EBCI Vienna Initiative

NPL Monitor for the CESEE

1H 2016

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At June-2015 stocks of NPLs in the 18 economies of Central, Eastern and South Eastern Europe ("CESEE")[2] remained high at €57.4 Bn, which is equivalent to about 5.5% of GDP or 7.2% of gross loans.[3] These figures exclude Cyprus, Greece and Ukraine which would add a further €130.4 Bn to this total. The gradual economic recovery in the CESEE, and efforts by banks to tighten lending practices, has contributed to a slowdown in the generation of new NPLs. In addition, some regulatory measures have allowed banks to start the long process of NPL restructuring and resolution, with notable successes for instance in Romania. Over €5.8 Bn of NPL sales were recorded in the 18 months to end-2015 in the CESEE countries, albeit concentrated in only a handful of countries (Romania, Poland, Hungary and Slovenia).

1. NPL EVOLUTION IN THE CESEE

Growth of NPL volumes has decreased in the CESEE in the year to June 2015

- The region observed an overall slowdown in the pace of NPL growth. Nearly 13 out of 18 countries recorded a drop in NPLs volumes year on year in the year to June 2015.
- The total volume of NPLs in the CESEE has effectively decreased by €8.3 Bn over the period (-12.6%).
- Over 95% of this total volume reduction has been recorded in 3 countries alone, i.e. Romania (€3.5 Bn; a drop by 36.9%), Hungary (€2.5 Bn; -29.6%) and Slovenia (€1.9 Bn; -34.6%).
- A large portion of reductions in the volumes can be explained by the spur in NPL transactions as well as by the pressure regulators have put on banks for adequate provisioning and subsequent write-offs (e.g. Romania, Albania), as the growth in new NPLs slowed.

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[1] *All views presented here are the author's views only. For more details, please contact NPL@ebrd.com*

[2] *We classify the 18 economies, comprising the EBRD country groups of central Europe and the Baltics (CEB), and south-eastern Europe (SEE), collectively as central and south-eastern Europe (CESEE), and wherever appropriate separately list figures for Cyprus, Greece and Ukraine. Please refer to Table 1 for the detailed list of countries.*

[3] *We classify the 18 economies comprising the EBRD country groups of central Europe and the Baltics (CEB), and southeastern Europe (SEE) collectively as central and southeastern Europe (CESEE), and wherever appropriate will separately list figures for Ukraine, Greece and Cyprus.*

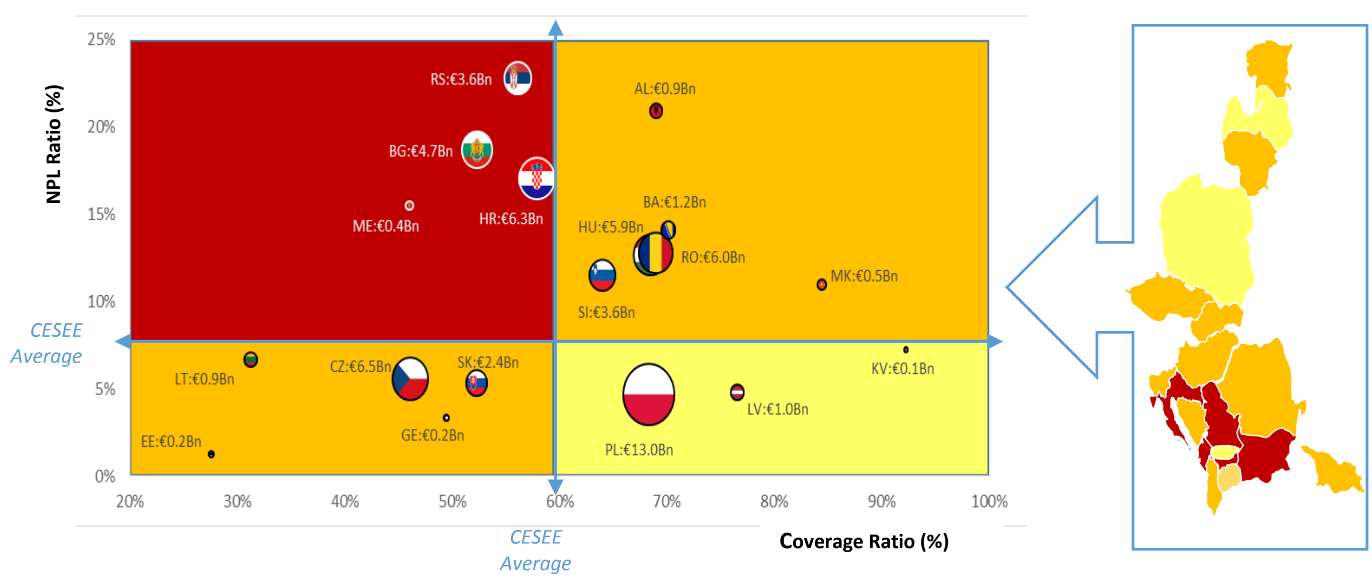
NPL ratios have decreased for most countries in the region

