Management of non-performing loans

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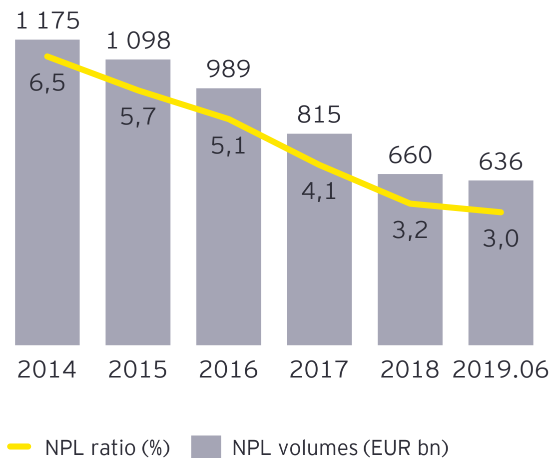
Building a better working world

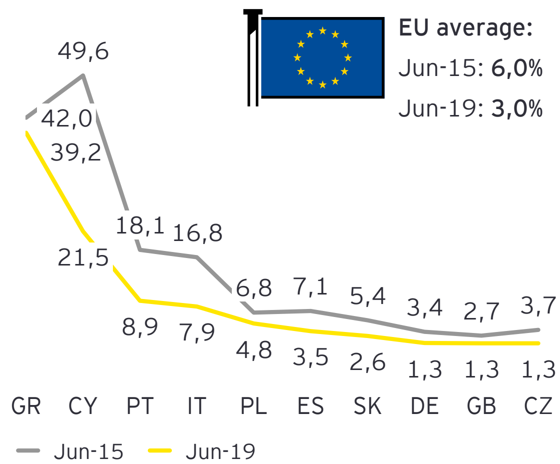
Recent asset quality trends

EU NPL RATIO AND VOLUME



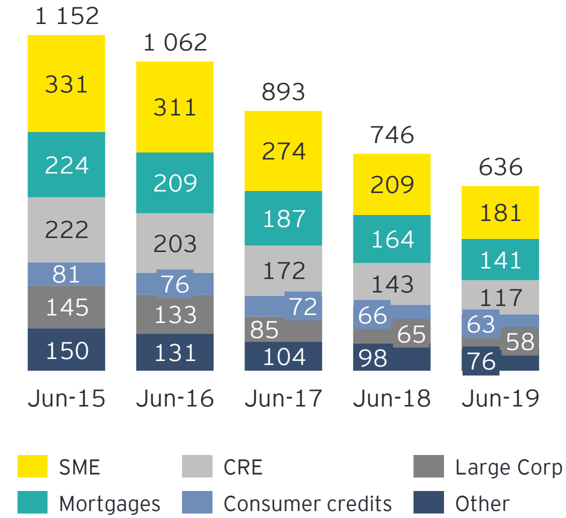
- The asset quality of EU banks has **improved significantly in the past 4 years**
- 2019 NPL ratio is the lowest since the EBA introduced a harmonised definition across European countries of NPLs in 2014
- On average, the **NPL ratio has improved by 75 bps each year**
- NPL volumes have decreased by 50% since 2015, but country dispersion remains wide

NPL RATIO PER COUNTRY (%)



- 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

NPL BY TYPE OF EXPOSURE (EUR bn)



- 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

European Commission Action Plan on the reduction of non-performing loans

LEGISLATIVE PACKAGE TO COME INTO FORCE

BRRD2, CRDV* and CRR2 [June 2021] - substantial measures to reduce risks and enhance the resilience of the EU banking sector

STATUTORY PRUDENTIAL BACKSTOP

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)
[April 2021]

GUIDELINES ON MANAGEMENT OF NON-PERFORMING AND FORBORNE EXPOSURES

The guidelines are aimed primarily at reducing NPEs on banks' balance sheets by ensuring that banks effectively manage NPEs and forborne exposures (FBEs) [June 2019]
NPL Disclosures [December 2019],
NPL FINREP reporting [June 2020**]

GUIDELINES ON LOAN ORIGINATION AND MONITORING

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
[June 2020**]

PROPOSAL OF A REGULATION TOWARDS CREDIT SERVICERS & CREDIT PURCHASERS; EBA NPL TEMPLATES

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
[January 2021**].
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

