NPLs:
are we doing enough?

Rennos Ioannides, 2 November 2018

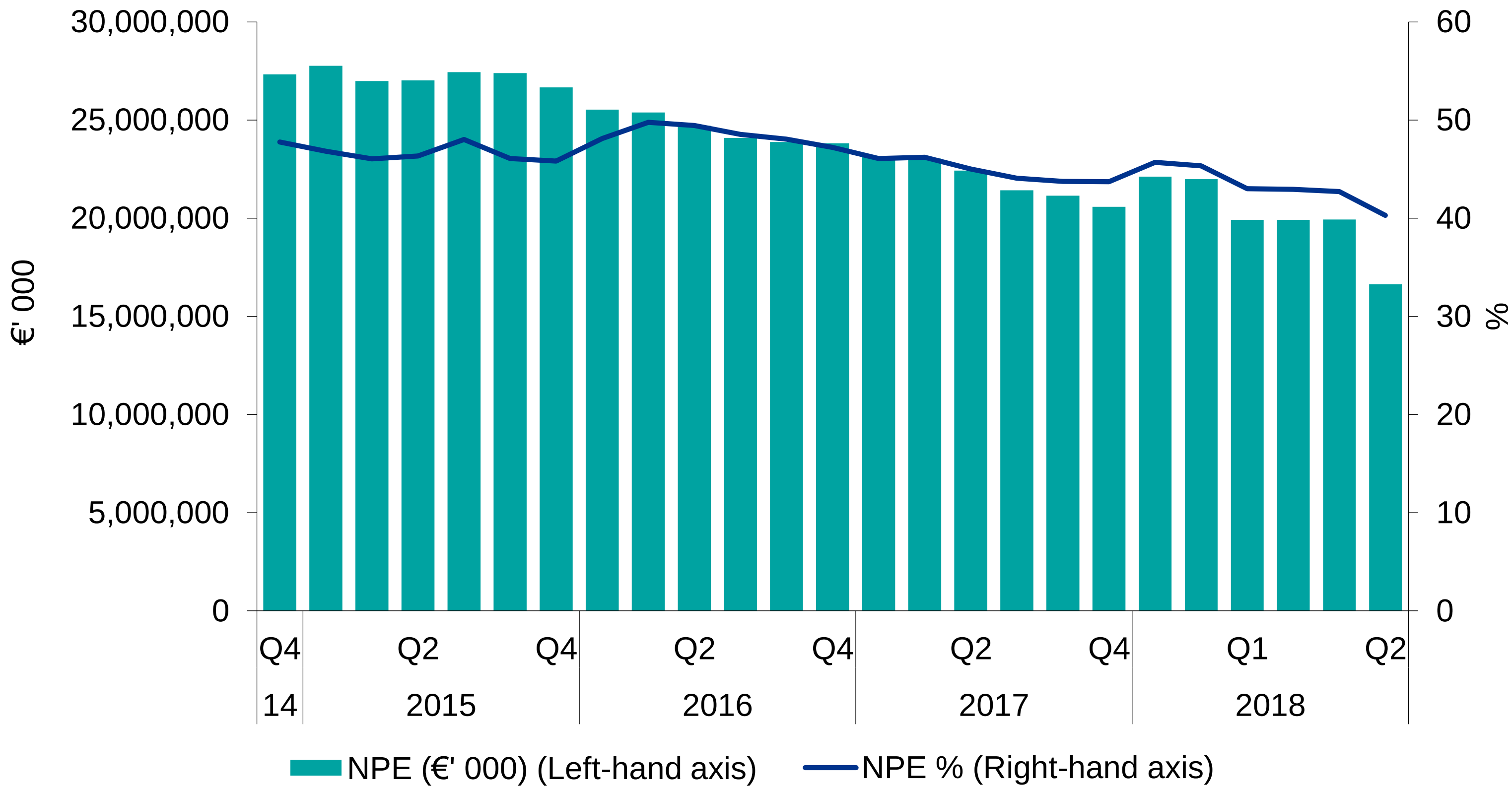
Cyprus NPEs: which way? A matter of interpretation?

NPE Movement

	Q4 2014	Q2 2018	Reduction	Change
NPEs in € bln	€ 27,3	€ 16,6	€ 10,7	-39%
NPEs in %	47,8%	40,3%	7,5 pcp	-16%

Reduction June 2018: €3,3 billion (mostly BoC).
A further c. €6,5 billion will be removed from the system due to Coop-AMC