- The NPL ratios have also improved, reaching an average NPL ratio for the CESEE of 7.2%, a decrease of 2.1% (from 9.3% in June 2014). There remains a wide dispersion in ratios, with Albania, Serbia and Bulgaria showing the highest vulnerability.
- 15 of the 18 countries included in the analysis have seen a decrease in NPL ratios in the year to mid-2015.
- The other three countries saw only minor increases: Bulgaria (+ 1%), Croatia (+ 0.7%) and Slovakia (+ 0.1%). These three countries hold nearly 23% of all NPLs in the region while their share of total gross loans in the region is less than 15%.

NPL coverage ratios have on average improved during the period

- The coverage of NPL stocks with loan loss provisions has also improved over the period, albeit only modestly (+ 2.2% y-o-y, reaching 61.5% in June 2015)[4].
- Countries such as Macedonia and Kosovo reveal the highest coverage, being above the 80% mark.
- Lithuania and Estonia demonstrate some of the lowest coverage of the region (31.2% and 27.5% respectively) but NPLs are already quite low (6.7% and 1.3% respectively), thus moderating risks.
- Figure 1 identifies Serbia, Croatia, Montenegro and Bulgaria as some of the most vulnerable countries with relatively high NPL ratios and low NPL coverage ratios than average.

Figure 1. NPL ratio, coverage ratio and volume (%, €b, June 2015)[5]



4 NPL coverage ratio for Montenegro is indicative and taken same as that for March 2015.
[5] Source: IMF Financial Soundness Indicators, Financial stability reports from the central banks of individual countries.

