

# Non-Performing Loans: lessons learned - and challenges ahead

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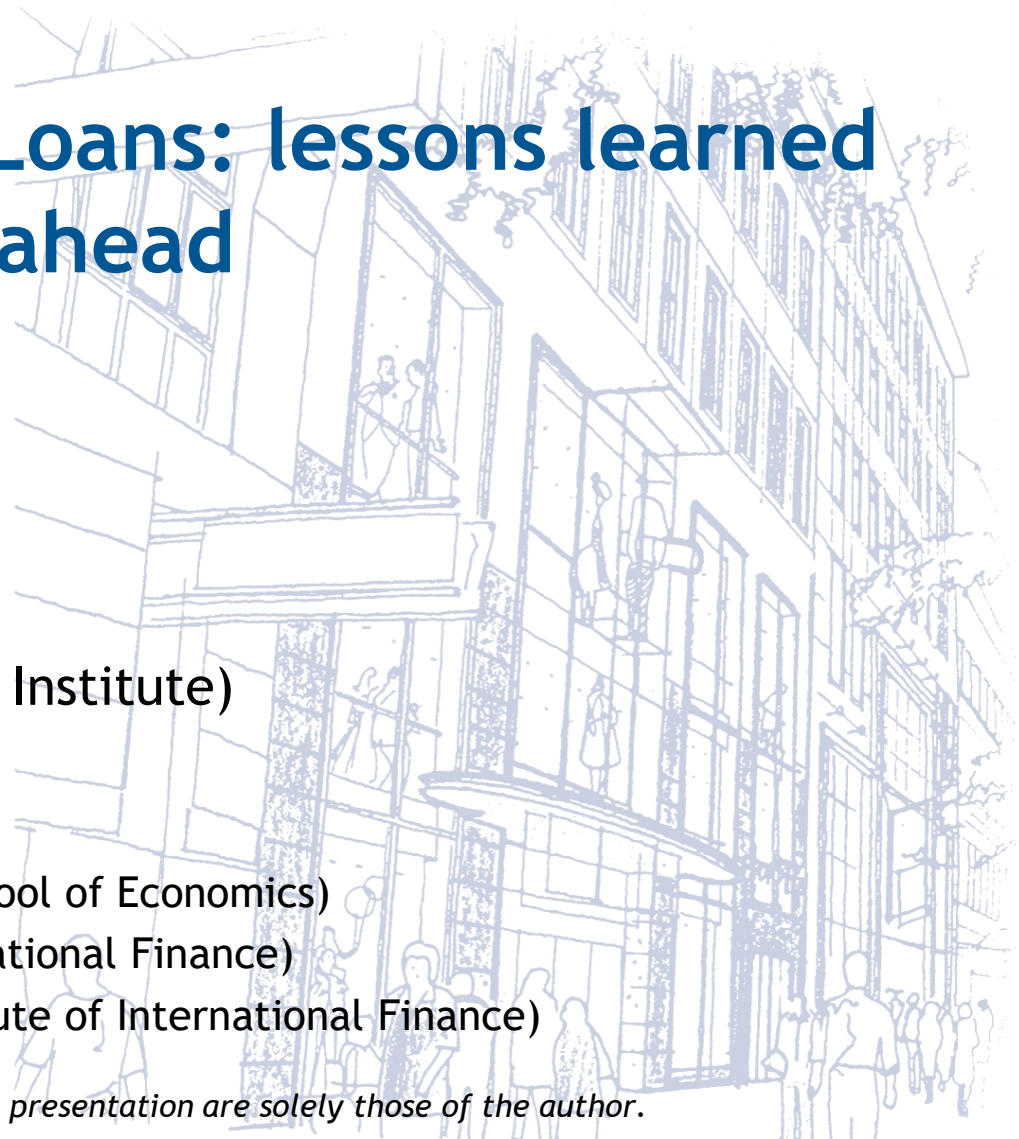
Based on joint work with

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**Elina Ribakova (Institute of International Finance)**

