



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Stocktake of national supervisory practices and legal frameworks related to NPLs

June 2017

BANKING SUPERVISION

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Executive summary

In September 2016, the European Central Bank (ECB) published its first stocktake on national supervisory practices and legal frameworks related to Non-Performing Loans (NPLs). The decision to publish was taken in order to support the ECB's consultation on the then draft guidance to banks on NPLs, as well as to generally promote further dialogue among the parties with a role to play in finding sustainable solutions to the elevated levels of NPLs within the EU. The first stocktake was completed in close collaboration with eight National Competent Authorities (NCAs) focussing in particular (but not exclusively) on the emerging best practices in jurisdictions with relatively high levels of NPLs.

It was subsequently decided to extend the stocktake to the remaining 11 countries participating in the Single Supervisory Mechanism (SSM) so that ECB Banking Supervision would have a full picture of the practices in the euro area as at 31 December 2016, and in order to continue the ECB's contribution to the European dialogue on NPLs. Given that the new countries in the second stocktake do not have high levels of NPLs, the policies and practices in their jurisdictions are not expected to be as prescriptive or coordinated as those in jurisdictions currently reacting to high levels of NPLs.

Progress has been made within the SSM to address the NPL issue from a supervisory perspective and the overall value of the NPL stock has decreased since the publication of the first stocktake. Nevertheless, one of the key lessons to be taken from the financial crisis and the experience of many jurisdictions with high NPL levels is the need for all stakeholders to be proactive and prepared before NPL levels become elevated. Current legal backlogs relating to insolvency and debt restructuring in a number of jurisdictions with high NPL levels can, for example, be traced back to a failure to establish out-of-court settlement frameworks in quieter times. As a result, banks in some jurisdictions cannot resolve NPL issues efficiently, and their NPLs have a negative impact on their performance. Crucially, banks themselves should ensure that their second and third lines of defence guarantee compliance with various regulatory standards and good practices so that NPLs are promptly identified and managed and that, more broadly, they are prepared insofar as possible to identify and manage NPLs in the event of future downturns.

With regard to **supervisory regimes and practices**, the first stocktake noted that many jurisdictions with high NPL levels had implemented strategies and taken actions to address the issue, for example through on-site inspections and the publication of additional guidance and requirements. The ECB's recently published NPL guidance addressed to SIs builds on the good practices in these jurisdictions to some extent, and the implementation of this guidance within SIs will be an important part of supervisory assessment in future.

A number of low NPL jurisdictions currently have little in terms of specific guidance or requirements applicable to LSIs that (with due regard to proportionality) can be considered equivalent to the guidance addressed to those institutions directly

supervised by the ECB. A number of these jurisdictions have indicated, however, that they are in the process of considering whether to apply the ECB's guidance to banks on NPLs to their respective Less Significant Institutions.

Finally, tools such as dedicated or specifically focussed on-site inspections of arrears/NPLs play a material role in detecting emerging issues at an early stage. They can be used to assess compliance with the EBA ITS on NPE/forbearance, which is essential to ensuring that banks are properly classifying and provisioning their exposures. The ECB and NCAs recognise the importance of such tools and are committed to making any necessary enhancements to their supervisory frameworks on the basis of experience and emerging good practice.

With regard to the **legal, judicial and extra-judicial frameworks**, to the extent that there have been changes in high-NPL jurisdictions since the first stocktake, these have been (with some exceptions) incremental in nature and it is too early to assess their effectiveness. In any case, changes to judicial systems (including the recruitment of insolvency experts) are not keeping pace with legislative developments.

The pressure to implement frameworks for better-functioning NPL markets or to create AMC solutions is greater in countries with high NPL levels. Out-of-court mechanisms to, for example, enforce collateral or process corporate and household insolvency claims feature in only a minority of jurisdictions with low NPL levels. Many jurisdictions are therefore not as prepared as they could be to manage the legal aspects of any future escalation in NPL levels in a timely and efficient manner.

With regard to **information frameworks**, the second stocktake has identified little that is new. The majority of participating countries have central credit registers (CCRs) in place, usually managed by national central banks. Such registers are generally considered to be a valuable supervisory tool for on-site and off-site analyses as well as for the sharing of information between banks. However, not all NCAs refer to CCRs when conducting their supervisory activities. Other public registers are also an important source of information, although in some countries the availability of such sources of data remains limited. Finally, delays in the implementation of a CCR in one country included in the first stocktake were noted.

1 Structure, scope and validation methodology

1.1 Structure and scope

This report summarises the main findings of an ECB stocktaking exercise conducted to identify the range of practices relating to NPL workout in all SSM countries taking a broad perspective as at end-2016. It seeks to identify key supervisory practices and guidance in addition to current regulation, and obstacles (legal or otherwise) related to the workout of NPLs. It is a technical paper primarily intended for the NPL Task Force, its work streams and the Joint Supervisory Teams (JSTs), which has however been published to contribute to the ongoing European dialogue on NPLs. Building on work completed and published in 2016, this stocktake has been expanded to include all member states participating in the SSM.

The stocktake was a judgement-based exercise largely completed by the NCAs on behalf of the ECB. The ECB stocktaking exercise covered five key areas: (i) credit risk management and control, (ii) credit exposure classification, (iii) provisioning/impairment, (iv) NPE management and resolution, and (v) supervisory tools. In this report, these areas have been grouped under three headings: (i) supervisory regime and practices; (ii) legal, judicial and extrajudicial framework; and (iii) information framework. The stocktake focuses primarily on supervisory regimes and practices as this is the area in which NCAs have the most control in their jurisdictions.

The stocktaking exercise contained both open and closed questions, thereby guiding the analysis towards the key issues while at the same time providing ample opportunity for NCAs to provide clarification on specific matters. In addition to providing information for this report, the stocktaking exercise also served as an input to the conduct of country-specific analysis by the ECB, which is contained in the annexes to this report.

1.2 Validation of country-related information

To ensure the accuracy and consistency of the data contained in this report, the country-specific analysis and the stocktaking exercise relied on a validation exercise comprising three phases. These phases were: (i) a *quality assurance phase*, performed by a core ECB Team; (ii) a *consultation phase* with ECB country experts and (iii) an *additional NCA input phase*.

In the *quality assurance phase*, the responses to the stocktaking exercise were assessed on a country-by-country basis by case experts. This phase included the collection, analysis and assessment of the supporting documentation provided by the NCAs, after which relevant adjustments were made to the questionnaire responses.

In parallel, a horizontal team carried out an assessment by topic, comparing responses across countries.

The second part of the validation exercise consisted in a *consultation phase* with JSTs and ECB country experts. The aim of this phase was to validate the content and especially the findings of the country-specific analysis. The conclusion of this phase resulted in the fine-tuning of the country-specific analysis (and stocktake responses).

In the *additional NCA input phase*, the country reports were submitted to the NCAs for their final comments. The NCAs concur with the content of the analysis for their respective countries.

It should be noted that some of the legal, judicial and extra-judicial aspects in the report (e.g. the tax regime or insolvency law) are not in the primary scope of NCAs' responsibility. They are therefore merely indicative of the views of the NCA rather than being "hard facts".

1.3 How to read this report

Given its wide scope, certain tools and techniques have been used to distil the content of the exercise for the purposes of this report, **each of which has its own limitations**. Radar charts and tables, for example, are used to graphically represent the existing practices and areas requiring attention. **It should be noted that a lower positioning in such charts does not in itself indicate a lack of compliance with minimum standards or extensive weaknesses in the framework of a given country. Similarly, given that the origins and character of the NPL problem differ from country to country, it is to be expected that jurisdictions have to date placed differing emphasis on the value of certain tools to deal with NPL workout. Charts and figures should therefore not be taken out of context or viewed in isolation from the text that relates to them.**

Furthermore, with regard to what currently constitutes good practice, it is to be expected that the frameworks in countries that do not have high levels of NPLs will not be as prescriptive or coordinated as those in jurisdictions currently reacting to high levels of NPLs. The tables in the main report therefore generally distinguish between countries with higher and lower levels of NPLs.¹

Finally, please note that the country reports in the annexes represent a synopsis of the analysis carried out by the stocktake team. With specific reference to legal, judicial and extra-judicial practices, please note that the assessment and views contained therein are those of the individual NCAs.

¹ The jurisdictions with high NPL levels are Cyprus, Greece, Ireland, Italy, Portugal, Slovenia and Spain. The jurisdictions with low NPL levels are Austria, Belgium, Estonia, Finland, France, Germany, Latvia, Lithuania, Luxembourg, Malta, the Netherlands and Slovakia.

2 Analysis and key findings

2.1 Supervisory regime and practices

This chapter provides an overview of existing supervisory guidance and practices within NCAs. These are the guidance and practices that apply to the Less Significant Institutions, and that sit side-by-side with the guidance published by ECB Banking Supervision in March 2017 that applies to the Significant Institutions. While LSI banking assets represent approximately 15% of total banking assets overseen by the SSM, within the individual countries LSI assets represent anything from 2% to approximately 56% of national banking assets.

2.1.1 Supervisory regime (credit risk/NPLs) (Section A.1 in the country reports)

All NCAs have general guidance in place relating to credit risk, including guidance on credit risk management in banks. Some of this documentation contains stipulations relating to general methods, policies and processes that the banks should implement to ensure adequate and timely management of credit risk. Specifically, these stipulations include references to credit approval/governance and credit risk monitoring, data collection, computation and reporting.

More than half of NCAs in jurisdictions with high NPL levels also have guidance in place related to accounting (e.g. impairment triggers, measurement and procedures, disclosure, collateral valuation).

In terms of NPL-specific guidance, four jurisdictions with high NPL levels have comprehensive guidance on arrears management (all of which was published prior to the ECB guidance to banks on non-performing loans) which covers, for example, arrears management strategies, portfolio segmentation, restructuring options/sustainable restructuring and banks' organisational structure. To complement this guidance, banks in these countries are also required to comply with published Codes of Conduct when dealing with borrowers in financial difficulties, which set out general principles on: (i) arrears management strategies and related documents, (ii) the organisational structure that banks must have in place for the arrears management process and (iii) customer communication policies.

A number of countries (including the majority of jurisdictions with low NPL levels) have introduced system-wide macroprudential measures addressing real estate risks and excessive credit growth, including for example reference to debt-servicing amounts and limits on loan-to-value (LTV) and loan-to-income (LTI) ratios.

2.1.2 NPL recognition and classification (Section A.2 in the country reports)

An adequate NPL recognition and classification process in banks facilitates the timely and effective management of problem loans, thereby reducing their negative effects. Proper classification of loans is also essential for the correct representation of the banks' situation to stakeholders including external investors and market analysts. It is desirable therefore that banks adopt and apply common accounting and prudential principles. The promotion of appropriate recognition and classification criteria and practices that are consistent among banks is an important goal for banking supervisors.

All NCAs in the stocktake have indicated that the European Banking Authority (EBA) common definitions of NPLs and forbearance have been adopted in their respective jurisdictions. The tables below illustrate that while additional guidance on recognition and classification has not been developed typically in jurisdictions with low NPL levels, many NCAs in jurisdictions with high NPL levels have published additional guidance on performing loan/NPL sub-categories, forbearance criteria and data collection. Some NCAs in jurisdictions with high NPL levels have opted for a set of criteria for NPL recognition and classification and others have issued principles-based guidance that could guide banks towards early recognition and classification of NPLs.

Table 1

Additional supervisory guidance on NPL recognition and classification (beyond current regulation)

Jurisdictions with high NPL levels												
	CY	GR	IE	IT	PT	SI	ES					
NCA has published guidance on:												
additional performing loan/NPL sub-categories	x	✓	✓	✓	x	✓	✓					
additional forbearance criteria	✓	✓	✓	x	✓	✓	✓					
additional specific data collection requirements for forborne exposures	✓	x	✓	x	✓	✓	✓					
additional exit criteria from NPL/forbearance category	x	x	x	x	x	x	x					
Jurisdictions with low NPL levels												
	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
NCA has published guidance on:												
additional performing loan/NPL sub-categories	x	x	x	x	x	x	x	x	x	x	x	x
additional forbearance criteria	x	x	x	x	x	x	x	x	x	x	x	x
additional specific data collection requirements for forborne exposures	x	x	x	x	x	x	✓	x	x	x	x	x
additional exit criteria from NPL/forbearance category	x	x	x	x	x	x	x	x	x	x	x	x

Most NCAs in jurisdictions with high NPL levels have provided additional sub-categories for classifying performing exposures (PEs) and non-performing exposures (NPEs) based on the classes of the EBA Implementing Technical Standards (ITS). In addition to the sub-categorisation referring to days past due (dpd), other types of

sub-categorisation based on the quality of the loan were noted in some cases, allowing a better and more accurate recognition of risk (see Table 2 for details).

The existence of specific predefined impairment triggers (in addition to accounting standards) also pushes banks towards the recognition of NPLs (as was the case in the 2014 ECB asset quality review). Section 2.1.3 presents the list of impairment triggers identified in the stocktake.

As regards the classification of forborne exposures, some jurisdictions with high NPL levels have issued criteria to guide the classification of these exposures as performing or non-performing. Moreover, some countries have developed rules requiring banks to collect minimum levels of data for such exposures.

Additional supervisory criteria pertaining to the removal of loans from banks' NPL categories is uncommon.

The proper definition and application of additional criteria for NPL classification should take into account the characteristics of the legal frameworks and the credit relationship practices, which vary across jurisdictions. For this reason, the definition of strict common criteria (e.g. based on fixed thresholds) might be challenging.

There is a material contrast between jurisdictions with low and high levels of NPLs with regard to additional guidance on NPL recognition and classification. Jurisdictions with low NPL levels have not published additional guidance on recognition and classification, although one has additional specific data collection requirements for forborne exposures.

Table 2

Technical index of additional key supervisory guidance regarding classification

NPL/NPE classification
<p>Guidance related to NPL recognition and classification: increase the frequency of loan impairment assessment; require banks to define their own trigger events.</p> <p>Existence of PE/NPE sub-categories: definition of additional PE and NPE sub-categories (as per EBA category subsets). For performing loans, sub-categories relate to additional loans that were not previously classified as NPLs (e.g. without arrears, renegotiated loans), loans that were previously classified as NPLs (cured loans or loans in forbearance in a probation period) and PEs/debtors settled on the basis of an assessment and valuation of the debtor's ability to discharge the liabilities to the bank (e.g. category "A" debtors which are expected to be able to pay their liabilities without difficulties and pay their liabilities when they fall due or exceptionally up to 15 days in arrears, those insured with the best-quality collateral). For NPLs, sub-categories relate to the assessment of the debtors (e.g. NPLs to uncooperative or non-viable debtors, debtors in a state of insolvency) and the identification of specific weak situations of the debtors that should trigger the classification as an NPL/unlikely to pay (e.g. negative equity, persistent losses, the bank has already incurred a material economic loss when writing off or selling the financial assets).</p> <p>Risk management tasks in relation to classifications: stipulations which give to the risk management function the task to check the accuracy of the classifications and provide that in cases of divergent evaluations, those of the risk management function prevail.</p>
Forborne exposures
<p>Classification of forborne exposures: specific triggers to identify clients facing financial difficulties, with forbearance measures (e.g. loans in arrears registered in the CCR in the last 12 months; use of revolving credit lines, including current accounts and overdrafts, of at least 95% of the quantity initially authorised by the institution over a consecutive period of 12 months); the existence of guidance to identify types of measures to be considered as forbearance, which should evidence under certain conditions the weakness in the borrower's ability to pay, e.g. the granting of lengthy grace periods in respect of principal repayment.</p> <p>Forborne exposure data collection: minimum specific data collection requirements for forborne exposures that allow an effective monitoring of these exposures, mainly related to the dates of the restructuring, total number of restructurings, type/method of forbearance, effects on the value of the financial assets including the effects from write-offs or derecognition from the financial statement, change in the probability of loss, change in the debtor's credit rating and change in the performance status of the forborne financial assets. Requirements on data records (e.g. to be kept for at least five years after the facility has been unflagged with regard to forbearance measures).</p>

2.1.3 NPL measurement and provisioning (Section A.3 in the country reports)

The majority of institutions in participating countries follow provisioning practices in line with IAS (International Accounting Standard) 39². During the financial crisis, it was recognised that the current IASB (International Accounting Standards Board) approach³ could result in insufficient and delayed provisioning and could therefore be an obstacle to adequate NPL measurement within loan portfolios⁴.

Table 3
Supervisory guidance for provisioning (beyond accounting standards)

Jurisdictions with high NPL levels		CY	GR	IE	IT	PT	SI	ES
Additional guidelines		Yes	No	Yes	No	Yes	Yes	Yes
Accounting application		Non-binding		Non-binding		Non-binding	Non-binding	Binding
Provisioning	Impairment triggers	✓		✓		✓	×	✓
	Criteria for provisioning	×		✓		✓	✓	✓
Write-offs	Criteria for write-offs	✓		×		✓	✓	✓
Accrued interest	Criteria for accrued interest	×		×		✓	×	✓

Jurisdictions with low NPL levels		AT	BE	DE	EE	FI	FR ¹	LV	LT	LU	MT	NL	SK
Additional supervisory guidelines		No	No	No	No	No		Yes	Yes	No	Yes	No	No
Accounting application								Binding	Binding		Binding		
Provisioning	Impairment triggers						×	✓	✓		✓		
	Criteria for provisioning						×	×	×		×		
Write-offs	Criteria for write-offs						✓	×	×		×		
Accrued interest	Criteria for accrued interest						✓	✓	×		×		

1) Although no NCA specific guidance exists, the nGAAP provides further clarity on some of the assessed topics

As shown in **Table 3** above, the majority of supervisors in jurisdictions with high NPL levels have issued additional guidance related to provisioning. This guidance can be principles-based or rules-based. In addition, it can be binding or non-binding. Regarding the content, supervisors have set specific rules on impairment triggers or levels of provisioning or set general principles on how an institution should set its own rules. In this regard, the majority of jurisdictions with high NPL levels tended to issue mixed guidelines (rules-based for some sections and principles-based for others) as the basis for their assessments of institutions' credit risk policies and

² There are some countries where local institutions follow provisions set out in their national standards (national generally accepted accounting principles or nGAAPs).

³ The incurred loss approach to loan loss provisioning under IAS 39 is backward-looking (this is expected to be addressed when IFRS (International Financial Reporting Standard) 9 becomes effective in 2018) and leaves much room for judgement.

⁴ Mainly for this reason, the IASB is introducing a new standard on financial instruments (IFRS 9), which will be phased in from 2018.

capital adequacy. In two jurisdictions with high NPL levels banks are required to publicly disclose their impairment criteria.

With regard to jurisdictions with low NPL levels, a few NCAs have issued minor additional guidance/rules on NPL measurement and provisioning to supplement the international reporting standards requirements.

Finally, only four participating countries have additional binding rules on NPL measurement and provisioning.

Table 4

Technical index of additional key supervisory guidance regarding provisioning

Provisioning
<p><i>Impairment triggers</i></p> <ul style="list-style-type: none"> • Macroeconomic impairment triggers (i.e. dynamic provisioning): triggers related to current macroeconomic indicators (like GDP growth or the unemployment rate) that could affect a loan's future estimated cash flows. • Portfolio-specific triggers: definition of specific sets of triggers tailored to different portfolio segments like mortgages, commercial real estate (CRE) loans, loans to small and medium-sized enterprises (SMEs) or loans for which repayment depends directly on the value of the collateral. • Triggers linked to loan vintage buckets (i.e. days in arrears): definition of impairment triggers linked to dpd before NPL classification. <p><i>Criteria for provisioning</i></p> <ul style="list-style-type: none"> • Minimum level of provisioning according to the number of days in arrears (for unsecured assets): definition of minimum provisioning rates according to loans' vintage buckets (i.e. assigning a minimum level of provisioning, such as 25%, increasing the rate in relation of dpd, or enforcing full coverage after 21 months past due). • Specific provisioning intervals according to different ranges of situations (for unsecured loans): assigning provisioning rate intervals according to a borrower's contractual and financial situation (such as insolvency proceedings, quantitative indicators of financial and liquidity deterioration) and its classification with other institutions (according to the CCR reporting), and taking into consideration the country risk linked to its geographical area (specific coverage ratio assigned to six different buckets of countries grouped by their riskiness). • Adjustment of collateral valuation by applying a specific level of haircuts according to the type of collateral (for secured assets): definition of conservative haircuts to be applied to the lower of cost or appraised value for specific classes of collateral, from a minimum of 10% for financial collateral, to a maximum of 50% for land and other non-developed or non-liquid real estate (RE).
Accrued interest
<p><i>Criteria for accrued interest</i></p> <ul style="list-style-type: none"> • Specific limits on accrued interest recognition according to loan classification: accrued interest is reversed if a loan is classified under the <i>doubtful</i> category. • Specific limits on accrued interest recognition according to arrears of interest collection: accrued interest is reversed if a loan exceeds 90 dpd. • Disclosure requirements for differences between accrued and collected interest on impaired loans: disclosure of interest income recognised arising from impaired, non-performing but not impaired and forborne loans, and interest income received arising from impaired, non-performing but not impaired and forborne loans.

In order to achieve the main prudential objectives, it is important to ensure that institutions calculate impairments in a prudent way within an adequate risk management framework. Therefore, strong supervisory actions, such as guidance on internal best practices, on strategy and governance, and on the recognition and measurement of NPLs, combined with potential additional Pillar 2 measures, are deemed to be adequate instruments for this purpose.

2.1.4 NPL write-offs (Section A.4 in the country reports)

IAS 39 does not contain specific rules regarding the modalities of write-offs and recoverability, which would promote more consistent practices in this field and facilitate better individual and comparative analysis (e.g. assessment of the NPL ratio and coverage ratio). Some supervisors have issued NPL write-off and recoverability guidelines for these purposes and with a view to promoting timelier NPL disposal and, more generally, the development of a market for distressed debt.

Supervisors in the majority of jurisdictions with high NPL levels, and in one jurisdiction with low NPL levels, have issued additional criteria. As for provisioning, these guidelines can have a different content. With regard to write-offs, they are – with a few exceptions – principles-based to incentivise write-offs in accordance with the recovery expectations.

Table 5

Technical index of additional key supervisory guidance regarding write-offs (beyond accounting standards)

Write-offs
<p><i>Definition of criteria for write-offs</i></p> <p>Supplementary definition of what constitutes NPL uncollectability (remote recovery): defining a range of specific situations that determine the remote recovery of a loan, thus triggering its derecognition in line with accounting standards. Write-off should therefore follow based on evidence of situations that can be grouped into three categories:</p> <ul style="list-style-type: none"> • Time-related (prolonged arrears): i.e. unsecured transactions in arrears by more than three/four years⁵, or secured loans if past due by more than five years and the institution did not receive any repayment from collateral liquidation during the same period. • Legally/judicially-related: i.e. unsecured transactions for which the borrower is declared to be in bankruptcy proceedings. • Institution-specific: i.e. a transaction for which the institution has ceased recovery action (e.g. the case of debt forgiveness) or when a recovery procedure is no longer economically justifiable.

Banks are seldom encouraged to implement a write-off policy given either country-related external impediments such as legal and tax issues, or idiosyncratic impediments linked to institutions' governance. This could be a possible challenge when it comes to implementing consistent practices across the countries. For example, tax deductibility of losses arising from write-offs is, in some countries, bound by strict constraints aimed at ensuring the definitive extinction of all legal claims against the debtor. These impediments often prevent banks from making write-offs even if NPLs are fully provisioned.

2.1.5 Collateral valuation (Section A.5 in the country reports)

The use of robust and accurate collateral valuation methods is essential for the proper valuation of NPLs and for their effective management. It also contributes to the promotion of an active NPL market by reducing uncertainty relating to asset values. Moreover, a conservative approach to the valuation of collateral ensures that the NPLs are adequately provisioned, which is a key element for the soundness of institutions.

In all but one jurisdiction with high NPL levels, specific rules govern collateral valuation for the financial sector, especially for real estate collateral. Typically, these rules are related to professional requirements, but in some cases other specific rules have been drafted pertaining to, for example, appraiser independence, performance and limits on institutions' reliance on individual appraisers. In some cases, appraisers are also subject to the supervision of banking or financial market authorities.

⁵ The number of years varies in different countries linked to their specific economic and legal environment.

Table 6**Supervisory guidance on collateral valuation (beyond current regulation)**

Jurisdictions with high NPL levels												
	CY	GR	IE	IT	PT	SI	ES					
NCA has published guidance on:												
specific rules on valuation methods	✓	✗	✓	✓	✓	✓	✓					
rules on valuation frequency for NPL collateral	✓	✗	✓	✗	✓	✗	✓					
NCA has specific requirements:												
for appraisers	✓	✗	✓	✓	✓	✓	✓					
for data collection on collateral	✓	✓	✓	✓	✓	✓	✓					
Jurisdictions with low NPL levels												
	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
NCA has published guidance on:												
specific rules on valuation methods	✗	✓	✓	✗	✗	✗	✗	✗	✗	✗	✓	✓
rules on valuation frequency for NPL collateral	✗	✗	✗	✗	✗	✓	✗	✗	✗	✗	✗	✗
NCA has specific requirements:												
for appraisers	✗	✗	✓	✓	✗	✓	✓	✓	✗	✓	✓	✓
for data collection on collateral	✗	✗	✓	✗	✗	✗	✗	✗	✗	✗	✗	✗

With regard to valuation methods, most jurisdictions with high NPL levels have issued some guidance. In some cases valuations must be conducted according to public standards, while in other countries specific valuation methods for immovable property collateral are specified in addition to the requirements of the Capital Requirements Regulation (CRR).

Regarding the monitoring of collateral values in jurisdictions with high NPL levels, there are several national regulations governing/restricting the use of external or internal indices. In one jurisdiction with high NPL levels, the banking association has signed a Memorandum of Understanding (MoU) with all the professional associations in order to define common guidelines for RE collateral valuation, which are followed by each bank's panel of appraisers.

Table 7

Technical index of additional key supervisory guidance regarding collateral valuation

Valuation requirements
<p>Appraisers' requirements: (a) the appraiser should: (i) meet certain reputational and professional requirements and be enrolled in specific registers; (ii) be independent from the credit origination function and "in-house" valuers should report to the credit risk control function; and (iii) be assessed by banks in terms of their performance; and (b) there should not be an excessive use of one or a few appraisers, with the provision of specific non-binding thresholds in terms of the valuations performed by one valuer (<20% or <33% of all valuation reports).</p> <p>Higher frequency for RE collateral valuation and monitoring: (i) for performing loans, the requirement of an annual monitoring of RE collateral and an independent valuation for loans bigger than certain thresholds, with an impairment trigger, and indications about updating valuations of particular categories of collateral (e.g. non-listed securities and artwork); (ii) for collateral of NPLs, the requirement of a reassessment once the exposure becomes more risky/impaired and the requirement of a more frequent monitoring (and with more conservative assumptions) of defaulted assets.</p>
Valuation methods
<p>Guidance on methods allowed for the valuation and the monitoring of values: (i) requiring the use of international valuation standards⁶; (ii) requiring the use of external independent appraisals in specific situations, e.g. for exposures above certain thresholds, in the event of a deterioration in the exposure, in the event of "doubtful loans" or for upward revaluations; (iii) limiting the use of statistical methods for loans < €500,000; and (iv) prohibiting or limiting the use of internal indices (e.g. not for RE collateral, not for loans above certain thresholds, not for upward revaluations, and not in the case of an old external appraisal) and/or requiring their validation by an external independent entity.</p> <p>Specific rules for the valuation practices for foreclosed assets: aligning with the requirements for immovable property collateral in the CRR, underlying the need for a regular review of the assets, and requiring an independent appraisal company valuation every three years.</p>

Concerning the required frequency of collateral valuations, for performing loans, all participating countries follow CRR rules with some exceptions for large loans secured by non-real estate collateral. Additional rules for collateral related to an NPL have been issued in most jurisdictions with high NPL levels. These standards mainly require a reassessment or a more frequent monitoring once the exposure becomes more risky/impaired or has defaulted. Some countries provide specific rules for the valuation practices for foreclosed assets.

In all participating countries, institutions are required in effect to have a reliable data collection framework for collateral and the estimation of loss given default (LGD) parameters, but no minimum content for this data collection has been defined.

Some jurisdictions with low NPL levels have also implemented specific rules on valuation methods. These have typically been issued by the NCA or other authority with competence (e.g. for auditing standards). Such standards usually relate to (among other things) appraiser independence and monitoring of collateral. One NCA indicated that valuation methods have been the focus of on-site inspections.

Finally, while a number of NCAs in jurisdictions with low NPL levels have specific requirements for appraisers, none has issued additional rules on the frequency of collateral valuation and only one has issued any requirements for data collection on collateral.

2.1.6 NPL governance/workout (Section A.6 in the country reports)

Banks should be given incentives to identify problematic cases in a timely manner such that loans which are considered viable can be restructured promptly and

⁶ Royal Institution of Chartered Surveyors ("Red Book"), the European Valuation Standards ("Blue Book") or the International Valuation Standards ("White Book").

prompt recovery steps can be taken for non-viable exposures. Supervisory guidance can increase the priority given to NPL management and governance within banks.

Table 8

Detailed supervisory guidance on NPL governance/workout (beyond current regulations)

Jurisdictions with high NPL levels												
	CY	GR	IE	IT	PT	SI	ES					
NCA has published guidance:												
on NPL workout practices/arrears management	✓	✓	✓	✗	✗	✓	✗					
requiring banks to have NPL strategies/action plans	✓	✓	✓	✗	✗	✓	✗					
on banks' NPL restructuring practices	✓	✓	✓	✗	✗	✓	✓					
requiring a dedicated arrears/NPL unit	✓	✓	✓	✗	✗	✓	✗					
requiring banks to have NPL operational targets	✓	✓	✓	✗	✗	✓	✗					
The regulatory framework allows:												
banks to outsource NPL management	✓	✓	✓	✓	✓	✓	✓					
non-banks to manage NPLs	✗ ¹	✓	✓	✓	✓	✓	✓					
Jurisdictions with low NPL levels												
	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
NCA has published guidance:												
on NPL workout practices/arrears management	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗
requiring banks to have NPL strategies/action plans	✗	✗	✗	✗	✗	✗	✗	✗	✗	✓	✗	✗
on banks' NPL restructuring practices	✗	✗	✗	✗	✗	✗	✓	✗	✗	✗	✗	✗
requiring a dedicated arrears/NPL unit	✓	✗	✓	✗	✗	✗	✗	✗	✓	✗	✗	✓
requiring banks to have NPL operational targets	✗	✗	✗	✗	✗	✗	✗	✗	✗	✓	✗	✗
The regulatory framework allows:												
banks to outsource NPL management	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
non-banks to manage NPLs	✗ ²	✓	✓	✓	✓	✓	✓	✓	✗ ¹	✓	✓	✓

1) possible under certain conditions

2) non-banks are allowed to purchase and sell off loans but not manage them

Many jurisdictions with high NPL levels have developed some form of guidance on NPL governance, some of which is rules-based and some of which is principles-based. In addition, the following was observed.

- Four countries have published guidance on the management of loans in arrears and NPLs (covering arrears management strategies, portfolio segmentation, restructuring options and sustainable restructuring, and banks' organisational structure), together with Codes of Conduct on dealing with borrowers in financial difficulties; one of these countries published guidance focused specifically on mortgage arrears.
- Four countries have issued specific guidance requiring banks to have NPL management strategies. In all of these cases, banks are required to have operational targets for NPL reduction; and two in-scope countries disclose or require the disclosure of public targets, for example in Pillar 3 disclosure.

- At a national regulatory level, the principle of the clear separation of functions between problem loan management and loan origination/performing loan services is established in various forms in all jurisdictions with high NPL levels. In some of these, the creation of specialised units dedicated to these tasks is required by the regulations.
- Five jurisdictions with high NPL levels have issued guidance on loan restructuring practices, providing indicative lists of modifications/forgiveness measures to be applied, as well as on resolution and foreclosure measures (modification or termination of a contract aimed at the resolution and extinction of the bank claim on the debtor).
- One jurisdiction with high NPL levels issued guidance requiring banks to put in place a process for the early detection of increased credit risk and to set appropriate qualitative and quantitative early warning indicators for the timely identification of obligors with potential financial difficulties.

Table 9

Technical index of additional key supervisory guidance regarding NPL management

<p>Governance and organisation</p> <p>Organisational requirements: rules requiring the setting-up of specialised units dedicated to the management of problem loans/NPLs, with the following specific requirements: (i) clear criteria for the transfer of problem loans to this unit; (ii) independence of the unit from the credit and loan origination functions; (iii) separation of the unit from the debt recovery unit (which typically deals with non-viable borrowers); and (iv) organisational assessments and resource planning, as well as mechanisms to assess the unit's performance.</p> <p>Early warning systems (EWS) for increased credit risk: rules requiring banks to have an EWS for increased credit risk run by a specific independent monitoring unit, to have an EWS policy and to precisely define the indicators that it uses. Guidance on the recommended toolkit of indicators to be considered by banks (e.g. creditworthiness (financial liabilities/EBITDA), capital adequacy (negative equity, insufficient proportion of equity), interest coverage (times interest earned (TIE) ratio; EBIT/interest expenses)).</p>
<p>NPL management</p> <p>NPL workout strategies: rules requiring banks to have policies, procedures, mechanisms, approaches and systems for arrears management for every type of credit facility (workout strategies). Banks should choose and tailor different management solutions in different segments of their loan book (portfolio segmentation policy) and should at least: (i) segment each relevant portfolio and sub-portfolio, defining the portfolio segments based on consistent and clear segmentation criteria (e.g. purpose of loan, currency, etc.); and (ii) further segment each sub-portfolio into discrete cohorts on the basis of delinquency buckets and default risk. For each cohort of loans, the bank is supposed to set up a tailored strategy and a specific restructuring option. Workout strategies should be monitored by a specific unit (e.g. Risk Management Committee).</p> <p>NPL targets: rules requiring operational resolution targets to be applied to the whole loan portfolio and/or sub-portfolios (e.g. mortgages, non-financial corporations – NFCs). Targets established for specific predefined indicators mainly related to: (i) proposed resolution rates; (ii) concluded sustainable resolution rates; (iii) concluded restructured arrangements; and (iv) cure rates for early arrears management. Institution-specific targets are also set.</p> <p>Restructuring/viable modifications: rules requiring banks to develop and implement a suitable framework for alternative modifications/restructuring solutions for the different segments of the loan book in arrears and NPLs, with a view to offering to (cooperative and viable) debtors modifications that are robust. From the stocktake, the following indicative list of restructuring options was derived (a detailed description of these options is provided in the national guidance): (i) temporary/short-term solutions/modifications: interest only; reduced repayment instalments; arrears and/or interest capitalisation; grace period; interest rate reduction; skipping of payments; arrears settlement; (ii) permanent/long-term solutions/modifications: extension of maturity; capture surplus cash; additional collateralisation/security (may take many forms, such as a pledge on a cash deposit, etc.).</p> <p>Resolution and closure measures: guidance on measures to terminate a contract. From the stocktake, the following resolution and closure measures were indicated (a detailed description of these options is provided in the national guidance): other out-of-court settlements; voluntary surrender; debt to asset; debt to equity; mortgage to lease; mortgage to rent; voluntary sale of property; settlement of loans; loan sale; auction - collateral repossession; auction - collateral liquidation; closure via bankruptcy process; full debt write-off.</p>

For the purpose of an effective NPL resolution/workout, the possibility to use external entities specialised in NPL management is also an important factor, particularly for banks where there is lack of expertise, experience and resources. In this context, the following findings from the stock-take can be highlighted:

- the regulatory framework in all participating countries allows banks to outsource NPL management, although this practice is not very common.

- in one such jurisdiction there are restrictions on the management of NPLs by non-banks – either it is very difficult to obtain a licence to hold/manage NPLs or servicing is restricted to specific segments.

Finally, in three jurisdictions with high NPL levels, specific mechanisms for interbank coordination when dealing with individual debtor cases have been set up; in one case, there is a mechanism for coordination between the private and the public sector when dealing with individual debtor cases.

Typically, jurisdictions with low NPL levels have not developed additional guidance on NPL governance and workout. For example, none of these jurisdictions has additional guidance on NPL workout practices and arrears management. One jurisdiction does, however, require its banks to have NPL strategies and action plans. Moreover, four NCAs in jurisdictions with low NPL levels require their banks to have a dedicated arrears/NPL unit. Finally, the stocktake has noted that the regulatory framework allows banks to outsource NPL management, although non-banks cannot manage NPLs in some jurisdictions with low NPL levels.

2.1.7 Supervisory reporting (Section A.7 in the country reports)

Specific prudential reporting on NPL portfolios serves to encourage institutions to collect information that would assist in the development of reasoned NPL workout strategies. Additionally, it facilitates the introduction of standardised criteria for the assessment of NPLs within banks. Finally, the disclosure by the supervisor of NPL-related information and NPL management performances could be useful to foster transparency and discipline in the market.

Prudential reporting in jurisdictions with high NPL levels is broadly consistent with the rules of the EBA ITS, providing data on forborne exposures and NPEs at an exposure class level.⁷ To acquire more detailed NPL-related information, supervisors usually require additional data beyond the standard prudential reporting. The survey shows that all jurisdictions with high NPL levels have implemented an additional supervisory reporting framework, the content and granularity of which vary substantially across countries. Additional reporting on mortgages is a feature of the reporting requirements of most jurisdictions with high NPL levels. Some such countries additionally require specific reporting on a portfolio basis, with detailed information on collateral, forbearance or restructuring measures. Some NCAs rely heavily on granular data (at the borrower and/or instrument level) on loans reported

⁷ EBA ITS rules on reporting are as follows.

NPEs are divided into: (i) unlikely to pay that are not past due or past due by less than 90 days, and (ii) past-due exposures (with a further breakdown by dpd).

Forborne exposures are divided into: (i) PE with forbearance measures and (ii) NPEs with forbearance measures. For each of these, the forbearance measures have to be specified (i.e. the instruments with modifications in their terms and conditions/refinancing).

For both of the categories above, information on collateral and financial guarantees received is also required.

In addition, a geographical breakdown of assets by residence of the counterparty with the specification of NPLs is required.

by banks to central credit registers, including information on the type of loan, collateral, geographical area and economic sector, classification and loan loss provision (LLPs) (see Section 2.3 on the information framework). In this regard, two countries have started collecting loan-tape data, containing detailed information at the individual position level, on a biannual basis.

Regarding the transparency of institutions' workout strategies, a minority of jurisdictions with high NPL levels disclose or require the disclosure of institutions' NPL targets.

Regarding the quality assurance of additional reporting, the majority of supervisors in jurisdictions with high NPL levels rely primarily on on-site inspections to check the accuracy of the information received. A smaller proportion of respondents conduct benchmarking analyses to ensure consistency across institutions' reporting, while in some exceptional cases there is full reliance on internal or external auditors for quality assurance.

Regarding the disclosure of NPL-related information, all jurisdictions with high NPL levels publicly report statistics, usually via their central banks. This information is usually available online, with reporting updated on anything from a monthly to an annual basis. The granularity of the data provided is, on average, acceptable across the sample, but could be enhanced for some countries.

On-site inspections are also used for the purpose of quality assurance of the NPL reporting in a number of jurisdictions with low NPL levels. One NCA specifically refers to the use of the CCR data to assess the reliability of supervisory reporting, while another NCA uses regular peer benchmark analysis for consistency checks across reporting institutions.

Several jurisdictions also use data from additional solo-level reporting on banks' loan portfolios to carry out quality assurance of the NPL-related reporting.

Finally, in one jurisdiction with low NPL levels external auditors are specifically obliged by law to confirm the accuracy of prudential and financial reporting in cooperation with the NCA.

Table 10

Technical index of additional key practices regarding supervisory reporting

Examples of additional NPL-related reporting requirements
<p>Information on portfolio segmentation: segmentation of portfolios and sub-portfolios based on loan characteristics (purpose of loan, interest rate, currency, geographical area of borrower or collateral) and the borrower delinquency level and default risk (grouping by detailed vintage bucket, forbearance status, bankruptcy status).</p> <p>Information on key portfolio performance statistics: cash recoveries (from simple collection or collateral liquidation), forbearance measures (short-term, long-term, modified, moved to legal proceedings), type of collateral (residential real estate (RRE) occupied by the owner, RRE buy-to-let, CRE, machinery and equipment, movable assets, cash/financial securities pledge, etc.).</p> <p>Disclosure of instrument-level information on collateral and other guarantees</p> <p>Disclosure of NPL targets and workout strategies (key performance indicators (KPIs) on debt restructuring): information on NPL portfolio-specific operational and quantitative targets (e.g. average number of NPLs handled per business unit).</p> <p>Disclosure of provisioning and write-off policy and differences arising from prudential and accounting reporting: information requirements for institutions' impairments, impairment triggers, write-off policy and differences between interest accrued and interest received. Such information could also be reported and certified by institutions' external auditors.</p>
Quality assurance
<p>Benchmark analysis: analytical reviews of the NPL reports in order to identify any discrepancies (single or proxy basis) between the reports; analysing differences in the NPL classification of the same debtors between the bank and the banking system; peer comparison of the information reported for the largest exposures; automatic checks of the consistency of the data sent by the banks, through comparisons with other benchmarks (such as other reports of the same bank).</p> <p>Analysis of supervised entities' balance sheets: this could highlight inconsistencies with regulatory reporting.</p> <p>On-site inspections: compliance and consistency check of reported data, assessment of the appropriateness of loan classification, data validation procedures and accounting reconciliation.</p>
Disclosure of NPL-related information
<p>Granular and segmented disclosure related to NPLs: granular and segmented disclosure related to NPLs by supervisory authorities, e.g. NPLs by geographical area, by size class, by customer segment (NFCs, households, government, etc.). Also for NFC NPLs per industry. Quantitative and qualitative information on construction and RE sectors, housing mortgages and foreclosed assets.</p>

2.1.8 On-site and off-site supervisory practices and methodologies (Section A.8 in the country reports)

Effective supervisory engagement on NPLs is essential in order to understand banks' risk exposure and to ensure that it is effectively managed and mitigated. Supervisory engagement should focus on NPL prevention, monitoring/classification, provisioning, governance and workout.

Regarding on-site supervision, inspections of NPE portfolios were performed in all jurisdictions with high NPL levels in the period 2012-16. Many banks have been subject to granular on-site asset quality reviews (at a minimum during the SSM comprehensive assessment exercises) and to thematic reviews on NPL management. With regard to the scope of the inspections, the main topics included NPL classification, provisioning and, in the majority of cases, reviews of NPL governance and the related organisational framework.

With regard to on-site supervision resources and tools, inspection teams usually include experts on NPL collection and workout and some countries have reported using external consultants during inspections. One country made reference to the use of external auditor reports or the possibility to mandate them to verify the adequacy of classification and provisioning.

Table 11**Some features of on-site and off-site supervisory practices and methodologies**

Jurisdictions with high NPL levels												
	CY	GR	IE	IT	PT	SI	ES					
NCA carries (carried) out:												
dedicated on-site inspections on NPEs	✓	✓	✓	✓	✓	✓	✓					
thematic reviews on NPL management (2012-15)	✓	✓	✓	✓	✓	✓	✓					
NCA has:												
specific supervisory methodologies to assess banks' practices to handle NPEs	✗	✗	✓	✓	✓	✓	✓					
used CCR for on-site and off-site supervision	✗	n.a.	n.a.	✓	✓	✓	✓					
used CCR for feedback for banks	✗	n.a.	n.a.	✓	✓	✓	✓					
Jurisdictions with low NPL levels												
	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
NCA carries (carried) out:												
dedicated on-site inspections on NPEs	✗	✗	✓	✗	✓	✗	✗	✗	✗	✗	✗	✗
thematic reviews on NPL management (2012-15)	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✓	✗
NCA has:												
specific supervisory methodologies to assess banks' practices to handle NPEs	✗	✗	✓	✗	✗	✗	✗	✗	✗	✗	✓	✗
used CCR for on-site and off-site supervision	✓	✗	✓	✗	✗	✓	✓	✓	✗	✗	✗	✓
used CCR for feedback for banks	✓	✓	✓	✗	✗	✓	✗	✗	✗	✗	✗	✗

Many of the jurisdictions with high NPL levels that have a CCR use it for on-site supervisory purposes, mainly to check information about single debtors. One country stated that CCR data processed with IT tools and integrated with other information from internal or external sources are also used to determine the sample of loans to be analysed during the inspection.

Regarding off-site supervision in jurisdictions with high NPL levels, the banks' NPL portfolios are subject to off-site analysis in all jurisdictions with high NPL levels. All of the countries that have a CCR use it for off-site supervision purposes (mainly for the analyses reported above). Moreover, CCR data are always used to give feedback to banks (for example, on the amount of and the trend in the debt of a customer or on his/her/its classification by other banks).

Table 12**Overview of additional key practices regarding supervisory tools****Supervisory practices and methodologies**

Assessment methodologies: detailed guidance providing indications on and criteria for the supervisory assessment of banks' risk exposure and management practices related to NPLs. This guidance supports the credit file reviews and provides analysis patterns and checklists that inspectors should use for the assessment of the organisation of and procedures for NPL management, also including specific patterns for specialised lending areas.

Use of granular data on loans for supervisory purposes: CCR reporting requirements ensuring the collection of data on loans with a high degree of granularity and reporting frequency, and implemented IT tools and procedures, also integrated with other internal information (e.g. inspection assessments of individual loans) and external information (e.g. centralised archive of company balance sheets), enabling a large number of analyses and their use for off-site and on-site supervision activities, such as: (i) performing off-site analysis and holding meetings on NPL portfolios, including the analysis of samples of loans; (ii) checking and monitoring classification mismatches among banks for the same debtors; (iii) supporting the definition of the loan samples to be analysed during on-site inspections; and (iv) in some cases, checking the exposure of supervised institutions to large customers which are in financial difficulties or are involved in criminal investigations.

Some jurisdictions with high NPL levels do not yet have a CCR or the CCR is not sufficiently granular in terms of the minimum threshold for loans registered or the information collected (e.g. debtor classification by banks). For the purpose of implementing the described supervisory practices, however, the lack of a granular and complete CCR can be addressed by specific data requests to banks, as is the current practice among some NCAs.

The scope and intensity of on-site and off-site supervisory practices in jurisdictions with low levels of NPLs are less than those in jurisdictions with high NPL levels. Two jurisdictions are conducting dedicated on-site inspections of NPEs, however, and another has conducted thematic reviews of NPL management in addition to the asset quality review conducted by the ECB Banking Supervision. In some countries, NPEs are assessed as a dedicated and material component of on-site inspections focussing on credit risk.

CCRs are used by a number of supervisors in jurisdictions with low NPL levels to support their ongoing activities. Some jurisdictions, however, may not have a CCR or the CCR is not sufficiently granular in terms of the minimum threshold for loans registered or information gathered (an issue also identified in some jurisdictions with high NPL levels). NPL manuals do not seem to be well developed.

Finally, with regard to on-site supervision, it should be noted that since the establishment of the SSM in 2014, inspections of SIs have been initiated and planned by the ECB and conducted using teams comprising ECB and NCA staff. Dedicated and specifically focussed NPL inspections have been conducted in a consistent manner in accordance with the ECB's documented practices.

2.2 Legal, judicial and extrajudicial framework

This section identifies the main legal areas that, although generally outside the scope of supervisory influence, can pose particular challenges for NPL workout. Each sub-section describes how the topic can affect NPL workout, presents the main findings of the stocktake and summarises the main legal obstacles to NPL resolution. It is based on the views provided by each of the NCAs within the SSM. Note that the information available on the legal, judicial and extra-judicial framework is limited in

some jurisdictions with low NPL levels given that the matter is not the primary focus of supervisory attention.

2.2.1 Sale of portfolios (Section B.1 in the country reports)

The development of distressed debt markets (including public and private asset management companies – AMCs) has been shown to accelerate the NPL workout process in numerous instances. Conversely, the lack of a liquid market for NPLs creates uncertainty about the true value of such assets and can prevent the entry of capital and expertise in NPL management.

Table 13

Main features of the sale of portfolios

Jurisdictions with high NPL levels							
	CY	GR	IE	IT	PT	SI	ES
Existence of a developed NPL market?	No	No	Medium	No	No	No	Medium
Does an AMC exist?	No	No	Yes	No	No	Yes	Yes
Transfer of loans (and collateral) without borrower's consent?	Yes	Yes ¹	Yes	Yes	Yes	Yes	Yes
Banks are allowed to sell NPLs to third parties							
to non-banking institutions	Yes ²	Yes ¹	Yes	Yes	Yes	Yes	Yes
to foreign investors	Yes ²	Yes ¹	Yes	Yes	Yes	Yes	Yes

Jurisdictions with low NPL levels												
	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
Existence of a developed NPL market?	No	No	No	No	No	No	No	No	No	No	No	No
Does an AMC exist?	No	No	No	No	No	No	No	No	No	No	No	No
Transfer of loans (and collateral) without borrower's consent?	Yes	Yes ⁵	Yes	Yes	Yes	Yes	Yes	Yes	Yes ⁴	Yes	Yes	Yes
Banks are allowed to sell NPLs to third parties												
to non-banking institutions	Yes	Yes	Yes	Yes	Yes	Yes ³	Yes	Yes	Yes	Yes	Yes	Yes
to foreign investors	Yes	Yes	Yes	Yes	Yes	Yes ³	Yes	Yes	Yes	Yes	Yes	Yes

1) changes have been implemented in the first half of 2016

2) possible under strict conditions

3) restricted to EEA countries only

4) in some cases, the debtor may have to agree to such a transfer

5) provided there is an explicit provision allowing the transfer in the loan documentation

AMCs have been established in some jurisdictions with high NPL levels. In most cases, this was a specific measure that boosted the market for distressed debt in the short term. The market for distressed assets is relatively underdeveloped, however, in most jurisdictions with high NPL levels and is naturally not a feature in jurisdictions with low NPL levels. The survey shows that market stagnation is seldom caused by specific obstacles in the legal and regulatory framework as the majority of countries (including those with low NPL levels) have a favourable environment for NPL transfer and the entry of specialised investors into the local market. The few countries that had legal impediments to the sale of portfolios, such as portfolio transfer restrictions on non-banking institutions or barriers to the entry of foreign investors, have amended their regulatory frameworks since the publication of the first stocktake in

order to overcome most of these issues, but it is too early to measure the impact of these changes. NCAs in jurisdictions with low NPL levels are of the view that there are no legal impediments to the sale of portfolios to third parties.

2.2.2 Debt enforcement/foreclosure (Section B.2 in the country reports)

Straightforward, timely and clear processes for debt enforcement, especially foreclosure procedures, are important for NPL resolution. On the one hand, enforceability works as a default deterrent. On the other hand, it allows banks to recover as much as possible of the credit. Weak enforcement mechanisms are an obstacle to NPL reduction.

Table 14

Main features of debt enforcement/foreclosure

Jurisdictions with high NPL levels

	CY	GR	IE	IT	PT	SI	ES
Legal techniques to enable out-of-court enforcement of collateral?	Yes ¹	No	Yes	No	No ²	Yes	Yes
Bilateral sales of repossessed assets permitted?	Yes	No	Yes	n.a.	Yes	Yes	Yes
Blanket bans (moratoria) on sales/auctions/foreclosures?	No	Yes ¹	No	Yes	Yes	No	Yes ³

Jurisdictions with low NPL levels

	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
Legal techniques to enable out-of-court enforcement of collateral?	Yes	No ²	Yes	No	No	Yes	No	Yes	No	No	Yes	No
Bilateral sales of repossessed assets permitted?	Yes	Yes	n.a.	Yes	Yes	Yes	Yes	Yes	Yes ⁴	Yes	Yes	Yes
Blanket bans (moratoria) on sales/auctions/foreclosures?	No	No	No	No	No	No	No	No	No	No	No	No

1) changed recently, the effectiveness has yet to be tested

2) just on financial collateral

3) just on foreclosures

4) if allowed by the contract

NCAs' views of the legal framework for collateral enforcement diverge across the SSM. **Over one-third of the countries (mainly in jurisdictions with high NPL levels) consider the topic to be a challenge for NPL resolution**, largely due to the lack of a modern legal framework enabling timely out-of-court collateral enforcement.⁸

Regarding the foreclosure procedures, the average duration is a useful indicator to evaluate the effectiveness of debt enforcement proceedings in a country. As mentioned above, some jurisdictions with high NPL levels are making efforts to set up fast out-of-court procedures for the main purpose of alleviating the burden on the judicial system. NCAs in jurisdictions with high NPL levels consider the inefficiencies of the court systems a challenge for NPL resolution in the majority of the surveyed countries. Out of court settlement is a feature of some, but not all, jurisdictions with low NPL levels.

⁸ Mainly following the instructions of Directive 2002/47/EC as amended by Directive 2009/44/EC.

Moreover, the stocktake shows that in-court proceedings on occasion must consider “super-seniority” claims whereby public claims are given precedence over those of secured creditors. Although in general bilateral sales of loans are allowed, some surveyed countries reported bans and moratoria on foreclosures or auctions.

2.2.3 Corporate insolvency and restructuring (Section B.3 in the country reports)

The limitations of the insolvency regime can noticeably affect creditors’ expectations about the timing and value of recovery. This risk represents a considerable discount factor for NPL values from a market perspective and an important hurdle from a workout point of view. The essential general features of the corporate insolvency regime are twofold: (i) a restructuring framework (for going-concern cases) and (ii) a liquidation resolution framework (for non-viable cases).

All jurisdictions with high NPL levels have undertaken initiatives to update their corporate insolvency frameworks in recent years in response to elevated NPL levels. In addition, almost all of these countries have a “pre-pack” (i.e. fast-track resolution or rehabilitation) process and half of them have an out-of-court mechanism, although in some cases this is de facto not operational. Some of the issues linked to corporate insolvency regimes that can pose an obstacle to NPL resolution relate to: (i) the lack of simplified and cost-effective frameworks (out-of-court mechanisms and pre-pack procedures) especially for SMEs, which are the largest and weakest corporate segment in many respondent countries; (ii) obstacles for creditors to actively intervene in the restructuring process (i.e. it is not possible to limit shareholders’ decisions or change companies’ management); (iii) a limited process for clearance of public arrears or partial debt-servicing agreements; and (iv) limits on asset sales through auctions or open market bilateral sales. Finally, the ultimate effectiveness of the corporate insolvency and restructuring framework is considerably affected by the judicial system.

Naturally, elevated NPL levels have not driven change across the entire SSM and, with some exceptions, the mechanisms in place in jurisdictions with low NPL levels have not yet been tested by any sudden or marked downturn resulting in an increase in non-performing loans. Out-of-court settlement mechanisms do not seem to be a feature in a number of jurisdictions with low NPL levels. Similarly, the picture is mixed with regard to the availability of other aspects such as the possibility to limit shareholder decisions on a business restructuring and the use of pre-pack restructuring procedures. However, the assets of a company under debt restructuring can be sold in the majority of jurisdictions with low NPL levels. Finally, it should be noted that two NCAs in jurisdictions with low NPL levels have identified the duration of judicial processes as being a potential challenge to effective NPL workout.

Table 15**Main features of the corporate insolvency and restructuring framework****Jurisdictions with high NPL levels**

	CY	GR	IE	IT	PT	SI	ES
Process for clearance of arrears to public sector?	Yes ⁴	Yes ²	Yes	Yes	Yes	Yes ¹	Yes
Possible to limit shareholders' decision on a business restructuring?	Yes ³	No	Yes	Yes	Yes ¹	Yes	No
Possible to change company management in all debt restructuring?	No ¹	No	Yes	No	Yes	No ¹	No
Can assets of a company under debt restructuring be sold?	No ¹	No ¹	Yes	Yes ¹	Yes	Yes	Yes
Is there an out-of-court mechanism?	No	No	No	Yes	Yes	Yes	Yes
Is there a pre-insolvency restructuring regime?	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Is there a fast "pre-pack" restructuring procedure?	No	Yes	Yes	Yes	Yes	Yes	No ¹
Average length of the pre-pack procedure (months)	n.a.	-	1-6	6-12	6-12	6-12	n.a.

Jurisdictions with low NPL levels

	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
Process for clearance of arrears to public sector?	No	Yes ⁴	No ¹	No ¹	n.a.	Yes	No	Yes	No	Yes	No	Yes
Possible to limit shareholders' decision on a business restructuring?	Yes	Yes	Yes	No	Yes	Yes	Yes	No	No	Yes ¹	No	No
Possible to change company management in all debt restructuring?	No	No ¹	n.a.	No	Yes ¹	No	Yes ⁵	Yes	No	Yes	No	Yes
Can assets of a company under debt restructuring be sold?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes ¹	Yes	Yes	No	Yes
Is there an out-of-court mechanism?	No	Yes	No	No	No	No	Yes	n.a.	No	Yes	No	Yes
Is there a pre-insolvency restructuring regime?	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	No	No	Yes
Is there a fast "pre-pack" restructuring procedure?	No	Yes	Yes	No	No	Yes	Yes	Yes	No	No	No	No
Average length of the pre-pack procedure (months)	n.a.	6-12	<12	-	-	4	-	-	n.a.	-	-	n.a.

1) with some exceptions

2) but very poor and dysfunctional

3) possible under the examinership scheme

4) partial clearance possible

5) except under legal protection regime

2.2.4 Household insolvency and restructuring (Section B.4 in the country reports)

Inefficiencies in the household insolvency and debt restructuring regime could represent a challenge to private debt workout, in particular regarding the enforcement of credit claims.

Table 16**Main features of the household insolvency and restructuring framework****Jurisdictions with high NPL levels**

	CY	GR	IE	IT	PT	SI	ES
Out-of-court mechanism?	Yes ¹	No	Yes	No	Yes	No	Yes
Bankruptcy regime for consumers/households?	Yes	Yes ¹	Yes	Yes	Yes	Yes	Yes
Insolvency/bankruptcy discharge period (years)	3	3	1	1 ²	5	2-5	5
Average time for insolvency/bankruptcy proceedings (months)	-	-	-	-	-	24-48	-

Jurisdictions with low NPL levels

	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
Out-of-court mechanism?	Yes	No	No	No	No	Yes	Yes	No	Yes	No	Yes	Yes
Bankruptcy regime for consumers/households?	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	No	Yes	Yes
Insolvency/bankruptcy discharge period (years)	3-7	3-7	6 ³	-	10	7	1-3.5	5	7	-	1-5	3
Average time for insolvency/bankruptcy proceedings (months)	2-6	-	12-24	-	-	12	30	11.5	-	-	5	6

1) with strong limitations

2) after liquidation

3) 3 or 5 years under certain conditions

The survey continues to show that the main challenge identified for household insolvency proceedings in jurisdictions with high NPL levels is not so much related to the framework, but instead to the volume and duration of court cases. Inefficiencies related to the judicial system have considerable repercussions for this segment as well. This is the reason why jurisdictions with high NPL levels continue work to set up fast out-of-court procedures for the main purpose of easing some of the pressure on the judicial system. Nevertheless, the second stocktake has not noted material progress with regard to the development of out-of-court mechanisms. Another possible challenge is the low level of coverage of the household bankruptcy regime due to the classification of a person/entity as a “household”. This issue limits the scope for institutions to make use of such a mechanism.

Again, elevated NPLs have not driven change across the entire SSM and, with some exceptions, the mechanisms in place in the majority of jurisdictions with low NPL levels have not yet been tested by any sudden or marked downturn resulting in an increase in non-performing loans. Out-of-court settlement mechanisms do not seem to be a feature in a number of jurisdictions with low NPL levels. Bankruptcy regimes for households are in place in the majority of jurisdictions with low NPL levels. Insolvency discharge periods range from one to ten years across jurisdictions with low NPL levels.

2.2.5 Judicial system (Section B.5 in the country reports)

Judicial issues represent a key challenge to NPL resolution since settlements between debtors and creditors which require judicial intervention can be severely delayed. This risk, present in all of the sections above, represents a considerable discount factor for NPL values from a market perspective and an important hurdle from a workout point of view. Additionally, the lack of insolvency practitioners can also be a reason for delays in rehabilitation or liquidation.

Table 17

Main features of the judicial system

Jurisdictions with high NPL levels

	CY	GR	IE	IT	PT	SI	ES
Specialised courts or judges to deal with insolvency issues?	No	Yes ¹	Yes ²	No	Yes	Yes	Yes
Set time requirements for insolvency processes?	No	No	Yes ²	Yes	Yes	Yes	Yes

Jurisdictions with low NPL levels

	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
Specialised courts or judges to deal with insolvency issues?	Yes	No	Yes	No	No	Yes	No	No	No	No	No	No
Set time requirements for insolvency processes?	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	No	No	No	No

1) with strong limitations

2) personal insolvency

The survey continues to show that the vast majority of jurisdictions with high NPL levels consider the inefficiencies of the judicial system to be a notable challenge for NPL resolution, mainly owing to the excessive length of proceedings due to the clogging-up of the courts. The inexistence of specialised judges dealing exclusively with insolvency proceedings is also a reason for judicial inefficiencies. Moreover, in some countries insolvency administrators do not require professional certification and there are seldom time requirements for insolvency procedures.

Given the low NPL levels, court proceedings in other jurisdictions are not typically delayed. However, the majority of jurisdictions with low NPL levels do not have specialised courts or judges to deal with insolvency issues.

2.2.6 Tax regime (Section B.6 in the country reports)

The tax regime can be a challenge for NPL resolution to the extent that it acts as a deterrent for institutions to dispose of NPLs.

In recent years, the majority of jurisdictions with high NPL levels have tried, to some extent, to revise their tax regimes in order to offer a more favourable environment for NPL disposal. The majority of in-scope countries acknowledge tax deductions for LLPs, write-offs⁹ and collateral sales, as well as tax loss carry-forward mechanisms.

Table 18

Main features of the tax regime

Jurisdictions with high NPL levels

	CY	GR	IE	IT	PT	SI	ES
Tax deductions for LLPs?	Yes	Limited	Yes	Yes	Yes	Yes	Yes
Tax loss carry-forward mechanism (e.g. DTA)?	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Tax deductions for loan write-offs?	Yes	Yes	Yes	Yes	Limited	Limited	Yes
Tax deductions for collateral sales?	Yes	n.a.	Yes	Yes	Yes	No	Yes
Debtors taxed upon favourable debt write-off/restructuring?	No	No	No	No	Yes	Yes	Yes

⁹ Some limitations could be: (i) the write-off of a loan might only be tax deductible under certain conditions (legal extinction of the credit claim by means of a court decision) and (ii) write-offs are considered taxable income if they result from out-of-court restructuring agreements and meet other conditions or for some types of borrowers and some types of loans. They may also only be partially tax deductible.

Jurisdictions with low NPL levels

	AT	BE	DE	EE3	FI	FR	LV	LT	LU	MT	NL	SK
Tax deductions for LLPs?	Yes	Limited	Yes	No	Limited	Limited	Yes	Yes	Yes	No	Yes	Yes
Tax loss carry-forward mechanism (e.g. DTA)?	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Tax deductions for loan write-offs?	Yes	Yes	Limited	No	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Tax deductions for collateral sales?	No	Yes ⁵	n.a.	No	Yes	No	No	Yes	No	No	Yes	No
Debtors taxed upon favourable debt write-off/restructuring?	Yes ¹	No ²	n.a.	No	Yes	Yes	Yes ¹	n.a.	Yes ⁴	No	Yes	Yes

1) with the exemption of private individuals

2) if certain conditions are met

3) zero tax rate for corporate profits

4) tax exemptions possible if certain conditions are met

5) according to the general rules relating to deductions for taxes

On the debtor side, the tax regime could, in some cases, charge capital gains upon a favourable debt write-off/restructuring. Since the agreement of the debtor is necessary, this may pose a considerable challenge to debt restructuring.

Some form of tax deduction for LLPs and some form of tax carry forward mechanism is available in the majority of jurisdictions with low NPL levels.

2.3 Information framework (section C in the country reports)

Comprehensive and reliable central credit registers are a valuable supervisory tool as they are the data source for off-site analyses and preliminary analyses in preparation for on-site inspections. Moreover, the disclosure of reliable and granular NPL-related data is a helpful means to increase awareness and market transparency.

Table 19

Heat map of the overall perception of the quality and comprehensiveness of the information framework across the sample

	Adequate
	Adequate with room for improvement
	Room for improvement

Jurisdictions with high NPL levels

	CY	GR	IE	IT	PT	SI	ES
Central credit registers							
Other public asset registers¹							
Debt counselling and outreach							
Consumer and data protection							

Jurisdictions with low NPL levels

	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
Central credit registers												
Other public asset registers ¹												
Debt counselling and outreach												
Consumer and data protection												

1) Other public registers include the cadastral system (land registry), the asset registers (e.g. for road vehicles, ships, aircraft, plant, heavy equipment, intellectual property, etc.) and the RE transaction registers.

NB: The overall assessment of the information framework has to be considered from the point of view of information collection and sharing for the purpose of NPL resolution.

Apart from two countries¹⁰ within the SSM, all respondents have established a CCR. The register is mainly operated by the public sector (the central bank is the competent authority in such instances), but there are also cases of privately managed credit registers either running in parallel to the public ones or as the only register in the country.

The CCRs were established at different times and hence work with data series of different lengths. Some countries can rely on long-term time series (more than ten years)

The content of the reporting varies substantially across the sample. Most of the countries provide information at an instrument level (loan by loan), but some only report data at a borrower level.

A common practice is that reporting agents are required to provide data at a “solo level”, with some exceptions in which they only provide consolidated reporting.

As regards the granularity of the information available, most of the countries do not have minimum size thresholds for instruments within their reporting requirements. There are reporting thresholds for exposure amounts in a number of jurisdictions, ranging from €30 to €1 million.

As a general rule, in most countries the definitions used by CCRs to collect and report information are harmonised with accounting definitions. In some countries, the reporting may contain some discrepancies with accounting definitions or is not harmonised at all.

Most countries have requirements with regard to the frequency of updating. As a general rule, updating should be immediate when the underlying information changes, but the frequency and responsibility for doing so are not specified in many countries.

With regard to CCRs, it should be noted that all participating countries are involved in the AnaCredit project (an ECB initiative to establish a dataset containing detailed information on individual bank loans above €25,000 in the euro area, harmonised across all member states). This should help to increase the availability of data beginning in 2018.

¹⁰ In one country, the process is under development but has been subject to delays.

Regarding other public registers, the cadastral system is mostly centralised across the sample. In some countries fees for queries are high, while some others do not make data easily accessible to the public. Therefore, the overall perception of the quality of the service is quite weak.

There are real estate transaction registers in seven jurisdictions with high NPL levels. In almost all cases, these provide the price of RE transactions, both residential and commercial. The granularity and frequency of information vary across countries, but the availability to the public seems to be common practice and, on average, the cost of queries is low or even zero. Information on upcoming sales/auctions is also publicly available across the sample.

As shown in Table 19, the level of debt counselling and outreach services seems to be a source of concern for some NCAs in jurisdictions with both high and low NPL levels. In fact, in some countries there is no free or subsidised financial and legal advice for household debtors. Furthermore, on the SME side, with a few exceptions¹¹ countries do not provide credit management training and advice.

Regarding consumer data protection, even if there are necessary restrictions mainly related to confidentiality requirements, these seem to represent challenges for information-sharing on portfolios among market participants (mostly for the household sector). In some countries, institutions experience challenges in relation to household debt enforcement or other workout practices in general, due to an unfavourable legal framework that can lead to cases of moral hazard and voluntary bankruptcies.

The current legal framework is based on a 1995 EU Data Protection Directive (Directive 95/46/EC), which was ratified by each EU Member State in varying forms. The Directive stipulates that personal data may be processed (i.e. transferred) only if the data subject has unambiguously consented. The Directive also applies the principle that personal data may only be transferred to third countries that ensure an adequate level of protection. In the absence of such protection, transfer is only permitted in certain situations, either on the basis of an exception, or where adequate safeguards have been provided in contracts or other relevant instruments.

However, the framework will be subject to amendment in the near future. The European Commission has drafted a new EU data protection framework that takes the form of a Regulation – the General Data Protection Regulation (GDPR). The GDPR will replace the current Directive and will be directly applicable in all Member States without the need for implementing national legislation. It will likely come into force in the first half of 2018. Under the new law, data protection rules will be strengthened and harmonised.

¹¹ Some countries do have debt counselling and outreach mechanisms in place, but they are not free/subsidised.

