



NPL Resolution and provisioning policies

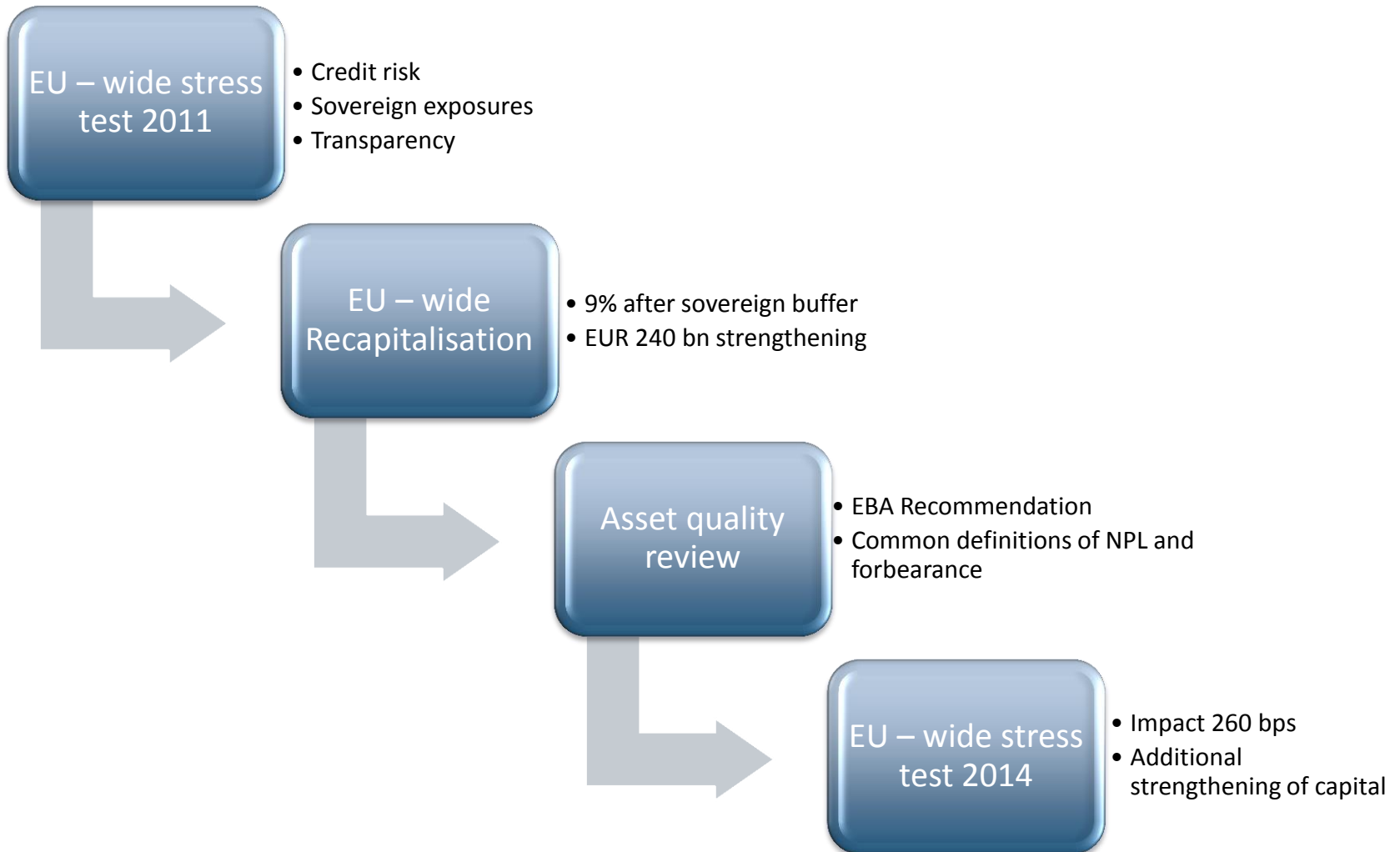
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Vienna Initiative Meeting | 26 June 2015

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Repair of banks balance sheet 2011 - 2014



AQR results overview

The first EU-wide application of the harmonised definition of non-performing loans (NPL) in the 2014 AQR exercise resulted in additional NPLs of EUR 136 billion (+18.4 %).