**Jonathan M. Fortun Vargas (Institute of International Finance)**

*The views expressed in this presentation are solely those of the author.*

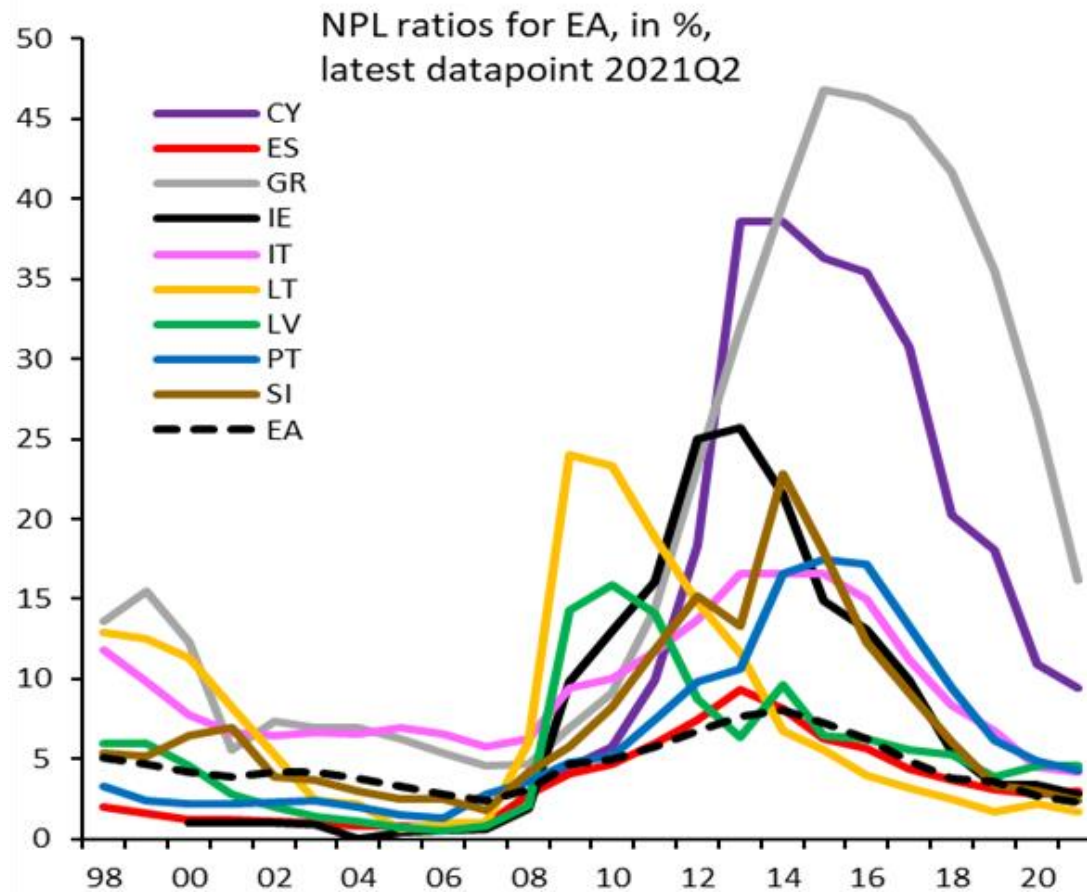


# Outline

**1. Key lessons from previous crises**

**2. Challenges and policy proposals**

# Europe went through an NPL surge pre-COVID



Source: IMF

# NPL resolution curbed by multiple impediments

## Supply Side

- First mover disadvantage
- Unwillingness to realize losses
- Accounting recognition of cost of recovery
- Bans/restrictions on loan sales
- Lack of expertise in asset management and asset valuation

## Demand Side

- Information asymmetries
- Barriers to investor entry
- Imperfect excludability: creditors compete with each other

## Structural & Legal Issues

- Weak and unpredictable insolvency frameworks
- Opaque and lengthy collateral enforcement
- Lack of debt enforcement capacity

# Different problems require different solutions

- Country-specific conditions determine the right combination of NPL solutions
- Resolution by banks always part of the solution mix
- Market-based solutions often suffer from market failures - also in the euro area at the beginning of the last NPL wave

|                  |                   | APS | Public AMCs | Securitization | Direct Sales | Debt Restructure | Out-of-Court Workout |
|------------------|-------------------|-----|-------------|----------------|--------------|------------------|----------------------|
| Nature of shock  | Slow growth       |     |             | √              |              | √                | √                    |
|                  | Crisis            | √   | √           | √              | √            | √                | √                    |
| Asset types      | Mortgages         |     |             | √              |              | √                |                      |
|                  | SME loans         |     | √           | √              | √            | √                | √                    |
|                  | Large corp. loans |     | √           |                | √            |                  | √                    |
|                  | Unsecured loan    |     | √           | √              | √            | √                |                      |
| Fiscal space     | Limited           | √   | √           | √              | √            | √                |                      |
| Legal constraint | Strong            |     |             |                |              |                  | √                    |

## COVID NPLs: “This time *was / is* different”\*

- Banks in Europe better prepared (e.g. higher capitalisation / loan loss provisioning)
- Much better understanding of NPL management and resolution approaches
- “Whatever-it-takes” policy mix with “European characteristics”:
  - ✓ Massive anti-cyclical policy mix that integrated also macroprudential/regulatory policies in a systemic way
  - ✓ ECB’s monetary policy easing
  - ✓ EU-level easing: suspension of the fiscal, state aid and competition rules
- More willingness to support the banks; crisis didn’t originate from the financial sector

\* Based on R. Martin, Nagy-Mohacsi, P., Ribakova E., Fortun-Vargas, J. M. (2022), The COVID Non-Performing Loan ‘Tsunami’ that Never Happened and How to Avoid it Now, SUERF Policy Brief No. 276, February