Annex: Country reports

Annex I: Austria

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

In December 2016 Austria (including CESEE subsidiaries) had a total NPL ratio of 5.6% (of which by segment: households 4.8%, NFCs 7.4%, SMEs 8.4% and CRE 8.7%).¹²

The NPL ratios reported on Austrian balance sheets present different pictures from consolidated and non-consolidated perspectives. The main bulk of NPL exposures actually originates from Austrian bank subsidiaries outside Austria, i.e. primarily in CESEE countries. As a result, the NPL ratio of those exposures issued in Austria is significantly lower (domestic NPL ratio of 4%) and Austrian authorities have pursued a less pervasive strategy to tackle the NPL workout issue with regard to Austrian portfolios. Therefore, the resolution of the NPL portfolios of Austrian banks is to a significant extent dependent on the national frameworks of the CESEE countries.

As a result of the lower levels of NPLs in Austria, the market for NPLs is undeveloped and, while the sale of loans is legally possible, only very few transactions have been recorded in recent years.

The Austrian regulatory framework relies primarily on European legislation and standards. The Austrian Financial Market Authority (*Finanzmarktaufsicht* – FMA) did, however, publish FMA Minimum Standards for the Credit Business and other Transactions entailing Counterparty Risks (FMA-MS-K) in 2005, which covers some issues regarding NPL management and is currently being revised. The minimum requirements are principle-based, and compliance with these supervisory expectations is assessed regularly.

Additionally, the Vienna Initiative 2 (VI2) allows the Oesterreichische Nationalbank (OeNB) and FMA to tackle the persistent regional economic challenge of NPLs in Eastern Europe within the action plan of the European Bank for Reconstruction and Development (EBRD). This action plan stipulates setting up country-specific groups

¹² Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance-sheet exposures. The sample covers 2% of banks in Austria or 66% of total banking assets.

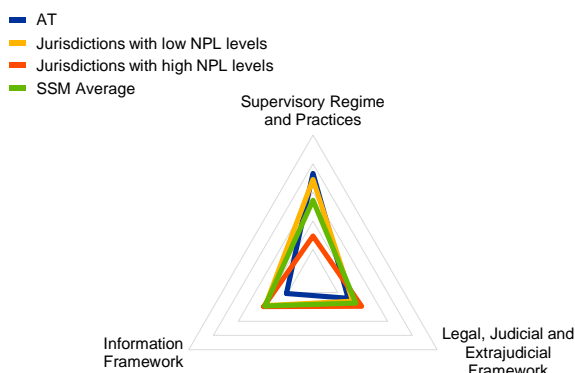
to identify and address the key obstacles to NPL resolution and proposes potential remedies.

Chart 1

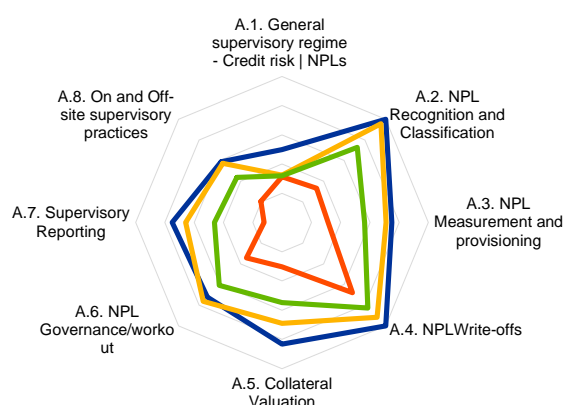
Country overview

How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

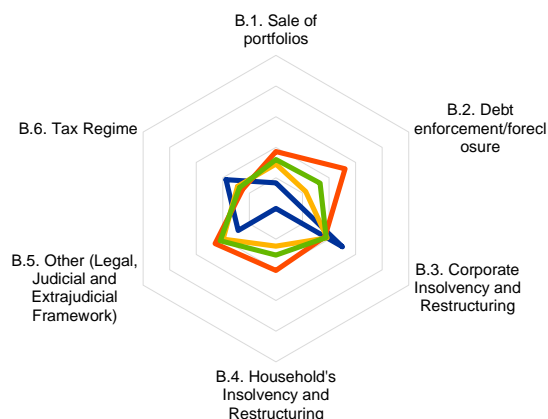
NPL Framework Overview



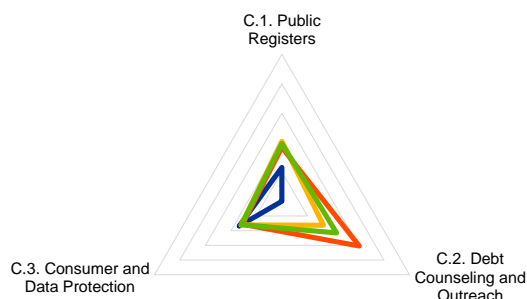
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



Even though the current NPL situation seems favourable overall, the survey reported some features in the framework which may represent **potential challenges to NPL workout in Austria**:

- **Supervisory practices:** the Austrian principle based approach does not provide specific NPL-related guidance. The Austrian agencies involved in banking supervision apply a risk-based and proportionate approach. This approach is reflected in the frequency and intensity of on-site and off-site assessments.

- **NPL recognition and classification/write-off:** there are no additional specific guidelines on the prudential accounting approach regarding provisioning and write-offs other than general accounting principles (nGAAP and IFRS) and the relevant EU-wide legal regime.
- **NPL measurement and provisioning:** no additional guidance is in place apart part from accounting standards and the relevant EU-wide legal regime.

Current supervisory measures also reflect the significant decrease in NPL stock in recent years and the existing low domestic NPL volume.

A Supervisory Regime and Practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 20
Main Sources of NPL-related regulation

Type	Ref.	Scope	Topic	Summary Description	Entry into force
Law		All credit institutions	General Banking Act	Austrian Federal Banking Act (Bankwesengesetz – BWG)	1993
Guideline	11/2004	All credit institutions	Credit Risk Management	FMA/OeNB Guideline: Rating Models and Validation	2004
Guideline	12/2004	All credit institutions	Risk Management	FMA/OeNB Guideline: Credit Approval Process and Credit Risk Management Guideline issued to help implementing the Basel II framework. The guideline is principle based, dealing with credit approval processes, credit risk management, organisational structure and internal auditing.	2004
Minimum Standard	04/2005 (currently updated)	All credit institutions	Counter Party Risk	FMA Minimum Standards for the Credit Business and other Transactions entailing Counterparty Risks (FMA-MS-K) The main purpose of the FMA-MS-K is to create transparency with regard to the relevant provisions under banking law. The Minimum Standards are intended to provide the Austrian credit institutions with guidelines on how to structure the credit business in terms of organisation and processes in greater detail.	2005
Minimum Standard	01/2013	All credit institutions		FMA-Minimum Standards for the Risk Management and Granting of Foreign Currency Loans and Loans with Repayment Vehicles (FMA-FXTT).	2013
Regulation		All credit institutions	Risk Management	Credit Institution Risk Management Regulation (Kreditinstitute-Risikomanagementverordnung – KI-RMV) - regulating minimum standards for the proper capture, management, monitoring and limitation of risks according to Section 39 (2b) BWG (these include among others credit and counterparty risk and the residual risk from credit risk mitigation) techniques.	2014
Regulation	04/2016	LSI	Recovery plans	FMA Regulation: Bank Recovery Plan Regulation (Bankensanierungsplanverordnung – BaSaPV) The BaSaPV stipulates that recovery plans must contain the “growth rate of non-performing loans” asset quality indicators. According to Article 10 (2) of the Federal Act on the Recovery and Resolution of Banks (Bundesgesetz über die Sanierung und Abwicklung von Banken – BaSAG) all indicators must be monitored regularly. The institutions must define specific recovery thresholds that, if breached, trigger the activation of the recovery plan and respective notification of the FMA. The recovery plan and the calibration of the indicator threshold are subject to annual off-site reviews by the OeNB (by order of the FMA).	2015
Law	BGBI 135/2015	RRE debtors	Contract design & processing	Austrian Federal Mortgage and Real Estate Loan Act (Hypothekar- und Immobilienkreditgesetz – HIKrG) Debtors holding residential real estate loans are not subject to regular consumer credit laws, but rather to these regulations regarding the processing and contract design of these loans.	2016

The Austrian framework establishes principles in the form of minimum requirements relating to credit risk processes and management. There is no guidance defining specific limits on household portfolios. However, some qualitative expectations on LTV-ratios, DTI-ratios and DSTI-ratios relating to real estate financing were published by the Financial Market Stability Board (Finanzmarktstabilitätsgremium – FMSG) in September 2016¹³, and the legal basis for quantitative requirements in this regard is currently being defined.

A.2 NPL recognition and classification

Austrian banks are legally required to comply with Article 178 of the CRR and with the EBA ITS regarding the definition/classification of NPEs, which are relevant for reporting purposes. Beyond this, the FMA-MS-K gives additional principle-based guidance on procedural and organisational requirements for the intensified handling of loans (relating to performing loans with evidence of increased risk) and for dealing with problem loans.

Banks are required to develop risk classification procedures taking into account quantitative as well as qualitative criteria (the responsible department may not be part of the front office), and to review the risk score at least once per year. The FMA-MS-K states that institutions should develop guidelines for intensified loan management, including criteria to identify such loans (e.g. overdrafts, deterioration of ratings, hesitant submission of accounting documents, bill protests, damaging events with a substantial impact on the borrower). These exposures must be reviewed at predefined intervals to determine their treatment (further intensified loan management, return to normal monitoring or transfer to liquidation or recovery). According to the FMA-MS-K, identification as a “problem loan” may be triggered by a default or any other plausible criteria and, in such cases, the department responsible for the restructuring, the recovery procedure or the monitoring of these procedures is required to follow certain processes (e.g. management reporting or restructuring concepts). Institutions must also develop early identification indicators to constantly monitor the deterioration of risk assessment.

A.3 NPL measurement and provisioning

Austrian banks follow IAS/IFRS or nGAAP accounting requirements. In addition, Articles 72 to 74 of the FMA-MS-K contains some principle-based guidance for adequate loan-loss provisioning and requires banks to set up adequate processes and structures. There is not, however, any specific guidance regarding accrued interests or estimate of the recovery time used for the provisioning of NPEs. The topic of provisioning is duly considered during on-site inspections of credit risk. This is done by reviewing provisioning policies and methodologies as well as via a review of a sample of credit files.

¹³ [Ninth meeting of the Financial Market Stability Board](#)

A.4 NPL write-offs

Depending on the accounting standard to be applied, financial institutions are subject to nGAAP or IFRS. However, the FMA-MS-K requires banks to have internal guidelines defining objective and logical criteria which indicate the need for write-downs. In this case, Austrian supervisory authorities do not provide any additional incentive for NPL write-offs, i.e. no increased capital charges and no hard limits on how long NPLs can be carried on banks' balance sheets.

A.5 Collateral valuation

The Austrian authorities involved in banking supervision have no concerns that collateral-related issues could represent an obstacle to private debt resolution. According to the FMA, there is no known issue with the enforcement and liquidation of collaterals. In addition, the real estate market in Austria is currently strong.

The FMA does not have any guidance in place specifying valuation methods for collaterals. Collateral valuation methodologies are not linked to the loan status.

The required frequency for the valuation of immovable property collateral follows CRR requirements ($CRE \leq 12$ months; $RRE \leq 3$ years). Banks can, however, set stricter intervals. Article 61 of the FMA-MS-K states that internal guidelines must determine the process and suitable intervals for valuing the collateral. Furthermore, Article 62 requires an ad-hoc risk analysis, including collateral, if external or internal sources indicate a substantial adverse change in the risk assessment of the exposures or collateral. A valuation is also necessary upon transfer of the exposure to the workout unit.

The Austrian Credit Approval and Credit Risk Management Guideline (Section 2.4.2.4) also deals with the valuation of collaterals. The guideline addressing the risks relating to collaterals in particular requires:

- the establishment of internal guidelines, e.g. a collateral catalogue;
- general risk reductions (haircuts, procedural cost) in the valuation of collateral;
- a process to control and monitor risks related to the collateral;
- that the valuation of collateral be carried out by specialised employees and, if possible, in separate organisational units, which do not belong to the front office, or external providers.

Besides current CRR requirements, there are no additional requirements to use a real estate valuation standard, and internally computed indexes may be used. Tax values and last transaction values, however, are not accepted as adequate valuation. There is no specific guidance requiring banks to have a reliable data collection to assess collateral recovery.

Within the limitations of the CRR, both bank internal collateral appraisals and external appraisals are accepted for valuation.

In Austria, there is no dedicated authority responsible for supervising the valuation of collateral and appraisal entities.

The risk management process is evaluated on a case-by-case basis through on-site inspections.

The Austrian supervisory authorities did not provide additional incentives to reduce reliance on collateral, whether through increased provisioning or through assessment of valuation practices.

A.6 NPL governance/workout

The relevant provisions for work-out processes are established in the FMA-MS-K in a principle-based manner, requiring banks to set up internal guidelines. These internal guidelines must define the criteria governing the transfer of bad exposures to the internal or external experts specialised in restructuring or recovery (Article 67). Banks must develop systems to identify and manage NPLs, although there is no formal requirement to implement an NPL management strategy. When the bank decides to restructure an exposure, it is required to develop a restructuring/recovery strategy for the loan.

The adequacy of the processes is assessed during on-site inspections.

Responsibility for the restructuring or recovery procedures and its monitoring may not reside with the front office (Article 26). Banks are allowed to outsource NPL management but should still build up their own expertise.

According to the regulatory framework enabling non-banks to provide NPL management services, the service provider must hold a banking license if it holds or manages NPLs, whereas it is not required to do so if the services merely include the purchase and sale of loans. At the moment, however, no special servicing firms manage NPL portfolios in Austria.

There are no special guidelines issued by the FMA addressing restructuring practices or the handling of NPEs apart from the guidelines mentioned in Section A.1.

A.7 Supervisory reporting

Credit institutions submit the required COREP/FINREP reporting templates, including information relating to the EBA ITS, on a quarterly basis. Apart from this there are national reporting requirements in place for institutions subject to nGAAP. There is therefore no NPL reporting requirement in place that goes into more reporting detail than the FINREP requirements.

However, as the Austrian authorities follow a proportional and risk-based approach, additional information requests during the ongoing off-site inspection process allow deeper analyses.

A.8 On-site and off-site supervisory practices and methodologies

The Austrian banking supervision authorities follow a clear proportionate and risk-based approach. While external auditors perform annual checks of the quality of the accounts, the ongoing off-site supervision and on-site inspections are performed by dedicated departments inside the OeNB.

On the one hand, credit risk issues are assessed thoroughly in the course of regular on-site inspections as well as during the assessments of the internal ratings-based models developed by banks, which relates to SIs in particular. On-site inspections typically include the assessment of NPL portfolios, including management capabilities and the adequacy of loan loss provisions.

On the other hand, the off-site supervisory department continuously assesses whether there are any issues relating to credit quality/NPLs. It is common practice to use the rating outlier analyses (debtors defaulted in dealings with one bank but not with another) from the central credit register for the purpose of off-site examinations. Such comparisons are sometimes performed on an ad-hoc basis for significant exposures. In addition, there are annual reviews of recovery plans, including an assessment of the calibration of trigger levels for asset quality indicators (NPL growth rate is an obligatory indicator), and of monitoring procedures.

In addition, NPL-related topics are regularly discussed during annual senior management meetings with larger banks.

Nine Austrian banks were subject to AQRs in 2014 or 2015 in the context of SSM comprehensive assessments. Those capital needs revealed were addressed, primarily by raising capital and retaining earnings.

B Legal, Judicial and extrajudicial framework

B.1 Sale of portfolios

Although there are no legal impediments to loan sales, the Austrian market for NPL portfolios is undeveloped. This is due to the fact that portfolios with higher rates of NPLs are usually located outside Austria, i.e. in banks' CESEE subsidiaries. Credit institutions with significant NPLs have restructured their organisational set-ups to facilitate the transfer of NPLs to separate entities responsible for the winding-down of bad assets. There are both private (e.g. Immigon Portfolioabbau AG) and public (e.g. KA Finanz AG) solutions, while HETA Asset Resolution AG was handled by the resolution authority. According to the FMA, however, although the creation of

separate entities helps to cure NPL portfolios, the lengthy public discussions preceding these solutions may generate a loss of confidence in the financial sector, as evidenced in the aforementioned cases of Immigon Portfolioabbau AG, KA Finanz AG and HETA Asset Resolution AG.

For transactions going beyond the simple purchase and sale of NPLs, as in the case of additional services relating to debt collection, the regulations on banking business apply and a banking license is required.

Borrowers do not have to agree to the transfer of the loan, although they should be informed of the identity of the new creditor. Although the collaterals can be transferred, the kind of legal act necessary depends on the type of collateral in question. Loans may also be sold even if legally and economically written off. Third-party banks and (foreign) institutional investors are allowed to purchase NPLs.

The BaSaG provides legal grounds for the creation of AMCs. It also includes provisions intended to ease asset restructuring equivalent to the ones in the special law issued for the restructuring of Hypo Alpe-Adria-Bank International AG, the Federal Act on the Creation of a Wind-Down Unit (*Bundesgesetz zur Schaffung einer Abbaueinheit*), which states that banks are free to set up an AMC in cooperation with investment firms. However, AMCs, insofar as they trade or securitise NPLs, are not common practice in Austria. Public or partially-private solutions are much more common, as mentioned above.

B.2 Debt enforcement/foreclosure

The FMA does not perceive that the real estate transaction setup could represent an obstacle to private debt resolution.

There are no blanket bans (moratoria) in place. All of a debtor's assets can be subject to an enforcement procedure, although exemptions from seizure are listed in Section 250 of the Austrian Enforcement Directive (*Exekutionsordnung*). One example of such an exemption is property for the personal use of the concerned persons or the needs of their household if it provides a modest livelihood, including food, heating fuels and the like.

Real estate sales: before overdue payments occur, the owner/debtor and the creditor may contractually agree that the sale of the property by the creditor is permitted so long as it is not sold at a price lower than the valuation price at the time of the sale. Alternatively, the creditor may be permitted to sell to a person designated by the debtor at an agreed price. After the debt has become past due, bilateral agreements are permitted without any restrictions.

Non-real estate assets: generally, out-of-court sales are governed by Section 466a et seq. of the Austrian Civil Code. If the debt is due, the creditor who plans to realise the asset must, if possible, inform the debtor one month in advance, after which the legally or contractually pledged objects may be realised through public auction. Private sales at market prices are permitted in the case of pledged objects and

securities. The termination and collection of a conveyed claim is permitted in the case of bearer instruments or instruments payable to order. In specified cases the creditor is permitted to sell pledged assets before the debt is past due, for example if the deterioration of the assets is imminent.

In the case of first demand guarantees, the creditor may be authorised to contact the guarantor directly without addressing the debtor first.

B.3 Corporate insolvency and restructuring

The FMA does not perceive that the current corporate debt resolution regime presents an obstacle to private debt resolution.

There are no legal provisions or special schemes in place to support distressed companies.

Public sector authorities are generally equivalent to private creditors in terms of the clearance process (e.g. regarding tax obligations). Public creditors can agree to partial debt servicing. There are no special procedures for microenterprises and SMEs in the clearance of arrears to the public sector. There is no out-of-court settlement mechanism in Austria.

There is no change of management in insolvency proceedings, which are regulated by the Austrian Federal Insolvency Law (*Insolvenzordnung* – IO). In regular proceedings, the debtor (management) loses the right to dispose of the companies' assets and the bankruptcy administrator is responsible for legal representation under Section 2 of the IO, while Section 3 states that any legal acts of the debtor are invalid with regard to bankruptcy proceedings. The assets of a company under debt restructuring may be sold through auctions or open market bilateral sales.

Section 166 of the IO provides the possibility for the debtor to prepare a recovery solution under certain conditions, or to develop an insolvency plan that can be submitted to the insolvency court together with the insolvency filing or in the case of threatened insolvency.

If a need for reorganisation is identified, companies can apply for restructuring proceedings under the Company Reorganisation Act, which does not apply to credit institutions, insurance companies, investment firms and financial institutions. Doctrine and jurisprudence concur that this law does not provide sufficient creditor protection and requires decision-making by unanimity.

B.4 Household insolvency and restructuring

The FMA does not perceive that the current household debt resolution regime could represent an obstacle to private debt resolution.

In Austria only natural persons (consumers, entrepreneurs) are eligible for the private debt resolution scheme. There is no legal regime for household bankruptcy or any possibility to combine the proceedings of more than one natural person. Before the proceedings begin, the debtor must prove that his request for an out-of-court settlement has failed or would have failed (not applicable for individual entrepreneurs).

There are publicly certified credit counselling centres that will assist the debtor with a request for an out-of-court settlement and with in-court proceedings free of charge, although there is no mediation mechanism.

Unless a five-to-seven-year payment plan is agreed, the debtor becomes subject to a so-called *Abschöpfungsverfahren* repayment procedure. As long as this procedure is enforced, the debtor is subject to attachment of salary and may only retain the amount exempt from execution in order to ensure a minimum living wage. The average duration of in-court insolvency proceedings is two to six months. The insolvency discharge period lasts three years if the insolvency creditors received 50% of their open claims and seven years if they received at least 10%. If they have received less than this after seven years, the court may extend the period up to ten years.

B.5 Judicial system

The Austrian supervisory authorities do not consider the judicial system to be an obstacle to private debt resolution.

The commercial courts have insolvency departments with specialised judges. Court fees relating to personal insolvency proceedings are within a reasonable range, although fees relating to corporate insolvency proceedings are higher. Neither of these is considered an obstacle to debt resolution.

The IO establishes time requirements for certain steps of the corporate insolvency process and provides the option, at the discretion of the court, to set such requirements for the personal insolvency process as well. In general a debtor must make an insolvency application within 60 days of the occurrence of illiquidity or over-indebtedness.

B.6 Tax regime

Tax deductibility for LLPs is limited to specific provisioning, even if they have been calculated based on grouped criteria. Tax deductibility does not depend on the specific resolution measure used. The framework includes a tax loss carry forward mechanism, following the general rules of income tax law. Loan write-offs for non-collectible parts of the loan are tax-deductible.

There is no specific tax deduction for loan write-offs; a loss will only reduce the basis for taxation through P&L.

The sale of collaterals reduces the balance of the loan receivable. If a sale of collateral exceeds a provisioned loan, the excess part is qualified as taxable income.

Private debtors are not charged capital gains tax in the event of debt restructuring at more favourable terms. Debt reduction for a business is treated as income and therefore subject to corporate income tax.

C Other Information Framework

C.1 Public registers (central credit registers, cadastral system, asset register)

The Austrian supervisory authorities do not have concerns that the implemented public registers could be an obstacle to private debt resolution in the country.

The CCR is operated by the OeNB and its definitions are aligned with CRR and nGAAP definitions.

The agents required to report to the CCR are credit and financial institutions supervised by the FMA; branches established in Austria by credit and financial institutions and their subsidiaries in other Member States; and insurance undertakings. The CCR covers approximately 80% of the total value of loans in Austria.

The OeNB requires institutions to report to the CCR loans of €350,000 or more, net of any write-off amounts. Data are reported monthly on a borrower-by-borrower¹⁴ basis. Reporting requirements involve on-balance sheet exposures, off-balance sheet exposures and counterparty credit risk. The reported data cover information on past-due claims, specific valuation allowances, rating system, credit rating, probability of default, risk weighted assets, expected loss, the method used for the calculation of the capital requirement, and groups of connected clients. They do not, however, contain information on forbearance, tax and social security payments. Reporting agents are also required to complete a separate collateral report, which differentiates between collaterals pursuant to the CRR and collaterals pursuant to internal risk management. The information collected on collateral is linked to the borrower, not to the specific asset. The CCR is available to: (i) reporting agents to obtain information on the total exposure of one customer or group of connected clients (exclusive of risk, collateral and other information relating to counterparties/institutions); (ii) auditing authorities; and (iii) borrowers, which are allowed to conduct searches on themselves.

The cadastral system (land registry) is a centralised database, populated with data provided by regional courts and available to the public to conduct searches. Public

¹⁴ All legal entities, natural and legal persons and groups of joint borrowers (jointly and severally liable) must report to the CCR, regardless of their country of residence.

access to this database is via access providers delegated by the Federal Ministry of Justice. The cost of a search depends on the scope and level of detail, although the range of prices is considered to be reasonable. The public registries (land registry, commercial registry and registry for patents/licenses) are available to creditors and contain information on the owner and the characteristics of the asset.

C.2 Debt counselling and outreach

The Austrian supervisory authorities do not have concerns that limitations in terms of debt counselling/outreach are an obstacle to private debt resolution. Several subsidised agencies exist to support indebted SMEs and households.

C.3 Consumer and data protection

There are restrictions on the recording/sharing of personal information for debt workout purposes, essentially related to general data confidentiality requirements in Austria.

Nevertheless, the Austrian supervisory authorities do not have concerns that a lack of information-sharing due to consumer protection law represents an obstacle to private debt resolution.

Annex II: Belgium

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

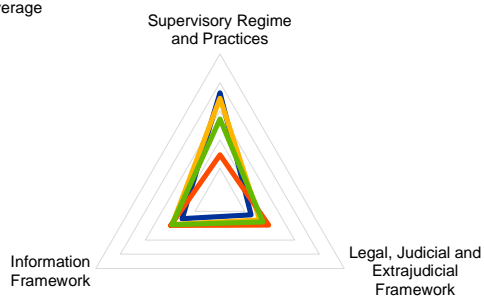
Chart 2

Country overview

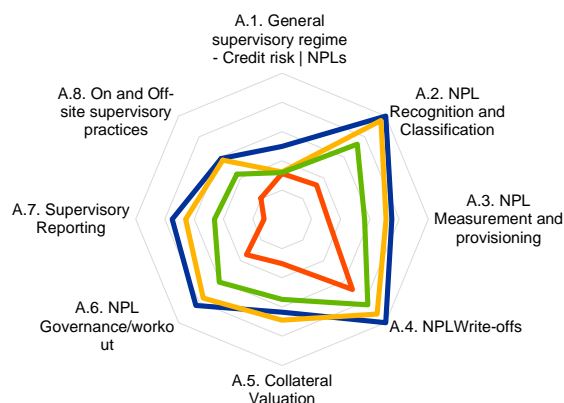
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

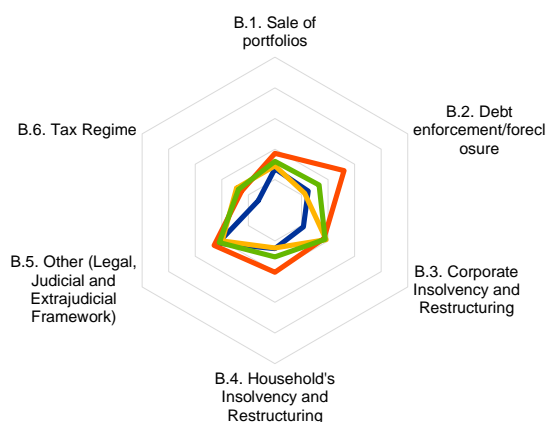
- BE
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



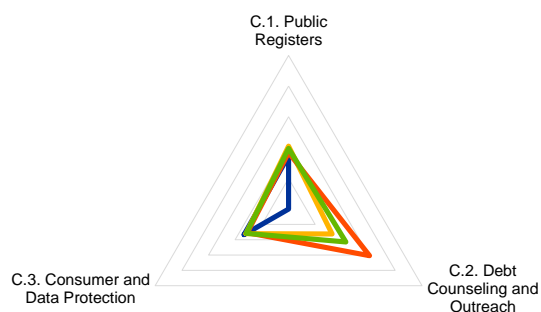
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Belgium had a total NPL ratio of 3.5% (by segment: households 3.7%, NFCs 4.8%, SMEs 5.9% and CRE 7.1%).¹⁵

Even though the current NPL situation seems favourable overall, the survey reported some features in the framework that could represent **potential challenges to NPL workout in Belgium**:

- **NPL governance**: due to the more favourable NPL conditions in the country overall, no particular guidance has been issued on NPL workout practices.
- **NPL recognition and classification/write-off**: apart from the general accounting principles (nGAAP and IFRS), there are no additional specific guidelines on the prudential accounting approach regarding provisioning and write-offs.

In terms of **specific supervisory practices** for addressing NPLs, the Nationale Bank van België/Banque Nationale de Belgique (NBB) has developed actions with respect to the quality of information reported in the CCR. In order to improve its risk assessments, in 2012, the NBB redeveloped its credit register of loans to firms to include additional information: the date and total amount due to the participant (e.g. bank) in case of non-repayment, the estimated probability by the participant that a non-repayment will occur within the year, as well as the amount that can be recuperated in the case of non-repayment, estimated by the participant.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

¹⁵ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance-sheet exposures. The sample covers all banks in Belgium.

Table 21**Main sources of NPL-related regulation**

Type	Ref.	Scope	Topic	Summary description	Entry into force
Circular (binding)	12/2012/NBB	All credit institutions	Collateral valuation	Regulation of the National Bank of Belgium concerning the practical modalities for the application of the law of 3 August 2012 that establishes a legal regime for Belgian Covered Bonds dated 29 October 2012; This circular gives some indication on the accepted valuation of collateral (real estate) for mortgage credits included in covered bonds. The value of immovable properties has to be justified in written document by a person unrelated to the commercial credit process and having the sufficient qualifications.	2012
Royal decree (binding)		All credit institutions investment firms and management companies of undertakings for collective investment.	Annual accounts	Royal Decree of 23 September 1992 on the annual accounts of credit institutions, investment firms and management companies of undertakings for collective investment. It details the principles that apply to the annual account of credit institutions, and includes Belgian accounting practices generally accepted in the banking sector.	1993
Act (binding)		All credit institutions and stockbroking firms	Banking Act	Law of 25 April 2014 on the legal status and supervision of credit institutions and stockbroking firms.	2014

The NBB has not issued specific guidelines on credit risk management practices and processes. The NBB uses international standards such as the Basel Committee principles for the “Management of credit risk” and “Sound credit risk assessment and valuation for loans” to assess the adequacy of banks’ credit risk management and processes. There is no guidance defining specific limits on household portfolios.

A.2 NPL recognition and classification

For regulatory reporting purposes, Belgian banks are legally required to comply with the EBA ITS regarding the definition/classification of forbearance and NPEs. The NBB has not issued additional criteria beyond the EBA ITS in this respect.

The consolidated accounts of credit institutions must be prepared in accordance with IFRS.¹⁶ The statutory accounts are established based on the national legal framework which is also applicable to the FINREP at solo level unless the institution has requested and obtained a special agreement from the ECB (SIs) or the NBB (LSIs) to prepare their FINREP at solo level based on IFRS.

The national legal framework used for Belgian nGAAP reporting (so-called “Scheme A” reporting) requested at statutory level requires the classification of loans based on borrowers’ creditworthiness.¹⁷ The law does not explicitly refer to performing/non-performing loans but distinguishes two types of problem assets for which provisions are expected to be recorded based on the prudence principle: (i) doubtful or unrecoverable loans and (ii) loans with an uncertain future. Further distinctions are

¹⁶ Royal Decree of 23 September 1992 on the consolidated accounts of credit institutions.

¹⁷ Royal Decree of 23 September 1992 on the annual accounts of credit institutions.

made depending on the nature of the problems (commercial credit risk and country-related risk).¹⁸

A.3 NPL measurement and provisioning

Belgian banks follow nGAAP accounting requirements for solo reporting and IAS/IFRS accounting requirements for reporting at a consolidated level. The NBB has not issued additional specific prudential guidelines on NPL measurement and provisioning.

Regarding the valuation of loans and problem assets, credit institutions are required to apply a forward-looking approach and to reflect realistic repayment and recovery expectations.¹⁹

Regarding accrued interests on non-performing loans, income allocation is only allowed when its settlement is certain.²⁰

The quality of banks' provisioning policies is regularly reviewed by the NBB supervisory teams. Based on reports received from the institution, from the external auditor and from its own inspectors, the NBB is empowered to require institutions in its area of responsibility to strengthen their credit policies and procedures and to provide for additional provisioning if the level thereof is deemed unsatisfactory. If this requirement is not respected, the NBB may impose a capital add-on under the Pillar 2 process or a deduction from regulatory own funds for the calculation of the solvency ratio.

A.4 NPL write-offs

Write-offs are regulated according to nGAAP or IFRS. There are no specific national guidelines/rules or any additional incentive for NPL write-offs, i.e. no increased capital charges and no hard limits on how long NPLs can remain on banks' balance sheets.

A.5 Collateral valuation

The Belgian supervisory authority has no concerns that collateral-related issues could represent an obstacle to private debt resolution.

The Belgian Banking Act stipulates that the risk mitigation techniques used by credit institutions, such as taking collateral, must be both effective and regularly assessed.

¹⁸ It should be noted that the country-related risk, though still recognized in the accounting regulation, has been replaced, in the prudential framework inspired by CRD II (Basel II), by specific risk weighting requirements.

¹⁹ Article 35 of the RD of 23 September 1992 on the annual accounts of credit institutions.

²⁰ Article 19 of the RD of 23 September 1992 on the annual accounts of credit institutions.

For tangible collateral such as real estate, the Act requires a correct evaluation, a monitoring of the collateral and an assessment of the legal effectiveness of the contractual mechanism used. For guarantees, a correct evaluation and monitoring of the guarantor's financial capacity as well as an assessment of the legal effectiveness of the contractual mechanism used, are required.

Circular No 12/2012/NBB on the practical modalities of the Belgian covered bonds regime provides several precisions with regard to real estate valuation. Practical experience (through contacts with banks / inspections) has shown that these precisions (relating to real estate valuations) are aligned with those for loans which are not considered in covered bonds programmes. The Circular mentions that the sale value of the property or the architect's estimation (in the case of a new construction) can be used if the value is lower than €3 million (or 2% of the covered bond to be issued). If the value is higher than one of these thresholds, the credit institution is requested to perform an appraisal based either on the intrinsic value of the house or on the future yield associated with the property, and ideally by a combination of both types of methods. There is no specific guidance requiring banks to have reliable data collection for the assessment of collateral recovery, although general principles are stipulated in Annex I to the Banking Act.

The aforementioned circular further stipulates that:

- the value of immovable properties must be justified in writing by a person not involved in the commercial credit process and having the appropriate qualifications;
- the regular monitoring of immovable properties' values can be done using "adequate and representative indices" like the Stadim index (which is the index used by most of the important actors on the market). When the credit institution receives information indicating that the value has significantly declined or when the value of the property is above predefined thresholds (see above), the monitoring of the valuation must take the form of a re-appraisal (the use of indices being prohibited). Otherwise, the required frequency for the valuation of immovable property collateral follows CRR requirements (CRE ≤ 12 months; RRE ≤ 3 years).

The Belgian supervisory authorities did not provide additional incentives to reduce reliance on collateral, whether through increased provisioning, or through the assessment of valuation practices.

A.6 NPL governance/workout

The Belgian supervisory authorities are not concerned that overall NPL management-related issues may represent an obstacle to private debt resolution. There are no specific national guidelines for valuing foreclosed assets.

In general, Belgian banks have a separate NPL workout unit which is in charge of the treatment of doubtful loans (restructuring of the loans, recovery, sale of

collateral). The NPL unit is generally not a separate legal entity, although there are some exceptions, notably for consumer finance. NPLs are managed outside commercial and/or credit origination units.

Outsourcing of NPL management outside the banking group is legally possible but is not a common practice in the Belgian banking system. On the contrary, some banks provide recovery services and credit insurance to their own customers, notably SMEs, through specialised subsidiaries.

There is no formal mechanism for interbank coordination or for coordination between private and public debtors in individual debtor cases.

A.7 Supervisory reporting

Credit Institutions in Belgium submit the required COREP/FINREP reporting templates, including information relating to the EBA ITS requirements on forbearance and NPEs, on a quarterly basis.

As part of their regular prudential reporting, all banks (at a solo level) must additionally submit separate reports on problem assets to the NBB, on a quarterly basis.²¹ This provides additional information on the evolution of so-called exposures with an uncertain future, and doubtful or unrecoverable exposures (as defined by Belgian nGAAP) with a detail of the stock of loans, the level of provisions (specific or collective) and non-accrued interest.

A.8 On-site and off-site supervisory practices and methodologies

The review of the proper loan classification and adequate level of provisioning is one of the central tasks entrusted to banks' external auditors, who must submit an opinion on the correctness thereof to the NBB on a semi-annual basis. A full audit is required for the annual prudential information, including NPL reporting, and a limited review is required for the semi-annual prudential information, both reported to the NBB. It should be noted that, in order to ringfence the contribution of the external auditor to the prudential supervision, external auditors for banks and other financial institutions must be accredited by the NBB.

A regular horizontal analysis is also performed of the quality of credit portfolios to support line supervisors' risk analyses. The NBB's focus is explicitly on the evolution of the mortgage loan portfolio which represents the largest credit exposure for the banking sector.

On-site supervisory practices and methodologies are in line with the ECB Supervisory Manual for both SIs and LSIs.

²¹ Under the so-called "Scheme A" reporting, tables 50.10 to 50.15.

In cases where the NBB considers that the bank does not have adequate provisioning levels, it may require the bank to increase its provisions or impose Pillar 2 requirements.

A large number of Belgian banks are SIs and were subject to an AQR in 2014. This exercise did not reveal major weaknesses in the provisioning policies and level of provision with regard to Belgian credit portfolios (even if some weaknesses were highlighted in terms of data quality and the valuation of real estate collateral).

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

Due primarily to the limited number of NPLs, the Belgium market for NPL portfolios is not developed and selling NPLs is not common practice.

The Belgian regulatory framework does not establish specific legal impediments to the transfer of loans, and even facilitates and accommodates such transfers, e.g. the assignment of claims is operated by the simple consensus between assignor and assignee, not requiring any consent of the assigned debtor but merely that he or she be notified.²² Loans can be sold even if legally and economically written off.

An institution may also use Articles 77 and 78 of the Belgian Banking Act to transfer assets to other financial institutions without the prior consent or notification of the debtor. Under these provisions, the transfer is authorised by the supervisor and the publication of this authorisation in the Official Journal is sufficient to ensure the legality of the transfer. Thus far, these provisions have not been used for NPLs but only for certain asset portfolios.

Both credit institutions and institutional investors²³ are allowed to purchase loans from domestic banks, and there are no impediments related to the nationality of the buyer (unless the buyer is located in a jurisdiction considered by the Financial Action Task Force (FATF) to be “high-risk and non-cooperative”).

Although no specific regulation on AMCs exists, there are no legal impediments to banks establishing an AMC in cooperation with investment firms.

With regard to the potential structure that may be used, it is worth mentioning (i) the possibility of using the legal structure of an institution to investment in receivables under Article 3, 7° of the Law of 3 August 2012 on certain forms of collective

²² The Law of 3 August 2012 on “Various measures to facilitate the mobilization of receivables in the financial sector” introduced additional possibilities for financial and credit institutions to use their assets for their own financing and removed various obstacles to the use of loans held by credit institutions for financing purposes.

²³ Institutional investors are allowed to buy loans from domestic banks only to the extent that they hold the suitable license, if such license is required taken into account the nature of the assigned loans (consumer credits, mortgage loans, ...)

management of investment portfolios which could, under certain conditions, be considered appropriate for the transfer of NPLs (institutions for investment in receivables can be attractive from a tax perspective) and (ii) the possibility for the resolution authority – provided for specifically for credit institutions in Articles 255 and 260 to 264 of the Belgian Banking Act specifically for credit institutions – to create a temporary “bridge institution”, to which certain (non-performing) assets, rights and commitments can be transferred, in preparation for their eventual alienation to third parties.

B.2 Debt enforcement/foreclosure

The rapid out-of-court enforcement/foreclosure of collateral is possible under the Law of 15 December 2004 on financial collateral arrangements.²⁴ This is only possible for pledges (or transfers of title as security or repos) on securities, cash and credit claims.

With regard to security interests on other assets (pledge on moveable assets, mortgages), there should be an enforcement title and authorization from the court to realize the collateralised asset. Any creditor has the right to seize the goods of a debtor in order to recover his claims. When there is a mortgage on real estate, the creditor, after obtaining an enforcement title, must seize the property (in Belgium this takes place via an enforcement judge) and the sale takes place either via bilateral sale or auction, both via the intervention of a notary.

The NBB considers that there are no disincentives to realising collateral. The average length of a foreclosure proceeding is less than one year.

B.3 Corporate insolvency and restructuring

Corporate insolvency and restructuring regimes are not assessed as an obstacle to debt resolution.

As far as restructuring is concerned, judicial reorganisation applies to corporates and natural persons who are traders (merchants). The judicial reorganisation proceedings can take place either out of court as an amicable settlement or, in court as an amicable debt settlement, a collective debt settlement plan or a transfer of all or part of the company under the supervision of the court. There is no debt mediator in judicial reorganisation proceedings.

An amicable debt settlement, be it in-court or out-of-court, requires the unanimity of all the creditors involved (at least two creditors). Amicable debt settlement agreements under court supervision, have an average duration of 6 to 12 months.

²⁴ This implements the Financial Collateral Directive 2002/47/EC into Belgian law.

A collective debt settlement plan must be approved by the majority of the creditors representing more than half of the value of the claims, after which it becomes mandatory for all the creditors. A plan elaborated by the debtor may contain various measures to restructure the debts, including a partial reduction of the principal and/or interests of the claim, debt-to-equity conversion, etc. Since the collective debt settlement plan aims only to restructure the debts, there is no sale/realisation of assets. Unlike in the case of bankruptcy, such a plan is not a winding-up procedure. Nevertheless, if the debtor opts for a transfer of all or part of the company under court supervision, assets will be sold through either bilateral sales or through auctions.

There are no legal provisions or schemes in place to support distressed companies (e.g. establishment of financing funds for SME).

B.4 Household insolvency and restructuring

The household insolvency and debt restructuring regime is not seen as an obstacle to private debt resolution.

There is no out-of-court restructuring for natural persons who are not traders (merchants) although there is a collective debt settlement which can be either an amicable debt settlement under the control of the court (which requires the agreement of all the creditors involved) or a judicial settlement plan which is decided by the court if the amicable settlement plan fails to obtain the unanimous approval of the creditors. The collective debt settlement aims to restructure the debtor's assets and, unlike judicial reorganisation (see section B.3), is a *concursum creditorum*, meaning that the equal treatment of the creditors must be respected.

Within eight days of the application to initiate the proceedings, the court must decide on its admissibility. If the court approves the application the judge appoints a debt mediator. The debtor then elaborates a plan with the help of the debt mediator. If it is not possible to reach an amicable settlement plan (i.e. it is not endorsed by the unanimity of the creditors) within a period of six months (with a single possible extension of a further six months), the court may impose a judicial settlement plan, compliance with which is controlled by the debt mediator. The plan can contain various measures such as the total (under specific circumstances) or partial reduction of the principal and/or interests for claims, debt deferral or debt rescheduling, etc.

For the amicable settlement plan, the length of the plan (discharge period) cannot exceed seven years, unless the debtor expressly requests its extension in order to protect specific elements of the debtor's assets and to ensure the respect of human dignity. The court decides whether such a request is justified.

For the judicial settlement plan, the judgement establishes the duration of the plan at anything from three to five years, unless it is extended by the judge at the express request of the debtor under the conditions described in the preceding paragraph.

The aforementioned periods are shortened if the collective debt settlement is revoked by the court.

B.5 Judicial system

The NBB does not consider the judicial system to be an obstacle to private debt resolution. The duration of judicial proceedings depends primarily on the complexity of the case and on the number of debtors involved. Bankruptcy usually takes more time than a judicial reorganisation or collective debt settlement.

An application for a collective debt settlement is free of charge, and the debtor may request a lawyer. Since debtors under a collective debt settlement do not have sufficient financial resources, they generally benefit from free legal assistance, meaning that the lawyer will be paid by the State at a rate established by law.

The fees for the debt mediator (who assists the debtor in elaborating the plan) are also set by law. The fees must be paid in priority to all other creditors. The fee amounts do not in any way limit the debtor's right or ability to initiate the proceedings.

B.6 Tax regime

The current Belgian tax framework is not assessed by the NBB as being an obstacle to private debt workout.

If a credit institution makes a provision for a "bad loan", it is tax-deductible under certain very strict conditions. The loss must in principle be established and certain, or the conditions of Article 48(2) of the Belgian Income Tax Code must be met (reorganisation plan approved by a court or an amicable settlement established by a court in accordance with the Law of 31 January 2009 on the continuity of enterprises).

A provision for a probable loss may be tax-deductible on a case-by-case basis, and it must be justified by a detailed analysis. Because of this, tax deductions for LLPs are not widely used in Belgium.

In Belgium, tax losses (or the unused part of the losses) are deductible by carrying them forward against future profits (tax loss carry-forward mechanism). The realised loss on a bad loan (loan write-off) is in principle tax-deductible. There are no specific tax deductions for collateral sales, although realised losses on the sale of collateral are in principle tax-deductible.

In Belgium, capital gains tax owed by debtors on the debt write-off/restructuring of their debts at more favourable terms is not considered to be taxable income if the conditions of Article 48/1 of the Belgian Income Tax Code are met (reorganisation plan approved by a court or an amicable settlement established by a court in accordance with the Law of 31 January 2009 on the continuity of enterprises).

Public creditors can provide debt write-off within reorganisation proceedings.

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

The NBB operates two credit registers, the Central Corporate Credit Register (CCCR) and the Central Individual Credit Register (CICR).

The CCCR contains information on all credits to legal entities (i.e. enterprises, associations, administrations, etc.) as well as those to natural persons (i.e. individuals) in the context of their business activities. This applies to all persons, whether resident in Belgium or abroad.

The participants in the CCCR are credit institutions, leasing companies, factoring companies and insurance companies approved to provide guarantee insurance and credit insurance, insofar as far as they are established in Belgium.

The CCCR is used by participating institutions as a credit risk management tool, in particular to assess the credit worthiness of a debtor during the loan origination and monitoring processes. The information in the CCCR is also used by the NBB in connection with its legal missions (prudential supervision of credit institutions, financial stability and monetary policy). Debtors can also access any information relating to them held by the CCCR.

The CICR contains information relating to all consumer credits and mortgage loans contracted by natural persons for private purposes as well as any payment defaults resulting from these loans. The data recorded in the files of the CICR are supplied by credit institutions; social lenders; instalment sellers; other financial institutions providing consumer credits; insurance companies and other lenders providing mortgage loans; credit insurance companies; and debt collection agencies.

It is mandatory to consult the CICR prior to the conclusion or amendment of a consumer credit or mortgage loan contract subject to the Law on the CICR. The CICR can also be consulted by consumers and debtors.

The cadastral system (land registry) is digitalised and centralised. The real estate transaction register contains the prices of RRE and CRE transactions, as well as a description of the property characteristics.

The public asset registry (e.g. road vehicles) includes information on the owner and the characteristics of the asset, although this information is not publicly available.

C.2 Debt counselling and outreach

The NBB is of the opinion that the quality of debt counselling and outreach is adequate. Each region (Brussels, Flanders and Wallonia) offers free or subsidised personal budgeting and legal advice services for indebted households and has institutions that provide credit management training and advice to SMEs.

C.3 Consumer and data protection

There are restrictions on the recording/sharing of personal information for debt workout purposes, essentially resulting from Belgian confidentiality requirements. Nevertheless, the Belgian supervisory authorities do not have concerns that a lack of information sharing due to consumer protection law is an obstacle to private debt resolution.

Annex III: Cyprus

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Following the requests made by the international creditors, Cyprus has started a comprehensive reform process (e.g. introducing new insolvency and foreclosure frameworks) to remove from its framework the main legal impediments to private debt resolution. This is taking place in a context exacerbated by unprecedented high levels of NPLs (in December 2016 the total NPL ratio stood at 39.2% (of which by segment: households 54.6%, NFCs 54.7%, SMEs 61.5% and CRE 58.2%)).²⁵ It is an extensive package of legislation, introducing new concepts to Cypriot law, and involving significant changes to both personal insolvency and bankruptcy, and the examinership and winding-up of companies. Some of the main objectives of the reforms are incentivising the restructuring of loans, setting up Personal Repayment Plans and providing debt relief to qualifying natural and legal persons. In addition, the Central Bank of Cyprus (CBC) has adopted a number of regulatory measures, such as the Arrears Management Directive, which provides, inter alia, instructions to banks on the processes for restructuring loans. Although these reforms have already been completed, their effectiveness is still being tested. The **main challenges to workout of NPLs in Cyprus** were identified as being in the following areas:

- **Sale of portfolios and market capacity:** the law allowing the transfer of loans to public/private AMCs²⁶ entered into force in 2015 and its effectiveness still needs to be tested; however, the efficiency of this tool could have a limited effect, at least in the short term, given the distressed market conditions (amplified by the inexistence of meaningful transactions in loans and collateral sales) and, until now, the lack of independent servicing capacity in the market.
- **Corporate insolvency and restructuring:** agreements on debt restructuring are difficult, especially taking into account the large amounts due to the public sector. The current framework includes a process for the partial clearance of public arrears. For microenterprises and SMEs, banks could perform restructurings under the provisions of the Arrears Management Directive, although the process is slow due to a lack of financial data and information or non-cooperation of the borrowers. Under the Directive, in corporate credit

²⁵ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers all banks in Cyprus. Due to a change in definition these figures are not comparable with those figures provided in the ECB Stocktake published in September 2016.

²⁶ In this report, AMC should be understood as a credit-acquiring firm (see also the list of abbreviations).

restructuring, it is not possible to change a company's management or to sell the assets of the company through auctions or open-market bilateral sales without the shareholders' consent.²⁷ Furthermore, special in-court procedures are not considered successful. The recent reform of the Foreclosure Law and of the corporate insolvency framework might mitigate some of these constraints.²⁸

- **Household insolvency and restructuring:** within the mandate of the Financial Ombudsman, a voluntary out-of-court settlement/mediation mechanism, subject to limits, was introduced in 2014. The Financial Ombudsman has been receiving increasing numbers of applications ever since. Although not yet fully operational, this mechanism is currently yielding satisfactory results, with a success rate of 85%. One constraint relates to the practice of providing multilateral guarantees, in a context where the legal regime, currently under reform, did not provide clear evidence on the liability of the guarantors. The changes made in the insolvency reform could mitigate the factors mentioned, particularly through the implementation of the Personal Repayment Plan (PRP), which allows an insolvent debtor, with the mandatory help of a licensed insolvency practitioner (IP), to develop a voluntary plan aimed at restructuring his/her debts, both secured and unsecured. Another version of the PRP is the compulsory PRP, which also allows the debtor to apply to the court for the imposition of a restructuring plan on the creditors.²⁹ The Personal Insolvency Law gives a debtor the option to proceed with a coordinated scheme that could provide restructuring both for his/her personal loans and for his/her microenterprise. The discharge of uncollectable personal unsecured debt up to €25,000 is facilitated by the new Debt Relief Order procedure. Equal treatment (i.e. equal to the debtor's unsecured discharged amount) is applied to the guarantors as long as the guarantors had not collateralised and/or secured the debtor's discharged debt with their personal property/assets.
- **The judicial system** needs to be streamlined, because in-court procedures are lengthy and courts or judges are not specialised in insolvency issues. Time restrictions related to personal insolvency have only been introduced for a few insolvency processes in the recent reform.
- Although significant progress has been made³⁰ by the banks in terms of establishing dedicated structures and procedures for **NPL management and restructuring**, there is still room for improvement in the experience, expertise

²⁷ Except in cases where banks had applied floating charges to the borrowers' assets (used as collateral for the loan), where they could easily appoint a receiver and manager, which is an out-of-court procedure that addresses some of these issues.

²⁸ More specifically, secured property has been included in the liquidation procedure for companies which are in liquidation. This new mechanism is another tool for secured creditors in addition to the new Foreclosure Law tool. The new examinership scheme is similar to that of Ireland, although it does not allow the removal of directors. The appointed examiner can provide solutions for reorganising and restructuring a business on a going-concern basis.

²⁹ Under specific criteria, but restricted for the purpose of protecting debtors' primary residence.

³⁰ Preliminary results at the end-of September 2015 indicate that, while the banks still did not meet their targets in aggregate terms, the pace of restructuring has further increased, and that greater use has been made of long-term restructuring solutions. In addition, the CBC has reported improved re-default rates.

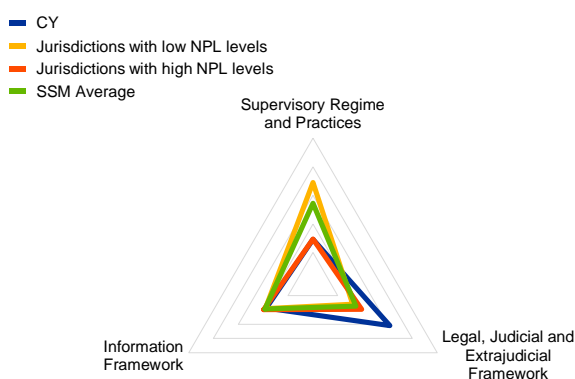
and resources of banks, because these influence the pace, effectiveness/sustainability of NPL workout/restructuring plans. Additional supervisory action, taking account of the systemic nature of the problem, is considered an important tool to ensure a faster implementation of the NPL workout strategies.

Chart 3

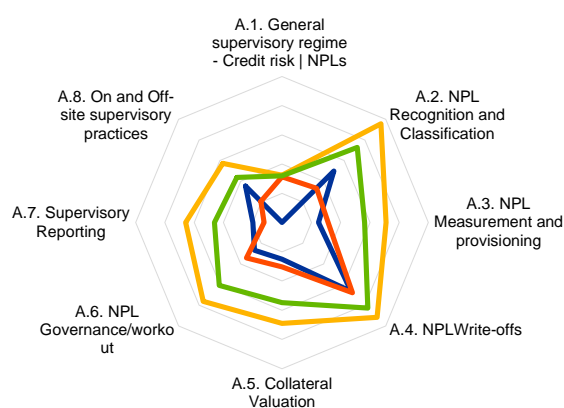
Country overview

How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

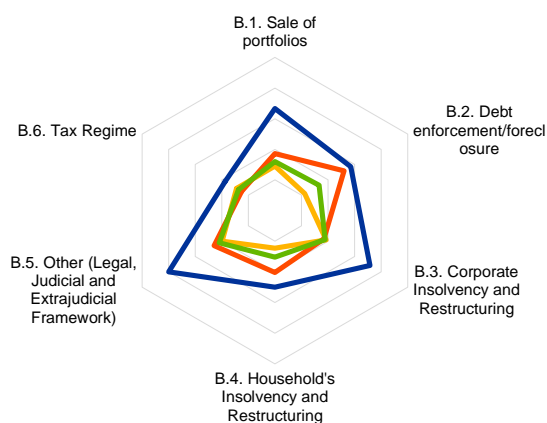
NPL Framework Overview



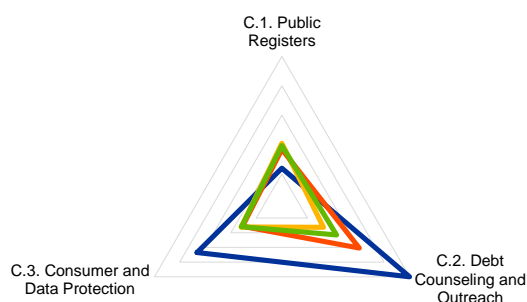
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



Specific supervisory practices for addressing NPEs can be summarised as follows:

- **NPL measurement and provisioning:** in the context of the loan impairment test, the CBC provides guidance to banks on what constitutes a loss event by formulating a number of trigger events (in line with the general principle of IAS 39) as well as macroeconomic triggers which might affect the future estimated cash flows of the borrowers. Moreover, the CBC requires banks to define their

own additional trigger events relating to specific classes of credit facilities, such as mortgage and CRE portfolios.

- **Supervisory guidance on NPL governance:** the CBC has addressed the topic of bank NPL management by issuing an Arrears Management Directive, as well as by monitoring policy deficiencies and operational bottlenecks in the institutions. Within this framework, the CBC has defined (based on proposals from the banks) quarterly bank-by-bank targets and assesses reports by external auditors regarding banks' debt restructuring arrangements and strategies on a six-monthly basis³¹.
- **Valuation of foreclosed assets:** specific requirements for valuing foreclosed assets on the foreclosure date were set by the Foreclosure Law. Banks are required to obtain two valuations from separate professional appraisers. If the difference is less than 25%, the value applied is the average of the two. Otherwise, a third valuation is obtained and then the value taken is the average of the two closest values. The starting price of the auction process is set at 80% of this value.
- **Reporting:** the supervisory reporting is based on EBA NPE templates, but in the context of the loan restructuring process, the CBC introduced an additional extensive framework aimed at supporting the assessment of the activities of each bank in 2015. It provides detailed information on bank performance relative to the targets set, the types of solutions proposed, the obstacles to completion of the restructuring and the effects on the portfolio in terms of success rates and migration between days-past-due (dpd) buckets.

Moreover, the implemented Directive aims to foster debt restructuring by banks (on the condition that clients are considered viable) and requires banks to establish an independent Arrears Management Unit, supported by adequate systems, policies, processes and procedures, which will be entrusted with adopting specific restructuring solutions tailored to different segments of the loan book. Another objective is to improve discipline during the credit-granting process by stipulating that the credit decision is to be based solely on the client's ability to repay the debt, and not on collateral considerations. Specific sets of documents are required for the affordability assessment and banks need to define a clear policy supported by specific limits (including in terms of the LTV ratio and debt-servicing capacity), in accordance with banks' risk appetites, in order to avoid excessive concentration.

³¹ This requirement concerned the submission of four reports (reference dates: 30/06/2016, 31/12/2015, 30/06/2015, 31/12/2014).

A Supervisory regime and practices

A.1 General supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 22

Main sources of NPL-related regulation

Type	Scope	Topic	Summary description	Entry into force
Directive (binding)	All credit institutions	Loan origination and review of existing loans	Prescribes minimum practices for the process of assessing and granting/reviewing credit facilities and specifies the minimum documentation institutions must obtain in the process of assessing and granting/reviewing credit facilities	2013-17
Directive (binding)	All credit institutions	Loan impairment and provisioning procedures	The main content refers to: provisioning policies and procedures; assessment of credit facilities for impairment; measurement of impairment; income recognition on impaired exposures; assets repossessed in debt collection; accounting write-off of credit facilities; disclosures.	2013-16
Directive (binding)	All credit institutions	Arrears management	The main content refers to: the application of efficient and effective strategies, policies, structures, procedures and mechanisms for the management of arrears and the attainment of fair and sustainable restructurings of credit facilities of borrowers with financial difficulties.	2013-15
Circular (binding)	All credit institutions	Guidelines to banks on the management of credit risk	The main content refers to: the credit risk management environment (credit strategies, policies, processes and procedures); the credit-granting criteria and credit-granting process; the measurement of credit risk and the management information system (MIS); credit administration; credit monitoring; the internal risk rating system; stress testing; and the control of credit risk.	2008
Law (binding)	All credit institutions	Sale of loans	Law on the sale of loans and the implementing Directive. The main content refers to the possibility of the sale of loans or portfolios of loans.	2015

The CBC has issued guidance which states that supervised banks must have a limit system in place to ensure that loans are granted within exposure limits established in accordance with their credit strategy/policies, risk appetite, concentration limits and diversification efforts. Limits should be established for all activities where credit risk exists and should generally be binding, and not driven by customer demand.

Binding limits³² have been set for the ratio of the debt-servicing³³ amount to the debt-servicing capacity of the borrower and for the maximum LTV ratio³⁴ at origination, for retail portfolios. For NFCs, LTV limits are defined for RE financing.

Banks have to collect adequate information and documents (specified by the Directive and varying according to the type of borrower and credit facility), including from the CCR, in order to properly assess the risks taken, the borrower's ability to

³² A macroprudential circular was issued on 22 February 2016 (and revised on 18 March 2016 in order to be aligned with the revised directive) establishing maximum LTV ratios and the loan-servicing amount as a percentage of the borrower's net disposable income.

³³ In assessing the repayment ability of the applicant, the total debt servicing amount should be limited to 80% of the Net Disposable Income, while in the case of loans in foreign currency, the total debt servicing amount should be limited to 65% of the Net Disposable Income.

³⁴ The LTV ratio shall not exceed 80% in cases where the credit facility is granted to finance the primary residence of the borrower and 70% for all other property financing cases.

repay the credit facility within the set time limit, the adequacy of collateral and the purpose of the loan.

A.2 NPL recognition and classification

For regulatory reporting purposes, banks are legally required to comply with the EBA ITS regarding the definition and classification of NPEs. Moreover, banks are required by the CBC's Loan Impairment and Provisioning Directive to disclose specific tables with information on their NPLs. The classification as performing and non-performing does not comprise further sub-categories, but a breakdown by vintage buckets (including a migration matrix)³⁵ is provided in the reporting.³⁶ In accordance with IAS 39, institutions have to conduct an assessment of loans at least on a semi-annual basis, in order to identify whether there is objective evidence that a financial asset or group of financial assets is impaired. Institutions must have in place a system for monitoring the status of individual loans and borrowers in different loan portfolios, in particular to determine the adequacy of provisions and reserves. In accordance with the Loan Impairment and Provisioning Directive, banks are required to identify and monitor an extensive list of trigger events, which forces them towards early recognition and classification of NPLs.

In addition to the requirements of the EBA ITS, when classifying loans as forborne exposures, banks are required to report, under the CCR reporting framework, the total number of restructurings made in the past concerning a specific borrower and the date of the latest restructuring.

Reclassification of loans out of the NPL portfolio follows the provisions of the EBA ITS.

A.3 NPL measurement and provisioning

Banks follow the IFRS accounting framework. The Loan Impairment and Provisioning Directive complements the IFRS by setting guidelines on what constitutes a loss event.³⁷ The Directive formulates some trigger events in line with the general principle of IAS 39, although banks additionally assess the presence of macroeconomic triggers³⁸ which may affect the estimated cash flows of the borrowers. Moreover, the Directive requires banks to define their own additional

³⁵ LNMATRIX return.

³⁶ The LNMATRIX return was requested through a circular (and subsequent circulars for amendments and clarifications); its submission is therefore not legally binding. However, all banks do submit the LNMATRIX return and cooperate with the CBC, which analyses the returns submitted.

³⁷ Directive issued to credit institutions on loan impairment and provisioning procedures.

³⁸ These macroeconomic triggers include: (i) current economic conditions which may adversely affect the estimated future cash flows of the borrower with a consequent adverse impact on the borrower's repayment ability; (ii) an increase in the unemployment rate; (iii) a decrease in property prices that may adversely affect the repayment ability of certain borrowers operating in particular sectors, such as developers, and the collateral value of mortgaged properties of all classes of borrowers; and (iv) other adverse changes in the conditions of the economy in general.

trigger events relating to specific categories of credit facilities like RRE and CRE portfolios. So far, the consistency of provisioning approaches across banks is not ensured horizontally by a national mechanism. Checks are performed by banks' internal and external auditors.

The CBC does not have specific accounting powers but, under the CRD IV as transposed into the national banking law, it can require a bank to apply a specific provisioning policy or treatment of assets via the usual supervisory tools such as additional capital requirements. There is no specific regulation concerning particular provisioning rules for NPLs, apart from the inclusion of default classification among the impairment triggers. In terms of recovery time estimation, banks have to estimate a realistic time for collateral liquidation, taking into account current and expected market conditions, as well as the underlying legal framework for the disposal of mortgaged properties.

As per the provisions of IAS 39, incorporated in the Loan Impairment and Provisioning Directive, interest income has to be recognised on the unimpaired part of a credit facility, using the original effective interest rate of the credit facility. This also applies to credit facilities assessed for impairment on a collective basis.

A.4 NPL write-offs

There are no specific national guidelines or rules for NPL write-offs. The CBC requires institutions to have in place a derecognition policy which must ensure a timely accounting write-off of facilities where there is no realistic prospect of recovery and provide adequate governance procedures for the authorisation of the write-off. The CBC specifies that the derecognition of a credit facility does not imply that the institution discontinues its efforts to recover the outstanding debts, which may only be discontinued when the cost of pursuing the recovery exceeds the expected recovery amount.

A.5 Collateral valuation

Immovable property has to be evaluated by an independent appraiser listed on the bank's approved panel. Only appraisers licensed by the Technical Chamber of Cyprus can provide this kind of service. Banks have to carry out an ongoing assessment of the performance of its appraisers, to decide whether they should or should not remain on the mentioned panel. The panel should include expertise in various areas of the property sector, as appropriate to the lending business of the bank. Moreover, banks must set a limit on the total number of valuations to be performed by each single appraiser or firm of valuers. Market valuations should be carried out in accordance with the Royal Institute of Chartered Surveyors (RICS) Valuation Standards ("Red Book"), the European Valuation Standards ("Blue Book") or the International Valuation Standards ("White Book").

The required frequency for the valuation of immovable property collateral has to be clearly stated in the bank's policy and guidelines, to ensure that it is carried out at regular intervals and reflects current market conditions. It must in all cases comply with the minimum CRR requirements (CRE; ≤ 12 months; RRE ≤ 3 years). The valuation method has to be defined according to the type of property, and banks are required to assess its appropriateness. The frequency of collateral valuation of defaulted assets is not defined separately. Banks have to use property price projections for each class of property held as collateral (based on transactions conducted, macroeconomic conditions, input from professional appraisers and the historical property price indices produced by the CBC), and these projections, which have to be based on conservative assumptions, can be produced internally by appropriately qualified personnel (not subject to validation by an external independent and credible party) or provided by external experts. If a restructuring plan is proposed, banks have to conduct an independent professional valuation to determine the open market value and forced sale value of properties in order to define suitable and sustainable solutions. When using adjustments based on internal indices, the estimated market value of property collateral at the point of liquidation cannot be higher than the current market value. However, the CBC has introduced a circular which allows limited exceptions to this rule. Banks have to record all supporting documentation for each individually assessed credit facility. With reference to the process of data collection to assess collateral recovery, banks need to have in place appropriate models to calculate the LGD on the basis of the type of collateral, the length of time taken for disposal and the timing of all available cash flows. In the absence of the appropriate LGD, banks may use, following a sample test, for each pool of credit facilities, the LGD used for credit facilities of similar characteristics which were individually assessed.

In Cyprus, there are no specific requirements for the calculation of the credit risk-mitigating effect of collateral for risk management purposes under Pillar 2. The CBC has not provided additional incentives to reduce the reliance on collateral through an increase of provisioning or the assessment of valuation practices.

For valuing foreclosed assets on the foreclosure date, specific requirements were set by the Foreclosure Law, which lays out the details of the forced sale process. Banks are required to obtain two valuations from separate professional appraisers. If the difference is less than 25%, the value applied is the average of the two, otherwise a third valuation is obtained and then the value taken is the average of the two closest values. The starting price of the auction process is set at 80% of this value. If, instead of a forced sale, banks, in the context of a voluntary arrangement, acquire collateral from the debtor in the collection of debts, the classification of the asset is made according to the IFRS. So far, collateral has been disposed of through auctions organised by the land registry department of the Government, but banks are now applying the new Foreclosure Law, which permits auctions to be directly arranged by banks without any intervention by the land registry.

The leasing law was enacted on 28 April 2016. Some remaining obstacles relate to the securitisation framework.³⁹

A.6 NPL governance/workout

Given the unprecedented level of the NPL ratio, the strategy adopted in recent years by the authorities was aimed at enhancing efforts to restructure loans in arrears in a sustainable way. In this context, banks are requested to assess their own capacity and implement a robust operating model that encompasses systems, policies (code of conduct, transparency), processes (assessment of sustainable restructuring) and procedures (e.g. detailed management of communication with borrowers) to support its strategy. Banks need to establish and operate an independent and centralised Arrears Management Unit (AMU) to monitor arrears and troubled cases, and to conduct restructuring. The characteristics of the AMU, in terms of centralisation, structure and staff, are determined on the basis of the specificities of each bank and of the principle of proportionality. The Arrears Management Directive states that the AMU should be distinct from the debt recovery unit, which deals with non-viable borrowers. CBC directives promote granular portfolio segmentation in order to tailor specific restructuring solutions to different segments of the loan book. The assessment of the effectiveness of debt restructuring arrangements and strategies is performed based on information from various sources: CBC on-site visits and off-site assessments; banks' appointed auditors/consultants, who are requested to submit a specific report⁴⁰ every six months on their restructuring arrangements and strategies; and banks' internal audit reports.

Currently, Cypriot banks can outsource NPL management to third parties only after obtaining the approval of the CBC. Non-banks are allowed to provide loan-collection services for NPLs. Until recently, there were no companies operating in the NPL-servicing sector, but one servicing company has now been established in Cyprus and has entered into an agreement with a local bank to manage its NPL portfolio.

