Management of non-performing loans

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Building a better working world
Recent asset quality trends

The asset quality of EU banks has improved significantly in the past 4 years.

2019 NPL ratio is the lowest since the EBA introduced a harmonised definition across European countries of NPLs in 2014.

On average, the NPL ratio has improved by 75 bps each year.

NPL volumes have decreased by 50% since 2015, but country dispersion remains wide.

Banks in countries with high NPL ratios at the beginning of the period generally reported the biggest improvements and are the main driver of the decrease at the EU level.

These countries were also subject to supervisory attention from the outset, especially from ECB supervision, and they were required to comply with NPL reduction strategies.

However, Greece, which has the highest NPL ratio in the EU, has reported a decrease of only 2.8 p.p. since June 2015.

SMEs, mortgages and CREs have been the largest sub-segments by volume of NPLs.

As of the second quarter of 2019, NPLs to SMEs stood at EUR 181 billion (28.5% of the total), mortgages at EUR 141 billion (22%) and NPLs to CREs at EUR 117 billion (18.4%).

The largest percentage decrease was reported by large corporates (60% reduction), CRE (47% reduction) and SMEs (45% reduction).

Source: EBA report on NPLs. Progress made and challenges ahead.
<table>
<thead>
<tr>
<th><strong>European Commission Action Plan on the reduction of non-performing loans</strong></th>
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</thead>
<tbody>
<tr>
<td><strong>LEGISLATIVE PACKAGE TO COME INTO FORCE</strong></td>
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<tr>
<td>BRRD2, CRDV* and CRR2 <strong>[June 2021]</strong> - substantial measures to reduce risks and enhance the resilience of the EU banking sector</td>
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<td><strong>STATUTORY PRUDENTIAL BACKSTOP</strong></td>
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<tr>
<td>Common minimum levels for the amount of prudential provisions banks need to set aside to cover losses caused by future loans that turn NPLs (any excess to be deducted from own funds) <strong>[April 2021]</strong></td>
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<tr>
<td><strong>GUIDELINES ON MANAGEMENT OF NON-PERFORMING AND FORBORNE EXPOSURES</strong></td>
</tr>
<tr>
<td>The guidelines are aimed primarily at reducing NPEs on banks' balance sheets by ensuring that banks effectively manage NPEs and forborne exposures (FBEs) <strong>[June 2019]</strong>, NPL Disclosures <strong>[December 2019]</strong>, NPL FINREP reporting <strong>[June 2020]</strong></td>
</tr>
<tr>
<td><strong>GUIDELINES ON LOAN ORIGINATION AND MONITORING</strong></td>
</tr>
<tr>
<td>The guidelines are to improve institutions’ practices and associated governance arrangements, processes and mechanisms in relation to credit granting in order to ensure robust and prudent standards for credit risk taking, management and monitoring <strong>[June 2020]</strong></td>
</tr>
<tr>
<td><strong>PROPOSAL OF A REGULATION TOWARDS CREDIT SERVICERS &amp; CREDIT PURCHASERS; EBA NPL TEMPLATES</strong></td>
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<tr>
<td>This regulation will provide banks with an efficient mechanism of out-of-court value recovery from loans and will encourage the development of secondary markets <strong>[January 2021]</strong>. The EBA NPL templates aimed at enhancing the granularity, quality and comparability of NPL data and facilitation of the exchange of information between banks and investors</td>
</tr>
<tr>
<td><strong>EC BLUEPRINT ON ASSET MANAGEMENT COMPANIES</strong></td>
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<td>The main aim of AMCs is to remove troubled assets from banks' balance sheets and reduce related uncertainty premia, to accelerate the restructuring of banks with high levels of distressed assets and stabilise the national banking sectors</td>
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</tbody>
</table>

*To be implemented in the national law
**expected date (consultation in process)

[June 2021] - effective date of entry intro force
There are three main pillars that determined the overall reduction in NPLs...

**MAIN DRIVERS OF THE REDUCTION IN NPL LEVELS DURING THE PAST FEW YEARS (%)**

**Banks’ and Analysts’ RAQ, Autumn 2019**

- **Accommodative macroenvironment** (e.g. positive economic growth, decreasing unemployment)
  - Banks: 55%
  - Analysts: 47%

- **Investors’ appetite** (including due to low interest environment and search for yield)
  - Banks: 18%
  - Analysts: 69%

- **Development of secondary markets for NPLs** (e.g. market entrance of servicers, establishment of NPL transaction platforms and introduction/update in securitisation laws or schemes)
  - Banks: 26%
  - Analysts: 48%

- **Efficiency of banks’ NPL workout units and applied strategies for NPL reduction**
  - Banks: 75%
  - Analysts: 31%