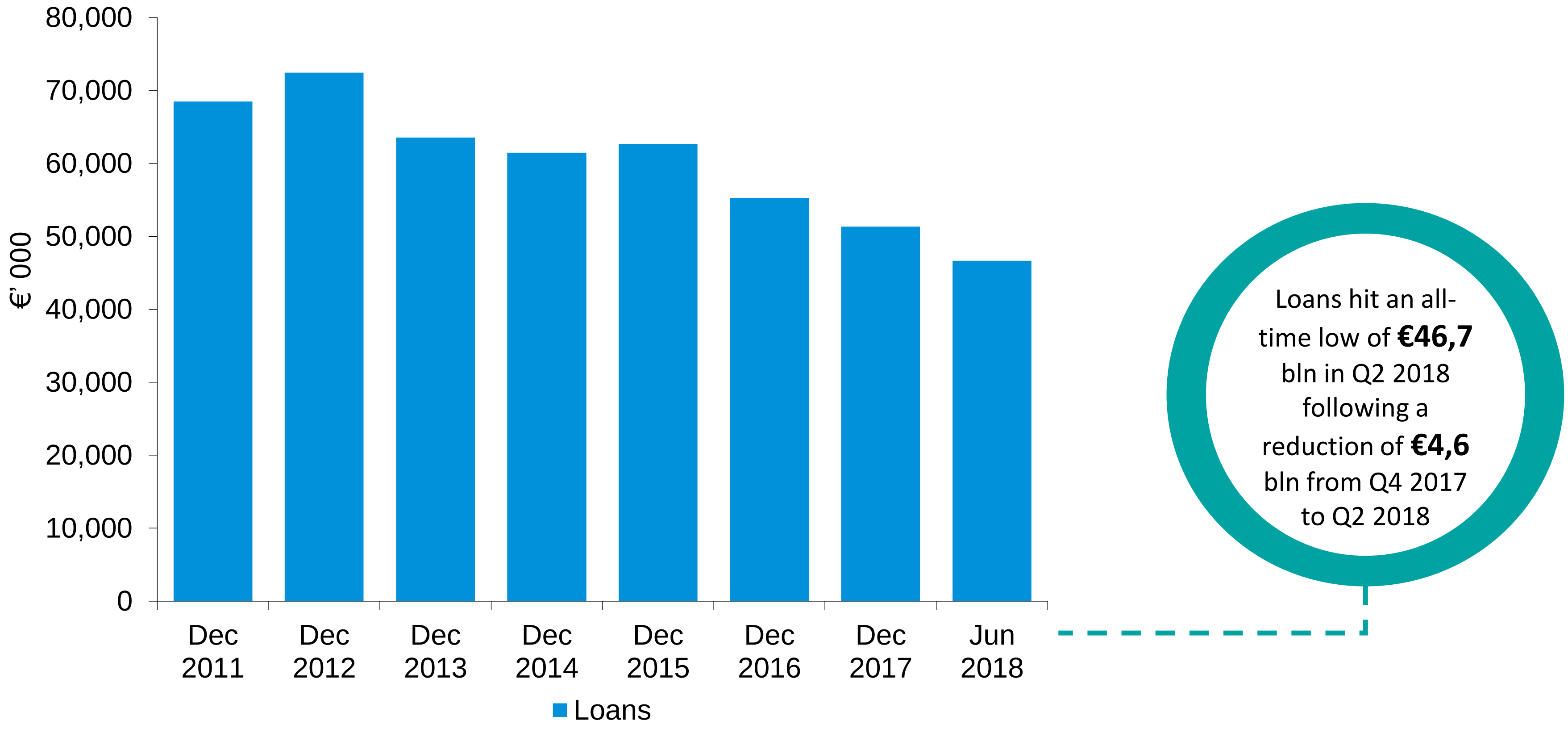
NPE Movement since 31.12.2014 on a quarterly basis



