FinSAC NPL Resolution Conference

NPL RESOLUTION STRATEGY

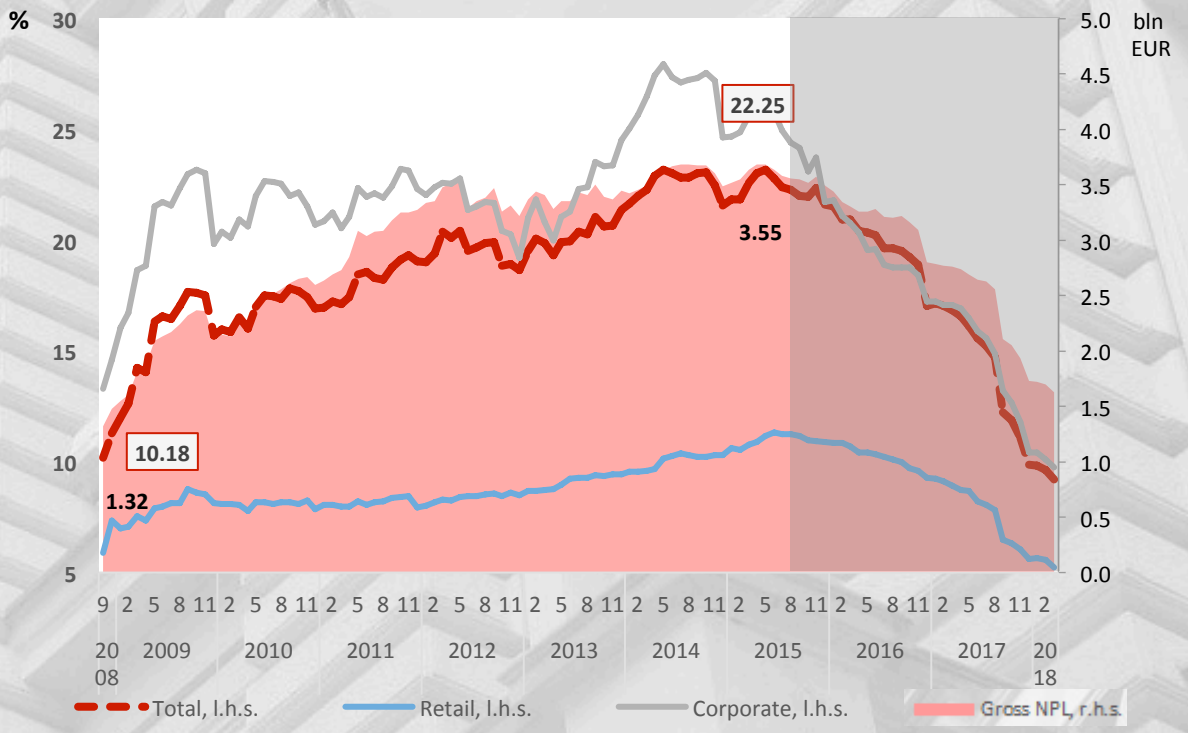
- LESSONS LEARNED FROM THE NPL WORKING GROUP IN SERBIA -

Vienna, May 2018

Evolution of NPLs in the Republic of Serbia (1)

- NPL definition in line with IMF methodology was introduced in autumn 2008, together with regular monthly reporting
- Since then we evidenced persistent upward trend, both, in the level and in the share of NPLs