Table 1. Overview of the NPL profile of the CEE, 30 June 2014 to 30 June 2015

Country	NPL Volume (€ Bn)		NPL ratio[6,7] (%)		NPL Coverage ratio[8,9] (%)		Net NPL/ Capital[10]		Market share NPLs[11] (%)		Market share Loans [12] (%)	
	June 2015	Δ(%)[13]	June 2015	Δ(%)	June 2015	Δ(%)	June 2015	Δ(%)	June 2015	Δ(%)	June 2015	Δ(%)
Albania (AL)	0.9	▼ (8.4)	20.9	▼ (3.2)	69.0	▲ 2.7	30.8	▼ (9.7)	1.5	▲ 0.1	0.6	— 0.0
Bos. & Herz. (BA)	1.2	▼ (8.1)	14.1	▼ (1.4)	70.1	▲ 3.6	26.5	▼ (4.9)	2.0	▲ 0.1	1.1	— 0.0
Bulgaria (BG)[13]	4.7	▼ (4.9)	18.7	▲ 1.0	52.3	▲ 2.9	....	—	7.9	▲ 0.6	3.5	▼ (0.4)
Croatia (HR)	6.3	▲ 3.0	17.1	▲ 0.7	57.9	▲ 9.9	36.5	▼ (6.3)	10.8	▲ 1.3	5.1	— 0.0
Czech Rep. (CZ)	6.5	▲ 0.9	5.6	▼ (0.1)	46.1	▼ (1.0)	23.5	▲ 0.1	11.1	▲ 1.5	16.1	▲ 0.5
Estonia (EE)	0.2	▼ (3.2)	1.3	▼ (0.1)	27.5	▼ (2.2)	7.4	▲ 1.0	0.3	— 0.0	2.2	▲ 0.1
Georgia (GE)	0.2	▲ 21.4	3.3	▼ (0.2)	49.4	▼ (2.5)	7.1	▲ 1.1	0.3	▲ 0.1	0.8	▲ 0.2
Hungary (HU)	5.9	▼ (29.6)	12.7	▼ (3.6)	68.5	▲ 11.2	21.0	▼ (22.1)	10.0	▼ (2.4)	6.4	▼ (0.7)
Kosovo (KV)	0.1	▼ (6.2)	7.2	▼ (1.0)	92.3	▲ 3.3	3.1	▼ (2.8)	0.2	— 0.0	0.3	— 0.0
Latvia (LV)	1.0	▼ (12.4)	4.8	▼ (0.5)	76.5	▼ (1.2)	7.7	▼ (1.3)	2.4	— 0.0	4.1	▼ (0.2)
Lithuania (LT)	0.9	▼ (30.1)	6.7	▼ (3.2)	31.2	▲ 1.1	26.5	▼ (12.6)	0.4	▼ (0.1)	0.5	— 0.0
Macedonia (MK)	0.5	▲ 5.1	11.0	▼ (0.3)	84.4	▲ 5.7	10.0	▼ (3.3)	0.8	▲ 0.1	0.6	▲ 0.1
Montenegro (ME)	0.4	▼ (8.2)	15.5	▼ (1.4)	46.0	▲ 1.2	....	—	0.6	— 0.0	0.3	— 0.0
Poland (PL)	13.0	▼ (0.5)	4.7	▼ (0.2)	68.3	▼ (0.8)	11.7	▼ (0.7)	22.1	▲ 2.7	38.2	▲ 1.1
Romania (RO)	6.0	▼ (36.9)	12.8	▼ (6.4)	69.0	▲ 0.5	23.5	▲ 11.5	10.1	▼ (3.9)	6.4	▼ (0.4)
Slovakia (SK)	2.4	▲ 9.3	5.3	▲ 0.1	52.3	▲ 1.7	15.8	▲ 0.4	4.0	▲ 0.8	6.1	▲ 0.4
Serbia (RS)[14]	3.6	▼ (0.6)	22.8	▼ (0.2)	56.1	▲ 1.2	30.4	—	9.3	▲ 1.1	3.3	— 0.0
Slovenia (SI)	3.6	▼ (34.6)	11.5	▼ (3.8)	64.0	▲ 2.9	32.5	▼ (26.4)	6.1	▼ (2.1)	4.3	▼ (0.7)
CESEE	**57.4**	▼ **(12.6)**	**7.2**	▼ **(2.1)**	**61.5**	▲ **2.2**	**....**	— **....**	**100.0**	— **0.0**	**100.0**	— **0.0**
Greece	87.9	▲ 12.6	33.4	▼ (0.8)	65.6	▲ 15.2	136.5	▲ 22.5	...	— ...	...	— ...
Cyprus	28.6	▲ 1.4	44.7	▲ 0.6	33.1	▲ 3.1	272.2	▲ (38.9)	...	— ...	...	— ...
Ukraine	13.9	▲ 20.3	24.3	▲ 9.7	71.3	▲ 15.7	94.9	▲ 47.9	...	— ...	...	— ...
Grand Total	**188**	▲ **2.3**	**17**	▲ **0.2**	**59.9**	▲ **8.9**	**...**	— **...**	**...**	— **...**	**...**	— **...**

[6] *Source: IMF; Calculated as (NPL=Gross value of loans on which (1) payments of principal and interest is past due by 90 days or more, or (2) interest payments equal to 90 days interest or more have been capitalized, refinanced, or rolled over, and (3) loans less than 90 days past due, which are recognized as nonperforming under national supervisory guidance) divided by (The total value of the loan portfolio (including nonperforming loans, and before the deduction of specific loan loss provisions).*

[7] *NPL ratio data for Albania, Bulgaria, Montenegro and Serbia for June-2015 from the Financial Stability Reports published by the central banks. Montenegro defines NPLs as non-performing loans (without interests, and prepayments and accruals) divided by total loans. Serbia defines as gross non-performing loans divided by total gross loans. Albania has same definition as IMF. Bulgaria defines as the total amount of balance sheet loans exposures, which are restructured or non-performing past-due over 90 days (includes the categories non-performing exposures, loss and all restructured exposures as defined in the repealed BNB Ordinance No. 9 of 3 April 2008 on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for Credit Risk) divided by total loans.*