The Arrears Management Directive establishes that banks should develop an arrears management strategy, with sustainable debt restructuring techniques/options, and should submit to the CBC their proposed targets for NPL reduction (focusing on an increase in sustainable restructurings) and their performance against these targets. Additionally, the CBC is entitled to monitor, on a quarterly basis, the quantitative data on NPLs and restructured loans in order to encourage NPL workout. Thus far, the follow-up shows that banks' experience, expertise and resources still have room for improvement, which influences the pace and effectiveness/sustainability of NPL workout/restructuring plans. Considering that the restructuring process started with the simplest cases and that banks are currently assessing the more complex

³⁹ The draft securitisation law is being reviewed with the various stakeholders and has not yet been enacted.

⁴⁰ This requirement concerns the submission of four reports. The last one submitted was for the six month period ending 30 June 2016.

situations, it is crucial that further steps are taken to enhance the effectiveness of the proposed solutions.

Neither the current mechanism for interbank coordination in monitoring NPLs nor the coordination between private and public creditors (e.g. tax authorities, social security authorities) is effective in individual debtor cases. Banks are required to develop internal systems (key performance indicators, or KPIs) for the risk management department to monitor and assess arrears management performance.

A.7 Supervisory reporting

With the Directive for the exchange, collection and provision of data⁴¹, the CBC set up an information framework harmonised with its NPE classification categories (see Section C). Apart from this, supervisory reporting is mainly based on EBA NPE templates. In addition, in the context of the loan restructuring process, the CBC has introduced an extensive reporting framework, based on the following templates: (i) DRRA – KPIs on Debt Restructuring & Related Activities; (ii) LNMATRIX – Loan Arrears Monitoring Matrix Return; (iii) LATS – Targets on restructured loans and early arrears; (iv) MRTG – data relating to the auctions of foreclosed properties by banks and (v) DRU – data relating to debt recoveries (detailed data for loans in recovery in order to identify possible impediments to the resolution of terminated loans. The first submission by the banks is due on 30 April 2017). As a consequence, starting from the second half of 2015, banks are requested to submit on a quarterly basis a broad range of information on the following: (i) specific key performance indicators (e.g. the success rate for loans that went through restructuring, distinguished according to how many times they were restructured and the vintage of current arrears; cash flows collected, by restructured loan; types of solution proposed; reasons why an agreement with the client was not reached); (ii) a migration matrix that shows how the cohort of loans was modified, distinguishing between loans in performing, forborne and non-performing status as well as by the length of arrears; and (iii) a comparison of restructuring performance and targets.

NPE-related reporting is quality-assured by internal/external audit reviews.

A.8 On-site and off-site supervisory practices and methodologies

Towards the end of 2012, a due diligence and stress-testing exercise, including a review of arrears management processes for a sample of large borrowers was carried out by independent consultants with the involvement of international creditors. No specific comprehensive assessment has been performed for the LSIs in addition to that led by the ECB for the SIs.

⁴¹ Directive for the operation of a system or a mechanism for the exchange, collection and provision of data of 2015.

The CBC receives information from various sources (e.g. appointed auditors/consultants and internal auditors), which forms the basis for supervisory actions, meetings or correspondence with the banks. The criteria/framework that the CBC applies to assess the policies and procedures used by banks in order to handle NPLs does not accommodate the specific features of each bank, although these features are assessed taking into account the Arrears Management Directive, including the principle of proportionality.

A thematic review of bank NPL management capability was conducted in 2014. This was in addition to dedicated inspections of NPL portfolios, performed both on-site and off-site. In the latter case, inspections were performed with the support of CBC staff who had significant experience with NPL collection and workout.

Given that the CBC does not yet have access to data from the CCR (work on this is ongoing), the CCR is not currently used to generate aggregate statistics on NPL developments or to generate and provide feedback to banks. Moreover, bank-by-bank arrears resolution targets have been set and are monitored on a quarterly basis by the CBC.⁴²

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

The Cypriot market for NPE portfolios is not developed. In addition, there have not been any transfers to a public/private investment vehicle.

In November 2015, the Parliament of Cyprus approved a new law on the sale of credit facilities and other related issues, enabling the sale of all loans. Loans to individuals and microenterprises and SMEs not exceeding €1 million⁴³ can only be sold to certain types of investors: (i) credit institutions authorised in Cyprus; (ii) branches of credit institutions authorised by the EU that operate in Cyprus; and (iii) non-bank companies authorised by the CBC. Further resale is allowed to any of the aforementioned institutions, or to other entities with the prior written approval of the CBC. A non-bank company wishing to buy loans needs to be registered as a company in Cyprus and to obtain a licence from the CBC. The CBC is required to supervise the company's management, its books and records, and its financial reporting on an ongoing basis. In addition, all credit institutions have to report their loan sales to the CBC semi-annually.

¹⁹ There are four main target rates: (i) proposed sustainable solution target rate; (ii) concluded sustainable solution rate; (iii) terms being met rate; and (iv) aggregate early arrears cure rate (%). See also the [publication](#).

⁴³ Specifically exempt from the scope of the Law are loans to non-residents, loans to financial operations and/or investments outside Cyprus, loans secured by property located outside Cyprus, and loans governed by foreign law.

Prior⁴⁴ to the sale of all or part of a loan portfolio, the credit institution needs to notify its intention either (i) through a publication in the Official Gazette and in three daily newspapers, or (ii) by a letter to the borrower and its guarantors. The consent of borrowers and guarantors is not required. In both cases, the borrower and the guarantors may (but are not required to) submit, within 45 days, a proposal to purchase the loan. Such a proposal is not binding for the creditor.

Banks may sell loans above the described threshold (€ 1 million), but without providing safeguards other than following the rules regarding the prior notification, as well as the notification after the sale with the details of the entity which has purchased the loans.

B.2 Debt enforcement/foreclosure

In order to enable rapid out-of-court enforcement/foreclosure of the collateral, new laws and regulations have been introduced, and their effectiveness is currently being tested.

It should be noted that, over the course of 2016, banks have been actively engaging in voluntary debt-for-asset swaps, encouraged in part by the tax benefits arising from the temporary suspension of capital gains tax on the transfer or sale of assets until 31 December 2017. Some disposals have already been achieved.

The new insolvency framework may result in enforcement measures for the benefit of all claimants, whereas the previous framework did not provide for such a procedure.

Previously, the forced sale of mortgage collateral was a difficult process. The sale was carried out by a government department, and debtors habitually appealed to the court to postpone the auction, which resulted in the granting of a postponement order in the majority of cases. In addition, the large scale of the problem was a disincentive for Cypriot banks to liquidate collateral, because a large volume of properties being sold in auctions could have led to a further drop in RE prices. The new foreclosure framework allows creditors to arrange a private auction which does not involve a government agency, with specific time limits on subsequent steps in the procedure, which is subject to a judicial review only where strictly necessary.

B.3 Corporate insolvency and restructuring

The corporate insolvency and debt restructuring regime is seen by the Cypriot authorities as a factor that can have a negative effect on private debt resolution. The full implementation of the new insolvency framework, as of May 2015, is expected to remove most of these constraints.

⁴⁴ Directive on the notification of borrowers and guarantors of 2016.

The Insolvency Practitioners Law, which came into force on 7 May 2015, is intended to protect against misconduct and promote good and honest ethical practice by IPs in all areas of their insolvency practice, including personal insolvency procedures, receivership, examinership, administration of a bankrupt party's estate and compulsory and voluntary liquidations.

There are clauses in the Law which provide for compulsory indemnity insurance coverage for all IPs and which set standard minimum amounts of insurance coverage for each insolvency case handled by the IP, thus protecting the estate from any harm to the business, whether from negligence, any coincidental and/or accidental damages, fire, theft, or misconduct by the IPs. These clauses aim to protect the interests of all the parties and beneficiaries involved.

The Insolvency Practitioners Law and Regulations regulate fees at reasonable levels for specific actions, e.g. for the restructuring of personal loans, the fees are regulated with a ceiling for loans up to €350,000, and for the restructuring of loans of companies (examinership), there is a ceiling for loans up to €500,000.

There are three Licensing Bodies: the Insolvency Service, the Cyprus Bar Association and the Cyprus Institute of Certified Public Accountants. Each Licensing Body has a separate disciplinary committee for the enforcement of the code of conduct and practice of IPs. As provided for in the Law for the establishment and the implementation of personal repayment schemes and a debt relief order scheme for individuals of 2015, the Insolvency Service⁴⁵ has established a Code of Conduct which governs the practice and ethical behaviour of all IPs.

Given the high amounts of arrears to the public sector, it was often difficult in the past to agree on partial debt servicing because the framework did not include a process for the clearance of public arrears, although arrears to the public sector are linked to private sector restructuring. Both the Personal Insolvency Law and the corporate restructuring mechanisms (examinership), which were introduced in 2015, now provide procedures that cover debt owed to public authorities. These procedures allow public authorities to accept majority creditor decisions if a viable personal and/or business plan has been accepted in a majority decision by different classes of creditors, including both secured and unsecured creditors.⁴⁶

For microenterprises and SMEs, banks may perform restructuring under the provisions of the Arrears Management Directive, although the process is lengthy due to a lack of financial data and information, and occasionally to the non-cooperation of certain borrowers. In the context of business/loan restructuring, it is not possible to

⁴⁵ "Insolvency Service" means the Official Receiver or any other department or service of the Ministry of Energy, Commerce, Industry and Tourism, appointed by the Minister to exercise the duties assigned to the Insolvency Service under the present Law.

⁴⁶ Outside of the insolvency framework, and on an ad hoc basis, public creditors can agree on partial debt servicing. Within the insolvency framework, in particular in accordance with the Law providing for the establishment and implementation of personal repayment schemes and a debt relief order scheme for individuals, if the debtor chooses to apply for a Personal Repayment Plan, there are provisions allowing the restructuring of all of the debt of an individual, including his/her public debt. Part of the public debt can be included in the debt to be restructured, whereas for all of it to be included, creditor consent is required. Restructuring of public debt of companies is possible if an examiner is appointed to restructure corporate debt, in accordance with the Companies Law (Amending) (No 2) of 2015.

restrict shareholders' decisions, to change the company's management, or to sell the assets of a company through auctions or open-market bilateral sales.⁴⁷ Furthermore, special in-court procedures are not considered successful.

The Insolvency Law was reformed to facilitate swifter resolution of debt. An examinership scheme, modelled on the Irish scheme (although it does not allow the removal of directors), was introduced to give creditors a greater role in determining the parameters of corporate debt restructuring before reaching insolvency. The appointed examiner can provide solutions for reorganising and restructuring a business on a going-concern basis.

Deficiencies of the corporate insolvency framework are currently addressed by: (i) the recent reform of the Foreclosure Law and the establishment of a new Insolvency Service; (ii) the establishment by a Council of Ministers decision of a project team responsible for the effective enforcement of the insolvency regime; (iii) the action plan put forward for this purpose; (iv) the collection and maintenance of statistics; and (v) the monitoring of the entire insolvency regime. Also, the licensing and supervision of the insolvency practitioner profession and the inclusion of secured debts in the bankruptcy and liquidation (winding-up) procedures should enhance insolvency procedures and enable a better return for creditors, as well as enhancing the efforts to find mutually beneficial restructuring solutions. More specifically, secured property has been included in the liquidation procedure for companies which are under liquidation. This mechanism is a new tool for secured creditors that as a supplement to the tool provided by the Foreclosure Law.

Also noteworthy here is the recently amended Insurance and Reinsurance Law, which transposes European Directives 2009/138/EC⁴⁸, 2011/89/EU⁴⁹ and 2014/51/EU⁵⁰ (Solvency II). This law protects the interests of investors in each insurance company, while enhancing the regulation of these organisations.

B.4 Household insolvency and restructuring

An out-of-court voluntary settlement/mediation mechanism, subject to limits, was introduced within the mandate of the Financial Ombudsman in 2014. The Financial Ombudsman has been receiving increasing numbers of applications since then.

⁴⁷ Except in cases where banks had applied floating charges to the borrowers' assets, where they could easily appoint a receiver and manager, which is an out-of-court procedure that addresses some of these issues.

⁴⁸ Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (Text with EEA relevance) (OJ L 335, 17.12.2009, p. 1).

⁴⁹ Directive 2011/89/EU of the European Parliament and of the Council of 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate Text with EEA relevance (OJ L 326, 8.12.2011, p. 113).

⁵⁰ Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority) (OJ L 153, 22.5.2014, p. 1).

Although not yet fully operational, this mechanism is currently yielding satisfactory results and has a success rate of 85%.

Banks may perform restructurings for households under the provisions of the Arrears Management Directive and the Code of Conduct, but the process is slow due to a lack of financial data and information, and occasionally to the non-cooperation of certain borrowers. An additional constraint relates to the practice of providing multilateral guarantees, in a context where the legal regime, currently under reform, did not provide clear evidence on the liability of the guarantors.

On average, out-of-court negotiation processes between the borrower and the bank take between 1.5 months and 6 months, which is significantly shorter than in-court negotiations.

Applications under the bankruptcy regime for consumers/households have seen a constant decline in numbers (from 1,083 in 2008 to 112 in 2014, 80 in 2015 and 50 in 2016), in part because the old bankruptcy regime did not allow for the discharge of the debtor. Furthermore, the personal bankruptcy regime has been reformed and now allows a second chance for the bankrupt/debtor to be released from the unsecured debt after a predetermined period of three years, but only under specific criteria. The streamlining of the new bankruptcy procedures should further increase the creditor return. The regime now includes the administration by the appointed trustee of all of the debtor's secured and/or charged property, which is considered part of the bankruptcy estate. The new system of appointing licensed IPs as trustees of the bankruptcy estate, in addition to the official receiver, will help to administer the cases faster.

In May 2015 a new insolvency framework was adopted. It introduces new concepts to Cypriot law, especially with regard to personal insolvency arrangements, namely the Personal Repayment Plan (PRP) and Debt Relief Orders (DROs) for natural persons. The DRO is a pre-bankruptcy tool which facilitates the write-off of uncollectable personal unsecured debt⁵¹ up to €25,000. Equal treatment (i.e. equal to the debtor's unsecured discharged amount) is applied to the guarantors as long as the guarantors had not collateralised and/or secured the debtor's discharged debt with their personal property/assets. The provisions of the new Personal Insolvency Law could lead to the courts being involved in significantly more cases, particularly with regard to the PRP, which allows an insolvent debtor, with the mandatory help of a licensed IP, to develop a voluntary plan aimed at restructuring the debts (both secured and unsecured) in a consensual way. The plan should, where possible, avoid the sale of the debtor's primary residence.

Another version of the PRP is the compulsory PRP, which allows the debtor to apply to the court for the imposition of a restructuring plan on the creditors, subject to certain criteria, notably that the creditors should not be made worse off by the plan

⁵¹ An amount equal to the debtor's unsecured discharged debt, being provided to its guarantors as long as they had not collateralised and/or secured the debtor's discharged debt with their personal property/assets.

than they would be in the case of insolvency and forced sale of the debtor's assets, and provided that this plan was previously rejected in the consensual procedure.

The same Personal Insolvency Law provides an additional coordinated restructuring tool that could offer solutions both for a debtor's personal debts and for his/her micro business (company) utilising the corporate examinership scheme. In this context, it seems that, for the insolvency law to be effective, the judiciary, the Insolvency Service and the IP profession need to have sufficient capacity and capability to implement it. Delays in court decisions can have an adverse effect on the value of assets or on the viability of the plan.

In addition to the above, a new subsidy scheme has been introduced (with a duration of 4 years) that works in connection with the personal repayment plan (PRP) and is specifically designed for extremely vulnerable households in order to be able to restructure mortgage debt secured by their primary private residence. It includes a subsidy on 60% of the household's monthly payment, granted based on strict criteria: the level of the household's income, its composition, the value of the debt and the market value of the primary residence. The scheme was introduced on 1 October 2016, is organised by the Cyprus Land Development Corporation, a government authority, and is enforced in parallel with an approved PRP.

B.5 Judicial system

The judicial system is considered by the Cypriot authorities to be an obstacle to private debt resolution, because court procedures are lengthy, courts or judges are not specialised in insolvency issues (although the ongoing reform may introduce dedicated judges to deal with insolvency cases) and there are no set time restrictions for insolvency procedures.

B.6 Tax regime

The tax regime is not considered by the CBC to be an obstacle to private debt resolution. When specific provisions/loan write-offs are accrued, a tax deduction is permitted, including realised losses on the sale of collateral. The framework also includes a tax loss carry-forward mechanism (a deferred tax asset). The practical application of the tax regime is, however, somewhat uncertain with regard to the deductibility of provisions on loans subject to collective assessment.

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

The credit register in Cyprus is regulated by the CBC and based on two existing data exchange mechanisms⁵², which are operated by private organisations⁵³ but under the CBC's monitoring and supervision.⁵⁴ In the future, the two mechanisms will submit the data (received by the reporting agents) to the CBC. The CCR covers ACIs (authorised credit institutions), which are domestic banks, local branches of foreign banks and foreign subsidiaries of local credit institutions. Non-deposit-taking institutions are not currently required to report. ACIs are required to submit data at the solo level. Regarding the information reported, there is no minimum required threshold for exposure sizes and the information is collected both at the borrower and the instrument level. Regarding the instrument-related information, the CCR requires the total recoverable collateral value per collateral type, the NPL status, the number of days in arrears/excess, the amount in arrears/excess, the forbearance status, the total number of restructurings (with the date of the last restructuring) and LLPs at borrower level (only available to the CBC). Annex IX of this report gives a detailed overview of the main features of the information collected by the CCRs.

The disclosure of data collected is regulated by the CBC.⁵⁵ Only authorised members of ACIs, credit bureaus and the CBC itself are allowed to access the database.

The current CCR mechanism was set up in September 2014, with the involvement of international creditors. The CCR may assist banks in private debt resolution, although there is still uncertainty about the quality and granularity of the time series provided. The complete development and implementation of the CCR for supervisory, financial stability and statistical purposes is still ongoing.

The cadastral system (land registry) is centralised and the costs of conducting a credit search are reasonable, both for individuals and businesses (€20 each). It contains the prices of RRE and CRE transactions, as well as a description of property characteristics. Until now, the general public has not been allowed to conduct searches (except for prospective property buyers, with the consent of the seller, and simple searches such as printing topographical plans). Information on upcoming forced sales/auctions is publicly available. Towards the end of 2016, the

⁵² Aiantas and Artemis.

⁵³ Artemis meets the programme requirement to create a CCR listing all borrowers. In accordance with the relevant provision in the MoU with the EU, the CBC has the responsibility to create a CCR for both commercial banks and cooperative credit institutions. It has been decided that this provision will be satisfied by using existing infrastructure, namely Artemis, which covers the banking institutions, and Aiantas, which covers the cooperative credit institutions and the Housing Finance Corporation.

⁵⁴ According to the Directive for the operation of a system or a mechanism for the exchange, collection and provision of data of 2015.

⁵⁵ Business of Credit Institutions Law of 1997 to 2015.

land registry initiated a web portal through which the general public can perform property searches and print topographical plans for free, subject to registration.

The Public Asset Registry (e.g. for road vehicles, ships, aircraft, plant, heavy equipment and intellectual property) includes information on the owner and the characteristics of the asset. This information is not publicly available.

C.2 Debt counselling and outreach

In Cyprus, there is no debt counselling provided by the government or any other public authority other than the aforementioned Financial Ombudsman. There are also no free or subsidised personal budgeting or legal advice services for indebted households, and there is no institution that provides credit management training or advice to SMEs.

C.3 Consumer and data protection

The restrictions on recording/sharing personal information regarding a borrower's financial assets for debt workout purposes, essentially related to confidentiality requirements, are regarded as having some negative effects on private debt resolution.

Annex IV: Estonia

Executive summary

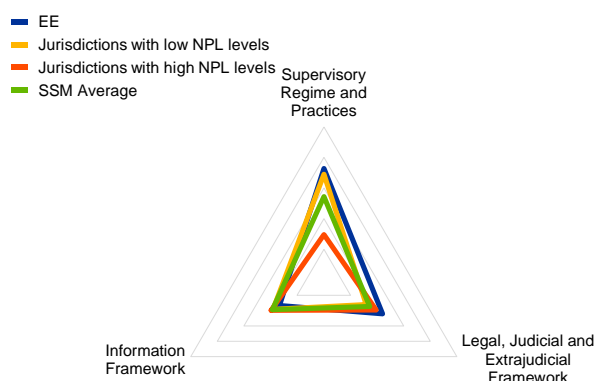
This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Chart 4

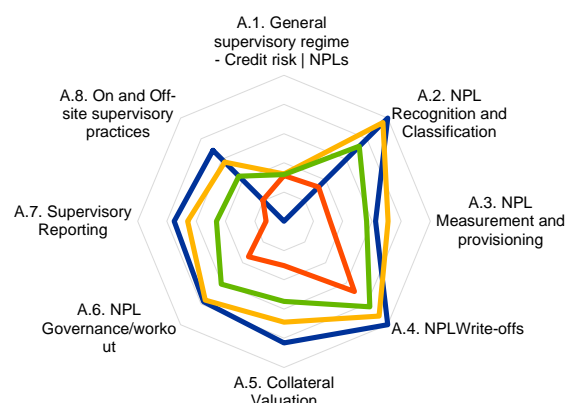
Country overview

How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

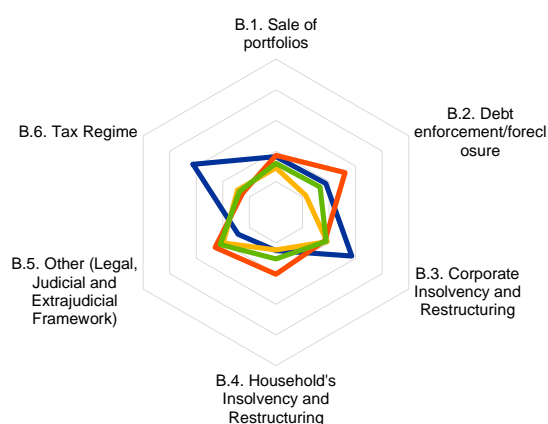
NPL Framework Overview



Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Estonia had a total NPL ratio of 2.0% (by segment: households 2.1%, NFCs 1.4%, SMEs 1.6% and CRE 1.3%).⁵⁶

The levels of NPLs in Estonia have improved continuously in recent years, and are currently at historically low levels. This improvement is primarily due to the improved economic performance of companies operating in Estonia and the ability of households to repay their loans.

In 2014 specific macroprudential guidance was adopted for mortgage loans on the basis of maximum LTV, DSTI and maturity.

The Estonian regulatory framework provides guidance in the form of minimum requirements. Nevertheless, banks' policies and practices with regard to NPL management and collateral valuation are within the scope of AQRs and on-site credit risk investigations, which include a loan-level review of a selected sample of NPLs.

In performing the quarterly credit risk analysis, the Estonian Financial Supervisory Authority (*Finantsinspektion* – FSA) also monitors NPL movements and requests that banks provide additional information about their largest NPL exposures (company names, projects descriptions, collaterals and forecasts).

Even though the current NPL situation seems favourable overall, the survey reported some aspects of the framework that may represent potential challenges to NPL workout in Estonia.

- **Supervisory practices:** the Estonian principle-based approach does not provide specific NPL-related guidance.
- **NPL governance:** no particular guidance has been issued on NPL workout practices. Banks are not required to separate NPL management from loan origination and performing loan services.
- **NPL recognition and classification/write-off:** apart from general IAS/IFRS principles, there are no additional specific guidelines on the prudential accounting approach regarding provisioning and write-offs.
- **NPL measurement and provisioning:** apart from accounting standards, no additional guidance is in place.
- **CCR:** only a private credit register established by Estonian banks in 2001 is available.

⁵⁶ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance-sheet exposures. Sample covers 44% of banks in Estonia or 70% of total banking assets.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 23

Main sources of NPL-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Act	07.2016	All credit institutions	Credit Institutions Act	The Credit Institution Act applies to all banks. The general requirements for credit risk management practices are set in Chapter 7.	1999
Regulation	05.2005	All credit institutions	Credit risk management	The Regulation on Credit institution credit granting and write-down of receivables regarded as doubtful establishes general principles and requirements for loan granting, classification, monitoring, etc.	2005
Guideline	01.2009	All credit institutions	Consumer rights protection	In accordance with the guideline on pre-contractual information for home loans, the credit institutions must provide their clients with relevant and sufficient pre-contractual information regarding the terms and conditions of home loans, with a view to protecting the interests of the clients in using their financial resources and supporting the making of informed loan decisions.	2008
Guideline	12.2010	All credit institutions	Credit risk management/consumer rights protection	Responsible lending requirements are aimed at fostering socially responsible behaviour on the loan market by credit institutions. These guidelines define the preconditions for granting a loan, the scope of information to be collected, requirements for assessing the capacity of the customer to service an obligation arising from a specific loan contract, the provision of pre-contractual information and warnings to customers etc.	2011
Regulation	03.2015	All credit institutions	Credit risk management	The Regulation on Limits on granting housing loans and maximum loan maturity established by Eesti Pank, which sets the requirements for the ratio of the amount of a housing loan to the value of the loan collateral as well as the requirements for the ratio of the loan and interest payments periodically payable by the borrower under various loan contracts to the income of the borrower and the maximum maturity of a housing loan.	2014

The Estonian banking market is relatively small. There are only 16 banks operating in Estonia, including two SIs under direct SSM supervision, seven LSIs under the direct supervision of the FSA and branches of seven foreign banks.

Banks under the direct supervision of the FSA are relatively small in size and differ in terms of their business models and strategies. Therefore, instead of setting granular rules or guidelines, the FSA carries out intensive on-site and off-site supervision tailored to each particular institution.

With regard to the NPL-specific legislative framework, the most important guidance is the EBA ITS.

In general the Estonian framework sets out principles in the form of minimum requirements pertaining to credit risk management rather than granular rules. The Estonian Credit Institution Act in particular establishes general requirements for credit risk management practices. There are not, however, any specific requirements relating to NPL management.

With regard to national specific requirements relating to loan-granting practices, all credit institutions operating in accordance with the limits on granting housing loans

and maximum loan maturity established by Eesti Pank must comply with three requirements when issuing housing loans:

- An LTV limit of 85% (90% if guaranteed by KredEx⁵⁷) for new housing loans. This limit can be exceeded by no more than 15% of the total aggregate monetary amount of new housing loans advanced by a lender during a three-month period.
- A DSTI limit of not more than 50% of borrower's net income for new housing loans. The DSTI ratio is calculated using either the interest rate in the loan contract (base rate plus margin) plus two percentage points, or an annual rate of 6%, whichever is higher. Up to 15% of new housing loans issued each quarter are allowed to exceed the limit(s).

A maximum permitted maturity of 30 years.

A.2 NPL recognition and classification

For regulatory purposes Estonian banks are legally required to comply with Article 178 of the CRR as well as the EBA ITS with regard to the recognition and classification of NPEs. There is no national guidance or regulation in place beyond the EBA ITS regarding the definition and classification of NPLs or forbearance.

A.3 NPL measurement and provisioning

Estonian banks follow IAS/IFRS accounting requirements, and there are no national rules beyond these standards with regard to NPL measurement and provisioning. There are no specific provisioning rules for NPLs in Estonia, and no specific guidance regarding accrued interests or estimate of the recovery time used for the provisioning of NPLs.

The topic of provisioning is duly considered during on-site inspections focused on credit risk. This is done by reviewing provisioning policies and methodologies as well as via credit file reviews. A supervisory benchmark model is used for collective provisioning assessments.

As long as there are enough statistical data available, banks use the historical recovery information in their collective impairment models. The models can be purely statistical (e.g. for consumer loans) or expertly adjusted where changes in lending standards, collateral requirements, etc. are taken into account (e.g. mortgage loans).

The FSA has the legal right (in accordance with the Credit Institution Act) to demand an appropriate write-down of the assets of a credit institution by issuing a precept.

⁵⁷ Institution providing loan guarantees with a state guarantee for housing loans

A.4 NPL write-offs

There are no specific national guidelines or rules for NPL write-offs. EBA or IFRS requirements apply.

There are no additional specific incentives for NPL write-offs, i.e. no increased capital charges and no hard limits on how long NPLs can be carried on banks' balance sheets. In SREP, potential losses for performing and NPL portfolios are taken into account in Pillar 2 capital charges. As long as NPLs are adequately provisioned there are no additional charges on the NPL segment.

Write-offs on NPLs are within the scope of AQRs and on-site inspections.

A.5 Collateral valuation

The FSA has no concerns that collateral-related issues could represent an obstacle to private debt resolution.

General principles for appraisers and valuation processes are defined in the Estonian Creditors and Credit Intermediaries Act. The FSA has not defined any guidance on specific rules regarding valuation methods. CRR requirements apply for the frequency of the valuation of collateral (CRE \leq 12 months; RRE \leq 3 years).

Banks must define internal procedures for the valuation of collaterals. The use of external assessments is allowed. Banks set their own rules for the acceptance of external appraisals, but in general the appraisal company must be a member of the Estonian Association of Appraisers and the appraisal must be carried out by a certified/accredited appraiser.

The Regulation on Requirements for the appraisal of immovable property standing as security for a consumer credit agreement relating to residential immovable property requires external appraisers (third-party appraisers) to possess a certain professional qualification. It also states that a real estate valuation must be carried out in accordance with coherent and well-established best practices.

The Estonian Association of Appraisers is the authority responsible for the supervision of valuation and collateral appraisal entities.

The general principles for the appraisal of collateral for consumer loans secured by residential immovable property are defined in a regulation issued by the Ministry of Finance. There is no legally binding requirement to apply any particular real estate valuation standard, however it is standard practice to use Estonian Property Valuation Standards (EVS 875), prepared by the Estonian Association of Appraisers on the basis of IVS and EVS.

Collateral valuations are typically based on market prices. Banks use different kinds of valuations depending on the purpose. Fire-sale values can be used for potential loss estimates, while market prices can be used for point-in-time provisions. The use

of internal indexes is allowed, but only in exceptional cases (e.g. the bank has the majority of the market share in specific segment).

The FSA does not provide additional incentives to reduce reliance on collateral, whether through increased provisioning or the assessment of valuation practices.

A.6 NPL governance/workout

The FSA does not perceive that overall NPL management-related issues could represent an obstacle to private debt resolution. There are no specific national rules for NPL governance and work-out.

Estonian banks must define internal rules for dealing with problem loans, although there is no formal requirement to implement an NPL management strategy. Based on their experiences in the recent crisis, most banks have established dedicated NPL work-out units, but they are not required to separate NPL management from loan origination and performing loan services.

Banks are able to outsource NPL management in line with the guidelines set by the FSA. Outsourcing firms in Estonia are not subject to supervision, although they must follow strict rules established in the aforementioned guidelines (e.g. they must be qualified to perform relevant tasks and duties in a sustainable manner, respect appropriate confidentiality arrangements, etc.).

The adequacy of banks' NPL governance arrangements is assessed during on-site inspections.

A.7 Supervisory reporting

Credit institutions submit the required COREP/FINREP reporting templates, including information related to the EBA ITS requirements on forbearance and NPEs, on a quarterly basis. There is no additional reporting in place beyond basic EBA reporting requirements.

The FSA monitors the quality of the banks' loan portfolios on a quarterly basis and conducts peer benchmark analyses. The assessment of banks' reporting takes place in the context of quarterly meetings during on-site reviews and using detailed data queries and credit file reviews. For the purposes of the quarterly credit risk analysis in particular, the FSA monitors the NPL movements and requests that banks provide additional information about their largest NPL exposures (including information about company names, descriptions of projects, collaterals, forecasts, etc.).

A.8 On- and off-site supervisory practices and methodologies

During the period from 2012 to 2016, banks were subject to granular AQRs which did not identify any capital shortfalls needing to be covered with additional capital. Only a number of small banks used private markets to raise capital during this period.

Both performing and non-performing credit portfolios are reviewed during on-site inspections, which are usually focused on banks' biggest and/or highest-risk portfolios. The assessment of the bank's NPL management capabilities is also part of on-site inspections focussed on credit risk.

During the on-site inspections, the FSA assesses the provisions, collateral valuations and assumptions used by banks in their impairment models. The assessment of the conservatism and consistency of loan loss provisions allows outlier banks to be identified.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

The FSA does not perceive that the deficiencies of the NPL market could represent an obstacle to private debt resolution in the country.

Due primarily to the limited levels of NPLs, the Estonian market for NPL portfolios is not developed and selling NPLs is not a common practice.

Although no specific regulation on AMCs exists and no AMC has so far been created in Estonia, there are no legal impediments to banks establishing an AMC in cooperation with investment firms.

The consent of a borrower is not required for the sale of a loan. Domestic and foreign third-party banks, institutional investors and other non-bank entities are allowed to purchase loans.

Banks usually collect debts themselves or use private debt collection firms. These firms are not subject to licencing or supervision by the FSA.

B.2 Debt enforcement/foreclosure

The FSA does not perceive that the real estate transaction process could represent an obstacle to private debt resolution.

Lenders have several legal options to begin judicial enforcement procedures, but in every case there is the requirement of a court judgement/decision.

The out-of-court private sale of the pledged property may take place only by mutual agreement between the mortgage lender and borrower. The government has not taken specific measures to tackle debtors which can afford to pay but choose not to.

B.3 Corporate insolvency and restructuring

The FSA does not perceive that deficiencies in the corporate debt resolution regime could represent an obstacle to private debt resolution in the country.

Public creditors may agree to partial debt servicing.

The assets of a company undergoing debt restructuring can be sold through auctions in accordance with the requirements set in the Estonian Law of Obligations Act. Bilateral sales of assets on the open market are permitted only if agreed with all creditors.

The Estonian legal environment does not provide for special in-court and out-of-court procedures for microenterprises and SMEs; they must follow the same provisions and procedures as other entities.

There is a bankruptcy regime for legal persons regulated by the Estonian Bankruptcy Act.

There is also a pre-insolvency regime to enable the early rehabilitation of distressed enterprises in Estonia. Enterprises must file an application with the court in order to begin restructuring proceedings for the avoidance of bankruptcy.

A write-off and forgiveness of tax arrears is possible only in cases defined in Article 114 of the Estonian Taxation Act, e.g. when the collection of tax arrears is hopeless or would be unfair due to circumstances beyond the control of the taxable person (including *force majeure*), or as a compromise in bankruptcy proceedings or in debt restructuring, etc.

B.4 Household insolvency and restructuring

The FSA does not perceive that deficiencies in the household debt resolution regime could represent an obstacle to private debt resolution in the country.

The out-of-court settlement mechanism is regulated by the Estonian Debt Restructuring and Debt Protection Act.

There is a specific bankruptcy regime for natural persons regulated by the Bankruptcy Act. It provides the possibility for a natural person to be released from his/her obligations through bankruptcy proceedings. Individual entrepreneurs are also eligible for this regime unless established otherwise by law.

B.5 Judicial system

The FSA does not perceive that deficiencies in the judicial system could represent an obstacle to private debt resolution.

Personal insolvency-related court fees/charges range from €10 to €300 if no additional external aid is sought.

There are no specialised courts or judges dealing solely with insolvency issues. Insolvency administrators are subject to professional certification by examination.

The law establishes time requirements for specific actions and parts of insolvency proceedings, but not for the insolvency proceedings themselves.

B.6 Tax regime

The FSA does not perceive that tax disincentives could represent an obstacle to private debt resolution. There are no tax deductions for loan loss provisions, write-offs and collateral sales due to the zero rate of tax on corporate profits (only distributed profits are subject to tax), meaning that this does not have any impact on NPL resolutions.

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

There is only a private credit register established by Estonian banks in 2001 and administered by Krediidinfo AS (subsidiary of the Creditinfo Group, which is also active in Latvia and Lithuania). It contains data on delayed payments (e.g. outstanding amounts, date on which the debt was incurred and settled) on the part of companies and private individuals. The register uses a specific definition of default: commitments more than 45 days past due with interest and fines for delays exceeding €30. The register also provides credit scoring for SMEs and large corporates (approx. 500 largest companies).

This private credit register is available to the public for searches.

The land register, real property price statistics, ship register, vehicle register and aircraft register are centralised online public registers. The vehicle register is partially public (information about the owner is not public).

C.2 Debt counselling and outreach

The FSA does not have concerns that limitations in terms of debt counselling/outreach are an obstacle to private debt resolution. Subsidised legal advice services for indebted households are available.

C.3 Consumer and data protection

There are restrictions on the recording/sharing of personal information for debt workout purposes, which are in accordance with the requirements of the Estonian Personal Data Protection Act. Personal data may only be processed if allowed by law.

Annex V: Finland

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

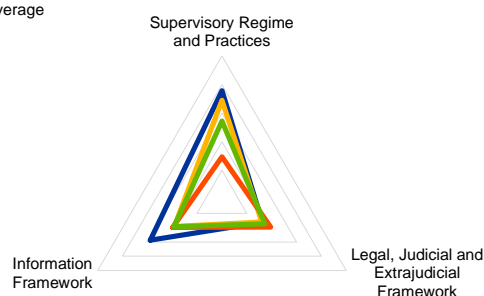
Chart 5

Country overview

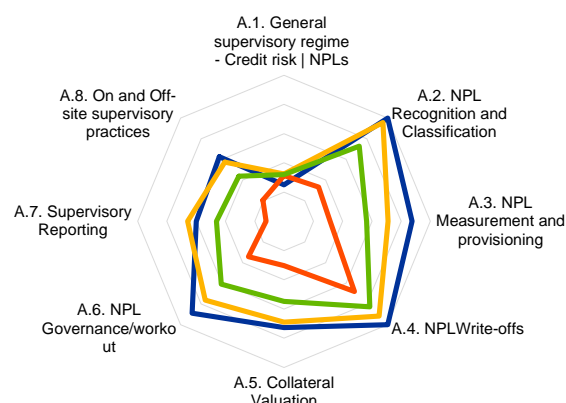
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

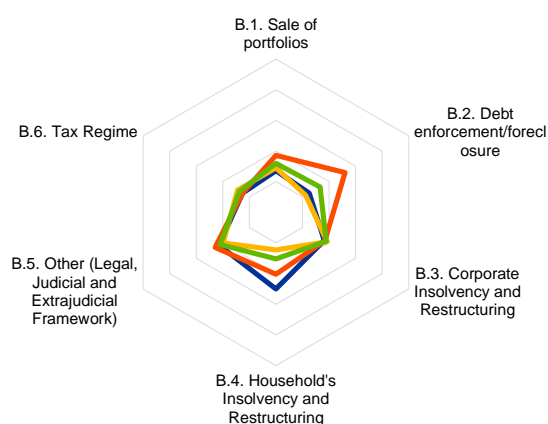
- FI
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



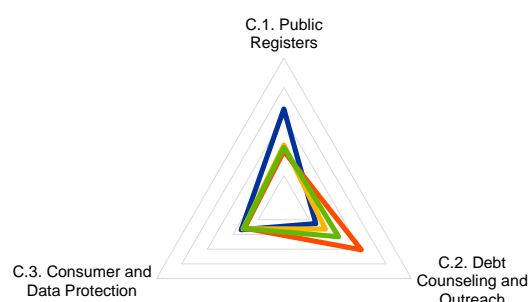
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Finland had a total NPL ratio of 1.6% (by segment: households 1.8%, NFCs 2.5%, SMEs 4.3% and CRE 2.6%).⁵⁸

Even though the current NPL situation in Finland seems favourable overall, the survey reported some features in the framework that could represent potential **challenges to NPL workout** in Finland:

- **NPL recognition and classification/write-off:** apart from the general accounting principles (Finnish nGAAP and IFRS), there are no additional specific guideline on the prudential accounting approach regarding measurement, provisioning and write-offs.
- **NPL governance:** no particular guidance has been issued on NPL workout practices.
- **Central credit register:** with only a private credit bureau collecting negative information, there is no central credit bureau collecting positive information in Finland, nor any legal obligation for banks to report debtor information.
- **Supervision regime and practices:** it is important to supervise how the Finnish banks have implemented the EBA ITS requirements in their supervisory reporting and credit risk management processes. The Finnish Supervisory Authority (*Finanssivalvonta* – FIN-FSA) has conducted on-site inspections of two SIs regarding NPLs and forborne exposures. These inspections concluded that further improvements are needed in the banks' forbearance processes. There is a risk that forborne exposures are not all recognised due to their late identification and that further improvements are needed for the implementation of the probation period and exit criteria.

At the beginning of 2017, a thematic review has been started for LSI banks on forbearance and NPL. It examines how LSIs have implemented the EBA ITS requirements in their credit processes and procedures (e.g. identification of the unlikely to pay criteria).

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

⁵⁸ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance-sheet exposures. Sample covers all banks in Finland.

Table 24**Main sources of NPE-related regulation**

Type	Ref.	Scope	Topic	Summary description	Entry into force
Act (binding)	610/2014	All credit institutions	Act on Credit Institutions	General Banking Act of Finland http://www.finlex.fi/en/laki/kaannokset/2014/en20140610.pdf	15.8.2014
Regulations and guidelines (binding)	3/2015	All credit institutions	Calculation of maximum loan-to-value ratio	LTV is a macroprudential tool appropriate for containing any overheating of the housing markets. The objective of the regulation is to promote advance saving for a home and to prevent situations where the debt of a housing loan customer exceeds the value of the collateral in the event of potential decrease in house prices. The LTV ratio calculation is described in this regulation.	1.7.2016
Standards (binding)	4.4a	All credit institutions	Management of credit risk	Establishing appropriate principles and methods of credit risk management, operating under a sound credit-granting process, maintaining an appropriate credit management, measurement and monitoring process, ensuring adequate controls over credit risk.	25.2.2004

The Finnish framework sets out principles in the form of minimum requirements pertaining to credit risk processes rather than granular rules. In general there is no guidance defining specific limits on household or NFC portfolios other than Regulation and guidelines 3/2015, which sets a maximum LTV ratio for mortgage loans, which seeks to contain excessive household indebtedness and prevent spiralling credit expansion and the inflation of market prices of assets used as collateral.

A.2 NPL recognition and classification

For regulatory purposes, Finnish banks are legally required to comply with the EBA ITS regarding the definition/classification of forbearance and NPEs. FIN-FSA has not issued any additional criteria going beyond the EBA ITS in this respect.

FIN-FSA Standard 4.4a on credit risk management⁵⁹ does not explicitly refer to performing/non-performing loans but banks' risk rating systems must differentiate between the degrees of credit risk in their different credit exposures (well-managed and problem loans) as well as reflect changes in their credit risks. A deterioration of a customer's payment capacity must lead to an adjustment of its risk category and a thorough loan review as well as an inclusion of the loans on a separate watch list. Finnish banks classify their exposures as substandard, doubtful and watch loans according to equivalent rating classes.

A.3 NPL measurement and provisioning

Finnish banks follow IAS/IFRS accounting requirements for financial instruments, investment properties and financial leases. FIN-FSA has not issued any additional specific prudential guidelines on NPL measurement and provisioning.

⁵⁹ This standard is based on the recommendations of the Basel Committee on Banking Supervision.

Banks apply IAS 39⁶⁰ requirements for what constitutes a loss event, although inspections conducted by the FIN-FSA regarding their application (including the list of impairment triggers) showed that in some cases banks did not fully comply with these requirements. There are neither additional specific provisioning rules for NPEs nor further criteria on how to assess estimates of the recovery time for NPE provisioning. FIN-FSA does not have the authority to impose a capital add-on under the Pillar 2 process to enforce provisioning for prudential provisioning.

According to IAS 39, when a financial asset or group of financial assets has been written down as a result of impairment loss, banks should recognise interest income at the rate of interest used to discount cash flows for the purpose of measuring the impairment loss. Beyond the provisions of these accounting standards, the FIN-FSA has not issued any additional specific guidance on accrued interest in the case of a non-performing classification for prudential purposes.

A.4 NPL write-offs

There are no specific national guidelines or rules for write-offs, which are regulated according to IFRS.

It is common practice to recognise a write-off when it is highly probable that the receivables will not be collected, e.g. in a bankruptcy case.

Finnish supervisors do not provide any additional incentives for NPL write-offs, i.e. no increased capital charges or time limits on how long NPLs can be carried on banks' balance sheets.

A.5 Collateral valuation

The Finnish supervisory authorities have no concerns that collateral-related issues could represent an obstacle to private debt resolution. There are no specific rules on entities allowed to perform the valuation of collateral beyond Article 208 of the CRR, and no authority is responsible for the supervision of valuation and collateral appraisal entities. The credit decision is primarily based on the creditworthiness of the borrower.

According to FIN-FSA Standard 4.4a on credit risk management⁶¹, credit institutions must have policies and procedures in place to assess, classify and monitor collateral, ensure proper pledging, and identify and manage concentration risks arising from collateral.

⁶⁰ IAS 39: Financial Instruments: Recognition and Measurement.

⁶¹ This standard establishes appropriate principles and methods for credit risk management, operating under a sound credit-granting process, maintaining an appropriate credit management, measurement and monitoring process, and ensuring adequate controls over credit risk.

The required frequency for the valuation of immovable property collateral follows CRR requirements (CRE \leq 12 months; RRE \leq 3 years), and FIN-FSA does not prescribe methodologies for the collateral-value update. Considering that Finnish banks follow the CRR, statistical methods can be used to monitor the value of the property and to identify properties which need revaluation.⁶² There is also no requirement to apply a real estate valuation standard. According to the CRR, index valuation is used to monitor mortgage collateral prices. The collateral valuation is reviewed when there is an indication that the value of the collateral has declined materially or during a loan decision (e.g. in the case of a new loan, new repayment schedule, refinancing, impairment calculations or other arrangement). The collateral value is based on the market value, which is in turn based on the purchase price or current price information received from a real estate agent. Generally, Finnish banks have an agreement with local real estate agents to obtain this information.

In Finland, there are no specific requirements for the calculation of the credit risk mitigating effect of collateral for risk management purposes under Pillar 2.

The Finnish supervisory authorities do not provide additional incentives to reduce reliance on collateral through increased provisioning or the assessment of valuation practices.

There are no additional specific rules or criteria on the valuation of foreclosed assets on or after the foreclosure date beyond the CRR requirements.

A.6 NPL governance/workout

The management of NPLs is part of sound credit risk management. There are no additional specific regulations or guidance for managing NPLs.

Since the levels of NPLs are low in Finland there has not been any need to establish dedicated units for NPLs or for banks to have NPL management units separate from their credit granting units. Furthermore, there are no requirements to set a separate NPL strategy or operational targets for NPL reduction. However, in their credit risk strategies credit institutions should at a minimum define their risk appetite. Finnish banks generally set a limit on their NPEs/problem credits.

Finnish banks may outsource their NPL management. Responsibility for the outsourced activities nevertheless remains within the bank, meaning that internal control and risk management must also cover outsourced activities. Additionally, supervised entities must notify the FIN-FSA when they enter into material outsourcing arrangements. In Finland, there are currently no banks that have outsourced their NPL management. The use of a debt collection agency is also possible. There is no mechanism for interbank coordination or for coordination between private and public creditors (e.g. tax authorities or social security authorities) in individual debtor cases.

⁶² Article 208(3) of the CRR.

A.7 Supervisory reporting

Credit institutions in Finland submit the required COREP/FINREP reporting templates, including information relating to the EBA ITS requirements on forbearance and NPEs, on a quarterly basis.

In order to ensure the quality of banks' NPE-related reporting, FIN-FSA applies all relevant EBA validation rules. Data is automatically uploaded to an analysing tool called Riski.

FIN-FSA publishes a report on lending and bank guarantees, past due and non-performing assets and impairment losses by sector and industry category on its website on a quarterly basis. A new data collection process, begun in Q3 2016, requires banks to report information on new collateralised housing loans and the relevant collateral. This information will allow FIN-FSA to monitor the loan-to-collateral ratio of new loans as well as their LTV (based on the primary collateral). This process relates to new lending only.

A.8 On-site and off-site supervisory practices and methodologies

In 2014 the three largest Finnish Sis, followed by another Finnish SI in 2015, were subject to an AQR in the context of the SSM comprehensive assessment. The AQR framework is also used for LSI credit risk inspections. In 2015 and 2016, two Sis were subject to inspections regarding forbearance and NPLs. FIN-FSA is also undertaking a thematic review of LSIs regarding NPL and forbearance in 2017.

The assessment of problem credits (included NPLs and forborne exposures) is usually part of the overall on-site credit risk assessment, which also includes a credit file review.

Finnish supervisors do not prescribe the adequate level of impairment charges. Nevertheless, supervisors assess estimated cash flows, collateral valuation, procedures on NPL classification and impairments.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

The Finnish regulatory framework does not prevent non-banks from holding or managing NPLs. Special debt collection agencies operate in the country. As a result of the low levels of NPLs, the Finnish market for NPL portfolios is not developed. Though there are no legal impediments to loan sales, selling NPLs is not a common practice.

The Finnish Promissory Notes Act permits the sale of a loan agreement without the borrower's consent.⁶³ This principle also applies to the general terms and conditions of the loan agreement. Loans can be sold even if legally and economically written off. The regulation allows the transfer of loans to third-party banks or institutional investors, together with all relevant collateral. Although currently no AMC has been created in Finland, there are no legal impediments to banks to set them up in cooperation with investment firms.

B.2 Debt enforcement/foreclosure

The Finnish supervisory authorities do not perceive that the real estate transaction regime could represent an obstacle to private debt resolution.

Regarding debt enforcement and asset foreclosure, contractual loan agreements allow the sale of collateral on a voluntary basis or via public auction. Out-of-court collateral sales are only possible on a voluntary basis, with any other enforcement of the collateral only possible via a court decision. Finnish banks do not have any enforcement power to repossess collateral on their balance sheet, and every enforcement procedure requires an enforceable title confirming the executed receivable. There are also no blanket bans (moratoria) in place and there are no legal impediments affecting the enforcement procedure.

Regarding mortgage loans, the Finnish Consumer Protection Act and Debt Collection Act require banks to negotiate with borrowers to overcome temporary financial difficulties before selling the collateral.

B.3 Corporate insolvency and restructuring

FIN-FSA does not see the corporate debt resolution regime as being an obstacle to private debt resolution.

The corporate debt restructuring regime is regulated by the Finnish Restructuring of Enterprises Act.⁶⁴ The restructuring procedure and the confirmation of the restructuring programme is official and decided by the court (debtors and creditors may propose a draft restructuring programme). There is no out-of-court settlement mechanism. The Finnish Bankruptcy Act provides a credible threat for the collection of outstanding debts, stipulates preconditions for bankruptcy and establishes a time limit of eight days for debtors to pay their outstanding debts before bankruptcy is declared.

In Finland there are no special in-court and out-of-court procedures for microenterprises and SMEs. If allowed by the debt restructuring plan, the company's assets may be sold via public auction or open market bilateral sales. It is possible to

⁶³ The Finnish Promissory Notes Act is the main legal framework applicable to the transfer of receivables.

⁶⁴ There are 3 types of insolvency proceedings in Finland: bankruptcy, restructuring of an enterprise, and adjustment of the debts of a private individual.

change the company's management in all debt restructuring procedures, except in the case of microenterprises.

There are no schemes in place to support distressed companies (e.g. financing fund for SMEs).

B.4 Household insolvency and restructuring

FIN-FSA does not have concerns that the household insolvency and debt restructuring regime is an obstacle to private debt resolution.

The Finnish legal framework does not provide for an autonomous pre-insolvency regime. Private debt resolution is based on the Finnish Act on the Adjustment of the Debts of a Private Individual. The procedure and confirmation of the payment schedule is official and decided by the court. There are, however, private independent counselling organisations which offer help to consumers overburdened with debt with the aim of reaching a voluntary agreement between creditors and debtors. This legislation also applies to microenterprises and SMEs.

B.5 Judicial system

FIN-FSA does not consider the judicial system to be an obstacle to private debt resolution.

Finnish legislation provides different possibilities for obtaining consumer protection against execution, e.g. minimum coverage of the cost of living (basic necessities are exempt from auction).

There are no specialised courts or judges dealing solely with insolvency issues. There is also no certification framework for insolvency administrators.

B.6 Tax regime

Loan loss provisions, write-offs and collateral sales are tax deductible in Finland. Instead of accounting impairment losses, specific LLPs for tax purposes are tax deductible up to a limit of 0.6% (per tax year) of the bank's total loans and receivables, with a total maximum amount of 5% of LLPs. If the bank's collateral sale price is less than the exposure amount, the difference is tax deductible. Capital gains tax owed by debtors on a debt write-off/restructuring of their debts at more favourable terms is considered to be taxable income for a going concern.

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

There is no public CCR in Finland. There is one credit bureau, the *Suomen Asiakastieto* (SAT), but this collects only negative information (i.e. reporting of delinquencies). FIN-FSA does not receive any regular reporting on defaults of individual counterparties and only requests such information in connection with credit risk inspections (e.g. when determining the loan sample in the inspection plan).

The National Land Survey of Finland maintains the cadastral system (land registry) and the official purchase price register for real estate. These registers are free for official by authorities (e.g. for police investigations, legal acts for recovery proceedings, enquiries by the tax authorities). Professional users may gain online access, subject to a fixed monthly fee and a fee for inquiries. The purchase price register is only for real estate and so, since more than two million Finns live in flats owned by housing companies, flat prices are not covered by the register.

Such housing companies (*asunto-osakeyhtiö*) are common legal entities in Finland. They are listed in the register maintained by the National Board of Patents and Registration and subject to the Finnish Act on Housing Companies. Their purpose is to own and control at least one building or part thereof, in which at least half of the combined floor area of the flat or flats is reserved for use as residential apartments possessed by the shareholders. There is therefore no purchase price register for individual apartments in Finland.

C.2 Debt counselling and outreach

The Finnish supervisory authorities do not have concerns that limitations in terms of debt counselling/outreach are an obstacle to private debt resolution.

Free or subsidised personal budgeting services and legal advice services for indebted households are available. Municipalities provide financial and debt counselling services to private citizens on how to manage and plan their finances (e.g. assistance in reaching agreements with creditors, preparing debt restructuring documents, applying for social lending and education-related social lending, etc.).

The Guarantee Foundation (*Takuu Säätiö*) is a national organisation which assists private persons in financial difficulties in solving their debt and payment difficulties, grants guarantees for restructuring loans and offers telephone counselling.

C.3 Consumer and data protection

FIN-FSA does not have concerns that a lack of information-sharing due to consumer protection laws is an obstacle to private debt resolution.

There are restrictions on the recording/sharing of personal information for debt workout purposes, in accordance with the Finnish Personal Data Act.

Annex VI: France

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

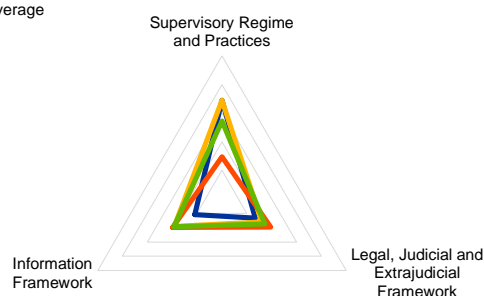
Chart 6

Country overview

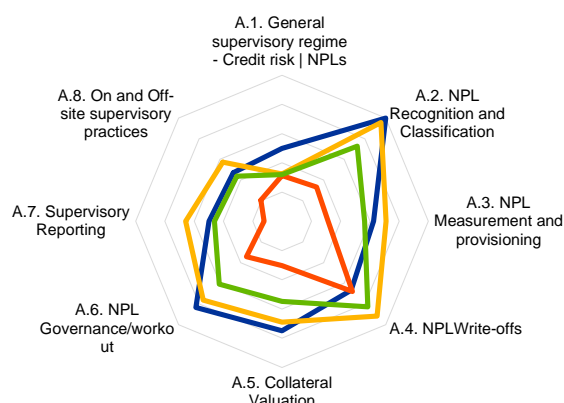
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NPL Framework Overview

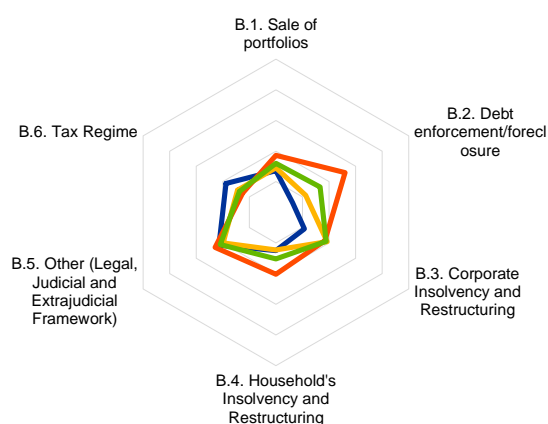
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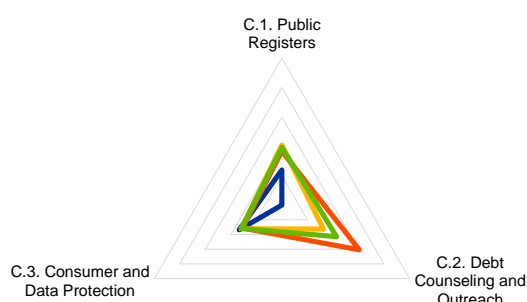
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 France had a total NPL ratio of 3.8% (by segment: households 4.1%, NFCs 5.8%, SMEs 8.3% and CRE 6.4%).⁶⁵

In recent years the NPL ratios in France have been favourable overall.

The country's regulatory framework (established by the French internal control regulation⁶⁶) is high-level and principle-based. It covers all internal control and risk management matters, and contains requirements for credit risk management processes. The regulation enables the French Prudential Supervision and Resolution Authority (*Autorité de contrôle prudentiel et de résolution* – ACPR) to assess whether banks have appropriate credit risk processes and governance given the banks' business model and risks.

In practical terms, French banks have taken ownership of the principles of the internal control regulation and have regularly implemented and developed those principles according to the risks with which they were confronted. Additionally, it is worth noting that the French banking system is very much concentrated on a handful of large systemic banks which have developed internal models, thereby improving their ability to analyse their exposure to risks and the related IT systems.

Despite the manageable levels of NPLs, the survey revealed some features in the framework that could be useful to further enhance NPL workout in France.

- **Supervisory regime and practices:** banks must comply with the French principles-based and process-oriented regulatory framework. The regulation does not explicitly prescribe specific requirements and/or rules for NPLs. Banks' implementation of the principles prescribed by the internal control regulation are subject to on-site and off-site inspections.
- **NPL recognition and valuation:** no additional recommendations have been issued which go beyond the general accounting (French nGAAP and IFRS), prudential and regulatory principles or the EBA ITS. Nevertheless, French nGAAP clarifies criteria for the write-off of doubtful exposures and banks' options for the recognition of accrued interest in the P&L. The principles-based French internal control regulation requires banks to have adequate processes and governance to achieve appropriate NPL recognition and measurement and to perform prudent and updated collateral valuation. Furthermore, the bank's credit valuation process is assessed by the ACPR during on-site credit risk inspections.
- **NPL governance:** due to the more favourable NPL conditions in the country overall, no particular guidance on NPL workout practices has been issued

⁶⁵ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance-sheet exposures. The sample covers 13% of banks in France or 96% of total banking assets.

⁶⁶ Decree of 3 November 2014 on the internal control of companies in the banking sector, payment services and investment services subject to the authority of the *Autorité de contrôle prudentiel et de résolution* (*Arrêté du 3 novembre 2014 relatif au contrôle interne des entreprises du secteur de la banque, des services de paiement et des services d'investissement soumises au contrôle de l'Autorité de contrôle prudentiel et de résolution*).

beyond the internal governance and risk management requirements established in the internal control regulation and the accounting rules issued by the French Accounting Norms Authority (*Autorité des normes comptables* – ANC).

National insolvency and recovery proceedings are not perceived to be an obstacle to the appropriate management of NPLs, although banks are induced to keep NPL on their balance sheet to facilitate judicial recovery.

Although the sale of loans is not legally prohibited, the NPL secondary market remains minimal owing to the low levels of NPL.

Specific supervisory practices for addressing NPLs can be summarized as follows:

- **Supervisory regime and practices:** the French credit risk management requirements set out by Banking and Financial Regulations Committee Regulation 97-02⁶⁷ in 1997 notably foresaw later Basel Committee on Banking Supervision (BCBS) guidance on the management of credit risk⁶⁸ and sound credit risk assessment valuation for loans⁶⁹. The current internal control regulation provides principles-based requirements regarding, inter alia, credit selection, credit risk identification and monitoring, and NPL valuation. Compliance with these requirements is monitored on an ongoing basis via off-site supervision on the basis of supervisory reporting and the internal control report. This report is submitted annually by each bank in accordance with the internal control regulation⁷⁰ and given an indicative letter provided each year by the AMF. In addition to the information provided in the prudential reporting on NPL (EBA ITS), this ongoing process gives the supervisor a broad view of the NPL situation across the French banking industry, allowing it to adjust its oversight to the risks of each individual case by, for example, requesting additional information from banks (e.g. internal audit report, ad hoc reporting or through dedicated meetings) and making dedicated on-site inspections. When deemed necessary, thematic reviews regarding a specific credit risk area are also carried out.

⁶⁷ Banking and Financial Regulations Committee Regulation 97-02 of 21 February 1997, since abrogated by the French internal control regulation.

⁶⁸ Basel Committee on Banking Supervision (2000), *Principles for the Management of Credit Risk*, Basel, September.

⁶⁹ Basel Committee on Banking Supervision (2006), *Sound Credit Risk Assessment and Valuation for Loans*, Basel, June.

⁷⁰ Article 258 et seq. of the French internal control regulation.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 25

Main sources of NPE-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Regulation (binding)	Banking and Financial Regulations Committee (CRBF) Regulation 97-02 of 21 February 1997, since abrogated by the Decree of 3 November 2014 on the internal control of companies in the banking sector, payment services and investment services subject to the authority of the ACPR	Credit Institutions, the "so-called Sociétés de financement", electronic money and payment institutions	Internal control, risk management and governance	CRBF Regulation 97-02 now abrogated by the Decree of November 3, 2014 on the internal control of banks (French internal control regulation), provides for the implementation of minimum security measures in decision-making, the management of current activities and the management and measurement of risks. It therefore establishes internal, qualitative management standards. It applies both on a company and consolidated basis and helps to prevent institutions' financial difficulties by requiring them to implement an internal control system suitable for their activities and risks.	1997

The French internal control regulation stipulates principles in the form of minimum requirements pertaining to credit risk processes and management rather than granular rules. Even though the internal control regulation does not contain specific NPL guidelines, it goes beyond the requirements of Article 79 of CRD IV regarding the treatment of credit and counterparty risk, in particular the criteria to be assessed before granting a loan (including an analysis of the probability of default), credit granting procedures (including an independent assessment), a review of the credit files' completeness and the monitoring of credit quality.

There are no macro-prudential measures in place which establish specific limits on household portfolios (e.g. LTV or DSTI caps). However, it should be noted that LTV is not the main driver in the French market as most credit are insured loans (i.e. a third party guarantees the bank that it will be paid in case of default of the borrower). On DSTI, it is a current banking practice requiring limits on services to debt before granting the credit as the lending practice is based on the ability of the borrower to reimburse its loan.

A.2 NPL recognition and classification

For credit risk classification purpose, most of the French institutions have adopted the regulatory definitions on distressed loans provided by CRR and the EBA ITS on forbearance and NPEs, seeking, as far as possible, to merge those definitions. The ACPR has not issued additional requirements or guidelines beyond those texts.

The French internal control regulation requires banks to put in place credit measurement and management systems enabling them to efficiently detect and

manage distressed loans. Banks must also carry out a quarterly review of the quality of their credit exposures in order to ensure their correct allocation to the appropriate internal classification and accounting category.

The French accounting regulation which determines the accounting rules to be applied by French banks for their statutory financial statements requires credit institutions to classify their distressed exposures into two different categories given the level of credit risk: (i) doubtful and (ii) compromised doubtful.

Additionally, the accounting regulation requires⁷¹ specific disclosures on credit risk within the notes of bank's financial statements, in particular concerning the methodology for the identification of doubtful exposures, the rules for recognising interests in P&L, the valuation methodology for impairment and for collateral valuation, a breakdown of doubtful exposures, and the write-off policy.

Finally, the French supervisor, through its supervisory practices, encourages the early recognition of distressed situations by promoting the existence of early warning indicators and the identification and monitoring of relevant exposures (e.g. through watch lists).

A.3 NPL measurement and provisioning

French banks apply nGAAP or IAS/IFRS accounting standards. Consolidated financial statements are prepared in accordance with IAS/IFRS accounting requirements by publicly listed banks and banks that have opted for the application of IFRS. Otherwise, French institutions apply nGAAP standards, in which the rules for specific provisioning are broadly similar to IFRS.

According to the French internal control regulation and in line with the relevant BCBS guidelines on sound credit risk assessment valuation for loans, banks must have to demonstrate that they have appropriate processes in place to record provisions or depreciations of adequate amounts.

Regarding accrued interest, for doubtful exposures, this can be recognised in the P&L in the statutory financial statements. In the case of compromised doubtful exposures, they may not be recognised. These options are generally adopted by French banks given tax incentives.

A.4 NPL write-offs

Write-offs are regulated according to IFRS or French nGAAP. In the latter case, doubtful exposures must be written off no later than when the creditors' claim to the exposure lapses. Thus far, the French supervisor has not yet seen the need for guidance or specific incentives to foster early NPL derecognition, i.e. no increased

⁷¹ Article 2251-1 of ANC Regulation No 2014-07.

capital charges and no hard limits on how long NPLs can remain on banks' balance sheets. In this regard, it should be noted that French banks are induced to keep NPL on their balance sheets in order to facilitate judicial recovery.

A.5 Collateral valuation

The French supervisory authorities have no concerns that collateral-related issues could represent an obstacle to private debt resolution.

When setting the level of provisions, the French internal control regulation requires banks to have a recent collateral valuation carried out on a prudent basis and that the collateral be disposable.⁷² The ACPR does not have any other specific guidance in place specifying valuation methods for collaterals.

For collateral valuation, apart from the banks' internal rules, French credit institutions apply the CRR, in particular Article 208(3), which encompasses requirements regarding the frequency of the valuation ($CRE \leq 12$ months, $RRE \leq 3$ years) and the independence of the valuer. Additionally, the French regulation on internal control requests that banks demonstrate the enforceability of the guarantee and to provide a recent and prudent valuation of the collateral. The banks' credit risk measurement and management systems must allow for the computation of appropriate value adjustments and provisions involving collateral valuation. The reassessment of this valuation should be part of the required quarterly NPL credit file review to be undertaken by French credit institutions in accordance with the internal control regulation.

The quality of the banks' valuation process is assessed by the French supervisor mainly via on-site inspections. The French supervisory authority has not yet seen the need to provide additional incentives to reduce the reliance on collateral through increased provisioning.

A.6 NPL governance/workout

The French supervisory authority does not perceive that overall NPL management-related issues could represent an obstacle to private debt resolution.

In general, French banks have a separate NPL workout (e.g. recovery) unit. NPL workout and, more generally, credit risk management and governance requirements are framed by the internal control regulation. A credit risk management unit independent of the front office must be established and provided with the necessary means. This unit must be involved in the loan granting process (known as the "four eyes" rules) as well as in the risk monitoring process.

⁷² Article 119 of Regulation CRBF 97-02 on internal control now incorporated in the arrêté du 3 novembre 2014.

From a regulatory point of view, banks are allowed to outsource the management of NPLs (e.g. special servicers, agreements with asset managers), though this practice is not very common.

The appropriateness of banks' credit risk management is assessed through on-site and off-site supervision, in the latter case primarily by means of the internal control report submitted annually to the supervisor in compliance with the French internal control regulation.

Corporate law provides for interbank coordination mechanisms, both within insolvency proceedings and in the context of early intervention measures. In the latter case, debtors are entitled to request conciliation measures in order to prevent financial difficulties. There is an equivalent interbank coordination mechanism for over-indebted households once the over-indebtedness of the debtor has been acknowledged.

A.7 Supervisory reporting

All supervised credit institutions (including LSIs applying French nGAAP from June 2017 onwards) are, unless an exemption is granted, required to submit the required COREP/FINREP reporting templates including information relating to the EBA ITS. No additional prudential reporting is in place beyond these EBA requirements because of low NPL levels and the maximum harmonisation principle applied to the EBA ITS. The French supervisor has the power to request ad-hoc reporting on a bank-by-bank basis if required.

The French supervisor has implemented the EBA taxonomy validation rules. In addition, off-site supervision is used to assess the reliability of the supervisory reporting on the basis of its knowledge of each specific situation involving the use of the CCR for NPL reporting. On-site supervision also verifies the quality and accuracy of the bank NPL supervisory reporting as part of a credit risk or dedicated on-site inspection.

The French supervisor publishes an annual analysis of housing finance in France, which includes NPL statistics.