Source: Central Bank of Cyprus, Analysis

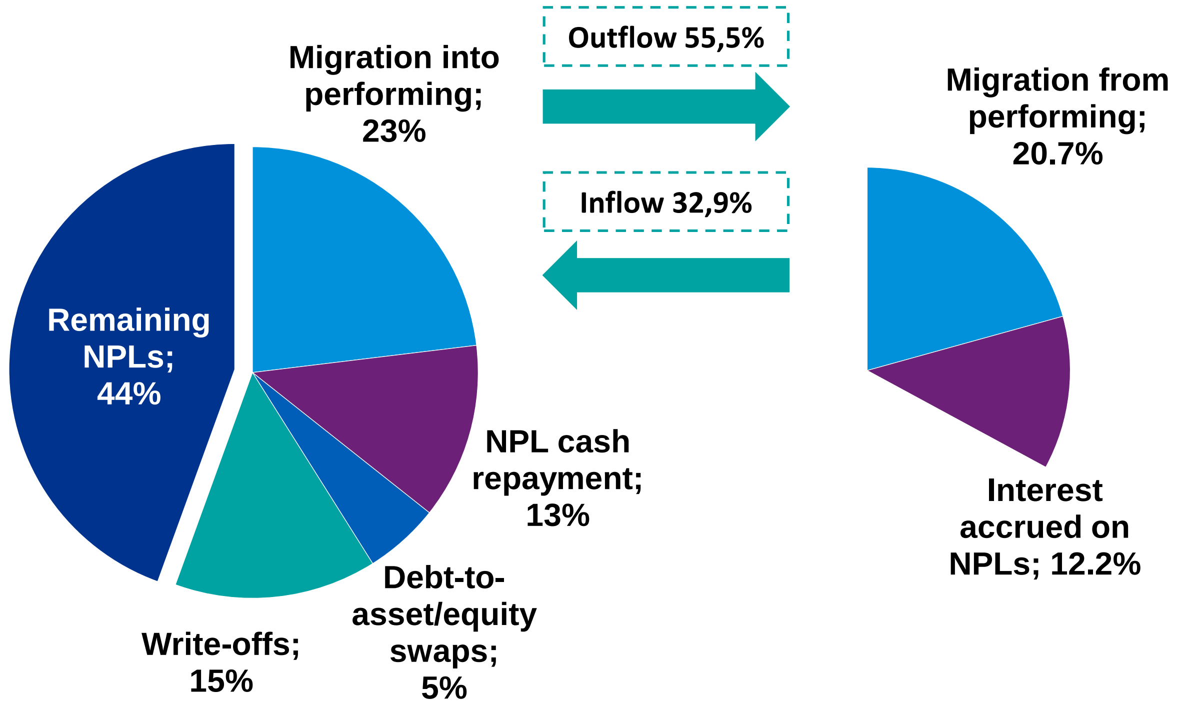
Loans Movement

Movement since December 2011



Source: Central Bank of Cyprus, Analysis

Cyprus: Flows of Non-Performing Loans Q4 2015 – Q42017



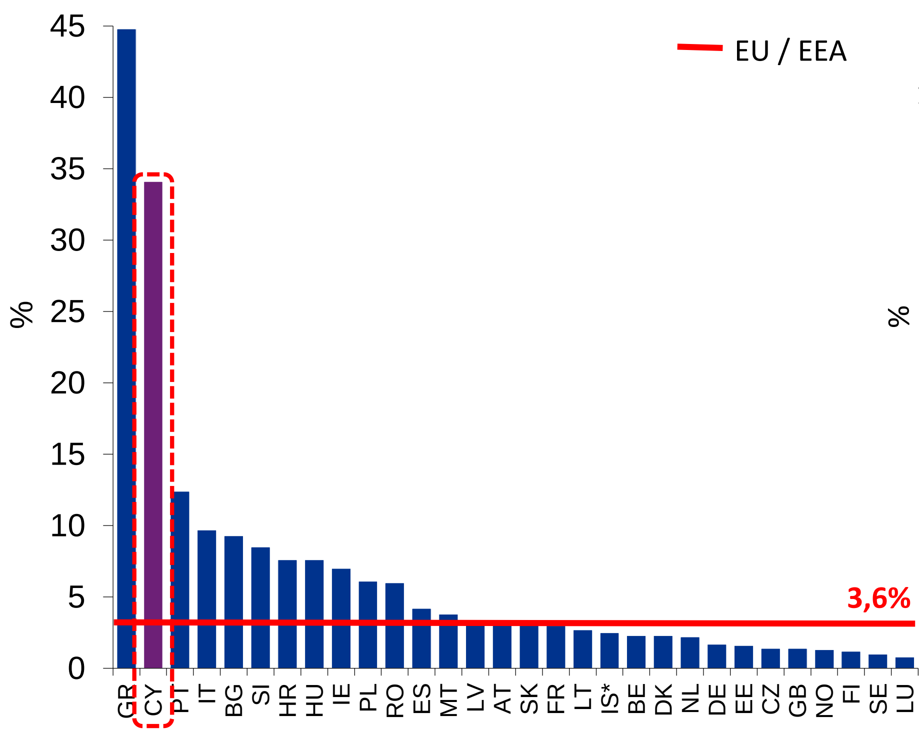
As per the IMF, NPE improvement between Q4 2015 – Q4 2017 has been as follows (in percentage terms of NPEs):

NPE Improvement Source	%
To Performing	23
(From Performing)	(21)
Cash Collections	13
Debt to Asset	5
Write-offs	15
(Capitalised Interest)	(12)
NET improvement	**23**

Note: Data cover fixed term loans owned by locally active banks. Two banks, RCB and Astro, are excluded.
Source: IMF Cyprus Report, June 2018

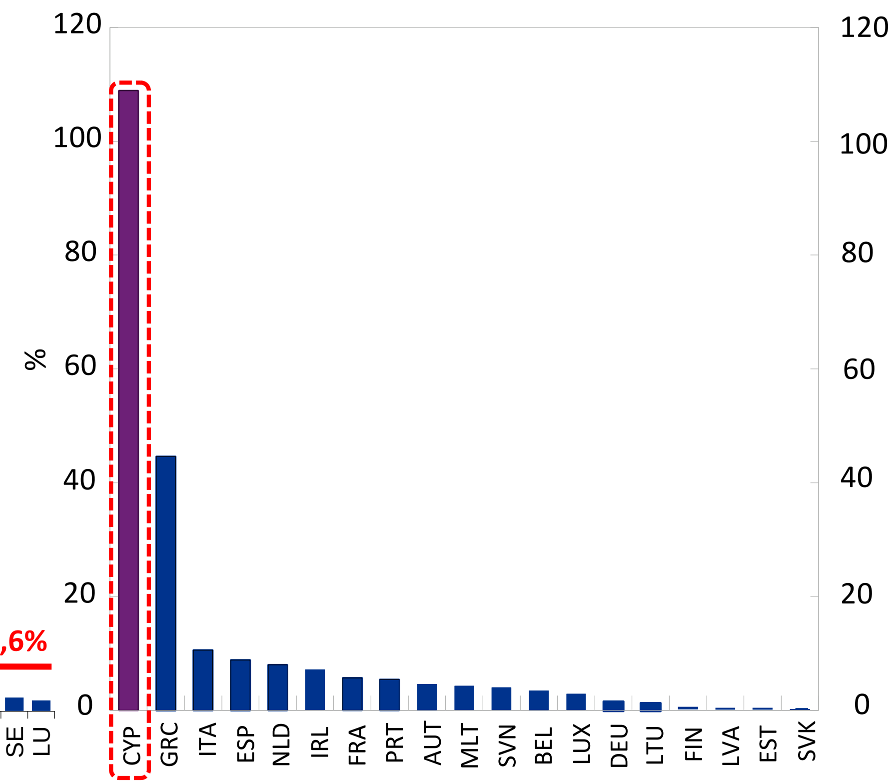
NPEs Cyprus vs Europe

NPLs % in the EU (Q2 2018)



