National Bank of Ukraine

The NPL situation in Ukraine

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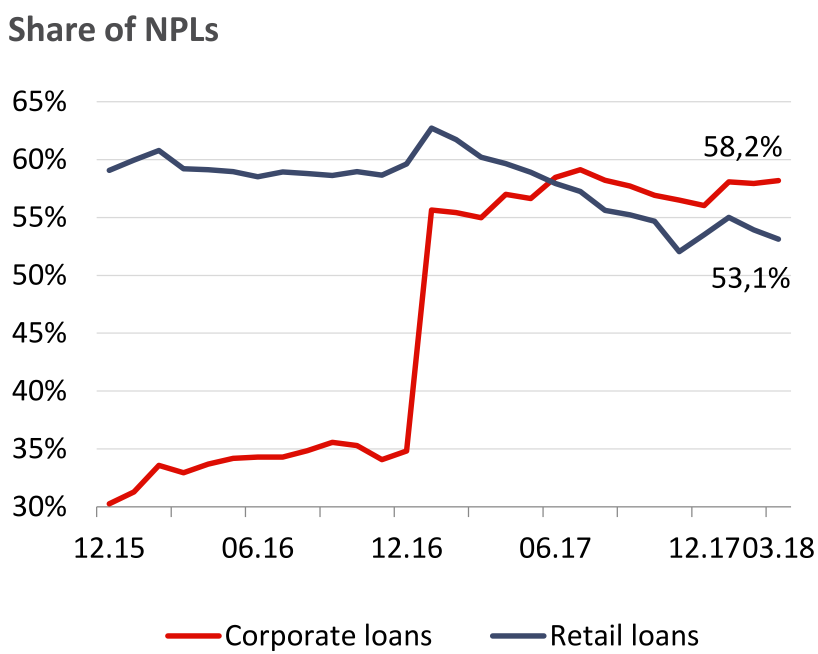
NPLs – one of systemic risks to banking sector

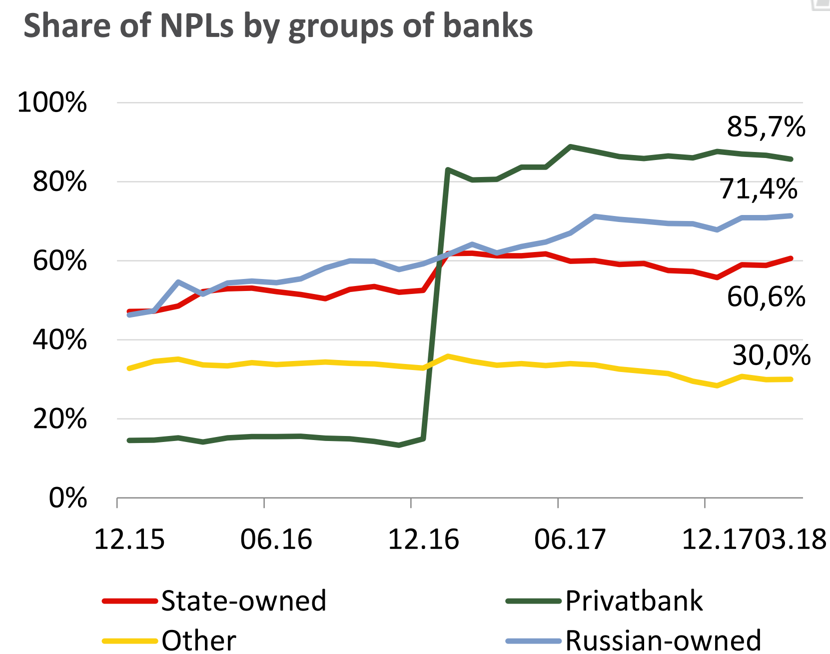
Three key systemic risks for Ukraine's financial sector remain as highlighted in NBU's Financial stability report:

- Extensive presence of government in the banking sector, weak operational efficiency and inadequate credit risk management at state-owned banks.
- High NPL stock.
- Insufficient creditor protection.

The progress with NPL resolution has been unimpressive so far and NBU don't expect a material improvement in the next 12-18 month.