A.8 On-site and off-site supervisory practices and methodologies

The on-site assessment of NPL workout is performed through inspections focussed on credit risk management. These inspections are in particular intended to assess the banks' practices regarding the management and the assessment of credit risk (e.g. loan granting policies, credit risk function, IT and data collection), the valuation and provisioning of credit exposure (including collateral valuation), the monitoring of credit risk (relevant and timely recognition) as well as the internal control framework relating to these processes. The approach used depends on the characteristics of the reviewed portfolio (e.g. business line, credit type of the loan, the provisioning methodology applied by the bank, etc.).

Inspections are generally initiated on the basis of the off-site assessment of the bank's risk significance. This assessment relies particularly on the analysis of the supervisory reporting and of the annual internal control reports, which notably describe banks' loan-granting processes, their risk management and measurement procedures (e.g. frequency of the credit file reviews, breakdown of exposures by risk level), and the outcomes of the internal control processes regarding credit risk. In addition, this report is a useful basis for discussions with the bank and usually gives rise to requests for information in order to further understand and assess their credit risk management processes. When conducting their assessments, both on-site and off-site supervisors refer to the internal control regulation and may, whenever necessary, also refer to the BCBS guidance on the management of credit risk and sound credit risk assessment valuation for loans.

The French CCR and the *Fichier bancaire des entreprises* (FIBEN) companies database, which are both owned by the Banque de France, are used by on-site and off-site teams as inputs for supervisory purposes (e.g. assessing the adequacy of banks' exposure classification, challenging their internal ratings, etc.).

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

In general, French law does not require the consent of the borrower for the sale of a loan, only that he or she be notified. Loans can be sold even if legally and economically written off. The buyers can be third-party banks and institutional investors, but must be authorised within the European Economic Area. The sale of loans is not, however, common practice for banks. As a result of the lower levels of NPLs in the country overall, there is no secondary market for NPLs in France.

Although no specific regulation on AMCs exists, there is no legal impediment to their creation.

B.2 Debt enforcement/foreclosure

The French supervisory authority does not perceive that the real estate transaction setup could represent an obstacle to private debt resolution in France.

Regarding debt enforcement and asset foreclosure, the debtor providing the collateral can agree to certain contractual out-of-court arrangements that enable faster enforcement, i.e. by transferring ownership of the collateral to a trust or including a contractual penalty clause for non-performance.

B.3 Corporate insolvency and restructuring

From the French supervisory perspective the corporate debt resolution regime is not seen as being an obstacle to private debt resolution.

The French insolvency and debt restructuring regime is designed to take into account the interests of all stakeholders. Most of the changes that have been made since the French Insolvency Act of 1984 relate to pre-insolvency procedures.

In the context of a business/loan restructuring, it is possible to sell a company's assets via auctions or open-market bilateral sales with the approval of the court.

Public schemes are in place to support distressed companies, such as facilitating access to finance for SMEs or providing mediation to overcome financing difficulties.⁷³

There are pre-pack procedures for the rapid approval of restructuring plans agreed by the debtor and creditor. These procedures take an average of four months.⁷⁴

B.4 Household insolvency and restructuring

The household insolvency and debt restructuring regime is not considered to be an obstacle to private debt resolution.

A debtor has the obligation to enter into an out-of-court proceeding in the case of consumer insolvency. The aim is to reach an out-of-court agreement between the debtor and the creditors.

The household insolvency regime is managed by the Banque de France. The supervisory authority has three months during which to verify the admissibility of the household's request. If it is admissible a recovery plan is elaborated, otherwise the case is transferred to the court which begins liquidation proceedings or pronounces the cancellation of all or part of the debt.

The debt settlement plan may take up to seven years in the case of a recovery plan or twelve months in the case of liquidation proceedings.

B.5 Judicial system

The French supervisory authority does not consider the judicial system to be an obstacle to private debt resolution.

⁷³ The public authorities which provide such support include the *Comité départemental d'examen des problèmes de financement des entreprises*, the *Médiateur national du crédit* and *Bpifrance*.

⁷⁴ Pre-packs refer to procedures under which the court expeditiously approves a debt restructuring plan negotiated between the debtor and its creditors in a consensual manner before the initiation of an insolvency proceeding.

Most insolvency cases are dealt with by commercial courts which consist of lay judges with business experience. Insolvency administrators require a professional certification and there are set time requirements for the personal and corporate insolvency process.

B.6 Tax regime

The French supervisory authority does not consider the tax regime to be an impediment to private debt resolution in France.

Loan loss provisioning is tax-deductible so long as it meets the following criteria: (i) the risk of default is clearly established and (ii) the loss is likely to occur. Loan loss allowances recognised in the French banks' annual financial statements generally meet the conditions for tax deductibility.

There are tax deductions for loan write-offs, but not for the sales of collateral. The framework includes a tax loss carry-forward mechanism, while on the debtor side capital gains tax applies to any favourable debt write-off/restructuring.

C Other information framework

C.1 Public registers (CCR, cadastral system, asset register)

The French CCR (*Service Centrale des Risques* - SCR) is administrated by the Banque de France. Domestic banks, local branches and subsidiaries of foreign banks⁷⁵ are required to declare every exposure exceeding €25,000 on a monthly basis. This information is provided at a borrower level⁷⁶. Credit exposures are broken down by asset type. Since 2016, reporting agents must identify, borrower by borrower, the outstanding nominal amounts and accrued interests for all defaulted exposures in the meaning of the SCR. The SCR does not include information on loan loss provisions.

The SCR provides participating institutions with information on their clients' total financial liabilities on a monthly basis, free of charge. In addition, banks may request information on the indebtedness of any company.

At the same time, French Banks can subscribe to the FIBEN credit rating service provided by the Banque de France. This paid service also allows banks to check the indebtedness of every French company listed in the database.

⁷⁵ Two non-deposit-taking institutions, the *Caisse des Dépôts et Consignations* and the *Caisse Nationale des Autoroutes*, are also required to provide information.

⁷⁶ It represents 1.8 million borrowers among all economic agents except financial institutions, individuals and households.

The cadastral information is digitalised and centralised to some extent, and comprehensive information is available on request. Any sale, purchase or transfer of real estate by donation or succession is subject to registration, verified by a notary. This information is then centralised by the land register services and available upon request.

C.2 Debt counselling and outreach

From the French supervisory perspective, debt counselling and outreach services are not seen as being an obstacle to private debt resolution as free or subsidised services are available.

C.3 Consumer and data protection

French law establishes some restrictions on the recording/sharing of personal information due to confidentiality requirements. Nevertheless, these restrictions are not deemed to have an impact on NPL workout.

Annex VII: Germany

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

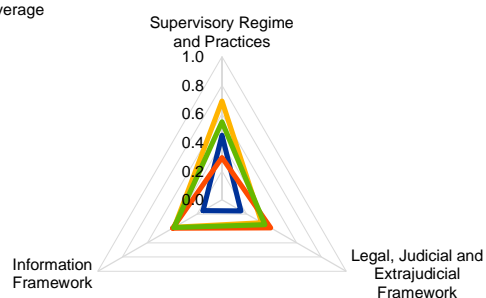
Chart 7

Country overview

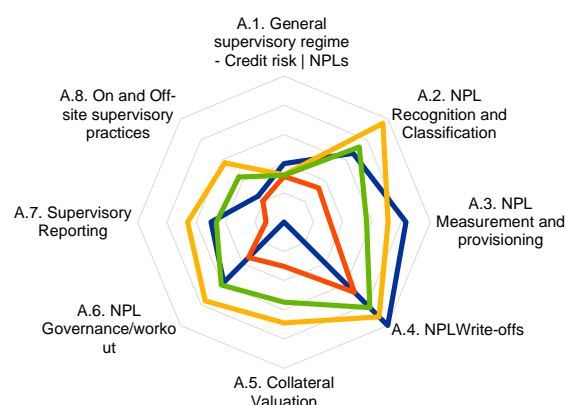
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

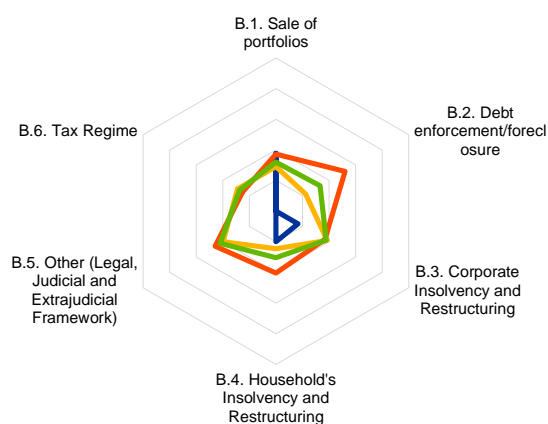
- DE
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



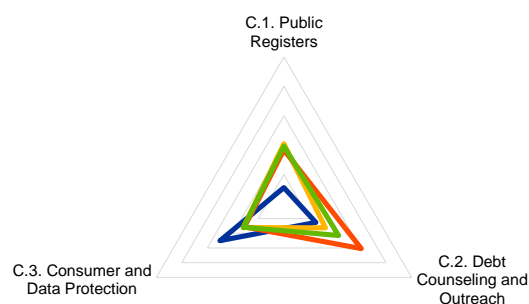
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Germany had a total NPL ratio of 3.1% (of which by segment: households 2.4%, NFCs 5.9%, SMEs 8.4% and CRE 3.7%).⁷⁷

In view of the comparatively low overall NPL ratios in recent years, the German authorities had reason to pursue a less pervasive strategy to tackle the NPL workout issue. The German regulatory framework – especially MaRisk⁷⁸ (Minimum Requirements for Risk Management) – provides inter alia minimum requirements for banks in terms of early warning systems to detect problem loans and in order to ensure intensive loan management and problem loan treatment (including workout and provisioning or liquidation). Compliance with the minimum requirements is regularly checked by external auditors and in supervisory on-site inspections.

Although it is principles-based, the framework also allows for specific in-depth investigations as needed. If NPLs rise in specific banks, those banks are monitored more closely and more frequently. This can comprise thematic reviews where NPL deterioration is driven by an industry sector (e.g. shipping) to which a number of banks have material exposure.

The banks' NPL management is perceived by national supervisors as generally adequate across all exposure classes due to the fact that, when applicable, foreclosure procedures are regularly conducted and are effective/efficient (i.e. lead to good repayments from the collateral). This is partially achieved by conservative collateral valuation rules that banks apply to RE given that the supervisor expects banks to apply haircuts on collateral valuations. Their adequacy is to be validated by the bank taking into account its own past foreclosure cases. Depending on the technique used for the valuation, the calculated collateral values are usually lower than the market price. In addition, the legal framework facilitates the foreclosure of collateral.⁷⁹

As a result of the lower levels of NPLs in the country overall, the market for NPLs is not developed and, even though the sale of loans is legally possible, only a small number of transactions have been recorded in recent years.

Even though the current NPL situation seems favourable overall, the survey reported some features in the framework that could represent **potential challenges to NPL workout in Germany**:

- **Large sector-specific exposures:** Large sector-specific exposures, in particular outside Germany (e.g. large exposures without an active market, such as specific project finance), can pose a particular challenge to NPL

⁷⁷ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers 2% of banks in Germany or approximately 77% of total banking assets (proxy due to nGAAP and IFRS accounting differences). Due to a change in definition these figures are not comparable with those figures provided in the ECB Stocktake published in September 2016.

⁷⁸ These requirements were drafted and amended as a lesson learned from the experience of financial losses on property after German reunification in the 1990s. With comparatively low NPL ratios also in the past years, the German authorities had no reason to implement further specific requirements (apart from the existing set) on the NPL workout issue.

⁷⁹ These new measures could have beneficial effects on the reduction and working-out of banks' NPLs, with possible effects also on the market for NPLs.

workout as the standardised management procedures tend not to be applicable. Moreover, the foreclosure of large individual collateral can be difficult and pose higher risks.

- **Supervisory regime and practices:** The German principles-based approach does not provide specific NPL-related guidance. Banks' implementation of the principles prescribed mainly by MaRisk is subject to mainly process-orientated on-site and off-site inspections. The frequency of these inspections is dependent on the size and riskiness of the individual institution. The statutory auditors are required to review and assess the quality of implementation of MaRisk annually as part of the statutory audit.
- **NPL governance:** Due to the more favourable NPL conditions in the country overall, no particular guidance has been issued on NPL workout practices (though MaRisk sets a number of principles-based guidelines).
- **NPL recognition and classification/write-off:** Apart from the general accounting principles (nGAAP and IFRS), there is no additional specific guideline on the prudential accounting approach regarding provisioning and write-offs. Within predefined limits, national GAAP allows banks to build up hidden reserves and reserves for general banking risk applying a rather prudent valuation of assets.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 26**Main sources of NPE-related regulation**

Type	Ref.	Scope	Topic	Summary description	Entry into force
MaRisk (binding)	12/2012	All credit institutions	Risk management	The Minimum Requirements for Risk Management (MaRisk) form a comprehensive risk management framework, which applies to all banks, regardless of their size. MaRisk notably sets out requirements relating to the credit process, the early detection of risks and the need for risk classification in credit business. It is principles-based and does not provide prescriptive rules for specific loan categories. Institutions are requested to implement those principles by defining their loan categories and procedures.	2005
PrüfV (binding)	04/2016	All credit institutions	Audit of annual accounts	The Audit Report Regulation (Prüfungsberichtsverordnung – PrüfV), which is issued by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), addresses the auditing of the annual accounts of credit institutions and financial service institutions as well as the reports to be drawn up on these.	1998
KWG (binding)	12/2016	All credit institutions	General Banking Act	General Banking Act of Germany	1961
SolvV (binding)	09/2016	All credit institutions	National specificities (e.g. capital buffers)	Before the CRR came into force, the Solvabilitätsverordnung (Solvency Regulation) regulated the calculation of capital requirements in Germany. Today, SolvV covers a number of requirements not covered by the CRR (e.g. regarding the countercyclical and capital conservation buffers). SolvV extends the scope of BelWertV to all credit institutions in Germany.	2013
BelWertV (binding)	09/2009		Collateral valuation	The Beleihungswertermittlungsverordnung (Regulation on the determination of the mortgage lending value) sets rules for the valuation of RE used as collateral for mortgage loans, providing for different techniques to calculate the collateral value of RE.	2006
GroMiKV (binding)	12/2016	All credit institutions	Large exposures	The Großkredit- und Millionenkreditverordnung specifies further the reporting requirements for large exposures and loans above €1 million.	1998
FinaRisikoV (binding)	12/2014	All credit institutions	Reporting	Reporting of financial information and details concerning banks' risk-bearing capacity	2014

The German framework sets out principles in the form of minimum requirements pertaining to credit risk processes rather than granular rules. For instance, there is no guidance defining specific limits on household or NFC portfolios (e.g. max. LTV, max. maturity).

A.2 NPL recognition and classification

For regulatory reporting purposes, German banks are legally required to comply with the EBA ITS regarding the definition/classification of NPLs. In addition, MaRisk sets out additional criteria for NPL recognition and classification: banks are requested to define their own triggers for at least two categories of loans – intensified monitoring loans and problem loans (recovery process and liquidation) – that take account of the stipulations of the regulation (the CRR's 90-day hard trigger) and the EBA ITS. Banks are requested to review the risk classification of their loan portfolio yearly. The treatment of problem loans is also audited by external auditors.

The Banking Act does not explicitly refer to performing/non-performing loans. In general, the assessment of the borrower's ability to meet their contractual obligations forms the basis for determining provisions (if the borrower is not able to meet all of the contractual obligations, provisions have to be made for the amount of the projected losses); more detailed classifications to the bank's discretion. However, banks have to develop a risk classification procedure (see MaRisk BTO⁸⁰ 1.4) and review the risk score (even for low risk exposures), at least annually and whenever a

⁸⁰ Section in MaRisk regarding the organisational and operational structure.

risk-related event occurs. MaRisk provides that institutions should identify loans that are subject to intensified loan management (the criteria to be used are to be defined by the bank). These exposures have to be reviewed at predefined intervals to determine their treatment (further intensified loan management, return to normal monitoring, transfer to liquidation or recovery). Institutions also have to develop early risk identification indicators based on quantitative and qualitative risk features. Data sources must be available for all loans, including non-performing ones.

A.3 NPL measurement and provisioning

German banks follow the nGAAP and the IAS/IFRS accounting standards. In addition, MaRisk requires banks to: (i) define criteria on the basis of which (taking due account of the accounting standards used and their risk classification system) the banks shall make allowance for write-downs, impairments and provisions on their credit business, including country risk provisions (e.g. an internal claim valuation procedure); and (ii) calculate and update the necessary risk provisions (notifying the management board, if changes are substantial). As another general principle, banks are invited to formulate stricter requirements in terms of identification of potential losses and risks and set early indicators based on quantitative and qualitative risk features.

Although the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – BaFin) does not have powers with regard to auditing and accounting, prudential provisioning is ensured through a series of measures that the supervisor can apply such as an own funds filter⁸¹, Pillar 2 capital add-ons or even official orders (e.g. restriction of business).

Regarding accrued interest, usually it can only be recognised and revalued if it is likely to be paid.

A.4 NPL write-offs

Write-offs are regulated according to the nGAAP (“strict lower of cost or market principle” and “moderate lower of cost or market principle”)⁸² or to the IFRS. There are no specific national guidelines or rules for NPL write-off. As previously mentioned, MaRisk encourages banks to define internal write-off criteria in line with their accounting policies. German supervisors, in this case, do not provide any additional incentive for NPL write-offs, i.e. no increased capital charges or time limits on how long NPLs can be carried on banks’ balance sheets.

⁸¹ According to Section 10(7) of the KWG, own funds filters can be used which may reduce the bank’s Pillar 1 capital if, for example, provisioning or write-offs are not seen as adequate.

⁸² Section 253, paragraphs 3 and 4, of the German Commercial Code (HGB).

A.5 Collateral valuation

The German supervisory authorities have no concerns that collateral-related issues could represent an obstacle to private debt resolution.

Collateral should be evaluated by an independent unit. In practice, qualified internal staff from the front office can appraise certain collateral if plausibility checks are run by another unit, segregated from the front office. The analysis of value and legal validity of collateral should be checked before granting a loan. MaRisk also prescribes a current monitoring of collateral values and reporting to management body. The further processing of loans includes reviewing the value and legal validity of collateral at appropriate intervals. Also, an independent internal audit function which examines and assesses in a risk-oriented and process-independent manner the effectiveness and appropriateness of the risk management system and the internal control system is required. The German supervisory authorities verify the appropriateness of the institution's internal risk management and the application of MaRisk in on-site and off-site inspections. Moreover, the Audit Report Regulation specifies how external auditors must assess compliance with MaRisk and document their analysis in the long version of the annual report that is sent to BaFin and the Deutsche Bundesbank.

The required frequency for the valuation of immovable property collateral follows CRR⁸³ requirements (CRE \leq 12 months; RRE \leq 3 years), but banks can set stricter intervals (the supervisor expects banks to value collateral when a loan is classified as an NPL). Banks have to define a procedure to determine the value of collateral. External assessment can be used, but the bank should still build up its own knowledge of credit and counterparty risk. When reviewing the value of collateral, available collateral values may be relied on if there are no indications of any change in value. Ad hoc reviews of exposures need to be promptly conducted whenever the institution obtains information from external or internal sources that indicates a material negative change in the risk assessment of the exposures or the collateral. Such information has to be promptly passed on to all organisational units involved. The expected realisable (net) value of collateral has to be indicated. If RE is used as collateral, the application of a RE valuation standard is required. In general, for the collateral value update either the fair value or the German mortgage lending value is used (see the BelWertV Regulation for the valuation method). If the exposure is classified as a problem loan, the need for a new valuation of the collateral has to be assessed. Depending on the status of the exposure (going-concern or gone-concern), different methods of valuation are used (e.g. for gone-concern exposures institutions should consider additional haircuts for foreclosure or determine a realisation (liquidation) value). Banks can also take into account external information from public registers on sale prices or cross-sale prices. For mortgage loans, specific guidance is in place that requires banks under certain circumstances to reassess the value of the RE that is used as collateral (Section 26 of BelWertV). It is common practice for banks to refer to the *Pfandbriefgesetz* (PfandBG) and use it as a quality

⁸³ Article 208(3).

standard for internal use (e.g. limiting the loan to 60% of the mortgage lending value).

According to the Audit Report Regulation (PrüfbV), external auditors must assess annually the viability of the collateral for what are termed exceptional exposures, which are: (i) loans on which significant provisions have been made; (ii) loans that face a high risk of impairment; (iii) loans for which collateral of an extraordinary nature exists; or (iv) loans to managers and related parties of large size or where there is a risk of a conflict of interest.

Regarding the assessment of collateral recovery, the German supervisory authorities expect the institutions to implement appropriate reporting and documentation systems. At the same time, in the context of an inspection, there is a clear expectation that institutions implement processes for data validation and measures for ensuring data quality.

There is no explicit requirement for the calculation of the credit risk-mitigating effect of collateral for risk management purposes. On-site inspection checks follow the internal ratings-based (IRB) methodology. However, stress tests should also reflect the risk of declining collateral values. The German supervisory authorities have not provided additional incentives to reduce the reliance on collateral through increased provisioning (this is done instead through the assessment of valuation practices). Regarding foreclosed assets, for the retail sector, the main disposal channel is auction (required by law).

A.6 NPL governance/workout

NPL workout requirements are generally stipulated in MaRisk (Section BTO 1.2.5) which requires banks to implement appropriate processes and procedures to deal with NPLs through an independent unit. In doing so, the requirements leave a noticeable degree of discretion to the institutions in setting their own criteria and practices. As a general rule, institutions have to implement a separate unit outside the front office for dealing with problem loans (recovery process and liquidation) and define criteria when an exposure has to be transferred to this internal unit. Banks are also expected to have operational targets for NPL reduction in place.

The adequacy of banks' NPL governance arrangements is checked during credit risk-focused inspections (see also the section on on-site and off-site supervisory practices and methodologies).

In the NPL monitoring of individual debtor cases, there is no mechanism for interbank coordination or for coordination between private and public creditors (e.g. tax authorities, social security authorities) on individual debtor cases.

A.7 Supervisory reporting

On a national basis, FinaRisikoV determines reporting requirements for all credit institutions referring to credit volume as defined in Sections 19 and 24 of the KWG (German Banking Act). All institutions are requested to report, nGAAP-based figures at solo level. At consolidated level, FinaRisikoV (nGAAP) or FINREP ITS (IFRS) is applicable. The adaption of FINREP reporting for nGAAP adopters is currently in progress. The credit institutions have to report information on loan quality, corresponding provisioning and the amount of loans with an increased probability of default (PD) or which are in default. The reporting frequency is quarterly.

Banks reporting FINREP use the EBA NPE reporting template. For quality assurance in this respect, the supervisor does not have additional automatic rules beyond the required validation rules. In addition to the quarterly information on loan quality required by FinaRisikoV, the auditor has to provide specific data concerning loan business on an annual basis in relation to the annual supervisory data catalogue SON01 of the Audit Report Regulation (PrüfbV) in the course of auditing the annual account.⁸⁴ This information requirement is directed to the auditor but normally compiled by the institutions and in this case has to be checked by the auditors in accordance with PrüfbV (SON01).

Regarding the disclosure of NPL-related information, the Deutsche Bundesbank has published NPL ratios on an annual basis since 2005 in relation to the Financial Soundness Indicator project of the IMF. Information is based on audited figures as per SON01.

A.8 On- and off-site supervisory practices and methodologies

The supervisory approach in Germany is threefold; it relies on (1) on-site inspections usually carried out by the Deutsche Bundesbank or external auditors, (2) external auditors' long-form annual reports, and (3) off-site supervision.

1. Banks' policies and procedures to handle NPLs are assessed through credit risk-oriented on-site inspections. The objective of these inspections is to assess the quality of the bank's exposures and the robustness of the provisioning and collateral policies applied, as well as the actual implementation of the policies within the supervised institution's loan loss accounting rules. Specific credit risk inspections on topics like risk classification procedures, treatment of problem loans or risk provisioning also cover NPL portfolios.
 - The composition of the inspection team depends on the mandate and the bank's characteristics.
 - Credit risk-focused on-site inspections usually cover the appropriateness of assumed income recognised from NPLs and whether the

⁸⁴ Component of the BAKIS (the Bundesbank's prudential database).

macroeconomic conditions in the country of exposure are taken into account.

Larger German banks, including certain less significant institutions (LSIs), were subject to an asset quality review in 2014 in the context of the SSM comprehensive assessment. However, NPLs are not a preponderant issue for the German banking system. Inspections are focused on credit risk if this risk is significant.

2. The statutory auditors' annual report is one of the supervisors' key sources of information.

In the context of their annual audits, statutory auditors are requested to assess the appropriateness of risk classification, risk provisioning and related processes according to the accounting rules. This covers, in particular, the recoverability of the loans, the appropriateness and sufficiency of the provisioning and, if relevant, the realisable value of collateral. The figures are regularly assessed on an entity-by-entity basis but also e.g. at peer group level, based on the figures reported pursuant to the PrüfV. In addition, BaFin may mandate external auditors to look into a specific topic as part of the yearly audit (e.g. adequacy of provisioning and classification documentation) or in separate asset quality checks.

3. The off-site supervisors review, on an ongoing basis:

- processes and governance structures;
- the bank's documentation and reporting on internal classification and provisioning levels, and the external auditors' findings (both special audits and annual audits). Figures are analysed on an entity-by-entity basis but also at peer group level;
- the degree of conservatism in collateral valuation and accounting policies followed by the bank to measure loan loss provisions (LLPs). They have to ensure that the institution has implemented a system to make haircuts in the valuation of collateral for collective provisioning.

In addition to the NPL information provided by banks and by the audit reports, Bafin/Deutsche Bundesbank use the CCR for both on-site and off-site supervisory activities. The CCR computes the total indebtedness of an individual borrower or a single borrower unit (for loans \geq €1 million) and serves as a data pool:

- for banking supervisors, providing valuable information on the amounts and sector-specific concentration of institutions' risk from lending business;
- for the reporting of credit institutions, which are notified of the total amount of indebtedness of their borrowers;
- for generating aggregated statistics (NPL amounts for selected large reporting institutions, indication of risk provisioning, etc.).

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

The German regulatory framework does not prevent non-banks from holding or managing NPLs. Special servicing firms operate in the country. Although there are no legal impediments to loan sales, the German market for NPLs portfolios is not developed (also as a result of a lower level of NPLs) and selling NPLs is not common practice.

Bad banks for toxic assets are rare in Germany. In the recent years, bad banks were created and funded with public money for two crisis banks: Hypo RE (bad bank *FMS Wertmanagement* in 2010, €175 billion of assets transferred) and West LB (bad bank *Erste Abwicklungsanstalt* in 2009, more than €200 billion of assets transferred). Both were established in the context of a resolution scheme for a gone-concern bank. However, private AMCs are rarely used by German going-concern banks as a NPL disposal/solution tool (especially because NPLs are generally not a key issue for German banks).

A sale of NPLs and a subsequent assignment of receivables are in general possible as long as the parties have not agreed on a ban on assignment. Loans can be sold even if legally and economically written off. Loan buyers can be third-party banks or institutional investors. Additionally, banks are free to set up an AMC in cooperation with investment firms.

B.2 Debt enforcement/foreclosure

Regarding debt enforcement and asset foreclosure, the party that provides collateral can agree to certain out-of-court contractual arrangements that enable a faster enforcement: for example (i) in the case of a first-demand guarantee, the creditor can be authorised to have recourse to the guarantor without addressing the debtor first; (ii) in the case of charged RE, collateral foreclosure can be carried out by the owner of the land charge with respect to the secured claim by means of a compulsory auction or compulsory administration. By agreeing on immediate execution, which is a standard clause in the notary deed used when creating the land charge, the debtor may submit his/her property in advance without recourse to the court. However, every enforcement procedure requires an enforceable title confirming the executed receivable. This is legally necessary to protect the rights of the creditor and the debtor.

B.3 Corporate insolvency and restructuring

The German supervisory authorities do not have concerns that deficiencies in the corporate debt resolution regime are an obstacle to private debt resolution.

There are no legal provisions in place to support distressed companies. German law does not provide for an autonomous pre-insolvency regime. Nevertheless, a debtor has the possibility to reach an out-of-court agreement with his/her creditors (and in the case of consumer finance, the bank has to offer negotiations with the borrowers – see Section 498 German Civil Code BGB). Furthermore, after the application for insolvency, German Insolvency Law⁸⁵ provides, under certain conditions, the possibility for the debtor to prepare a recovery solution; for debtors there is the possibility to develop an insolvency plan that can be submitted to the insolvency court together with the insolvency filing.

Experience shows that RE proceedings on average do not take longer than approximately one year.

B.4 Household insolvency and restructuring

The German supervisory authorities do not have concerns that the household insolvency and debt restructuring regime is an obstacle to private debt resolution. German law does not provide for an autonomous pre-insolvency regime. Nevertheless, in the case of consumer insolvency, the debtor has an obligation to try to reach an out-of-court agreement with his/her creditors before submitting a petition for insolvency proceedings. For RE a discharge of residual debt is provided for and, in the case of consumer insolvency, the loans are covered up to 100%. For consumer credits, which are generally not covered by particular collateral, all of the debtor's assets could be subject to an enforcement procedure (for example the attachment of salary). Every natural person can receive a discharge of residual debt. The average length of insolvency/bankruptcy proceedings is approximately 12 to 24 months. The insolvency/bankruptcy discharge period is generally six years, with the possibility for this period to be shortened to three years under specific conditions.

B.5 Judicial system

The German supervisory authorities do not consider the judicial system to be an obstacle to private debt resolution and there are specialised courts or judges that only deal with insolvency issues. German law provides different possibilities for obtaining borrower/consumer protection against execution, e.g. the attachment of salary. In this case, legal provisions stipulate an amount that is exempt from execution in order to secure the debtor's minimum living wage.

B.6 Tax regime

Tax deductions are granted for loan write-offs and for LLPs where there is also a tax loss carry-forward mechanism (e.g. a deferred tax asset).

⁸⁵ § 270 b of the *Insolvenzordnung* (InsO).

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

NPL information based on the EBA definition has been available since March 2015 and is published quarterly. Previously classification was carried out according to national law (Audit Report Regulation – PrüfV). There are a few discrepancies between the accounting and supervisory definitions of the EBA in relation to the CCR. Some types of exposures are currently exempted (open credit lines, shares, securities in the trading book). The minimum threshold regarding exposure sizes (to be included in the CCR) is €1 million on the basis of the single borrower unit. The information is collected at a borrower level. Banks may also buy granular information on borrowers (notably for those not captured by the CCR because of the threshold) from private providers. Annex IX of this document gives a detailed overview of the main features of and the information collected by the CCRs.

The cadastral system (land registry) is digitalised but decentralised, as the responsibility for the cadastral register lies with the Federal States. In Germany, there are no public registers for RE transaction prices. However, prices are collected by a *Gutachterausschuss* (Committee of Valuation Experts) in the context of the RE valuation, if such a committee exists in the community. The general public can only receive anonymised information upon request. Moreover, data are also published on an aggregated or average basis. The cost of searches depends on the location of the RE as well as on the kind of information needed. Some information is available on the internet. If more detailed information is needed which requires further research, the fees might be higher. Information on upcoming sales/auctions is publicly available. The public asset registries are available to the creditors and contain information on the owner and the characteristics of the asset.

C.2 Debt counselling and outreach

The German supervisory authorities do not have concerns that limitations in terms of debt counselling/outreach are an obstacle to private debt resolution. Free or subsidised personal budgeting services and legal advice services for indebted households are available.

C.3 Consumer and data protection

There are restrictions on recording/sharing personal information for debt workout purposes, essentially related to confidentiality requirements in Germany. Nevertheless, the German supervisory authorities do not have concerns that a lack of information-sharing due to consumer protection law is an obstacle to private debt resolution.

Annex VIII: Greece

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Chart 8

Country overview

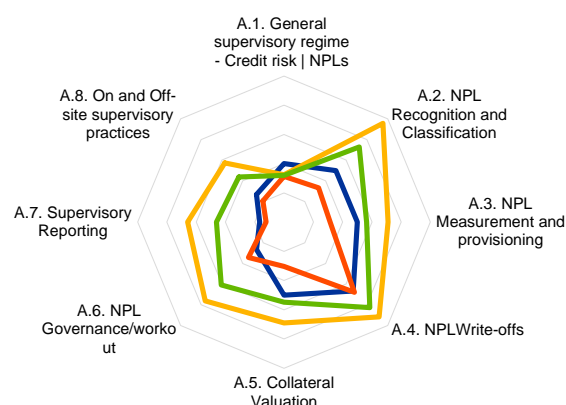
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (in addition to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not represent a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

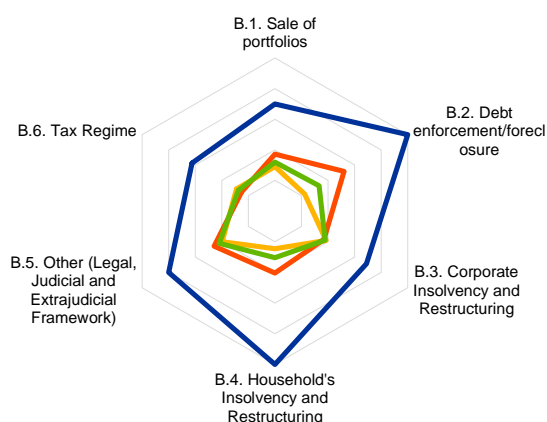
- GR
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



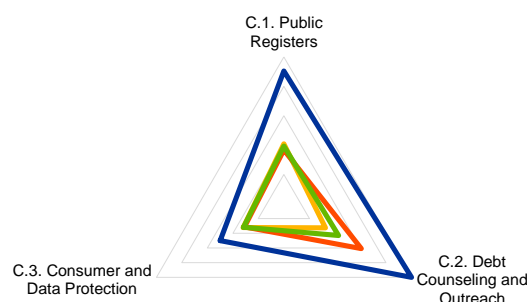
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



Greece has taken a number of measures to tackle the high NPL ratio. In December 2016 Greece had a total NPL ratio of 47.8% (of which by segment: households 46.3%, NFCs 53.9%, SMEs 66.1% and CRE 62.6%).⁸⁶

Greece has taken considerable steps towards commencing a programme of reforms, including an independent diagnostic study⁸⁷ conducted by third parties on the loan portfolios of all the Greek commercial banks. The key findings of the study, along with the technical assistance received from the IMF and supervisory authorities in countries facing similar issues, informed the development of an enhanced supervisory framework for NPL management. Since 2014 the Bank of Greece (BoG) has introduced: (i) **a supervisory framework⁸⁸ for the management of loans in arrears and NPLs**; and (ii) **a guideline⁸⁹** that requires banks to define resolution procedures with distressed borrowers in order to standardise the loan workout process. Since mid-2015 the third Memorandum of Understanding (MoU) between the Greek State and the European institutions has induced a large number of improvements and has required the Greek authorities to develop a credible strategy for addressing the NPL issue.

In the course of the ECB survey, the following **challenges were identified as impediments to NPL resolution in Greece**. The table below summarises the main barriers to NPL workout and the measures taken during 2015 and 2016, or currently being discussed, to tackle these barriers. The efficiency of the measures adopted largely depends on the swift implementation of the NPL strategy and the associated action plan.

⁸⁶ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers all banks in Greece. Due to a change in definition these figures are not comparable with those figures provided in the ECB Stocktake published in September 2016.

⁸⁷ Troubled asset review (TAR).

⁸⁸ Executive Committee Acts 42/2014, 47/2015 and 102/2016.

⁸⁹ Code of Conduct on NPL Management, Credit and Insurance Committee Decision 116/I/2014.

Table 27**Main barriers to NPL workout and adopted/foreseen measures**

Area	Impediment	Measures adopted in 2015 and 2016 or foreseen
Legal framework/debt enforcement and foreclosure	1. Super-seniority of public claims discouraged collateral liquidation	Rationalisation of statutory preferences by setting the minimum percentage of recovery for secured creditors at 65% of the proceeds from auctions conducted under the amended Civil Procedure Code
Household insolvency regime	2. De facto unlimited stay on enforcement for borrowers filing for bankruptcy, encouraging strategic defaulters and introducing bottlenecks in the courts 3. Blanket moratorium on auctions of (almost) all household residential properties until end-2014	Limited stay and full documentation required prior to the hearing to determine eligibility, following amendments to the Household Insolvency Law General protection abolished; temporary protection of the primary residence applies under strict eligibility criteria based on income, a liquidation test, the residence value and the cooperativeness of the borrower
NPL governance/workout	4. Insufficient interbank coordination on common borrowers, especially SMEs 5. Insufficient coordination between banks and public authorities	In July 2016 the Hellenic Financial Stability Fund (HFSF) conducted a study on promoting interbank coordination on common borrowers, which was communicated to banks. The study identified key elements of the coordination mechanism (e.g. structure, procedures) and identified priority sectors based on economic value added, export orientation, NPE ratio and share of multi-bank exposures. In the meantime, in January 2017 the Hellenic Bank Association set-up a Coordination Committee for NPL Management, as well as a Forum for NPL Management, in order to coordinate the treatment of large corporate. A multiparty committee with stakeholders both from the public and private sector discussed potential approaches for the handling of distressed borrowers with arrears above €1 million to both banks and the public sector. Some of its findings were incorporated into the design of the out-of-court mechanism.
Portfolio sales or servicing	6. Sales and servicing of NPLs restricted only to banks, including foreign ones, and factoring companies (only servicing). No incentives to sell and write off	Legislation was introduced in 2015 and 2016 that allows the operation of credit-servicing firms and AMCs (credit-acquiring companies). Secondary legislation to fully operationalise the new framework has been issued (Executive Committee Act 82/2016 and 95/2016.)
Tax regime	7. No deductions on restructuring measures 8. Large volume of arrears to the public sector. No public debt write-off	Tax exemption of loan write-offs for borrowers was introduced in 2016. Ongoing consultations in the context of an out-of-court workout mechanism including arrears both to the private and public sector. Repayment schedule similar for arrears to the private and public sector; debt write-off for arrears to the public sector possible under certain conditions and limitations.
Corporate insolvency regime	9. Lengthy insolvency procedures. Pre-insolvency regime not efficient and does not enable debtors to restructure at an early stage and prevent their insolvency. Debt (including public) restructuring procedures poor and dysfunctional	Amendments to the Corporate Insolvency Law aiming at accelerating pre-court proceedings. Further amendments were introduced in December 2016 (Law 4446/2016).

1. Super-seniority of public claims discouraged collateral liquidation. The statutory preference for public claims discouraged banks from debt enforcement and subsequently collateral liquidation. The amendment of the Civil Procedure Code limits these statutory preferences by increasing the minimum percentage of recovery for secured creditors (from 33% to 65% of liquidation proceeds) for auctions conducted in line with the revised Civil Procedure Code. The same ranking also applies to liquidations conducted in the context of corporate insolvency under the Greek Bankruptcy Code.

2. Household Insolvency Law was inefficiently implemented. Until the amendments in August 2015, the Household Insolvency Law allowed de facto an unlimited stay on enforcement for all borrowers filing for a debt arrangement. The Law did not foresee a pre-screening of the supporting documentation and the waiting time until the hearing date could be up to ten years. The weak implementation of the Law encouraged strategic defaulters. The amendment to the Law under the third MoU requires full documentation prior to the hearing and obliges applicants to pay to their creditors a monthly instalment equivalent to the excess of their income over

their reasonable living expenses. Specialised judges were hired in 2016 as a measure to reduce bottlenecks, especially in the provinces where problems persist.

3. Blanket moratorium on auctions of household residential property until end-2014.

Under the previous Household Insolvency Regime, almost all residential property was fully protected from collateral realisation. Moreover, in addition to the Household Insolvency Regime, a temporary blanket moratorium prevented the auctioning of the primary residence of any debtor fulfilling certain criteria, even if they were not eligible to apply under the Household Insolvency Regime. In January 2015 the auction moratorium expired and since then primary residences may be protected from auction only under the Household Insolvency Regime or the Civil Procedure Code. Following the amendments introduced to the Household Insolvency Regime in August and November 2015, a new temporary protection scheme applies to the primary residence of mortgage borrowers under strict eligibility criteria based on income, residence value, the cooperativeness of the borrower and a liquidation test. Vulnerable households failing the liquidation test may be granted protection, provided that their monthly instalments are topped up by the State.

4. and 5. Limited coordination among banks and between banks and the public authorities.

NPL levels are affected by deficient coordination between banks. Some improvements have been made recently such as the introduction of regular meetings of the four Greek significant institutions (SIs) to discuss individual cases of common borrowers and enter into protocols for syndicated loans, but more progress is needed to arrive at common restructuring solutions. The same applies for the limited coordination observed between banks and public authorities, for customers with arrears both to banks and to the public sector. In July 2016 the HFSF conducted a study outlining a coordination mechanism (e.g. secretarial support, interaction between banks, etc.) and priority sectors (depending on the economic value added, share of NPL, common exposure, etc.). The study has been communicated to banks. An additional study with a focus on borrowers with arrears above €1 million is ongoing. In the meantime, in January 2017, the Hellenic Bank Association set-up a Coordination Committee for NPL Management, as well as a Forum for NPL Management, in order to coordinate the treatment of large corporates.

6. Virtually inexistent market for NPLs. Until end-2015 the servicing of NPLs was restricted to banks and factoring companies, and other non-bank entities were not allowed to service NPLs. A first round of legislation was adopted in the second half of 2015 and was further amended in 2016, allowing the operation of credit-servicing firms, to which banks can outsource the servicing of troubled assets, and the operation of AMCs (credit-acquiring companies), to which banks can sell such assets. The BoG has issued Executive Committee Act (ECA) 82 and 95/2016 regarding the secondary legislation that specifies the licensing procedure and other issues to operationalise the new framework. The BoG approved the first license for a non-bank NPL servicer in December 2016, followed by a second license in March 2017, while a number of applications are currently under review. The recently passed Laws No 4389/2016 and No 4393/2016 allow the sale of all kinds of NPLs as well as performing loans. The new measures adopted are expected to gradually create a functional market for NPLs.

7. and 8. The tax regime and the large volume of arrears to the public sector give little incentive to banks to proceed with restructuring. No tax deductions are foreseen for specific workout measures or collateral sales, and an illustrative example is that a consensual potential write-off was considered taxable income. By July 2016, a full tax exemption of loan write-offs for borrowers (both households and NFCs) had been implemented. Moreover, the BoG performed a review of the tax treatment for banks and creditors in 2016 and delivered its proposals to the government. Regarding arrears to the public sector, the super-seniority of public claims vis-à-vis secured creditors has been significantly reduced via the amendments to the Civil Procedure Code. That said, the high volume of such claims poses a significant challenge to the restructuring of viable firms. Against this backdrop, the out-of-court workout framework, which is a milestone for the second programme review, envisages a balanced approach towards the restructuring and, in certain cases, the haircut of both private and public arrears.

9. Inefficient Corporate Insolvency Law. In broad terms, the corporate insolvency framework is not in line with the European Commission Communication of 2012 on insolvency. Existing in-court procedures that could encourage viable distressed debtors to restructure their debt at an early stage through an efficient process or facilitate a smooth liquidation of non-viable distressed corporates are not fully functional. Partial debt-servicing schemes are not tailored to the debtor, processes for clearance of arrears to the public sector are lengthy, and “pre-pack” procedures are inefficient and therefore rarely used. As part of the Greek programme, amendments to the Corporate Insolvency Law aim at accelerating pre-court proceedings, notably through the alignment of the ranking of creditors in insolvency with the revised Civil Procedure Code, the reduction of the discharge period from ten to three years, the streamlining of the preventive restructuring procedure and the establishment of a regulated profession of insolvency administrators. Further amendments are expected following the completion of the ongoing comprehensive review of the corporate insolvency framework.

In terms of **specific supervisory practices for addressing NPLs**, the Greek supervisory framework addresses the following:

Guidance on NPL management strategy and procedures: based on Executive Committee Act 42/2014, banks are required to design and implement an NPL management strategy, by setting up a dedicated NPL management unit and suitable governance structures, implementing a detailed reporting and monitoring framework for NPLs and having in place a comprehensive toolkit of forbearance measures. Within this supervisory framework, three main practices are highlighted:

1. **Portfolio classification guidelines:** the BoG requires banks to segment each portfolio based on consistent and clear criteria, such as the purpose of loan, currency, amount of exposure, etc., but also based on vintage buckets and default risk.
2. **Monitoring and reporting framework:** the reporting framework goes beyond the EBA guidelines. Additional reporting schemes (as amended by ECA 47/2015 and 102/2016) are required with regard to portfolio segmentation,

collateral, legal workout activities, NPL flows, forbearance measures, sectoral analysis of business loans and the performance of modification measures and closure actions.

3. **Forbearance options:** the BoG went beyond the EBA guidelines on forbearance measures in an attempt to standardise a non-exhaustive list of commonly used closure and modification options.

Guideline on the loan workout process: within the same context, the BoG introduced a Code of Conduct that requires banks to define an Arrears Resolution Process based on five broad steps: (i) communication with the debtor; (ii) information-gathering; (iii) the financial assessment of the debtor; (iv) the proposal of resolution solutions; and (v) an objection-handling process. In 2016, BoG revised the Code of Conduct to improve its operational effectiveness and encompass additional guidelines for specific groups of borrowers (e.g. common borrowers).

Operational targets for NPL management: in the course of 2016 the BoG, in cooperation with ECB Banking Supervision, asked the Greek significant banks and high-priority LSIs to set operational targets for NPL management. The BoG identified nine NPL operational targets and asked banks to submit their proposals for the target values. In June 2016, the BoG, ECB Banking Supervision and the banks agreed specific targets for the period from the second half of 2016 until 2019. The NPL operational targets will be monitored on a quarterly basis and will be supplemented by monitoring indicators. To this end, the Bank of Greece enhanced the prudential reporting framework regarding NPLs to encompass the full set of NPL operational targets and key performance indicators, as well as vintage and NPV analysis. The BoG will also be publishing a report regarding the implementation of operational targets and potential deviations on a quarterly basis. Furthermore, the banks submitted updated NPL strategy plans in 2016, with specific action plans and timetables. The project is part of the obligations of the Greek State under the third MoU and aims at ensuring that banks actively manage their NPL portfolios through workout and closure actions. Moreover, the BoG has included a specific operational target for NPLs with common borrowers: "Value of SME and corporate NPLs with an exposure in multiple banks (i.e. common borrowers) for which a common restructuring solution has been implemented".

Targeted on-site inspections for the purpose of monitoring compliance with and preparedness in line with the supervisory framework for NPL

management: the BoG has conducted several on-site inspections at the Greek banks, especially the SIs, at first to monitor the progress of implementation of the supervisory framework, and then to monitor the preparedness of banks in relation to the framework.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 28

Main sources of NPL-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Executive Committee Act (ECA) (binding)	42/2014	All credit institutions	Management of NPLs	Supervisory framework for the management of loans in arrears and NPLs, addressing governance issues, portfolio segmentation, modification and resolution options, borrower assessment and loan modification effectiveness at credit institutions; establishes an elaborate NPL monitoring and reporting framework	2014
ECA (binding)	47/2015	All credit institutions	Management of NPLs	Introduces changes to ECA 42/2014 in terms of the reporting templates (e.g. detailed breakdown by asset classes and economic sectors for business loans, analysis of legal workout activities, enhanced information by type of forbearance measures).	2015
ECA (binding)	102/2016	All credit institutions	Management of NPLs	Introduces further changes to ECA 47/2015 in terms of the reporting templates to incorporate NPLs, operational targets framework coupled with key performance indicators	2016
Code of Conduct on NPL Management (binding)	195// 29.7.2016	All credit institutions	Supervisory framework	General principles of conduct and best practices regarding the interaction of credit institutions with borrowers in arrears, with a view to enhancing the climate of confidence and the information exchange between the two parties, with the ultimate goal of working out the most appropriate solution for loans in arrears for which the loan agreement has not been terminated; introduces an Arrears Resolution Procedure (ARP), broadly based on information requirements, the concept of the cooperating borrower, financial assessment criteria, forbearance proposals and an objection-handling process; lays down the communication policies and organisational structures that credit institutions must have in place in order to properly govern the ARP	2/8/2016

The NCA has not provided any guidance defining specific limits on household or NFC portfolios (e.g. max. LTV, max. maturity).

A.2 NPL recognition and classification

For regulatory reporting purposes, Greek banks are legally required to comply with the EBA ITS regarding the definition/classification of NPEs, and the BoG has not issued additional criteria beyond the EBA ITS or criteria supplementary to the EBA ITS conditions for the declassification of loans from non-performing status. The BoG has issued further guidance on the segmentation of NPLs into the following sub-categories: (i) loans in pre-arrears; (ii) loans in early arrears (1-89 dpd); (iii) NPLs; and (iv) “denounced” loans (i.e. NPLs to non-cooperative or non-viable debtors). Furthermore, the BoG has developed additional guidance for forborne exposures⁹⁰, which standardises a non-exhaustive list of commonly used forbearance and closure measures in order to ensure transparency, harmonisation and comparability of those measures, and the efficient monitoring of their performance. The modifications are

⁹⁰ ECA 47/2015 and ECA 102/2016.

broadly distinguished as short-term and long-term ones. There is also a non-exhaustive list of resolution or closure solutions.

A.3 NPL measurement and provisioning

With the adoption of the IFRS by the Greek cooperative banks in early 2015, all Greek institutions apply the IFRS. The BoG has not issued additional specific guidelines on what constitutes a *loss event* or defined a set of impairment triggers. The BoG has indicated that there are no guidelines in place for prudential provisioning. There is currently no regulation concerning specific provisioning for NPLs, which would, inter alia, entail the recovery time estimation or the haircuts to be applied by type of collateral.

A.4 NPL write-offs

Law No 3869/2010 provides a framework for the protection of over-indebted personal borrowers and potential (partial) contractual write-off only after a court decision; the court also decides on the payment plan. A write-off only occurs at the end of the payment plan and only if the borrower has honoured it. A more favourable tax treatment was introduced in 2016 (Law 4389/2016) as a contractual write-off is no longer considered as taxable income for the borrower (natural person or legal entity).

A.5 Collateral valuation

Collateral-related issues represent an obstacle to private debt resolution mainly owing to the legal framework, since collateral is largely unenforceable in Greece, due to moratoria and court backlogs for collateral not subject to moratoria (see Section B). However, the measures adopted during the second half of 2015 under the MoU (see Executive summary) are expected to address this issue.

Pursuant to the supervisory framework for the management of NPLs⁹¹, all credit institutions are required to have in place documented methodologies for the valuation and revaluation of collateral for the purpose of assessing viable forbearance measures. Although a register of certified appraisers is maintained by the Ministry of Finance, the BoG does not oblige the banks to request collateral valuation services from certified appraisers, except, for instance, in cases of distressed households that file for bankruptcy (under Law No 3869/2010) and do not agree with the collateral (re)valuation by the bank. For high-value collateral (usually related to large debtors), a physical on-site appraisal is undertaken when negotiating/proposing modifications (often restructuring). In any case, the requirement for collateral revaluation does not depend on the loan's classification as

⁹¹ ECA 42/2014, ECA 47/2015 and ECA 102/2016.

non-performing. However, RE revaluations are common business practice among banks. Furthermore, there is no requirement to apply an RE valuation standard.

The frequency of collateral valuation is in line with the CRR requirements⁹²: the majority of the collateral backing the loan portfolios of the banks is RE (residential and commercial), the value of which the banks typically monitor once a year through physical or desktop valuations. Other types of collateral are revalued more frequently.

In the context of the NPL reporting framework (ECA 42/2014, as amended by ECA 47/2015 and ECA 102/2016), banks report all the changes in collateral values on a quarterly basis. Auctions are the main disposal channel used by the banks for foreclosed assets. Pursuant to Law No 4335/2015 (revision of the Civil Procedure Code), as of 1 July 2015 the banks will be able to set the starting auction price at the market value of the foreclosed assets. Before the entry into force of the Law, the first auction price is set at the so-called objective value of the property (as determined for taxation purposes). Nevertheless, banks rarely proceed to auctions since they are too costly and time-consuming. Therefore, they do not have large portfolios of owned real estate.

A.6 NPL governance/workout

The BoG commissioned a global consulting firm in July 2013 to carry out a troubled asset review (TAR) focusing on the NPLs and modified loans of the four major Greek banks, aimed at assessing their operational readiness, established frameworks, policies, procedures and practices to deal with the large-scale resolution of troubled assets, resource capacity and staffing, credit policies and guidelines, resolution strategies and execution ability, as well as reporting and quality assurance. The TAR was part of a broader diagnostic study conducted by the consulting firm at the time. The key findings of the TAR, along with technical assistance received from the IMF and supervisory authorities in countries facing similar issues, informed the development of an enhanced supervisory framework for NPL management in 2014 (ECA 42/2014). The supervisory framework requires all banks to define a NPL management strategy, which consists of:

1. a well-defined governance structure with internal NPL workout units and an independent, well-staffed and qualified body for the centralised monitoring of the unit; both the unit and its monitoring body must be independent of other related functions, such as lending or risk management (however, they are required to closely cooperate with the latter);
2. an enhanced monitoring and reporting framework (see the section on supervisory reporting);

⁹² Article 208(3).

3. guidelines for portfolio segmentation, for borrower assessment and for loan modification effectiveness – each portfolio and sub-portfolio should be segmented based on consistent and clear criteria, such as loan purpose, currency, amount of exposure, etc., but also vintage buckets and default risk;
4. a standardised list of forbearance options: credit institutions are required to develop and implement a suitable framework of forbearance options for NPLs, with a view to offering them to cooperative and viable debtors; banks are required to develop concrete methodologies to assess the debtor's repayment capacity and to value and revalue their collateral, as well as to define available modifications for each sub-portfolio and monitor its evolution.

In the course of 2016 the BoG, in cooperation with ECB Banking Supervision, asked the Greek significant banks to set operational targets for NPL management. The same set of NPL operational targets will also apply for the high-priority LSIs. For the remaining LSIs, a smaller set of targets is requested. The BoG has identified nine NPL operational targets and requested banks to submit their proposals for the target values and in 2016 has already agreed specific values for the period from the second half of 2016 until 2019. The NPL operational targets will be monitored on a quarterly basis and will be supplemented by monitoring indicators. The banks also submitted updated NPL strategy plans in 2016, explaining how they envisage meeting their operational targets with specific action plans and timetables. The project is part of the obligations of the Greek State under the third MoU and aims at ensuring that banks actively manage their NPL portfolios through workout and closure actions.

In the NPL monitoring of individual debtor cases, there is no formal mechanism for interbank coordination or coordination between private and public creditors. In July 2016 the HFSF conducted a study outlining a coordination mechanism between banks for their common borrowers and identifying priority sectors. The outcome of the study has been communicated to banks. In January 2017 the Hellenic Bank Association set-up a Coordination Committee for NPL Management, as well as a Forum for NPL Management. Both structures seek to facilitate coordination among banks regarding the treatment of large corporate common borrowers. An additional study focusing on borrowers with arrears above €1 million is ongoing. Moreover, the BoG has included a specific NPL operational target for common borrowers: "Value of SME and corporate NPLs with an exposure in multiple banks (i.e. common borrowers) for which a common restructuring solution has been implemented".

A.7 Supervisory reporting

Credit institutions in Greece provide the required COREP/FINREP reporting templates, which contain information relating to the EBA ITS requirements on forbearance and NPEs, on a quarterly basis. In addition, pursuant to ECA 42/2014 (prior to the implementation of the EBA guidelines) as amended by ECA 47/2015 and ECA 102/2016, the BoG requires all credit institutions to report data on portfolio segmentation, collateral, legal workout activities, NPL flows, forbearance measures,

sectoral analysis of business loans and the implementation of modification measures and closure actions.

In order to quality-assure the banks' NPL reporting, the BoG conducts on-site inspections to ensure the compliance and consistency of reported data, and the Financial Data Analysis Section of the BoG's Banking Supervision Department regularly monitors the data.

The NCA publishes aggregate monthly data on write-offs, whereas NPLs and other related statistics are not published.

A.8 On-site and off-site supervisory practices and methodologies

Greek banks were subject to granular asset quality reviews (AQRs) and thematic reviews on NPL management between 2011 and 2015. A global consulting firm conducted two diagnostic studies of the loan portfolios in 2011 and 2013 (the latter included a TAR) and an NPL resolution toolkit study in the second half of 2015.

The supervisory framework on workout practices is a cornerstone of NPL management. The BoG thus requests a broad set of information to monitor banks' compliance with the framework, with the involvement of the Risk Management Unit being a prerequisite. The following information is collected from banks: (i) documentation on the NPL management strategy; (ii) reports of the management bodies of the workout units to the board of directors; (iii) internal audit reports on compliance with the supervisory framework; and (iv) upon the BoG's request, data on the implementation of ECA 42/2014 and the achievement of its objectives (e.g. number of modifications, re-default rates, number of performing modifications). The BoG assesses these policies and procedures taking into account the organisational and operational features of each credit institution, as well as the size and structure of its portfolio. In addition, the BoG monitors compliance with the supervisory framework and the appropriateness of loan classifications (according to performance status) through targeted on-site inspections. During 2014 and 2015 detailed and lengthy on-site inspections were conducted in some banks in order to monitor the implementation of ECA 42/2014, the execution of banks' NPL strategy plans and their level of preparedness for implementing the Code of Conduct.

The Greek banks (especially the SIs and some LSIs) have undergone two diagnostic studies of their loan portfolios conducted by a consulting firm (for all commercial banks), as well as two AQRs in the recent years, after which additional provisioning was recognised on their financial statements.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

Greek banks have not used NPL disposal mechanisms such as portfolio sales or transfers to private/public AMCs or other non-credit institutions between 2012 and 2014 mainly due to legal impediments, which result in a limited market for distressed debt.

The legal framework in Greece for the management of problematic portfolios has undergone a series of reforms required by the MoU. Up until 2015 and the introduction of the third MoU, the servicing of loans was restricted only to banks, including foreign ones, and factoring companies, whereas non-bank entities (other than factoring companies) were not allowed to service NPLs. Within this context, Greek banks could sell “denounced” loans to other banks or to other investors, as long as the servicing was undertaken by a bank or a factoring company.

Under the third MoU, primary legislation was introduced with the Law 4354/2015 allowing the operation of credit-servicing firms and of AMCs (credit-acquiring firms). The BoG issued Executive Committee Act 82/2016 in March as the secondary legislation that specifies the licensing procedure and other issues to operationalise the new framework. The scope of servicing solutions encompasses all NPLs. Any changes in the terms of loan servicing can be implemented without the consent of the borrower and must be communicated to them within one year of the change. For the sale of loans, the banks are required to inform the borrower, which in turn opens a window for negotiating the terms of the loan between the bank and the borrower. If the negotiations are not successful, a sale takes place. Until recently, the new framework only allowed for the sale of two specific asset classes (large NFC NPLs and mortgages on non-primary residences). In fact, after the completion of the first review of the programme by the European Commission/ECB/ESM/IMF in June 2016, with Law 4389/2016 the sale of loans has been allowed for all asset classes, with a temporary derogation (until end-2017) for loans backed by primary residences with an objective value below €140,000.

B.2 Debt enforcement/foreclosure

The BoG has indicated that there is no legal framework for rapid out-of-court collateral enforcement. Collateral enforcement and foreclosure measures in broader terms were generally unfavourable in Greece, mainly because of the super-seniority of State claims (tax, social security, etc.) compared with all other creditors' claims in in-court proceedings. Therefore, banks had little incentive to proceed with collateral enforcement and liquidation. As part of the August 2015 MoU obligations, Law No 4335/2015⁹³ was adopted, significantly reducing the seniority of public claims. In

⁹³ Amendment to the Greek Civil Procedure Code.

particular, under the new Law, at least 65% of the proceeds from collateral liquidation are paid to secured creditors.

Further reforms have been introduced by the aforementioned law in order to tackle the issue of the lengthy foreclosure and collateral enforcement procedures. The average length of a foreclosure procedure is 18 months, or even longer for full execution. These reforms refer mainly to the reduction of impediments to enforcement actions, limiting the number of appeals against court decisions and setting shorter deadlines for the completion of the whole process.

B.3 Corporate insolvency and restructuring

Deficiencies in the corporate insolvency and restructuring regime have hindered private debt resolution. Obstacles in the corporate insolvency regime included the absence of legal provisions that could restrict shareholder decisions or could allow a change in management as a means of business restructuring. Additionally, company assets could not be sold in auctions within the context of forced out-of-court debt restructuring. Furthermore, existing procedures intended to facilitate corporate debt restructuring are not fully functional: partial debt servicing is available through broad instalment schemes, but not necessarily tailored to the debtor, whereas processes for clearance of arrears to the public sector, although available and linked to business restructuring, are deemed poor and dysfunctional. Moreover, out-of-court settlement mechanisms are almost completely absent. Only in 2014 was a temporary out-of-court law introduced, which, however, has not been applied in practice because of the elevated economic and political uncertainty during 2015, as well as the lack of incentives for out-of-court settlements. Overall, the out-of-court workout process appears to be lengthy, especially for syndicated loans and common borrowers. Nevertheless, it is expected to be amended within the context of the third MoU. Overall, deficiencies in the regime are also reflected in the high percentage of cases being blocked by debtor protection laws (78%).

“Pre-pack” procedures for the fast approval of restructuring plans are virtually inexistent; although introduced in 2011, they are rarely used, with an average of 20 cases per year.

Public sector claims used to have seniority over private sector ones. However, this changed with the amendment of the national legal framework under the Greek programme in August 2015 (see the section above on debt enforcement/foreclosure). The low effectiveness of the corporate insolvency regime is also highlighted by the lengthy proceedings: 18 months for rehabilitation and more than 10 years for liquidation.

Nevertheless, the recent amendments to the Corporate Insolvency Law under the Greek programme (last amendment by Law 4446/2016) aim at accelerating the pre-court proceedings, notably through the alignment of the ranking of creditors in insolvency with the revised Civil Procedure Code, the reduction of the discharge period from ten to three years, the streamlining of the preventive restructuring procedure and the establishment of a regulated profession of insolvency

administrators. The effectiveness of this recent reform is yet to be tested due to its very recent implementation.

B.4 Household insolvency and restructuring

The household insolvency and restructuring regime represents a major obstacle to private debt resolution. First, there is no actual out-of-court settlement mechanism for households. Second, the bankruptcy regime for consumers and households under Law No 3869/2010 was not considered a credible threat, and it did not apply to individual entrepreneurs, but only to micro merchants. Furthermore, the low coverage of household NPLs by a personal bankruptcy regime (28.6%) and the excessively long court backlogs (over ten years) exemplified the limitations of the regime. Nevertheless, the MoU agreed in August 2015 introduced changes in the national legal framework that aimed to remove such impediments to private debt resolution. In particular, the previous bankruptcy regime of Law No 3869/2010 allowed borrowers with no legal entity and with collateralised loans to file for bankruptcy even with insufficient documentation, while possibly also being ineligible, enabling them to take advantage of the lengthy court backlogs and the de facto unlimited stay on the enforcement of the Law. The amendment of the latter under Law No 4336/2015 introduced stricter eligibility rules, under which households and individuals are required to provide full documentation prior to the hearing in order to be considered eligible. This measure is expected to address strategic defaults, which were estimated to be as high as 30% of the cases applying for bankruptcy under the previous regime.

Furthermore, the blanket moratorium on auctions of all types of residential property (primary, secondary, etc.) used as collateral by households expired on 1 January 2015. Under the new framework, which applies from 1 January 2016 onwards, only the primary residence can be fully protected, and only for households meeting strict eligibility criteria based on income, residence value and a liquidation test. Partial protection for the primary residence is also offered against more lax income thresholds and larger residence values. In addition, protection applies only to cooperative borrowers, who provide updated financial information and contact details upon request. A liquidation test is also applied to all debtors under the primary residence protection scheme. Based on this, households are assessed on whether they can meet the repayment plan previously determined by the court. The liquidation test aims at providing a social safety net to distressed households and their primary residence.

The protection scheme seems to have narrowed its scope of application, protecting only vulnerable borrowers that meet certain eligibility criteria. In addition, the BoG, in its regulatory capacity, issued Executive Committee Act 54/2015, laying down the details and procedures for determining the maximum repayment capacity of the borrower and the collateral liquidation value. Within this context, the BoG has indicated that long-term modifications are expected to increase.

B.5 Judicial system

Deficiencies in the judicial system, combined with the recent sharp increase of bankruptcy filings in the country⁹⁴, pose significant challenges in terms of private debt resolution. Examples are the limited number of specialised judges dealing exclusively with insolvency issues, the fact that insolvency administrators do not require a professional certification, and the fact that the time requirements for insolvency processes are rarely observed in practice. Nevertheless, in the light of the amendment of the Household Insolvency Law earlier in 2015, the Greek State has taken significant steps towards improving the efficiency of its judicial system: in 2016, 190 new judges specialised in insolvency issues have been hired, especially in the provinces with the largest backlogs.

B.6 Tax regime

The tax regime used to be a significant impediment to private debt resolution in Greece. In particular, there were no tax deductions for specific resolution measures. An illustrative example is the consensual write-offs under the corporate out-of-court settlement mechanism as stipulated by Law No 4307/2014, which were considered taxable income. This treatment was, in turn, a disincentive for the banks to proceed with such restructurings. As a result of legislative amendments in 2016, consensual write-offs are no longer taxable on the borrower side. Regarding arrears to the public sector, write-offs are generally not foreseen, unless the debtor challenges the tax authority in – still lengthy – legal procedures. The virtually inexistent possibility of a public debt write-off (principal), along with the large volume of arrears to the public sector, discourages banks from actively looking for viable modifications for debtors with coexisting large public and private arrears. Nonetheless, the out-of-court workout settlement mechanism, which is one of the milestones of the second programme review, envisages a balanced approach to the restructuring, and in certain cases, haircut of both private and public arrears. Notwithstanding the impediments identified, there is an average tax deduction of 1% of the banks' loan book for LLPs⁹⁵, and a tax loss carry-forward mechanism (deferred tax assets – DTAs) according to IFRS standards. However, Greek banks are not allowed to accumulate more deferred tax credits (DTCs)⁹⁶ in excess of their level in the second quarter of 2015.

Amendments to Articles 27 and 27A of tax Law No 4172/2013 on DTAs arising from temporary differences and DTCs were introduced by the Ministry of Finance on March 2017. These amendments aim at a substantial reduction of existing tax disincentives and resolving the high stock of accumulated NPLs. More specifically, the tax Law was revised to ensure that, in the event of NPL write-offs, loan

⁹⁴ Between 2011 and 2013 company bankruptcy filings increased almost eightfold, from 418 to 3,076 cases.

⁹⁵ The BoG estimates that the Greek significant banks have provisioned 3-4% of their (gross) loan book on average in recent years.

⁹⁶ State-guaranteed DTAs.

forgiveness or sales, the stock of DTAs and DTCs could be gradually amortised or utilised through the prescribed amortisation over 20 years. This would help Greek banks to avoid reductions of their own funds while implementing the NPL resolution targets agreed in 2016, while they can use their stock of DTAs/ DTCs to offset taxation.

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

There is no CCR operating in Greece in the broader sense of a credit register operated centrally by the NCB with mandatory submission of harmonised data. There is a private credit registry that specialises in the collection and supply of credit profile data on corporate entities and individuals and in the operation of a risk-consolidated system for consumer credit. However, submission of data is not compulsory.

Land registers in Greece are considered highly problematic, as they are not centralised and they do not cover the entire country. Some other public asset registers are centralised but only cover some parts of the country. However, they do not identify the owner or the asset's characteristics and they are not available for public searches. Public registers of RE transactions do not exist either, and public access to information on upcoming sales or auctions is only theoretically possible.

C.2 Debt counselling and outreach

Debt counselling services are almost inexistent in Greece. Some limited personal budgeting services are provided only by voluntary groups, whereas free or subsidised legal advice services to indebted households are inexistent. Furthermore, there is no institution to provide credit management training and advice to SMEs. However, the Greek State is reportedly designing a debt counselling scheme for distressed borrowers, with offices across the country expected to open in 2016.

C.3 Consumer and data protection

The protection of personal information for debt workout purposes does not go beyond what is stipulated in EU rules.