The highest relative increase was identified in the large corporate portfolios (+33.3 % or EUR 33.8 billion), whereas the highest absolute impact could be seen in the real estate portfolios (EUR 36.7 billion or 18.4 %).

	31/12/2013 € billion	Additional NPE	End of AQR € billion
EU total	779	141	920
<i>of which: SSM</i>	743	136	879
<i>of which: non-SSM</i>	36	5	41

For the SSM, the use of the harmonised NPE definition alone has resulted in € 55 billion additional NPE (40% of the increase)

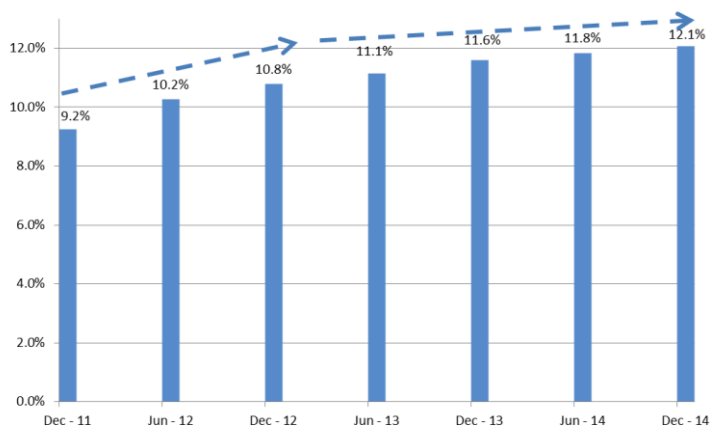
Additional amount of NPE has been accompanied by additional amount of impairment: + € 43 billion for SSM (+12%) and € 2.2 billion for non-SSM (+12%)

	31/12/2013 € billion	Additional impairment	End of AQR € billion
EU total	380.3	45.2	425.5
<i>of which: SSM</i>	362	43	405
<i>of which: non-SSM</i>	18.3	2.2	20.5

UK not included in the above figures

Capital ratios growing, but profitability remains subdued

Evolution of the CET1 ratio. Source: KRI



- **CET1 and RoE have been steadily improving (year-over-year) since 2011:**

Year end...	2011	2012	2013	2014
RoE	0.0%	0.5%	2.7%	3.6%
CET1	9.2%	10.8%	11.6%	12.1%

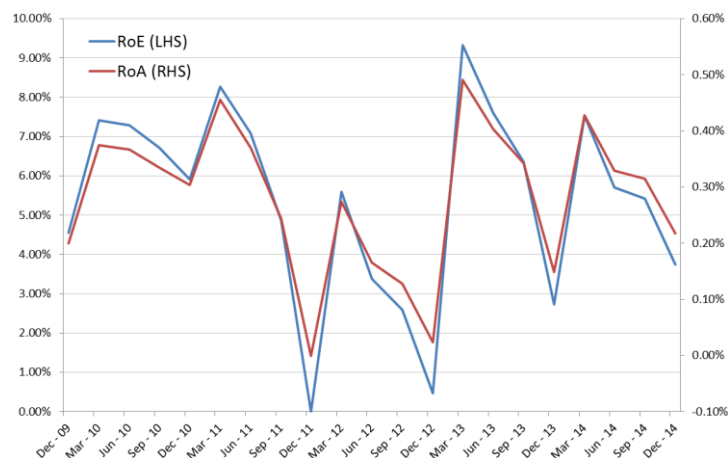
Source: EBA KRI.

