets</li> </ul>	<ul style="list-style-type: none"> <li>The consultant usually develops rolling the 13- week' cash flow forecast which allows lenders to monitor the borrower's liquidity on a real time basis</li> </ul>
<b>Is the quality of information adequate?</b>	<ul style="list-style-type: none"> <li>Borrowers often fail to explain their plan to the lenders in a comprehensive way, slowing down the process and requiring lenders to make less positive assumptions</li> </ul>	<ul style="list-style-type: none"> <li>The consultant can prepare a proper information package for the lenders, which will greatly facilitate the discussion of the business plan and the restructuring plan</li> </ul>
<b>How to coordinate the process with other lenders?</b>	<ul style="list-style-type: none"> <li>If many lenders participate in the restructuring, it may be complex to coordinate their actions and align their interests</li> </ul>	<ul style="list-style-type: none"> <li>The consultant can have a central coordinator role, setting agendas, arranging and guiding meetings, centralising information, notifying of the process and next steps, etc.</li> </ul>

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