



Non-Performing Loans in Asia and Europe— Causes, Impacts, and Resolution Strategies

Maciej Grodzicki, Adviser, European Central Bank
Reiner Martin, Lead Economist, Joint Vienna Institute
Peter Rosenkranz, Economist, Asian Development Bank

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Book Overview

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Summary of Nonperforming Loan Trends and Lessons from Three Decades of Crisis Resolution in Asia and Europe

2

Empirical Analyses of the Macroeconomic Implications of Nonperforming Loans in Asia and Europe

3

Country Case Studies on Nonperforming Loan Resolution in Asia and Europe

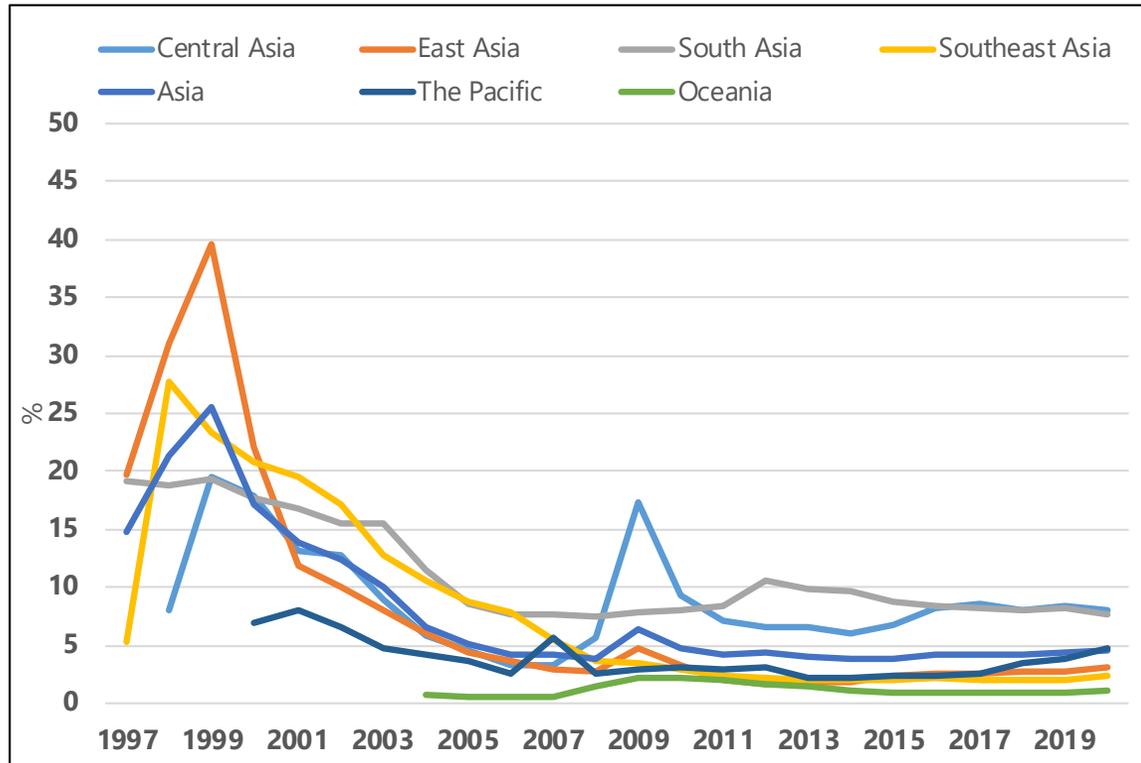
4

Policy Strategies for Nonperforming Loan Resolution and Market Development in Asia and Europe



