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Finance, Competitiveness & Innovation

Financial Sector Advisory Center (FinSAC)

A holistic approach to NPL resolution

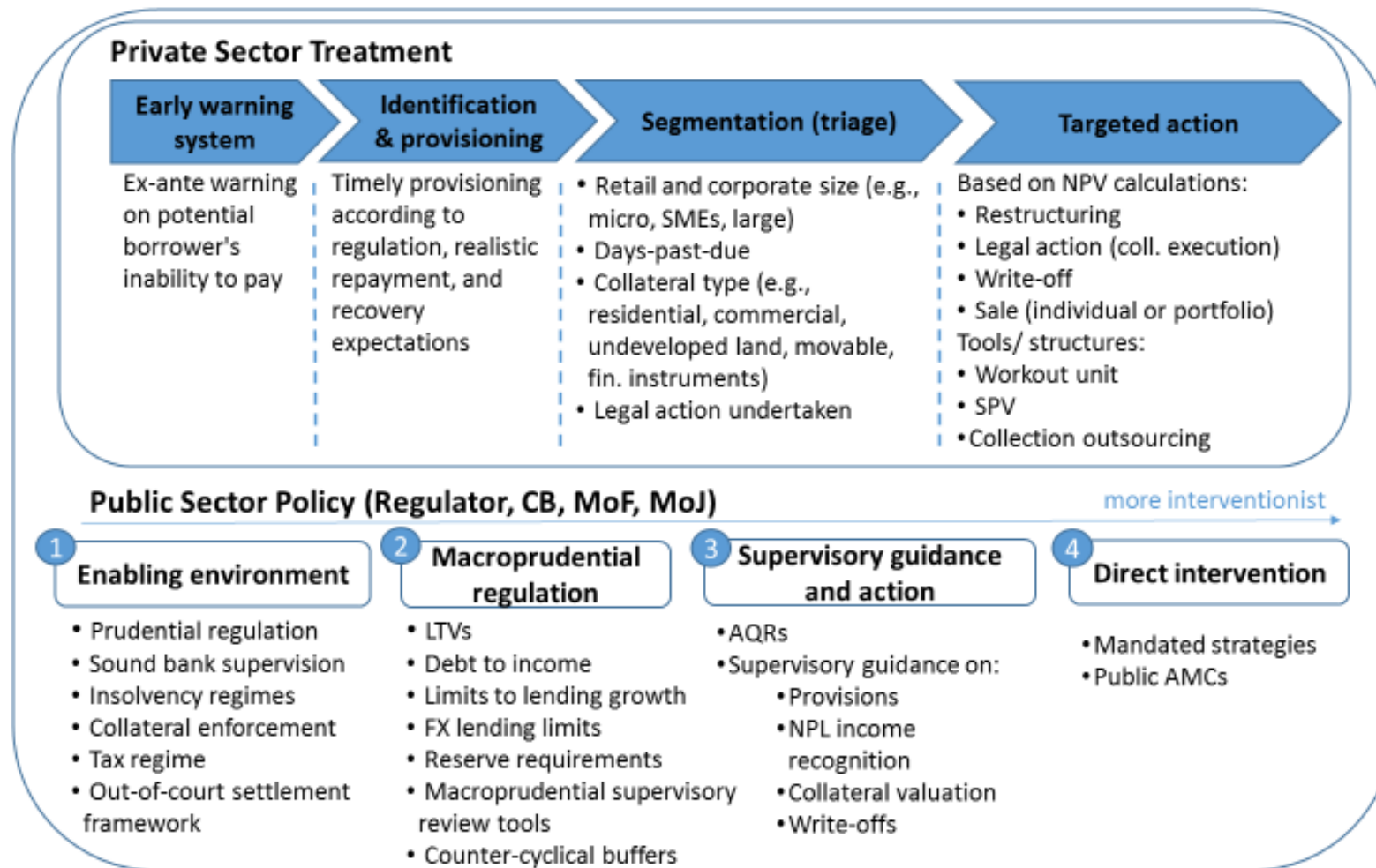
FinSAC NPL conference

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NPL resolution needs a holistic approach