Source: European Banking Authority

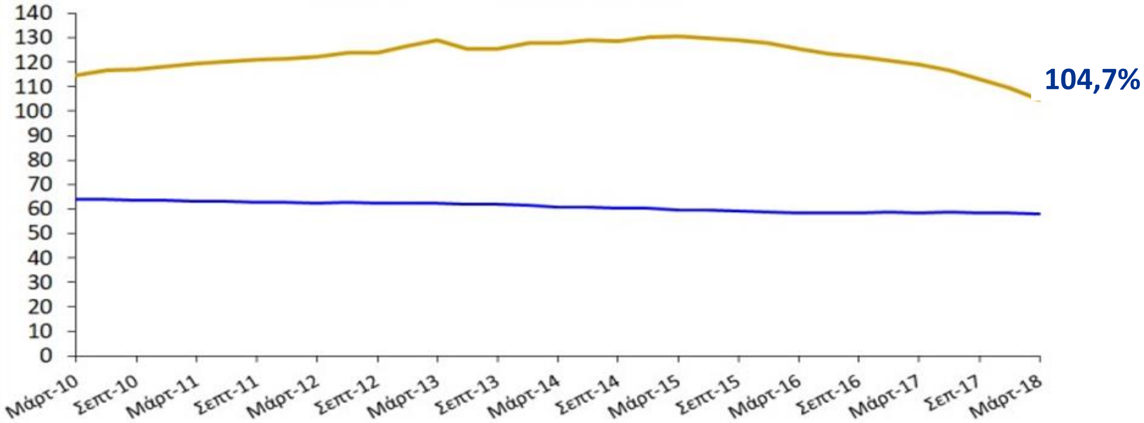
NPLs – to – GDP Ratio % in the EU (Q3 2017)



Source: IMF Country Report, June 2018

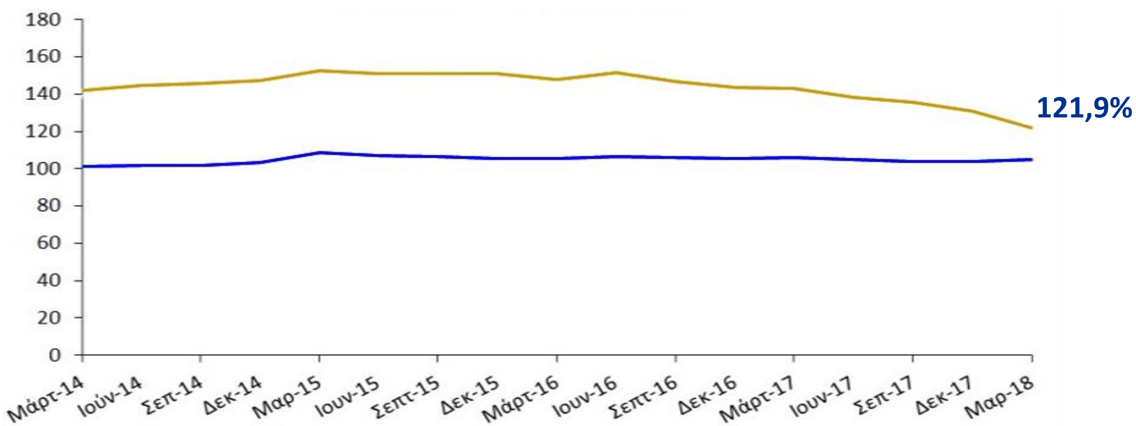
Private Sector Debt Overhang

Debt of Households (Percent of GDP)



CY
Eurozone

Debt of Non-Financial Corporation (Percent of GDP)