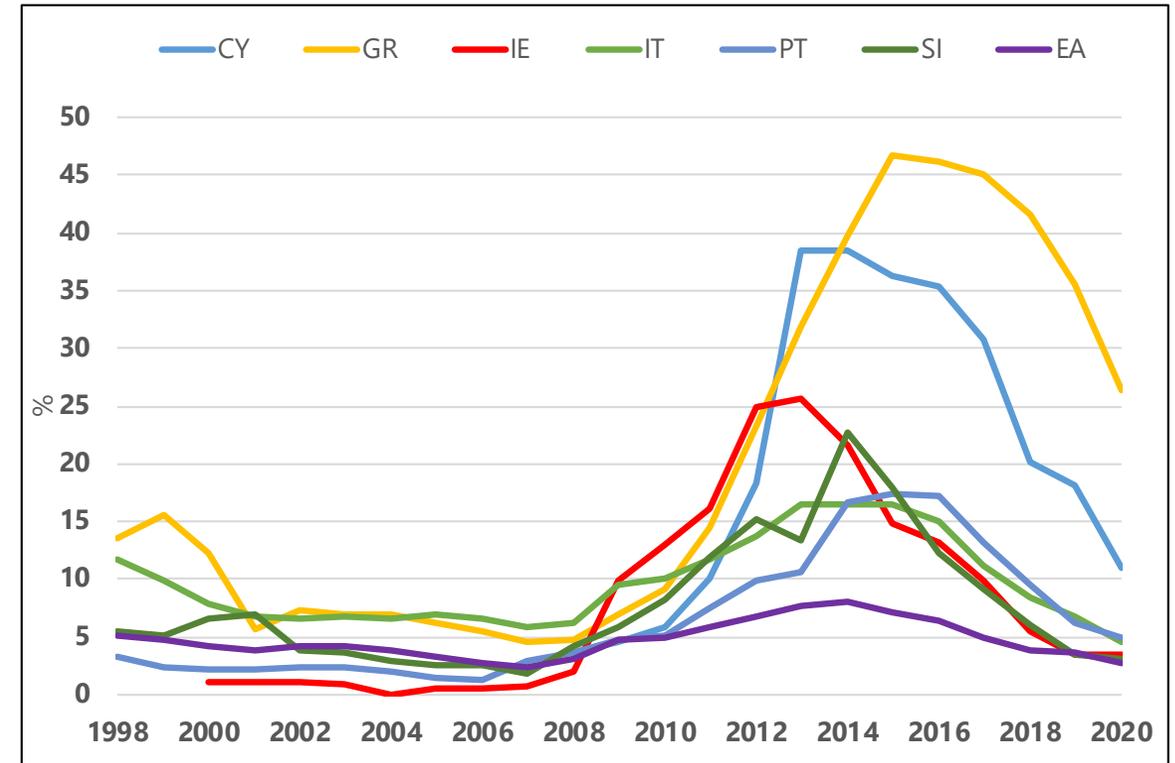
Asia and Europe went through NPL surges in the last two decades

NPL ratio in Asia, by subregion (1997-2020)



Note: Asian Development Bank calculations using data from Bank of Mongolia; CEIC Database; International Monetary Fund Financial Soundness Indicators.

NPL ratio in the euro area and selected countries (1998-2020)