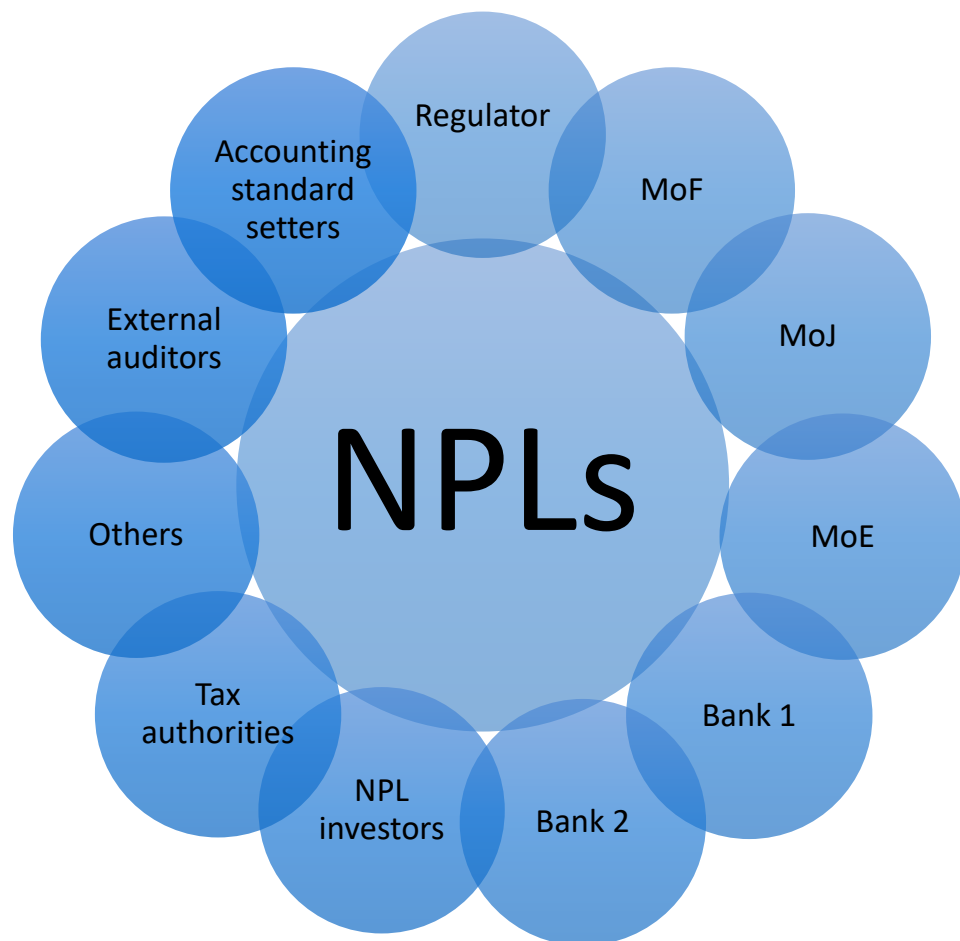


Only a coordinated work of private and public sector stakeholders could bring meaningful results in NPL reduction

Banks have the primary responsibility in NPL resolution at individual level and should ensure time bound and efficient NPL workout

Public sector authorities should set a comprehensive and clear framework for NPL reduction (workout) in the system in order to remove impediments for financial stability and economic growth