Annex IX: Ireland

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake, applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Chart 9

Country overview

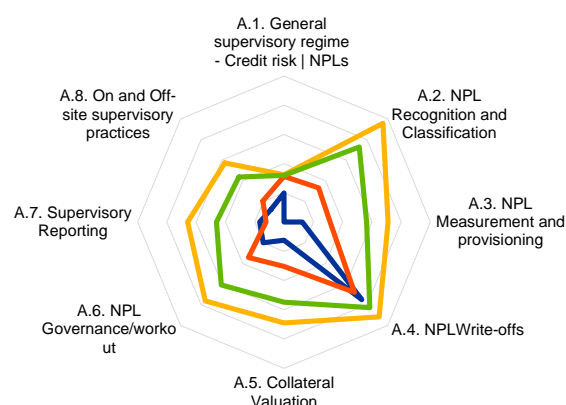
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

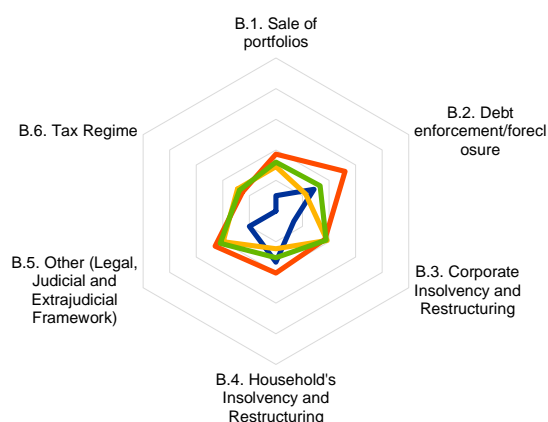
- IE
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



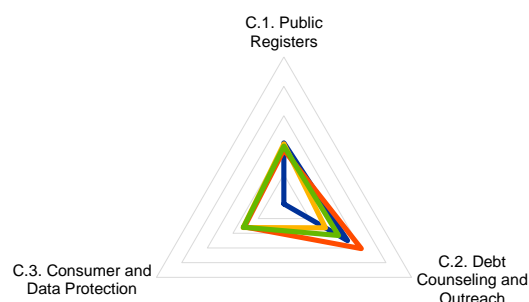
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



The domestic banking sector in Ireland is dominated by five institutions (AIB, Bank of Ireland, Permanent TSB, Ulster Bank and KBC Bank Ireland). In December 2016

Ireland had a total NPL ratio of 17.9% (of which by segment: households 17.5%; NFCs 21.9%, SMEs 27.8% and CRE 29.7%).⁹⁷

To tackle the issue of high NPL levels across the banking sector, Ireland has carried out a series of comprehensive specific actions including: (i) a number of recapitalisation and provisioning initiatives/reviews such as the 2011 Financial Measures Programme, the 2013 Balance Sheet Assessment, the 2014 comprehensive assessment and the 2015 CBI Impairment Provisioning Review; (ii) Distressed Credit Operations Reviews of banks; (iii) public Mortgage Arrears Resolution Targets and non-public SME targets; and (iv) the publication of banking guidelines and frameworks on provisioning, collateral valuation, governance and sustainable mortgage arrears solutions.

A particular focus was placed on supervisory activities, especially on-site inspections, in order to assess banks' practices and issue recommendations to drive NPL workout strategies.

Since the start of the crisis, Ireland has taken comprehensive actions to address the NPL issue. Nevertheless, some issues still remain and based on the potential obstacles identified in the ECB survey, the **main challenges to NPL workout in Ireland** are:

- **The scale of NPLs and the time lag to resolve them:** despite the transfer of €74 billion of NPLs (nominal value) to the National Asset Management Agency (NAMA) in the period 2009-12 and a further €46 billion reduction in NPLs in the three-year period from year-end 2013 to year-end 2016, the scale of the issue in Ireland remains large, with over €38 billion of NPLs as at year-end 2016. In addition, there can be a significant lag between a sustainable solution being agreed with a distressed borrower and an NPL reduction (due to a number of factors including for example probation periods); this increases the length of time it takes to reduce NPL levels.
- **Potential deterioration in macroeconomic factors:** a number of macroeconomic factors are currently conducive to NPL resolution (such as improving employment trends and the low interest rate environment). However, a potential future deterioration in macroeconomic conditions, for example rising interest rates and "Brexit"-related economic headwinds, may pose a significant risk to the sustainability of continued NPL reduction especially given the high Irish household indebtedness compared with European peers and an economy which is heavily export reliant.
- **Collateral enforcement:** the high volume of cases moving through the Irish judicial system and the timelines associated with the repossession process primarily for primary dwelling home (PDH) mortgages are key challenges for Irish banks and affect their ability to repossess and sell PDH collateral in an

⁹⁷ Information provided by the NCA; NPL refers to NPE (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers 25% of banks in Ireland or 62% of the total banking assets. Due to a change in definition these figures are not comparable with those figures provided in the ECB Stocktake published in September 2016.

efficient manner.⁹⁸ This is not the case, for example, in CRE as the appointment of Fixed Charge Receivers to take control of defaulted borrowers' assets (receivers have the power to collect rents and/or sell CRE) enables a faster enforcement of collateral.

- **CCR:** an Irish CCR is still under development, with a planned completion date of 2017, which is expected to contribute positively to monitoring credit risk within individual institutions and in the financial system, as well as to private debt resolution.

In terms of **specific supervisory practices for addressing NPLs**, the Central Bank of Ireland (CBI) has developed actions mainly related to guidelines/frameworks and prudential priorities, by intensifying on-site inspections and conducting reviews:

- **Impairment Provisioning and Disclosure Guidelines:** the CBI has issued non-binding best practice guidelines for Covered Institutions⁹⁹ regarding how to recognise and measure incurred loan losses and to improve asset quality, credit risk management and disclosure. Notwithstanding the limited number of addressees of these guidelines, the CBI expects implementation of these guidelines by all credit institutions. These guidelines define: (i) a set of impairment triggers beyond those already established in the accounting standards; (ii) additional risk (sub-)categories; (iii) criteria to be considered in the provisioning calculation under a going-concern approach; and (iv) quantitative (templates) and qualitative information on asset quality and credit risk management to be disclosed by banks.
- **Mortgage/SME Arrears Resolution Targets:** the CBI has issued a framework for setting mortgage and SME arrears resolution targets for certain banks, with the objectives of ensuring the fair treatment of customers and prompting banks to implement sustainable solutions rather than short-term forbearance. Common public Mortgage Arrears Resolution Targets (MART) were set in 2013 and lasted until the fourth quarter of 2014. The Institutions were required to make public disclosure of their performance against these targets and the CBI periodically audited performance against the targets. Additionally, the CBI had considered regulatory action, including the imposition of additional capital requirements in the event that Institutions failed to meet the targets or demonstrated poor resolution strategies or poor execution against their strategies. Additionally, the CBI published internal guidelines on sustainable mortgage arrears solutions to provide guidance to supervisors on the important factors to consider when conducting sustainability assessments. Non-public bank-specific targets were set for the main SME lenders in Ireland in 2013 and were valid until end of 2014. The targets required the banks to move distressed SME borrowers from short-term forbearance to longer-term solutions.

⁹⁸ The ability to resolve the large 720 dpd mortgage NPL cohort is a challenge for Irish banks. As at the fourth quarter of 2016, 32% of Irish mortgage NPLs were in arrears by more than 720 days.

⁹⁹ The term "Covered Institutions" refers to the credit institutions that have received financial support under the Covered Institutions (Financial Support) Act 2008.

- **Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future:** the CBI has issued guidance on standards for valuing commercial property assets, recommended practices with regard to the timing and frequency of such valuations and also outlined the primary weaknesses in credit institutions' valuation processes that arose during the boom in property market lending in Ireland during the mid-2000s.
- **Distressed Credit Operations Review:** in 2012 BlackRock Solutions was commissioned by the CBI to undertake an independent Distressed Credit Operations Review (DCOR) focusing on residential mortgage and SME distressed credit management, to examine and challenge banks' operational capacity to resolve NPLs. The assessment covered the organisational structure and resource capacity, staff skills and experience, workout strategy and execution ability, reporting and monitoring as well as quality assurance and internal controls. The exercise was supported by the review and re-underwriting of a number of loan files.
- **Intensification of on-site inspections/reviews on NPL management:** since 2011, there have been intensive credit on-site inspections with regard to NPL resolution, including operational effectiveness reviews of NPL management units, loan-file deep-dives and system-wide MART audits assessing the sustainability of solutions provided. Additionally, between 2011 and 2014 the Irish retail banks were subject to three AQRs (2011: Prudential Capital Assessment Review as part of the Financial Measures Programme; 2013: Balance Sheet Assessment; 2014: ECB's comprehensive assessment). More recently, a provisioning assessment was conducted in 2015 to ensure that appropriate practices are being maintained by the Irish retail banks in relation to their credit loss provisioning methodology for their domestic mortgage portfolios.
- **Distressed credit strategies:** in the first half of 2015 the SSM (in conjunction with the CBI) wrote to the significant credit institutions in Ireland clearly outlining supervisory expectations in relation to each bank's strategy, management, measurement and reporting of the continued resolution and restructuring of their NPL books. A range of supervisory outcomes were outlined to each institution, including expectations with regard to the sustainable resolution of both retail and commercial NPLs. Banks were requested to submit updated distressed credit strategies and other supporting information identifying how the institution would resolve and reduce NPLs (by portfolio) over the coming years. Furthermore, institutions were required to submit to the CBI enhanced reporting information including revised loan-level and aggregate data.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set out in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 29

Main sources of NPL-related regulation

Type	Scope	Topic	Summary description	Entry into force
Guidelines (non-binding)	All credit institutions and foreign subsidiaries	Risk management, provisioning and reporting	"Regulatory Document – Impairment Provisions for Credit Exposure": from 2005 on, all listed companies had to apply IFRS. Therefore, the financial regulator set guidelines with regard to policies and procedures for credit losses.	2005
Guidance (non-binding)	All credit institutions	Valuation process	"Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future": this provides credit institutions with details of the lessons learned from the banking crisis regarding valuation processes for commercial property. Originally published in 2011 and subsequently revised in 2012.	2011
Guidelines (non-binding)	Covered Institutions	Policies, procedures and disclosures	"Impairment Provisioning and Disclosure Guidelines": guidelines on the development and application of the impairment provisioning framework, together with significantly enhanced disclosures on asset quality and credit risk. Although the guidelines are aimed at Covered Institutions, the CBI interprets material deviations as running counter to best practices. Originally published in 2011 and subsequently revised in 2013.	2011
Framework (binding)	Six banks	Mortgage Arrears Resolution Targets	"Mortgage Arrears Resolution Targets": framework for setting performance targets for mortgage arrears resolution with respect to principal dwelling homes/primary residences and buy-to-let (BTL) mortgages to ensure that banks have an appropriate workout strategy.	2013
NCA Internal Guideline	NCA	Mortgage arrears	"Internal Guideline – Sustainable Mortgage Arrears Solutions": guideline to enable supervisors to assess sustainable mortgage arrears solutions (which were set within the above-mentioned framework). Originally published in 2013 and subsequently revised in 2014.	2013
Macro-prudential regulation (binding)	Financial service providers	Proportional caps on mortgage lending	"Information Note – Restrictions on Residential Mortgage Lending": inter alia limits for LTV and LTI ratios will be implemented by the CBI.	2015

The CBI introduced macroprudential regulations in February 2015, which apply limits on the proportion of mortgage lending at high LTV and LTI ratios by regulated financial service providers in the Irish market. Key objectives of the regulations are to increase the resilience of the banking and household sectors to the property market and to reduce the risk of bank credit and housing price spirals developing in the future. The regulations introduce proportionate limits for LTV and LTI measurements for PDHs and proportionate limits for LTV for BTL mortgages: (i) LTV: limits of between 80% and 90% LTV depending on the categories of buyers and a limit of 70% LTV for BTLs, with these limits being on a proportionate cap basis; (ii) LTI: an LTI limit of 3.5 times gross annual income applies to all new lending for PDH purposes. This limit should be exceeded by no more than 20% of the total aggregate monetary amount of loans for PDH purposes. Mortgages for non-PDH purposes, i.e. BTL mortgages, are exempt from the LTI limit.

A.2 NPL recognition and classification

For regulatory reporting purposes, Irish banks are legally required to comply with the EBA ITS regarding the definition/classification of NPEs. In addition, Irish banks are required by the CBI impairment provisioning guidelines on a non-legally binding basis to adopt impairment provisioning guidelines for loans and financial asset receivables (and held-to-maturity financial assets where applicable) that are subject to impairment review in accordance with the requirements of IAS 39. The CBI impairment provisioning guidelines set out clear criteria for NPL recognition and classification.

The CBI guidelines¹⁰⁰ group exposures into five categories: (i) performing: includes the sub-categories performing without arrears, performing in arrears (1-30 days; 31-60 days; 61-90 days) and renegotiated loans (for borrowers that are not in financial difficulty); (ii) non-performing; (iii) cured: category to reclassify loans that come out from the NPL classification; (iv) foreclosed loans: loans for which there is no likelihood of repayment, resulting in the decision to foreclose; and (v) forbearance.

In terms of forbore exposures, for regulatory reporting purposes the Irish banks are required to follow the criteria defined by the EBA ITS. The CBI's impairment provisioning guidelines also set out that banks should separate loan assets subject to forbearance measures into different pools in order to be able to comment on the sustainability of the forbearance measures over time. They also require that in respect of the forbore loan pools, the PD will increase (as forbore borrowers are more likely to re-default/default), with a lower cure rate, in both performing loan and NPL portfolios. In addition, to ensure that forbearance measures are adequately applied and represent a sustainable solution for the respective borrower, banks are required to document, besides the options offered to the borrowers, also the respective key assumptions. Banks have to monitor and back-test borrowers' performance in relation to a forbearance measure.

A.3 NPL measurement and provisioning

Irish banks follow the IAS/IFRS accounting standards. In addition, the CBI has issued specific guidelines¹⁰¹ on the factors that should be taken into consideration when assessing whether a loss event occurs (e.g. debt-service capacity, financial performance, net worth and future prospects) and provided a non-exhaustive list of *impairment triggers* such as macroeconomic triggers and portfolio-specific triggers (for mortgage, CRE and SME portfolios); the CBI also considers an impairment trigger when a loan is classified as an NPL. The CBI requires banks to use a conservative approach when setting impairment triggers to ensure that a trigger identifies a loss event as early as possible and to disclose their triggers for each loan asset portfolio.

¹⁰⁰ Impairment Provisioning and Disclosure Guidelines (2013), page 14 et seq.

¹⁰¹ Impairment Provisioning and Disclosure Guidelines, page 10 et seq.

For *provisioning criteria*, each bank has a different model compliant with IAS 39. The CBI does not have specific “accounting” powers and the CBI provisioning guidelines have been issued on a non-binding comply or explain basis. These national guidelines aim to promote consistent application of provisioning across the Irish banks. The CBI interprets material deviations as running counter to best practices.

The CBI has issued guidance that sets out a provisioning methodology for both collectively and individually assessed loans, together with significantly enhanced disclosures on asset quality and credit risk. In this context, the CBI set provisioning guidance specific for NPLs¹⁰², indicating the need to review regularly and in a conservative manner the NPL assumptions (regarding collateral values, LTV ratios, workout periods and associated costs) and to back-test key assumptions. The CBI also indicates that the value of the underlying collateral should be reflected in the provisions and the time, costs and difficulties involved in obtaining repayment through collateral should be taken into account.

Considering that Irish banks follow the IAS/IFRS, when a financial asset or group of financial assets has been written down as a result of impairment loss, according to IAS 39 (AG93), banks should recognise interest income using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Nevertheless, banks are required to report to the supervisor both the value of accrued interest and the value of collected interest.

A.4 NPL write-offs

There are no specific national guidelines or rules for NPL write-offs. The CBI provisioning guidelines refer to NPL write-offs, but do not set out requirements or a methodology for this topic. The same guidelines also include a disclosure requirement regarding banks’ write-off policy.

A.5 Collateral valuation

The CBI has issued guidance¹⁰³ on the valuation standards for commercial property assets held as collateral for CRE and SME loans, which contains detailed recommended practices/principles in terms of valuation processes (e.g. instructions for valuers), independence and selection of valuers, frequency/updates of valuations, sensitivity analysis and stress test scenarios for property values, and the development of in-house expertise for property valuation methodologies.

For collateral valuation, banks have to use qualified professional appraisers which are independent from the credit origination (risk-taking) process. For the origination

¹⁰² Impairment Provisioning and Disclosure Guidelines, page 17.

¹⁰³ “Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future”, 2012.

of commercial loans exceeding €50 million, the credit institution should obtain two independent valuations from external appraisers.¹⁰⁴

The aforementioned valuation professionals are self-regulated by associations, like the Society of Chartered Surveyors. Credit institutions are required to ensure that valuation standards comply with international valuation standards and that valuations are carried out in accordance with the standards of the Royal Institution of Chartered Surveyors ("Red Book"), the European Valuation Standards ("Blue Book") or the International Valuation Standards ("White Book"). Moreover, in terms of valuer panels the CBI recommends that, to avoid a concentration of certain valuation entities, credit institutions should also ensure that none of these appraisers is performing more than 33% of all valuations for commercial loans.

The CBI also provides guidance on when credit institutions can use in-house valuers, who must possess the requisite professional qualification, experience and market knowledge to execute a valuation. In-house valuers must be independent from the credit origination (first line) function and should report to the credit risk control (second line) function.

The required frequency for the valuation of immovable property collateral follows CRR¹⁰⁵ requirements (CRE ≤ 12 months; RRE ≤ 3 years).

The following guidance is outlined in respect of collateral valuation for credit monitoring purposes:

1. For gross loan exposures ranging from €1 million to €3 million in-house valuations are acceptable. The collateral value should be monitored on an annual basis using credit institution valuation guidelines with a consistent approach applied across the group. An independent valuation should be obtained if there is an impairment trigger or on migration to impaired risk.
2. For gross loan exposures ranging from >€3 million to €20 million, the collateral value should be monitored on an annual basis using credit institution valuation guidelines with a consistent approach applied across the group. An independent valuation should be obtained every three years in accordance with CRD (Capital Requirements Directive) minimum requirements, with a valuation obtained if there is an impairment trigger or on migration to impaired risk.
3. For gross loan exposures >€20 million, the collateral value should be monitored on an annual basis using credit institution valuation guidelines. An independent valuation should be obtained every three years in accordance with CRD minimum requirements. Independent valuation is required if there is an impairment trigger or on migration to impaired risk by an external valuer on the bank's panel of recognised valuers. For financial collateral, valuations need to be completed on a regular basis, whereby the frequency and type of valuation

¹⁰⁴ "Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future", page 19.

¹⁰⁵ Article 208(3).

should be based on the risk profile of the exposure and its impact on the credit institution's capital position.

CBI guidance¹⁰⁶ on the valuation of RE indicates that for valuations of RRE mortgages, only an external index is an appropriate method for review, provided the index itself is assessed regularly. However, if a significant house mortgage is in difficulty, then a specific valuation should be obtained.

The CBI requires institutions which have received financial support under the Covered Institutions Act 2008 to apply conservative and supportable assumptions for assessing collateral recovery.¹⁰⁷

In Ireland there are no specific requirements for the calculation of risk mitigants linked to collateral for risk management purposes under Pillar 2. However, the CBI has provided incentives to reduce reliance on collateral through conservative assessments of valuation practices.

The CBI has issued specific rules for valuing foreclosed assets after the foreclosure date. Although this rule is aligned with the requirements for immovable property collateral in the CRR (Article 208), it underlines the need for a regular review of the collateral. There are no additional capital requirements in place to reduce the risks of foreclosed assets.

Although statistics are not available, the CBI has stated that credit institutions are using multiple channels to dispose of collateral, including auctions, direct sales, portfolio sales or via third parties.

A.6 NPL governance/workout

Since 2011 the CBI has published a number of different internal and external guidelines relating to NPLs. These guidelines cover inter alia the following topics: assessing sustainable mortgage arrears solutions; impairment provisioning and disclosure for individually and collectively assessed loans; and valuation standards for commercial properties and the attendant implications for provisioning. In addition, the CBI has also published a Code of Conduct on Mortgage Arrears (CCMA) and a Code of Conduct for Business Lending to SMEs.

With regard to the consumer protection for distressed mortgage borrowers, the CCMA provides a strong consumer protection framework to ensure that each borrower who is struggling to keep up mortgage repayments is treated in a timely, transparent and fair manner by lenders. The CCMA applies to all regulated mortgage lenders operating in Ireland when dealing with borrowers facing or in mortgage arrears on their primary residence, including any mortgage lending activities outsourced by these lenders. Furthermore, following the enactment of the Consumer

¹⁰⁶ The guidance is called "Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future".

¹⁰⁷ Impairment Provisioning and Disclosure Guidelines, page 3 et seq.

Protection (Regulation of Credit Servicing Firms) Act 2015, the CCMA applies to credit servicing firms and an addendum to the CCMA was published during 2015 to reflect this fact. Regulated entities are required to comply with this Code by law.¹⁰⁸ The CCMA requires that lenders must have in place a Mortgage Arrears Resolution Process (**MARP**), which sets out the steps lenders must follow when dealing with distressed borrowers: (i) communication with the borrowers; (ii) financial information to be obtained from the borrowers in arrears or in pre-arrears using a standard financial statement for the collection of data; (iii) assessment of the borrower's case; and (iv) resolution. The Code of Conduct also details when a regulated entity may commence legal proceedings for repossession of the borrower's primary residence and also outlines the requirements for classifying a borrower as not cooperating¹⁰⁹.

The Irish banks have dedicated NPL workout units and the outsourcing of NPL management activities is used minimally. A number of loan servicing companies operate in the country and primarily service loans from banks which have exited the Irish market.

Additionally, the CBI has published internal guidelines¹¹⁰, available to the public/banks, which provide guidance to supervisors as to the important factors to consider when assessing if the modifications provided by banks are sustainable solutions for mortgage arrears cases, for example when assessing temporary arrangements, term extensions and arrears capitalisation solutions. A definition of a sustainable solution is also provided and refers not only to an arrangement with a cooperating borrower, but also a personal insolvency arrangement or a repossession of the property if an arrangement could not be reached.

In 2011, the CBI requested Mortgage Arrears Resolution Strategies (**MARS**) from mortgage lenders to ensure banks developed Board-approved strategies to address mortgage arrears. By December 2011, all banks had submitted MARS and the associated implementation plans.

In 2012, BlackRock Solutions was commissioned by the CBI to undertake an independent Distressed Credit Operations Review (DCOR) focusing on SME distressed credit management, to examine and challenge banks' operational capacity to resolve NPLs. A number of deficiencies were identified including: (i) the lack of arrears management experience; (ii) insufficient availability and utilisation of financial information at the borrower level; and (iii) excessive short-term forbearance. To address these issues, the CBI requested comprehensive strategies for dealing with SME borrowers in difficulty as well as the respective implementation plans, which were required to cover the execution of the NPL strategy, the deployment of

¹⁰⁸ For the purpose of the CCMA, "primary residence" means a property which is: (a) the residential property which the borrower occupies as his/her primary residence in Ireland, or (b) a residential property which is the only residential property in Ireland owned by the borrower.

¹⁰⁹ The CCMA requires that prior to classifying a borrower as not cooperating, a regulated entity must send a warning letter to the borrower, outlining the implications of being classified as not cooperating and providing specific information on how to avoid this classification. Where a regulated entity has classified a borrower as not cooperating, it must notify the borrower that he/she is being classified as not cooperating.

¹¹⁰ Internal Guideline – Sustainable Mortgage Arrears Solutions.

loan modification options, borrower engagement, financial analysis and collateral valuations, as well as arrears management teams, IT systems and the collection and utilisation of data. The implementation and effectiveness were monitored via (non-public) bank-specific targets and on- and off-site intensive engagement with the SME lenders throughout the following years. Similar exercises were conducted for the management of distressed mortgage loans.

In 2013, to ensure the fair treatment of consumers, to minimise losses through improved management of arrears cases and to press banks to move from short-term forbearance to longer-term sustainable solutions, the CBI introduced portfolio-specific targets, specifically: (i) *common public Mortgage Arrears Resolution Targets (MART)* – demanding quarterly targets were imposed on the six main mortgage lenders (which accounted for circa 90% of the Irish mortgage market) with respect to their PDH and BTL mortgage portfolios¹¹¹; (ii) *institution-specific non-public SME targets* – bank-specific targets for SME portfolios were set for the main SME lenders aimed at ensuring that banks migrated distressed borrowers from short-term forbearance to longer-term sustainable solutions in line with the institutions' stated NPL strategy.

With regard to MART, the institutions were required to make public disclosures of their performance against the public targets. Furthermore, the CBI periodically audited performance against the targets to assess whether the solutions reported were in fact sustainable.

A.7 Supervisory reporting

Credit institutions in Ireland provide the required COREP/FINREP reporting templates including information relating to the EBA ITS requirements on forbearance and NPEs. In addition, the CBI requires additional regulatory reporting from institutions, including the Quarterly Summary Financial Returns, the Mortgage Arrears and Repossession Returns for PDH and BTL loans and the Quarterly Sustainable Mortgage Resolution Templates. Banks are also required by the Impairment Provisioning and Disclosure Guidelines to disclose forbearance measures and the number of properties in possession and disposed of in their annual accounts. Furthermore, since June 2010, granular data have been collected semi-annually which include loan, borrower and collateral information (circa 250 fields). These are available for both the household and NFC sectors. The CBI also receives bank-specific management information related to NPLs.

For quality assurance of the EBA NPE template within FINREP, the CBI does not have additional automatic rules besides the required validation rules; however supervision teams – on- and off-site – are challenging the reported NPEs and information can be cross-validated by other returns. In particular, on-site inspections

¹¹¹ The targets focused on resolving accounts in arrears by over 90 days and comprised the following components: (i) proposing sustainable solutions to borrowers; (ii) concluding those sustainable solutions; and (iii) subsequent performance of the concluded solutions.

are also assessing the appropriateness of loan classifications. Additionally, the CBI collects NPL data from different sources, which enables a consistency check of the reporting.

Credit risk statistics for residential mortgages are publicly available on the CBI's website, along with charts, statistical bulletins and detailed datasets. These series provide details on arrears and restructurings. Aggregate NPL information is also published in the semi-annual Macro-Financial Reviews. NPE statistics according to the EBA ITS are not published.

A.8 On-site and off-site supervisory practices and methodologies

Between 2011 and 2014 the Irish significant institutions were subject to three granular asset quality reviews (in 2011 for the Prudential Capital Assessment Review, in 2013 for the Balance Sheet Assessment and in 2014 for the ECB's comprehensive assessment). Additionally, the CBI performed: (i) in 2012 a review of banks' NPL management capacity, which resulted in the aforementioned Mortgage Arrears Resolution Targets and in 2013 the establishment of non-public bank-specific targets for the largest institutions to work out SME NPL portfolios; and (ii) in 2013 and 2014 individual on-site inspections of the operational capacity of the significant institutions' SME workout divisions and of their mortgage operations units (arrears support units, legal divisions, credit units).

The CBI undertook a number of inspections of the sustainability of a sample of the solutions reported by the retail credit institutions as part of the MART. Three such audits took place (two in 2013 and one in 2014) across all retail banks. These audits facilitated testing and challenging by the CBI of the quality and durability of institutions' mortgage restructurings and legal/voluntary disposal cases. The CBI also undertook on-site inspections of five institutions' BTL mortgage workout, including a review of a sample of individual credit files to test the quality of the restructuring/legal progress.

In the first half of 2015 ECB Banking Supervision (in conjunction with the CBI) wrote to the significant credit institutions in Ireland clearly outlining the supervisory expectations in relation to each bank's strategy, management, measurement and reporting of the continued resolution and restructuring of their NPL books. A range of supervisory outcomes were outlined to each institution, including expectations with regard to the sustainable resolution of both retail and commercial NPLs. Banks were requested to submit updated distressed credit strategies and other supporting information identifying how the institution would resolve and reduce NPLs (by portfolio) over the coming years. Furthermore, institutions were required to submit to the CBI enhanced reporting information including revised loan-level and aggregate data. Furthermore, a provisioning assessment was conducted in 2015 to ensure that appropriate practices were being followed and maintained by the Irish retail banks in relation to their credit loss provisioning methodology with regard to the banks' domestic mortgage portfolios.

Drawing on the Distressed Credit Operations Reviews, the CBI has assessed the policies and procedures used by banks to handle NPLs, focusing on banks' SME and mortgage arrears management operations. To assess the respective policies and procedures used by banks to handle NPLs, institution-specific factors were taken into account. Furthermore, banks' respective policies and procedures are regularly challenged as part of the ongoing supervision.

The on-site inspection team focuses on a range of credit risk areas including inter alia: (i) risk classification; (ii) provision adequacy; (iii) collateral valuation; (iv) case strategy adequacy and case management intensity; and (v) the quality of risk underwriting and credit obligor assessment.

In this context, the monitoring of the adequacy of loan classification is verified by the CBI through on-site inspections. Besides these regular on-site inspections, to ensure an adequate loan classification, the CBI published the categorisation of loans (in line with the categories mentioned in the section on NPL recognition and classification) and guidance on macroeconomic and portfolio-specific examples of impairment triggers.

The CBI's ongoing supervision is also responsible for assessing the appropriateness of provisioning levels, including individual credit file reviews and the use of challenger collective provisioning models, to assure adherence to the guidelines. Therefore, banks have to report on a semi-annual basis detailed loan information.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

There are no legal impediments to the sale of assets or loans in Ireland.

During the crisis, Irish banks transferred €74 billion of property-related gross loans to an AMC named the National Asset Management Agency (NAMA), a public asset management company. Although noticeable in size, these sales were rather compulsory and contingency-related.

In recent years (2014-15) there has been a strong investor appetite for NPL sales in Ireland as evidenced by recent sales by a number of banks in the final quarter of 2015.

B.2 Debt enforcement/foreclosure

In 2013 the Irish Government passed the Land and Conveyancing Law Reform Act 2013 to address the uncertainty created by the Dunne Judgement in 2011 (which effectively led to the halting of PDH repossession proceedings through the courts in Ireland). The Irish Circuit Court has jurisdiction for the majority of residential property-related repossession proceedings. There is presently a high volume of cases moving

through the court system (mainly for PDHs) and the end-to-end timelines are often lengthy with multiple adjournments common.

With respect to commercial property and the majority of BTLs, there are legal techniques in place that enable rapid enforcement/foreclosure of collateral, e.g. secured lenders can appoint “Fixed Charge Receivers”¹¹² to take control of defaulted borrowers’ assets (if such rights are established in the loan agreement) by collecting the rent or, if desired, liquidating the property (in this case, although the borrower is no longer in possession of the property, the collateral is not reported as a foreclosed asset by the bank).

B.3 Corporate insolvency and restructuring

There are a number of mechanisms available to companies and creditors under Irish legislation for dealing with insolvent companies, including: (i) Examinership; (ii) Creditors’ Voluntary Liquidation; (iii) Receivership; and (iv) Court Liquidation.

The Examinership process was established in Ireland in 1990 as a pre-insolvency regime and refers to a process whereby the protection of the court is obtained to assist the survival of a company; it is a pre-pack procedure for fast approval of restructuring plans negotiated between the debtor and its creditors before initiation of an insolvency proceeding. This process allows companies to apply to court for a protection period of 70 days, which should assist companies in the restructuring process. An extension to 100 days or even longer can be granted by a court decision, in exceptional circumstances.

A number of voluntary schemes exist to provide various forms of support to SMEs: (i) the Irish Government set up an SME Credit Guarantee Scheme to provide financial support to viable SMEs that cannot access funding or whose sector or business model is considered to be high risk; and (ii) since January 2014 a Protocol on Multi-Banked SME Debt has been in place, which allows an SME in financial difficulty, with multi-banked debt, to communicate with the relevant banks on a collective basis. Between 2013 and 2015, there were 3,578 corporate insolvencies in Ireland, with the vast majority relating to Creditors’ Voluntary Liquidations. In comparison, the number of Examinerships has been limited, at 58.

B.4 Household insolvency and restructuring

The Irish Government passed the Personal Insolvency Act 2012 which provided for the introduction of three types of debt resolution mechanism: the Debt Relief Notice (DRN), the Debt Settlement Arrangement (DSA) and the Personal Insolvency Arrangement (PIA). This legislation also introduced changes to the bankruptcy

¹¹² There are two conditions to be met to appoint a “Fixed Charge Receiver”: (i) although the lender has informed the borrower of the arrears, the borrower has not remedied them within the notice period; and (ii) the power to appoint such a receiver is stipulated in the mortgage itself or arises from the legislation.

regime, including the automatic discharge from bankruptcy, subject to certain conditions, after three years (replacing a 12-year condition). Recent legislation has since reduced this to one year. The Personal Insolvency (Amendment) Act 2015 introduced further changes to the insolvency process, including a strengthening of the powers of the Insolvency Service of Ireland (ISI) and provisions which allow for a debtor to request a review by the court where a PIA was rejected by creditors. Given that the updated personal insolvency legislation was only recently enacted (late 2015), it is too early to make a detailed assessment of the implications for the household debt resolution regime.

In terms of household debt resolution, at end-2016 the number of cases through either a PIA (ISI) or a bankruptcy of consumers/households was limited, at 1,538 cases and 1,511 cases, respectively.

B.5 Judicial system

The high volume of cases and the timelines associated with repossession proceedings for residential property security represents an important challenge for private debt resolution; this primarily relates to PDHs as BTL mortgage contracts generally allow for the appointment of receivers.

B.6 Tax regime

Concerning the tax regime, the current framework is considered not to be an obstacle to private debt resolution given that loan loss provisions (LLPs) are fully tax deductible. Additionally, after the Finance Act 2013 write-offs are treated as the receipt of income only for: (i) borrowers that engage in the trade of dealing in or developing land; and (ii) loans used to purchase land or property, which is held as trading stock.

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

The CCR in Ireland is currently under development and will enter into force not before 2017. The CCR is owned by the CBI but will be operated by CRIF Ireland Ltd. (a private company). The CBI has been collecting granular data from the main supervised institutions since 2010 encompassing loan (approximately 250 fields), borrower and collateral information. A privately owned credit bureau (the Irish Credit Bureau) exists. Nevertheless, the existence of a CCR will positively contribute to monitoring credit risk within individual institutions and in the financial system, as well as to private debt resolution.

RE transactions (for commercial leases and residential property sales) are reported in a fairly comprehensive way. Transaction data on individual asset prices and some characteristics are publicly available. Information on commercial leases is available as well as information on upcoming sales/auctions with a very high updating frequency.

The Public Asset Registry (e.g. for road vehicles, ships, aircraft, plant, heavy equipment and intellectual property) is not publicly available, as it includes information on the owner and the characteristics of the asset.

C.2 Debt counselling and outreach

There are a range of debt counselling and outreach services available in Ireland. For example, the Money Advice and Budgeting Service (MABS) provides information, advice and assistance to household customers facing payment difficulties via a helpline and face-to-face services throughout Ireland. For clients who cannot access the main offices, many of the local companies offer outreach services. Additionally, some MABS services are allowed to provide an approved intermediary service for clients who wish to avail themselves of Debt Relief Notices (one of the three measures under the Personal Insolvency Act). Furthermore, StepChange Debt Charity Ireland provides telephone advice service, offering free and independent help to people struggling with debt problems.

C.3 Consumer and data protection

Although in Ireland there are restrictions on recording/sharing personal information as required by data protection legislation, the overall perception is that protections are proportionate and do not pose an obstacle to private debt resolution.

Annex X: Italy

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Chart 10

Country overview

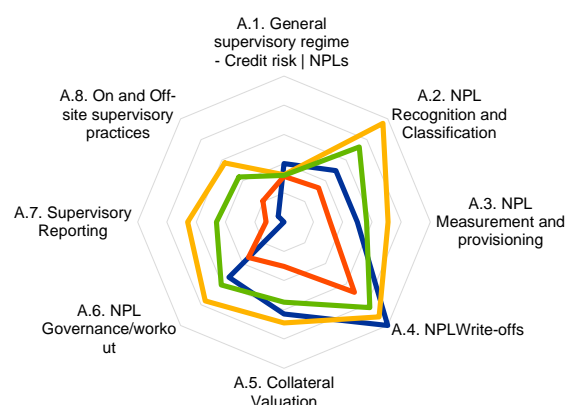
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

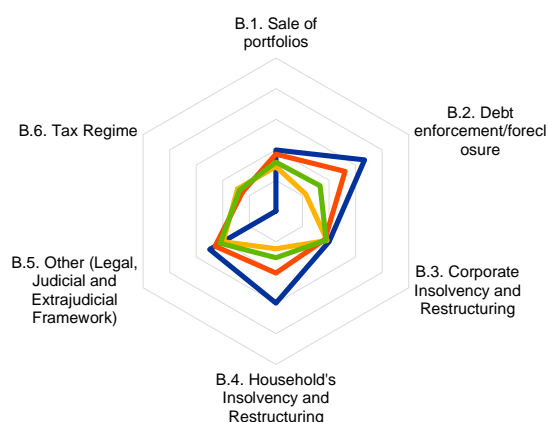
- IT
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



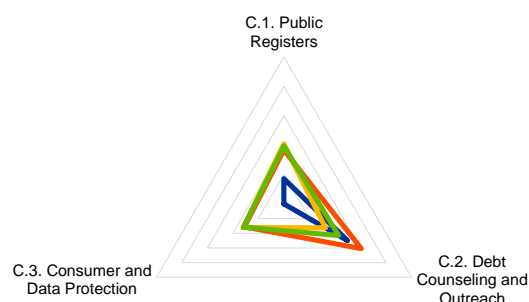
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Italy had a total NPL ratio of 16.4% (of which by segment: households 11.7%, NFCs 24.0%, SMEs 27.4% and CRE 35.3%).¹¹³

To address the high levels of NPLs, Italy has recently carried out specific actions. In August 2015 the government introduced a new piece of legislation (Law No 132/2015), amending the procedures for firms' liquidation and restructuring and for the foreclosure of assets, aiming to increase the speed and efficiency of insolvency procedures and property foreclosures, and to promote higher recovery rates for creditors.¹¹⁴ With the same law, the government has approved a revision of the tax treatment of LLPs which permits their immediate full deductibility¹¹⁵ (under the previous regime, LLPs were deductible in five years). Further important changes to the legal framework concerning NPL recovery (i.e. non-possessory pledge and foreclosure) have been recently introduced with the bankruptcy reform of 2016. Another initiative to tackle the NPL issue is the Decree No 18 approved in February 2016, which envisages a guarantee mechanism, i.e. *Garanzia Cartolarizzazione Sofferenze* (GACS), to be used to facilitate the removal of bad loans from a bank's balance sheet. It is a State guarantee scheme, open to all banks on a voluntary basis. The State guarantee covers the senior tranches of newly established securitisation structures containing bad loans. These new measures could have beneficial effects on the reduction and working-out of banks' NPLs, possibly also stimulating the market for NPLs. Among the market initiatives, an important contribution for the disposal of NPLs could derive from the "Atlante" funds, two Italian private equity investment funds¹¹⁶ set up in 2016 to invest in (i) shares of banks that must make capital increases at the request of the supervisory authority and (ii) tranches of bad debt securitisations. They invest in non-guaranteed junior and mezzanine tranches.

The main challenges to NPL workout in Italy include:

- **Long recovery and bankruptcy procedures:** insolvency/bankruptcy proceedings take on average more than six years, representing one of the main hurdles to the disposal of NPLs. This has contributed to the large accumulation of NPLs in banks' balance sheets over the last years. With Law No 132/2015, the Italian insolvency and foreclosure regulation has been changed to:
(i) improve the legal framework for early intervention in distressed firms, promoting early action in the event of a crisis and making restructuring more likely; and (ii) reduce the length and costs of bankruptcy and foreclosure

¹¹³ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers all banks in Italy. Due to a change in definition these figures are not comparable with those figures provided in the ECB Stocktake published in September 2016.

¹¹⁴ For an overview, see the note entitled "The changes of the Italian insolvency and foreclosure regulation adopted in 2015", available at <http://www.bancaditalia.it/pubblicazioni/note-stabilita/2015-0002/index.html>.

¹¹⁵ Includes provisions/impairments and write-off losses.

¹¹⁶ The pool of investors consists primarily of Italian banks, banking foundations, insurance companies and pension funds.

procedures¹¹⁷. Further measures were introduced in 2016. The new provisions and measures include: (i) two new legal instruments to strengthen creditor protection (*Patto Marciano* and a non-possessory pledge); (ii) a new public register for pending foreclosure and insolvency proceedings; (iii) changes to the rules on foreclosure procedures (measures aimed at accelerating judicial property foreclosure proceedings, streamlining the procedures and improving the probability of selling pledged assets, e.g. electronic auction); and (iv) amendments to the bankruptcy procedure. The so called *Patto Marciano* introduced the possibility of inserting into loan agreements to enterprises a new form of collateral (acquisition of direct ownership of a property), in the case of the default of the borrower. This new provision is expected to result in a material reduction in the time needed to enforce collateral in the event of a debtor's non-performance, although it will primarily affect the new loans as its implementation for existing loans/NPLs, it depends on the parties consent to the necessary contractual changes.

- **A very limited NPL secondary market and a still inadequate NPL-servicing sector:** a second factor that has contributed to the build-up of the stock of NPLs is that the volume of NPL sales is small (in absolute terms, in relation to the stock, as well as in comparison with other EU countries). The thinness of the market has several causes. One seems to be the distance between bid and ask prices, as investors have been demanding a particularly high risk premium – mainly related to the type of investment and the lower leverage of banks – meaning that banks believe they can achieve better results by continuing to hold and manage the NPLs. The aforementioned recent reform and the GACS scheme are expected to narrow the bid-ask spread, fostering the development of an NPL market. Furthermore, anecdotal evidence suggests that the servicing market is developing. This could have beneficial effects on NPL management, regardless of whether or not these assets are removed from banks' balance sheets.

In terms of **specific supervisory practices for addressing NPLs**, the Banca d'Italia (BdI) has developed specific tools to support its analysis and intervention activity; these tools include very detailed reporting requirements for banks and formalised methodologies and procedures:

- **Data reporting to the CCR and new granular reporting on bad loans:** the BdI requires institutions to report to the CCR a very wide set of granular information on performing and non-performing loans (bad loans¹¹⁸ above €250 and other NPLs above €30,000).¹¹⁹ The BdI makes extensive use of the CCR for off- and on-site supervision.¹²⁰ The BdI has recently introduced a new

¹¹⁷ As a result of these new rules, the average length of the bankruptcy process could decrease from more than six to around four years, while judicial foreclosures could be shortened from more than four years to around three years. More work on this front is warranted.

¹¹⁸ This relates to borrowers in a state of insolvency.

¹¹⁹ See Section C for a detailed overview.

¹²⁰ See the note entitled "[The recent asset quality review on non-performing loans conducted by the Bank of Italy: Main features and results](#)".

reporting requirement aimed at obtaining very detailed micro information on bad loans and on the collateral and other guarantees that are crucial in the recovery processes, so that all banks maintain such information in a standardised form, with the aim of fostering proactive management of bad loans. This initiative also aims to improve the transparency and availability of NPL-specific data, fostering the development of the NPL market.

- **Methodology for assessing the credit risk management process in on-site supervision:** the Bdl guidance for on-site inspections states that each inspection should include: (i) a quantitative assessment of the exposure to credit risk, focused mainly on the classification of NPLs and on the adequacy of provisioning levels. This analysis relies on credit file reviews (on a single borrower basis) and covers a significant part of the NPL portfolio; performing portfolios are also examined to check for misclassifications. The inspector is given guidance and criteria for the identification of NPLs; whenever inspectors' evaluations (of the loan classification or LLPs) differ from those of the bank, they must be formally notified to the bank; and (ii) an assessment of the organisational aspects concerning risk governance, management and internal control and covering all the phases of the credit process (including monitoring, provisioning and the recovery process). The guidance provides analysis patterns and checklists that inspectors should use for the assessment.
- **Assessment of the credit risk management process in off-site supervision:** quantitative and qualitative aspects of the credit process, with a particular focus on NPLs, are also subject to off-site assessment. With the support of automatic tools developed to manage and analyse CCR data, thematic meetings with banks' representatives are organised and/or other supervisory intervention measures on NPL management are taken.

Based on the information provided by the Bdl, it is also considered relevant to highlight that Italian supervisory regulation for NPLs is mainly principles-based with regard to the guidelines issued to banks on NPL management practices.¹²¹ Regarding NPL measurement and provisioning, the Bdl has not issued any additional specific prudential guideline beyond the IAS/IFRS, as it has so far relied mainly on on-site inspections to ensure a consistent classification and level of provisions across institutions. In specific cases, Pillar 2 add-ons have been considered and implemented to address risks related to NPLs. As regards the classification under the impairment category, the supervisor requires the full harmonisation of the NPE classification across the prudential and accounting frameworks.

¹²¹ On 27 September 2016, the Banca d'Italia has issued rules relating to the valuation of real estate guarantees (as an update of Circular 285/2013).

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 30

Main sources of NPE-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Circular (binding)	285/13	All credit institutions	Credit risk management	Provisions detailing: (i) the tasks and responsibilities of the credit risk management function; (ii) the main characteristics of the function (in terms of its position within the organisational chart, qualitative and quantitative characteristics of resources and the remuneration system); and (iii) the minimum expectations regarding credit risk management processes (credit granting, monitoring, problem credit management and provisioning, creditworthiness assessment, real estate collateral valuation, decision-making process)	2013
Circular (binding)	269/08	All credit institutions	Credit risk management	Detailed provisions for the assessment of the credit risk management process by off-site and on-site supervision. This is the Bdl supervisory manual (containing RAS and SREP processes). Only a part of the manual can be accessed by the banks, which defines the general principles of supervisory assessment without disclosing the main thresholds, indicators and triggers used by the Bdl for the assessment	2008
Circular (binding)	272/08 & 115/90	All credit institutions (individual & consolidated)	Supervisory reporting	Provisions detailing the rules for the compilation of supervisory data on capital ratios and credit, market, liquidity, interest rate and operational risks. The provisions on the definition and classification of NPEs and forbearance are in line with the EBA ITS on forbearance and non-performing exposures; a breakdown of NPLs has been adopted in the "non-harmonised" section of the supervisory reporting	2008 & 1990
Circular (binding)	139/91	All credit institutions	Central credit register	Provisions for the banks on how to transmit the data to the CCR	1991
Circular (binding)	262/05	All credit institutions	Disclosure requirements	Balance sheet reporting	2005

The Bdl issued¹²² general principles regarding the minimum set of data to be collected by banks in order to perform an adequate assessment of borrower creditworthiness (the Bdl requires that banks make use of CCR data before granting a loan to a new client and for monitoring the credit risk of their clients). The Bdl rules stipulate that the documentation must enable an assessment of the consistency between the amounts, the type of loan and the financed project and the identification of the characteristics and quality of the borrower. In the case of loans to NFCs, the information acquired should include at least the financial statements (individual and, if available, consolidated) to assess the business situation of the company. The IT procedures should provide accurate indications on the reliability of the customer (e.g. through credit scoring systems and/or rating). If the borrower is part of a group, the assessment should take into account the situation of the group as a whole. The Bdl has not issued any guidance defining specific limits on household or NFC portfolios (e.g. max. LTV, max. maturity), except for the rules regarding transactions with related parties.

¹²² Circular No 285, part 1, title 4, chapter 3, annex 4, paragraph 2.

A.2 NPL recognition and classification

For regulatory reporting purposes, Italian banks are legally required to comply with the EBA ITS regarding the definition/classification of NPEs. In addition, the Bdl adopted in the “non-harmonised” section of its supervisory reporting¹²³ the following breakdown of NPLs, ensuring continuity with the pre-existing definition and time series: (i) past due/overdrawn exposures (past due by 90 days or more, with a further breakdown by days past due (dpd) band); (ii) unlikely to be paid exposures (with a further breakdown by dpd bands); and (iii) bad loans (state of insolvency). When applicable, NPL forborne exposures are included in each of these categories. For performing exposures, the Bdl also has the following classification: performing; performing but past due by less than 90 days (1-30 days, 30-60 days, etc.); and performing forborne (with a distinction between one concession or more than one concession). Banks are required to record in their internal credit database all information necessary for credit risk management.

In terms of forborne exposures, for regulatory purposes the Italian banks are required to follow the criteria defined by the EBA ITS.

A.3 NPL measurement and provisioning

Italian banks follow the IAS/IFRS accounting requirements and the Bdl has not issued additional specific prudential guidelines on NPL measurement and provisioning. As regards the classification under the impairment category, banks are required to consider as impaired all exposures meeting the definition of NPEs (the prudential concept of NPE and the accounting definition of impairment are harmonised). Specifically, Circular No 262 states that Italian banks are required to consider as impaired all credit exposures meeting the definition of NPE as defined in the supervisory reporting.

There is no regulation concerning specific provisioning rules for NPLs, also in terms of how to treat the recovery time estimation.

According to IAS/IFRS, when a financial asset or group of financial assets has been written down as a result of impairment loss, according to paragraph AG93 of IAS 39, banks should recognise interest income using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Beyond the provisions of the accounting standards, the Bdl has not issued any additional specific guidance on accrued interest in the case of a non-performing classification for prudential purposes.

¹²³ Circular No 272.

A.4 NPL write-offs

There are no specific national guidelines or rules for NPL write-off. The write-off of an NPL follows the derecognition rules of IAS 39 and partial write-offs are allowed. The Bdl provides a general principle according to which write-offs take place when the competent management formally acknowledges the impossibility to collect the loan or part of it, or ceases any action to continue the collection of amounts due. The Bdl does not normally make use of supervisory tools, such as setting time limits, to provide incentives for NPL write-offs.¹²⁴ Before 2015 the tax treatment of LLPs (provisions and write-offs) and losses on disposals was different, as losses on disposals were immediately fully deductible, whereas LLPs were deductible in five years. Since the entry into force of Law No 132/2015, the tax code permits the immediate deductibility of valuation losses.

A.5 Collateral valuation

In Italy, there are no specific rules (in addition to Article 208 of the CRR) on entities allowed to perform the valuation of collateral and no authority is responsible for the supervision of valuation and collateral appraisal entities. The Italian Banking Association signed an MoU in May 2011¹²⁵ with all the professional associations (representing for example surveyors, engineers, architects, agricultural engineers and agronomists) in order to define common guidelines for the RE collateral valuation, which are followed by the banks' panels of appraisers. The required frequency for the valuation of immovable property collateral follows CRR¹²⁶ requirements (CRE \leq 12 months; RRE \leq 3 years) and does not depend on/change if the loan is classified as an NPL. The Bdl does not prescribe the methodologies allowed for the collateral value update. Considering that Italian banks follow the CRR, statistical methods can be used to monitor the value of the property and to identify property that needs revaluation (Article 208(3) of the CRR) and the Bdl does not determine if internal or public indices can be used for this purpose.

In 2016 the Bdl issued rules relating to the valuation of real estate guarantees. The main provisions concern: (i) the role of corporate bodies and control functions in the definition of policies and processes for carrying out the valuation of the properties; (ii) the professional and independence requirements for the valuers; (iii) the use of external experts for the valuations; and (iv) certain criteria relating to the conduct of the evaluation of the properties.

In Italy, there are no specific requirements for the calculation of the credit risk-mitigating effect of collateral for risk management purposes under Pillar 2. However, among all the risks to be assessed by the banks under Pillar 2, the Bdl suggests considering also the residual risk from the possibility that the use of credit risk-

¹²⁴ This just refers to write-offs. However, concerning provisioning, if the level of coverage is not deemed adequate, the Bdl considers imposing a Pillar 2 add-on in the SREP process.

¹²⁵ This was updated in December 2015.

¹²⁶ Article 208(3).

mitigation techniques is less effective than expected. The collateral valuation is addressed during the supervision activity, especially during the inspections, through the assessment of the quality and updating of the appraisals used by banks.

There are no additional specific rules or criteria to value foreclosed assets on or after the foreclosure date beyond the CRR requirements. For the financial statements, the valuation policy is decided by the bank, following the international accounting principles, and then the consistency is potentially assessed in on-site inspections on credit policies. Legally, the disposal of collateral occurs only through auctions managed by the courts. However, foreclosures are currently not significant for Italian banks.

A.6 NPL governance/workout

Although only principles-based guidance/regulation for banks on how to manage NPLs has been issued, the Bdl provides indications to banks on these aspects through its supervisory action, also in accordance with the proportionality principle.

In general, banks are encouraged to proactively manage NPLs and take specific action to ascertain the adequacy of provisioning policies and levels. This is usually achieved through frequent meetings with the senior management of the bank and letters aimed at identifying a strategy and targets to reduce NPLs.

On a case-by-case basis taking into account the specific situation of each bank and for banks with the highest NPL ratios (no threshold defined), since 2015 the Bdl requests measures aiming to reduce NPLs, such as the draft multiannual plans for the sale of NPLs (mainly bad loans). In order to achieve these goals, since 2015 an incentive/disincentive system using SREP capital targets is sometimes applied. However, there are no supervisory requirements for banks to have NPL operational reduction targets.

Most of the banks have dedicated NPL workout units and are required to separate NPL management from loan origination and performing loan services, although there are no specific rules prescribing this. NPL workout units are separated according to the severity of the situation (pre-NPL or watch list, unlikely to pay, restructured credit and bad loans). There are only a few cases where NPL workout units are independent from the Chief Lending Officer. Some banks, especially the largest ones, outsource NPL management to special servicers, even though so far the servicing market has still not developed much due to the limited NPL market.

It is also important to note that in Italy there is a licensing/regulatory regime for non-banks that carry out the following activities: (i) servicing securitisations; and (ii) purchasing NPLs using leverage. According to this regulatory regime, these non-banks should fulfil simplified capital requirements.

A.7 Supervisory reporting

The Bdl requires that banks report a set of data (Circulars No 115, 139 and 272) that goes beyond the EBA ITS. In particular, in the CCR (Circular No 139) data are reported monthly on a borrower-by-borrower basis and are broken down by type of exposure (see also Section C). For each loan, information on the type and amount of the guarantee is available. At a single borrower level, the value of the collateral is also provided. Banks are required to signal to the CCR any change in the status of a debtor within three working days following the assessment of the competent bodies and also to report promptly to the CCR the writing-off of a bad loan.

In addition, Circulars No 115 and 272 (concerning, respectively, individual and consolidated supervisory reporting) require data on credit quality that go into further detail than the EBA ITS (for example, as regards NPEs, the breakdown of NPE categories by economic sector and location of debtors, flow data – i.e. increases and decreases – for NPE categories, and the reconciliation of changes in the loss allowances for NPE categories).

Finally, the Bdl has recently introduced a new reporting requirement for NPLs consisting in a detailed reporting template aimed at obtaining micro information on bad loans and on the collateral and other guarantees that are crucial in the recovery processes, so that all banks maintain such information in a standardised form, with the aim of fostering proactive management of bad loans or their disposal.

In order to quality-assure banks' NPL-related reporting, the main procedures are the following: (i) diagnostic programmes provided by the Bdl to banks to verify the technical correctness of the reporting before its transmission; (ii) automatic checks of the consistency of the data sent by the banks, through comparisons with other benchmarks (such as other reports of the same bank); (iii) inspections, which may also lead to sanctions for incorrect reporting; and (iv) analysis of supervised entities' balance sheets, which could highlight inconsistencies with regulatory reporting.

NPL statistics are publicly available in Bdl statistics and the Bdl publishes a Quarterly Statistical Bulletin and a series of supplements (most of which are monthly). These publications include information on NPLs, provided both in aggregate form and differentiated according to several criteria, such as by NPL category, by geographical area, by economic sector and by size class. Data on NPL stocks and flows are provided. Moreover, some information about NPLs, with less detail and at a lower frequency, is reported in other Bdl publications, such as its Annual Report, Financial Stability Report and Quarterly Economic Bulletin.

A.8 On-site and off-site supervisory practices and methodologies

The loan classification (and the overall monitoring process) and the level of LLPs (along with the effectiveness of the bank's internal LLP policy) are assessed by:

1. **Off-site supervision:** a credit risk analysis is conducted to assess a bank's risk level and control using a list of key risk indicators (KRIs), supervisory tools,

benchmarking analysis (e.g. analysing differences in the NPL classification of the same debtors between the bank and the rest of the banking system; high persistence of loans in the “unlikely to pay” class) and a review of the bank’s main internal policies. For banks presenting indicators of potential incorrect classifications or low levels of provisioning (also comparing the coverage ratios among banks for similar portfolios and/or collateral), a deeper analysis is usually performed and thematic meetings with the bank’s representatives are organised, including discussions on the evaluation of loan samples, often followed by letters of intervention. The off-site analysis is based on statistical comparisons. If the bank does not satisfactorily incorporate the supervisory assessments, an on-site inspection is usually performed.

2. **On-site inspections:** loan classification and LLP assessments are performed based on individual credit file reviews. Credit policies (e.g. processes, responsibilities, information sources, trigger definition, controls) and practices related to NPL classification and provision calculation are reviewed. The analysis focuses on the bank’s estimations of the recovery rate on unsecured loans, the recovery from collateral and the recovery times. These assessments take into account several factors, such as the characteristics of the loans or whether there are any court proceedings. Inspectors’ evaluations are disclosed to the inspected bank in the form of findings in the on-site inspection report. The bank is asked to transpose in its accounting systems the inspectors’ evaluations.

In cases where the Bdl considers that a bank does not have adequate provisioning levels, in addition to the moral suasion aimed at increasing the LLP to an appropriate level, it imposes additional Pillar 2 requirements.

NPL governance is also assessed in off-site and on-site supervision, according to the methodologies provided by Circular No 269. For on-site supervision in particular, the Circular provides guidance on how to assess the policies and procedures used by banks to handle NPLs for specific loan segments (leasing, factoring, corporate financing, retail).

As regards inspection activities, the on-site missions aimed at analysing the credit risk portfolio are full scope, thematic or targeted and they focus on both performing and non-performing loans. Concerning LSI on-site missions, which are normally full scope, they are mainly focused on credit risk analysis.

To select the loan sample to be analysed during an on-site inspection, judgemental samples are taken by applying several selection factors to the different credit risk classes using an IT tool (MARC). The loans are selected with reference to the exposure amount and provisioning levels (e.g. the 100 largest exposures and the riskiest borrowers by risk class). Other material elements such as the balance sheet and financial ratios, the bank’s overall exposure and information on other borrowers are also considered. As a general rule, the threshold for the credit files to be analysed is related to the bank’s total loans. Moreover, it is possible to use a statistical IT tool for sampling. As a result of this sampling process (judgemental and/or statistical), the percentage of the total credit portfolio assessed in the on-site

inspection varies according to the bank's size. On average it is around 20%, and it increases for problematic portfolios.

In addition to the regular inspection activity, during 2012-13 the Bdl carried out on-site thematic inspections on credit risk, which focused on provisioning and the analysis of performing borrowers with a high probability of impairment. The provisioning inspection campaign, covering 20 major banking groups, was focused on the adequacy of the provisioning level for NPLs for each bank and evaluated policies and procedures set up by the banks to manage those assets.

The Bdl has on-site inspectors with NPL collection/workout experience, although there are no dedicated units. With regard to NPLs, inspections are carried out by the head office inspectors at the large banks and, at smaller less significant banks, by Bdl branch staff.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

In Italy, there still is not a fully developed market for NPLs and only a limited number of deals have been completed. The Italian Government approved a Decree in February 2016 which envisages the use of a guarantee mechanism, i.e. *Garanzia Cartolarizzazione Sofferenze* (GACS), to facilitate the removal of bad loans from the banks' balance sheets. It will be a voluntary State guarantee scheme, open to all banks, to cover the senior tranches of newly established securitisation structures containing bad loans.

In general, Italian law does not require the consent of the borrower for the sale of a loan, only the notification of the borrower. Moreover, Article 58 of the Italian Banking Act (No 385/93) provides an exemption from the obligation to notify each debtor in the case of a bulk loan sale; in such cases, the registration in the commercial register and the publication in the Official Journal of the Italian Republic or other forms of disclosure established by the Bdl are required. Further exemptions are established by specific provisions regarding securitisations and factoring.

The past virtual absence of an active NPL market has also contributed to the large accumulation of NPLs in banks' balance sheets over the last years. In Italy, the workout of NPLs is also affected by the long recovery and bankruptcy procedures, which are on average longer than the EU average and highly variable across regions and banks.

B.2 Debt enforcement/foreclosure

The Civil Procedure Code provides court enforcement actions (*procedimento esecutivo*), which are for the benefit of one or more creditors that take the initiative.

In August 2015 the government introduced new legislation (Law No 132/2015) amending the procedure for the foreclosure of assets. The main innovations include: (i) the mandatory use of professional experts (such as notaries, lawyers and accountants) to carry out the activities related to the disposal of the collateral; (ii) shorter time limits for certain procedural activities; (iii) new criteria for accepting bids in auctions; and (iv) a dedicated website to advertise forced sales. This Law has changed the Italian insolvency and foreclosure regulation to reduce the length and costs of foreclosure procedures. The new rules are expected to reduce the duration of judicial foreclosures from more than four years to around three years.¹²⁷

The new rules governing the foreclosure of collateral apply not only to new proceedings, but also to those already initiated at the time of entry into force of the reform. Under the previous regime, multiple auctions for RE collateral occurred, with as many as four auctions being needed to sell the collateral, which caused significant delays in the liquidation process. The reform also aims to reduce some hurdles that made it unprofitable for creditors to have collateral assigned to them. Creditors can now bid a price equal to that of the last unsuccessful auction, thereby benefiting from discounts like any other bidder. Under the old regime, interested creditors had to offer the initial estimated price of the collateral even if this price had been revised downwards as a result of several unsuccessful auctions. This mechanism made the direct assignment of the foreclosed asset to creditors extremely rare.

Further changes to the legal framework concerning these aspects have been adopted through a Government Decree which was issued on 29 April 2016 and converted into law at the end of June. The new provisions aim at promoting: (i) a speedy foreclosure of collateral through new out-of-court mechanisms and amendments to the judicial foreclosure procedures; (ii) full transparency of pending foreclosure and insolvency procedures to enable more accurate assessments of the value of claims by potential investors; and (iii) further streamlining of the bankruptcy procedure. In particular, the new provisions include: (i) two new legal instruments to strengthen creditor protection (*Patto Marciano* and a non-possessory pledge); (ii) a new public register for pending foreclosure and insolvency proceedings; (iii) changes to the rules on foreclosure procedures; and (iv) amendments to the bankruptcy procedure.

B.3 Corporate insolvency and restructuring

The corporate insolvency and debt restructuring regime is considered by the Italian authorities as an important challenge to private debt resolution. For instance, there are no legal provisions or schemes in place to provide financial support to distressed companies (e.g. funding for SMEs).

¹²⁷ "The changes of the Italian insolvency and foreclosure regulation adopted in 2015", *Notes on Financial Stability and Supervision*, Banca d'Italia, November 2015.

The bankruptcy law provides both in-court and out-of-court restructuring tools. *Concordato preventivo* is a court-supervised procedure based on a restructuring plan to be approved by a majority of the creditors (and, if the restructuring proposal divides creditors into different classes, also by a majority of classes). In this case a cram-down of dissenting creditors is allowed. Once approved, the proposal has to be confirmed by the court. *Accordi di ristrutturazione* is an out-of-court restructuring agreement, which is non-binding for dissenting creditors who maintain the right to be paid in full. Both the *concordato* and the *accordi* have been reformed and in 2015 a new type of restructuring agreement was introduced that allows under certain circumstances the cram-down of financial creditors; competing bids and offers have been introduced for *concordato preventivo* aimed at increasing the recovery rates for creditors and promoting the contestability of distressed firms.

Due to the new Decree approved in August 2015, the supervisor expects that the average length of the bankruptcy process will decrease from more than six years to around four years. The length of Italian insolvency proceedings is deemed to be one of the main hurdles to the disposal of bad loans.

No data are available on the average out-of-court negotiation processes, the recovery rate of the out-of-court negotiation processes and the value of debt restructured under the out-of-court mechanism. The number of bankruptcy cases doubled from 7,272 cases in 2008 to 14,475 cases in 2015.

B.4 Household insolvency and restructuring

The legislative framework for overindebtedness was enacted in Italy in 2011-12 at the end of a two-stage process establishing a comprehensive set of rules for the management of the insolvency of individuals and small enterprises. The first stage started with the adoption of Decree No 212/2011, which was subsequently converted into Law No 3/2012, aimed at providing a remedy to debt distress situations that were not subject to the insolvency procedures provided in the Insolvency Act. For this purpose, the Law, which did not specifically address consumer insolvency, introduced a debt settlement mechanism (available to all debtors, i.e. covering also those not included in the scope of the Insolvency Act), based on a composition agreement with creditors, subject to validation by the court. The reform process was then concluded with the adoption of Decree No 179/2012, which was converted into Law No 221/2012, whereby two additional procedures to address overindebtedness were introduced, one of which is specifically for consumers.

B.5 Judicial system

The judicial procedures (for both insolvency and foreclosure) are considered by the supervisor as an obstacle to NPL workout, although the 2015 and 2016 reforms introduced measures that aimed to increase the speed of both types of procedure. In each court, there are specialised judges for insolvency and bankruptcy procedures.

However, in the smaller courts (which make up the vast majority), insolvency judges deal also with other disputes.

B.6 Tax regime

Decree No 83/2015 should eliminate the disincentive for NPL disposal from the tax treatment of losses, as it allows the immediate full tax deduction of losses from NPLs (from write-offs, write-downs and disposals). Under the previous regime, new credit losses were deductible in five years (in 18 years until 2013).

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

The Bdl requires institutions to report to the CCR bad loans above €250 and other performing and non-performing loans above €30,000. Data are reported monthly on a borrower-by-borrower basis and are broken down by type of exposure. For each loan, information on the type and amount of the guarantee is available. At a single borrower level, the value of the collateral is also provided. For each non-performing credit line/debtor, the default status is reported. This information is mainly used for off- and on-site supervision. In off-site supervision, it is used to monitor the trends in portfolio quality and concentration and to assess, through quantitative analysis accompanied by an examination of the organisational aspects, the adequacy of supervised entities' credit evaluation policies and practices (in terms of provisioning and classification of loans). In on-site supervision, it is used to identify, taking into account also the other data provided by the bank, the sample of loans to be evaluated during the inspection, and to monitor the classification of the bank's debtors by other intermediaries.

At the moment, there is no information in the CCR on forbearance. Up to December 2014 the category "restructured loans" was listed, which was basically comparable to non-performing forbearance. With the implementation of the EBA categories, restructured loans have been largely merged into the "unlikely to pay" category. Information on LLPs is not included directly in the CCR, but other supervisory reporting is available every six months providing the LLPs related to a debtor against whom the banks have an exposure (bad loans) greater than or equal to €500,000.

In addition, Circular No 139 provides that CCR data should be used to generate and provide feedback for banks.

In general, registers related to the type of asset are public, allow searches to be conducted (there are also specialised market companies offering the same service) and identify the main characteristics of the assets. In some cases, a justified request is needed to access information. For example:

- The land/cadastral registry system is centralised, in the sense that the servers where the data are stored are currently managed at a central level. Therefore, a single national search is possible, covering all the local districts where a land registry office is located. It may be that some old documents are not included in the digital data, depending on the date when each land registry office started digitising data.
- The ships register, which identifies the asset owner and asset characteristics, allows the public to conduct searches subject to the submission of a justified request. Information is available in the registry held at the relevant port authority where the vessel is registered.

Annex IX of this report gives a detailed overview of the main features of and information collected by the CCRs.

C.2 Debt counselling and outreach

There are institutions (so-called *Confidi*) that, in addition to providing guarantees to help SMEs obtain credit, give advice and assistance to these enterprises in relation to raising funding and improving their financial management.

C.3 Consumer and data protection

Restrictions established by consumer and data protection law do not apply to the public CCR, as the latter is a prudential supervision tool.