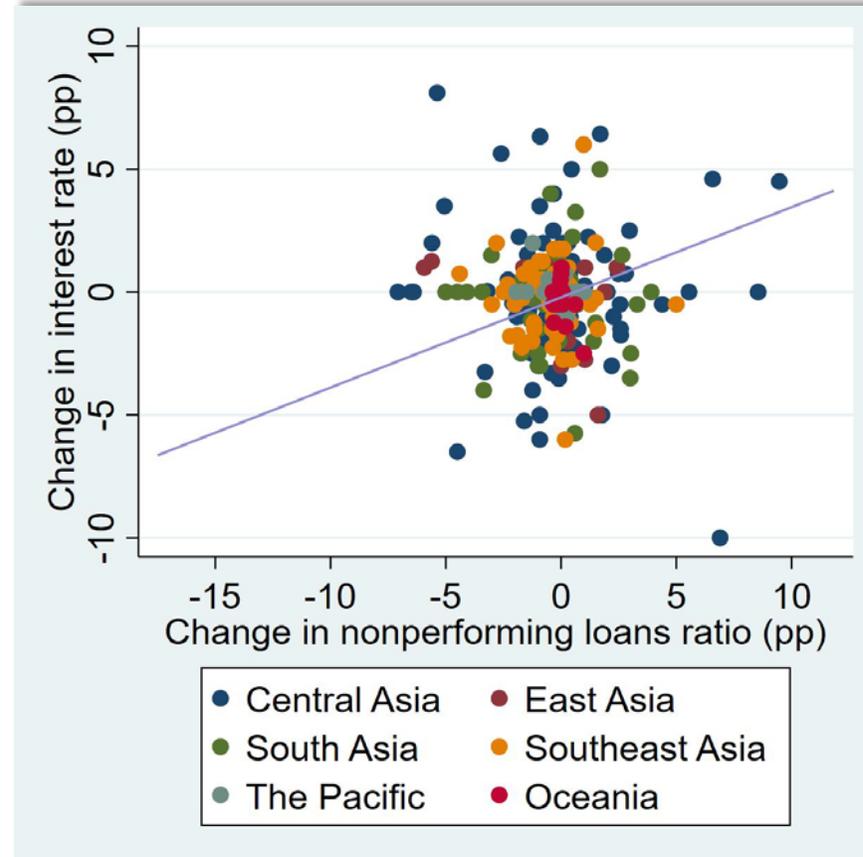
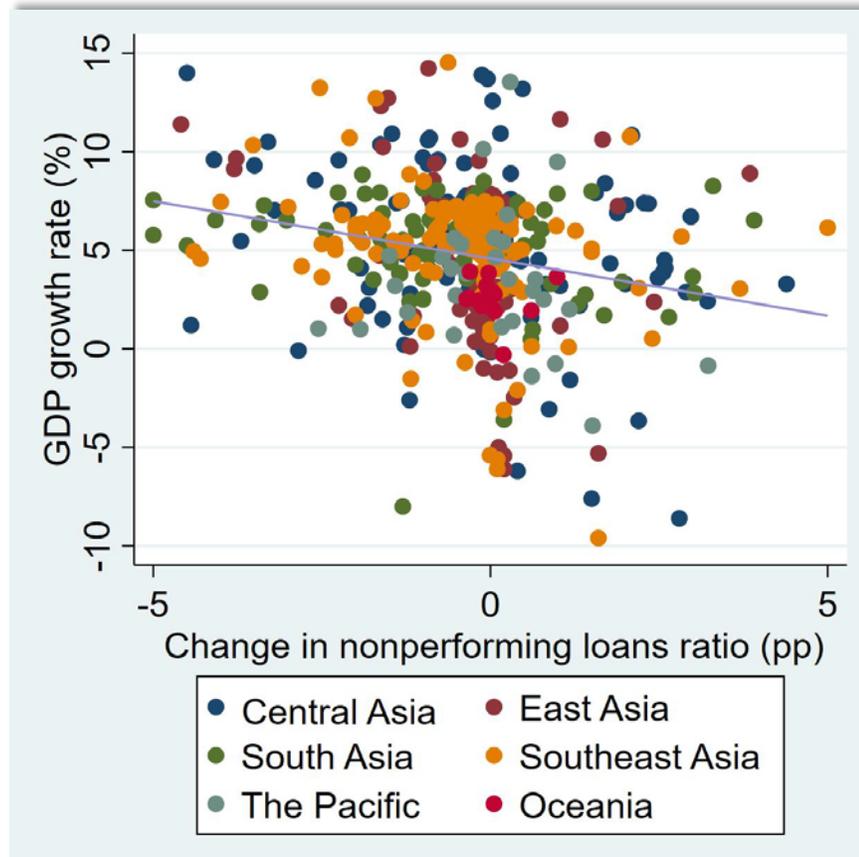


Note: data for Ireland and Cyprus available from 2000 and 2008 only. Source: IMF, ECB.