NPLs continue hovering above 50%



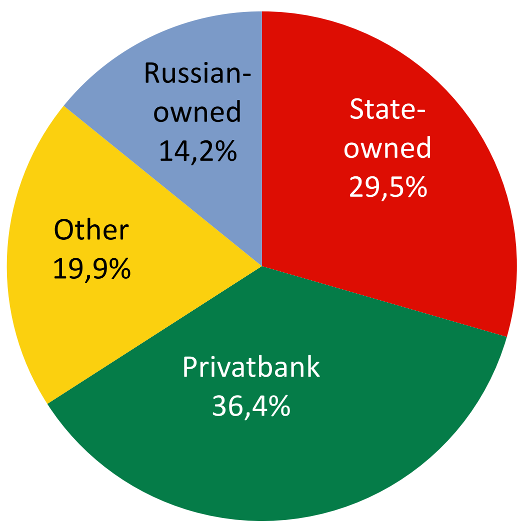


Source: NBU

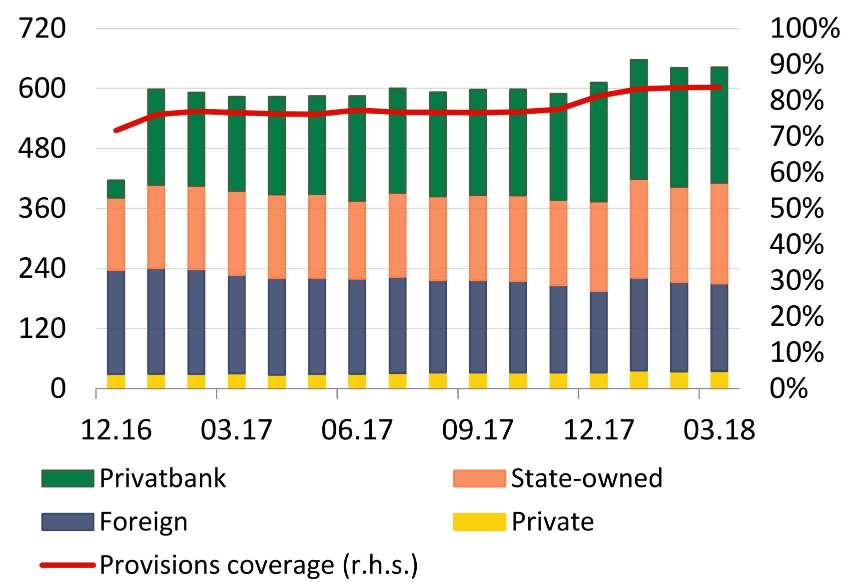
- The share of non-performing loans is decreasing due to growth in the loan portfolio…
- … but no improvement in money terms: USD 24 bln (equiv) of NPLs remain in the banking sector.
- State-owned banks have the worst loan quality. Workout of NPLs at state-owned banks is not efficient.
- At private banks and banks of international groups NPL share is high, but not critical.