Graph 1. **NPL trend before the addoption of NPL Strategy (bln EUR, %)**

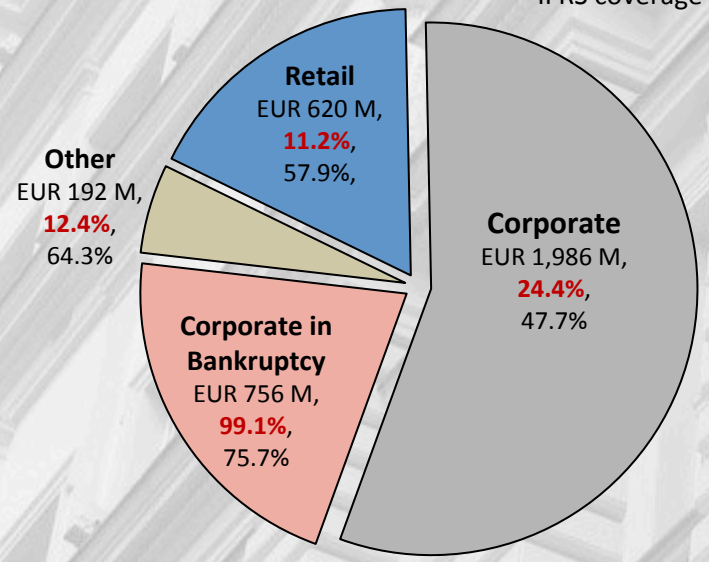


Evolution of NPLs in the Republic of Serbia (2)

Corporate sector accounted for the largest share of NPLs (56%), especially those engaged in manufacturing, trade, construction and real estate, as well as legal entities in the bankruptcy procedure (21%)

Graph 2. **NPL structure before the addoption of NPL Strategy**
Gross NPL in million EUR,
NPL ratio in %,
IFRS coverage in %

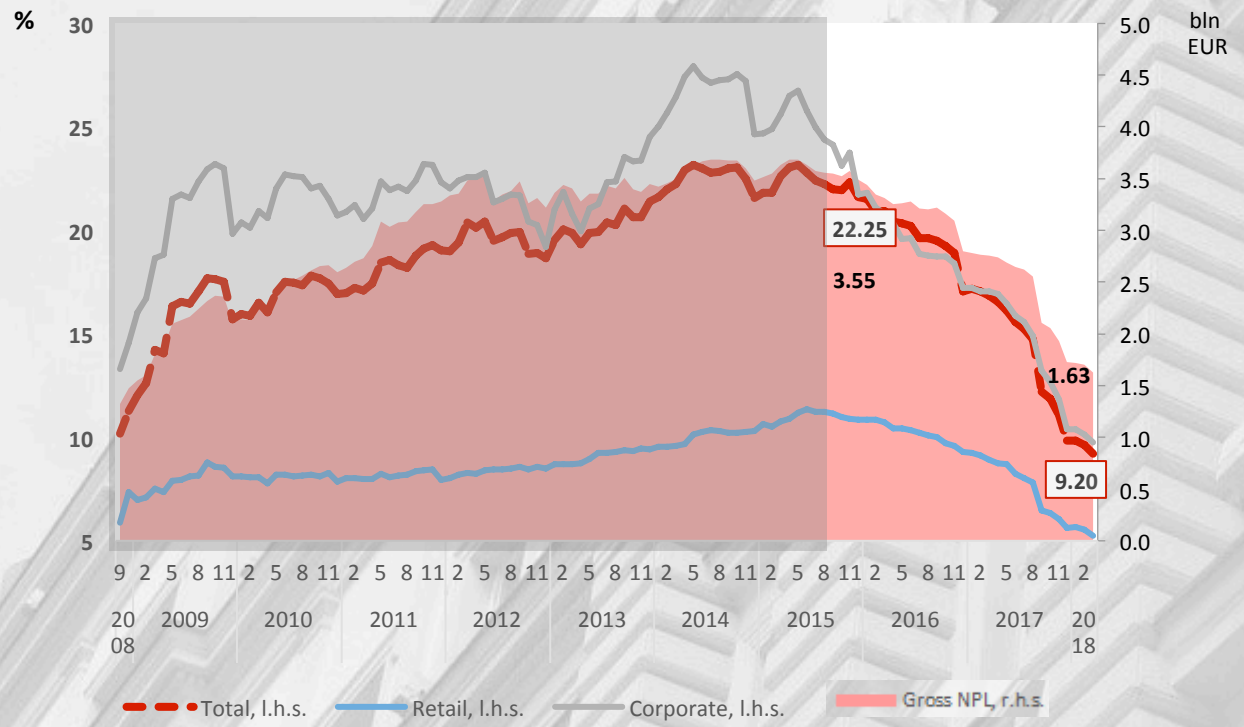
Total
EUR 3,554 M,
22.2%,
56.3%



Manufacturing EUR 658 M, **24.7 %**, 47.0%
Trade EUR 527 M, **24.6%**, 55.1%
Construction, EUR 341 M, **49.8%**, 45.5%
Real Estate, EUR 246 M, **38.2%**, 42.1%
Other, EUR 213 M, **10.7%**, 42.1%

