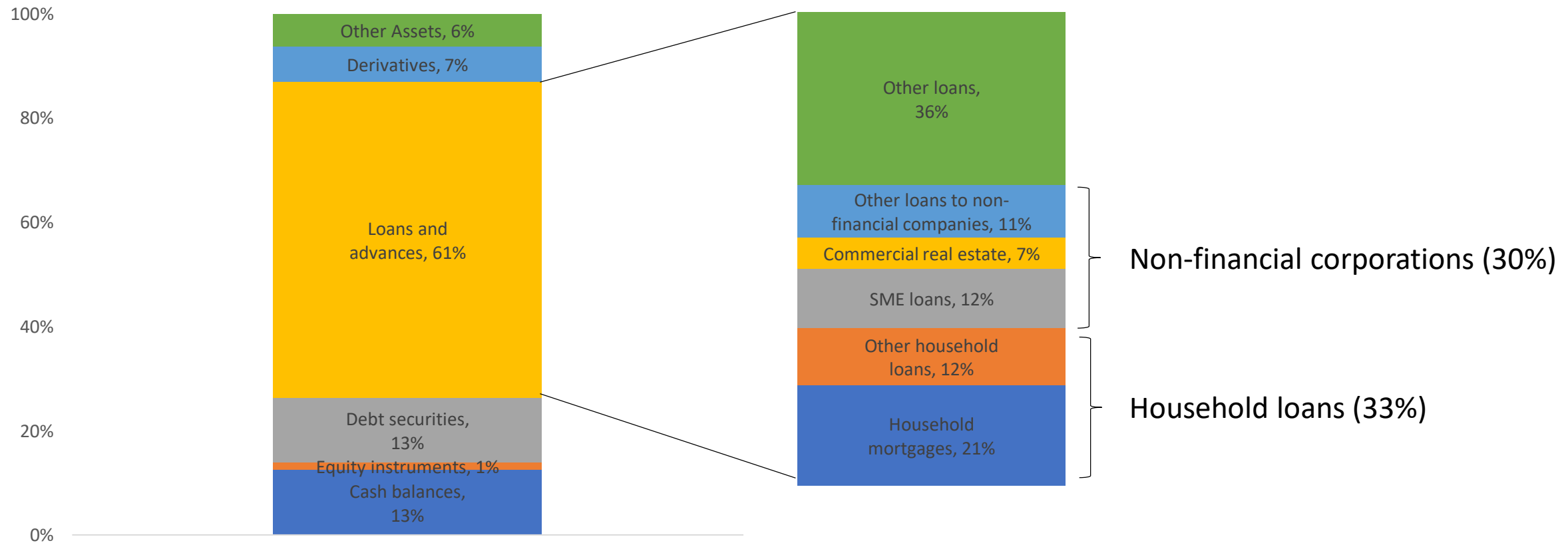


The Issue of Non-Performing Loans: Pros and Cons of Asset Management Companies

26 May 2021

Loans main component on EU banks' balances



Source: EBA (2021)