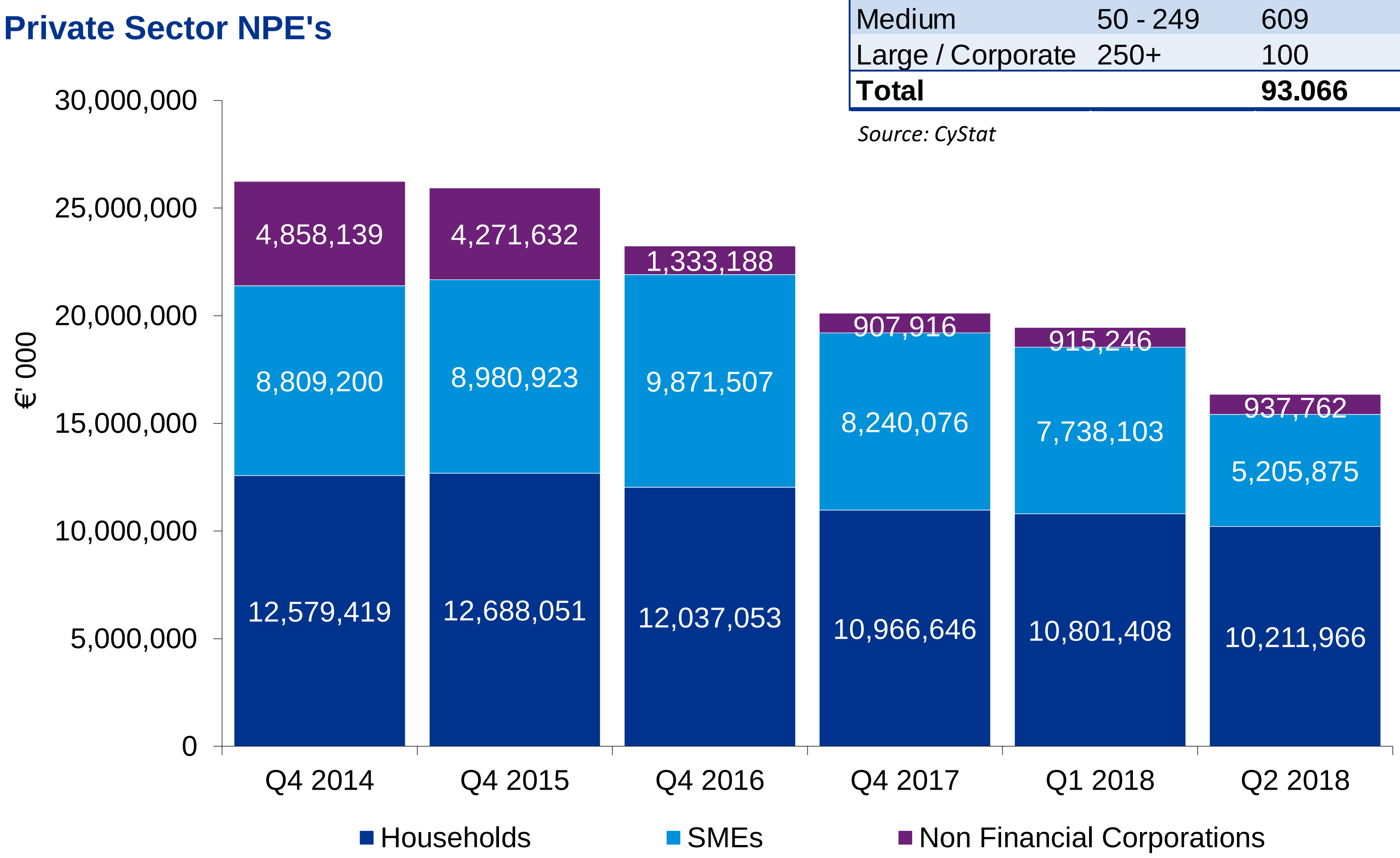
EC's Scoreboard threshold for private debt is **133%** (Cyprus **227%**)

Source: Central Bank of Cyprus

NPEs Private Sector

Company Classification	Number of employees	Number of companies
Micro	0 - 9	88.689
Small	10 - 49	3.668
Medium	50 - 249	609
Large / Corporate	250+	100
Total		**93.066**