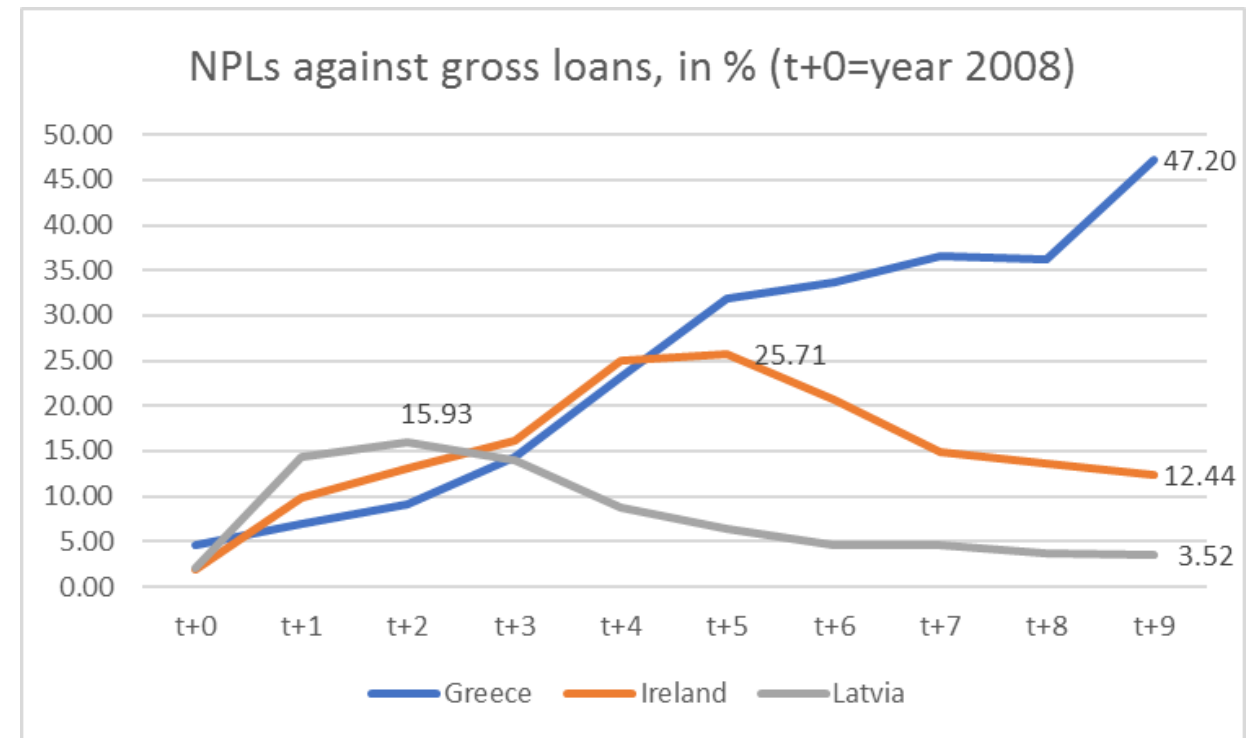
NPL resolution is a complicated task with many institutions involved



- Regulator: regulation on credit risk, loan provisioning, migration of loans from NPL to performing category, income recognition on NPLs, NPL resolution targets per bank
- MoF: usually a lead institution for the financial crisis resolution, tax legislation (CIT, PIT, VAT), other initiatives
- MoJ: corporate and personal insolvency laws, out-of-court resolution, bailiffs regulation, improvements in judicial system
- MoE: foreign investors, economic growth, SME loans
- Bank 1 and 2: provisioning of NPLs, internal NPL resolution (workout) units, multi-lender cases, financial statements are prepared in accordance with the applicable financial reporting framework
- NPL investors: access to market, availability of NPL servicing platforms, licensing, NPL pricing gap
- Others: regulation of appraisers and methodology for appraisal of immovable assets
- Tax authorities: tax debts, super-priority of claims
- External auditors: deliver quality bank audits which foster market confidence in banks' financial statements and provide audited statements of corporations
- Accounting standard setters: deliver a set of accounting policies, valuation norms and disclosure requirements, based on which financial statements should be prepared