EC BLUEPRINT ON ASSET MANAGEMENT COMPANIES

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

*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

Banks Analysts

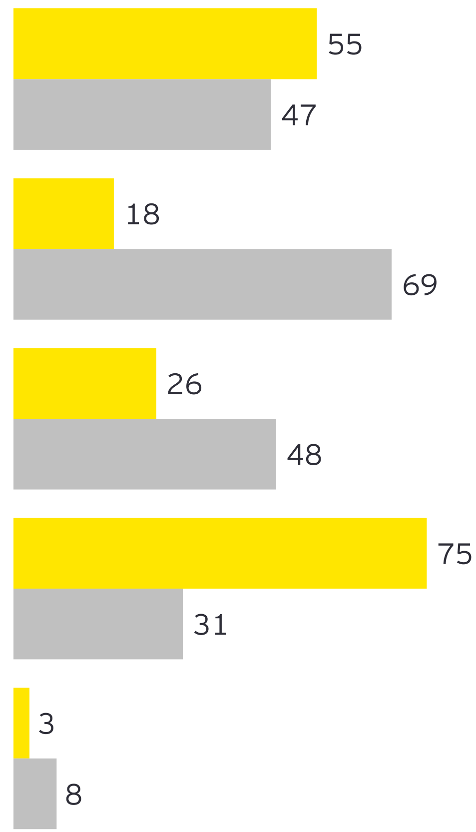
Accommodative **macroenvironment** (e.g. positive economic growth, decreasing unemployment)

Investors' appetite (including due to low interest environment and search for yield)

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)

Efficiency of banks' NPL workout units and applied strategies for NPL reduction

Changes to the legal framework (e.g. improved insolvency and foreclosure procedures) and judicial system (e.g. out of court procedures, more judges)



Source: EBA report on NPLs. Progress made and challenges ahead

3 MAIN PILLARS of NPLs REDUCTION

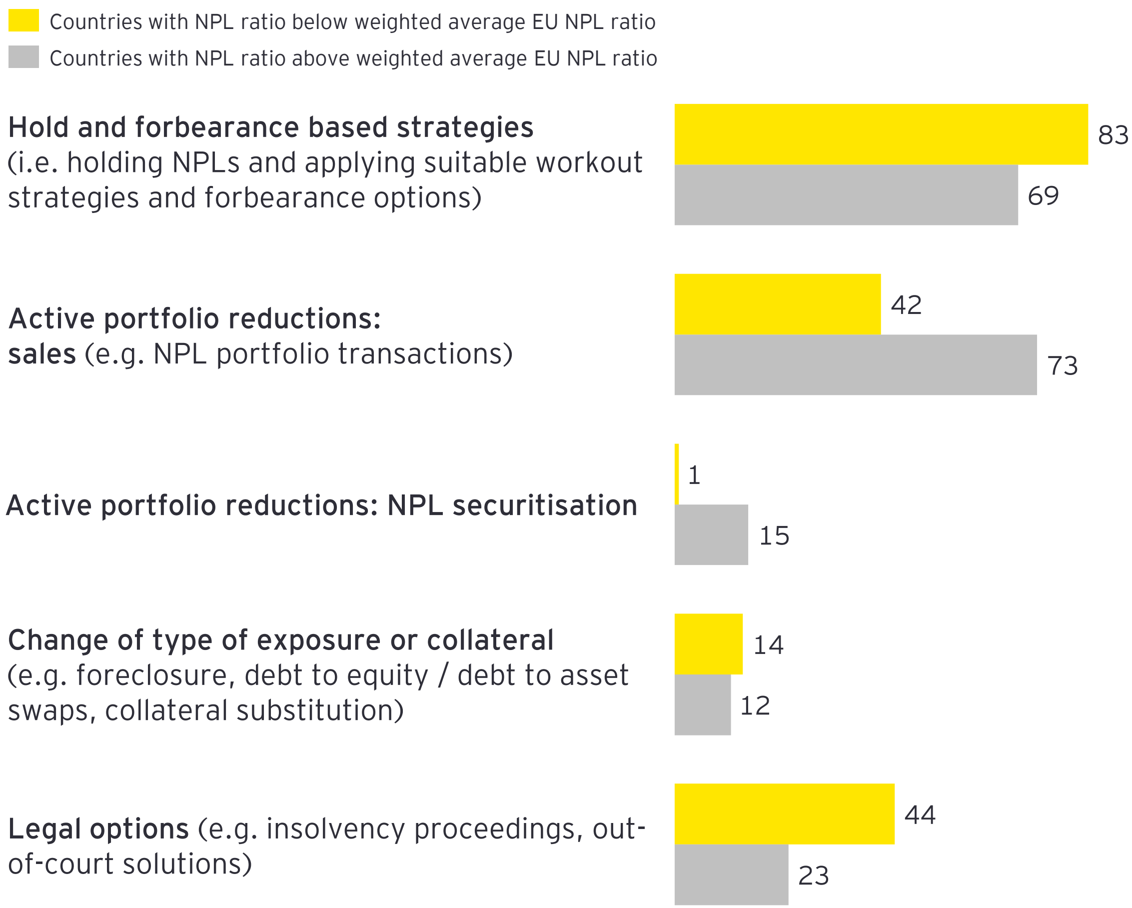
1 **Clear policy stance of the EBA** and the supervisory community, and the Council of the EU's action plan