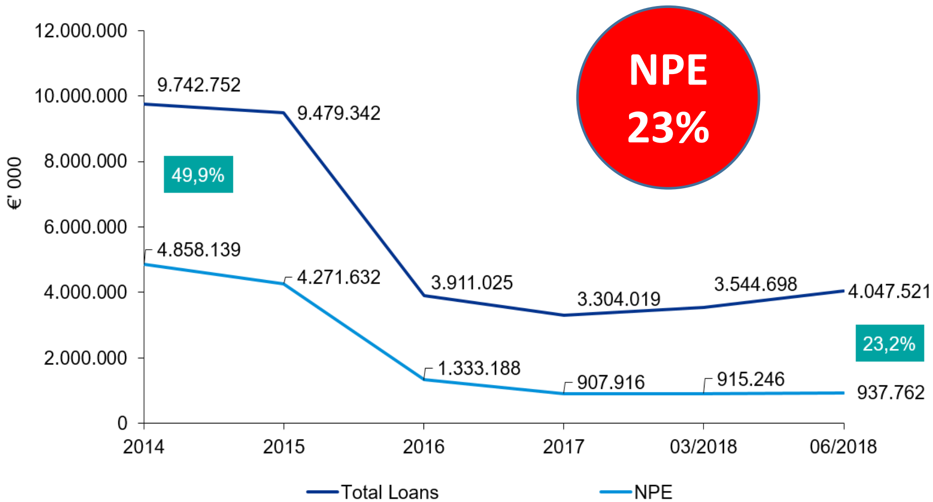
Source: CyStat



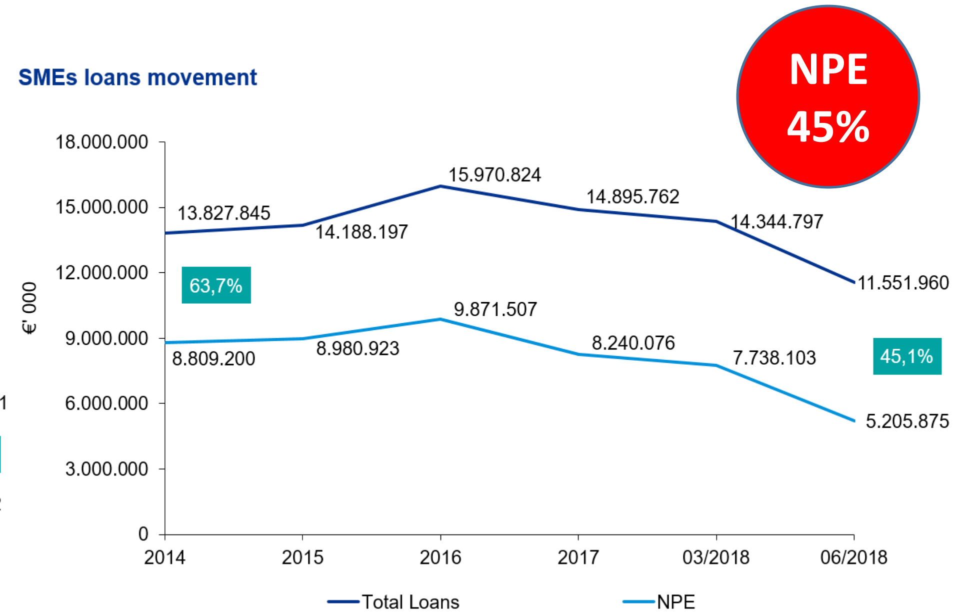
Source: Central Bank of Cyprus, Analysis