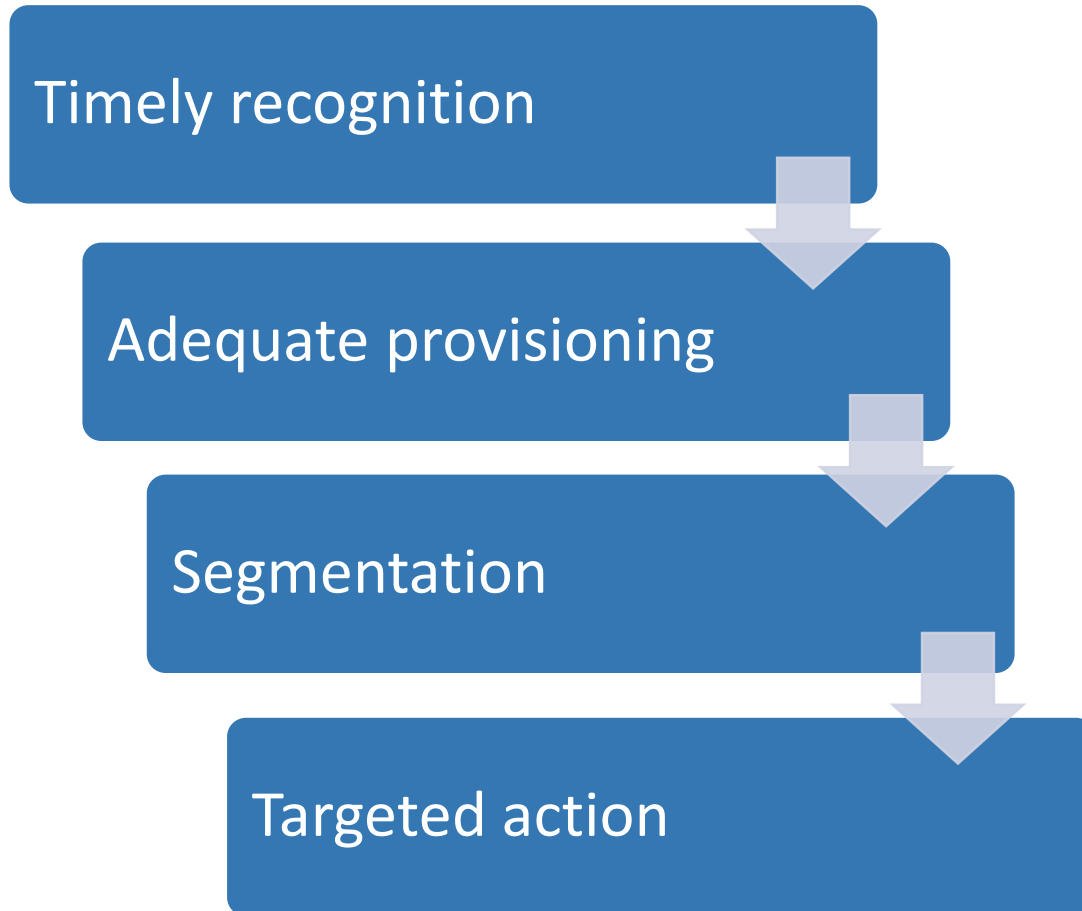
Different experiences with NPL resolution

- The economic and financial crisis hit many EU countries in 2008
- Latvia, Ireland, and Greece had IMF, EC, and ECB programs
- The countries chose to apply different crisis and economic resolution methods:
 - one of the most successful was in **Latvia** – quick and decisive decisions with substantial short term “economic pain” (internal adjustment);
 - **Ireland** started decisively but structural problems were deeper;
 - **Greece** had substantial structural problems and opted for a slow reform process leading to protracted economic and financial difficulties.
- A holistic approach to NPL resolution and ownership of reforms matter



Source: IMF, Financial Soundness Indicators

Stages of NPL resolution



- Four basic NPL resolution blocs are essential for a successful tackling of impaired assets
- All of them require serious consideration
- Banks and regulators play crucial role in the resolution process
- The proper recognition and valuation of NPLs is bank's primary responsibility
- Regulators should set an unambiguous framework for NPL resolution
- More prescriptive and intrusive regulation is justified in case of a systemic NPL problem

NPL resolution at individual banks – available options

SEGMENTATION:

- Viable
- Non-viable



RESTRUCTURING:

- Debt workouts - bilateral or multilateral forbearances, rescheduling, restructurings (terms and collateral)
- Voluntary out-of-court corporate and financial debt restructuring – more comprehensive to restore viability to the business, including both financial and operational restructuring