[8] *Source IMF; Calculated as (Total specific loan-loss provisions, only) divided by NPLs.*

[9] *Data for Albania, Bulgaria, Macedonia, Montenegro and Serbia for June 2015 from the Financial Stability Reports published by the central banks. All define it as specific loan loss provisions/ total NPLs.*

[10] *Source: IMF; Calculated by taking the value of NPLs less the value of specific loan provisions as the numerator, and capital as the denominator. Capital is measured as capital and reserves, and for cross-border consolidated data, also total regulatory capital.*

[11] *Calculated as total country gross NPL divided by total CEE gross NPLs.*

[12] *Calculated as total country gross loans divided by total CEE gross loans.*

[13] *Δ (%) is the delta variation in percentage points between 2 periods and is calculated as ((“value period 1”/”value period 0”) -1). Δ are shown from June 2014 to June 2015.*

[14] *30-06- 2014 data taken same as that on 30-12-2014, for NPL Volume, NPL Ratio, NPL Coverage Ratio, and Market Share NPLs.*

2. PROGRESS WITH RESOLVING IMPEDIMENTS TO NPLS (VIENNA INITIATIVE PARTNER COUNTRIES)[15]

- Notable progress has been made in some countries to resolve impediments to bank restructuring and transactions. We provide more detail for the partner countries of the Vienna Initiative NPL Action Plan on the respective country pages.
- Establishing adequate insolvency laws and continuing to bring down barriers to NPL sales (e.g. borrower consent, restrictive licensing) remain at the top of the agenda across the region, with some countries more advanced than others.
- A high level of uncertainty however remains for many countries regarding regulations, laws and tax impacting on both restructuring and the sale of loans, creating challenges for banks in planning portfolio sales, as well as in the perceived risks to investors.
- In addition, the difficulty with performing multi-creditor restructurings and the prevailing lack of expertise within smaller banks for handling and resolving NPLs still present important challenges which require regulators to develop and provide more robust guidelines and tools to the industry.

Highlights of significant measures implemented in the CESE in the last 18 months and underway for 2016

Albania

- **Published guidelines:** In 2014, Bank of Albania published (1) the guidelines on loan restructuring for individuals[16], and (2) the guidelines for the preparation of real estate appraisals.[17]
- **Amendment to the tax law:[18]** In effect since April 2014 with the aim to remove some of the legal and technical issues impeding loan write-offs.
- **Management of large exposures:** [19] Regulation (July 2015) to enhance responsibility of Board of Directors. The purpose of this Regulation is to set out rules and criteria for calculating, supervising and reporting bank's large exposures to a person/client or group of persons/clients connected between them or with the bank, for the purpose of managing the risk arising from concentrated exposure to them.
- **Write off:** Obligatory write-offs for lost loans older than 3 years (law came into force in early 2015).
- **Improved collateral execution:** Changes in the law in progress. Amendments to the Civil Procedure Code became effective in October 2013 to help simplify and shorten the collateral enforcement procedures.
- **NPL Working Group and action plan:** Developed a comprehensive strategy to address the NPL issues (published in November 2015[20]). It integrates and sequences reforms in the areas of supervision, enforcement, debt restructuring, and insolvency. Two of the measures included in the strategy are included as IMF proposed structural benchmarks for 2016

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[15] *Source: EBRD, Central Banks websites and Financial Stability Reports of individual countries, KPMG.*

[16] *Guidelines on loan restructuring for individuals, Bank of Albania, January 2014.*

[17] *Guidelines for the preparation of real estate appraisals used for the purpose of obtaining a loan from a financial institution, bank of Albania, January 2014,*

[18] *Albania, letter of intent, Memorandum of economic and financial policies, and technical memorandum of understanding, January 27, 2015,*

[19] *Regulation on the risk management from large exposures of banks, Bank of Albania, February 26, 2014.*

[20] *International Monetary Fund, Fifth and Sixth Review under the Extended Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria-Press Release, February 2016*