NPEs Private Sector Movements

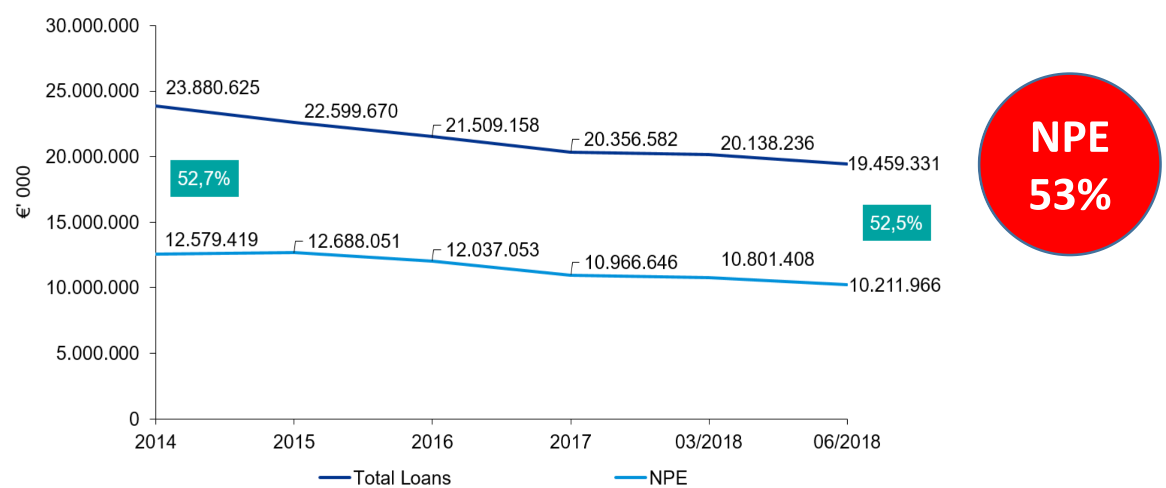
Corporate loan movement



SMEs loans movement



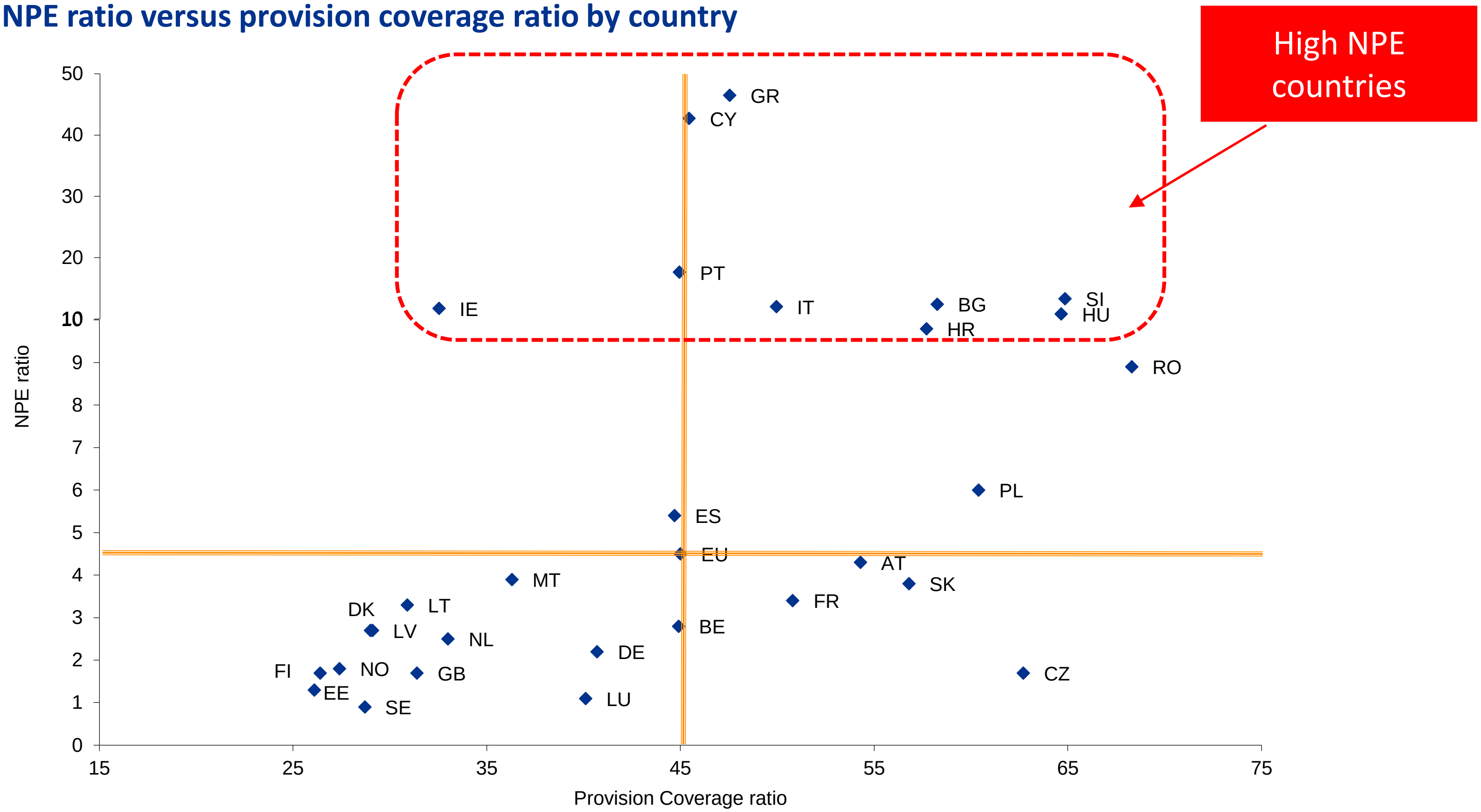
Household loans movement



Source: Central Bank of Cyprus, Analysis

Banks possibly still under-provisioned?

NPE ratio versus provision coverage ratio by country



Source: European Banking Authority

Regulations getting tougher (1/2)

New Provisioning Guidance
(ECB Guidance to Banks on NPLs, Addendum)
applies to all new NPEs from 1.4.2018

	Unsecured Part	Secured Part
After **two** years of NPE vintage	100%	
After **three** years of NPE vintage		40%
After **four** years of NPE vintage		55%
After **five** years of NPE vintage		70%
After **six** years of NPE vintage		85%
After **seven** years of NPE vintage		100%

Regulations getting tougher (2/2)

Proposal for 'Statutory Prudential Backstops'
European Commission (March 2018)
applies to all new exposures (originated after 14 March 2018) as soon as they are classified as NPE

Proposal to amend the Capital Requirements Regulation:

- Introduction of a 'statutory prudential backstop' – common minimum coverage levels for newly originated loans that become non-performing
- **Unsecured non-performing exposures to be covered within two years, 35% in year 1, 100% in year 2** (with a deduction of 20% if exposure is less than 90 days past due)
- **Secured non-performing exposures to be fully covered within eight years** (in pre-determined annual step factors based on days past due criteria – deduction of 20% for exposures less than 90 days past due)

Verdict: are we doing enough? (1/2)

Progress has been made, the banking system is much stronger but we are still a long way from getting out of the woods …

We are still faced with massive challenges:

1. Excessive private debt: the removal of loans from the banking system is not reducing the level of private debt
2. Mass of small ticket - backbone of the economy (SMEs, households) - NPL exposures, many of which are collateralised on primary residences
3. Further reduction of NPLs may be hampered by economic growth deceleration + Some banks may not be doing enough
4. Vulnerability of *truly deprived* households
5. Excessive stock of real estate assets both on the books of banks and also coming to market through enforcement
6. Problems in real estate market: backlog of unissued title deeds, existence of SPAs, memos

Verdict: are we doing enough? (2/2)

7. Inefficient judicial system (* see next page) – ‘justice delayed is justice denied’ :

- Doing Business 2018: 138th out of 190 countries on contracts enforcement
- Global Competitiveness Index 2018: 73th out of 140 countries on efficiency of legal system in settling disputes

8. Lack of credible threats ‘on the table’ – prevalence of strategic defaulters – non-payment culture

- Untested foreclosure / enforcement procedures
- Out of date civil procedure rules and company-related legislations