SALE OR TRANSFER of distressed loans at discount to third parties or AMC

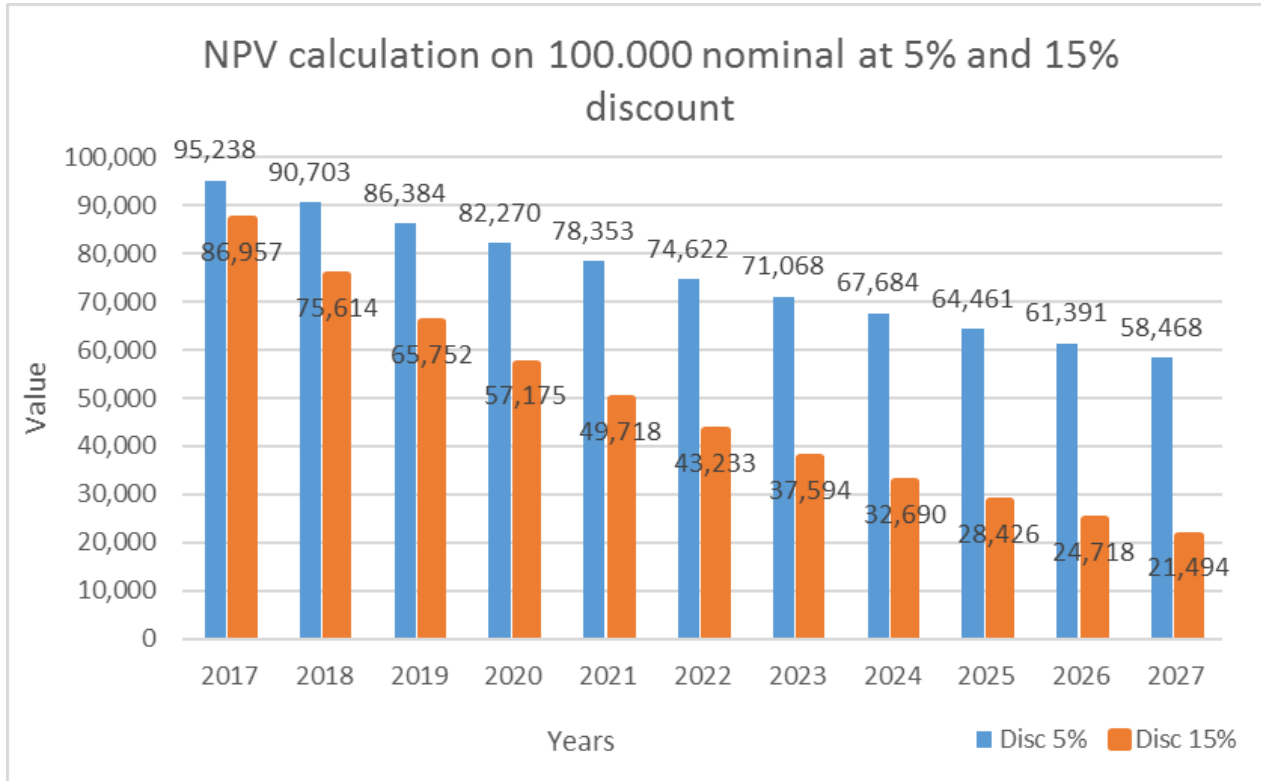
COLLECTION:

- Foreclosure, execution and enforcement
- Bankruptcy liquidation proceedings
- Write-offs



- To select the most cost efficient options, an NPV calculation should be done for all available options. The calculation must include all costs associated with a selected option, including the costs of internal or external workout unit (e.g., internal - human resources, IT, legal expenses- or external – asset storage costs, advisory or other services)
- Depending on bank's NPL resolution strategy, it might conduct NPL workouts (i) internally; (ii) create an external SPV; or (iii) outsource the process to a third party (with pre-determined profit sharing plan or investent contribution) or decide to sell all or part of its NPL portfolio