Evolution of NPLs in the Republic of Serbia (3)

Graph 3. **NPL trend after the addoption of NPL Strategy (bln EUR, %)**

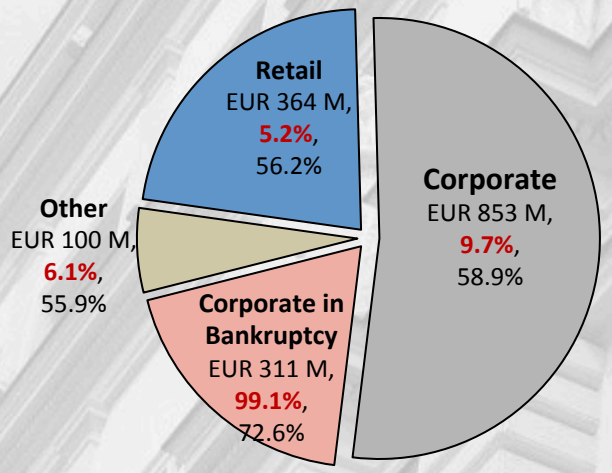


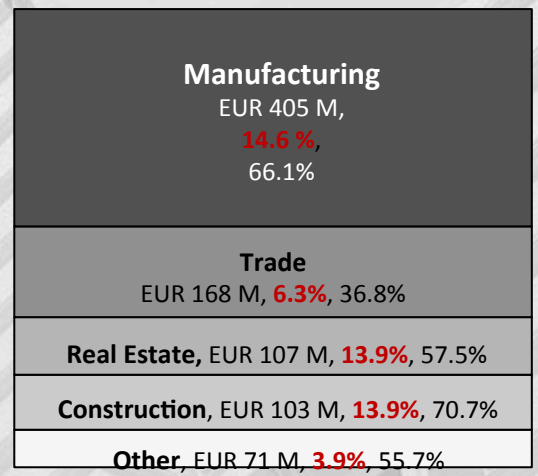
- After the adoption of NPL strategy, the trend has changed in opposite direction, with gaining momentum
- At the end of 2017, first time ever single digit NPL ratio was reported - 9.8%, which was more than two times lower than at time of the Strategy adoption. At the end of Q1 2018 it was even lower - 9.2%

Evolution of NPLs in the Republic of Serbia (4)

Graph 4. **NPL structure as of 31 March, 2018**
Gross NPL in million EUR,
NPL ratio in %,
IFRS coverage in %

Total
EUR 1,629 M,
9.2%,
60.8%





More than halved NPL level and ratio in all segments of the portfolio!

How we did it?

NBS Action Plan (1)

Banking supervision

Enhancement of regulatory treatment of restructured receivables and restructuring process

- ✓ The NBS adopted the Decision amending Decision on the classification of balance sheet assets and off balance sheet items amending definition and treatment of the restructured receivables taking into account definitions and treatment of the forborne receivables as envisaged by the EBA

Enhancement of procedures and distressed asset management

- ✓ The NBS adopted the Decision amending Decision on Risk Management by Banks introducing the concept of bad assets and prescribing the management of bad assets

Accounting standards and practices

Enhancement of IAS 39 implementation

- ✓ The Supervisory Guidelines for Application of IAS 39 regarding impairment provisioning has been published

Strengthening the capacities

- ✓ Action Plan for Strengthening the Capacity of the Bank Supervision Department in the area of IFRS has been prepared
- ✓ Educational programs, seminars, cooperation with international institutions

Improvement of NPL reporting requirements

- ✓ The NBS adopted the Decision amending the Decision on Reporting Requirements for Banks, in order to improve reporting on non-performing loans

NBS Action Plan (2)

Disclosure requirements for banks

Enhancement of disclosure by banks regarding information on asset quality

✓ Guidelines on disclosure of asset quality data and information by banks have been published.

NPL market

Identification and addressing obstacles to the Serbian distressed debt market and analyzing the possibilities and obstacles for liberalization of the assignment of retail receivables

✓ The Report on Possibilities and Obstacles for Liberalization of the Assignment of Retail Receivables and Other Issues under the National bank of Serbia's Competence Important for NPL market has been prepared.