Annex XI: Latvia

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

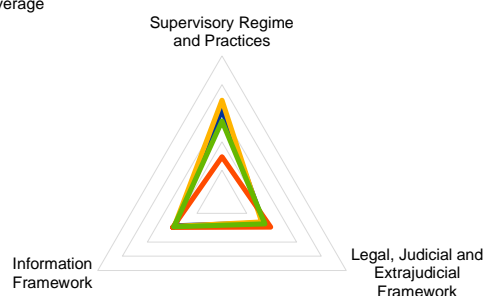
Chart 11

Country overview

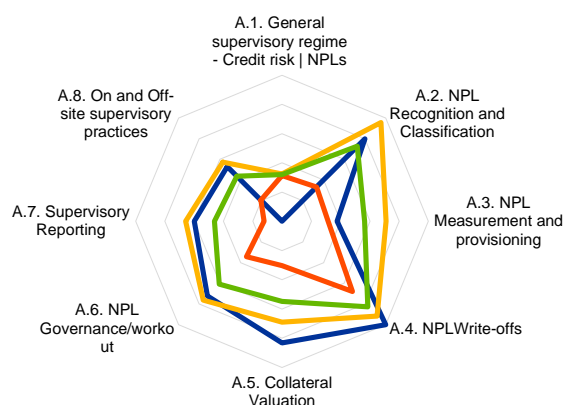
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

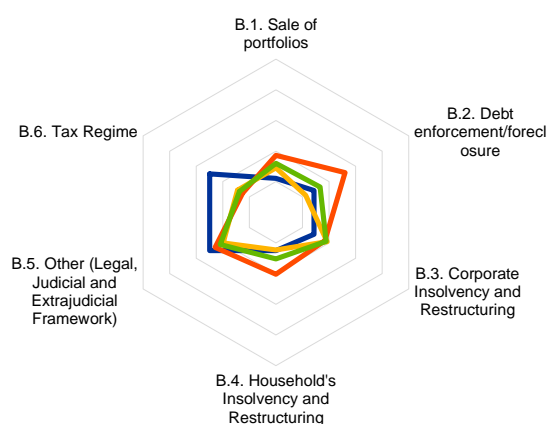
- LV
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



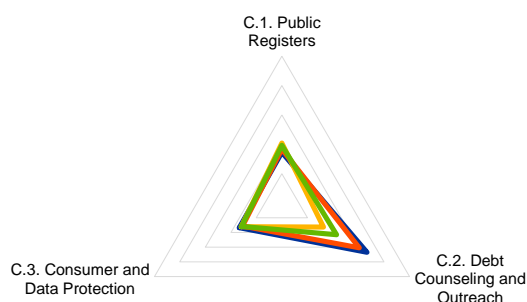
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Latvia had a total NPL ratio of 6.9% (by segment: households 7.8%, NFCs 10.8%, SMEs 13.3% and CRE 9.8%).¹²⁸

The Latvian Financial and Capital Market Commission (*Finanšu un kapitāla tirgus komisija* – FCMC) considers that the regulatory framework and supervisory practices enhanced at the onset of the financial crisis, have played a material role in reducing the elevated levels of NPLs in Latvia. Further enhancements could now be made with due regard to the experience gained in other jurisdictions since 2008.

The Latvian regulatory and supervisory framework for NPLs is quite general in some aspects and mostly principles-based. The survey based on the findings as of the end 2016 revealed some features in the framework that could represent **potential areas of improvement to NPL workout in Latvia**:

- **NPL governance**: while general principle-based guidelines and requirements pertaining to governance and sound risk management are in place, these do not explicitly and specifically prescribe requirements and/or rules for the workout of NPLs.
- **Collateral enforcement**: the long duration of judicial processes may represent a bottleneck for the quick enforcement of collateral.

In terms of supervisory requirements and practices, there are some loan classification and provisioning-related aspects that might represent distinguishing features of the national supervisory framework.

National supervisory provisioning rules encourage banks to assess the sufficiency of provisions formed in accordance with accounting standards to cover the expected loss and to make adjustments to their own funds in the case of a positive difference between the supervisory and accounting provisions. When major deficiencies are found in the loan review and quality assessment process conducted by the bank, supervisors conduct their own classification of the loans selected for verification by splitting them into five categories: standard, supervised, sub-standard, doubtful and lost. These are based on criteria specified in Articles 55-59 of the FCMC Regulations on Valuation of Assets and Supervisory Provisioning (RVASP). Supervisors then calculate provisions for these loans in accordance with indicative provisioning rates (% of the outstanding amount of loans in each category) set in the aforementioned regulation. Any positive difference between the supervisory provisions and the accounting provisions are deducted from the bank's own funds.

The supervisory approach to off-site analysis and procedures for on-site examinations are set in the FCMC off-site and on-site manuals (handbooks). These manuals are regularly improved and periodically updated in consideration of actual lending practices.

¹²⁸ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers 81% of banks in Latvia or 96% of total banking assets.

There are currently some discrepancies between the NPL-related definitions¹²⁹ used by the FCMC in its internal manuals and procedures and the harmonised NPE definition based on the EBA ITS. In this regard the FCMC, plans to update all supervisory procedures relating to credit risk evaluation, taking into account the harmonised NPE definition. However, the numbers of problematic loans according to the current FCMC definition are in most cases higher than those according to FINREP, so this does not lead to an underestimation of risks.

Finally, in terms of specific national macroprudential measures aimed at addressing excessive credit growth and leverage, there is a binding cap in place for the LTV ratio for residential mortgage lending.

Although there are no legal impediments to domestic or foreign third-party banks and institutional investors purchasing NPLs, according to the FCMC NPL sales in Latvia have been relatively insignificant thus far and the domestic NPL market is not developed. One exception to this are several relatively significant transfers of assets to publicly owned distressed AMCs as part of a bank resolution process.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

¹²⁹ In particular, a specific category of “problem loans” is used in internal manuals and procedures. This category comprises loans more than 90 dpd, forborne loans and loans in workout. This category is not fully aligned with the NPE definition based on EBA ITS.

Table 31

Main sources of NPE-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Law (binding)	Consumer Rights Protection Law (CRPL)	Trades in goods and providers of services (including all household lenders)	Consumer Rights protection	The Consumer Rights Protection Law inter alia defines the requirements for contracts (consumer loans, residential mortgages); sets LTV limits for residential mortgages exceeding 100 minimum salaries and defines requirements for consumer lenders (e.g. borrowers income verification requirements for loans exceeding the amount specified in the law)	1999 (LTV requirement introduced in 2008)
National regulation (binding)	Regulation on Credit Risk Management (RCRM)	Institutions as defined in the CRR	Credit risk management	The FCMC Regulation on Credit Risk Management sets requirements for banks' credit risk management strategies, internal policies, procedures and processes; defines the responsibility of the banks' board of directors and senior management for credit risk management; sets requirements for management information system as well as for assessments; measures for preventing and avoiding excessive credit risk under stressful conditions; establishes requirements for banks to define and implement specific policies on the restructuring and work-out of loans with impaired credit quality; and encourages banks with a significant share of problematic loans to establish dedicated work-out units with appropriately qualified staff etc.	2010, revised version in 2014
National regulation (binding)	Regulation on Valuation of Assets and Supervisory Provisioning	Institutions as defined in the CRR	Valuation of assets and supervisory provisioning	The FCMC Regulation on Valuation of Assets and Supervisory Provisioning specifies: guidelines and requirements for banks for their loan reviews and supervisory provisioning and defines restructured loans and treatment of interest accrued on restructured loans.	2009
National regulation (binding)	Regulation on the Preparation and Submission of Information on Loan Portfolio Structure of Banks	Credit institutions and branches located in Latvia of credit institutions established outside Latvia	Supervisory reporting	The FCMC Regulation on the Preparation and Submission of Information on Loan Portfolio Structure of Banks prescribes the procedure for the preparation and submission of information necessary for analyses of the banks' loan portfolio structures for supervisory and statistical purposes.	2010

In addition to the requirements set in CRD IV, the FCMC has issued specific regulations on credit risk management. In accordance with these regulation banks must develop credit risk strategies (including the definition of credit risk appetite) as well as internal credit risk management policies and procedures. The regulations also define the responsibility of banks' senior management and management boards to ensure that the credit risk management environment is appropriate for the scale and complexity of the banks' activities.

In addition, prior to granting a loan a bank must assess the borrower's creditworthiness based on the information specified in the RCRM (e.g. purpose of the loan and sources of repayment; borrower's current risk profile and sensitivity to economic changes; types of eligible collateral; value of the collateral and its market liquidity; mismatch between the loan currency and borrower currency; borrower's credit history including the data from the CCR; etc.). In accordance with the requirements of the CRPL, prior to granting a loan (including household mortgages) the bank must obtain a statement from the Latvian State Revenue Service regarding the borrower's income or an equivalent statement from another national tax administration. This applies to loan amounts greater than 100 minimal wages (currently €38,000).

The CRPL establishes a binding LTV ratio limit for residential mortgages, which for residential mortgage loan amounts greater than 100 minimal wages is set at 90% of the market value of the relevant immovable property. For loans supported by a state guarantee under the Latvian Law on Assistance in Resolution of Dwelling Issues, the LTV cap is set at 95%.

There are no other binding limits (e.g. for maximum maturity, maximum leverage etc.). However, the banks must set internal limits to be followed during the loan granting process.

A.2 NPL recognition and classification

Banks are required to comply with the EBA ITS. There are no additional national guidance/regulations specifically concerning NPL definition, the classification/declassification of NPLs and the classification/declassification of forbearance in NPLs. The definition of restructured loans in the RVASP is close to the definition of forbore exposure, with minor discrepancies including additional indicators for forbearance such as a take-over of collateral, replacement of a borrower, etc.

The RVASP establishes general guidelines for loan review and provisioning. Latvian banks are in particular required to develop and consistently apply an internal loan classification system that ensures the credible classification of loans in accordance with inherent credit risks as well as the precise and timely identification of changes in risk parameters and problematic loans¹³⁰. This internal loan classification system is the basis for the banks' credit risk management, evaluation of expected loss and appropriate provisioning.

There are additional specific data collection requirements on forbore exposures in place. In accordance with national reporting requirements on the structure of their loan portfolios, banks are, inter alia, subject to monthly reporting on the outstanding amounts of forbore loans and related types of forbearance (e.g. extension of maturity, change of interest rate, etc.). In accordance with IAS 39¹³¹, interest on forbore exposures is accrued in financial statements. To neutralise this accounting treatment, banks must ensure that interest accrued on forbore loans is identified in internal management information systems and that own funds are adjusted by the respective amount.

A.3 NPL measurement and provisioning

Latvian banks must prepare financial statements in accordance with IAS/IFRS requirements. The RVASP provides a minimum list of loss events which is in line with IAS 39. In addition, the RVASP defines an impairment of the value of collateral as a loss event specific to so-called collateral-dependent loans¹³².

With regard to supervisory provisions, the RVASP defines a number of considerations which may have a material effect on the quality of the loan portfolio

¹³⁰ All loans which are not standard loans within the meaning of the classification of loans prescribed by the RVASP.

¹³¹ IAS 39: Financial Instruments: Recognition and Measurement.

¹³² A collateral-dependent loan is a loan for which the repayment depends entirely upon the realisation of the collateral because the borrower has no other sources for loan repayment.

(e.g. indirect foreign exchange risk, country risk, etc.) while not being taken into account in provisioning in accordance with IAS 39.

Banks must carry out verifications of loan quality on at least a quarterly basis, as well as whenever they become aware of information indicating that a significant impairment of loan quality has taken place.

The RVASP requires that banks develop a provisioning methodology appropriate to the size and structure of their loan portfolio. Banks must assess the sufficiency of provisions to cover the expected loss in accordance with IAS/IFRS requirements.

With regard to the enforcement of appropriate provisioning, the RVASP also defines rules to be used by supervisors for the evaluation of banks' loan reviews and provisioning. If the supervisors do not consider the bank's provisions to be sufficient to cover the expected loss, they must instruct the bank to adjust its own funds. This adjustment must be equal to the estimated difference between the expected loss and the provisioning made in accordance with the requirements of the accounting standards.

In addition to the classification criteria mentioned above, the RVASP establishes indicative rates (percentages of the book value of the loans in each category) for each category of loan in Article 63¹³³. These are to be used as recommended (non-binding) benchmarks for the supervisory assessment of the appropriateness of the provisions made by banks for loans in each category.

A.4 NPL write-offs

There are no specific regulations in place for the write-off of NPLs. The FCMC, in this case, does not provide any additional incentive for NPL write-offs, i.e. no increased capital charges and no hard limits on how long NPLs can be carried on banks' balance sheets.

Banks usually write off NPLs if their legal departments are of the opinion that there is no possibility of further recovery (e.g. due to the liquidation of the company).

With regard to potential disincentives for NPL write-offs, the FCMC has received feedback from some banks regarding cases in which the courts have been reluctant to recognise claims on written-off items, albeit on the basis of subjective evaluations rather than any legal/regulatory provisions.

With regard to tax-related factors facilitating loan write-offs, there currently exists the possibility for a borrower to exclude benefits from written-off debts from taxable

¹³³ The indicative rates to be compared against the provisions made by the bank are: 10% for close-watch loans, 30% for sub-standard loans, 60% for doubtful loans and 100% for lost loans. Any positive difference between the supervisory provisions calculated using the indicative rates mentioned above and the accounting provisions must be deducted from the bank's own funds (50% from Tier 1 and 50% from Tier 2).

income for the purposes of calculating personal income tax. This provision applies to benefits arising from write-offs of residential mortgages and expires on 31/12/2017.

A.5 Collateral valuation

The CRPL requires an independent and objective valuation of real estate pledged as collateral for residential mortgages, carried out by a company certified by the Latvian Association of Property Appraisers in accordance with Cabinet of Ministers Regulation No 559 of 23/09/2014. The Latvian Association of Property Appraisers also performs quality assurance on valuations, either on its own initiative or upon request, e.g. from the FCMC. Certifications can be revoked in cases of major misperformance. However, there is no dedicated authority responsible for supervising the valuation of collateral or appraisal entities.

In general, real estate appraisers determine the market value of real estate in accordance with the LVS 401:2013 national standard, EVS/IVS standards as well further national regulations.

The RVASP requires banks to develop procedures for the assessment of the collateral valuations made by independent certified appraisers. Banks must evaluate the assumptions, limitations, restricting factors, projections and data used by the appraiser during the valuation process and, if necessary, adjust them and take them into account during their loan review and provisioning process.

Standard CRR requirements apply with regard to the frequency of immovable property collateral valuations (CRE \leq 12 months; RRE \leq 3 years).

Standard practice is for periodic reassessments (and possible corrections) of collateral value during the lifetime of loans to be based on market prices and other publicly available information (e.g. data from real estate companies about quoted market prices or the prices of actual transactions). However, there is no specific guidance restricting the use of internally computed indexes.

Banks' internal policies, procedures and methodologies used for collateral valuation are assessed during on-site inspections.

The Latvian supervisory authorities do not provide additional incentives to reduce the reliance on collateral, whether through increased provisioning or the assessment of valuation practices.

A.6 NPL governance/workout

In accordance with the RCRM, if an impairment of quality is evident for a significant share of a bank's loan portfolio the bank may establish a separate organisational unit to manage these loans. There are no specific national requirements for banks to have a separate NPL management strategy or to implement an action plan or operational targets.

Although outsourcing is generally permitted under the Latvian Credit Institution Law, banks do not currently outsource NPL management to specialised companies.

In 2009 the FCMC, in cooperation with World Bank experts, issued principles and guidelines for out-of-court consumer mortgage restructuring. The aim of these principles is to encourage both the bank and the consumer to act fairly and reasonably in the resolution of financial problems (e.g. in terms of communicating and negotiating in good faith and considering all possible solutions) without resorting to judicial action. These principles apply only to mortgage contracts concluded with households for which the fulfilment of mortgage obligations is problematic or impossible.

In addition, the Ministry of Justice has issued guidelines for out-of-court corporate debt restructuring to provide Latvian companies, creditors, and relevant public institutions with information regarding relevant best practices.

A.7 Supervisory reporting

Banks in Latvia submit COREP/FINREP reporting templates according to the EBA ITS on a quarterly basis.

There is also granular monthly solo-level reporting of credit quality data for loans grouped by similar characteristics, including information on industry, past due status, restructuring and provisioning. Based on this reporting the FCMC publishes aggregated data on banks' loan portfolio quality on its website on a quarterly basis. The data on NPEs as defined by the EBA ITS (based on FINREP) is not currently publicly available.

Banks which are part of a consolidated group provide quarterly templates on forbearance and NPLs on a consolidated basis as part of their FINREP. All banks, including branches of foreign banks, must provide FINREP (including templates on forbearance and NPEs) on a solo basis as of 31/12/2016. The plan is to begin publishing aggregated NPL data for the entire banking sector after FINREP on a solo basis is introduced.

Alongside standard automatic validations rules, FCMC experts have introduced certain additional manual validation rules for the quality assurance of the NPL data that are checked on a regular basis to identify possible mismatches. The assessment of the quality of reported data on past due loans is also within the scope of on-site and off-site inspections.

A.8 On-site and off-site supervisory practices and methodologies

According to the FCMC there are on-site and off-site measures in place to ensure proper provisioning by banks. In particular, individual loan quality is assessed for sampled loans during regular on-site inspections, with a special focus on problem loans. If during an on-site inspection the bank's loan quality review system is

assessed as being insufficient, the FCMC requires the bank to recognise additional provisions in the financial statements or make an own funds adjustment (see section A. 3).

In addition to the assessment of loan evaluations performed during on-site inspections, banks' data on loan classifications is verified for consistency across peer groups and each bank's individual historical data. Any inconsistencies identified are investigated further. This analysis is supplemented by cross-checking between FINREP data and data from the FCMC KREDIS database, which is based on granular solo-level reporting of banks' loan portfolio structures (see section A. 7).

During the period from 2012 to 2016, all banks were subject to regular on-site and off-site inspections conducted by the FCMC, as a result of which the supervisor requested that banks implement capital strengthening measures.

The FCMC plans to carry out the first off-site thematic horizontal review of banks' NPLs in 2017. The FCMC makes use of information from the CCR for analytical and supervisory purposes, including for sampling loans to be reviewed during on-site examinations as well as for the verification of the accuracy of data submitted by banks to the CCR.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

The establishment of AMCs, including for the management of private "bad" or "distressed" loans, is not prohibited by national laws and regulations.

Although there are no legal impediments to the sale of loans, in Latvia sales of NPLs have thus far been relatively insignificant, with the exception of transfers of bad assets to publicly supported AMCs (e.g. Reverta and Hiponia).

Reverta (formerly AS Parex banka) began as a state-owned "bad bank" in 2010 after the largest domestically owned commercial bank was resolved and taken over by the Latvian government in 2008. Reverta continues to operate as the largest AMC in the Baltic countries (with approx. €1 billion in assets under management) in accordance with the restructuring plan approved by the European Commission.

Hiponia is another state-owned AMC which manages bad assets of the former state-owned bank AS Hipotēku un zemes banka, which was reorganised in 2013 as a state-owned development institution (rather than a bank) called Altum.

Private commercial banks in Latvia also establish subsidiaries that act as private AMCs and manage NPLs and foreclosed assets of a parent bank.

There are no restrictions on the purchase of NPLs by domestic or foreign third-party banks and institutional investors. The borrower's consent is not required. Loans can also be sold if they are written off.

B.2 Debt enforcement/foreclosure

A lender has several legal options to begin judicial enforcement procedures. All of the options below require a judgement/decision by the court.

The standard procedure is for a lender to bring a matter before the court as usual.

The optional procedure is the voluntary sale of immovable property at auction by the court, as regulated by the Latvian Civil Procedures Law. A judge's decision in this case should be based on the assessment of the application submitted by the owner or the pledgee who has the right to sell the pledge in the open market. Following a positive decision, the sale at auction is carried out by a bailiff in accordance with the procedures established by law.

A further alternative procedure is the undisputed compulsory enforcement of obligations, which is also regulated by the Civil Procedures Law. In this case the judge reaches a decision determining whether, and to what extent, the obligation is to be enforced on the basis of the application submitted by the lender. The judge's decision can be enforced, with immediate effect, in accordance with the rules on the enforcement of judgments. The debtor may appeal against such a decision under certain conditions.

The private out-of-court sale of the pledged property may only take place by mutual agreement between a mortgage lender and borrower. Such a sale is not regulated by law and is at the discretion of the parties.

There are no legal or other national reasons disincentivising banks from taking over collateral. However, if the borrower has brought an action against the lender disputing the claim, the court that ruled on the application is entitled to suspend the enforcement of the judgment.

The provisions regarding enforcement of court rulings are the same for all cases.

The government has not taken any specific measures relating to borrowers that can afford to pay but choose not to.

B.3 Corporate insolvency and restructuring

The FCMC does not perceive that deficiencies in the corporate debt resolution regime could represent an obstacle to private debt resolution in the country.

The Latvian legal environment does not provide for in-court and out-of-court procedures specific to microenterprises and SMEs. All entities must observe the same provisions and procedures.

Generally, debt restructuring procedures (with the exception of the legal protection proceedings described below) permit changes to the company's management as well as the sale of its assets at auction or through open-market bilateral sales. If agreed, the parties can apply an out-of-court settlement mechanism.

With regard to out-of-court procedures, the guidelines for out-of-court debt restructuring prepared by the Latvian Ministry of Justice provide an option for the debtor and the creditor to enter into a voluntary debt restructuring agreement before the initiation of in-court insolvency proceedings. In this case both parties seek to reach an agreement to change the terms of the debt repayment in a way that allows the debtor to continue doing business.

With regard to in-court procedures, there is a pre-insolvency regime enabling the early rehabilitation of distressed enterprises (i.e. going concern restructuring). There are special pre-pack procedures for the rapid approval of restructuring plans agreed between debtors and creditors. So-called legal protection proceedings are a collection of legal measures intended to renew a debtor's ability to settle debt obligations.

Legal protection proceedings include such measures as a prohibition on creditors requesting the sale of the debtor's pledged property (with the exception of cases in which such a prohibition causes significant harm to the interests of the creditor), initiating insolvency proceedings, seeking the liquidation of a debtor, etc.

Under legal protection proceedings, the court expeditiously approves a debt restructuring plan negotiated between the debtor and its creditors (including tax authorities) in a consensual manner before the initiation of insolvency proceedings. The court is then obliged to examine the application within a period of 15 days.

The standard duration of legal protection proceedings is two years, which may be extended by an additional two years if the majority of creditors agree.

In the case of legal protection proceedings, creditors may request a debt-to-equity conversion under certain conditions established in Article 39 of the Latvian Insolvency Law¹³⁴. A debtor is also prohibited from entering into any transactions or performing activities which may worsen its financial situation or harm the overall interests of its creditors.

Standard insolvency proceedings may be also initiated by a creditor, a debtor or an administrator. The insolvency process is managed by a court-appointed insolvency administrator who prepares a liquidation plan that includes the costs of insolvency proceedings and the procedures for the compensation of creditors' claims.

Public creditors can agree to partial debt servicing, and there is a procedure available for the clearance of arrears to the public sector. This is part of insolvency proceedings, with tax authorities having priority in the recovery of debts. A process

¹³⁴ Law on Insolvency of Undertakings and Companies of 12 September 1996.

for the clearance of arrears to the public sector linked to private sector restructuring is available, but entails additional restrictions on the insolvency process.

B.4 Household insolvency and restructuring

The FCMC does not perceive that deficiencies in the household debt resolution regime could represent an obstacle to private debt resolution in the country.

With regard to out-of-court debt settlement practices, the Latvian Law On Extrajudicial Recovery of Debt¹³⁵ defines the rights and duties of creditors and providers of debt collection services dealing with household debt. The primary intent of this law is to foster fair, proportional and rational debt recovery¹³⁶ and to promote the voluntary payment of a debt by households. Out-of-court debt collection companies are subject to licencing by the Consumer Rights Protection Centre (issued for a period of three-years). The law also sets limits for debt collection costs to be covered by the debtor.

The FCMC has also established principles and guidelines for out-of-court consumer mortgage restructuring. These high-level principles cover communication and cooperation between the borrower (consumer) and the lender, including the provision of all necessary information, consideration of all possible restructuring solutions prior to any steps to enforce the collateral, confidentiality, etc.

With regard to in-court proceedings, the Insolvency Law provides for a personal insolvency regime for households, an option introduced in 2010 to facilitate the resolution of over-indebtedness in cases in which individual debtors are unable to reach a voluntary out-of-court agreement with creditors.

The filing of a petition to initiate insolvency proceedings is at the sole discretion of a household. The costs of doing so are currently in excess of €800 and consist of a fee of €71.14 to submit the application and a one-off payment of two minimum monthly wages (currently €760) to the insolvency administrator.

The personal bankruptcy procedure comprises the sale of all of the debtor's property and the distribution of the proceeds to the creditors. This is followed by a procedure for extinguishing obligations, during which the income of the household is partly used to satisfy the creditors' claims. Following the completion of this procedure the household is released from its obligations.

The duration of these insolvency/bankruptcy proceedings ranges from one to three-and-a-half years depending on the case.

The corporate insolvency framework is applied to individual entrepreneurs.

¹³⁵ Law on Extrajudicial Recovery of Debt of 27 November 2012.

¹³⁶ This includes, for example, a prohibition on aggressive and offensive communication and restrictions on approaching the debtor at his or her place of employment or residence, during holidays, etc.

B.5 Judicial system

The FCMC does not perceive that the deficiencies in the judicial system could represent an obstacle to private debt resolution. However, the long duration of judicial processes in some cases can prevent banks from liquidating collateral quickly.

Insolvency administrators are subject to professional certification under the Insolvency Law.

B.6 Tax regime

In accordance with the Latvian Law on Enterprise Income Tax¹³⁷, deductions are available for banks' loan loss provisions in accordance with the regulations set by the FCMC. Tax deductions do not depend on the specific resolution measures applied.

In Latvia debtors are subject to capital gains tax on debt write-offs (see Section A. 4).

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

In Latvia the CCR is managed by Latvijas Banka and was launched on 1 January 2008.

The CCR is digitalised and centralised and contains data on debtors (private individuals and legal persons) and their guarantors, their liabilities and the performance thereof, as well as on loan loss provisions and write-offs.

CCR participants (reporting agents) are domestic credit institutions, branches of foreign credit institutions, non-deposit-taking institutions having close links with the aforementioned credit institutions (e.g. leasing companies) or entitled to provide insurance, credit unions and Latvian state companies implementing development and aid programs.

Information within the CCR is available on a loan level. Participants must update the information in the CCR within five days if there is a change in the status of a loan, including the origination of a new loan, a repayment or a breach of loan obligations if the loan is more than 60 days past due and the amount past due (principal and interest) exceeds €150, etc. CCR participants are also obliged to update the information about the outstanding amount of their clients' liabilities on a quarterly basis.

¹³⁷ Law on Enterprise Income Tax of 1 March 1995.

Debtors and their guarantors may access the information about their obligations in the CCR free of charge.

Since 1 January 2015 the operation of private credit information bureaus has been subject to the Latvian Law on Credit Bureaus. Such bureaus can be established and managed by private companies. There are currently two private credit bureaus licensed and supervised by the Data State Inspectorate, specifically AS Kredītinformācijas Birojs (a subsidiary of Creditinfo Group, which is active also in Estonia and Lithuania) and AS CREFO Birojs. In contrast to the CCR, membership and the provision of data to these credit bureaus is voluntary for banks and other service providers.

In accordance with the provisions of the Law on Credit Bureaus, any legal entity that is a member of a credit bureau may only obtain and use the information of a private individual to assess the creditworthiness of a potential client or for credit risk management purposes. Private individuals may only obtain information about their own credit history.

Credit bureaus may also collect and provide information on the credit history of legal entities.

Public asset registers such as the Land Register, Cadastral Registry, Ship Register and Road Vehicles Register identify the asset owner and characteristics and are available to the public to conduct searches. The Land Register also provides data on the prices of residential and commercial real estate transactions, and is available to the general public for searches.

Information on upcoming sales/auctions is published in the official gazette of the Republic of Latvia.

C.2 Debt counselling and outreach

The Consultation and Mediation Centre established by the Association of Latvian Commercial Banks provides free legal advice to indebted households. The main aim of this centre is to help households in financial difficulties to find solutions for loan repayment or restructuring and to encourage the mutual fulfilment of obligations between the banks and their customers.

In order to encourage debt recovery processes, the FCMC has issued two sets of guidelines for settling disputes and handling consumer complaints: (i) Principles and guidelines for out-of-court consumer mortgage workouts and (ii) Guidelines for communication between the financial and capital market participants and their customers.

C.3 Consumer and data protection

In general the FCMC does not perceive that consumer and data protection laws could represent an obstacle to private debt resolution.

However, there are some restrictions on the recording/sharing personal information for debt workout purposes in accordance with the requirements of the Latvian Personal Data Protection Law¹³⁸. Specifically, the processing of personal data is permitted only if the person in question has given his or her consent.

138 Personal Data Protection Law of 23 March 2000.

Annex XII: Lithuania

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Chart 12

Country overview

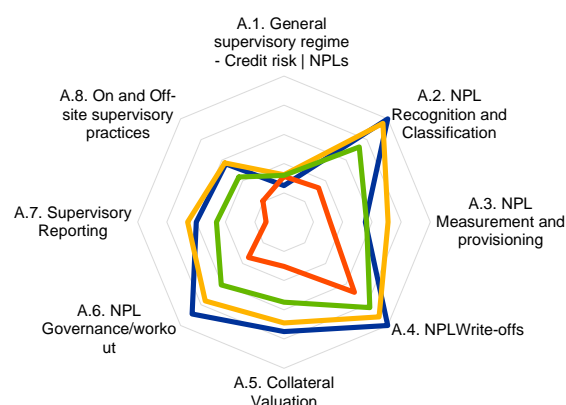
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

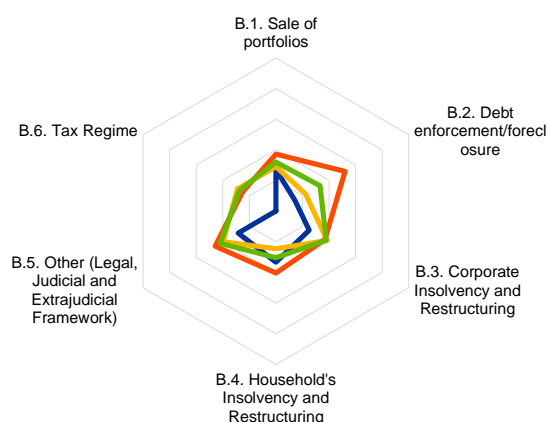
- LT
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



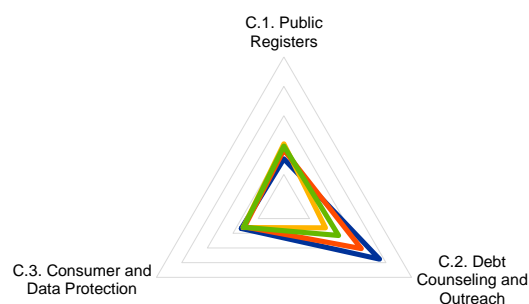
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Lithuania had a total NPL ratio of 4.5% (by segment: households 4.8%, NFCs 6.2%, SMEs 11.2% and CRE 7.8%).¹³⁹

Based on experience from last crisis several **challenges for NPL workout in Lithuania** can be identified.

- **NPL governance:** lack of binding national regulations and guidelines dedicated specifically to NPL management and workout.
- **Domestic NPL/collateral market:** during the recent economic downturn the liquidity of the domestic real estate market was rather limited and in general the local NPL market is not developed.
- **Judicial and extrajudicial framework:** lengthy enforcement procedures can represent a bottleneck for NPL workout.

According to Lietuvos bankas, the NPL workout regime and practice in Lithuania is driven by the specifics of the banking sector itself. Three major participants in the Lithuanian banking sector are relatively minor subsidiaries (e.g. in terms of assets) of Scandinavian banking groups. This does not mean they are of insignificant importance within their groups, and during difficult periods they can expect reasonable financial support from their parent banks, as was perfectly demonstrated during the most recent crisis. When the quality of credit portfolios began to deteriorate, a conservative loan loss assessment was applied, with the outcome of huge credit losses which were essentially directly covered by an injection of capital from the parent banks. Furthermore, specialised private AMCs were established to maintain real estate market liquidity and prices and to manage acquired collateral.

Despite a lack of NPL-specific national regulation, banking supervision is very intensive, with each bank undergoing an annual on-site inspection with a focus on actual issues at that time (i.e. NPL management). Inspections are one of the primary means of expressing supervisory requirements and expectations, including NPL recognition, management and provisioning topics.

On the other hand, NPL management is not adequately addressed in relation to less significant market participants with limited possibilities of capital strengthening, in which case forbearance measures are preferred over enforcement. In this case, national supervisory regulations or guidelines could possibly play a role.

Overall, strong support from Scandinavian parent banks and supervisory measures have worked well, although the introduction of more extensive national regulations on NPL management must be considered.

In terms of **specific supervisory practices** for addressing NPLs, the supervision of NPL management and workout is not extensively and explicitly prescribed in national regulations. The supervisory practices, requirements and expectations

¹³⁹ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITRS), excluding debt securities and off-balance-sheet exposures. The sample covers 69% of banks in Lithuania or 97% of total banking assets.

communicated to banks are based on Basel principles and EBA standards and guidelines. Contemporary best practices, requirements and standards are followed, although communication currently takes place via a dialogue with banks (which is more flexible to some extent) rather than the introduction of formal supervisory requirements or rules.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 32
Main sources of NPL-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Regulation (binding)	114	Banks (incl. branches)	Minimum loan assessment requirements	Document prescribes minimum requirements for the identification of impaired loans and loan loss provisioning.	2005
Regulation (binding)	149	Banks (incl. branches)	Organisation of Internal Control and Risk Assessment (Management)	Document covers general principles of sound risk management within a bank.	2008
Regulation (binding)	03-144	All credit institutions	Responsible Lending Regulation	Responsible lending requirements (maximum LTV, DSTI, maturity etc.) applicable to loans granted to private individuals.	2011

The aforementioned regulation covers the general requirements for credit risk management and loan loss provisioning by banks. In addition, the Lithuanian Regulation on Responsible Lending sets legally binding thresholds for LTV and DSTI ratios along with some other requirements for granting loans to private individuals. In particular, the regulation does not allow (with some exceptions¹⁴⁰) banks to grant loans with an LTV above 85% of the residential real estate market price or acquisition value, whichever is lower. It also requires DSTI ratios to be lower than 40% with the actual interest rate and lower than 50% with the stressed interest rate of 5% (with some exceptions¹⁴¹).

A.2 NPL recognition and classification

For regulatory reporting purposes, banks are legally required to comply with Article 178 of the CRR and with the EBA ITS.

¹⁴⁰ The LTV limit can be up to 95% if government support is provided for low income families. In practise, LTV exceptions are rare.

¹⁴¹ To address extremely high-income households, up to 5% of new lending can be granted to loan applicants with a DSTI below 60%. However, such cases must be supported by a reasonable explanation. In practise, DSTI exceptions are rare.

There are no further national guidelines beyond the EBA ITS concerning the definition and classification of exposures. Banks are free to use their own NPL and forbearance definitions for internal risk management and internal management reporting purposes. However, since a common definition is currently in place, banks are expected to harmonise NPL and forbearance definitions and classification throughout all processes (supervisory reporting, risk management and internal reporting).

Lietuvos bankas has not issued specific guidelines on sub-categories of performing or non-performing exposures or any requirement to reclassify loans out of the NPL portfolio. There are no further national regulations (e.g. early warning indicators) regarding the definition of forbearance and classification/declassification of forbearance in NPLs beyond the EBA ITS. The Central Bank has also not issued any additional specific data collection requirements for forbore exposures.

A.3 NPL measurement and provisioning

Lithuanian banks follow the IAS/IFRS accounting framework. The Minimum Loan Assessment Requirements (MLAR) introduced by the Central Bank provide a minimum list of loss events which is in line with IAS 39¹⁴². In addition, the MLAR define an impairment of the value of collateral as a loss event specific to cases in which the repayment of the loan is directly dependent on the value of the collateral. Banks are expected to expand the prescribed list further in their internal loan loss provisioning rules.

Since the MLAR prescribe more general requirements for loan assessment and provisioning and banks differ in terms of the scope and complexity of their activities, lending profile, internal models for risk management, etc., provisioning approaches are not necessarily comparable across all banks¹⁴³, meaning that no mechanism for the horizontal alignment of provisioning practices is in place.

Compliance of individual bank's provisioning rules with the MLAR is ensured through on-site and off-site supervision. The MLAR also prescribe some considerations that must be taken into account when assessing cash flows from collateral for provisioning purposes. There is not, however, any specific guidance regarding accrued interests, nor estimate of the recovery time, used for the provisioning of NPLs.

Banks are allowed to estimate specific provisions on an individual loan or collective (group of loans) basis. The latter is normally applied to granular portfolios with similar risk characteristics (private loans for house purchases, consumer loans, credit cards etc.) and loss rates must be supported by historical data (preferably internal data). This is not an issue for those banks with internal ratings-based (IRB) approaches in

¹⁴² IAS 39: Financial Instruments: Recognition and Measurement

¹⁴³ Banks with IRB models have more data and data of higher quality on historical losses (PD, LGD), allowing them to establish the level of provisions more accurately than banks without IRB models.

place where they must still collect data (defaults, loss/recovery rates etc.) for the IRB models' validation purposes.

A.4 NPL write-offs

There are no specific national guidelines or rules for NPL write-offs. The Central Bank requires institutions to have a derecognition policy in place, which must ensure a timely accounting write-off of credit facilities where there is no realistic prospect of recovery and provide adequate governance procedures for authorising write-offs.

The Central Bank has not provided any additional incentive for NPL write-offs, i.e. no increased capital charges and no time limits on how long NPLs can be carried on banks' balance sheets, although it does specify that derecognition of a credit facility does not imply that the institution is discontinuing its efforts to recover the outstanding debts.

A.5 Collateral valuation

The Lithuanian authorities involved in banking supervision have no concerns that collateral-related issues could represent an obstacle to private debt resolution.

The Lithuanian Law on the Bases of Property and Business Valuation¹⁴⁴ defines major principles for the valuation of property or business as well as requirements for appraisers. While there are no legally binding requirements for collateral valuation for loan provisioning purposes, IVS/EVS requirements do apply. As market value is expected to be used when calculating cash flows from the potential realisation of collateral, the use of independent external real estate appraisals is common practice.

Appraisers are subject to licencing and supervision by the Lithuanian Authority of Audit, Accounting, Property Valuation and Insolvency Management.

External independent real estate appraisers are eligible to perform collateral valuations for Pillar 1 capital calculations. For risk management/ICAAP purposes, internal qualified valuers or other experts are eligible as well. The required frequency for the valuation of immovable property collateral must be prescribed in the banks' internal policies and guidelines to ensure that this takes place at regular intervals and reflects current market conditions. Banks must comply with minimum CRR frequency requirements (CRE ≤ 12 months; RRE ≤ 3 years). The frequency for the collateral valuation of defaulted assets is not defined separately. Normally, when the value of a loan becomes dependent on the value of the collateral (e.g. it acquires NPL status), the frequency of collateral revaluation is normally set at 12 months or less.

¹⁴⁴ Law of 25 May 1999 – No VIII-1202, as amended on 2 July 2013 – No XII-509.

Internally computed indexes are acceptable as well, although their estimation must be clear, sound, reasonable and supported by relevant data. The application of such indexes is normally only acceptable for mass retail collaterals with an active market, i.e. residential real estate.

When calculating provisions on an individual loan basis, the market value of collateral must be adjusted according to the estimated time to realisation (discounting effect), liquidity of collateral, realisation cost, insurance of collateral, stability of collateral value over time, likely difficulties, etc.

There are no specific rules that require banks to have a reliable data collection to assess collateral recovery.

From a supervisory perspective, the adequacy of the collateral values used for provisioning and risk management purposes is ensured through on-site and off-site supervisory measures.

In Lithuania, the supervisory authorities do not provide additional incentives to reduce reliance on collateral, whether through increased provisioning or the assessment of valuation practices.

A.6 NPL governance/workout

There is no specific national regulation on NPL governance and workout. Nonetheless, from a supervisory perspective, the requirement to separate NPL governance and workout from loan origination and performing loan services based on best practices has been communicated through on-site and off-site supervision measures. Currently, all banks have separate units to deal with NPLs.

There are no binding requirements or formal guidelines on NPL management practices, loan restructuring practices or data collection. Banks are not required to have NPL management strategies, action plans and operational targets for NPL reduction.

Banks are expected to maintain low levels of NPLs by applying regular credit risk management practices and monitoring potential threats. During the recent financial crisis supervisory expectations on how to recognise and deal with NPLs were communicated to banks through formal and informal bilateral meetings, after which appropriate actions were taken by banks and their shareholders. In addition, specific supervisory measures based on on-site findings were introduced (if needed) by individual banks, e.g. a requirement to prepare and implement an action plan to improve NPL management, recognise certain exposures as NPLs or book adequate level of provisions.

There are no any legal impediments to outsourcing NPL management or workout functions in Lithuania. However, banks do not outsource NPL management as no special service firms operate in the country.

There are no specific rules/criteria for valuing foreclosed assets on the foreclosure date.

A.7 Supervisory reporting

Credit institutions provide the required COREP/FINREP reporting templates, including information related to the EBA ITS requirements on forbearance and NPEs, on a quarterly basis. No additional reporting focused exclusively on NPLs beyond basic EBA reporting was introduced in Lithuania. Detailed aggregated NPLs statistics (e.g. NPL ratios by economic activity, debtor type etc.) are publicly available in the Central Bank's statistics.

In general there is also granular (loan level) quarterly reporting to Lietuvos bankas regarding banks' loan portfolios, which provides more details than standard FINREP reporting (gross value, net value, non-performing status, etc.) as it also contains data such as loan origination date and maturity, internal risk grade or interest rate. This reporting can, to some extent, be used to carry out quality assurance of the NPL reporting.

A.8 On-site and off-site supervisory practices and methodologies

There are no specific guidelines dedicated specifically to the supervision of NPL management and the Central Bank does not have a specific methodology to assess the policies and procedures used by banks to handle NPLs. EBA guidelines and SSM SREP manuals are followed for on-site inspections.

The on-site inspections are not exclusively focused on NPL portfolios, although this topic is a part of the credit risk review and all issues related to NPL management and provisioning are covered. In particular, the credit file reviews focus heavily on the adequacy of loan loss provisions where the status of a loan or borrower (performing vs. non-performing) and the value of collateral is of key importance. Banks are expected to use a conservative approach when assessing both of these elements.

A CCR, administrated by the Central Bank, is used for both on-site and off-site supervision purposes.

During the period from 2012 to 2016, only small and not systemically important banks were forced to dispose of assets in order to deleverage. During this period, the Central Bank did not undertake any thematic reviews focused on banks' NPL management capabilities.

In Lithuania, banks were subject to the AQR in the context of the SSM comprehensive assessments, and no capital shortfalls were identified.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

There is no developed market for NPLs in Lithuania, although there are no legal impediments to the sale of portfolios. Normally banks sell only small portfolios of defaulted consumer loans and credit card debts, although sporadic transfers of significant portfolios also occasionally occur, e.g. after the bankruptcy of a bank.

During the financial crisis, some banks established private AMCs when a huge amount of collateral which appeared to be illiquid was launched on the market (demand was squeezed). The role of these companies was to manage an asset (real estate) until the liquidity of the real estate market picked up again. There are no specific requirements for the establishment of such companies, i.e. they can be established via the regular procedure applied for the incorporation of companies.

Institutional investors and foreign institutional investors are allowed to purchase NPLs from domestic banks. Loan purchasers can be third party banks. However, the rights and obligations under a consumer credit agreement can be transferred only to a person included in the public list of consumer credit lenders¹⁴⁵, in accordance with the Lithuanian Law on Consumer Credit¹⁴⁶. This applies only to rights and obligations under valid consumer credit agreements.

B.2 Debt enforcement/foreclosure

The procedure to apply for the recovery of mortgage debt was simplified by amendments to the Lithuanian Civil Code in 2011. Previously, all matters relating to enforcement of the collateral were referred to a mortgage judge. Under the new procedure, the mortgagee may apply to a notary for an out-of-court execution if the debtor fails to discharge the obligation within the time period indicated in the mortgage agreement. The notary, having notified the debtor and the collateral provider, issues the endorsement to enforce the debt within a period of 20 days. Other bases for the initiation of this procedure may be agreed by the parties in the mortgage agreement as well. Furthermore, the Law on Financial Collateral Arrangements implements the Collateral Directive (Directive 2002/47/EC) in Lithuania.

¹⁴⁵ The person may be entered on the public list of consumer credit lenders if it meets the requirements of the Law on Consumer Credit and submits a set of documents to the supervisory authority. The supervisory authority publishes the public list of creditors on its website: http://www.lb.lt/list_of_public_consumer_credit_lenders

¹⁴⁶ Law of 23 December 2010 – No XI-1253, as amended on 18 December 2014 – No XII-1503.

B.3 Corporate insolvency and restructuring

The corporate insolvency and debt restructuring regime is not considered by Lietuvos bankas to be an obstacle to private debt resolution.

The Law on Restructuring of Enterprises¹⁴⁷ provides conditions for legal persons in financial difficulties, which have not discontinued their economic and commercial activities, to maintain and develop these activities, to settle their debts and to avert bankruptcy. Such legal persons can submit to a court a petition to initiate restructuring proceedings. The court must decide whether or not to initiate the restructuring within one month of the date of adoption of the ruling regarding the receipt of the petition.

There is also a simplified procedure in place for enterprise restructuring proceedings. It may be initiated if the restructuring plan is drawn up in accordance with the provisions of the aforementioned law prior to the filing of the petition to initiate the enterprise restructuring proceedings.

Restructuring must be conducted in accordance with the restructuring plan and may not last longer than four years.

The aforementioned legal provisions do not apply, inter alia, to credit institutions, payment institutions, electronic money institutions, insurance and reinsurance companies or management companies.

The activities of the company's management during the restructuring are supervised by a restructuring administrator appointed by the court. During the drafting of the restructuring plan, the sale of the company, whether in part or in its entirety, or of its fixed assets, real estate attributed to current assets or property rights is prohibited without the authorisation of the court. In general it is possible to change the company's management and to sell the company's assets (under debt restructuring), through both voluntary auctions and open market bilateral sales, within the context of the approved restructuring plan. As regards voluntary auctions, a company's assets may be sold if a creditor gives consent.

There is also a "pre-pack" legal procedure in place for the rapid approval of restructuring agreed by the debtor and creditor.

In Lithuania there are no special in-court and out-of-court procedures for microenterprises and SMEs.

B.4 Household insolvency and restructuring

The Lithuanian Law on Personal Bankruptcy¹⁴⁸ aims to restore the solvency of a natural person while ensuring that creditors' claims are satisfied and to strike a fair

¹⁴⁷ Law of 20 March 2001 – No IX-218.

¹⁴⁸ Law of 10 May 2012 – No XI-2000.

balance between the interests of debtors and creditors. The personal bankruptcy process takes the form of a judicial procedure. This law applies to natural persons irrespective of the time of occurrence of their liabilities. A natural person intending to file a personal bankruptcy petition is obliged to provide written notice thereof to all creditors no less than one month before doing so.

B.5 Judicial system

There are no specialised courts responsible solely for insolvency and bankruptcy issues. Therefore, insolvency and bankruptcy cases are handled by courts of general jurisdiction.

Insolvency administrators and their assistants require professional certification. Chapter 3 of the Lithuanian Enterprise Bankruptcy Law¹⁴⁹ establishes the relevant requirements, including a qualifying exam, the issuing and revocation of certification, the list of persons providing insolvency administration services and the liability of the insolvency administrator and his or her assistant. This law also provides for specific time requirements for certain parts of the insolvency process (e.g. creditors must file their claims within no more than 45 days of the effective date of the court order, and an appeal filed with the court of appeals against the decision to institute insolvency proceedings or to appoint, temporarily substitute or dismiss the administrator must be examined within no more than 14 days). The decision of the court of appeals is final and not subject to appeal by cassation.

B.6 Tax regime

Any losses related to loan value adjustments (e.g. loan loss provisions) or arising from loan enforcement procedures (e.g. realisation of collateral, write-offs) are treated identically to other costs and losses in a profit/loss statement, and these costs have a direct negative impact on the net profits which are subject to taxation. There is also a regime of deferred taxes on net profits in place, meaning that the amount of the deferred tax is accumulated during loss years and is used to decrease tax payable for the next profitable year.

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

The CCR in Lithuania was established in 1995 and is administrated by Lietuvos bankas. Currently, all credit institutions are obliged to provide data (at both

¹⁴⁹ Law of 20 March 2001 – No IX-216, as amended on 21 June 2012 – No XI-2092.

consolidated and solo levels) on individual loans greater than €290. As of 1 January 2017, consumer loans providers (that are not credit institutions) and P2P lending platform operators are included in the list of reporting institutions with an exposure threshold of €30.

Information within the CCR is available on a loan level. More specifically, the CCR includes basic borrower and loan identification data as well as data on the outstanding exposure and its movement (withdrawals and repayments), type of collateral and its value, value of the loan, indicators of default and past due status, etc. It also includes information on write-offs, although no information on loan loss provisions is included.

CCR information is updated within five days if there is any change in the loan-level data, such as partial repayment, disbursement of a loan, change in interest rate, change in collateral value or gain/cessation of past due status, etc. CCR data is used by the Central Bank for prudential supervision as well as financial stability and statistical analysis, and borrower-level information is provided to credit institutions upon request, usually for credit origination (borrower risk assessment) purposes. All legal or natural persons can access the CCR information pertaining to them, free of charge, to verify that it is correct.

Credit institutions are charged €0.16 per request for borrower information, regardless of whether it pertains to a business or private individual. Banks also use the State Enterprise Centre of Registers, which administers three main state registers: the Real Property Register and Cadastre, the Register of Legal Entities and the Address Register.

The Real Property Register and Cadastre contains data on all real property objects registered in Lithuania, including characteristics of the asset, as well as the prices of all residential and commercial real estate transactions. The data in the Register and Cadastre are public.

A further private register used by banks for credit risk management purposes is Creditinfo (a subsidiary of Creditinfo Group, which is also active in Estonia and Latvia), which provides information on the credit quality and indebtedness of individual clients (including both enterprises and private individuals).

C.2 Debt counselling and outreach

With regard to the provision of free or subsidised legal advice, in accordance with the Lithuanian Law on State-Guaranteed Legal Aid¹⁵⁰ households in Lithuania are eligible for primary and secondary legal aid. Primary legal aid is available to every citizen in the form of legal advice, the drafting of documents for the out-of-court settlement of disputes and the preparation of applications for secondary legal aid if

¹⁵⁰ Law of 28 March 2000 – No VII-1591, as amended on 15 April 2008 – No X-1492.

required. Secondary legal aid consists of representation in court, and is limited to low income households.

The Association for Fair Banking also provides legal support (including consultations on out-of-court settlement possibilities, lawyer recommendations if required, etc.) to private individuals who were/are facing disputes with banks. However, this service is not free and only those individuals who are members of the association (subject to entrance and annual fees) are eligible.

C.3 Consumer and data protection

Consumer and data protection laws are not considered by the Central Bank to be an obstacle to private debt resolution.

There are restrictions on the recording and sharing of personal information for debt workout purposes. The requirements for the processing of personal data are established by the Lithuanian Law on Legal Protection of Personal Data¹⁵¹, the fourth chapter of which is dedicated to the processing of personal data for the evaluation of solvency and debt management.

¹⁵¹ Law of June 11 1996 – No I-1374, as amended on February 1 2008 – No X-1444.

Annex XIII: Luxembourg

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Chart 13

Country overview

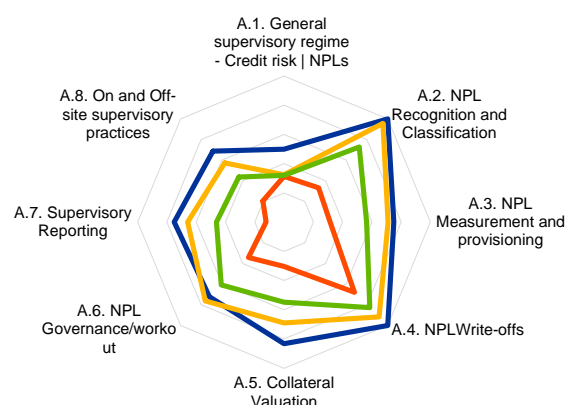
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

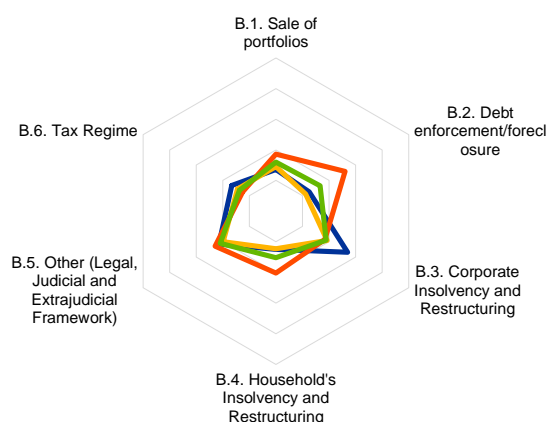
- LU
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



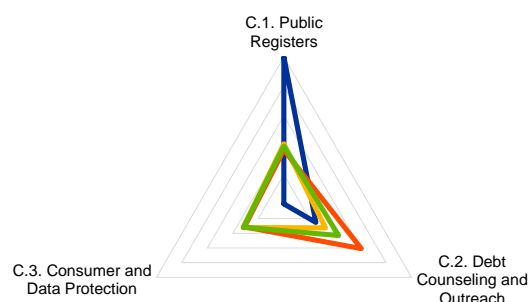
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Luxembourg had a total NPL ratio of 1.4% (by segment: households 2.2%, NFCs 1.8%, SMEs 4.2% and CRE 3.4%).¹⁵²

As a result of the comparatively low overall NPL ratios in recent years, the Luxembourg Financial Sector Supervisory Commission (*Commission de Surveillance du Secteur Financier* – CSSF) had reason to pursue a less pervasive strategy to tackle the NPL workout issue.

All banks in Luxembourg, including SIs and LSIs, must comply with CRD IV, EBA ITS and IAS/IFRS. All banks are subject to reporting based on IAS/IFRS.

The ECB guidance on non-performing loans of 20 March 2017 applies directly to SIs (representing more than 70% of Luxembourg banking assets).

The regulatory framework in Luxembourg, in particular CSSF Circular 12/552, is primarily designed to address internal governance and risk management. It provides minimum requirements for bank policies to identify and manage non-performing loans/commitments and exposures in default (as defined by European rules) as well as establishing specific provisions relating to loan origination. Circular 12/552 also requires banks to at least collect information and conduct an analysis of the debtor's creditworthiness, repayment plan and repayment ability throughout the maturity of the debt. Banks are also required to consider the overall debt level of the borrower and to establish a reasonable security margin in order to cover any increase in interest rates. This principle-based approach in Luxembourg does not provide specific NPL-related guidance.

As a result of the low levels of NPLs in the country overall, the domestic market for NPLs is not developed.

Following the publication of the aforementioned ECB guidance on 20 March 2017, the CSSF intends to apply this guidance to LSIs in a proportionate manner.

Even though the current NPL situation seems favourable overall, the survey based on the findings and assessment as of the end of 2016 reported some features of the framework that could represent **potential areas for improvement for NPL workout in Luxembourg**:

- **NPL governance**: while general principle-based guidelines and requirements pertaining to internal governance and risk management are in place (as established in CSSF Circular 12/552) these do not explicitly provide a detailed guidance on NPL work-out practices for banks.
- **CCR**: there is currently no CCR in Luxembourg, although the Banque Centrale du Luxembourg (BCL) is part to the ECB's AnaCredit project, which should go live for corporate debtors at the end of 2018.

¹⁵² Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers 79% of banks in Luxembourg or 86% of total banking assets.

Finally, apart from general accounting rules (IAS/IFRS) there is no additional specific guideline in place on the prudential accounting approach to NPL provisioning and write-offs. In this regard the CSSF notes that there is no legal scope to provide further national regulations beyond IAS/IFRS rules.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements established in CRD IV, EBA ITS NPL¹⁵³ and the ECB guidance mentioned above, the CSSF has issued the following specific guidelines/requirements regarding credit risk management practices and processes:

Table 33

Main sources of NPL-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Circular	12/552	Credit institutions	Internal governance and risk management	The circular requires that credit institutions have robust internal governance arrangements, including a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks and adequate internal control mechanisms.	2012-12
Circular	14/593	Credit institutions	Reporting requirements	Supervisory reporting requirements applicable to credit institutions.	2014

The CSSF has not issued any guidance defining specific limits on household or NFC portfolios (e.g. maximum LTV or maturity). This is because NPLs have not been a material issue at any bank in Luxembourg. In its capacity as a member of the Luxembourg Systemic Risk Board, the CSSF regularly collects statistical information on LTV, DSTI and LTI ratios in relation to residential real estate loans granted by the major players in this field. In this context, the CSSF, as the designated authority, holds regular meetings with the concerned banks regarding the risk management of their residential real estate exposures.

A.2 NPL recognition and classification

There is no guidance beyond the IAS/IFRS, EBA ITS and ECB guidance on non-performing loans mentioned above.

¹⁵³ The scope of application of the EBA ITS, which is part of the FINREP, has been extended by the CSSF to the institutions supervised on an individual basis. In the CRR, the scope of application of FINREP is limited to institutions supervised on a consolidated basis.

A.3 NPL measurement and provisioning

The IAS/IFRS and ECB guidance on non-performing loans apply as explained above.

The CSSF also has the legal power to require banks to apply a specific provisioning policy or treatment of assets to exposures in terms of own funds¹⁵⁴.

A.4 NPL write-offs

There is no guidance beyond the IAS/IFRS and ECB guidance on non-performing loans as explained above.

A.5 Collateral valuation

There is no guidance beyond the IAS/IFRS and ECB guidance on non-performing loans and the CRR as explained above.

The CSSF has no concerns that collateral-related issues could represent an obstacle to private debt resolution.

Regarding foreclosed assets, in Luxembourg creditors in principle do not take possession of the collateral received, except for certain types of collateral such as financial instruments or claims which may be subject to a security interest in the form of a title transfer or subject to a pledge enforced by way of an appropriation of collateral (e.g. a pledged bank account). There is no mechanism in place for interbank coordination or for coordination between private and public debtors on individual debtor cases.

A.6 NPL governance/workout

NPL management by SIs must be organised according to the aforementioned ECB guidance on non-performing loans. The CSSF intends to apply this guidance to LSIs in a proportionate manner.

Circular 12/552, which is primarily designed to address internal governance and risk management, also provides minimum requirements for banks' policies to identify and manage doubtful loans/commitments and exposures in default (as defined by European rules).

In accordance with Circular 12/552, institutions must establish measures to be applied when a debtor does not comply with the contractual provisions. In addition, the decision to restructure a credit must be subject to the decision-making process

¹⁵⁴ In accordance with Article 53-1(2)(4) the Law of 05/04/1993 on the financial sector, which is the national transposition of Article 104(1)(d) of CRD IV.

laid down in the circular. Banks must have a sound risk management framework in place to identify, monitor and manage commitments. In the context of private banking activities, banks must maintain an early warning system that monitors the financial collateral's value, triggers the liquidation process of the financial collaterals and is independent of the business function.

There are no legal obstacles to banks in Luxembourg outsourcing NPL management. However, as a result of the low levels of NPLs this is not standard practice.

There is a licensing and regulatory regime in place to enable non-banks to recover/manage debts (including NPLs).

Since NPL levels in Luxembourg are low, the CSSF has not issued formal guidelines to banks regarding NPL management strategies. Banks are not required to have operational targets for NPL reduction.

There is also no specific guideline in place in Luxembourg on restructuring practices. The CSSF requires banks to follow the requirements of Circular 12/552 for decision-making processes.

A.7 Supervisory reporting

All credit institutions submit the required COREP/FINREP reporting templates (using IFRS accounting rules), on both consolidated and individual basis.

A.8 On-site and off-site supervisory practices and methodologies

As regards on-site supervision, in addition to their annual statutory audit external auditors perform additional audit work documented in the "annual long-form audit report". Long-form reports are produced annually for all Luxembourg banks and submitted to the competent authorities. In accordance with Article 54(1) of the Law of 5 April 1993 on the financial sector and CSSF circular 01/27, the long-form report must include a detailed quantitative and qualitative analysis of the credit risk including, in particular, the follow-up and management of the credit/counterparty risk, the provisioning policy, the accounting treatment of interest of problematic debts, the assessment and the management of the collaterals and the quality of the loan files.

For the eight Luxembourg banks subject to the AQR in 2014 (as part of the comprehensive assessment exercise) the results confirmed low exposures to NPL. For banks considered less significant under the SSM regulation, the CSSF did not undertake specific thematic reviews of their NPL management capabilities during the period from 2012 to 2016 in light of the low levels of NPLs confirmed by the long-form reports and legal reporting.

The CSSF conducts regular on-site inspections targeted at credit risk in banks. An NPL review is usually part of on-site inspections in Luxembourg. When assessing the

policies and procedures used by banks to handle NPLs, the CSSF considers bank-specific features such as business model, legal nature, size, internal organisation, etc.

Off-site assessments are based in particular on the external auditor's long-form report, the bank's internal report, the supervisory reporting as defined in the EBA ITS and the stress testing of residential real estate exposures.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

The CSSF does not perceive any deficiencies in the NPL market that could represent an obstacle to private debt resolution in Luxembourg.

Due to the very low levels of NPLs in Luxembourg (1%), there is no secondary market for NPLs originated by Luxembourg banks.

The Luxembourg Civil Code provides the common legal framework for the assignment of claims and, accordingly, a transfer of NPLs would be subject to its relevant provisions. With regard to the effects against the debtor, it would in any case be necessary to ensure that the debtor is aware of the assignment or has consented to it. The CSSF is not aware of any legal impediments that would prevent banks or institutional investors, either national or foreign, from purchasing loans from domestic banks. Parties are free to contract as they see fit, subject to the relevant Luxembourg public order regulations.

To date, no publicly-sponsored AMCs have been established in Luxembourg. There are in principle no impediments to banks setting up an AMC in cooperation with investment firms (e.g. by way of a joint venture), subject to compliance by such an AMC with the conditions attached to the exercise of certain regulated activities under the Luxembourg Banking Act of 1993 (*Loi du 5 avril 1993 relative au secteur financier*).

B.2 Debt enforcement/foreclosure

The CSSF does not perceive that the legal framework for real estate transactions could represent an obstacle to private debt resolution in Luxembourg.

A strict framework applies with respect to mortgages under the Civil Code and other specific laws. Mortgages may be enforced by a judicial seizure proceeding according to the Law of 8 January 1889 on the seizure of immovable properties or, under certain conditions, according to Article 879 of the New Code of Civil Procedure, which entails a simplified out-of-court procedure before a notary.

With respect to types of assets other than real estate, the Luxembourg Collateral Act of 2005 offers a secure framework within which to ensure a rapid out-of-court enforcement/foreclosure in relation to security interests in the form of “pledges” (*gage*) and “transfers of title by way of guarantee” (*transfert de propriété à titre de garantie*) over claims and financial instruments. The law entitles a creditor whose debtor has defaulted on a debt to appropriate and liquidate collateral in the form of financial instruments, as well as to assign claims received as collateral by way of a private sale or a public auction.

In general, the Civil Code includes provisions with respect to security interests (such as pledges) in relation to those assets.

B.3 Corporate insolvency and restructuring

The CSSF does not perceive any deficiencies in the corporate debt resolution regime that could represent an obstacle to private debt resolution in Luxembourg.

The main types of formal in-court procedures available for companies in financial difficulties in Luxembourg include:

- Bankruptcy proceedings (*faillite*): a procedure for liquidating the assets of a debtor who has become insolvent.
- Composition with creditors (*concordat*): a procedure, like bankruptcy, allowing liquidation of the debtor’s assets while allowing him or her to avoid the effects of bankruptcy proceedings.
- Controlled management (*gestion contrôlée*): a procedure initiated by a debtor in order to reorganise a debtor’s business. It can also be used to ensure the best possible realisation of the debtor’s assets. If a court accepts the debtor’s application, it then appoints an administrator who is charged with preparing a reorganisation plan or an asset realisation plan.
- Suspension of payments (*suspension des paiements*): a procedure which applies only if a debtor is unable to honour debts as a result of extraordinary circumstances. Suspension of payments can only be granted for a certain period of time if the debtor’s circumstances allow assets and liabilities to be brought back into balance.
- Specific proceedings for judicial liquidation (*liquidation judiciaire*) and suspension of payments (*sursis de paiement*) provided for by the Banking Act of 1993. Both proceedings apply to entities that manage third parties’ funds and are subject to said law.

The applicable procedure depends largely on the nature of the difficulties facing the concerned entity and the activity pursued by said entity.

Once bankruptcy proceedings are begun by a court, a debtor is prohibited from administering his/her assets and may no longer undertake any payments or

transactions or take any other action in relation to those assets. In composition with creditors proceedings or suspension of payments proceedings, a debtor is not allowed to transfer, mortgage or commit assets without the authorisation of the judge appointed by the relevant court.

In general, by virtue of the freedom to contract, it is always possible for parties to a loan agreement to enter into an out-of-court debt restructuring arrangement provided that no formal insolvency proceedings have been initiated with respect to the debtor. Such out-of-court debt restructuring arrangements, when entered into in a pre-insolvency scenario, are also subject to the rules on the suspect period (*période suspecte*) seeking to protect a debtor's assets as well as the rules on the protection of other creditors.

B.4 Household insolvency and restructuring

The CSSF does not perceive any deficiencies in the household debt resolution regime that could represent an obstacle to private debt resolution in Luxembourg.

The Luxembourg Over-indebtedness Act of 2013 establishes a procedure for the collective settlement of non-professional (i.e. private) debts of natural persons with a view to restoring the situation of individuals who are excessively indebted by enabling them to repay their debts under conditions which are acceptable to all parties concerned.

The law provides for an agreed settlement procedure before an ad hoc mediation committee as well as a judicial settlement procedure before a court (*Justice de paix*). On a subsidiary basis, for cases where the situation of a debtor is irremediably compromised, the law provides for a personal restructuring procedure before a court, leading to a seven-year debt-discharge period.

B.5 Judicial system

The CSSF does not perceive any deficiencies in the judicial system that could represent an obstacle to private debt resolution in Luxembourg.

Insolvency cases are dealt with by specific chambers of the commercial court (Tribunal d'arrondissement siégeant en matière commerciale). Insolvency administrators are in most cases lawyers or statutory auditors, hence subject to a professional certification.

B.6 Tax regime

The CSSF does not perceive that the tax regime could represent an obstacle to private debt resolution in Luxembourg. Loan loss provisioning is tax deductible. Tax losses cannot be carried back to previous years, but may in principle be carried forward (up to a maximum of 17 years). In principle, Luxembourg banks draw up

their fiscal documentation under Luxembourg nGAAP. The carrying-forward of a tax loss is set out in the relevant tax legislation (*Loi sur l'impôt sur le revenu* – LIR) and all banks are entitled to make use of this option.

C Other information framework

There is currently no credit bureau/register in Luxembourg. However, the BCL is part to the ECB's AnaCredit initiative to introduce a harmonised credit bureau/register across the euro area. The proposed credit bureau/register is expected to receive its first report in September 2018, and will initially apply only to corporates with a reporting threshold of €25,000.