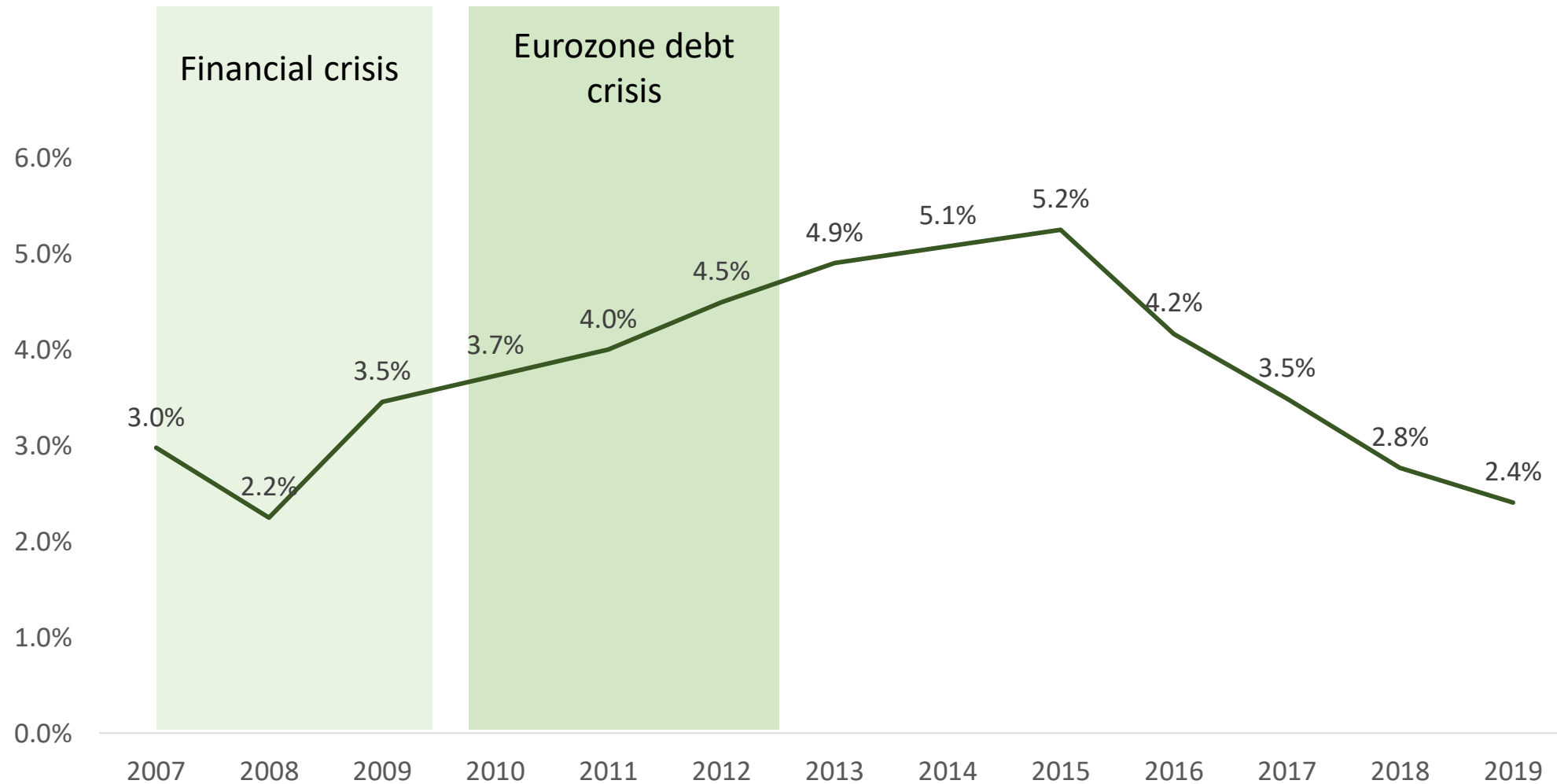
When does a loan become non-performing?

*“A loan becomes non-performing when there are indications that the **borrower is unlikely to repay the loan, or if more than 90 days have passed without the borrower paying the agreed instalments.** This may happen when an individual loses their job and therefore cannot repay their mortgage as agreed, or when a company experiences financial difficulties.*

Banks need to look closely at the loans they have granted and identify at an early stage those loans that are at risk of becoming non-performing. This is called ‘recognition of non-performing loans’.”

Source: ECB (2016)

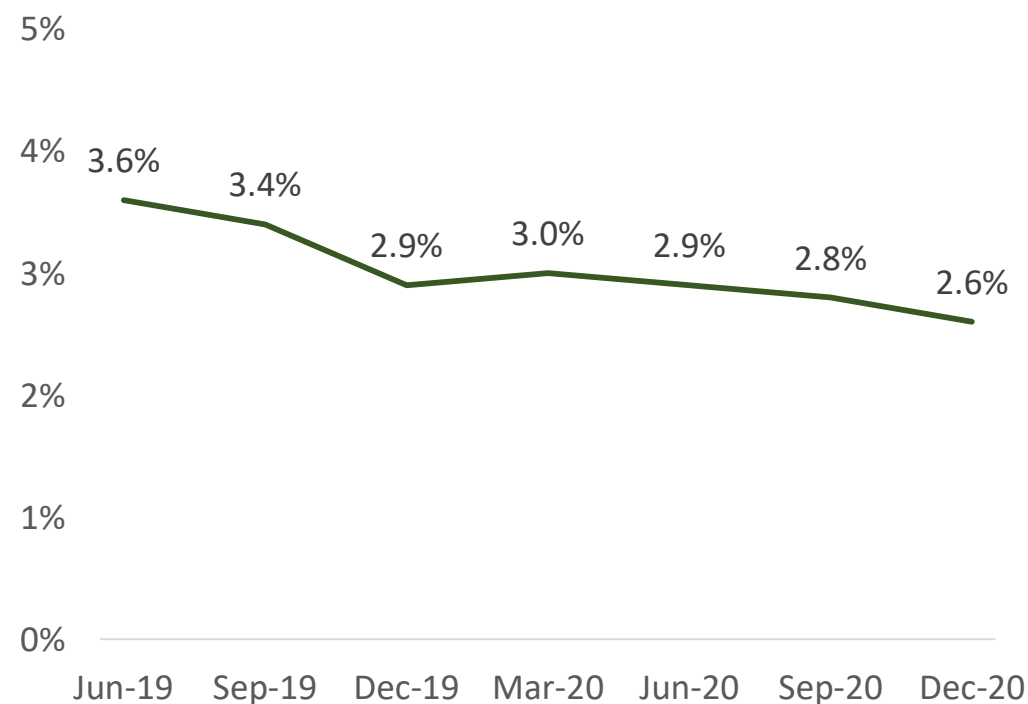
NPLs back to pre-crisis levels before COVID breakout (Eurozone)