9. Increasing regulation and provisioning requirements

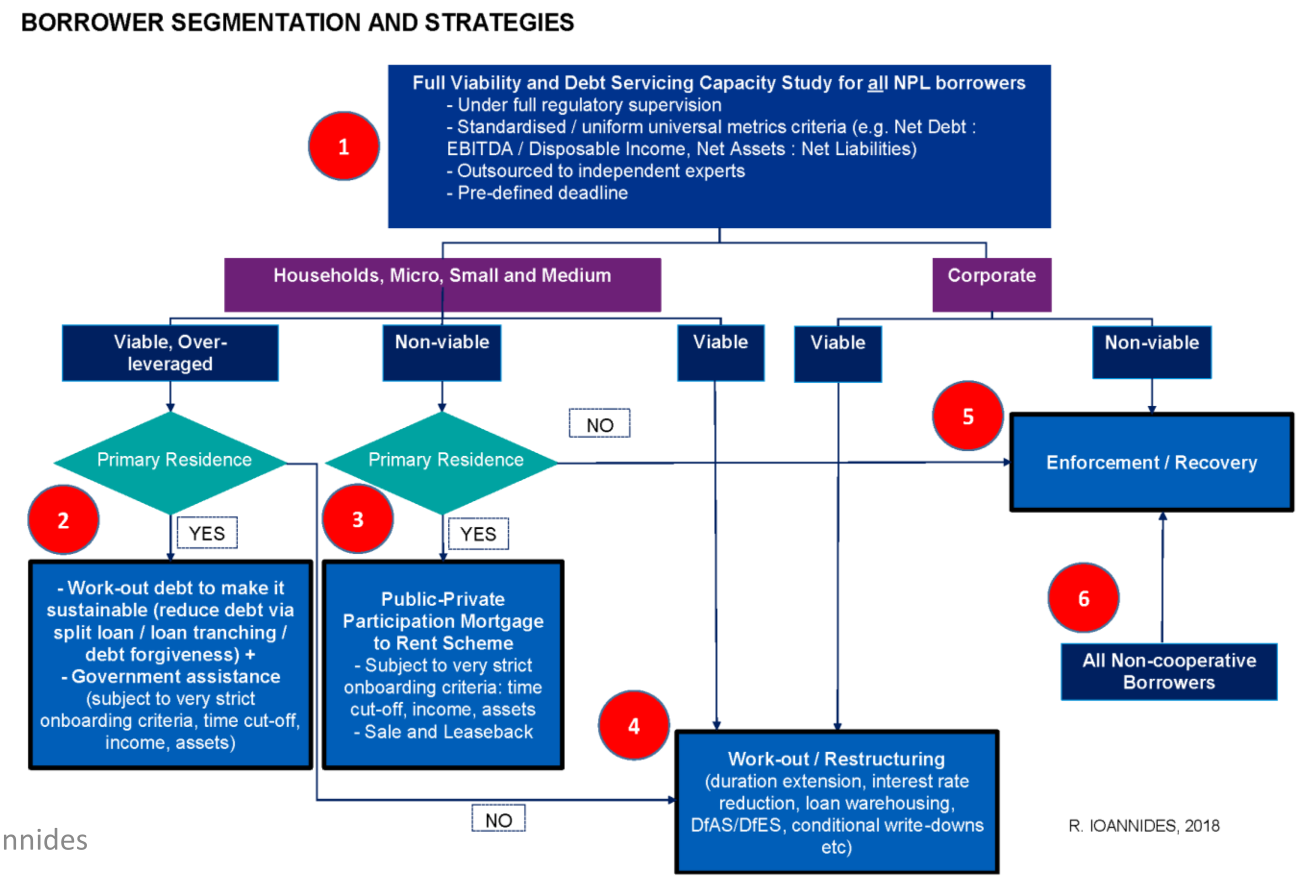
10. Excessive liquidity in the banking sector + cut-throat competition for a share of a finite pie + high cost base of banks → may lead to loosening of credit standards, unsustainable net interest margins and the beginning of another vicious circle

Our Judicial System …



Some Recommendations (1/4)

1. **National 'Plan Ahead' Strategy for the management of Private Debt:**
- Business Plan Blueprint
- Governed by board of independent experts
- Project – based approach with milestones and full accountability
- Full, uniform and universal segmentation of all borrowers and related strategies



Some Recommendations (2/4)

2. Estia Scheme: a purposeful scheme but the key eligibility criteria need refinement

- Relate income and house value to household set-up and reasonable living expenses
- Reduce substantially value of other assets
- Remove 'never-paid-anything' – strategic defaulters
- Use uniform and objective viability criteria
- Freeze foreclosures on these properties until scheme is fully up and running
- Regularly re-assess eligibility criteria
- Expedite!

3. Truly Deprived Households: not eligible for Estia

- Set up mortgage to rent (sale and leaseback) scheme
- Social housing scheme
- House trade-down platforms
- Run alongside Estia

Some Recommendations (3/4)

4. Judiciary: make it fit for purpose (and do it!)

- Introduce (and adhere to) maximum time limits (eg civil actions start to finish of maximum two years)
- Revamp civil law and rules
- Review corporate legislation (eg receiverships, audited accounts filing, simplify examinership up-front administrative requirements etc)
- Set-up specialised benches for insolvency cases (receiverships, examinerships, liquidations and bankruptcies, foreclosure etc)
- Fully automate case management (and filing!)
- Arbitration

Some Recommendations (4/4)

5. Various bits and pieces

- Subsidised debt counselling
- Payment priorities in receiverships and consensual sale of assets as per foreclosure law (this will supersede problems with memos, tax department's super powers)
- Change requirement for all guarantors signing all restructuring documents. Written Notification to suffice
- More assertive and intrusive banking supervision (on-site and off-site) and monitoring
- Multiple creditors' procedures to be run under the auspices of the Central Bank
- Full credit bureau
- Full automation of Registrar of Companies' database (shareholdings, directorships)
- … and many-many more

THANK YOU