NPL ratios are negatively correlated with GDP growth; and tend to increase in tandem with interest rates

NPL ratios, GDP growth, and interest rates in Asia, 1997–2020



GDP = gross domestic product; pp = percentage points.

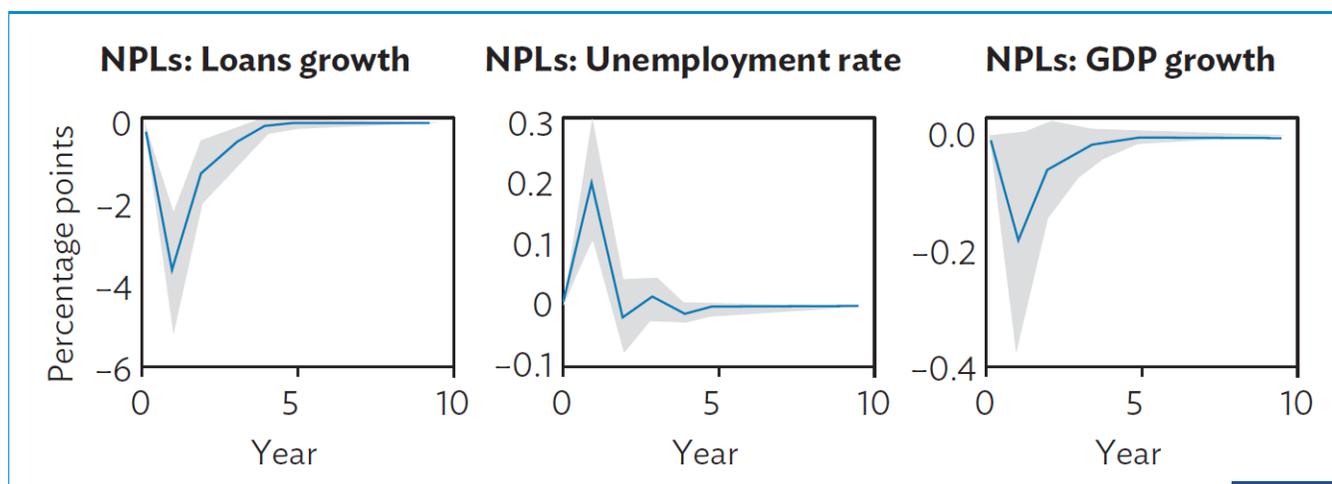
Note: Interest rates refer to central bank policy rates.

Sources: Asian Development Bank calculations using data from the Bank of Mongolia; CEIC Database; International Monetary Fund Financial Soundness Indicators.

Macrofinancial implications of nonperforming loans

- High NPLs can impair banking sector stability and its ability to financially intermediate
 - Chapter 3: Harmful macrofinancial implications of NPLs across Asian economies.
 - Chapter 4: Increases in NPL ratios depress bank lending in the euro area, widen bank lending spreads, and lead to a fall in GDP growth and residential real estate prices.
- Considerable economic benefits of dealing swiftly with elevated NPL levels, especially for bank-based financial systems such as in Asia and Europe

Estimated impulse response functions to a shock in the NPL ratio (Asia)



Source: Chapter 3.

NPL resolution is often hampered 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



Elements of a comprehensive approach to NPL resolution



Source: Chapter 7.