Real case NPL resolution – country X and country Y

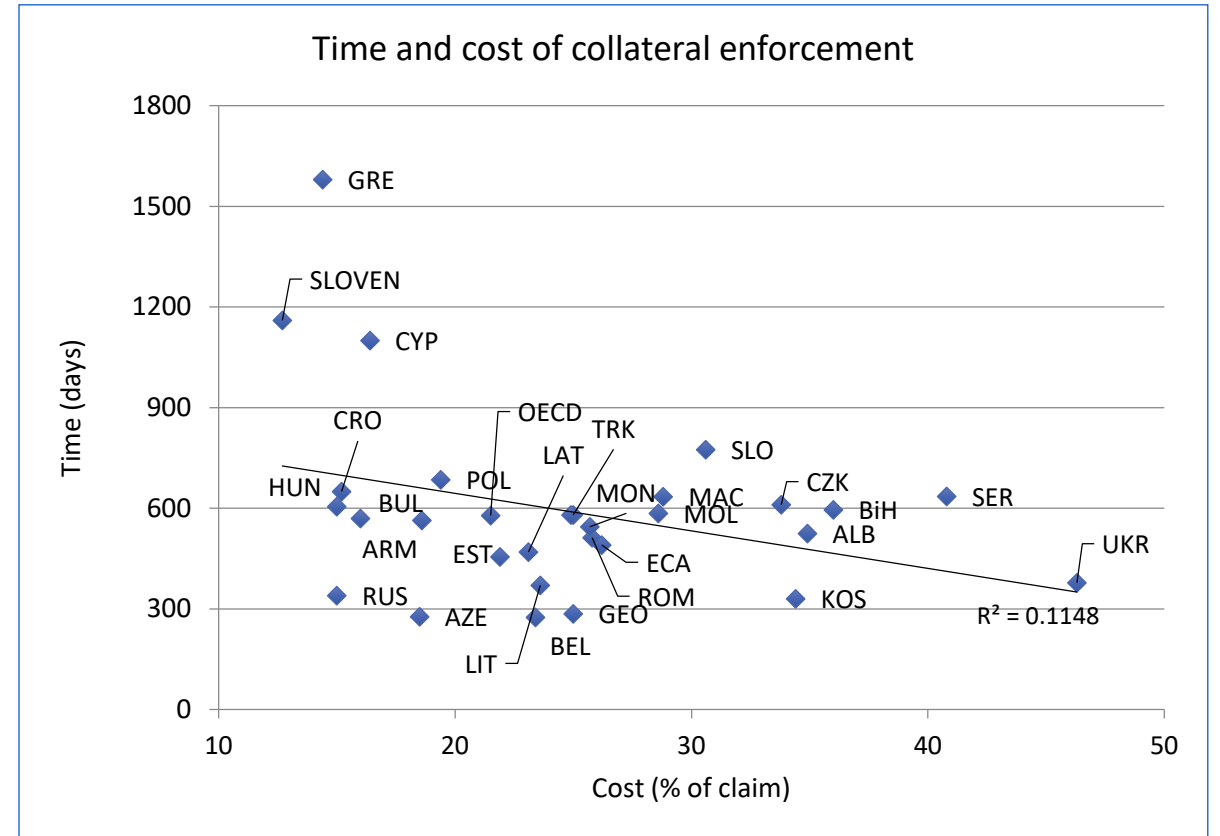
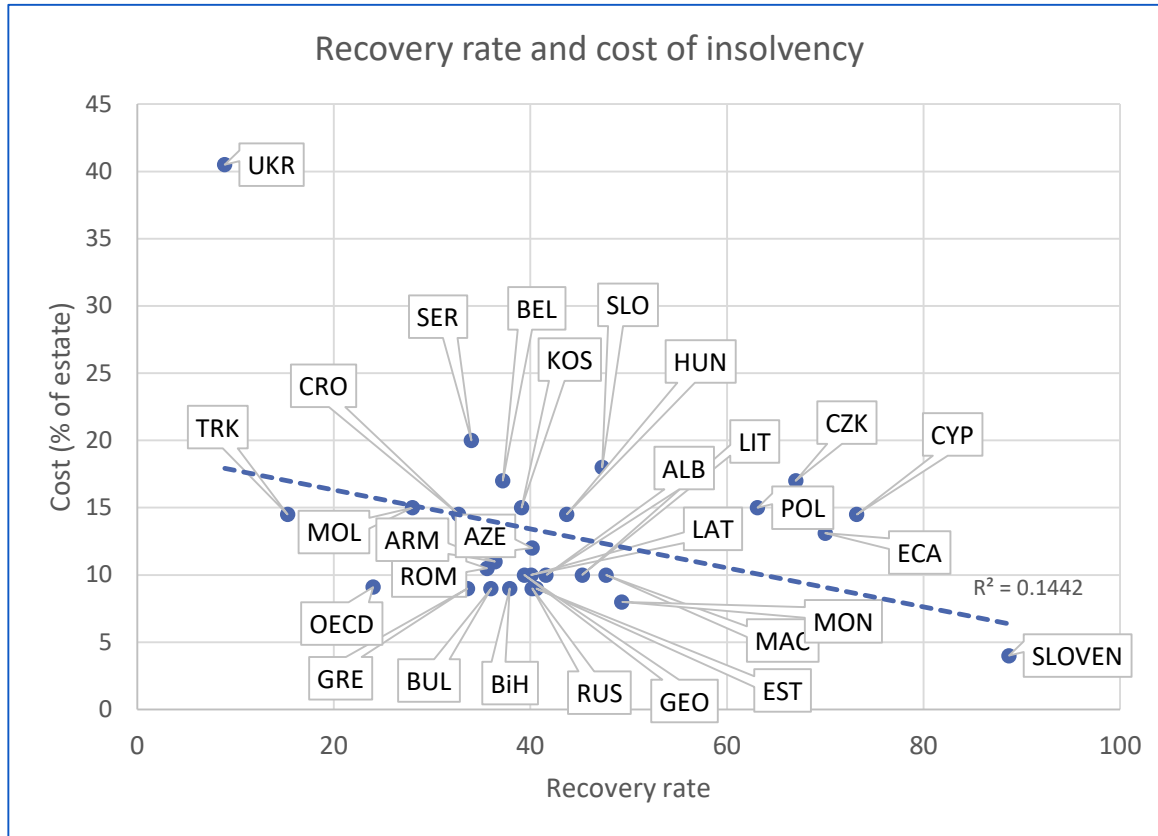