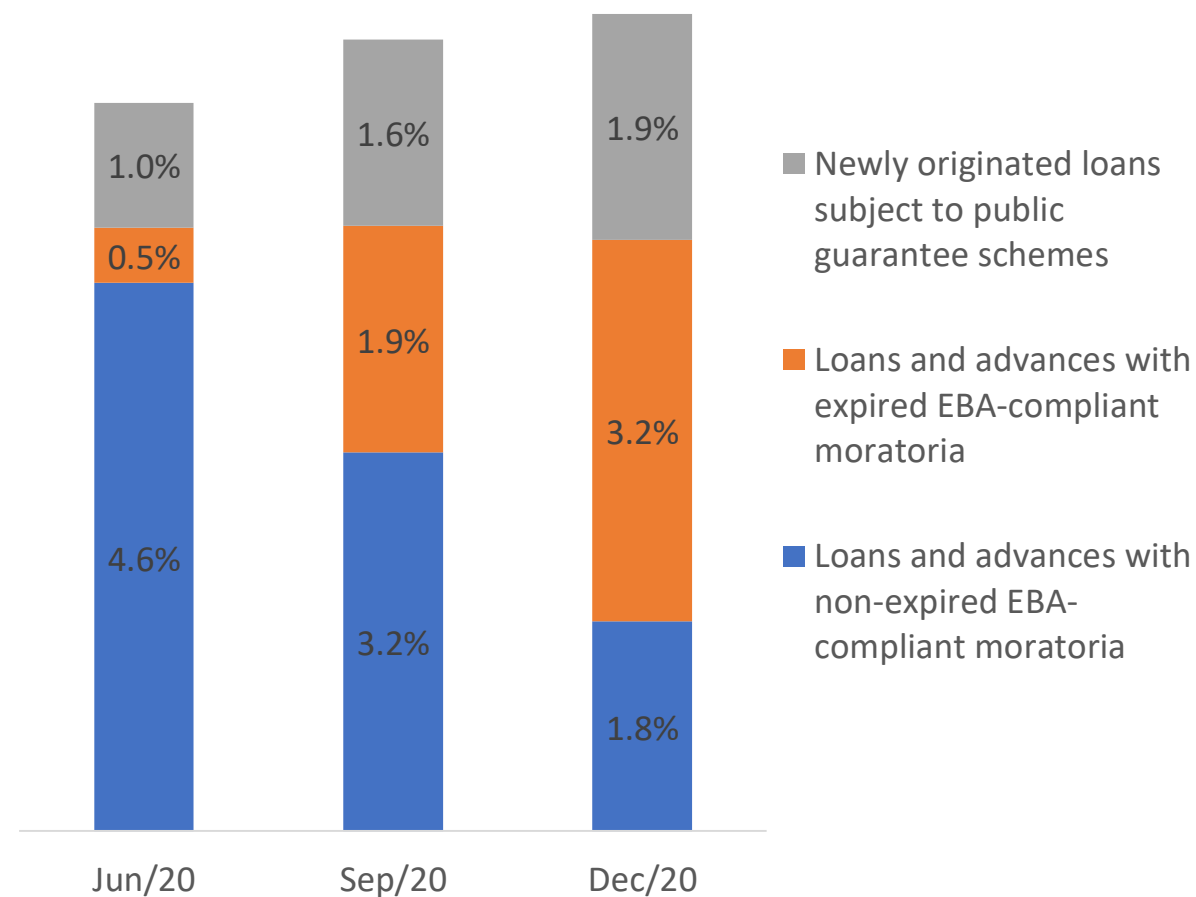
Source: ECB (2020)

NPLs since COVID outbreak (EEA)

NPLs continued to drop..



..at least partially due to mitigating measures



Source: EBA (2021)

Selection of tools to address distressed assets

SALE OF BUSINESS

The sale of business tool allows for the total or partial disposal of the entity in a financial transaction

BRIDGE BANK

Part or all of the business is transferred to a temporary entity totally or partially publicly owned.