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Different problems require different solutions

Resolution methods and characteristics of NPL problems

- Country-specific conditions determine the right combination of NPL solutions
- Resolution by banks always part of the solution mix
- Market-based solutions are promising but often suffer from market failures

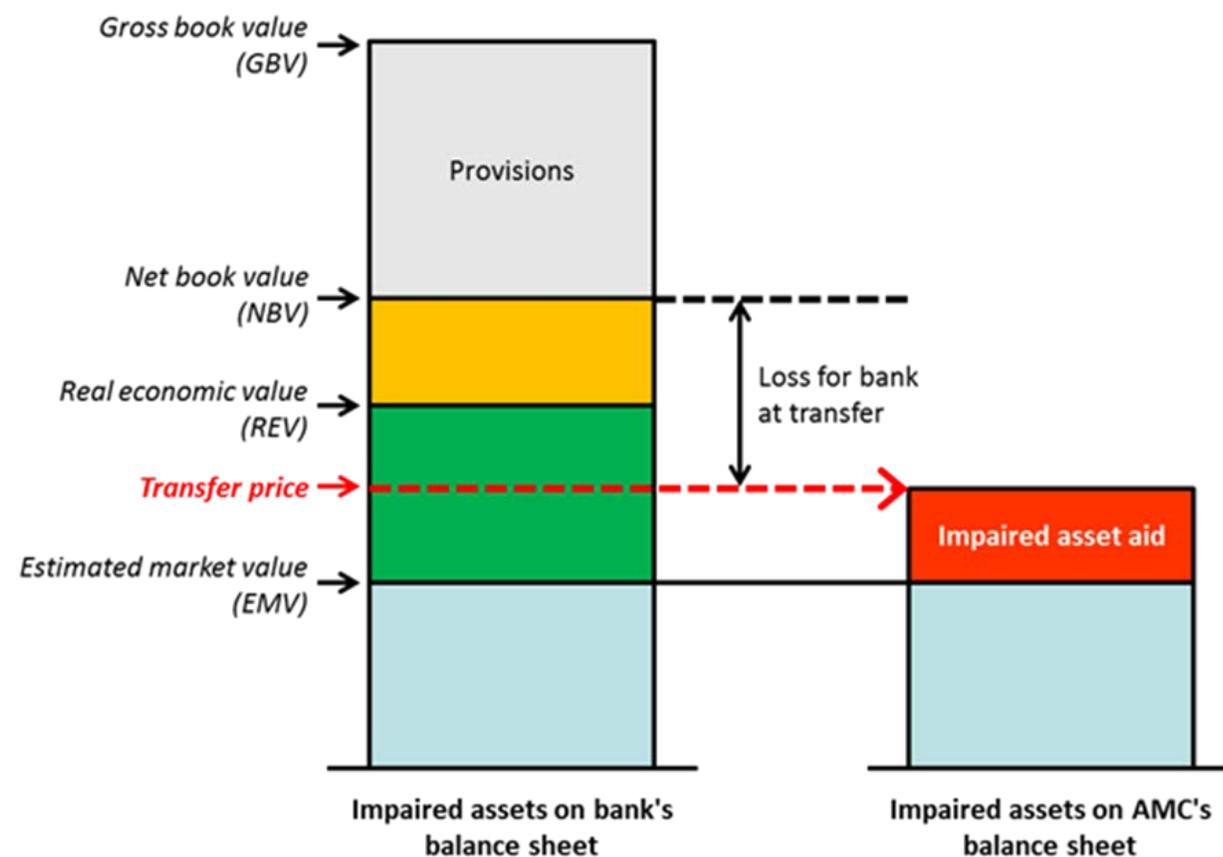
		APS	Public AMCs	Securitization	Direct Sales	Debt Restructure	Out-of-Court Workout
Nature of shock	Slow growth			✓		✓	✓
	Crisis	✓	✓	✓	✓	✓	✓
Asset types	Mortgages			✓		✓	
	SME loans		✓	✓	✓	✓	✓
	Large corp. loans		✓		✓		✓
	Unsecured loan		✓	✓	✓	✓	
Fiscal space	Limited	✓	✓	✓	✓	✓	
Legal constraint	Strong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

Note: AMC = asset management company, APS = asset protection scheme.
Source: Chapter 8.



