BANCO DE ESPAÑA
Eurosistema

MARKET-BASED SOLUTIONS TO BANK RESTRUCTURING: Can active financial markets help to clean up banks' balance sheets?

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TOWARDS THE RIGHT POLICY MIX FOR A THRIVING EUROPEAN CAPITAL MARKET

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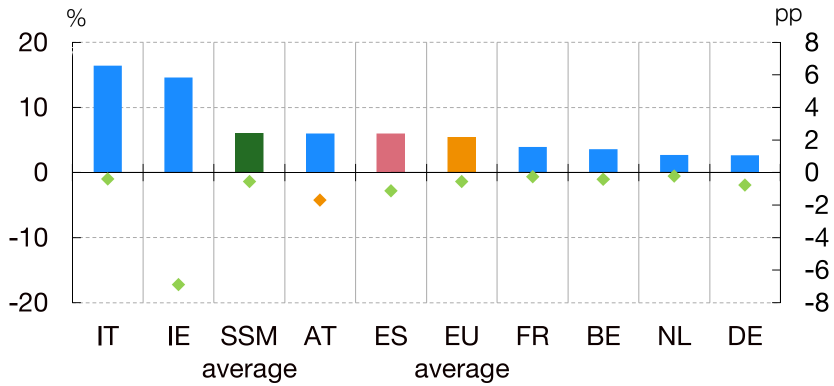
1. THE FACTS

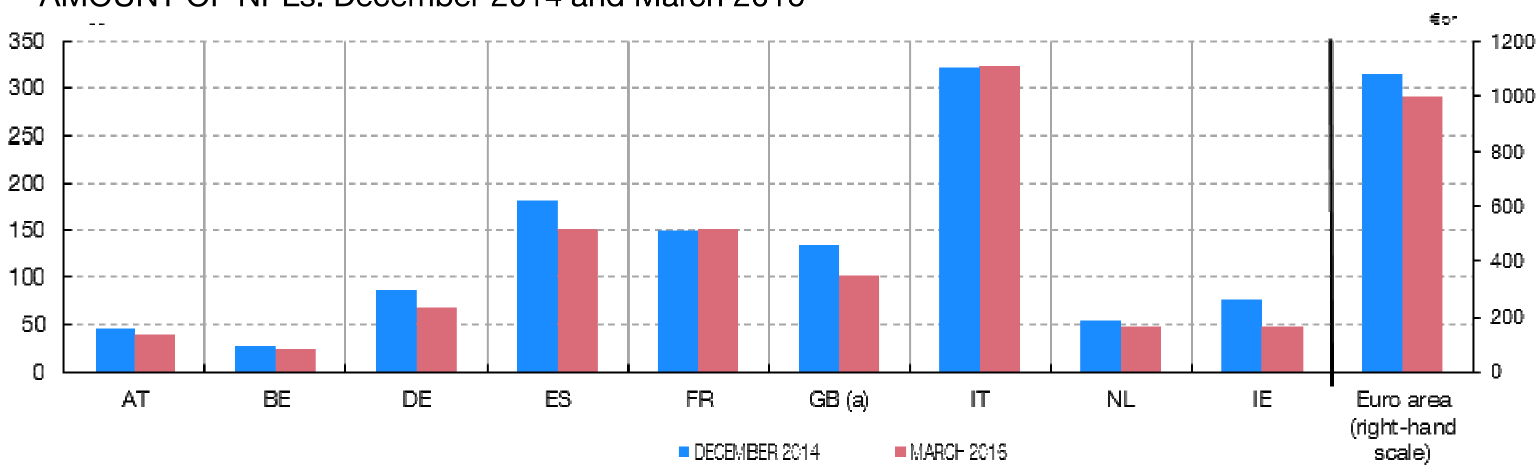
EU NPL RATIOS. June 2016



SOURCE: European Banking Authority
Risk Dashboard June 2016 (198 entities).

- **NPL ratios are still high** in many jurisdictions, despite the decrease observed in recent times.

AMOUNT OF NPLs. December 2014 and March 2016



SOURCE: European Central Bank.
a. GB data for 2014 refers to Q1 2015.

2. THE IMPLICATIONS

- **For banks**:
    - Lower profitability: due to higher provisioning needs and management costs.
    - Higher capital requirements: due to higher risk weights on impaired assets.
    - Higher funding costs: due to the weakness of the bank balance sheet.

- **For the economy:**
    - Negative effect on lending growth.
    - Inefficient corporate and household debt restructuring.

3. WHAT CAN BE DONE?

- **Facilitate moving NPL resolution** out of the banking sector.
- How? By developing **market for distressed assets.**

➢ **On the supply side**:

- Need to facilitate NPL sales (*SSM initiative on NPLs)*:
    i. Stringent supervision to ensure timely recognition of NPLs.
        - *Classification*
        - *Provisioning*
        - *Collateral valuations*

    ii. Improve documentation.
- Review taxation rules.