Option	Country X	Country Y
Restructure	81,215	80,673
Loan Sale	82,500	73,500
Enforcement	54,881	34,673
Insolvency	61,955	8,584

Source: FinSAC calculations, based on the World Bank Doing Business index data 2017

- Options for NPL resolution should be considered on NPV basis
- In countries with high interest rates, time value is very important
- Insolvency is almost not an option in country Y
- Calibration of discount rate is a very sensitive issue

Enabling environment for NPLs matters

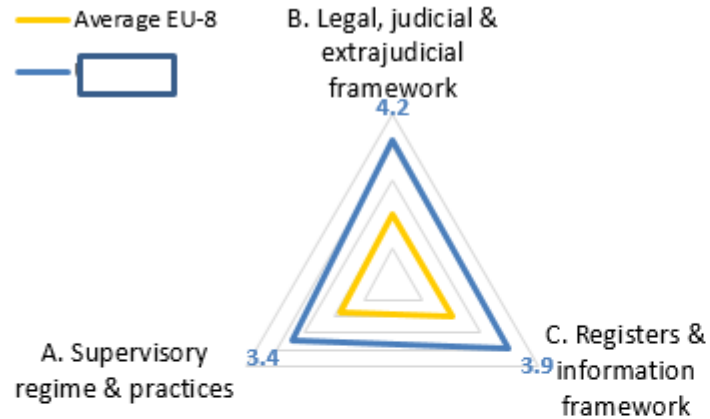


Source: FinSAC calculations, based on the World Bank Doing Business index data 2018

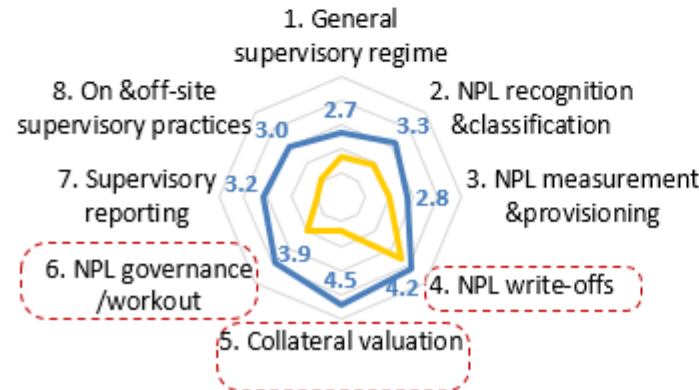
An example of a country assessment

- The assessment was based on the 3 pillar approach and 17 areas were analysed
- In this specific case, 11 areas were identified with negative scores above 3.5 (circled with red)
- Priority status of recommended improvements was assigned to these areas

NPL framework assessment



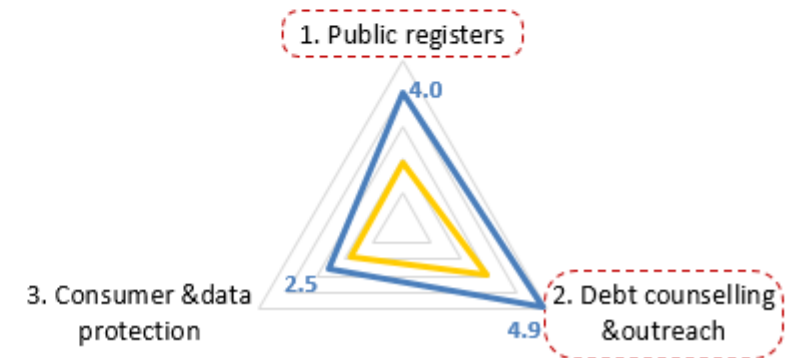
A. Supervisory regime & practices



B. Legal, judicial & extrajudicial



C. Registers & information framework





Many thanks for your attention!

Karlis Bauze

FinSAC web site: <http://www.worldbank.org/en/programs/financial-sector-advisory-center#1>

NPL Initiative under Vienna Initiative: <http://npl.vienna-initiative.com/>