2 **Banks' efforts to improve NPL management capabilities**, by enhancing NPL strategies in monitoring and restructuring, by investing in information technology and by strengthening governance

3 **Positive economic growth**, lower unemployment, low interest rates and positive development in real estate markets in the EU during the past 4 years

… 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



Source: EBA report on NPLs. Progress made and challenges ahead

- Countries **with higher NPL ratios have active NPL portfolio sales high on their agenda** (73%), followed by their hold and forbearance strategies (69%)
- This reflects both the investors' appetite for these portfolios and the supervisory pressure to reduce legacy assets within set timeframes
- Conversely, **banks with lower NPL ratios do not have a priority to sell NPL portfolios** and they are seeking to cure NPLs either through internal work-out strategies or through legal proceedings
- This also reflects the ability and flexibility of these banks, due to their lower NPL ratios, to wait and hold on to their non-performing assets

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

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

- 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 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 MANEGEMENT 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.

EXAMPLES

Source: EBA report on NPLs. Progress made and challenges ahead

Spanish AMC Case study: Sareb

Sareb

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

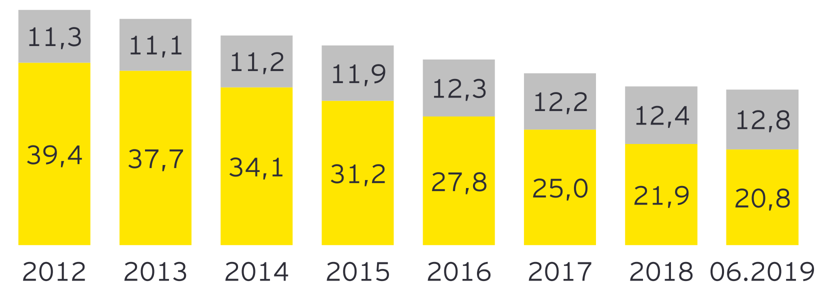
EUR 25,396m
Income

EUR 15,021m
Repayment of debt (30%)

98,493
Properties Sold

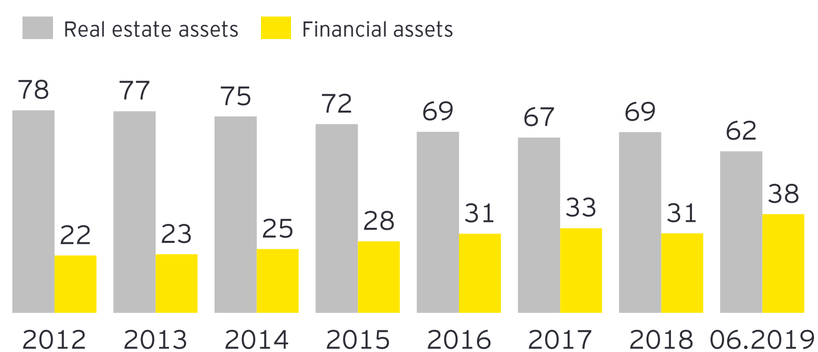
SAREB ASSETS PORTFOLIO

Evolution of the portfolio*, EUR bn



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

Composition of the portfolio, %



Source: Sareb. Activity report first half year 2019

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Irish AMC Case study: NAMA

National Asset Management Agency

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 Ireland Assurance, Allied Irish Banks Investment Managers), **49% State treasury**

KEY FIGURES

2009 - 2018

EUR 5,247m
Net income

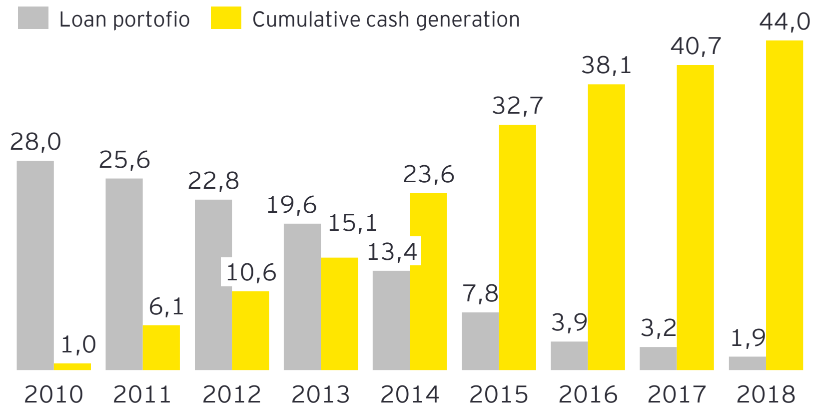
EUR 40,970m
Total cash generated, of which EUR37bn is asset disposal receipts