✓ The Decision amending Decision on Risk Management by Banks has been adopted extending the scope of receivables from legal entities that can be assigned to another legal entities

NBS Action Plan (3)

Collateral valuation

Development of a database on real estate collateral valuations

- ✓ the Decision on Submission of Data on Valuation of Mortgaged Real Estate and Loans Secured by Mortgage was adopted as well as electronic instruction on exchange of data between banks and the NBS

Strengthen supervisory requirements on the treatment of collateral

- ✓ The Report on Possibilities for Strengthening Supervisory Requirements on Treatment of Real Estate taken by Banks as Collateral has been prepared
- ✓ The Decision amending Decision on Risk Management by Banks has been adopted introducing the stipulations related to enhancement of collateral management in banks

NBS additional steps

Although NBS conducted all activities envisaged by its Action Plan, NBS continues to enhance the banks' capacities to resolve NPLs

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In August 2017 the NBS adopted *Decision on the accounting write-off of bank balance sheet assets* which entered into the force on September 30, 2017.

⇩

In December 2017, in order to additionaly reduce the level of NPLs in Serbian banking sector the NBS sent recommendations regarding the level of NPLs to all banks.

✓ According this decision, banks are obliged on direct write-off of NPLs which are fully impaired

✓ The purpose of introducing the obligatory accounting write-offs is that banks do not retain in their balance sheets loans they have estimated that they will not be able to collect them, but not to give up on their collection.

The main focus of these recommendations were:

✓ Adequate implementation of all internal acts of banks related to the management of NPLs;

✓ Adoption of precise action plan on reducing NPLs;

✓ Reports on the fulfillment of the action plan on monthly/ quarterly basis (the bank is obliged to notify the NBS on a monthly basis if the NPL ratio is above 10% and quarterly if it is in range of 5% to 10%).

NBS further steps

- ✓In the coming period, the supervisor's activities will be aimed at monitoring the steps banks are undertaking, namely it's acting in accordance with adopted operational plans - mentioned should ensure in comprehensive manner continuous commitment and focused approach by banks to resolve the NPLs, while having the regulatory instruments implemented in such way to ensure timely reaction by the National bank of Serbia;
- ✓Taking in account specificities of the domestic market and carefully considering activities of EU bodies and institutions in this field, NBS will continue to make regulatory efforts on NPL resolution.

NOTE: Republic of Serbia has chosen market approach for NPLs resolution which means the absence of government involvement for one-off resolution of the problem and point out on readiness of competent authorities to establish the system and environment that will prevent the accumulation of NPLs and provide the adequate solution, sustainable in a long run.

NPL Strategy Goals

1) Improve banks' capacity for dealing with NPLs,
2) Enabling conditions for NPLs market development,
3) Improving and promoting out-of-court debt restructuring,
4) Improving in-court debt resolution and mortgage framework.

1. Improve Banks' Capacity for Dealing with NPLs

Sub-area	Key issues	Achieved Results
Collateral Valuation	Improve regulation of real estate valuers.	New Law on Real Estate Appraisers was put into effect from the 5th of June 2017.
	Improve accuracy of real estate valuation.	Professional Board (regulatory body for real estate appraisers) was formed and National Valuation Standards were adopted in 2017.

2. Enabling conditions for NPLs market development

Sub-area	Key issues	Achieved Results
Tax incentives.	Recognition of banks' loans write offs as expenditure for tax purposes.	Corporate and Personal Income Tax Laws were amended twice (at the end of 2015 and 2017).
Resolve existing problem of sale of NPLs in the course of a litigation procedure.	To grant unconditional right to the new creditor (NPL acquirer) to take over an ongoing dispute without additional consent from the counterparty.	Amendments to the Civil Litigation Law are expected to be adopted by the end of H1 2018.
More efficient resolution of Deposit Insurance Agency (DIA) managed NPL portfolios.	DIA institutional capacity building.	Strategic and Annual Operational Plans for NPLs portfolio management were adopted and internal capacities developed.