- **EU banks** are in a better position than their **US peers** in terms of solvency, while the US banks are outperforming in terms of profitability:

	2011	2012	2013	2014
EU				
T1 ratio	11.1 %	12.5 %	13.1 %	13.3 %
RoA	0.00 %	0.02 %	0.15 %	0.21 %
USA				
T1 ratio	12.65 %	12.98 %	12.71 %	12.39 %
RoA	0.65 %	0.75 %	0.88 %	0.78 %

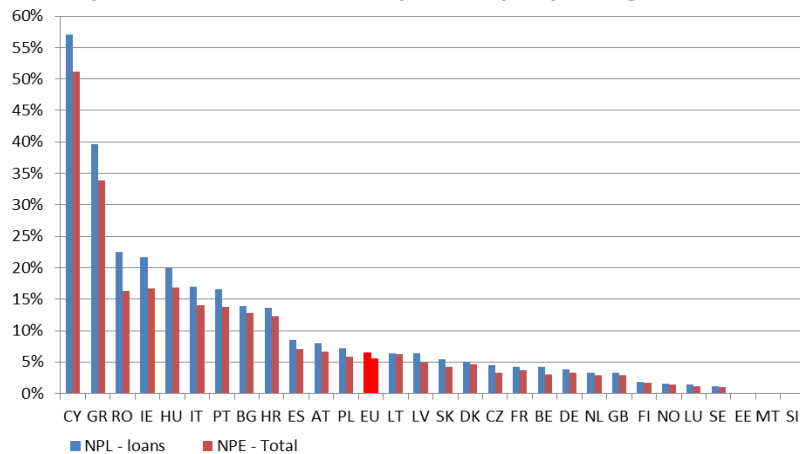
Source: EBA KRI, SNL Financials, EBA calculations.

Return on Equity (RoE, left hand scale) and Return on Assets (RoA, right hand scale) in comparison. Source: KRI

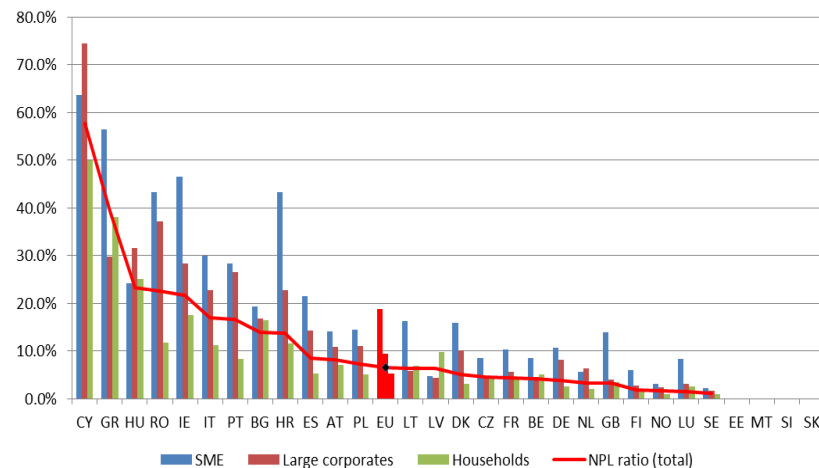


Asset quality in Europe

Non-performing ratios of loans and total exposures (by country of the bank). Source: Supervisory Reporting.