- ✓ *Submit to Parliament a new Bankruptcy Law, incorporating best international practices and simplifying existing procedures. (due End-June 2016)*
- ✓ *Submit to Parliament amendments to Civil Procedure Code and Private Bailiffs Law to increase the efficiency of litigation, foreclosure procedures, and debt collection (due End-September 2016)*

Croatia

- **New Bankruptcy Law:** Adopted in June 2015, aiming to shorten the notoriously long bankruptcy procedures and strengthen creditors' control over the process. The new legislation enforces these procedures within eight days if a company's bank accounts are blocked for more than 120 days. It speeds up the transition from pre-bankruptcy to bankruptcy. The government also introduced personal bankruptcy for citizens and entrepreneurs who are unable to meet liabilities for three consecutive months.
- **Consumer Bankruptcy Act:** Also in progress and should be enacted in 2016.
- **Pre-Bankruptcy Settlement Procedure (PBSP):** Introduced in 2012 but halted in 2014 after problems arose relating to minority creditor rights. A revised version of the 2012 procedure is under review and should be in effect in 2016.

Hungary

- **Electronic Sales System (EÉR):** Launched on 1st January 2015 as an online platform for selling the assets of debtors in liquidation.
- **New Personal Insolvency Law:** Amendment to the Personal Bankruptcy Act (September 2015) to simplify the existing framework and create an efficient personal bankruptcy system to provide relief to qualifying debtors and at the same time the creditor interests are taken into account.[21] It is mainly intended for housing NPLs.
- **MARK Zrt sd:** Created in q4-2014 to wind down part of the banks' real estate NPLs. Valuation principles were agreed with the European Commission in February 2016. The design of MARK benefitted from IMF technical assistance, and was ruled free of state aid by the EU Commission in February 2016. It is expected to begin purchasing commercial real estate ("CRE") exposure with the aim of reaching a significant drop in corporate NPL.
- **Report on "Analysis of Corporate Restructuring and Insolvency in Hungary":** Published in Q1 2015.
- **New principles on NPL out-of-court restructuring:** Aim at strengthening existing guidelines (the "Budapest Approach"). Completion exp. q4 2016.
- **Amendments to the Bankruptcy Act:** Under review by the Ministry of Justice, with amendments foreseen to be presented by the end of 2016 (estimation).

Romania

- **Progress with NPLs write-off:** NBR encouraged banks to write-off or sell non-collateralized, fully-provisioned, NPLs past due for over one year or delinquent loans undergoing legal (insolvency or bankruptcy) proceedings. This resulted in NPLs ratio decline by 5.7 percentage points (12-2013 to 06-2015).

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[21] *The Hungarian Personal Bankruptcy Act, published by "Lawyer Issue", accessed on April 25, 2016*

- **Corporate Insolvency Law[22]:** A new corporate insolvency law has recently been adopted to replace the one in force since 2006. Experience with its implementation is currently limited.
- **Personal Insolvency Law:** The personal insolvency law was adopted in mid-2015 and will enter into force towards the end of 2016. The rationale for the delay is to build up the necessary institutional capacity.
- **Examples of measures for 2016 include**:
  - ✓ *Centralised data on collateral valuations, to decrease the opacity of information for collateral valuations and transaction prices.*
  - ✓ *Repeal of buyer licensing requirement for acquisition of NPLs under Law 190.*