ASSET SEPARATION INCL. ASSET MANAGEMENT COMPANY

Assets whose liquidation could cause market disruption can be transferred to an asset management vehicle, totally or partially publicly owned.

BAIL-IN

Equity and debt can be written down, converted or bailed-in, placing the burden on shareholders and creditors of the bank rather than on the public.

Asset Management Companies – Strengths

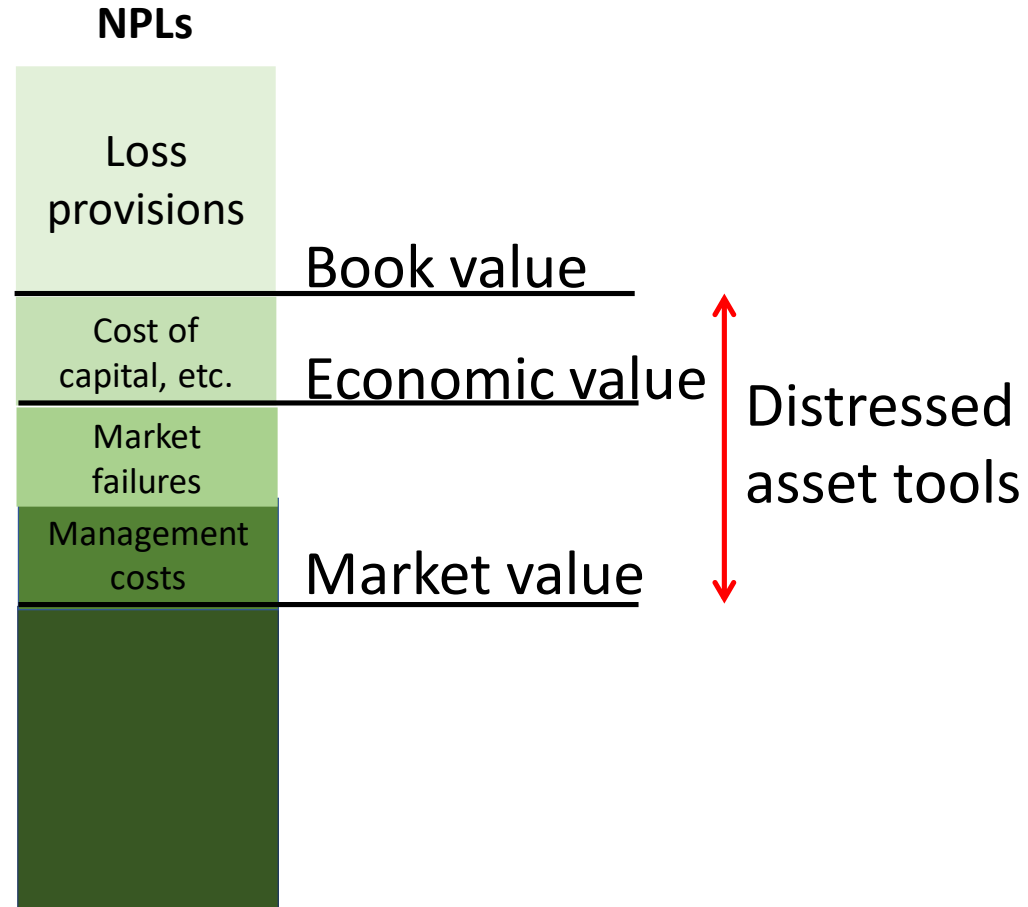
- Increase in economies of scale
- Strengthening of bargaining power
- Pooling of expertise
- Increase in recovery value
- Reduced funding costs

Asset Management Companies – Opportunities

- Remove bad assets from bank balances to boost credit growth and realign incentives
- Overcome unwillingness from banks to sell/transfer NPLs*
- Bridge the intertemporal valuation gap*
- Contribute to financial stability
- Reduce costs to the taxpayers (deposit guarantee scheme (DGS), resolution funds and government contributions)
- Enhance debtor coordination
- Contribute to the development of secondary market for NPLs

Market failures NPLs

- Inefficient judicial systems
- Information asymmetry (buyers and sellers)
- Pricing problem (inefficient markets)
- Incentives for banks to postpone loss taking



Asset Management Companies – Weaknesses

- Loss of information about the debtor
- Potential prolongation of the life of the AMC to maintain employment

Asset Management Companies – Threats

- Preferential treatment of certain borrowers because of inappropriate asset purchases (political interference)
- Risks becoming an indefinite warehouse of NPLs
- Weakened credit discipline
- Possible fire sale prices disrupting the economy
- Social distress caused by foreclosures
- Transfer of losses from banking system to taxpayers

Conclusions

- COVID might cause a sharp increase in NPLs
- Market failures hamper functioning of NPL-market
- AMCs at national or EU-level can overcome some of these failures
- Burden sharing, independent governance and skilled (seconded) staff are essential for good performance of AMCs
- Performance should consider recovery rate, but also broader financial stability and socio-economic impact

Thank you!