# Outline

**1. Key lessons from previous crises**

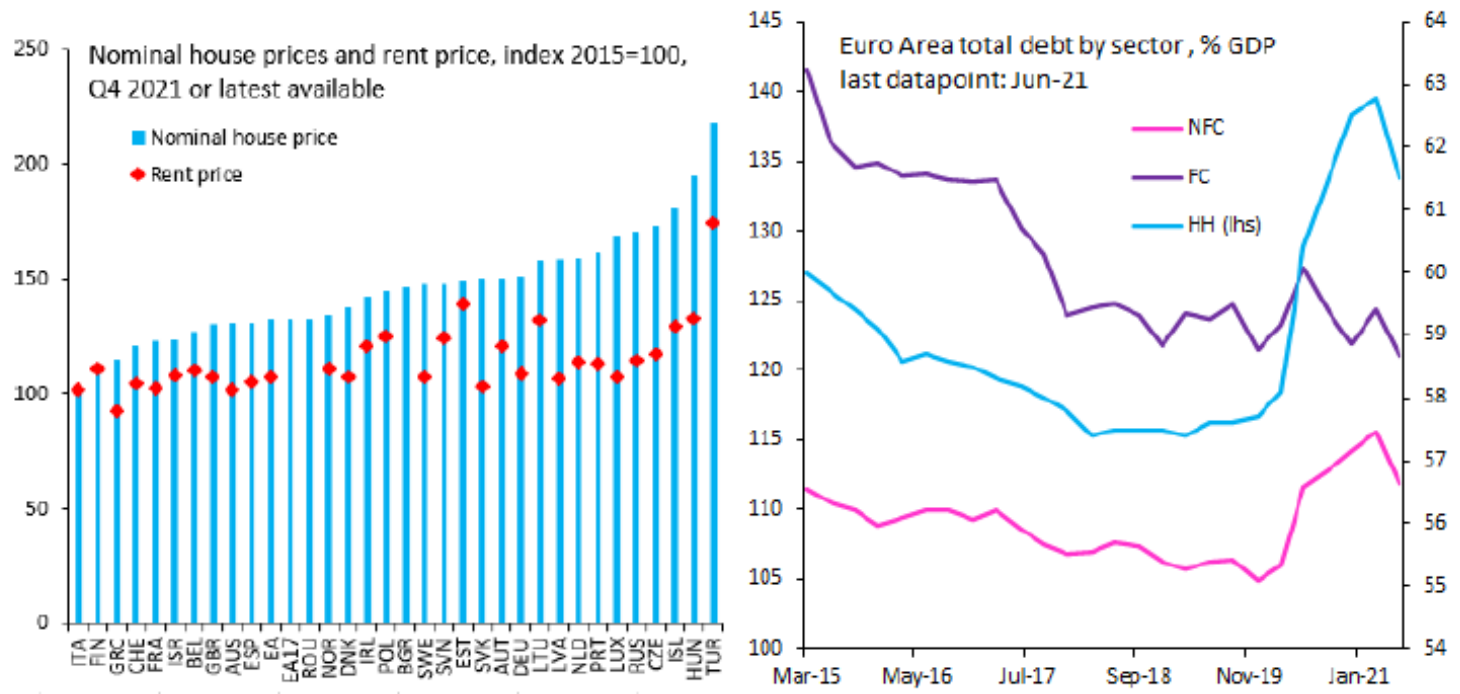
**2. Challenges and policy proposals**

## NPLs: challenges going forward

- ‘Legacy NPLs’ (in some countries)
- Unwinding of remaining COVID support measures
- Economic impact of the war in Ukraine(!):
  - ✓ Trade disruptions - goods and services (including e.g. tourism)
  - ✓ Energy and food price increases
- Inflation and the end of the long period of (highly) accommodative monetary policy
- Overvalued asset prices (including in real estate)
- Increased indebtedness




# Housing prices & private sector indebtedness



Source: OECD data.

## Policy proposals

- **Key lesson of the last NPL wave is that speed is of the essence when dealing with strong NPL increases**  
 **Need to close remaining gaps in ‘NPL infrastructure’**
- **Review loan enforcement regimes and insolvency frameworks**
- **Remove remaining obstacles to the functioning of secondary NPL markets, incl. the use of NPL securitization schemes**
- **Review and revise EU regulatory framework to make Asset Management Companies (AMCs) a realistic NPL resolution again**
- **Reconsider AMCs at the EU level, in case of a substantial increase in NPLs.**

## Success factors for systemic AMCs

- **AMCs have a strong track** - if properly designed and managed!
- **Normally don't require large start-up costs**; publicly owned AMCs are, however, (contingent) liabilities
- **Key determinants for AMC success**
  - *Appropriate transfer prices; key to avoid moral hazard problems*
  - *Asset selection; CRE and property development particularly suitable; corporate loans also suitable*
  - *Operational independence and professional management!*
- **AMCs in Asia often seen as part of 'crisis infrastructure'**; complement to ELA, Deposit Guarantee Fund etc.

**Thank you!**