2. Enabling conditions for NPLs market development

Sub-area	Key issues	Achieved Results
Analysis of the all obstacles to the transfer of NPLs (legal, regulatory, accounting etc.) to ensure that reform is comprehensive.	Conduct a detailed assessment of all obstacles to the sale of NPLs and the establishment and operation of AMCs or other SPVs used for such purposes.	Study “Analysis of the existing impediments to the sale of NPLs in Serbia”, was prepared by EBRD&KPMG and published at the end of 2016.

3. Improving and promoting out-of-court debt restructuring

Sub-area	Key issues	Achieved Results
Improving the Consensual Financial Restructuring legal framework.	To simplify the existing CFR procedure, allow for entrepreneurs to apply and improve the framework for mediators' participation.	Amendments to the CFR Law were adopted at the end of 2015.
Promoting out-of-court debt restructuring.	Strengthen support provided by the Serbian Chamber of Commerce to SMEs and entrepreneurs in the preparation of viable restructuring plans and further negotiation with their financial creditors.	Several workshops were held with the assistance of the EBRD&IFC. Template structure of CFR plan was published on the website of the SCC. From 2012 - 37,3 mil EUR of concluded Contracts on CFR.

3. Improving and promoting out-of-court debt restructuring

Sub-area	Key issues	Achieved Results
Improve efficiency of state owned creditors in restructurings (Development Fund - DF, Export Credit Agency – ECA and Tax Office).	Conduct feasibility analysis and propose relevant changes in regulations and/or instructions for internal restructurings of the Tax Office, DF and ECA. Develop formal internal policies for CFR and out-of-court financial restructuring participation for DF and ECA.	Diagnostic Study of DF and ECA was prepared by the consultant. DF actively involved in the process of approving CFRs, ECA has internal policies for CFR and out of court restructuring.

4. Improving in court debt resolution and mortgage framework

Sub-area	Key issues	Achieved Results
Improve efficiency of corporate and entrepreneurial debt enforcement.	To achieve a balance between the speed of procedure and the harmonization of the court practice, while accelerating proceedings and removing uncertainties which emerged in practice.	Law on Enforcement came into force on July 1st, 2016, all necessary by laws have been adopted. The Authentic Interpretation of the Article 48. of the Law on Enforcement was adopted on 14th of December.

4. Improving in court debt resolution and mortgage framework

Sub-area	Key issues	Achieved Results
Improving insolvency regulatory framework.	Shortening the bankruptcy procedure and improving secured creditors' position.	Amendments to the Bankruptcy Law were adopted on 14th of December 2017.
Improve performance and accountability of bankruptcy administrators.	Increase capacities of Bankruptcy Supervision Agency – BSA. Revision of administrator's fees in order to incentivize timely sale of assets or business entity and providing more choice to creditors in selecting bankruptcy administrators.	Center for control and development of the profession has been established in the BSA. Working Group for the preparation of Rules on Remuneration and other by-laws was formed in January 2018.

4. Improving in court debt resolution and mortgage framework

Sub-area	Key issues	Achieved Results
Enhance bankruptcy courts' handling of bankruptcy sales, prepackaged and bankruptcy reorganization plans and related procedures.	Enhance bankruptcy courts' handling of bankruptcy sales, prepackaged and bankruptcy reorganization plans and related procedures.	The Judicial Academy organized and realized trainings during 2017 for all judges in Serbian commercial courts on the subject of application of the Bankruptcy Law.
Consider development of personal bankruptcy legal framework.	Conduct a study on the options for bankruptcy of private individuals, with peer countries review.	The Study should be finished by the end of H1 2018.

4. Improving in court debt resolution and mortgage framework

Sub-area	Key issues	Achieved Results
Remove impediments for efficient functioning of mortgage framework.	Allow the buyer of a collateral property out-of-court to purchase it free of lower ranked liens, but provide sufficient protection of lower ranked mortgage creditors.	Amendments to the Law on Mortgages adopted during 2015.
	Create a functional second-instance decision process for land registry case files.	New internal organization was adopted and new Law on Republic Geodetic Institute procedure was prepared.
	Identify specific land registry branches of the Real Estate Cadaster with high backlog of case files and improve their efficiency.	Backlog of appeals is still an issue but it is planned to be resolved by the 2020.

THANK YOU FOR YOUR ATTENTION!

Q&A