Success factors for systemic AMCs

- Systemic 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 for the public sector
- Asset transfers should be informed by diagnostic exercises, ideally an Asset Quality Review as well as a stress test.
- Important to determine the appropriate transfer price and the scope of assets to be transferred



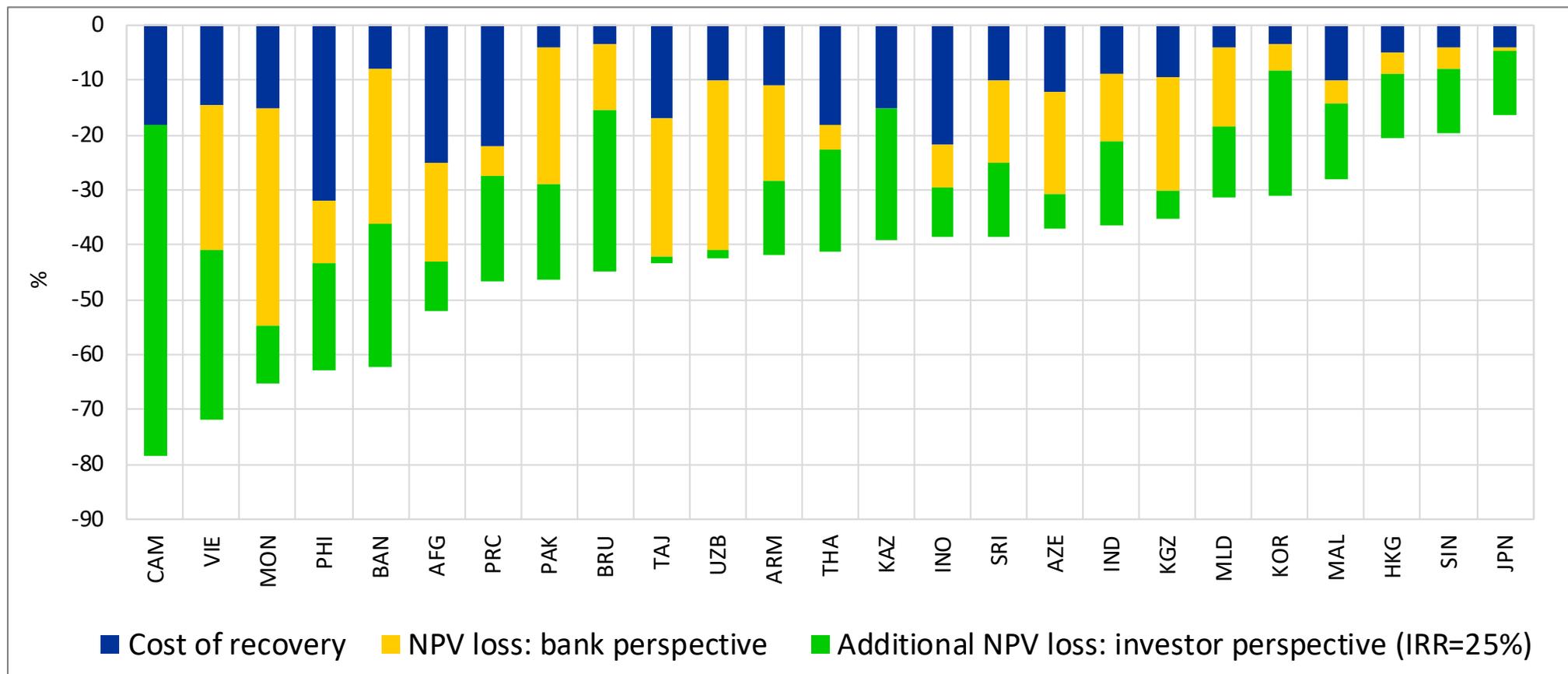
Success factors for systemic AMCs

- Commercial Real Estate (CRE) and property development loans are seen as particularly suitable but there is scope to consider other portfolios, notably corporate loans
- Finding the optimal scale and scope of assets is important. Economies of scale to be weighed against complexity.
- AMCs normally issue senior unsecured bonds to transferring banks; carrying full guarantee of the national treasury and eligible as collateral for central bank refinancing operations
- Operational independence and professional management improve business results.
- Differing views between many Asian and European economies on whether AMCs should be permanent or temporary entities