Annex XIV: Malta

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

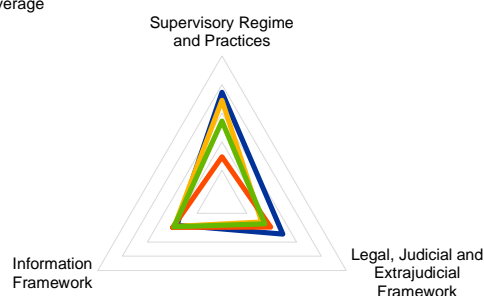
Chart 14

Country overview

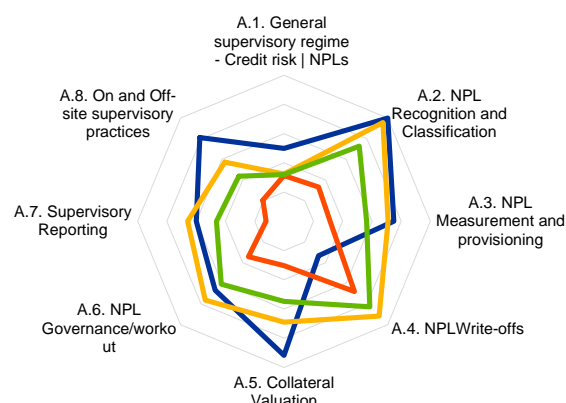
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NPL Framework Overview

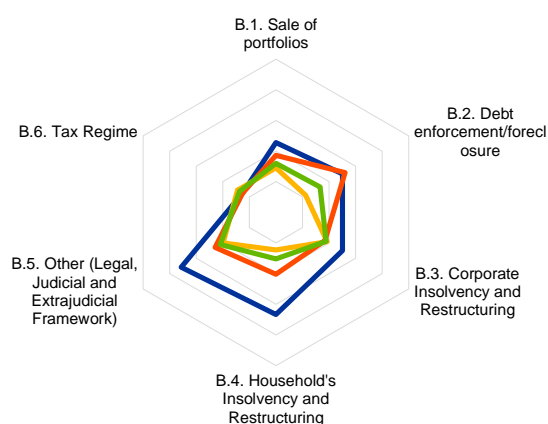
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- SSM Average



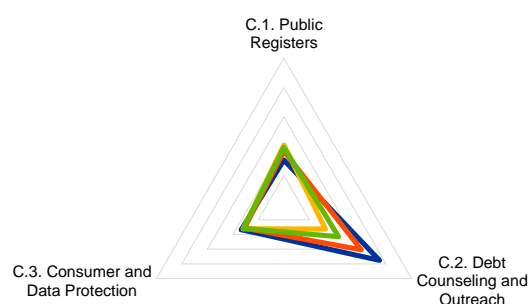
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Malta had a total NPL ratio of 5.8% (by segment: households 5.3%, NFCs 10.2%, SMEs 15.5% and CRE 29.9%).¹⁵⁵

The **main challenges to NPL workout** in Malta are as follows:

- **Collateral and related issues:** one of the main challenges faced by banks in terms of NPL workout is that immovable property is held as the main form of collateral, which results in concentration risk. The fact that regulatory guidance on collateral is principle-based does not ensure more streamlined practices in terms of how collateral valuations are carried out. Banking regulation does not provide incentives to reduce reliance on collateral through increased provisioning or the assessment of valuation practices.
- **Market for NPLs:** in Malta, due to the relatively small size of the loan book and even smaller aggregate non-performing loan portfolio, it is very difficult for banks to dispose of their non-performing loans by securitising them. There are no specific national-level initiatives regarding the creation of a public AMC in order to acquire and manage NPL portfolios. Nonetheless, the legal framework in place does not impose restrictions on the sale of NPL portfolios to private third parties (other banks or institutional investors).
- **Corporate insolvency and restructuring:** the corporate insolvency and debt restructuring regime is not considered conducive to private debt resolution. The main limitation is thought to be the lack of a pre-insolvency regime which would enable the early rehabilitation of distressed companies. This is exacerbated by the lengthy court proceedings which may take several years. In corporate credit restructuring, it is possible to change the company's management with court approval, but it is not possible to sell the assets of the company through open-market bilateral sales.
- **Judicial system:** the judicial process takes several years, unless the defaulter co-operates with the bank and grants it an executive title by signing what is known as a "constitution of debt". This lengthy process may also be one of the reasons contributing to the banks' legacy non-performing loans.
- **Debt enforcement/foreclosure:** the lack of supervisory guidance on foreclosure in this area may also hinder foreclosure practices. Furthermore, no specific measures have been taken by the Government to tackle debtors which can afford to pay but choose not to, and there are no legal measures available to enable the rapid out-of-court enforcement of the collateral. In this respect, a major challenge faced by banks in foreclosure proceedings is the recent legal amendment whereby the price of the collateral being sold at judicial auction is subject to a minimum floor of 60% of the value of the property as determined by a court expert.

¹⁵⁵ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance-sheet exposures. The sample covers all credit institutions and their subsidiaries licenced in Malta, except for branches.

The Malta Financial Services Authority (MFSA) has taken certain initiatives to address the NPLs in the country. Reflecting the focus on the issue of high NPLs, the amendments to Banking Rule 09 (BR/09)¹⁵⁶ were proposed at the same time as the ECB consultation on guidance to banks on non-performing loans¹⁵⁷. The recent BR/09 amendments are very much in line with the ECB guidance which require banks to establish a clear strategy aligned with their business plan and risk management framework to effectively manage and ultimately reduce their NPL stock in a credible, feasible and timely manner.

The recent amendments are essentially based around a medium-to-long-term threshold for the NPL ratios of credit institutions. Credit institutions holding a higher ratio than a target level (set at 6%) will be required to draw up a concrete reduction plan to bring the levels of non-performing loans below this long-term target. Failure to adhere to this plan will require the institution to shore up its resiliency through the accumulation of an additional capital reserve.

Under BR/09, credit institutions are now also required to report a number of variables on a semi-annual basis following the submission of the NPL reduction plan. The reportable figures include actual NPL level, actual “cure” rate and actual new NPLs, amongst the others.

Credit institutions will also be requested to conduct a yearly self-assessment of their performance against the milestones established in the reduction plan.

If a credit institution is found to be deviating from any phase of the NPL Reduction Plan, following an annual review by the MFSA, it will be required to allocate capital to a new “Reserve for Excessive NPLs”. This appropriation will run annually until the NPL reduction plan is back on track and is to be taken from the profits for each corresponding financial year.

The allocation of the reserve shall be equivalent to a percentage of the net NPL portfolio of each credit institution falling within the scope of consolidation. The applicable rates are also graded according to the classification of the NPLs, with higher levels carrying higher allocation rates.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

¹⁵⁶ BR/09/2016 Measures Addressing Credit Risks Arising from the Assessment of the Quality of Asset Portfolios of Credit Institutions Authorised under the Banking Act 1994.

¹⁵⁷ European Central Bank (2016), ECB Draft guidance to banks on non-performing loans, Frankfurt am Main, March.

Table 34**Main sources of NPE-related regulation**

Type	Ref.	Scope	Topic	Summary description	Entry into force
Banking rule	BR/09	All credit institutions	Credit risk management	Regulation on how credit institutions can mitigate risks arising from their loan portfolio, outlining the basis for a bank's sound credit risk policy, guidance on forbearance and non-performing loans. The rule also empowers the MFSA to impose Pillar 2 capital add-ons.	Amended in 2013 and 2016

BR/09 is a principles-based regulation. Banks are required to implement a robust impairment loss measurement policy and to have a collateral valuation policy as part of their overall credit risk policy, taking into account the minimum requirements set up by the MFSA.

As stated in BR/09, a bank's credit risk policy must include appropriate risk assessment processes and effective internal controls to consistently determine that any impairments are in accordance with the credit institution's stated policies and procedures. In particular, it must incorporate a description of the methodology for assessing credit risk and a description of the credit risk management system (credit risk classification system; collateral and guarantees; periodic review of exposures and collateral; monitoring of overdue credits; limiting and controlling exposures; forbearance measures and the processes for granting them; risk approval; etc.). No specific guidelines are foreseen for the granting phase, beyond a minimum set of data to be collected by banks in order to perform an adequate assessment of borrower creditworthiness. The CCR has been operational since February 2016 and allows banks to download credit histories (covering the period from March 2016 onwards) of both legal and natural persons (Central Bank of Malta Directive No 14). With regards to impairment loss measurements, the credit institution's policy is required by BR/09 to incorporate a description of the procedures and internal controls employed, of the methodology for assessing exposures on a specific/collective basis and of the process followed for the actual loss review.

The MFSA expects credit institutions to regularly review and revise their key management risk judgements and the assumptions and estimates in their overall credit risk policy. The banking rules require institutions to make a Pillar 2 allocation to a non-distributable reserve depending on their NPL levels, referred to as a "regulatory allocation". The new amendments to BR/09 will also require banks to adhere to a 6% NPL cap. Failure to adhere to this cap will require banks to draw up a concrete NPL reduction plan to bring levels below this new threshold. This plan will require institutions to shore up their resiliency through the accumulation of an additional capital reserve. The latter is essentially anchored around a medium-to-long term target for the NPL levels of credit institutions.

BR/09 does not define specific limits on household or NFC portfolios (e.g. maximum LTV, maximum maturity). In accordance with Article 124(2) of the CRR, the MFSA has set a lower LTV for the application of the preferential treatment (lower risk weight applied up to 70% and 50% of the property value, for residential and commercial real estate, respectively applicable to performing exposures). This is not a cap on LTV, but impacts the banks' decisions in terms of collateralisation.

A.2 NPL recognition and classification

For regulatory purposes, banks are legally required to comply with the EBA ITS regarding the definition/classification of NPEs. The banking regulations emphasise the impairment triggers already found in the accounting framework (i.e. IFRS as adopted by the EU).

No sub-categories of performing or non-performing exposures are foreseen by the current regulation. While the banking regulation in force until 2013 prescribed a grading of loans and advances (regular; watch; substandard; doubtful), with the introduction of the EBA ITS the MFSA decided to do away with the existing system so as not to conflict with the EBA provisions.

With reference to the EBA ITS, non-performing loans are those that satisfy one or both of the following criteria: a) material exposures which are more than 90 days past due; b) the debtor is assessed as unlikely to pay its credit obligation in full without realisation of collateral, regardless of the existence of any past due amount or of the number of days past-due.

With regards to forbore exposures and the removal of loans from banks' NPL categories banks are required to comply with the EBA ITS on forbearance and non-performing exposures.

A.3 NPL measurement and provisioning

Maltese banks apply IAS/IFRS requirements as adopted by the EU. In accordance with IAS 39, banks assess all credit exposures for "objective evidence" of impairment on an individual or collective basis with reference to current information and events as at the date of assessment. The general principle underlying this rule is that impairment triggers should recognise incurred losses as early as possible and appropriately for each loan asset. Therefore, BR/09 defines a minimum list of impairment triggers including macroeconomic triggers (e.g. increase in the unemployment rate, decrease in the prices of property pledged as collateral, deteriorating country risk) as well as other triggers such as material decreases in rents received on a buy-to-let property, a material weakening or lack of an active market for the assets concerned and, in the case of overdraft, the customer exceeding the approved limit on a frequent basis.

With regard to classification under the impairment category, the MFSA has carried over the EBA ITS and imposes on banks "a rebuttable presumption of objective evidence of impairment when a borrower misses a contractual instalment payment on interest or principal by 90 days and over in line with the Non-Performing Exposure definition" as well as those that meet the criteria for unlikeness to pay.

There is no additional regulation concerning specific provisioning rules for NPLs or how to treat the recovery time estimation, and the MFSA has not issued any additional specific guidance on accrued interest on non-performing loans for prudential purposes.

However, it can enforce appropriate provisioning following on-site inspections and through the SREP.

A.4 NPL write-offs

With reference to NPL write-offs, the national guidelines currently follow IAS 39 de-recognition rules.

BR/09 requires that management formally acknowledges the low probability of collection of the loan in full or in part, and thus requires, at a minimum, an annual assessment of the NPL to evaluate whether recoverability is still reasonable.

In the case of a borrower's failure to meet the requirements under the revised payment terms following forbearance measures, the MFSA expects a credit institution to take appropriate and timely actions to recover those facilities which have been long overdue (facilities in default for at least the past five years), including facilities whose performance has been "mostly unsatisfactory" over a period of time¹⁵⁸, irrespective of whether these are covered by collateral or not. A credit institution should reduce the level of long-outstanding NPLs in its portfolio to the lowest level possible. A decision not to take action should be adequately documented and approved by a relevant Board committee, senior management and any other relevant governance structures.

The amended version of BR/09 imposes a regulatory allocation of 2.5% of NPLs to a reserve for "general banking risks", increasing to 5% for NPLs which have been due for more than 12 months. Banks with NPL levels higher than 6% (excessive NPLs) can be penalised by a percentage ranging from 1.5% to 7%. The "penalty" is then transferred from the profits for the year to a "reserve for excessive NPLs".

A.5 Collateral valuation

The MFSA perceives collateral and related issues to be a major obstacle to private debt resolution since most collateral held by banks is represented by immovable properties.

There is no prudential guidance on specific rules regarding valuation methods. Instead, banks are required to have a collateral valuation policy which should include a detailed valuation methodology and internal control mechanisms.

Maltese regulations include no specific rules beyond Article 208 of the CRR on entities allowed to perform the valuation of collateral and no authority is responsible for the supervision of valuation and collateral appraisal entities.

¹⁵⁸ Under BR/09, for the purpose of this rule facilities are considered as having "mostly unsatisfactory" performance if repayments of capital instalments are few and far between. There must be at least 12 monthly consecutive payments of capital instalments (or equivalent for loans with other repayments terms) for the period of mostly unsatisfactory performance to end.

Banks are required to have their collateral valued by a person who has the necessary qualifications, ability and experience to execute a valuation and who is not involved in the credit decision process. Independent appraisers are not required to hold a specific licence. Market valuations are normally carried out in line with EVS even though there is no specific prudential requirement in this regard.

Banking rules require banks to assess whether the 'market value' of the collateral is indeed the best estimate of the net realisable value of the asset. Typically, the valuation of real estate collateral is based on market prices minus a haircut. In the case of other assets held as collateral, various methodologies are used including valuations made by experts in the relevant field.

The required frequency for the valuation of immovable property collateral must be clearly stated in the bank's policy and guidelines. Nonetheless, banks are required to comply with the minimum requirements for monitoring established in the CRR (CRE ≤ 12 months; RRE ≤ 3 years), otherwise, individually significant loans exceeding, €3 million or 5% of own funds of the credit institution must be valued by an independent appraiser at least every three years.

There are no further specific rules or criteria to value foreclosed assets on or after the foreclosure date beyond the CRR requirements.

A.6 NPL governance/workout

The MFSA does not perceive that overall NPL management-related issues could represent an obstacle to private debt resolution.

Some Maltese banks have a two-tier structure for dealing with NPL workout: a "rehab unit" working to resolve NPLs through restructuring and a "recoveries unit" as a final step towards foreclosure. From a regulatory point of view, banks are allowed to outsource NPL management, although none actually undertake such outsourcing.

The MFSA has not provided guidance to banks for handling NPLs by specific segments of loans (e.g. mortgage, corporate, consumer finance and shipping).

The recent regulatory approach (amended version of the BR/09) incentivises banks to reduce their NPL portfolio. Credit institutions holding a NPL ratio higher than a target level (set at 6%) will be required to draw up a concrete action plan to bring the levels of NPLs below the defined ceiling. Failure to adhere will require the institution to accumulate an additional capital reserve.

No guidance is provided to banks on the foreclosure of loans.

A.7 Supervisory reporting

For regulatory purposes banks are required to be compliant with the EBA ITS.

From 2017, BR/09 also requires banks to submit a NPL Resolution Plan, should the bank fail to comply with the 6% long-term target. This plan must clearly show when the target 6% threshold would be reached as well as state annual target ratios for NPLs and cure rates. These institutions must also to report variables on a semi-annual basis in order to facilitate their monitoring by the MFSA.

A.8 On-site and off-site supervisory practices and methodologies

The off-site review of banks by the MFSA is conducted in accordance with the SSM manual, albeit applying the principle of proportionality to take into account the size and the complexity of a bank's business model. During on-site inspections on asset quality the assessment is carried out in accordance with the EBA ITS.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

Due to the small size of the local portfolio of NPLs, Malta does not have a market for them. The legal framework does not, however, prevent the sale of loans (in particular, Articles 1471 to 1473, 1475 and 1483 of the Maltese Civil Code, Second book). The sale of loans can take place without having to obtain the consent of the borrower.

No legal restrictions exist as regards the counterparties (domestic/foreign banks and other institutional investors) of transactions should a credit institution sell its loan's.

The Maltese legal structure does not foresee the creation of public AMCs entrusted with the acquisition and management of NLP portfolios.

B.2 Debt enforcement/foreclosure

Debt enforcement and foreclosure is considered to represent an obstacle to debt resolution, primarily as a result of lengthy foreclosure procedures.

There is no supervisory guidance on foreclosure and the national legislation does not favour it. A recent legal amendment established a floor for the selling price of property sold by judicial auction at 60% of the value of the property as established by an expert appointed by court.

No legal measures have been introduced to enable the rapid out-of-court enforcement of collateral. Banks can only invite debtors to sign a "constitution of debt" in order to obtain the title to the collateral which would otherwise require a lengthy court case to prove that the bank's claim is certain, due and liquid.

No specific measures have been taken by the Government to tackle debtors that can afford to pay but choose not to. In the case of unsecured loans, banks are required to file a garnishee order (*mandat ta' sekwestru*) against the defaulter to ensure that the amount due is deposited with the court.

B.3 Corporate insolvency and restructuring

The corporate insolvency and debt restructuring regime may obstruct private debt resolution. The main limitations are the lack of a pre-insolvency regime which would enable an early rehabilitation of distressed enterprises. This may be exacerbated by lengthy court proceedings lasting several years. With regard to limited liability companies, the Maltese Companies Act¹⁵⁹ includes provisions on company reconstruction procedures and, in particular, somewhat more detailed provisions on the company recovery procedures, which have recently been amended and enhanced.

A debtor, including a company, has the possibility to resort to out-of-court mechanisms such as mediation and arbitration.

Public-sector entities can provide incentives to the general public to repay any amounts overdue. This could, for instance, take the form of an interest waiver. These incentives are not usually dependent on whether or not the individual or enterprise is undergoing restructuring.

It is possible to limit shareholders' decisions and to change the company's management in the context of a business restructuring, but only with court approval. In the case of distressed entities, courts are given the power to appoint a special controller to take over, manage and administer the business of the defaulter. An application for such an appointment may be made by the company, its directors, creditors representing more than half of the creditors of the company, or by creditors forming part of a class of creditors if said creditors represent more than half of the value of the company's creditors of said class. It is not possible to sell the assets of a company through open-market bilateral sales.

B.4 Household insolvency and restructuring

Households cannot file for personal bankruptcy in Malta. The insolvency provisions of the Companies' Act apply only to limited liability companies, while the bankruptcy provisions of the Commercial Code¹⁶⁰ apply only to sole traders. There is no out-of-court mechanism established by law regarding households, although individuals can reach an agreement with creditors based on common practice.

¹⁵⁹ Chapter 386 of the Laws of Malta

¹⁶⁰ Chapter 13 of the Laws of Malta

With regard to secured NPLs from individuals, banks can enforce their right to the collateral in cases in which debtors fail to pay their obligations. In such cases, banks must acquire an executive title, either directly from the client or by filing a garnishee order to obtain such a title.

B.5 Judicial system

The judicial system is considered an obstacle to private debt resolution. Insolvency cases are dealt with by the civil courts, which are not specialised on the subject area. As a result, proceedings tend to be complex and lengthy with average estimates stretching to over five years, although actual durations vary widely. It should be noted that a judicial reform is currently underway and is expected to increase the efficiency of civil court proceedings.

B.6 Tax regime

The MFSA does not consider the tax regime to be an obstacle to private debt resolution.

Tax deductibility in Malta does not depend on the specific resolution measure used and is not permitted for loan loss provisions. However, tax deductions are possible for loan write-offs and collateral sales. A tax loss carry-forward mechanism exists (deferred tax asset). Debtors in Malta are not subject to taxes on the debt write-off/restructuring of their debts at more favourable terms.

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

The CCR is a database managed by the Central Bank of Malta (*Bank Ċentrali ta' Malta* – CBM) which contains granular exposure-by-exposure data on all loans exceeding €5,000 extended to both legal and natural persons (cf. Central Bank of Malta Directive No. 14). Banks are required to submit this information on a monthly basis, and participation in the CCR by credit institutions is compulsory.

Data related to exposures that were designated as at least one of: (a) more than 90 days past due, (b) forborne or (c) written-off, are available on the CCR for a period of five years. The current available time-series is from the implementation date in April 2016 onwards.

The public land register is centralised, but still paper-based, and applies solely to immovable property. Searches are carried out on the basis of the owner while information on judicial sales by auction is published in two local newspapers.

Deficiencies in the public registers are not perceived to be a material obstacle to private debt resolution in Malta.

C.2 Debt counselling and outreach

Currently, there are no free or subsidised personal budgeting services or legal advice services for indebted households in Malta, nor is there any institution that provides credit management training and advice to SMEs. These limitations are not considered to represent a material obstacle to private debt resolution.

C.3 Consumer and data protection

Information sharing is limited to what is allowed by data protection laws, although these are not perceived to represent a material obstacle to private debt resolution.

Annex XV: The Netherlands

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

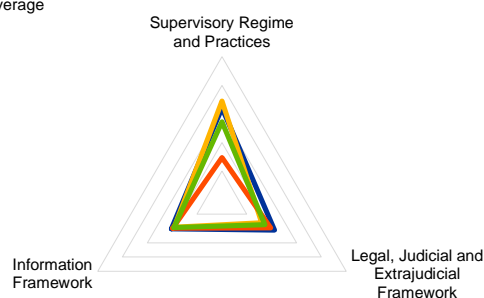
Chart 15

Country overview

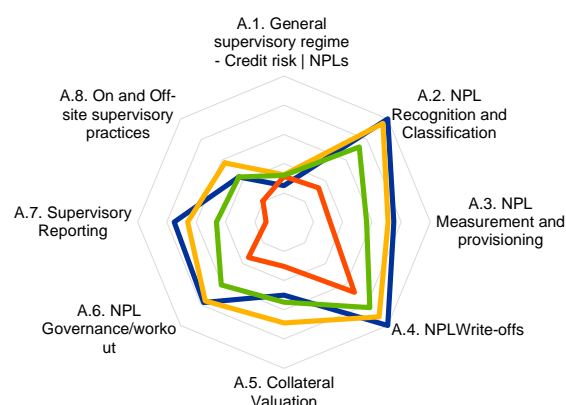
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NPL Framework Overview

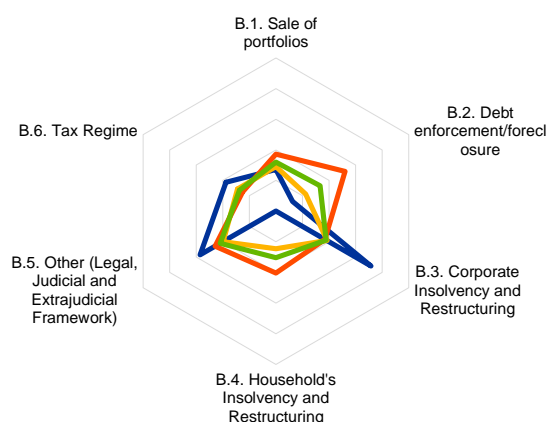
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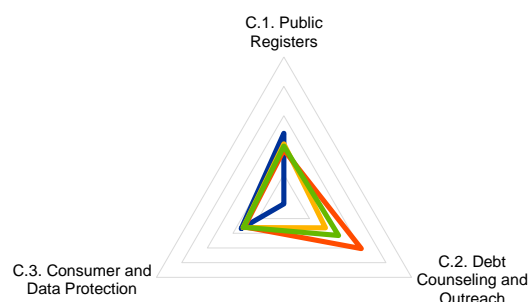
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 the Netherlands had a total NPL ratio of 2.5% (by segment: households 1.3%, NFCs 5.2%, SMEs 5.9% and CRE 6.6%).¹⁶¹

The current NPL situation in the Netherlands is favourable overall due to the country's low NPL levels and its relatively quick and efficient insolvency procedures. The survey revealed some features in the framework that could represent **further points of improvement to NPL workout in the Netherlands**:

- **NPL recognition and classification/write-off**: apart from the general accounting principles (nGAAP and IFRS), there are no additional specific guidelines on the prudential accounting approach regarding provisioning and write-offs.
- **NPL measurement and provisioning**: apart from accounting standards, no additional guidance is in place. However, on-site inspections and AQRs are conducted to ensure a consistent application and level of provisions across institutions, which may be enforced through the SREP.

Because the NPL levels are currently relatively low, it is unlikely that private debt resolution will be sought in the short run. However, if private debt resolution is sought in the future, difficulties in valuing less liquid collateral may present problems when accessing this channel.

Specific Supervisory practices for addressing NPEs:

- **Supervisory regime**: CRDIV, together with several national regulations (e.g. limits on residential mortgage loan issuance) has provided the Dutch Central Bank (*De Nederlandsche Bank* – DNB) with adequate tools to avoid an excessive build-up of NPL stocks at banks. For the valuation of commercial real estate, banks are required to use the recommendations designed by the Royal Netherlands Institute of Chartered Accountants. Drafted in consultation with DNB and the Dutch Prudential and Market Conduct Authority (*Autoriteit Financiële Markten* – AFM), this provides further guidance for the supervision of NPLs. In addition to the regulatory framework, the Code of Conduct on Residential Mortgage Loans gives further binding guidance to banks for assessing an individual's ability to repay his or her mortgage loan.
- **On-site inspections and thematic reviews**: during the period from 2013 to 2016, various on-site inspections and asset quality reviews were carried out on LSIs' and SIs' handling of NPLs. The results showed that banks' NPL management is adequate (the bank's valuation of residential collateral is on a portfolio level in line with the automated valuation model, its procedures to identify NPLs are in line with the regulatory framework, there are no unwarranted delays in foreclosure procedures, etc.). Supervisory inspections examined all aspects of credit management including loan-level file reviews (which focused in particular on troubled loans). Furthermore, thematic reviews

¹⁶¹ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance-sheet exposures. The sample covers all banks in the Netherlands.

of special asset management policies and practices were performed at three large Dutch banks. In several cases where the supervisors assumed a deterioration of conditions in a specific market segment or industry that could significantly impact the loan book of one or more banks, a deep-dive investigation was performed to assess the impact. Where appropriate, supervisors required banks to increase their write-offs. In recent years, however, there has been no need for DNB to impose any capital charges to induce banks to increase their write-offs.

- **Corporate insolvency law:** foreclosure in the Netherlands can generally take place by public auction or private sale. On average the length of an insolvency or bankruptcy procedure is 1.1 years for companies. New legislation is being prepared to further strengthen the restructuring framework and introduce the possibility of debt restructuring outside of solvency.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 35

Main sources of NPE-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Guidelines		Ten largest banks	Reporting	Monitoring of distressed loans	2013
Regulation	Tijdelijke Ministeriële Regeling Hypothecair Krediet	Issuers of mortgage loans	Limits on residential mortgage loan issuance	Regulatory limits on LTV and DSTI/LTI at origination are in place for residential real estate mortgage loans. Furthermore, to be eligible for the tax deduction of interest payments, new loans should follow annuity or linear amortisation schemes.	2013
Law	Wft, Art. 4:34	Issuers of loans to private persons	Credit register	There is a credit register in place for private persons (Bureau Krediet Registratie). Banks are required to check private clients' records during the credit approval process.	2006

Regulatory limits on LTV and DSTI/LTI at originations are in place for residential real estate mortgage loans. The DSTI limits are defined as the maximum percentage of the debtor's gross annual income with may be allocated to interest and amortisation payments.

A.2 NPL recognition and classification

For regulatory reporting purposes, Dutch banks are legally required to comply with the EBA ITS regarding the definition/classification of forbearance and NPEs. DNB has not issued additional criteria going beyond the EBA ITS in this respect.

A.3 NPL measurement and provisioning

Dutch banks follow IAS/IFRS or Dutch nGAAP accounting requirements. DNB has not issued additional specific prudential guidelines on NPL measurement and provisioning.

There is no specific guidance regarding accrued interests or estimate of the recovery time, used for the provisioning of NPEs.

The adequacy of banks' policies and processes and the levels of provisioning are ensured through on-site inspections and AQRs, and enforced through potential measures such as Pillar 2 add-ons in the context of the SREP.

A.4 NPL write-offs

Write-offs are regulated according to the IFRS or Dutch GAAP. There are no other specific national guidelines or rules. NPL write-offs are, however, within the scope of on-site inspections and AQRs. If appropriate, supervisors can require banks to increase their write-offs, although in recent years DNB has not imposed any capital charges to induce banks to increase their write-offs.

A.5 Collateral valuation

DNB has no concerns that collateral-related issues could represent an obstacle to private debt resolution.

Valuation practices are assessed through credit-risk orientated on-site inspections and AQRs. If they are considered insufficiently prudent banks are required to adjust their valuation practices.

For commercial real estate valuation, banks are required to use the recommendations of the Royal Netherlands Institute of Chartered Accountants¹⁶², which are in line with EVS and IVS requirements.

Collateral should be evaluated by a business unit that is independent from the originating businesses. Valuations may be carried out by internal and external

¹⁶² These recommendations were drafted in consultation with the DNB and the AFM.

valuers, which must be certified and registered in any relevant register for the type of collateral under consideration, e.g. for real estate.

Apart from the regulatory valuation frequency (CRE \leq 12 months; RRE \leq 3 years) in accordance with CRR requirements, valuations are typically performed when an exposure moves to the special asset management department and, subsequently, when important steps are taken in the special asset management process, such as foreclosure.

Internally developed indices may be used for the monitoring of residential real estate collateral values, provided said indices are properly validated, monitored and reviewed. In practice, however, Dutch banks primarily use external indexes such as the CBS index. The use of index valuations is not permitted for real estate collateral for loans exceeding €3 million or 5% of the banks' own funds. For these objects, valuations must be monitored via individual property valuations.

The collateral valuation is addressed during on-site investigations of residential mortgages, during which the banks' valuations are tested against an automated valuation model.

Other than the CRR rules for banks using the internal ratings-based approach, there is no specific guidance requiring banks to have a reliable data collection to assess collateral recovery.

A.6 NPL governance/workout

DNB has no concerns that overall NPL management-related issues could represent an obstacle to private debt resolution.

Although there are no specific requirements, it is common practice for banks to have departments specialised in the management of NPLs, which must be separate from those responsible for loan origination and performing loan services. Banks have the possibility to outsource the management of NPLs, but generally perform their own special asset management. For smaller exposures, especially to SMEs, this work is often carried out by special service organisations. There is no licencing and regulatory regime for such debt recovery agencies, although they are indirectly regulated in the case of outsourcing contracts with banks. There is no formal mechanism for interbank coordination or for coordination between private and public debtors in individual debtor cases.

A.7 Supervisory reporting

Credit institutions in the Netherlands submit the required COREP/FINREP reporting templates, including information relating to the EBA ITS, on a quarterly basis. No additional prudential reporting is in place which goes beyond the EBA requirements. Prior to the EBA ITS banks carried out quarterly reporting on NPLs in accordance with national reporting requirements, although this will probably be phased out.

Regarding the quality assurance of banks' NPL-related reporting, DNB relies primarily on on-site inspections to verify the accuracy of the information received.

A.8 On-site and off-site supervisory practices and methodologies

Dutch banks are subject to AQRs and on-site inspections for specific credit portfolios.

Though DNB has no specific guidance in place, the appropriateness of loan classifications is monitored during on-site inspections. DNB's on-site inspection guide examines specific features of each bank (legal structure, internal organisation and the bank's specific business model) to assess the policies and procedures used by banks in dealing with NPLs. There are no dedicated inspections of NPE portfolios, although they do form an important part of the loan-level investigations of credit-risk orientated on-site inspections. In addition, DNB conducted mini reviews of the restructuring departments of three Dutch SIs in 2012 and 2013, and more recently of one SI's special asset management portfolio.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

DNB does not perceive that deficiencies in the NPL market represent an obstacle to private debt resolution in the Netherlands.

Loans can be transferred to third parties after notification of the obligor, unless the loan contract specifies that the loan is non-transferable without the obligor's prior consent. There are no material legal impediments to domestic banks selling NPLs to other domestic or international banks, or to institutional or other investors. Loans can be sold even if legally and economically written off.

Although no specific regulation on public AMCs exists and no AMC has thus far been created in the Netherlands, there are no legal impediments to banks establishing an AMC in cooperation with investment firms.

B.2 Debt enforcement/foreclosure

DNB does not perceive that the real estate transaction setup represents an obstacle to private debt resolution in the Netherlands.

When the debtor is in default, a pledgee or a mortgagee has the right to sell off the collateral without any interference by the court. Foreclosure can generally take place by way of: (i) public auction before a notary; or (ii) private sale authorised by the

President of the competent district court. Banks maintain a right of recourse on any residual debt of private individuals until it has been paid off in full.

B.3 Corporate insolvency and restructuring

DNB does not perceive that deficiencies in the corporate debt resolution regime could represent an obstacle to private debt resolution in the Netherlands.

The Dutch corporate insolvency regime already provides for quick resolutions, with the average length for corporate insolvency/bankruptcy being 1.1 years.

There is currently no out-of-court settlement mechanism or pre-insolvency regime to enable the early rehabilitation of distressed companies. However, new legislation is being prepared to further strengthen the restructuring framework and to introduce debt restructuring or composition outside of insolvency. This composition procedure will also apply to microenterprises and SMEs. Furthermore, for several years many district courts have already recognised and applied the pre-pack concept. Legislation introducing a more formal pre-pack procedure is currently being enacted.

B.4 Household insolvency and restructuring

DNB does not perceive that deficiencies in the household debt resolution regime could represent a material obstacle to private debt resolution in the Netherlands.

In order to gain access to the statutory debt repayment scheme, a private debtor must first attempt to settle his or her debts via out-of-court debt rescheduling with the help of the municipal credit bank. For private persons and individual entrepreneurs the insolvency/bankruptcy discharge periods are between one and five years, but these can be renewed as long as the lender stays in contact with the obligor.

B.5 Judicial system

DNB does not perceive that deficiencies in the Dutch judicial system could represent an obstacle to private debt resolution.

There are no set time restrictions for insolvency procedures or specialised judges that only deal with insolvency issues. Personal insolvency related court fees/charges are deemed to be within a reasonable range.

B.6 Tax regime

DNB does not perceive that tax disincentives in general represent an obstacle to private debt resolution.

Loan loss provisions are allowed as a tax deduction in the annual calculation of taxable income. Tax losses can be offset against profits in the same tax year, with any remaining tax losses being carried back to the previous tax year or forward to the subsequent nine years.

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

Bureau Krediet Registratie (BKR) is a CCR for private individuals. It is a non-profit, independently operating foundation within the scope of the Dutch Financial Supervision Act. Any (financial) institution or company providing credit with a minimum duration of three months to private individuals is legally required to report this exposure to the BKR. Information is collected on any loans or credit lines, including debt restructuring arrangements and mail-order company loans, with a maturity of at least three months, as well as on operational car lease contracts with a maturity of at least one month. For mortgages, only negative credit events are reported, without any mention of the amounts involved, for example the fact that amounts are more than two or four months past due (depending on the type of exposure).

The cadastral system (land registry) is digitalised and centralised. Information on real estate collateral is registered in the cadastral real estate register.

The public asset registry (e.g. cars and shipping) is publicly available and contains information on the owner and characteristics of the asset.

The real estate transaction register contains the prices of RRE and CRE transactions, as well as a description of the property characteristics. This information is publicly available.

C.2 Debt counselling and outreach

DNB does not have concerns that limitations in terms of debt counselling and outreach are an obstacle to private debt resolution.

There is an independent national institute providing free budgeting advice to households, called *Nationaal Instituut voor Budgetvoorlichting* (Nibud). Furthermore, as required by law, local governments provide advice to heavily and/or problematically indebted households. SMEs can also obtain financial advice and training from the Chambers of Commerce.

C.3 Consumer and data protection

The Dutch Personal Data Protection Act also applies to the recording and sharing of personal information for debt workout purposes, but DNB does not consider this a material obstacle to private debt resolution.

Annex XVI: Portugal

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Chart 16

Country overview

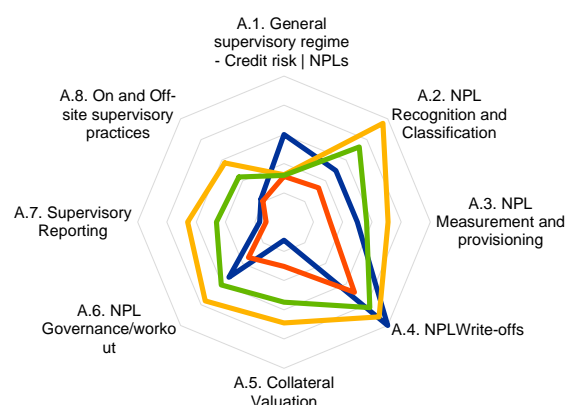
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

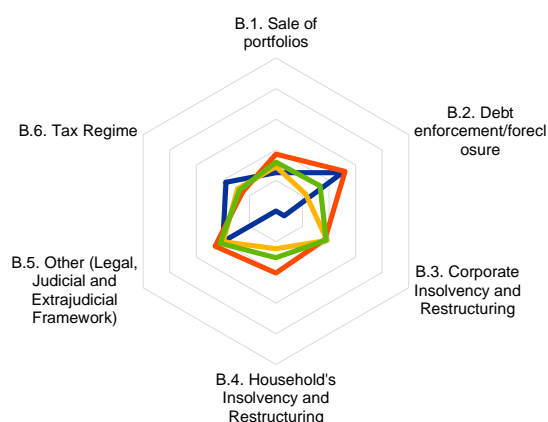
- PT
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



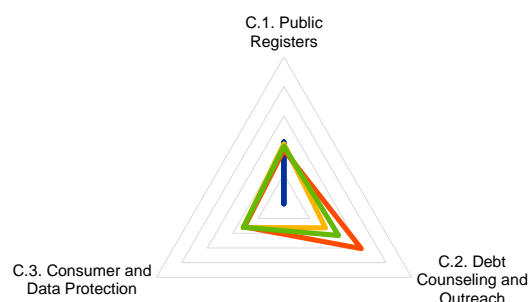
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Portugal had a total NPL ratio of 17.5% (of which by segment: households 8.7%, NFCs 29.4%, SMEs 27.3% and CRE 44%).¹⁶³

To address NPL workout, Portugal has taken specific actions, including the issuance of banking guidance and regulations on the classification, valuation, governance and disclosure of NPLs. In addition, a particular focus has been placed on supervisory activities, for example by intensifying on-site inspections to analyse and improve the NPL workout capabilities of the Portuguese banks. The primary impediments to resolving NPLs have been identified as the judicial framework, the length of collateral enforcement, the fiscal regime for impaired exposures and the lack of a robust NPL market, as explained below.

Based on the potential obstacles identified in the ECB survey, it was considered that the **main barriers to NPL workout in Portugal** are:

- **Judicial insolvency processes:** in-court procedures are complex and lengthy. This can prevent banks from resolving NPLs in a timely manner.
- **Judicial recovery processes for firms:** in 2012 the Portuguese Government created two programmes (in-court and out-of-court) directly targeted at achieving a faster recovery agreement of still-viable NFCs with the creditors. Both programmes require that there be a mutual agreement between the parties and a debtor solvency declaration. The usage of these programmes has been limited, with the number of insolvency cases far exceeding that of the cases processed under these new procedures.
- **Collateral enforcement:** the long duration of judicial processes tends to prevent banks from quickly liquidating collateral.
- **Fiscal treatment of impairment/write-offs:** the fiscal treatment of write-offs may be adverse in that losses are tax deductible only if the loan is past-due for more than 2 years.
- **NPL market and servicing firms:** NPL market activity has been limited; however, a number of servicers are active in the market.

In terms of **specific supervisory practices for addressing NPLs**, the Banco de Portugal (BdP) has developed specific actions predominantly in terms of guidance/regulation and prudential priorities (on-site inspections):

- **Impairment guidance – calculation, governance and disclosure by banks:** the BdP issued non-binding guidance¹⁶⁴ for consolidated accounts that summarises and discloses the criteria used by BdP in the impairment assessment. This guidance defines: (i) a set of impairment triggers beyond those already established in the accounting standards; (ii) a minimum level of

¹⁶³ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers all banks in Portugal. Due to a change in definition these figures are not comparable with those figures provided in the ECB Stocktake published in September 2016.

¹⁶⁴ Circular No 02/2014/DSP.

provisioning for NFC loans under specific conditions (under these conditions, impairment intervals are provided); (iii) criteria to be considered in the provision calculation for a going concern (viable businesses/projects) and for a gone concern (collateral realisation/foreclosure of assets); (iv) criteria for assessing when individual or collective impairment should be performed; (v) minimum requirements for internal governance in relation to impairment calculation; and (vi) quantitative (templates) and qualitative information on asset quality and credit risk management to be disclosed by banks.

- **Regulation containing specific criteria for identifying clients in financial difficulties and requirements for recording forbearance measures:** the BdP issued Instruction No 32/2013 which defines specific criteria, in addition to the EBA ITS, for identifying credits restructured due to financial difficulties and requires the recording of forbearance measures. Banks are required to record in their IT systems all necessary information, namely the dates and links between relevant facilities, to be used for credit risk management, impairment reports and compliance with other prudential requirements; forbearance records are to be kept for at least five years after the facility has been unflagged with regard to forbearance measures.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 36
Main sources of NPL-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Opinion (binding)	5/2008	All credit institutions	Risk management	Definition of minimum requirements for an appropriate internal control system in supervised institutions; risk management system designed to identify, assess, monitor and control all the risks that may influence the strategy and objectives defined by the institutions and to ensure compliance and necessary actions to address unwanted deviations.	2008
Instruction (binding)	32/2013	All credit institutions	Processes for addressing problem credits	Criteria for: (i) the identification and classification of problem loans; (ii) the recording of restructuring measures due to financial difficulties of the debtor; and (iii) the identification of concessions towards a debtor [(ii) and (iii) = EBA ITS on supervisory reporting on forbearance]. Specific quantitative triggers provided.	2013
Circular (non-binding)	2/2014/DSP	All credit institutions	Collateral and provisioning	Procedures and methodological guidance for impairment measurement (based on interpretation of IAS 39 and international practices). Reporting requirements on asset quality and credit risk management.	2014
Circular (non-binding)	44/2009/DSB	All credit institutions	Foreclosed assets	Guidance on the regular monitoring process of foreclosed property values [similar to Article 208 of the CRR, but additional guidance in terms of minimum documentation and valuer selection].	2009
Decree-Law (binding)	298/92	All credit institutions	Risk management	Defines the conditions for the activity of credit institutions and financial entities, such as prudential rules and limits, risk management practices and processes, according to the Commission Directives.	1992

The BdP has not issued any guidance defining specific limits on household or NFC portfolios (e.g. max. LTV, max. maturity).

A.2 NPL recognition and classification

Portuguese banks follow the EBA ITS regarding the definition/classification of NPEs; no additional criteria have been issued by the BdP. Furthermore, the BdP has not issued any guidance on sub-categories of performing or non-performing exposures, or conditions defining the criteria for exit from the non-performing status.

In terms of forbore exposures, Portuguese banks are required to follow the regulatory reporting criteria set by the EBA ITS, and the BdP has also developed additional guidance¹⁶⁵ both in relation to the identification of debtors in financial difficulties and to the recording requirements for forbearance measures. In this instance, banks are required to record in their IT systems all information necessary, namely the dates and links between relevant facilities, to be used for credit risk management, impairment loss calculation/reports and compliance with other prudential requirements. Forbearance records are to be kept for at least five years after the facility has been unflagged with regard to forbearance measures.

A.3 NPL measurement and provisioning

Portuguese banks follow the IAS/IFRS accounting requirements and the BdP has not issued additional specific guidelines on what constitutes a loss event, but guidance¹⁶⁶ was issued defining a set of impairment triggers beyond those already established in the accounting standards. This was non-binding guidance providing a prudential recommendation within the existing accounting framework.

For impairment calculation, each bank has a different model compliant with IAS 39. On this matter, the BdP has issued non-binding comply or explain prudential guidance¹⁶⁷ defining the minimum level of provisioning for NFC loans depending on the occurrence of specific conditions. Seven impairment intervals are provided and, for each interval, specific conditions are described, in addition to specific guidance for collectively assessed debtors, criteria for flagging NPLs, recognising collateral, etc. The BdP has also issued specific guidelines for provisioning NPLs and forbore exposures in terms of risk differentiation (see Circular No 2/2014).

Considering that Portuguese banks follow the IAS/IFRS, when a financial asset or group of financial assets that has been written down as a result of impairment loss, according to paragraph AG93 of IAS 39, banks should recognise interest income using the rate of interest used to discount the future cash flows for the purpose of

¹⁶⁵ Instruction No 32/2013. This instruction contains criteria for the recording of forbearance, for exit and for the identification of concessions towards a debtor.

¹⁶⁶ Circular No 02/2014/DSP.

¹⁶⁷ Circular No 02/2014/DSP.

measuring the impairment loss. This notwithstanding, the BdP issued an instruction¹⁶⁸, which indicates that accrued interest on pending settlement should be reversed if not paid in a period up to three months, unless the amount is covered by collateral which has been prudentially evaluated (the same applies to credits to some counterparties like central governments, public sector entities and central banks).

A.4 NPL write-offs

The BdP has issued specific guidance¹⁶⁹ on write-offs indicating that they should only occur when: (i) all the instalments have been required and all appropriate collection efforts have been performed; and (ii) credit recovery expectations are very small in a reasonably estimated time frame, thus leading to a scenario of full impairment. The written-off loans should be recorded as off-balance-sheet items at the moment of derecognition and should be kept until the extinction of the credit obligation through liquidation or cessation of rights under the applicable legal and contractual terms (e.g. debt forgiveness, court decision or definitive transfer of overdue loans).

A.5 Collateral valuation

Although Portugal has detailed prudential guidance on collateral valuation, collateral-related issues represent an obstacle to private debt resolution mainly owing to the lengthy judicial processes that tend to act as a hurdle to the liquidation of collateral.

For RE collateral, only appraisers which are registered and supervised by the Portuguese Securities Market Commission (*Comissão do Mercado de Valores Mobiliários* – CMVM) can provide RE valuation services to financial sector entities. The CMVM only grants access to the activity of RE appraisals to individuals or companies if certain minimum criteria are satisfied, namely: (i) good repute and suitability; (ii) qualifications and experience; (iii) independence; and (iv) the activity must be covered by professional insurance.

The required frequency for the valuation of immovable property collateral follows CRR¹⁷⁰ requirements (CRE ≤ 12 months; RRE ≤ 3 years). Pursuant to Circular No 2/2014, the collateral valuation of defaulted assets should be performed more regularly and with more conservative assumptions than when the credit is not in default. The Circular also stipulates that: (i) for non-listed securities, valuations should be updated at least every year by the investment bank of the group or an independent entity and should be based on the last audited financial statements; and (ii) for other collateral (e.g. art work), valuations should be updated at least every year by suitable appraisers, having due regard for the collateral type.

¹⁶⁸ Instruction No 6/2005.

¹⁶⁹ Circular No 15/2009/DSB.

¹⁷⁰ Article 208(3).

Complementary to CRR requirements, Circular No 2/2014 allows the use of the following valuation methods: (i) for immovable property collateral: cost method; comparison method; income method; and residual value¹⁷¹; and (ii) for other types of collateral: the market value. For the monitoring of collateral values, banks can use statistical methods or internal/external indices, although for the (upward) revision of value banks must have recourse to an independent appraisal and for internal indices a validation by an external independent entity is required.

Banks are required to have reliable data collection to assess collateral recovery and to use conservative assumptions for the time needed to sell and recovery costs (e.g. sales costs, maintenance costs). The BdP defines the permitted valuation methodologies that can be used by the independent appraiser and the respective haircuts and specifies that banks may use historical data, if available and if recovery costs are not considered.

In Portugal, there are no specific requirements for the calculation of the credit risk-mitigating effects of collateral for risk management purposes under Pillar 2.

The BdP issued specific rules/criteria¹⁷² for valuing foreclosed assets after the foreclosure date (e.g. accounting value, impairment). They provide additional guidance in terms of minimum documentation and valuer selection.

The liquidation of foreclosed assets is usually managed by banks through a dedicated website, although some have the support of RE agencies mainly for the sale of houses (direct sale or sale through third parties are the most-used disposal channels).

A.6 NPL governance/workout

A special NPL management inspection was jointly performed by the BdP and an external consultant in 2013 to assess the handling of distressed credit in the eight largest Portuguese banks (covering around 85% of assets). During this exercise, banks were required to align themselves with best practices and most of these recommendations have already been implemented. As a consequence, the in-scope banks have developed and carried out action plans, the implementation of which varies across institutions.

The BdP has a CCR to record and monitor information regarding the credit obligations of individual customers and the performing status of those obligations. This information is available to all banks in the Portuguese financial system, although a bank can only see the exposure of clients for which it is a creditor. Otherwise the bank requires a client's permission to see said client's information in the register. There is no interbank coordination on individual debtor cases, but CCR information allows banks to take preventive measures to address future NPLs.

¹⁷¹ Except for mortgage loans pledged as collateral for a covered bond.

¹⁷² Circular No 44/2009/DSB.

A.7 Supervisory reporting

Credit institutions in Portugal provide the required COREP/FINREP reporting templates, including information relating to the EBA ITS requirements on forbearance and NPEs, on a quarterly basis. In addition, banks must report the following to the BdP: (i) under Instruction No 22/2011 they must report, on a quarterly basis, credit exposures classified as “credit at risk” (credit at risk¹⁷³ is prior to NPE status, though there are similarities); and (ii) under Instruction No 32/2013 they must report loans restructured due to financial difficulties (banks are also required to disclose this information).

Another relevant report, submitted on a biannual basis to the BdP, is the external auditor’s opinion on provisioning (impairment report). The submission of such a report has been requested by the BdP and it includes the results of the assessment of provisioning levels, also based on a credit file review (based on a sample).

For quality assurance of the EBA NPE template within FINREP, Portugal does not have additional automatic rules besides the validation rules, but has conducted several on-site inspections of NPEs. Additional benchmark analysis procedures are currently being implemented for regular risk assessment purposes. Credit at risk statistics for residential mortgages, consumer loans and NFC loans are publicly available on the BdP’s website, in the form of both charts and data series.

A.8 On-site and off-site supervisory practices and methodologies

During 2012-14 the Portuguese banks were subject to several asset quality reviews (mostly focusing on impairment losses) and, as previously mentioned, in 2013 to the special NPL management inspection to assess the largest Portuguese banks’ policies, procedures and controls for managing NPLs.

At present, the monitoring of NPEs (including forbore exposures) is reviewed by the BdP through on-site inspections, based on the most recent guidelines published by the EBA. This includes the assessment of the methodology for the classification of NPEs. The BdP also performs on-site inspections of impairment losses of individually assessed debtors, as well as those of collectively assessed debtors (model revision).

Regarding on-site inspections on credit portfolios, the BdP issued guidance¹⁷⁴ for banks on the minimum level of impairments linked to specific events and a template to calculate the net present value of the credits and impairments. The BdP has a predefined work plan for NPE on-site inspections.

¹⁷³ “Credit at risk” is defined as: (i) the gross carrying amount of loans more than 90 days past due; (ii) the gross carrying amount of loans that were restructured after being more than 90 days past due, without an adequate reinforcement of collateral or a full payment of past due interest and/or other expenses by the debtor; and (iii) the gross carrying amount of loans less than 90 days past due, but for which evidence has been found justifying the classification of credit at risk. This evidence would be related to the debtor’s bankruptcy or a similar order in respect of the debtor’s credit obligation.

¹⁷⁴ Circular No 2/2014/DSP.

The on-site inspections performed by the BdP focus on the process for identifying non-performing exposures and are complemented with a sample check (for performing and non-performing exposures), while off-site teams assess on a regular basis the level of NPEs and forborne exposures.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

The legal framework in Portugal enables the sale of loans. Regulations permit lenders to transfer existing loans to third parties, together with linked collateral and securities, without the consent of the borrower, and allow loans to be sold even if “denounced” (i.e. legally and economically written off). Professional loan buyers can be third-party banks or other institutional investors, as well as credit-servicing companies. Although no specific regulation on AMCs exists, banks are allowed to set up an AMC in cooperation with investment firms.

Although there are no legal impediments to loan sales, the Portuguese market for NPE portfolios is not developed and the servicing activity is not material.

B.2 Debt enforcement/foreclosure

Theoretically, the legal framework seems well designed for collateral enforcement, allowing individual creditor claim actions (through the civil courts). Portugal has also implemented the European Directive¹⁷⁵ on financial collateral arrangements, which has enabled the rapid out-of-court enforcement/foreclosure of collateral and financial guarantee contracts.

However, the foreclosure procedure is lengthy, and the complexity and length of judicial processes make it difficult to liquidate collateral, as does the current level of NPLs and the position in the economic cycle (i.e. excess supply could put pressure on the collateral sale price).

B.3 Corporate insolvency and restructuring

The corporate insolvency and debt restructuring regime is considered to be an obstacle to private debt resolution. However, it was indicated that further changes could be implemented to facilitate the restructuring of the debt of viable firms, although the inefficiencies of the judicial system could pose a risk to their effectiveness. The IAPMEI (*Instituto de Apoio às Pequenas e Médias Empresas e à Inovação*) is a specialised public agency within the Ministry of Economy, which was

¹⁷⁵ Directive 2002/47/EC, as amended by Directive 2009/44/EC.

created to provide technical and financial support to enterprises, in particular SMEs. In 2012 the Portuguese Government created the *Programa Revitalizar* to improve the national legal framework for dealing with the insolvency and recovery of companies¹⁷⁶ and to help revitalise the corporate sector. This programme included the following: (i) SIREVE (*Sistema the Recuperação de Empresas por Via Extra-Judicial*), a pre-insolvency regime to enable early rehabilitation of distressed companies which establishes an out-of-court arrears settlement procedure; the fact that this settlement procedure is not binding on third-party creditors is seen by banks as a constraint; and (ii) PER (*Processo Especial de Revitalização*), a “pre-pack” regime where the court mediates in negotiations between a distressed company still likely to recover and its creditors in order to reach an agreement enabling companies to remain operational by revitalising them.

Although firms have used these new procedures since early 2012, the number of insolvency cases far exceeds the number of cases under the new procedures.

The Portuguese government is currently working on a set of reforms aimed at improving the efficiency of existing mechanisms for corporate debt restructuring and creating new regimes. Some of the reforms undergoing public consultation are as follows: (i) the creation of a company revitalisation mediator function (to support a debtor company that is in financial distress or insolvent in negotiations with its creditors in order to reach an out-of-court restructuring agreement that allows the recovery of the firm); (ii) the creation of a new regime, called RERE, under which a financially distressed or insolvent company can negotiate an out-of-court agreement with some or all of its creditors that allows the recovery of the company; (iii) a revision of the insolvency code and the proposal of a list of measures aimed at improving the efficiency of the procedures for company recovery and insolvency; (iv) a regime of appropriation of the debtor’s pledged collateral by the creditor in the case of arrears; and (v) a regime of conversion of credits conceded to firms into capital.

B.4 Household insolvency and restructuring

The household insolvency and debt restructuring regime is considered by the BdP not to be an obstacle to private debt resolution. The national legal framework dealing with the insolvency and recovery of households includes three different components: (i) the general regime¹⁷⁷: introduced in 2013, this sets out principles and rules for the prevention and out-of-court settlement of arrears on credit agreements (consumer and mortgage credit) of households and establishes an out-of-court arrears settlement procedure similar to the one for corporates (indicated above); this procedure is assessed by banks to be excessively bureaucratic; (ii) the extraordinary regime¹⁷⁸: this sets out specific rights for housing loan debtors facing severe financial difficulties; this regime ceased in 2016, but continued to be applied to procedures

¹⁷⁶ Decree-Law No 105/2004, as amended.

¹⁷⁷ Decree-Law No 227/2012.

¹⁷⁸ Law No 58/2012, as amended by Law No 58/2014.

that started before 31 December 2015; and (iii) the credit mediator¹⁷⁹ framework: a free of charge out-of-court mediation mechanism, hosted by the BdP, with the main purpose of defending and promoting the rights and interests of any natural or legal persons that have been refused a loan by a credit institution or that have been denied a restructuring or a consolidation of previously granted loans. Households can also use PER, which is also available to corporates, as previously mentioned.

In Portugal, the personal bankruptcy regime covers all loans taken out by households, consumers and individual entrepreneurs.

B.5 Judicial system

The judicial system is considered by the BdP to be one of the main obstacles to NPL resolution. The complex and lengthy in-court procedures could prevent banks from reaching restructuring agreements in a timely manner, which hinders the maximisation of the loan value and the timely realisation of collateral.

B.6 Tax regime

Regarding the tax regime, in May 2016, the Tax Administration Authority (Autoridade Tributária e Aduaneira) revised its interpretation regarding write-offs of doubtful loans and receivables, which may be seen as an improvement to the impediments faced before by banks to write-off loans. According to the recent interpretation, write-off losses are tax deductible only if (i) the credit is overdue for more than 2 years and (ii) the credit is fully provisioned/impaired. It should be noted that the previous regulation recognized tax deductibility of losses only if all the legal claims to the loan were extinct. In Portugal, tax deductions, are granted for loan write-offs (under certain conditions, as indicated above), for collateral sales and for LLPs, where there is also a tax loss carry-forward mechanism (e.g. DTA).

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

The CCR is operated by the BdP and has been available since January 2009, although data on NPLs and forbearance have only been available since December 2013. It is noteworthy that the CCR definitions (i.e. for NPLs and forbearance) are harmonised with the accounting standards and, in this sense, are not aligned with the prudential definitions set out in the EBA ITS. Credit data available in the CCR for private individuals can only be accessed by debtors or by a participating credit

¹⁷⁹ Decree-Law No 144/2009.

institution that has already granted credit or, in the absence of a credit relationship, that has obtained permission from the debtor concerned.

The agents required to report to the CCR are: (i) credit entities supervised by the BdP; (ii) branches established in Portugal by credit institutions established outside Portugal; and (iii) other entities designated by the BdP which perform credit functions or a related activity. Currently, the CCR covers more than 80% of the total loan amount in Portugal (≈98% of loans in the MFI¹⁸⁰ balance sheet), but information is only reported at a borrower level. Annex IX of this report gives a detailed overview of the main features of and information collected by the CCRs.

The cadastral system (land registry) is digitalised/centralised and designed to make public the legal situation of the RE market, guaranteeing the certainty of transactions. Given that the system is based on the buildings, it is not legally allowed for third parties to search for property information based on the owner's name.

RE transactions (both for commercial and residential assets) are reported in a fairly comprehensive way. The general public can conduct searches on transactions and find the main information, e.g. price and characteristics of the asset. Information on upcoming sales/auctions is also publicly available. The price for searches varies depending on the output required (max. ≈ €30). Concerning the updating frequency, there is no rule and updating is on the initiative of the people entitled to do it.

The Public Asset Registry (e.g. for road vehicles, ships, aircraft, plant, heavy equipment and intellectual property) is publicly available and includes information on the owner and the characteristics of the asset.

C.2 Debt counselling and outreach

Significant steps have been taken in Portugal to promote debt counselling and there is a good overall perception of the quality of debt counselling and outreach (see table 19).

Portugal established the Assistance Network for Indebted Consumers¹⁸¹ (*Rede de Apoio ao Consumidor Endividado* – RACE), a network of entities, accredited by the General-Directorate for Consumers following an opinion of the BdP, which provides free of charge information, advice and assistance to households facing payment difficulties. These entities are also entitled to provide information on indebtedness and overindebtedness and to carry out financial education activities. In addition, the above-mentioned IAPMEI provides training and advice to SMEs in several areas, including credit management. Recently, the IAPMEI teamed up with the Portuguese National Plan for Financial Education to promote financial training for entrepreneurs and managers of micro SMEs.

¹⁸⁰ Monetary financial institution.

¹⁸¹ Decree-Law No 227/2012 (general regime).

C.3 Consumer and data protection

Although in Portugal there are restrictions on recording/sharing personal information for debt workout purposes essentially related to confidentiality requirements, the overall perception of the quality of consumer data protection is good (see also table 19).

Annex XVII: Slovakia

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Chart 17

Country overview

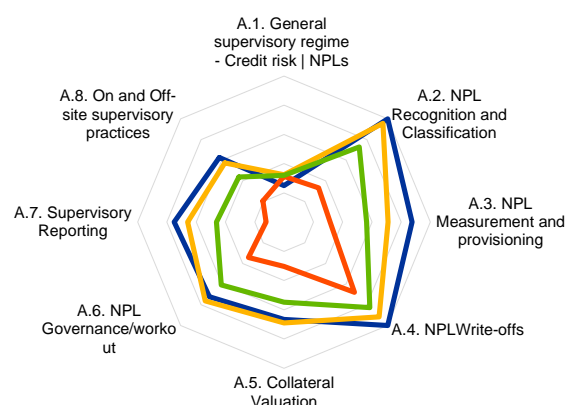
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

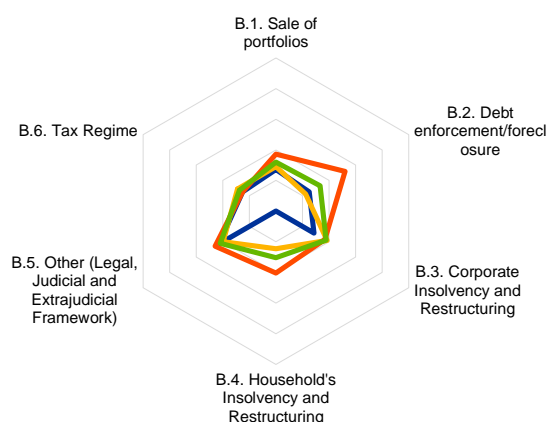
- SK
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



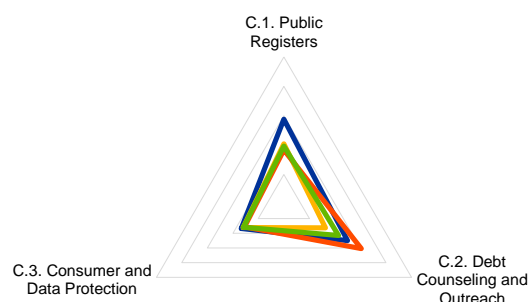
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Slovakia had a total NPL ratio of 4.7% (by segment: households 4.4%, NFCs 6.4%, SMEs 8.7% and CRE 9.9%).¹⁸²

According to Národná banka Slovenska (NBS), the key factors contributing to the improvement in the banking sector's loan portfolio quality for households are the downward impact of lower interest rates on the debt burden of borrowers, the continuing fall in unemployment and the increase in households' disposable income. For corporate loans the primary factors are the writing-off and selling-off of NPLs, supported by an increase in the repayment of non-performing loans or their re-categorisation as standard loans. Even though the current NPL situation seems favourable overall, some features may still represent **potential challenges to NPL workout in Slovakia**:

- **NPL governance:** due to the more favourable NPL conditions in the country overall, no particular guidance has been issued on NPL workout practices.
- **NPL recognition and classification/write-off:** apart from the general accounting principles (nGAAP and IFRS), there are no additional specific guidelines on the prudential accounting approach regarding NPL provisioning and write-offs.
- **Judicial insolvency processes:** in-court procedures are complex and lengthy. The duration of the judicial process represents a bottleneck as it reduces the ability of courts to resolve individual cases.

One final trend that is particularly significant for financial stability is the continuing and relatively strong growth in retail loans on the Slovak market. The measures introduced by NBS to tackle this issue are described below.

Even though it has not been necessary to address high NPL levels, NBS has taken a number of concrete actions **in terms of specific supervisory practices** for addressing NPLs, in particular adopting macroprudential policy recommendations, which it introduced in 2014, on risks related to market developments in retail lending. It has encouraged a prudent approach to lending, thereby addressing the risk of a rise in NPL levels. These recommendations address the following:

- **Loan-to-value (LTV) ratio limits:** the share of new loans in a given quarter that are secured by real estate and which have an LTV ratio of between 90% and 100% should not exceed a limit set by NBS.
- **Internal limit for the indicator of customer repayment ability:** a bank's internal systems should include a mandatory limit for the indicator of customer repayment ability. The indicator of customer repayment ability should take into account the customer's household income, standard household living costs and total debt servicing requirements.

¹⁸² Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers 46% of banks in Slovakia or 75% of total banking assets.

- **Limit for the indicator of customer repayment ability in the case of an increase in interest rates:** this recommendation applies to all new retail loans for which the interest rate is not fixed for the entire term of the loan. The internal limit for the indicator of customer repayment ability should still be met in the event that the interest rate for the loan increases by two percentage points and assuming that the maturity period is at the maximum recommended limit.
- **Prudential approach to lending through intermediaries:** this recommendation applies to new loans provided through intermediaries as well as the portfolio of retail loans provided in this way (not including loans provided through tied agents). Banks should independently assess and manage the credit risk of such loans, ensure that the share of these loans in the credit portfolio is such that it does not create pressure to loosen lending conditions, and maintain an appropriately diverse pool of intermediaries.
- **Prudential approach when appraising real estate collateral:** this recommendation applies to new loans and the portfolio of loans secured by real estate. Banks should observe certain prudential principles set by the regulator, e.g. banks should act prudently in dealings with appraisers whose appraisals have previously been found to be incorrect.

As a result, banks have curbed the provision of loans with unduly long maturities, reduced the proportion of loans with high LTV ratios (limiting of mortgage loans with LTVs between 80% and 90%) and improved the assessment of borrowers' ability to repay loans. In order to make these recommendations more effective (binding), they were enacted directly in law (in force from 1 January 2017).

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 37
Main sources of NPL-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Decree (binding)	3/2015	All credit institutions	Risk management	Decree on additional types of risk, on details of the risk management function of banks and branches of foreign banks and on the definition of a sudden and unexpected change in market interest rates.	7/2015
Decree (binding)	12/2016	All credit institutions	Macroprudential policy on risks related to market developments in retail lending	Recommendation on the LTV cap for new housing loans and internal limits on the indicator of the creditworthiness of the customer. Implementation of assumptions of increased interest rates and a rise in unemployment into stress testing scenarios. Compliance with the cap on the maturity of retail loans. Maintaining prudential approach to debt refinancing associated with a significant increase in principal. Maintaining a prudential approach to lending through intermediaries	2017

In October 2014 NBS adopted non-binding macroprudential recommendations to address risks stemming from the continuing and relatively strong growth in retail loans in the Slovak market. These were enacted in 2016 as a decree which became binding as of 1 January 2017.

These recommendations apply to all banks, home savings banks and branches of foreign banks in Slovakia, and NBS assesses compliance with each recommendation on a regular basis. According to these recommendations banks are, inter alia, obliged to:

1. **Comply with LTV limits.** The share of new loans in a given quarter secured by real estate and that have an LTV ratio of between 90% and 100% should not exceed: a) 25% until June 2015, b) 20% from July 2015 to March 2016, c) 15% from April 2016 to December 2016 and d) 10% from January 2017. No loan should have a LTV ratio of more than 100%.
2. **Comply with maturity limits for retail loans** (from 1 January 2016). These new limits are 30 years for new loans secured by real estate and 8 years for other loans.
3. **Maintain a prudent approach when appraising real estate collateral.**
4. **Set and adhere to an internal limit for the indicator of customer repayment ability.**
5. **Maintain the limit for the indicator of customer repayment ability in the case of an increase in interest rates.** The internal limit for the indicator of customer repayment ability should still be met in the event of an increase of two percentage points in the interest rate, assuming that the maturity period is at the maximum recommended limit.
6. **Perform stress testing for increases in interest rates and unemployment.** The stress testing outcomes should be taken into account when revising the internal limit for the indicator of customer repayment ability. Stress testing assumptions are prescribed by NBS.
7. **Do not provide loans with deferred payment**¹⁸³.
8. **Maintain a prudential approach to loan refinancing** in cases when the total outstanding principal is increased by more than €2,000 or 5%.
9. **Maintain a prudential approach to lending through intermediaries** (including loans provided through tied agents). Banks should: a) independently assess and manage credit risk on such loans; b) ensure that the share of these loans in the credit portfolio is such that it does not create pressure to loosen lending conditions and c) closely monitor these loans and compare them with other loans in terms of credit risk.

¹⁸³ This condition does not apply to cases when the consumer during the loan repayment gets into unexpected financial difficulties

The first assessment of the implementation of these recommendations took place during the second quarter of 2015. As a result, banks curbed the provision of loans with unduly long maturities, reduced the proportion of loans with high LTV ratios (limiting the granting of mortgage loans with LTVs between 80% and 90%) and improved the assessment of borrowers' ability to repay loans.

A.2 NPL recognition and classification

With regard to the definition/classification of NPEs, banks in Slovakia must comply with Article 178 of the CRR and follow the requirements of the EBA ITS. There is no additional guidance or regulations issued by NBS in this respect. Furthermore, NBS has not issued any guidance on sub-categories of performing or non-performing exposures, or conditions defining the criteria for exit from non-performing status.

In terms of forborne exposures, banks are also required to follow the regulatory reporting criteria set by the EBA ITS. No additional specific data collection requirements on forborne exposures are defined.

A.3 NPL measurement and provisioning

Banks follow IAS/IFRS accounting requirements, and NBS has not issued additional specific prudential guidelines on NPL measurement and provisioning. NBS has not issued additional specific guidelines on what constitutes a loss event or defined a set of impairment triggers. There is currently no regulation concerning specific provisioning for NPLs, which would, inter alia, include the recovery time estimation or the haircuts to be applied by type of collateral. There is no guidance about the accrual of interest in cases of classification as non-performing.

Collective impairment models used by banks are mostly based on the application of PD and LGD parameters, where LGD takes into consideration the recovery values derived from the historical data. These parameters are also subject to regular back-testing.

A.4 NPL write-offs

There are no specific national guidelines or rules for NPL write-offs. The write-off of NPLs should be conducted in accordance with the derecognition rules under IAS 39. Banks are required to have in place a derecognition policy which must ensure a timely accounting write-off of facilities where there is no realistic prospect of recovery and provide adequate governance procedures for its authorisation. NBS does not normally make use of supervisory tools, such as setting time limits on how long NPLs can be carried on banks' balance sheets or increased capital charges, to provide incentives for NPL write-offs.

A.5 Collateral valuation

NBS has no concerns that collateral-related issues could represent an obstacle to private debt resolution.