EUR 30,720m
Repayment of debt

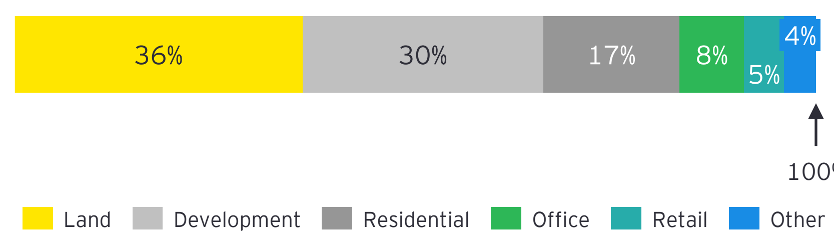
13,400
Number of residental units directly or indirectly facilitated by NAMA

SAREB ASSETS PORTFOLIO

Evolution of the portfolio, EUR bn



NAMA portfolio by sector, 2018, (%)



Source: NAMA Annual report for 2018

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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 MECHANIZM

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 MECHANIZM

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")

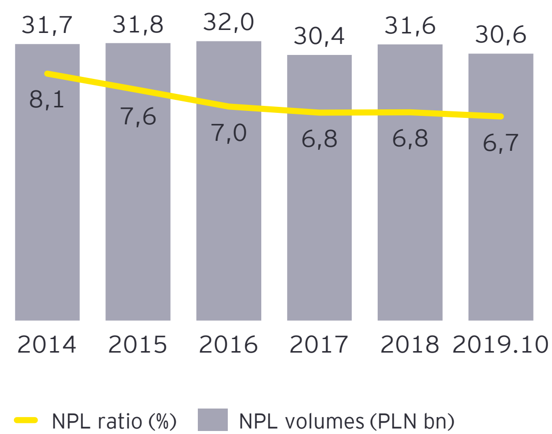
3 SCOPE

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."

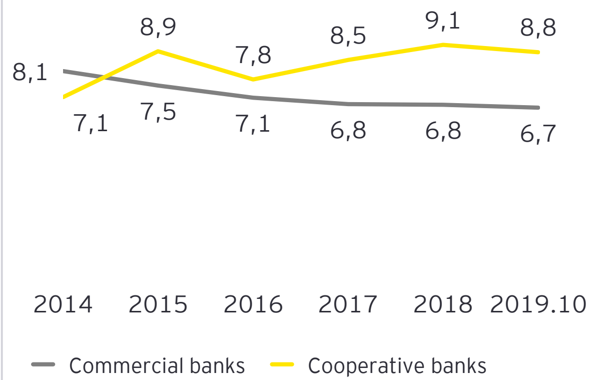
NPL in Polish banking sector

NPL RATIO AND VOLUME



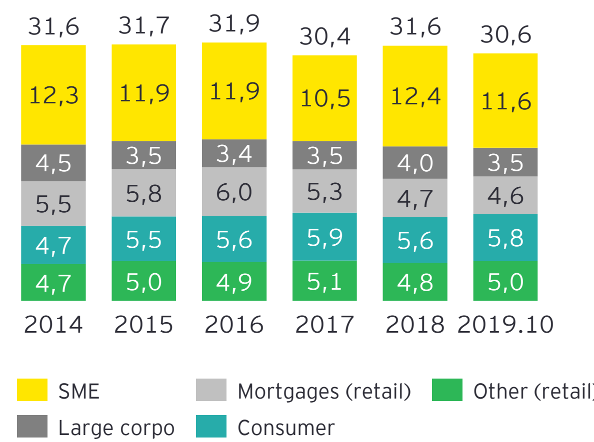
- NPL volumes remained flat during 2014 – 2017 and has increased starting from 2018
- Currently ca. **10% of total NPLs** volume is attributable **to cooperative banks**
- **Polish NPLs accounts for c. 1% of total EU NPL stock**

NPL RATIO PER TYPE OF BANK (%)



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

NPL BY TYPE OF EXPOSURE (PLN bn)



- **NPL ratio for corporate mortgages** was higher than maker average and amounted to 10% as at 2019.10
- NPL volume of housing loans for developers and loans for office real estates amounted to PLN 0.6bn and PLN 0.8bn respectively (ie. 2.0% and 2.5% of total NPL volumes)
- NPL ratio for housing loans for developers and loans for office real estates amounted to 15% and 7% respectively

* Banking sector NPL ratio based on PFSA data amounted to 6.7% as at Jun2018 (vs. 4.8% based on EBA data)

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