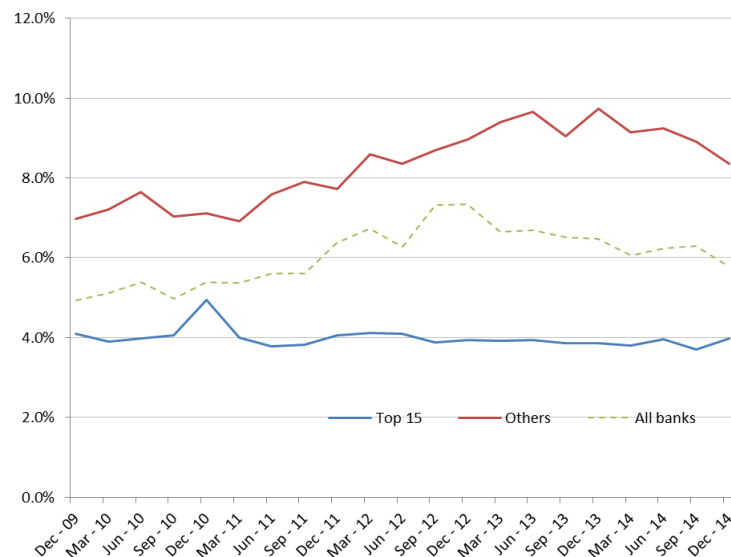
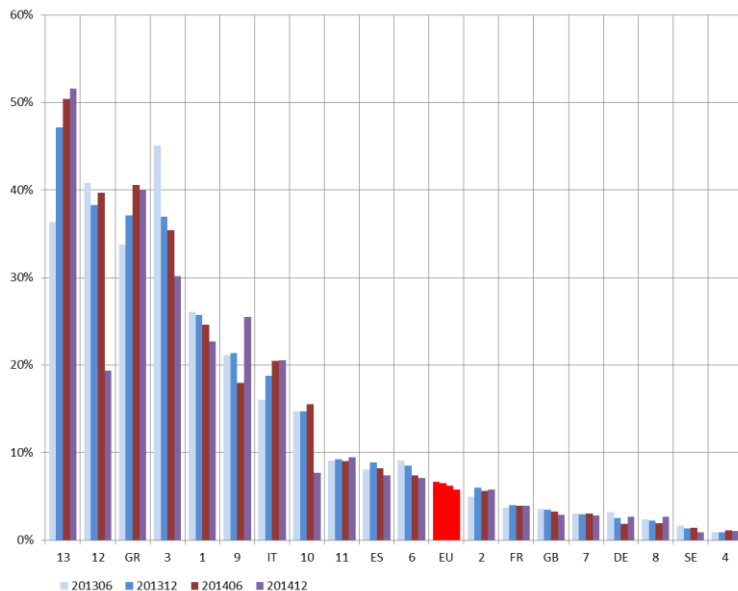


Non-performing loans by country of counterparty and sector. Source: Supervisory Reporting



- **Asset quality in Europe is low compared to its peers:** EU's NPL ratio per year end is 7.8%, for the US 2.3% and for Japan 1.9% (IMF definition and calculations, all per YE 2014).
- Within the EU the **country dispersion of the NPL ratio is wide**, with the highest ratios for CY, GR, RO and IE.
- The dispersion of the NPL ratio for different groups of counterparties is also wide. The non-financial corporates' NPL ratio was 11.5 % and the households' one was 5.3 %.
- Within non-financial corporates, large corporates' NPL ratio is 9.3 % and SMEs' NPL ratio is 18.6 %.

Impaired loans and past due loans in Europe



Source: EBA KRI, Q4/2014

- Slight decrease in 2014, but still remain high
- Wide dispersion across countries
- Depend also on the degree of progress in restructuring of legacy portfolios

NPL – Resolution strategies

Internal management

- Work out unit, bad banks
- Requires specialised and costly resources and expertise
- Possible cost in capital

Disposal of NPE

- NPE sold to other banks and/or specialised companies
- Requires a market (sellers and buyers), favourable institutional environment (especially for judicial workout or repossession of collateral procedures) that is known to them, and the ability to take losses

Bad bank

- Asset management companies that are set up by external parties (government, banking association) to deal with NPL issue
- Solve the problem of collective action and first-mover disadvantage and offer a shield for losses but may need socialising of costs (use of public money) and have to be compliant with the EU state aid rules

Post resolution strategies

- Improvement of risk management
 - Credit policies
 - Internal procedures (e.g. early collection, collateral valuation)
 - Improvement of provisioning policies
- New lending to restore profitability