Yet, need to avoid rigid targets for NPL reduction:

- *Quick sales are not always and everywhere the optimal solution.*

3. WHAT CAN BE DONE?

- **On the demand side:**

  - Revise insolvency procedure.
  - Accelerate disposal of guarantees.
  - Flexible eligibility criteria for buyers.
  - Promote servicing.
  - Transferability of loans.
  - Enhance transparency (on borrowers, collateral, real estate transactions, NPL sales).

- **The economic environment matters.**

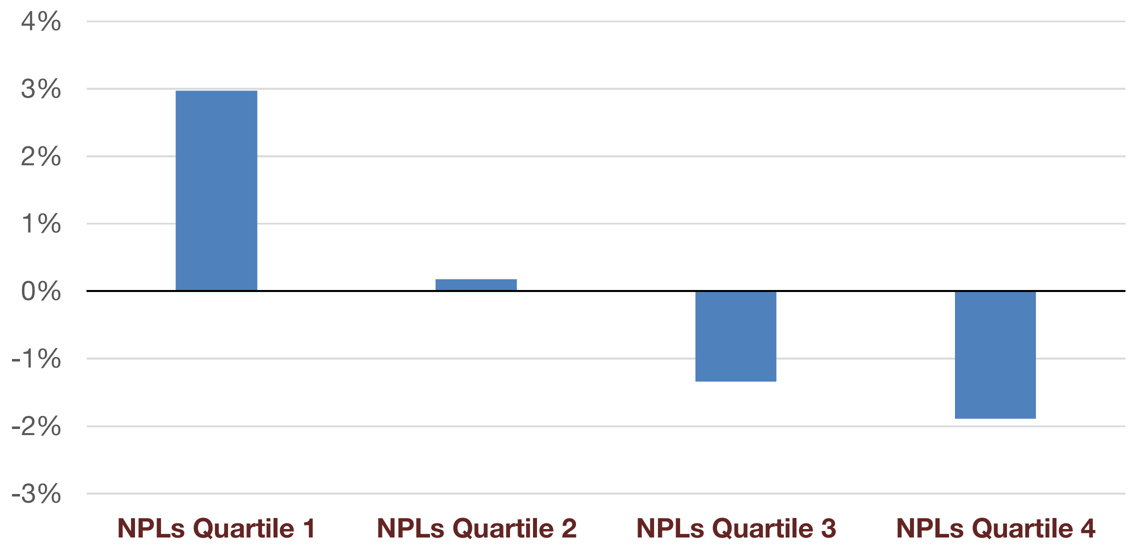
The Spanish experience:

- Moderate activity (12 bn ex SAREB 1H2016*) supported by:
  - Improvement of the economy.
  - Stringent bad-loan provisioning.
  - Improvement of insolvency/foreclosure procedures.
  - Enhanced transparency.
- Targeted assets on sale:
  - Highly provisioned loans and written-off portfolios.
  - NPLs near to foreclosure.

** Deloitte Research, 2016*

- During the trough of a business cycle, NPL reduction may have an immediate negative impact on profitability and capital buffers. There are enforceability difficulties, especially for weak banks which in turn are those with higher NPLs on balance sheets.

CET1 JUN 2016 (relative to SSM average)



Source: Own elaboration. Sample of 82 SSM significant institutions.

- … and sales may trigger higher LGDs for IRB banks.

5. CAN SECURITISATION HELP?

- **Only partially**:
  - It helps to offer products with different risk profiles.
  - However, it only amounts to splitting NPL risk between buyer and seller (and a third party if there is a guarantor, as in Italy). Milder effect on capital but also less risk transfer.

6. CAN AN AMC WORK?

- **Good experiences** in Sweden, Ireland, Spain, Slovenia…

- **AMCs help reduce obstacles** to developing a market for distressed assets.
  - Centralisation of sellers.
  - Standardisation of processes.
  - Facilitate tax regulatory reform.
  - Promote emergence of servicers and assessors.
  - But they absorb part of the value added provided by buyers.

- In most successful cases, some **public sector** involvement.

6. CAN AN AMC WORK?

- **In Spain**:
  - Transfers were compulsory for weak banks already receiving public support.
  - The AMC is partly owned by the State (45%), which also guarantees AMC´s senior debt.
  - Transfer prices were set below economic value. The difference between transfer prices and market values (as estimated by the EC) was considered additional State Aid.
  - Since transferring banks were already receiving capital support from the State, the transfer only entailed some additional stringency for burden-sharing and restructuring, but it did not trigger by itself the restructuring or resolution of the institution.
  - Challenging management, although homogeneity of transferred assets (real state related) helped.

7. CHALLENGES

- Would a **purely private sector** solution work?

- Is there **scope for a pragmatic interpretation** of the BRRD and State Aid rules?

    - *Asset transfer valuations*.

    - *Resolution triggers*.

    - *The scope of burden sharing*.

THANK YOU FOR YOUR ATTENTION