Serbia

- **Report on "Analysis of the existing impediments to the sale of NPLs in Serbia"** now being finalized and to be published q1 2016; highlights the key impediments to NPL sales and remedial actions.
- "**NPL Resolution Strategy", "Action Plan**": published by the Serbian authorities and enacted by an official Working Group.[23]
- **Amendments to the Mortgage Act:** The amendments to the mortgage act were adopted in July 2015. One of the most prominent changes was the possibility of any creditor regardless of the ranking of its claim, to initiate the foreclosure procedure.[24]
- **Deposit Insurance Agency ("DIA") and asset management companies ("AMC")**: Amendments to the Banking Act authorising the transfer of assets, rights and/or liabilities of a bank under resolution to the DIA or AMC.
- **Supervisory Guidance for Loan Loss Provisioning (LLP):** Setting expectations for LLP under IAS 39 (Implemented in December 2015).
- **Improving quality of collateral valuation:** "Introduction of a new legal and operational framework for transparent real estate appraisals, including: (i) legislation setting clear appraisal standards; (ii) development of a database, accessible to banks and appraisers, for detailed records on real estate valuations filed according to pre-established criteria; and (iii) legislation providing proper supervision of the licensed appraisers."[25] In progress.
- **Review of the corporate insolvency law:** "To ensure: (i) adequate safeguards for the secured creditors' rights; and (ii) better value maximization and more predictable and swift disposal of assets where assets are not strictly necessary for rehabilitation."[26] In progress.
- **Amendments to the corporate income tax regulation:** To remove disincentives for timely NPL resolution by facilitating banks' recognition of corporate loans' write-offs as expense for tax purposes. In progress.
- **Enhanced Supervisory Standards:** To be developed to improve restructuring of receivables and distressed asset management by banks. In progress.

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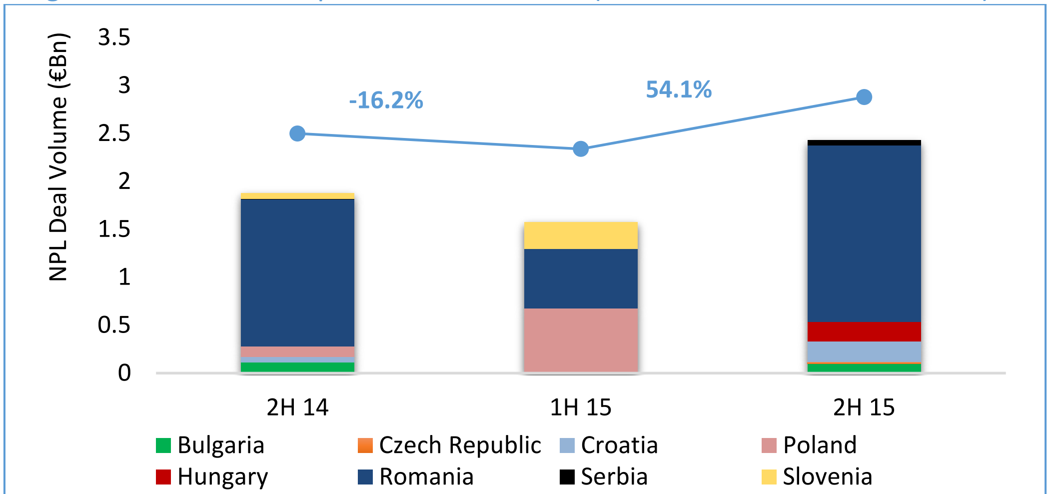
[22] *IMF, Romania: 2015 Article IV Consultation—Staff Report; Press Release, 27 March 2016*
[23] *Serbian Government, NPL Resolution Strategy, Official Gazette of the Republic of Serbia, Number 72/15, Q2 2015*
[24] *Recent developments in Serbian mortgage law, published on October 2015, article published by Gecic Law*
[25] *IMF, Republic of Serbia Country Report no. 15/347, Third Review under Stand-by arrangement and request for modification of Performance criteria, December 2015*
[26] *IMF, Republic of Serbia Country Report no. 15/347, Third Review under Stand-by arrangement and request for modification of Performance criteria, December 2015*

3. SNAPSHOT OF NPL TRANSACTIONS IN THE CEE[27]

Transaction dynamics have improved in 2014-2015 and further sales growth is foreseen for 2016

- Investors' interest and market confidence in the CEE is increasing, partly due to an improving macroeconomic backdrop and the notable progress that has been made in resolving impediments to restructuring and transactions in the past 18 months in some countries.
- In some markets (such as Romania), the greater provisioning by banks and measures initiated by the national regulators contributed to stimulate the banks' willingness to sell and in some cases closing the pricing gap with investors.
- Overall, a divergence between initial ask and bid prices still remain in the market, partly caused by the risk premium required by investors to account for the remaining impediments in the markets (e.g. poor data quality and transparency, illiquid real estate market, inefficient court systems and insolvency laws, etc.).