- **Changes to the legal framework** (e.g. improved insolvency and foreclosure procedures) and judicial system (e.g. out of court procedures, more judges)
  - Banks: 3%
  - Analysts: 8%

**Source:** EBA report on NPLs. Progress made and challenges ahead
... and two dominating strategies for NPL reduction among banks

MAIN DRIVERS OF THE REDUCTION IN NPL LEVELS DURING THE PAST FEW YEARS (%)
Banks’ and Analysts’ RAQ, Autumn 2019

Countries with NPL ratio below weighted average EU NPL ratio
Countries with NPL ratio above weighted average EU NPL ratio

Hold and forbearance based strategies
(i.e. holding NPLs and applying suitable workout strategies and forbearance options)

Active portfolio reductions: sales (e.g. NPL portfolio transactions)

Active portfolio reductions: NPL securitisation

Change of type of exposure or collateral
(e.g. foreclosure, debt to equity / debt to asset swaps, collateral substitution)

Legal options (e.g. insolvency proceedings, out-of-court solutions)

Source: EBA report on NPLs. Progress made and challenges ahead
National Asset Managements Companies (AMCs)

European Union experience shows the examples that the **AMCs have already contributed** to addressing financial stability concerns in countries with high levels of non-performing loans (NPLs) and to the elimination of a significant impediment to the flow of new credit to the economy. Additionally, AMCs can also act as a catalyst to **develop secondary markets** for distressed debt.

**A centralised AMC** is a very effective measure when impaired assets affect a large part of the domestic banking system and mainly cover loans secured by **commercial real estate and large corporate exposures**. Any transfer of NPLs by a bank to a publicly-supported AMC is subject to two EU regulatory frameworks:

- The bank resolution framework
- The State aid framework

- AMC's should not **operate as a for-profit enterprise and should remain a light operation**, with limited numbers of Staff
- Best practice internal controls must be in place
- AMCs should be transparent to the public with well-defined disclosure requirements

**AMCs** help to bridge the intertemporal **valuation gap** which is necessary to adopt structural reforms that take hold and hence improve the price of NPLs in secondary markets

Valuation options: book value, real economic value, estimated market value – transfer price between REV and EMV

AMCs procure expertise, can benefit from **economies of scale**, **creditor coordination** and they provide relief to affected banks that are struggling to manage their NPLs and aid them to re-focus on lending to viable firms and households.
In a number of countries there are ongoing initiatives to assist the final clean-up of legacy assets.

### 3 MAIN TYPES OF COUNTRY SPECIFIC ACTIONS

#### 1. ASSET MANAGEMENT COMPANIES

The establishment of AMCs in Ireland (NAMA), Spain (SAREB) and Slovenia (DUTB) acted as catalysts for their banks to decrease radically their NPLs but also for the development of secondary NPL markets.

#### 2. GUARANTEE SCHEMES

In Italy, the introduction of the GACS scheme by the government in 2016 has been instrumental in the reduction in NPLs.

In October 2019, the EC approved a Greek asset protection scheme. The scheme, called ‘Hercules’ is similar to the Italian GACS scheme and aims to further support the reduction of NPLs.

#### 3. COORDINATION PLATFORMS

Other national initiatives that aim to tackle NPLs swiftly are the coordination platforms established in Portugal and in Greece.

In Portugal the coordination platform aims to integrate negotiations with the debtor on behalf of multiple creditors.

There is a similar initiative in Greece, where banks have formed a committee to discuss common exposures to large corporates.

Source: EBA report on NPLs. Progress made and challenges ahead
### WHAT IS SAREB?

Sareb was founded in 2012, as part of the Memorandum of Understanding (MoU) signed between the Spanish and international authorities to assist the restructuring and recapitalisation of the Spanish banking sector.

Sareb at the moment of origination received 200,000 assets valued at EUR 51bn of which 80% was developer loans and 20% was properties.

Shareholders: 55% private investors (incl. Spanish and foreign banks, insurance companies, electricity company) 45% Fund for Orderly Bank Restructuring

### KEY FIGURES 2012 - 6M 2019

- **EUR 25,396m** Income
- **EUR 15,021m** Repayment of debt (30%)
- **98,493** Properties Sold

### SAREB ASSETS PORTFOLIO

#### Evolution of the portfolio*, EUR bn

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</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>11,3</td>
<td>11,1</td>
<td>11,2</td>
<td>11,9</td>
<td>12,3</td>
<td>12,2</td>
<td>12,4</td>
<td>12,8</td>
</tr>
<tr>
<td>Repayment of debt</td>
<td>39,4</td>
<td>37,7</td>
<td>34,1</td>
<td>31,2</td>
<td>27,8</td>
<td>25,0</td>
<td>21,9</td>
<td>20,8</td>
</tr>
</tbody>
</table>

*Sareb acquired the assets from Spain’s main financial entities at an average discount of 53%.