Bid-ask spreads can be significant

Difference between net book value and the estimated bid price (Asia)

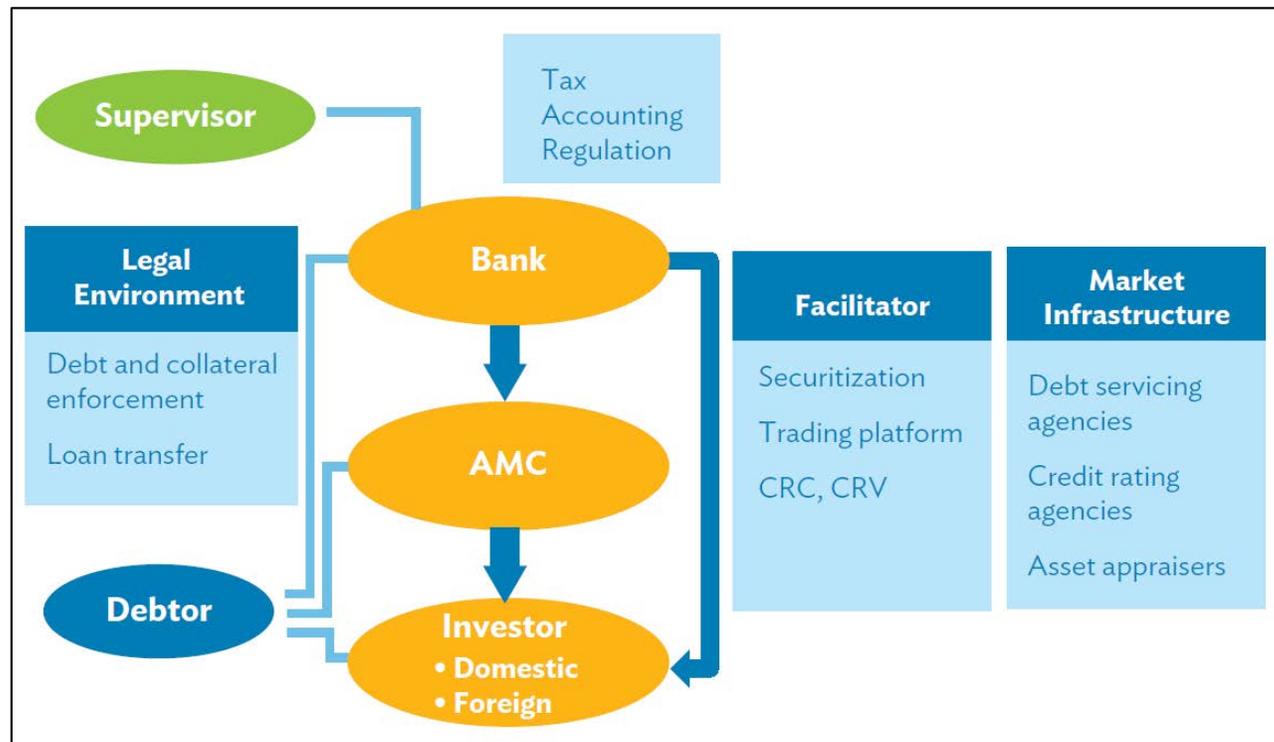


Notes: For Cambodia and Kazakhstan, only the total NPV loss is reported.
Source: Chapter 8.



Multi-pronged strategy needed to unlock potential of NPL markets

A strategic framework to develop NPL markets



Note: AMC = asset management company, CRC=corporate restructuring company, CRV = corporate restructuring vehicle.