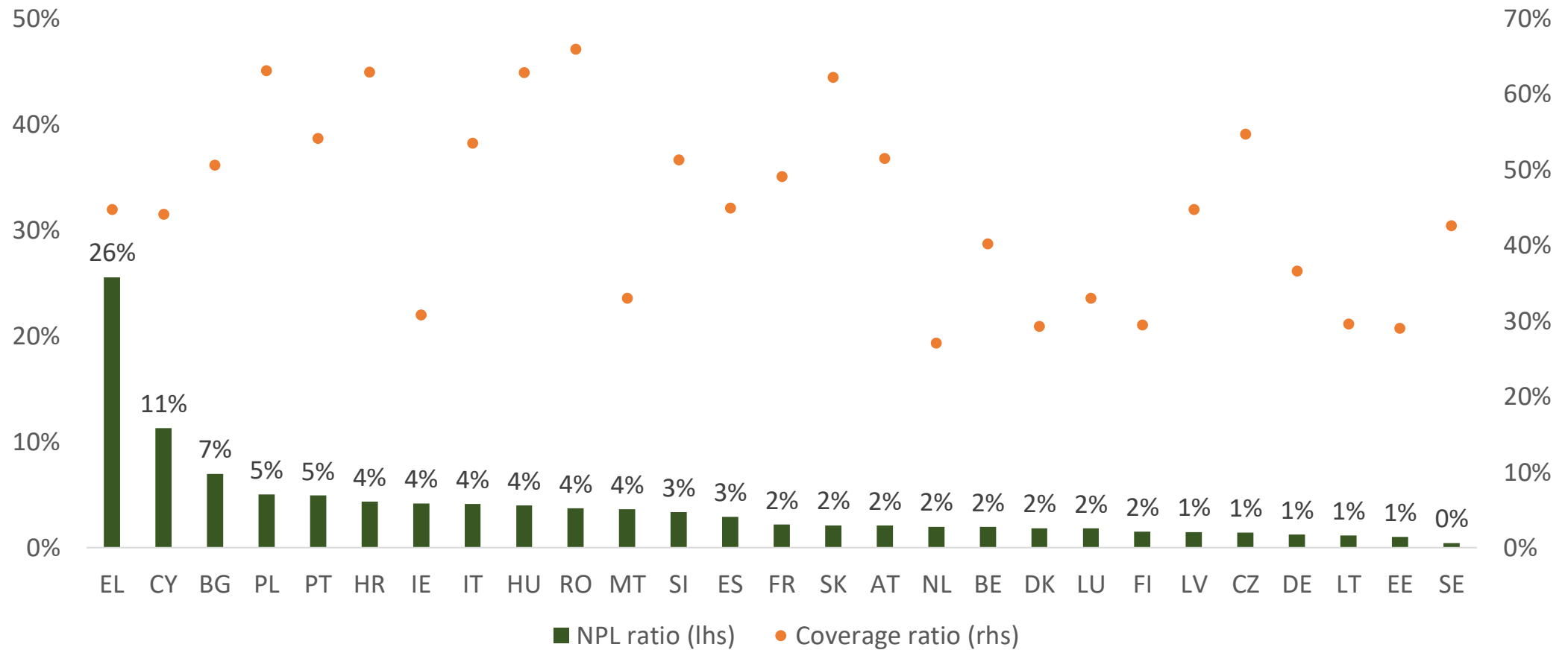
Willem Pieter DE GROEN

willem.pieter.degroen@ceps.eu

+32 2 229 39 57

Presentation based on:
Avgouleas, Ayadi, Bodellini, Casu, De Groen and Ferri (2021),
“Non-performing loans - new risks and policies: What factors
drive the performance of national asset management
companies?”, European Parliament.

Large difference in NPL ratios between countries



Source: EBA (2021)

AMC – SWOT

STRENGTHS

- Increase in economies of scale
- Strengthening of bargaining power
- Pooling of expertise
- Increase in recovery value
- Reduced funding costs

WEAKNESSES

- Loss of information about the debtor
- Potential prolongation of the life of the AMC to maintain employment

OPPORTUNITIES

- Remove bad assets from bank balances to boost credit growth and realign incentives
- Overcome unwillingness from banks to sell/transfer NPLs
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THREATS

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