#### Composition of the portfolio, %

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</tr>
</thead>
<tbody>
<tr>
<td>Real estate assets</td>
<td>78</td>
<td>77</td>
<td>75</td>
<td>72</td>
<td>69</td>
<td>67</td>
<td>69</td>
<td>62</td>
</tr>
<tr>
<td>Financial assets</td>
<td>22</td>
<td>23</td>
<td>25</td>
<td>28</td>
<td>31</td>
<td>33</td>
<td>31</td>
<td>38</td>
</tr>
</tbody>
</table>

Source: Sareb. Activity report first half year 2019
Irish AMC Case study: NAMA

WHAT IS NAMA?

The National Asset Management Agency was established in 2009 as one of a number of initiatives taken by the Government to address the serious crisis in Irish banking which had become increasingly evident over the course of 2008 and early 2009.

NAMA at the moment of origination received over EUR 74bn of assets from five participating institutions.

Shareholders at the moment of origination: 51% private investors (incl. Irish Life Investment Managers, New Ireland Assurance, Clients of Allied Irish Banks Investment Managers), 49% State treasury.

KEY FIGURES

2009 - 2018

EUR 5,247m
Net income

EUR 40,970m
Total cash generated, of which EUR37bn is asset disposal receipts

EUR 30,720m
Repayment of debt

13,400
Number of residential units directly or indirectly facilitated by NAMA

SAREB ASSETS PORTFOLIO

Evolution of the portfolio, EUR bn

<table>
<thead>
<tr>
<th>Year</th>
<th>Loan portfolio</th>
<th>Cumulative cash generation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>28.0</td>
<td>1.0</td>
</tr>
<tr>
<td>2011</td>
<td>25.6</td>
<td>6.1</td>
</tr>
<tr>
<td>2012</td>
<td>22.8</td>
<td>10.6</td>
</tr>
<tr>
<td>2013</td>
<td>19.6</td>
<td>15.1</td>
</tr>
<tr>
<td>2014</td>
<td>13.4</td>
<td>23.6</td>
</tr>
<tr>
<td>2015</td>
<td>7.8</td>
<td>32.7</td>
</tr>
<tr>
<td>2016</td>
<td>3.9</td>
<td>38.1</td>
</tr>
<tr>
<td>2017</td>
<td>3.2</td>
<td>40.7</td>
</tr>
<tr>
<td>2018</td>
<td>1.9</td>
<td>44.0</td>
</tr>
</tbody>
</table>

NAMA portfolio by sector, 2018, (%)

- Land: 36%
- Development: 30%
- Residential: 17%
- Office: 8%
- Retail: 5%
- Other: 4%

Source: NAMA Annual report for 2018
Guarantee scheme case studies: Italy and Greece

**GARANZIA CARTOLARIZZAZIONE SOFFERENZE (GACS)**

1. **SCHEME APPROVED IN 2016**
   State guarantee scheme designed to assist Italian banks in securitizing and facilitating the removal of NPLs from banks' balance sheets

2. **MECHANISM**
   SPV shall buy NPLs from the relevant bank and issue asset backed securities ("ABS")

3. **SCOPE**
   The GACS shall cover exclusively the senior tranches

4. **PURPOSE OF GACS**
   The main purposes of the GACS should be:
   1) to increase the credit worthiness of the senior ABS,
   2) reduce the funding cost of the SPV and
   3) incentivise banks to sell NPLs

**'HERCULES' SCHEME**

1. **SCHEME APPROVED IN 2016**
   State guarantee scheme designed to assist Greek banks in securitizing and facilitating the removal of NPLs from banks' balance sheets

2. **MECHANISM**
   Hercules is a voluntary scheme and will last for 18 months, although its duration could be extended. SPV shall buy NPLs from the relevant bank and issue asset backed securities ("ABS")

3. **SCOPE**
   The Scheme shall cover exclusively the senior tranches

“The Hellenic Financial Stability Fund, which holds stakes in Greek banks, has proposed the set-up of an asset protection scheme called ‘Hercules’, similar to the Italian GACS scheme.”
NPL in Polish banking sector

- NPL volumes remained flat during 2014 - 2017 and has increased starting from 2018
- Currently ca. 10% of total NPLs volume is attributable to cooperative banks
- Polish NPLs accounts for c. 1% of total EU NPL stock

- Banking sector NPL ratio has been decreasing since 2014*
- NPL ratio of cooperative banks has been increasing since 2014 with overall value of 8.8% as at Oct 2019

* Banking sector NPL ratio based on PFSA data amounted to 6.7% as at Jun 2018 (vs. 4.8% based on EBA data)
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