Provisioning policies

Prescribed classification and provisioning

- Classification rules
- Predefined level of provisions

Prudential provisions – expected losses

- Internal estimates based on historical losses
- Risk sensitive

IAS 39 – incurred losses

- Backward looking
- Not aligned with prudential view

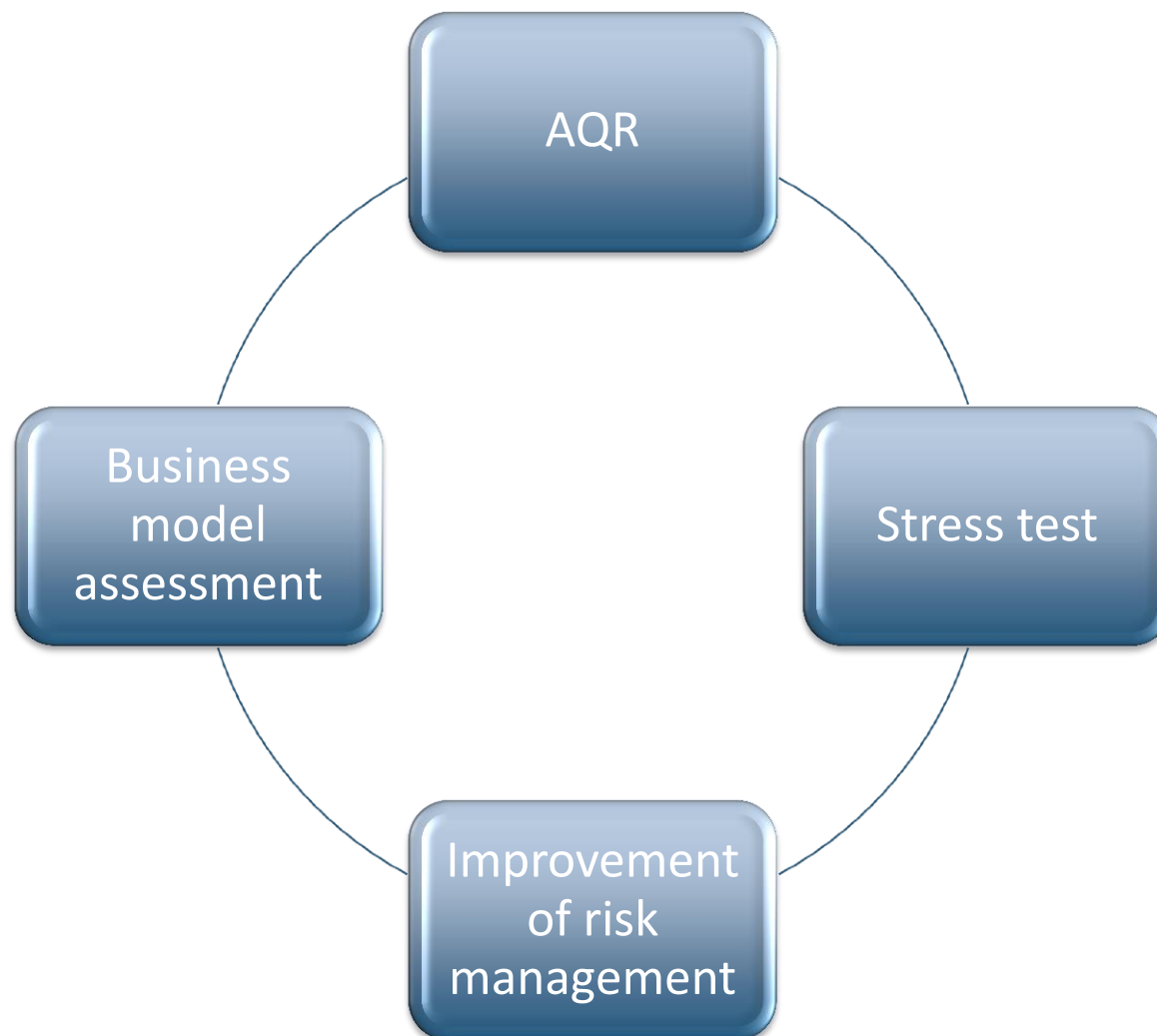
IFRS 9 - 1 January 2018

- Alignment of accounting and prudential view

Tax treatment of provisions

- **Tax regimes vary among jurisdictions**
 - Incentive to set aside provisions if tax deductible
 - Restrictive tax rules can result in postponing making provisions
- **Write-offs**
 - Uncollectible loans written off the books - deductible from the taxable income
- **Tax treatment of specific provisions vs. general provisions**

NPL – supervisory response



Supervisory monitoring and actions

- **Business model analysis**
 - Forward looking tool
 - Challenging bank strategy in macro-economic environment
- **Ongoing monitoring of risks and stress tests**
 - Regular monitoring
 - Peer group comparison
 - Stress testing
 - On-site reviews
- **Ongoing improvement of governance and risk management**
 - Thematic reviews
 - On-site reviews
 - Provisioning policies



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