Figure 2. Realised NPL portfolio transaction (June 2014 to December 2015)[28]



NPL Sales remain concentrated in a handful of countries

- Nearly €6 Bn of transactions have been realized in the CEE in the last 18 months
- This corresponds to over 10% of the current NPL stock (i.e. €57.4 Bn) of the CESEE countries.
- In 2H 2015, about 75% of the transactions occurred in Romania (3 sales transactions from BCR, Unicredit and Piraeus).
- Romania and Poland have accounted for around 80% of the total transactions of the last 18 months, although investors' interest is also growing in countries such as Serbia, Croatia and Bulgaria.
- NPL transactions have occurred overall for most asset classes (i.e. retail/consumer loans, CRE- backed loans and corporate/SME portfolios)
- Large corporate secured transactions have been largely driven by international investors, considering that possible upsides rely on skilled resources.

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[27] *Please also refer to "NPL Resolution: Sale of NPL Portfolios In CEE" for more details.*
[28] *Source: Portfolio Solution Group - KPMG, Deloitte, DebtWire, EBRD*

Loans servicing capabilities remain scarce in the region

- NPL management in the CEE remains mostly performed in-house at the banks, with an increasing number of banks setting up independent and dedicated workout divisions. Capabilities remain very fragmented across the banks, with the state banks and smaller national banks often lacking adequate internal skills and know-how to allow them to undertake sound corporate restructuring to prevent value erosion.
- External serving is mostly done by collection agencies rather than specialised NPL servicers and platforms. The current debt collection agencies are also predominantly focused on unsecured debt.
- Some collection agencies (e.g. APS, Credit Incasso, B2Holding) are exploring expansion into other segments or growth via consolidation and IPO. International specialised servicers and investors specialized in restructuring are also investigating the viability of different structures such as servicing platforms and partnerships.

Table 2. Sample of (publicly available) NPL transactions in the CEE (H1 and H2 2015)[29]

Date	Country	Vendor	Project	Type	Buyer	Buyer Country	Face value (€m)
2H-15	Bulgaria	TBI Credit	Retail Portfolio	Consumer	APS Holding	Czech Republic	50
2H-15	Bulgaria	BNP Paribas	Retail Portfolio	Consumer	Undisclosed	N/A	46
2H-15	Croatia	Erste & Steiermärkische	Project Janica[30]	Corporate / SME	B2Holding	Norway	217
2H-15	Czech Republic	Confidential	Syndicated loan – Czech asset	CRE	Confidential	N/A	20
2H-15	Hungary	MKB Bank	Project Danube – Symmetry Arena	CRE	Lone Star	United States	180
2H-15	Hungary	Major Hungarian Bank	Syndicated Loan	CRE	Confidential	N/A	20
2H-15	Romania	Banca Comercială Română	Project Tokyo	CRE / Corporate / Retail	Deutsche Bank, IFC and APS Holding	Germany, Czech Republic, Int.	1200
2H-15	Romania	UniCredit Tiriac Bank	Project Triton	CRE / SME	Kredyt Inkaso	Poland	340
2H-15	Romania	Pireaus Bank	NPL Portfolio	Various	Libra Group	Int. Conglomerate	300
2H-15	Serbia	Erste Bank Novi Sad	Project Grey	Corporate	APS Holding	Czech Republic	21
2H15	Serbia	Banca Intesa	NPL Portfolio	SME	Confidential	N/A	35
1H-15	Poland	Santander	Consumer Debt	Consumer	Kruk Group	Poland	75
1H-15	Poland	Bank Zachodni	Corporate NPL	Corporate	Confidential	N/A	600
1H-15	Romania	Pireaus Bank	Project Henri	Consumer	Kruk Group	Poland	189
1H-15	Romania	Banca Comercială Română	Project Saturn	CRE	Deutsche Bank	Germany	433
1H-15	Slovenia	BAMC (DUTB)	Claims to 4 companies	Corporate	Bank of America Merrill Lynch	United States	123
1H-15	Slovenia	BAWAG & Debtors	Istrabenz loans	CRE	York Capital / Elements Capital	United States / Slovenia	156

[29] Source: Portfolio Solution Group - KPMG, Deloitte, DebtWire, EBRD
[30] Transaction agreed but closing in process.