Source: Chapter 8.

- Supervisory efforts to recognize and resolve NPLs
- Reforms of the legal and judicial framework for debt enforcement
- Out-of-court work-outs
- Improving NPL data
- Public and private asset management companies
- Regional cooperation, such as 2017 EU Action Plan



2017 EU Action Plan: example of a multipronged strategy

Supervision

- Clarify **supervisory powers** as regards bank provisioning policies (completed)
- Consider **prudential provisioning backstops** for new NPLs (CRR amendment in April 2019)
- Implement **guidance on NPLs for LSIs** and for non-SSM member states (EBA GL published in Oct 2018)
- EBA Guidelines on **loan origination and monitoring** (completed in May 2020)

Macroprudential solutions

- Develop approaches to **prevent the future emergence of system-wide NPL problems** (ESRB report published in January 2019)
- Develop a **blueprint for national AMCs**, consistent with EU legal framework (State aid rules, BRRD) (published in March 2018)

Secondary markets

- Issue **disclosure requirements** on asset quality (EBA proposal)
- **Strengthen the data infrastructure** with uniform and standardised data templates for NPLs (published in Dec 2017)
- Consider the setting-up of **NPL transaction platforms** (COM SWD published on 28 Nov 2018)
- **Remove impediments to the transfer of NPLs** by banks to non-banks and simplify the licensing requirements for third-party loan servicers (adopted November 2021)

Insolvency frameworks

- Publish the results of the **benchmarking** exercise on the efficiency of **national loan enforcement regimes** (EBA report, November 2020)
- Consider to carry out dedicated **peer reviews of national insolvency regimes**
- Analyse the possibility of **enhancing the protection of secured creditors** (COM proposal, work ongoing)



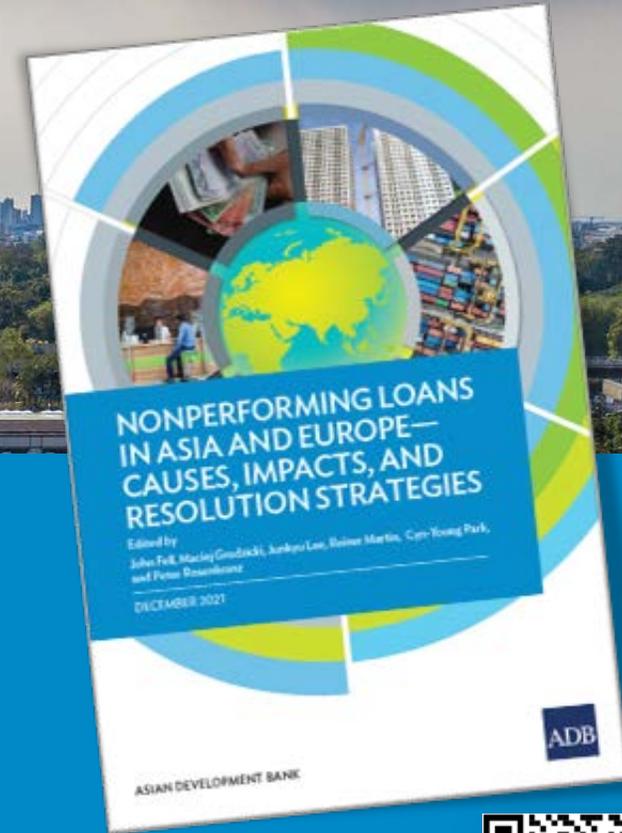
Key take-aways

- ✓ Context-specific, bespoke combinations of resolution approaches are the best way forward
- ✓ Identify and realistically assess the NPL problem early on
- ✓ Boost capacity to deal with NPL problem
- ✓ Address obstacles to NPL market development
- ✓ Reform legal frameworks – ideally proactively before NPL problems build up



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