Most of the NPL stock is with the state banks

Non-performing loans by bank groups as of 01.04.18



Non-performing exposures and provisions, UAH billion

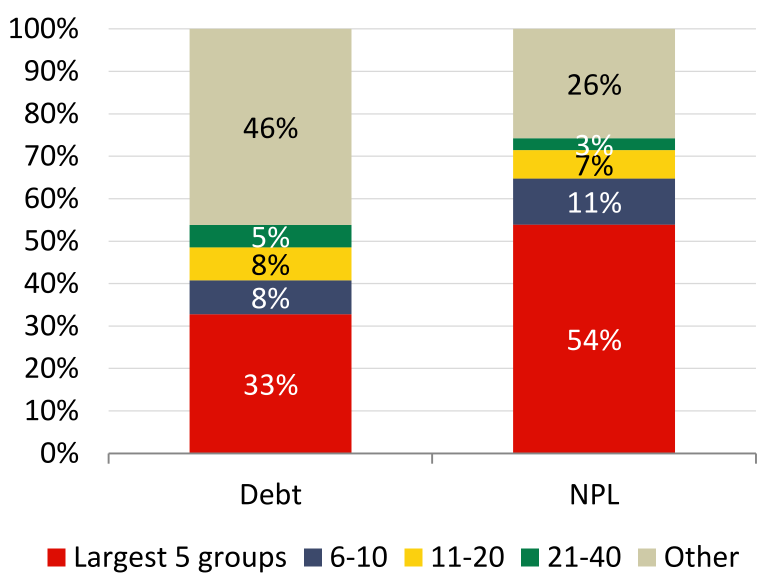


Source: NBU

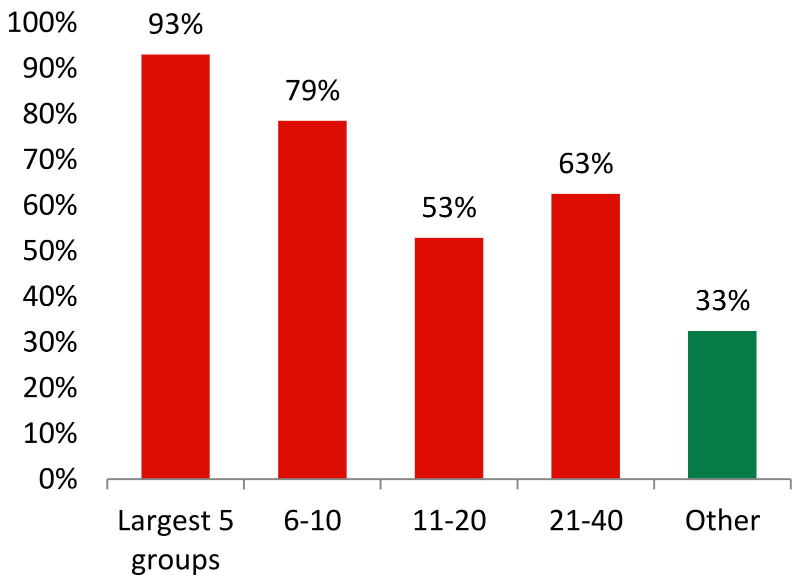
- Two thirds of total NPLs are with the state banks, most of those are legacy loans issued years ago
- The vast majority of NPLs have already been recognized and properly provisioned

Concentration risk fully materialized during the crisis

Loan and NPL structure, Mar. 2018



NPLs as % of banks' exposure to the largest business groups, Mar. 2018



Source: NBU

- The weak payment discipline is specific to large business groups: more than 90% of loans to the top-5 business groups are NPLs, far higher than the system average.
- Going forward, the NBU will be vigilant in monitoring high concentration risks in the banking sector.

Regulatory treatment of restructurings is very favorable

Restructurings are a fact of life due to huge borrower losses following macroeconomic shock and military conflict in eastern territories. Given this, NBU maintains very favorable treatment of restructured loans:

- in case of a viable restructuring (even if restructuring was necessitated by borrower's financial difficulties) bank can take a decision not to assign a default status to a borrower.

- cure period for defaulted loans (if a default status assigned following a restructuring) is just 6 months

If a restructuring is implemented under financial (out-of-court) restructuring law, default is not recognized even if:

- debt is partially written off;
- overdue interest payments (more than 90 days) are capitalized;
- debt converted to equity.

According to recent changes to the NBU regulations, NPLs can be lifted to performing categories immediately if restructuring happens based on "Kyiv approach".

Overcoming obstacles and creating incentives for NPL resolution

Already done:

- NPL definition brought in line with international practice since early 2017, banks were forced to show real asset quality following NBU diagnostics study. As a result NPL statistics is currently reliable and widely available.
- Favorable regulatory regime for loan restructurings introduced.
- Launch of the centralized Credit Registry operated by NBU.
- The bulk of tax impediments to NPL write-offs removed.
- Financial restructuring law (Kyiv approach) has been operational for more than one year.

To be done:

- Adoption of the Law on Debt Management Activities (Про діяльність з управління заборгованістю).
- Adoption of NBU resolution that sets a framework for NPL management and recovery by banks (a local version of the EBA's «Guidance to banks on non-performing loans»).
- Incorporation of Credit Registry data into loan underwriting practices and risk assessment by banks (obligatory loan downgrade if a borrower is not current on loans at other banks).
- New bankruptcy legislation.
- Continuation of the judicial system reform.