The Decree on the determination of general asset value using the methodology for calculating the general value of real estate¹⁸⁴ establishes general rules on valuation methods and procedures that are in line with Royal Institute of Chartered Surveyors valuation standards.

From a regulatory perspective, the requirements for the current valuation of loan collateral are defined by NBS Decree No 4/2015. The method of determining the value of collateral is described in Article 3 of NBS Recommendation No 1/2014 of October 2014.

For collateral valuation, NBS requires the use of an independent certified appraiser who possesses the necessary qualifications, ability and experience to execute a valuation in line with Decree No 492/2004. Banks must use qualified professional appraisers who are not involved in the credit decision process. Only appraisers registered on the list of sworn experts, translators and interpreters of the Slovak Ministry of Justice are authorised to carry out an expert evaluation of immovable property used as collateral.

After the initial appraisal of collateral, a regular revaluation is performed in line with CRR requirements (CRE \leq 12 months; RRE \leq 3 years). Statistical methods may also be used for revaluation purposes. The frequency of collateral valuation does not depend on the status of loan classification or the collateral value. Only if the real estate collateral exceeds the thresholds of €3 million or 5% of the bank's capital is it subject to review by an independent appraiser at least once every three years, in line with the CRR.

According to Decree No. 492/2004, the following methods can be used to determine the general value of collateral in Slovakia: the sales comparison approach, the localisation differentiation approach (or method of positional differentiation), the income capitalisation approach and the mixed approach (or combined method). Depending on the purpose, an expert valuation report may use several methods simultaneously.

According to NBS, banks in Slovakia generally take a conservative approach to collateral valuation. When banks conduct a review of the valuations conducted by an independent external appraiser, it is standard practice for them to accept either the value set in the expert report or their own internal estimate, whichever is lower.

The rules on the use of haircuts and indexes must be clearly defined in the bank's policy; NBS does not prescribe them. Banks use haircuts/indexes primarily for CRE and RRE.

¹⁸⁴ Decree of the Ministry of Justice No 492/2004 Coll.

Banks can use internal index models or statistical methods to monitor collateral values and identify property that requires revaluation. The property valuation must be reviewed by an independent appraisal when information indicates that the value of the property may have declined materially relative to general market prices. NBS does not require validation by an independent party.

There is no guidance requiring banks to have reliable data collection to assess collateral recovery. However, NBS is preparing a decree that defines the requirements for the use of internal valuation models and requirements for data collection.

Banks do not foreclose on collateral in Slovakia (see the legal details in Section B. 2). Banks either leave it to the clients themselves to organise the sale of collateral or sell their problem receivables to specialised companies.

NBS does not provide additional incentives to reduce reliance on collateral, whether through increased provisioning or the assessment of valuation practices.

A.6 NPL governance/workout

NBS does not perceive that overall NPL management-related issues could represent an obstacle to private debt resolution. All banks in Slovakia have developed dedicated NPL workout units, although there are no specific rules in this regard.

In general, activities related to NPL management (recovering outstanding claims) fall under risk management. Banks are required by the Slovak Act on Banks (Act No 483/2001) to conduct risk management independently and separately from banking activities. The separation of commercial activities from risk management activities must be maintained through the highest level of management.

Some banks outsource NPL management, although thus far the servicing market remains undeveloped owing to the limited market for NPLs.

Banks are allowed to assign their claim against the client to a third person (including non-banks) by way of a written contract, even without the client's consent (see Section B. 1).

In general, banks are required to have a risk management strategy and adopt and maintain an effective risk management system. NBS has not, however, issued specific guidance for handling NPEs by specific segments of loans or any guidelines to banks in relation to NPL management practices. Banks are required to have internal regulations specifying the procedure for recovering outstanding claims for the purposes of credit risk management. However, banks are not required to have operational targets for NPL reduction.

There is no guidance in place on restructuring practices.

With regard to the monitoring of individual debtor cases, there is no mechanism for interbank coordination or for coordination between private and public creditors in

individual debtor cases. However, the CCR data are available to banks upon the request. These data are provided for persons to whom the respective bank has provided a loan or whose liabilities it has assumed, and summary data are provided on persons who have received loans from another bank (NBS Decree No 5/2014 on the Register of Bank Loans and Guarantees).

Although banks are required to have internal regulations specifying procedures for the recovery of outstanding claims, there are no specific rules requiring the bank to have/maintain a minimum level of information when classifying loans as forborne exposures.

A.7 Supervisory reporting

Credit institutions submit the required FINREP reporting templates, including information according to the EBA ITS requirements on forbearance and NPEs, on a quarterly basis, also complying with the ECB Regulation on reporting of supervisory financial information (ECB Regulation (2015/534)).

There is also local reporting in place at the solo level, encompassing data on defaulted loans, impairments, allowances and days past due with breakdowns by sector and financial instrument. Only limited data from the local solo level reporting are published regularly and NPE statistics based on the EBA ITS are not publicly available.

A.8 On-site and off-site supervisory practices and methodologies

There is no specific supervisory methodology or guidance for the assessment of the policies and procedures used by banks to handle NPLs. The loan classification (and the overall monitoring process) and the level of loan loss provisions (along with the effectiveness of the bank's internal LLP policy) are assessed at both off-site and on-site levels.

Off-site supervision: a credit risk analysis is conducted to assess a bank's risk level and control using a list of key risk indicators, supervisory tools, peer analysis and a review of the bank's main internal policies. For banks with signs of potential incorrect classifications or low levels of provisioning (comparing the coverage ratios for similar portfolios and/or collateral among banks), a deeper analysis is usually performed and thematic meetings with the bank's representatives are organised. The off-site analysis is based on statistical comparisons. If the bank does not satisfactorily incorporate the supervisory assessments, an on-site inspection is usually performed.

On-site inspections: loan classification and loan loss provisioning assessments are performed based on individual credit file reviews. Credit policies (e.g. processes, responsibilities, information sources, trigger definition, controls) and practices related to NPL classification and provision calculation are reviewed. On-site supervision is mainly conducted via the verification of compliance with the CRR and NBS regulations.

NBS does not conduct on-site inspections solely dedicated to NPE portfolios. However, NPE portfolios are within the scope of credit risk inspections.

The CCR is used for on-site purposes and for the analysis of information about loans, but it is not used to generate and provide feedback for banks.

There was no horizontal thematic review of banks' NPL management capabilities during the period from 2012 to 2016.

Banks in Slovakia were subjected to AQRs in the context of the SSM comprehensive assessments. This did not identify any capital shortfalls.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

There are no legal impediments in Slovakia to non-banks holding or managing NPLs. If a client is more than 90 days in arrears, the bank may assign its claim corresponding to this liability to a third party by a way of a written contract, without obtaining the consent of a client. The Act on Banks and the Slovak Civil Code permit lenders to transfer existing loans to third parties, together with linked collateral and securities, even if “denounced” (i.e. legally and economically written off).

Although there are no legal impediments to loan sales, the NPL market in Slovakia is not developed (in part as a result of the relatively low levels of NPLs). Therefore, the selling of NPLs is not common practice. Professional loan buyers can be third-country banks or other institutional investors as well as credit-servicing companies. Banks are also free to set up private AMCs, either alone or in cooperation with investment firms.

B.2 Debt enforcement/foreclosure

Regarding debt enforcement and asset foreclosure, the party that provides collateral can agree to certain out-of-court arrangements to enable faster enforcement.

With regard to the out-of-court enforcement of payments, legislation in Slovakia provides the parties concerned with the opportunity to draw up a notarial deed as a tool for the recovery of outstanding claims. This notarial deed, confirmed by the state power authority, allows the debtor to schedule repayment under the newly agreed conditions. In the event of a failure to make repayments, the notarial deed also acts as an enforcement order with which enforcement can be initiated without further court proceedings. The debtor's willingness to sign a notarial deed is essential to the out-of-court settlement and often constitutes an obstacle since it is frequently difficult to obtain. However, in the context of an out-of-court settlement this technique can be considered a quick and cheap solution.

Banks in Slovakia are not allowed to foreclose on collateral themselves.¹⁸⁵ This function is usually outsourced to specialised companies that perform the out-of-court foreclosures for banks. This step follows the termination of the loan (when the client is approximately four months in an internal workout process).

B.3 Corporate insolvency and restructuring

The corporate insolvency and debt restructuring regime is not considered by NBS to be an obstacle to private debt resolution. The Slovak Bankruptcy Act permits two main types of insolvency proceedings. These are separate proceedings with limited options to convert from one to another and only a limited number of common rules:

- bankruptcy liquidation proceedings, which provide for the sale of the debtor's assets (piecemeal or as a going-concern) and proportional satisfaction of the creditors from the cash proceeds;
- restructuring proceedings, which provide a flexible approach under a restructuring plan, and in particular for the restructuring of the debtor's liabilities or for other restructuring measures (including a sale of the assets).

While both types of proceedings have the same aim, the satisfaction of creditors' claims, they are pursued separately and by different means. While bankruptcy liquidation always leads to the winding-up of a debtor as a corporate entity, restructuring may preserve the debtor's business and corporate existence. The law gives priority to restructuring, either by automatic suspension of the pending bankruptcy liquidation proceedings once the restructuring proceedings are commenced, or by giving an opportunity to the debtor to ask the court to suspend the bankruptcy liquidation proceedings pending the preparation of a restructuring. However, any significant breach of the restructuring rules may result in a conversion into bankruptcy liquidation.

Bankruptcy can also be arranged as a so-called "small bankruptcy", which provides the court with the option to declare bankruptcy if the debtor is a small business which meets at least two of the following three criteria: (i) assets of less than €165,000, (ii) sales below €333,000, and (iii) fewer than 50 creditors. Compared with the standard bankruptcy procedure, the "small bankruptcy" procedure is more time-efficient as a result of reduced requirements/procedures as well as being more cost-efficient for the debtor.

Slovak companies in financial difficulties looking for a rescue solution may opt for either in-court (formal) restructuring or out-of-court (non-formal) restructuring. Out-of-court restructuring (frequently referred to as internal, financial or economic restructuring), although not regulated under Slovak law, may result in certain benefits for debtors and shareholders (and to a certain extent creditors) not provided by formal restructuring. For example, when entering into out-of-court restructuring the

¹⁸⁵ In the general context of the Act on Banks, foreclosure and the sale of collateral (real estate) is not within the scope of activities for which NBS granting banking licenses.

debtor is not under any risk of bankruptcy, as opposed to in-court restructuring where bankruptcy might occur if the restructuring plan is not approved by the creditors.

Nevertheless, there are reasons to prioritise in-court restructuring over out-of-court restructuring, including tax benefits and the debtor's protection against lawsuits and individual enforcement actions initiated by creditors, as these are suspended during the court restructuring process.

In-court restructuring is a court-driven rescue process available to businesses at risk of insolvency. It is aimed at proportional satisfaction of the creditors' claims through the preparation and adoption of a restructuring plan, and is designed to protect the business (or at least a vital part of the business) from liquidation. In the initial phase of restructuring the court appoints a trustee to evaluate whether the business is suitable for restructuring (this stage lasts approximately one month).

Following a positive assessment by the trustee, this is followed by restructuring proceedings co-managed by the debtor's management and the trustee under the supervision of the court and the creditors. The restructuring proceedings last for approximately six to eight months, during which time the debtor enjoys statutory protection from creditors' individual enforcement actions.

Restructuring has priority over bankruptcy. If a petition to launch restructuring proceedings is submitted during bankruptcy proceedings, the court reviews it and, if it meets the requirements, interrupts the bankruptcy proceedings and commences restructuring.

If a dispute is already being dealt with in court proceedings, the parties to such proceedings may also reach an out-of-court agreement to have the dispute resolved via an arbitration agreement. An arbitration agreement is an agreement by the parties to submit to arbitration all or some of the disputes which have arisen or which may arise between them in relation to a defined contractual or other legal relationship. Such an agreement, once delivered to the court, constitutes both the withdrawal of the application and the consent of the respondent to the withdrawal.

In Slovakia there are no in-court or out-of-court procedures specifically tailored to microenterprises and SMEs, nor are there legal provisions or schemes in place to provide financial support to distressed companies (e.g. funding for SMEs).

B.4 Household insolvency and restructuring

There is an out-of-court settlement/mediation mechanism for households in Slovakia. Personal bankruptcy is governed by Act no. 7/2005 on bankruptcy and restructuring legally established in 2006, but only a very small percentage of borrowers actually make use of this option. However, statistics suggest that its use is steadily increasing.

Individual entrepreneurs are also eligible for the bankruptcy regime, which is also governed by Act no. 7/2005. If the debtor is a natural person (not an entrepreneur),

insolvency is always recognised as a so-called “small bankruptcy”. At least two preconditions must be met (as described in Section B. 3) for an individual entrepreneur to be eligible for “small bankruptcy”.

The “small bankruptcy” process takes approximately three-and-a-half years, with the initial bankruptcy proceedings lasting around six months depending on the complexity of the particular case (number of creditors, encashment of assets etc.), and the subsequent bankruptcy discharge period lasting three years.

B.5 Judicial system

With regard to possible obstacles to private debt resolution, NBS considers the duration of the judicial process to be a bottleneck which reduces the ability of courts to resolve individual cases. In-court procedures are complex and lengthy and there are no specialised courts or judges dealing solely with insolvency issues.

Insolvency administrators in Slovakia are required by law to hold a degree in law or economics and pass a professional exam held by the Ministry of Justice. Administrators are accountable to the Ministry of Justice, which exercises oversight over them.

B.6 Tax regime

NBS does not consider the tax regime to be an obstacle to private debt workout.

Tax deductibility depends on the resolution measure used. In Slovakia tax deductions are available for loan write-offs and for loan loss provisions, not for collateral sales. There is also a tax loss carry-forward mechanism (deferred tax assets).

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

In general NBS is of opinion that there are no material deficiencies in public registers (including the CCR) in Slovakia which could be seen as an obstacle to private debt resolution.

There are two credit registers in Slovakia: the CCR owned and operated by NBS (Slovak register of bank loans and guarantees) and a private credit register operated by the three largest banks that co-founded it (Slovak Banking Credit Bureau), which currently has 19 members consisting of banks and foreign bank branches.

The CCR operated by NBS was put into operation on 1 August 1997. It pools information on the credit commitments of individual entrepreneurs and legal entities as well as on credit institutions' guarantees. It does not contain information on individuals who are not entrepreneurs. The collection of credit information about clients in this register and the sharing of said information is based on Article 38 of the Act on Banks, as amended.

CCR participants are all banks and branches of foreign banks engaged in business in Slovakia as well as the Export-Import Bank of the Slovak Republic. Borrower data are complemented by the Companies Register administered by the Statistical Office.

There is no threshold used for the inclusion of data on loans in the CCR. The general structure of the CCR is based on individual lenders and borrowers with information listed by loan. The CCR does not contain credit scoring for SMEs or companies. The database is updated on a monthly basis, collects information at an instrument level and uses accounting/supervisory definitions (e.g. exposure definition, concept of default). CCR information on NPLs is available for five years after loan repayment.

The second, private, credit register was founded in 2004 by a private company owned by three Slovak SIs and covers only the borrowing commitments of private individuals. Participating banks use this register to provide each other with information on their clients' payment histories and creditworthiness.

The cadastral system (land registry) is digitalised and centralised. The cost of searches depends on the type of information requested. The costs of a credit search are reasonable both for individuals and for businesses.

The public asset registry (e.g. for road vehicles, ships, aircraft, plant, heavy equipment and intellectual property) includes information on the owner and the characteristics of the asset. This information is not publicly available.

C.2 Debt counselling and outreach

In Slovakia, some limited personal budgeting services are provided by voluntary groups and there is no public institution providing credit management training and advice to SMEs. There is a Centre for Legal Aid under the auspices of the Ministry of Justice, established by the Act on the Provision of Legal Aid for People in Material Need (Act No 327/2005 Col). One of the goals of this centre is to provide quality and complex legal aid (of a broad scope not limited solely to debt counselling) to persons who are financially unable to use legal services, thereby giving them legal protection in the also area of non-payment of loans and consumer protection.

Overall, NBS does not have concerns that limitations in terms of debt counselling/outreach are an obstacle to private debt resolution.

C.3 Consumer and data protection

In Slovakia the Office for Personal Data Protection is responsible for data protection and the protection of fundamental rights relating to the processing of the personal data. Rights, duties and liabilities related to the processing of personal data are defined in the Act on Personal Data Protection (Act No 122/2013). There are certain restrictions on the recording and sharing of personal information. In January 2015 NBS took over the duties of the Slovak Trade Inspection relating to the supervision of consumer protection on the financial market, making it responsible for the protection of financial consumers, i.e. ensuring that entities subject to its supervision comply with applicable legislation when offering or providing financial services or transactions.

NBS is of the view that consumer and data protection laws are proportionate and do not pose an obstacle to private debt resolution.

Annex XVIII: Slovenia

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Chart 18

Country overview

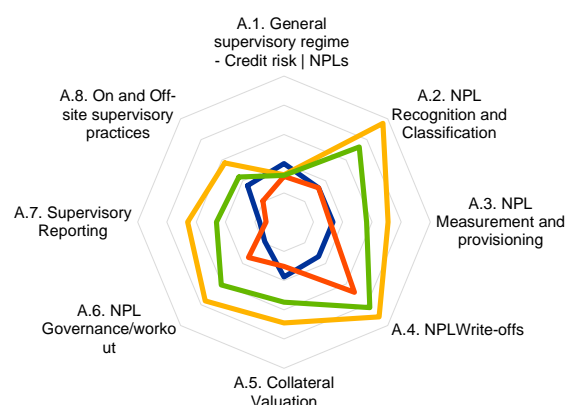
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

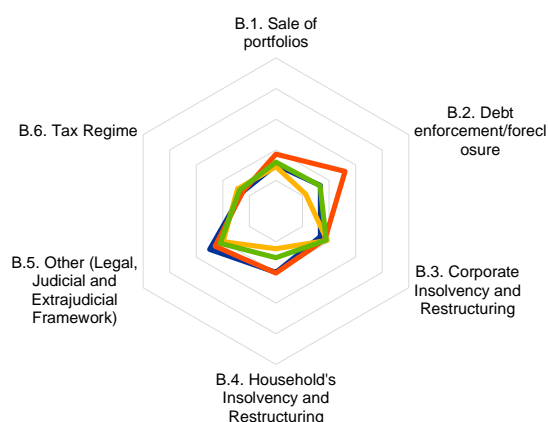
- SI
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



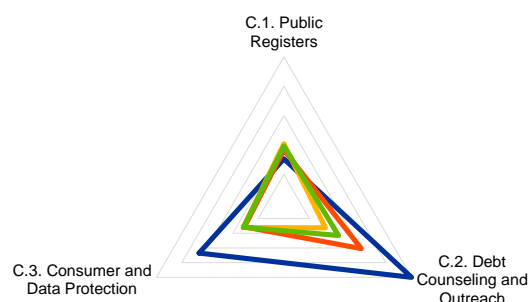
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Slovenia had a total NPL ratio of 13.9% (of which by segment: households 4.7%, NFCs 26.7%, SMEs 32.4% and CRE 37.5%).¹⁸⁶

Based on the ECB survey, it was considered that the **main challenges to NPL workout in Slovenia** are:

- **NPL market:** even though there have been some individual sales of NPLs and foreign investors expressed some interest to buy NPL portfolios, no well-developed market and infrastructure currently exists in Slovenia for the sale of NPLs. One of the barriers identified relates to the price gap of NPL portfolios which is a considerable disincentive for banks to sell their NPLs (or collateral).
- **Judicial insolvency processes:** in-court procedures are complex and lengthy.¹⁸⁷ The duration of insolvency procedures could represent a bottleneck for NPL resolution. The number of insolvency cases increased significantly during the post-crisis period. In addition, insolvency procedures for SMEs are not entirely suited to the specific features of these entities.
- **Debt enforcement/foreclosure:** although there are legal tools in Slovenia that enable rapid out-of-court enforcement/foreclosure of collateral, there is no quick and effective out-of-court procedure established for the foreclosure of mortgage loans originated before November 2013. These mortgage loans have to be foreclosed through in-court procedures, which are usually complex and lengthy. Although the Financial Collateral Act (originally passed in 2004) introduced out-of-court settlement also for mortgage loans originated before November 2013, these provisions were declared as unconstitutional by the Constitutional Court.
- **NPL workout practices:** Slovenia considers the lack of experience, expertise and resources in banks and companies on NPL management as a key barrier to NPL workout in recent years. This issue was prominent in the early phases of the economic crisis and has been a major cause of delay in the NPL workout process. One reason for this delay was that Slovenian banks primarily started with the resolution of the large NPL exposures, which required a tailor-made approach for each exposure and the use of Master Restructuring Agreements (MRAs), because the resolution of SME NPLs required the development of a more systemic and standardised approach due to the specific features of SME portfolios (a large number of exposures and borrowers with low single exposures). Since 2013 Slovenian banks have considerably improved their NPL management frameworks (also by hiring external advisors to sell NPL portfolios and find potential investors). Nevertheless, there is still room for improvement in areas like decision-making processes, strategies and the viability/sustainability of the selected NPL workout solutions. Just recently, Slovenian banks have started developing tailored tools for a systemic and standardised approach to resolving SME NPLs.

¹⁸⁶ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers all banks in Slovenia. Due to a change in definition these figures are not comparable with those figures provided in the ECB Stocktake published in September 2016.

¹⁸⁷ The average length of bankruptcy procedures with final distribution is 3.5 years.

To address NPL workout, Slovenia has taken a number of specific actions, in particular improving the legal framework, issuing banking guidance and setting up an asset management company (AMC¹⁸⁸):

- **Legal framework:** in 2013 Slovenia adopted insolvency legislation that enables the creditor to control and lead companies' restructuring processes and facilitates capital injections from new investors. A simplified and quick out-of-court settlement process for the mortgage loans originated after November 2013 is also in place.
- **Bank-specific NPL reduction strategy and operational targets:** Banka Slovenije (BoS) has dedicated considerable effort to addressing the issues identified in the banks' NPL management frameworks. In March 2015 the supervisor sent a letter to banks, which contained guidelines and requirements for banks to submit their NPL management strategies. By January of each year, Slovenian banks are required to set up individual NPL strategies/action plans for the upcoming three-year period which, among other things, should include: (i) target values for selected performance indicators (e.g. the NPL ratio) in absolute and relative values across individual portfolios; and (ii) coverage ratios and the status of restructured NPLs by selected groups of exposures. Banks are also requested to prepare implementation plans and describe measures to achieve their NPL targets. In July 2015 BoS sent an additional letter with the aim of further enhancing the banks' NPL reduction strategies and asked them, inter alia, to enhance their NPL management plans (by stratifying the NPL portfolio into various segments, describing the criteria used for segmentation, etc.). Although such requirements had a positive impact on the banks' NPL management, this initiative could be of further benefit if BoS would set minimum specific targets and plans in order to foster a larger reduction of NPLs in banks' books.
- **Disposal tools:** in 2013 the AMC (the Bank Asset Management Company – BAMC) was established in Slovenia to facilitate the transfer and management of banks' NPLs. This is considered to be having a significant impact on NPL reduction in Slovenia. The BAMC has purchased from major Slovenian banks circa 600 loans with a total nominal value of €5.5 billion. Currently, the reported transactions with the BAMC are small.
- **Early warning system (EWS) guidance:** in May 2015 BoS issued a Guideline on monitoring customers and early warning systems for increased credit risk. According to the Guideline, banks are required to establish a process for the early detection of increased credit risk, including setting appropriate qualitative and quantitative early warning indicators for the timely identification of obligors with potential financial difficulties. The responsibility for EWS management at the bank should lie with an independent monitoring unit. BoS also provided banks with a recommended toolkit of indicators, such as cash flow (steep

¹⁸⁸ In this report, AMC should be understood as a credit-acquiring firm (see also the list of abbreviations).

decline in or negative EBITDA), creditworthiness (financial liabilities/EBITDA) and capital adequacy (insufficient/negative equity).

- **Supervisory guidance:** in December 2014 BoS issued Guidelines for setting up impairments and provisions for exposures to restructured clients, while in May 2015 it issued Guidelines for the management of doubtful claims. Both documents provide guidance on the set-up of the organisational structure in a bank to facilitate NPL management (such as the separation of risk-taking (e.g. loan origination) and risk management (e.g. loan restructuring) activities) and set requirements for the specific number of staff members holding a NPL workout professional qualification.
- **Preparation of Handbook for the NPL management of exposures of micro, small and medium-sized companies (MSME):** the handbook was prepared by the World Bank at the request of BoS and in cooperation with the Slovenian banking industry, under a technical cooperation project funded by Structural Reform Support Service (SRSS) of the European Commission. The overarching purpose of this work is to support BoS and the Slovenian banking sector in their ongoing efforts to accelerate the resolution of a large volume of NPLs associated with the MSME sector. The Handbook consists of eight chapters covering all main areas of NPL management in order to provide banks with practical advice on implementing the guidelines adopted by the Slovenian Banking Association. The chapters deal with organisational issues in banks, SME portfolio segmentation and resolution alternatives. Case studies and samples of legal documentation can be found in the annexes to the Handbook.

The Handbook was published on 14 March 2017.¹⁸⁹

- **Write-off regulation:** BoS has issued guidelines on banks' write-off policies. These include a requirement for the derecognition timeline to be included for specific segments and loss events.¹⁹⁰

Other frameworks: there is good cooperation between the major stakeholders (i.e. BoS, the Slovenian Banking Association and the ministries), as well as a communication channel between BoS and the corporate sector. External advisors are involved in discussions not only with the banks, but also with the supervisor.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, BoS has issued specific guidelines/requirements regarding credit risk management practices and processes

¹⁸⁹ Available on the web page of BoS: <http://www.bsi.si/en/publications.asp?Mapald=2195>.

¹⁹⁰ Regulation on the assessment of credit risk losses of banks and savings banks.

indicated in the table below. In 2014 and 2015 the supervisory authority also initiated and coordinated activities for the adoption and implementation of two documents: “Principles for the financial restructuring of corporate debt” and “Restructuring guidelines for micro, small and medium-sized companies”.

Table 38

Main sources of NPL-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Regulation (binding)	135/06	All credit institutions	Risk management	Regulation on risk management and implementation of the ICAAP for banks and savings banks: general requirements regarding credit risk, in particular requirements for credit approval, monitoring, data collection, estimation of credit risk and reporting on credit risk	2007
Regulation (binding)	28/07	All credit institutions	Impairments and restructured exposures	Regulation on the assessment of credit risk losses of banks and savings banks: assignment of BoS ratings to exposures, requirements regarding impairments (in line with IFRS), the definition of restructuring, types of restructuring, accounting treatment of restructured exposures and documentation of restructured exposures. This Regulation has been regularly updated in line with legislation and best practices	2007
Guideline (non-binding)	-	All credit institutions	Impairments	Guidelines for setting up impairments and provisions for exposures to restructured clients	12/2014
Guideline (non-binding)	-	All credit institutions	EWS	Guidelines for monitoring customers and early warning systems for increased credit risk	05/2015
Guideline (non-binding)	-	All credit institutions	NPL management	Guidelines for the management of doubtful claims	05/2015

BoS has not issued any guidance defining specific limits on household or NFC portfolios (e.g. max. LTV, max. maturity). This is because household NPLs have not been an issue at any bank in Slovenia.

A.2 NPL recognition and classification

Concerning the definition/classification of NPEs, the Slovenian banks follow the criteria defined by the EBA ITS. In addition, BoS issued a Regulation on the assessment of credit losses of banks and savings banks, which groups exposures into five categories: A to C for non-defaulted exposures and D to E for defaulted exposures. For each category, the Regulation prescribes multiple criteria, including days past due (dpd), a creditworthiness assessment, collateral quality and legal proceedings (insolvency, liquidation, etc.). In the case of dpd, the following categories are defined¹⁹¹:

¹⁹¹ Regulation on the assessment of credit risk losses.

Table 39

BoS classification categories according to dpd

	Non-defaulted exposures			Defaulted exposures	
Categories	A	B	C	D	E
Dpd	None, exceptionally up to 15	Up to 30	Up to 90	91-360	Over 360

BoS has not issued any guidance defining criteria for the exit from non-performing status, besides the guidance on criteria for the aforementioned classification into categories A to E and guidance on write-offs (indicated in the section on NPL write-offs).

In terms of forbore exposures, for regulatory reporting purposes the Slovenian banks are required to follow the criteria defined by the EBA ITS. BoS has developed additional guidance for forbore exposures.¹⁹² Forbearance measures need to be specified (e.g. an extension of the deadline or a deferral of the repayment of the claims, a reduction in the interest rate and/or other expenses, a reduction in the amount of claims as a result of contractually agreed debt forgiveness and/or ownership restructuring, etc.). Regarding the reporting requirements for forbearance measures, for all forbore financial instruments that exceed €100,000, banks are required to document all related decisions, together with an appropriate analysis of alternative solutions (with their economic effects). The guidelines also state that a bank has to record in its IT systems all relevant information, such as the type of forbearance, the method used for and the dates of forbearance measures, the effects on the value of the financial assets (including the effects from write-offs or derecognition from the balance sheet), the change in the probability of loss, the change in the debtor's credit rating and the change in the performance status of the forbore financial assets.

A.3 NPL measurement and provisioning

Slovenian banks follow the IAS/IFRS accounting requirements. BoS issued additional principles-based guidelines for setting up impairments and provisions for exposures to restructured clients. When a documented assessment has been provided by the creditor banks or by an independent advisor concluding that greater repayment of liabilities can be ensured on the basis of operational, ownership or financial restructuring of a corporate than in bankruptcy, and that the corporate's continuation as a going concern can be facilitated, the bank must embark on activities to restructure the exposure to the corporate in question. Insofar as the banks assess that a restructuring plan of the large corporate is feasible and viable, and the banks are also willing to mutually coordinate the parameters in relation to their creditor position (collateral, other significant conditions), they conclude a Master Restructuring Agreement (MRA) with the corporate. A bank that has signed an MRA with a corporate regularly monitors the implementation of the restructuring plan and

¹⁹² Guidelines for setting up impairments and provisions for exposures to restructured clients.

the effects of the plan's implementation. In addition, according to BoS guidelines, the bank then regularly reassesses the potential and gradual reduction of impairments of the corporate's financial assets according to a time schedule, which starts at the time of signing of the MRA. However, currently the release of impairments has not been implemented by most of the Slovenian banks.

In addition, the regulation on the assessment of credit risk losses prescribes criteria for when a bank can use collateral in the calculation of impairment or provisions on certain exposures.

BoS may enforce appropriate provisioning through on-site inspections and the Supervisory Review and Evaluation Process (SREP).

BoS began implementing IFRS9 in 2016. Part of this process entails monitoring the status and progress of IFRS9 implementation in banks in Slovenia. An important part of the IFRS project represents also guidelines for development of model for forecasting expected losses. The guidelines for the model will be complementary to ECB NPL guidelines.

A.4 NPL write-offs

BoS has issued specific guidance¹⁹³ on write-offs, formulating a set of derecognition rules according to which specific types of NPLs have to be moved off balance sheet (OBS). The cases mentioned in the regulation where a write-off is required are: (i) for an unsecured financial asset deriving from a loan agreement or an exercised contingency (guarantee, uncovered letter of credit, bill of exchange or other contingent off-balance-sheet liability), if the debtor is more than one year in arrears with repayment; (ii) for a financial asset deriving from a loan agreement or an exercised contingency secured by RE collateral, if the debtor is more than four years in arrears with repayment and the bank has not received any repayment from the realisation of the RE collateral during this period; (iii) for an unsecured financial asset deriving from a loan agreement or an exercised contingency, if the debtor is already undergoing bankruptcy proceedings; (iv) for a financial asset for which the bank's right to claim payment from the debtor in judicial or other proceedings has been terminated by the approval of compulsory settlement, in the amount at which the right was terminated. As a general principle, partial write-offs are not considered.

Regarding the fiscal treatment of impairments/write-offs, the costs related to NPL write-off also become tax deductible if banks follow the above-mentioned set of rules.

BoS has not provided additional incentives for NPL write-offs in the form of increased capital charges or set specific time limits on how long NPLs can be carried on banks' balance sheets.

¹⁹³ Regulation on the assessment of credit risk losses of banks and savings banks.

A.5 Collateral valuation

In Slovenia, there are two types of authorised RE appraisers: (i) court RE appraisers; and (ii) certified RE appraisers. For court RE appraisers, the licensing authority is the Ministry of Justice, whereas for certified RE appraisers it is the Slovenian Institute of Auditors (a member of the International Valuation Standards Council). In line with CRR requirements, BoS requires banks to use an independent certified appraiser, who possesses the necessary qualifications, ability and experience to conduct a valuation. The most recent appraisal of the market value of the RE has to be made by an independent RE appraiser in accordance with the International Valuation Standards (developed by the International Valuation Standards Council) provided that the appraisal is no more than one year old. Alternatively, a sales contract no more than one year old shall be taken into account as the value of the RE collateral for impairment purposes. A general market value determined by means of mass RE valuation approaches, which the independent appraiser adjusts as necessary by means of an appropriate haircut, may be used as the basis for the appraisal of the market value of residential RE valued at no more than €500,000.

Regarding the frequency of valuation, the banks regularly monitor the value of the RE collateral in accordance with CRR¹⁹⁴ requirements (CRE ≤ 12 months; RRE ≤ 3 years). The frequency of collateral valuation does not depend on loan classification, whether a loan is in default or not; however, BoS guidance¹⁹⁵ indicates that once a borrower is transferred to the unit for managing doubtful investments (owing to a deterioration in the situation of a customer), the unit must immediately examine the collateral (market value, liquidation value, legal certainty, etc.) and regularly review the adequacy of the value and legal certainty of the collateral.

A reappraisal of the market value of the RE collateral undertaken by an independent certified appraiser has to be obtained by the bank in the following cases: (i) when there is a significant fall in the price of the RE compared with the general level of prices on the market; (ii) RE that serves as collateral for a financial asset or a commitment given under OBS items that exceeds €3 million or 5% of the bank's capital, which has to be reviewed at least once every three years by an independent appraiser.

After the asset quality review in 2013, Slovenian banks became rather conservative in valuing collateral, resulting in significant haircuts on collateral values determined by certified appraisers. The haircuts are bank-specific and are not prescribed by BoS.

Collateral valuations are not typically based on market prices; they are based on the last transaction values. To *monitor the collateral values*, banks can use statistical methods or indices, both external (e.g. from GURS¹⁹⁶, the Surveying and Mapping Authority of the Republic of Slovenia) and internal. In practice, public indices are

¹⁹⁴ Article 208(3).

¹⁹⁵ Guidelines for the management of doubtful claims.

¹⁹⁶ *Geodetska uprava Republike Slovenije*.

used to adjust the time value of the RRE appraisal if the independent appraisal is not older than three years. For internal indices, a validation by an external independent entity is required. The use of index valuation is permitted for CRE and RRE and BoS allows both positive and negative adjustments based on indices.

In Slovenia, there are no specific requirements for the calculation of the credit risk-mitigating effect of collateral for risk management purposes under Pillar 2. Banks are encouraged to use all other restructuring tools and techniques when assessing the viability of a borrower before the sale or acquisition of the collateral.

BoS has issued specific recommendations¹⁹⁷ on the valuation of foreclosed assets after the foreclosure date (e.g. accounting value, impairment). The recommendations cover the valuation of RE based on the assigned category in the bank's balance sheet (e.g. investment property held for sale or held for capital appreciation, or both; RE not in use or not leased out).

A.6 NPL governance/workout

The lack of experience, expertise and resources in banks may lead to delays in NPL resolution. Since 2013 Slovenian banks have considerably improved their NPL management frameworks (also by hiring external advisors to sell NPL portfolios and find potential investors). Nevertheless, there is still room for improvement in areas like decision-making processes, strategies and the viability/sustainability of the selected NPL workout solutions. In the early stages, banks started with the resolution of large NPL exposures, which required a tailor-made approach for each exposure and the use of MRAs, because the resolution of SME NPLs required the development of a more systemic and standardised approach due to the segment's specific features. However, recently Slovenian banks have started developing tools to address the challenges related to SME NPL resolution.

Most Slovenian banks have developed dedicated NPL workout units, as they are required to separate NPL management from loan origination and performing loan services. BoS has issued a Regulation¹⁹⁸ on managing NPLs by specific segments of loans, where particular attention is paid to corporate credit restructuring. According to the Regulation, a bank is required to assess the feasibility of the business plan. If the restructuring of the exposure is reasonable, the bank draws up an appropriate restructuring plan and monitors its implementation in cooperation with other creditors. However, if the bank assesses that the restructuring is not feasible, it is

¹⁹⁷ Recommendation letter sent to the banks and savings banks in 2013 and 2014.

¹⁹⁸ Regulation on risk management and implementation of the ICAAP for banks and savings banks, which transposed (i) Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 and (ii) the Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2012/06).

required to formulate a recovery strategy and an approximate timetable for collection.¹⁹⁹

BoS has issued formal guidelines to banks on NPL management practices. In addition, BoS has asked banks to submit the key elements of their individual NPL forbearance plans, a presentation of the target values for performance indicators used in NPL management and the bank's measures to attain the planned targets. Currently, Slovenian banks are required each year to set up individual NPL strategies/action plans for the three-year period ahead which include target values for selected performance indicators (absolute and relative values) across individual portfolios, such as the NPL ratio, the coverage ratio and the status of restructured NPLs by selected groups of exposures. Banks are also requested to prepare implementation plans and describe measures to achieve their NPL targets.

Even though no specific targets were set, BoS indicated²⁰⁰ that NPLs should be quickly reduced (banks should prepare individual timetables for reducing NPLs) to a level that is sustainable in the long term.

BoS has also asked banks to: (i) upgrade their NPL management plans (dividing the NPL portfolio into various segments, describing the criteria used for segmentation, etc.); (ii) prepare a more precise presentation of the approach to NPL reduction for the SME portfolio; and (iii) draw up an operational plan for the elimination of NPLs from the bank's balance sheet (transfer to a special-purpose vehicle (SPV), sale or transfer to the BAMC) and an assessment of the transfer/sale value of individual portfolios.

From a regulatory point of view, banks are also allowed to outsource NPL management, including to non-banks. Nevertheless, there are no companies in Slovenia operating in the NPL-servicing sector.

In the NPL monitoring of individual debtor cases, there is a mechanism for interbank coordination and coordination between private and public creditors (e.g. tax authorities, social security authorities) on individual debtor cases.

A.7 Supervisory reporting

Credit institutions in Slovenia provide the required COREP/FINREP reporting templates including information relating to the EBA ITS requirements on forbearance and NPEs. In addition to that, on a monthly basis, banks have to provide BoS with detailed information on NPLs and all restructured loans. The detailed reporting on restructured loans is part of the monitoring of their individual plan for NPL reduction.

¹⁹⁹ To this end, BoS formulates general instructions on NPL governance as the need for defining precise decision-making criteria as well as setting the deadline for recovery. At the same time, the bank has to keep a record of the monitoring of deadlines for the actual recovery of problem exposures and a computer record based on which the amount of problem exposures actually repaid directly by the obligor or from the liquidation of collateral and the amount of write-downs of these exposures are monitored.

²⁰⁰ BoS letter dated 23 December 2014.

In relation to this, banks are required to perform the following tasks: (i) report newly signed MRAs and key data on progress in implementing the MRAs (quarterly)²⁰¹; and (ii) label the restructured exposures in the credit register (monthly update). Moreover, as mentioned in the previous section, banks have to provide NPL targets on an annual basis: the NPL ratio and amounts, as well as the coverage ratio and amounts. BoS applies manual validation rules to ensure the quality of banks' NPL-related reporting.

Regarding the disclosure of NPL-related information, BoS has a monthly publication entitled "Bank performance in the current year, capital market developments and interest rates". In addition to the above data published monthly, on 24 November 2015 BoS started publishing NPL ratios on a quarterly basis as required by the EBA ITS (first data as at 30 June 2015).

A.8 On-site and off-site supervisory practices and methodologies

During 2012-14 the Slovenian banks were subject to granular asset quality reviews. BoS has undertaken a thematic review of banks' NPL management capacity as part of an asset quality review in 2012-14 and also sent out a questionnaire on NPL management to Slovenian banks.

BoS has developed a methodology to assess the policies and procedures used by banks to handle NPLs. The criteria/framework that BoS applies to assess the policies and procedures used by banks to handle NPLs does not accommodate the specific features of each bank (such as the business model, legal nature, size, internal organisation).

In addition to on-site inspections, off-site inspections are conducted on NPL portfolios. Such off-site inspections include regular analysis of NPL portfolio developments. Data for off-site inspections are obtained either from regular monthly reports from banks or by ad hoc requests from BoS on specific debtors. Furthermore, BoS requests banks to prepare plans and projections for NPL reduction; these plans are reviewed on a regular basis in off-site analysis.

Besides the NPL information provided by the banks, BoS also uses the CCR for supervisory purposes, namely for on-site and off-site supervision and for SREP purposes. BoS mainly uses the EBA ITS reporting for SREP scoring purposes; however, certain granular data are obtained from the CCR. The CCR is also used to generate and provide feedback to banks.

²⁰¹ According to Article 2.1.2.3 of Appendix I of the 2013 Regulation on risk management and the implementation of the ICAAP for banks and savings banks.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

Although there are no legal impediments to the sale of loans, the Slovenian market for NPL portfolios is not developed. Between 2012 and 2014 the NPL disposal mechanisms used were the transfer to private AMCs (97% of the total value of all disposals) and the sale of loan portfolios (3% of the total value of all disposals).

An AMC called the Bank Asset Management Company (BAMC) was created by the Slovenian Government in 2013. It has the authority to issue government-guaranteed bonds subject to a limit of €4 billion. The BAMC has purchased close to 600 loans with a nominal value of €5.5 billion from major Slovenian banks. The BAMC has two minimum performance standards: to sell 10% of its portfolio per year and to achieve an ROE of 8%.

The BAMC is viewed as an important mechanism for the transfer of NPLs, thereby relieving banks' balance sheets.

The legal framework in Slovenia enables the sale of loans. Regulations permit lenders to transfer existing loans to third parties, together with linked collateral and securities, without the consent of the borrower, and allow banks to sell "denounced" (i.e. legally and economically written off) loans. Loan buyers can be third-party banks or institutional investors. In addition, there is a specific regulation on AMCs (credit-acquiring firms) and banks are allowed to set up AMCs in cooperation with investment firms.

B.2 Debt enforcement/foreclosure

In Slovenia there are legal tools that enable rapid out-of-court enforcement/foreclosure of collateral. In principle, all collateral can be realised out of court. However, there is no quick and effective out-of-court procedure to realise mortgage loans established before November 2013; these mortgages must be realised through in-court procedures, which are usually complex and lengthy, and although the Financial Collateral Act introduced the out-of-court realisation also for mortgage loans established before November 2013, its provisions were declared as unconstitutional by the Constitutional Court. There is a simplified out-of-court procedure for the realisation of mortgages, but only for those established after November 2013. A new law for consumer loans is under preparation and is expected to be adopted in autumn 2016.

Furthermore, for certain assets the contractual framework must contain clauses enabling out-of-court realisation. In this context, the length of judicial processes in relation to mortgages taken out before 2013 is considered as a disincentive to the realisation of collateral.

B.3 Corporate insolvency and restructuring

The corporate insolvency and debt restructuring regime is currently considered by Slovenia not to be an obstacle to private debt resolution. In 2013 Slovenia adopted a new Insolvency Law that, among other things, enables the creditor to control and direct the restructuring process of companies.

In Slovenia, legal provisions²⁰² are in place to support distressed companies. There is a pre-insolvency regime that enables an early rehabilitation of distressed enterprises. The pre-insolvency procedure enables a debtor that is likely to become insolvent to conclude agreements with its financial creditors (including banks) to restructure their claims. If a sufficient quorum of financial creditors is achieved, the agreement is confirmed by the court and is binding for all financial creditors.

However, court procedures are complex and lengthy, leading to bottlenecks in the judicial system. The number of cases has increased significantly in the post-crisis period. In addition, insolvency procedures for SMEs are not entirely adapted to the specific characteristics of these enterprises.

“Pre-pack” procedures, under which the court expeditiously approves a debt restructuring plan negotiated between the debtor and its creditors in a consensual manner before the initiation of an insolvency proceeding, took an average of 32 weeks in 2015 (17 weeks in 2014).

B.4 Household insolvency and restructuring

The household insolvency and debt restructuring regime is considered by Slovenia not to be a major obstacle to private debt resolution, even though currently the country still does not have an out-of-court settlement/mediation system for households.

In Slovenia, the personal bankruptcy regime covers all loans taken out by households, consumers and individual entrepreneurs. In 2014 roughly 4,000 personal insolvency/bankruptcy cases involving natural persons (consumers, sole traders and entrepreneurs) commenced and the average length of these proceedings was 36 months (17 months for proceedings terminated without debt discharge, 40 months for proceedings terminated with debt discharge).

According to the regulation, the procedure for the discharge of debt is carried out in the framework of personal bankruptcy proceedings if the debtor proposes the discharge of debt. Therefore, personal bankruptcy proceedings cannot be finalised before the end of a trial period determined by the court, which lasts from two to five years. This is why personal bankruptcy proceedings that end with the discharge of debt last on average 3.3 years. The proportion of proceedings ending with debt

²⁰² Act governing the rescue of and restructuring aid for companies in difficulty.

discharge amounted to 82% of all proceedings completed in 2014. The insolvency/bankruptcy discharge period lasts between two and five years.

B.5 Judicial system

As previously mentioned, in-court procedures are complex and lengthy. The duration of the judicial process represents a bottleneck as it reduces the ability of courts to resolve individual cases. The number of cases has increased significantly in the post-crisis period. The system is trying to tackle this issue and has already introduced specialised courts or judges that deal only with insolvency issues.

B.6 Tax regime

The tax deductibility of write-offs does not depend on the specific resolution measures used. In general, impairments and provisions in the banking sector are tax deductible (see also Section A.4).

Tax deductions in Slovenia are granted for loan write-offs (under certain conditions, as indicated) and for LLPs where there is also a tax loss carry-forward mechanism (e.g. DTA). However, there are no tax deductions for collateral sales.

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

Regarding the perception of the overall level of quality of public registers in Slovenia, there is a medium degree of concern about deficiencies in public registers (especially the CCR) which are a possible challenge to private debt resolution.

The CCR in Slovenia is currently split into two parts: the credit register for individuals (SISBON) and the credit register for legal persons and individuals pursuing registered business activities (RAZ-1). The latter is currently under revision and will be shared with credit institutions and borrowers and later also with other lenders. NPL data according to the national definition (90 dpd) have been available since 1993. Data on forbearance have been available since 2013 and have been compliant with the EBA definition since September 2014.

Domestic banks, local subsidiaries of foreign banks and local branches of foreign banks submit information to the CCR.²⁰³ Leasing companies also currently report information to the credit register for individuals. The reporting agents submit

²⁰³ Instructions for implementing the Regulation on the assessment of credit risk losses of banks.

information at a solo level. However, BoS plans to move the reporting by parent credit institutions into the part of the credit register related to exposures of legal persons and individuals pursuing registered business activities, in accordance with the prudential consolidated scope under the CRR (with separate data for exposures for each subsidiary within the group). Credit institutions will report inter alia information regarding types of loans, debt securities, derivatives and OBS exposures.

In second quarter of 2016 Bank Slovenije established a public central credit register for corporate exposures which became available to all interested parties in November 2016. The main new feature of the upgraded register enables users to follow online exposures and credit rating of each individual legal entity.

There is no minimum threshold regarding exposure size for inclusion in the CCR. In this regard, the CCR covers the total amount of loans in Slovenia and information is reported at an instrument level.

Annex IX to this report gives a detailed overview of the main features of and information collected by the CCRs.

The cadastral system (land registry) is digitalised and centralised. It is available to the public to conduct searches, which are free of charge for individuals, but there is a requirement to demonstrate a legal interest in conducting a search. The registry identifies the asset owner and asset characteristics.

RE transactions (both for commercial and residential assets) are reported in a fairly comprehensive way. The general public can conduct searches on transactions and collect the main information such as the price of the asset. A search costs less than €10 on average. However, a detailed description of the property's characteristics is not included.

Information on upcoming sales and auctions is publicly available. There is a continual updating of information on RE transactions.

The Public Asset Registry (e.g. for road vehicles, ships, aircraft, plant, heavy equipment and intellectual property) is publicly available and contains information on the owner and the characteristics of the asset.

C.2 Debt counselling and outreach

The overall perception of the quality of debt counselling and outreach is that it is adequate. Currently, in Slovenia, there are no free or subsidised personal budgeting services or legal advice services to indebted households, and there is no institution that provides credit management training and advice to SMEs.

C.3 Consumer and data protection

In Slovenia, there are restrictions on recording/sharing personal information for debt workout purposes, which are in accordance with personal data protection law requirements. Personal data may only be processed if allowed by law, if the consent of the individual has been given for the processing of certain personal data or if processing is needed for the conclusion or execution of the contract (this also includes loan sale contracts). The purpose of the processing must also be provided by law, or in the case of the consent of the individual, the individual has to be notified in advance about the purpose of the processing. The overall perception of the quality of consumer data protection is medium.

Updated law on consumer protection published on 2 December 2016 (Official Gazette 77/2016) introduced licencing and supervision of all credit agents and leasing institutions engaged in residential real estate lending. Both licensing and supervision in the sense of consumer protection, have been integrated into (new) supervisory functions of Banka Slovenije.

Annex XIX: Spain

Executive summary

This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections A to C present a brief description of the country-specific national regulatory and legal frameworks and supervisory practices related to NPLs.

Chart 19

Country overview

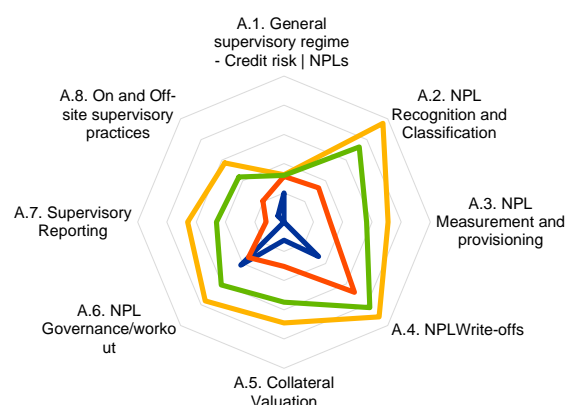
How to read the graphs: for the graph "Supervisory regime and practices", the centre corresponds to comprehensive supervisory guidance for banks (additional to current regulation) or supervisory stringency; for the graphs "Legal, judicial and extrajudicial framework" and "Information framework", the centre corresponds to no concern or no identified main obstacles to NPL resolution. The graphs refer to end-2016; more recent developments are indicated in the report. The graphs do not attempt to be a complete assessment of the regulatory and supervisory framework of the countries involved in the project (see paragraph 1.3 for more detailed explanations).

NPL Framework Overview

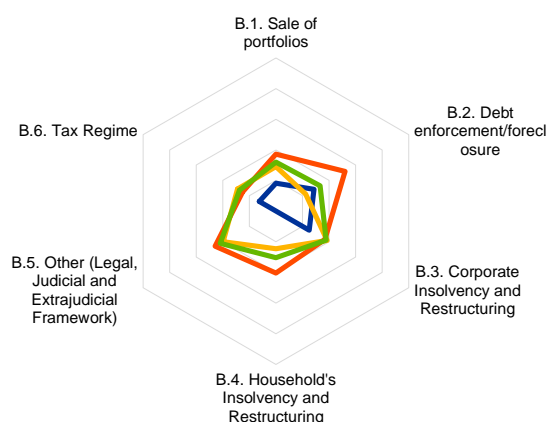
- ES
- Jurisdictions with low NPL levels
- Jurisdictions with high NPL levels
- SSM Average



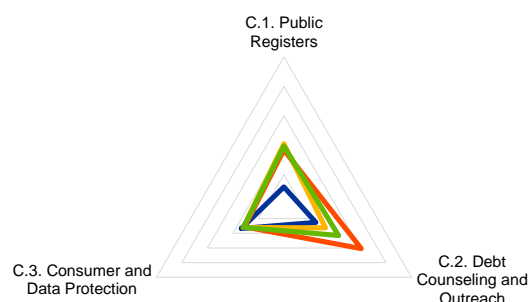
Supervisory Regime and Practices (see section A)



Legal, Judicial and Extrajudicial Framework (see section B)



Information Framework (including CCR) (see section C)



In December 2016 Spain had a total NPL ratio of 6.0% (of which by segment: households 4.5%, NFCs 10.9%, SMEs 17.0% and CRE 18.7%).²⁰⁴

Based on the potential obstacles identified in the ECB survey, the **main challenges to NPL workout in Spain** are:

- **As regards conduct issues, increased consumer protection** prevents or hampers enforcement of debts and mitigates reputational risk. Since 2013, Spanish courts have a power to delay or freeze the eviction of home buyers who have fallen behind on their mortgage payments when they are facing personal hardship. Even if home buyers are not protected by the law, banks try to minimise the evictions, given the social repercussions and the visibility of anti-eviction campaigners. However, this issue mainly concerns low-income households' mortgage loans, which account for a small part of total NPLs.
- **Operational targets for the reduction of NPLs:** Spanish regulation does not specifically require banks to have formal NPL management strategies aimed at setting operational targets for NPL reduction, although the Banco de España (BdE) (the SSM for SIs) may require such strategies for some entities.
- **To address high NPL levels, Spain has taken a number of specific actions,** mainly aiming to improve its accounting and legal framework or to increase the provision of information on NPLs:
- **Provisioning, collateral haircuts and classification rules:** the BdE in addition to being a supervisor, is also an accounting regulator which is a rather unique feature among supervisors in the European Union. The accounting regulation has recently been revised, to include developments in banking regulation and the best practices identified in credit risk management and accounting²⁰⁵. Circular 4/2004 establishes requirements to guide both the development of own methods for individual estimates of specific provisions and of internal models for collective estimates of specific and generic provisions. For less complex institutions, revised alternative solutions are provided in the new Annex IX, which includes a more granular provisioning matrix.
- **Legal framework:** between 2012 and 2015 Spain approved legislative measures to facilitate debt restructuring. The reforms aim at helping firms and individuals to recover and at maintaining borrowers' payment culture and the social protection of the most disadvantaged sectors. Spain approved amendments to the Insolvency Law to facilitate out-of-court payment agreements in terms of both procedural and practical implementation. Moreover, the Insolvency Law has been extended to individuals. It also includes a debt exemption procedure for debtors (self-employed natural persons and

²⁰⁴ Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities and off-balance sheet exposures. The sample covers all banks in Spain. Due to a change in definition these figures are not comparable with those figures provided in the ECB Stocktake published in September 2016.

²⁰⁵ These provisioning requirements were revised by BdE Circular No 4/2016, which entered into force on 1 October 2016.

households) once their entire assets have been settled for the benefit of their creditors. Spain has also implemented measures to strengthen the protection of mortgagors and on debt restructuring and social rentals, including the suspension of habitual residence evictions of vulnerable sectors (low-income households) until 2020.

- **Well-functioning CCR and public registers:** the CCR covers nearly all loans and reports information at an instrument level, whereas the cadastral system and the land registry offer comprehensive and up-to-date information on RE to the public. The Public Asset Registry provides information on vehicles, heavy equipment and intellectual property. Moreover, the CCR data are used by the BdE as a supervisory tool (e.g. to compare the debtor classification - specific bank classification versus the system).
- **Disclosure:** between 2008 and 2014 Spain adopted a number of new measures to provide more detailed information on NPLs to the markets. The BdE publishes, on a regular basis, aggregate information on Spanish banks' troubled assets, whereas institutions' annual reports contain: (i) information on RE exposures or troubled assets; (ii) quantitative and qualitative disclosures on the exposure to the construction and RE sectors, housing mortgages and foreclosed assets (including data on forborne loans); and (iii) information on policies and strategies to deal with troubled assets and risk concentration by geographical area and business segment.

In addition to the above-mentioned specific actions, the following information is also noteworthy when describing how Spain has addressed NPLs:

- **Disposal tools:** Spain founded an asset management company named SAREB in 2012, which is a majority private-owned entity that was founded to help clean up the balance sheet of the Spanish banking sector (specifically banks with problems due to their overexposure to the RE sector). SAREB received almost 200,000 assets, which were valued at €51 billion. The assets transferred were: (i) foreclosed assets whose net carrying amount exceeded €100,000; (ii) loans/credits to RE developers whose net carrying amount exceeded €250,000; and (iii) controlling corporate holdings linked to RE developers.

Institutions' **internal procedures were strengthened**. In December 2012 the BdE required credit institutions' internal audit functions to review the strategies, policies and procedures for dealing with asset impairments, including the operational capability to manage arrears, in order to identify operational deficiencies and issues for improvement. The BdE evaluated the action plans and monitored their implementation, carrying out on-site reviews of the credit institutions with poorer arrears management systems.

A Supervisory regime and practices

A.1 Supervisory regime (credit risk/NPLs)

In addition to the requirements set in CRD IV, the following specific laws and guidelines/requirements regarding credit risk management practices and processes were issued:

Table 40

Main sources of NPE-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Circular	4/2004 (Annex IX) Amended by Circular 4/2016	All credit institutions	Risk analysis and management including loan refinancing and restructuring	Requirements regarding credit risk analysis, allowances and provisions including criteria for the documentation, monitoring and review of refinanced and restructured loans	2005

While there is guidance regarding concentration risk and LTV, no specific limits (e.g. max. LTV, max. maturity) on household portfolios have been set, whereas for NFC portfolios and for RE development projects the initial financing of the cost of acquiring land for subsequent urban development must not exceed 50% of the lower of the amount declared in the public deed and its appraised value. An LTV limit of 80% has been introduced for retail operations as a benchmark. Transactions with individuals for the purchase of housing are subject to stricter credit standards when more than 80% of the purchase price of the dwelling is financed. Other Spanish regulation contains additional incentives to comply with the 80% LTV threshold (not only beneficial treatment for capital regulation, but also eligibility to issue covered bonds).

A.2 NPL recognition and classification

In addition to the EBA ITS concerning the classification of NPEs, the BdE has issued detailed criteria²⁰⁶ other than delinquency to classify exposures as “Doubtful for reasons other than in arrears” (included in the NPL category), such as: negative equity, continuing losses, recurrent late payments, inappropriate financial structure, insufficient cash flows, balances judicially claimed by the credit institution, etc., as well as additional qualitative criteria²⁰⁷ like the appropriateness of previous refinancing/restructuring transactions.

The BdE has also developed additional guidance for the classification of forborne exposures²⁰⁸ in terms of additional situations that are treated as forbearance

²⁰⁶ Point II of Annex IX, Circular No 4/2004.

²⁰⁷ April 2013 BdE formal communication to banks (criteria on refinancing and restructuring) incorporated into the updated Circular No 4/2004 in 2016.

²⁰⁸ Criteria for the application of Circular No 4/2004 in respect of loan refinancing and restructuring. In 2016 incorporated in the updated Circular No 4/2004.

measures, e.g. assets that are received to reduce debt, the extension of maturity, or the short-term change or reduction of the frequency of the instalments. Furthermore, there are also recording requirements for forbearance measures. Banks are required to record in their IT systems appropriate individual identification and monitoring of refinancing and refinanced and restructured transactions. This includes information on how many times the loan has been restructured and a link between new facilities and the original loan.

Performing loans are divided into “standard loans” and “standard loans under special monitoring” (exposures to debtors showing signs of weakness, including high debt levels, a drop in revenue and narrowing of operating margins (e.g. forbearance during the probation period)). NPLs are divided into “doubtful in arrears” (90 days past due) and “doubtful for reasons other than in arrears” (as stated above). In addition to the performing and non-performing loan categories, there are two related asset classes: “foreclosed assets” and “write-off”. Criteria for the exit from the non-performing status are defined separately for “doubtful in arrears” and “doubtful for reasons other than in arrears”. The “doubtful in arrears” can be reclassified when the payments in arrears are collected. Regarding “doubtful for reasons other than in arrears”, the exposures of customers declared as being subject to bankruptcy proceedings without a liquidation request are reclassified in the normal category when predetermined conditions are met. In addition, in April 2013 the BdE sent a formal communication to banks on criteria for refinancing and restructuring which, in addition to Annex IX of Circular No 4/2004, stated the rules for the classification of restructuring loans. Earlier guidance was revised in 2016 (new Annex IX amended by Circular 4/2016) to fully align curing rules with the EBA ITS.

A.3 NPL measurement and provisioning

Spanish banks apply the IFRS; however, the BdE has traditionally enforced accounting standards in the financial statements. In this context, Circular No 4/2004 specifies criteria to classify exposures in the “doubtful for reasons other than in arrears” category, as previously mentioned, which constitutes additional evidence of loss events/impairment triggers.

The revision of Circular 4/2004 made in 2016 establishes minimum requirements to be met by the accounting methods used by the entities. In that regard it establishes requirements to guide both the development of own methods for individual estimates of specific provisions and of internal methods for collective estimates of specific and generic provisions.

In case of institutions that have not developed internal methods for collective estimation of provisions, Annex IX offers alternative solutions (percentages for provisions and percentage discounts applied to the reference value of the collateral), calculated on the basis of Banco de España’s information on the sector and experience. In this regard, the exposure not covered by collateral (valued incorporating a haircut) is required to be fully provisioned within 18 months year.

No interest is accrued on loans classified as “doubtful loans” since impairment has been identified.

A.4 NPL write-offs

According to Annex IX, exposures can be written off provided that an individualised analysis has concluded that there is only a remote probability of recovery. This category includes: loans of borrowers subject to bankruptcy proceedings for which a liquidation phase has been or is to be declared; exposures to customers whose solvency has undergone a marked and unrecoverable deterioration, and exposures classified as doubtful due to arrears of more than four years, unless effective collateral covers at least 10% of the gross carrying amount of the transactions.. Entities are then responsible for defining their own write-off policy, with due consideration to the aforementioned criteria.

The BdE has not set additional incentives for NPL write-offs, such as increased capital charges, as its focus is more on the appropriate provisioning of the loans, rather than on whether they are removed from the balance sheet.

A.5 Collateral valuation

In Spain, the appraisers are certified by the certifying authority for appraisal companies. For RE collateral, only specialised companies (*sociedades de tasación*), which are registered and supervised by the BdE can provide valuation services to financial sector entities.

The revised Annex IX prescribes minimum frequencies for the valuation of collateral (depending on the credit quality and the amount of the exposure). In case of collateral of doubtful exposures and foreclosed assets valuation should be revised at least annually.

In addition to CRR²⁰⁹ requirements, Order ECO/805/2003 of the Ministry of Economy allows for the use of the following valuation methods for immovable property collateral: cost method; comparison method; income method; and residual value. For the monitoring of collateral values, banks can use statistical methods for loans, as long as they comply with certain requirements established on Circular 4/2004. The use of internal indices is not permitted.

Banks are required to collect reliable data to assess the collateral recovery. To estimate impairments, banks should take into account past experience, the geographical and business areas in which the entity and the group operate, risk levels and all of the information available at the date the estimate is made.

²⁰⁹ Article 208(3).

In Spain, banks are required to evaluate the effectiveness of their collateral in their ICAAP.

A.6 NPL governance/workout

In December 2012 the BdE required credit institutions' internal audit functions to review the strategies, policies and procedures for dealing with asset impairments (under a broad concept), including the operational capability to manage arrears, in order to identify operational deficiencies and issues for improvement. The BdE evaluated the action plans and monitored their implementation, carrying out on-site reviews of the credit institutions with poor arrears management systems. Currently, the banks' internal audit functions are looking into these aspects.

The BdE indicated that currently most Spanish credit institutions have dedicated workout units, but it does not prescribe or recommend general workout practices to credit institutions. Spanish regulation does not specifically require banks to have formal NPL management strategies aimed at setting operational targets for NPL reduction, although the BdE (the SSM for SIs) may require such strategies for some entities.

Although no specific guidance is in place on how to handle NPEs by segment, in 2012 a Code of Good Practices²¹⁰ for the viable restructuring of selected mortgage debts (of persons under extraordinary difficulty) was issued, to be voluntarily followed by credit institutions. This Code defines the measures to be applied depending on whether a debtor is viable or not (a specific criterion is defined to assess viability). These measures range from the existence of a restructuring plan (with measures such as a principal repayment grace period) to partial acquaintance of debt and the date of payment. The parties adhering to the Code send to the BdE on a quarterly basis certain information including, inter alia, the number, volume and characteristics of the transactions requested, executed and denied in application of the Code.

In April 2013 the BdE set guidance on the application of the provisions of Circular No 4/2004 on loan refinancing and restructuring, as regards the definition, documentation, monitoring and review of such refinancing/restructuring. It sought to establish general uniform criteria, bearing in mind that institutions should understand that refinancing, although being a credit risk management instrument, should be used without distorting the timely and prompt recognition of impairment on transactions due to default risk.

In Spain, there is no restriction on non-banks owning NPLs. However, banks can only outsource some aspects of NPL management, such as the recovery of certain doubtful loans, including to non-banks, and there are companies specialising in NPL servicing.

²¹⁰ Royal Decree-Law No 6/2012 (9 March).

In terms of mechanisms for coordination between debtors, although currently there is no mechanism between private and public creditors (e.g. tax authorities, social security authorities), in April 2015 a legal mechanism for coordination between banks on a single debtor was launched.²¹¹ This mechanism was first used by the six largest banks in Spain, as a vehicle for restructuring viable large and medium corporate debtors. The management of the debtor is entrusted to consulting companies.

Circular No 4/2004 contains specific rules/criteria for valuing foreclosed assets on and after the foreclosure date, in particular that: entities may develop a methodology based on the appraised value (applying appropriate discounts). In this sense, capital is impacted through higher impairment.

A.7 Supervisory reporting

Besides the basic EBA ITS prudential reporting, Spain follows the provisions of Circular No 4/2004 (amended by Circular No 6/2012²¹², Circular No 1/2013, and Circular No 4/2016) to formulate additional reporting requirements, e.g. for mortgage loans the banks are required to report their exposures broken down into six LTV brackets²¹³.

On the disclosure side, the BdE has adopted a number of measures to provide more detailed information on NPLs to the markets. These measures are: (i) regularly publishing aggregate information on Spanish banks' troubled assets (since 2008, through its Financial Stability Report); (ii) including information on RE exposures or troubled assets in public financial statements since 2012; (iii) requiring quantitative and qualitative disclosures from institutions²¹⁴ relating to exposures to the construction and RE sectors, housing mortgages and foreclosed assets (including data on forbore loans); and (iv) requiring, in the notes to the institutions' annual accounts, information on policies and strategies to deal with troubled assets and risk concentration by geographical area and business segment, as well as information on good practices for responsible lending.

For the quality assurance of the supervisory reporting, the BdE (the SSM for SIs) makes use of on-site inspections and ongoing monitoring teams where IT experts apply data validation procedures and accounting reconciliation to ensure the appropriateness of the reporting of NPEs. Data quality reviews are also performed to ensure that the inventory database is consistent (reconciliation with physical documents). In addition, the Financial Reporting Department carries out quality assurance processes on the NPE reports regularly provided by the credit institutions.

²¹¹ Royal Decree-Law No 4/2014 (7 March).

²¹² Circular No 6/2012, of 28 September, in which it requested financial entities to provide information on refinancing transactions in the notes to their financial statements.

²¹³ Up to 40%, >40% and <=60%, >60% and <=80%, >80% and <=100%, >100% and <200%, and >200%.

²¹⁴ Required by rules 4 and 5 of Circular No 4/2004, which were modified by Circulars No 5/2011 and No 6/2012.

On-site inspections check the appropriateness of the identification of NPEs through the analysis of a sample of debtor files.

NPE statistics are publicly available in BdE statistics. Several reports containing charts and data series on NPLs are regularly published on the BdE's website (*Boletín Estadístico y Boletín Económico* – published monthly; *Informe de Estabilidad Financiera* – published every six months).

A.8 On-site and off-site supervisory practices and methodologies

Following the rules of Circular No 4/2004, when the BdE (the SSM for SIs) carries out a supervisory activity related to credit risk, it analyses banks' policies and procedures (reviewing internal manuals, interviewing senior managers, inquiring about the allocation of powers and responsibilities, etc.). In general, the BdE (the SSM for SIs) applies the same supervisory approach for all types of banks. However, the characteristics of each bank's credit portfolio depend on bank-specific features so that both on-site inspections and off-site credit risk monitoring teams focus on the specific features.

Although there are no checklists for on-site inspections on credit portfolios and/or NPEs, the BdE issued internal guidelines that develop the action protocols and work procedures related to on-site inspections²¹⁵. The BdE also carries out an analysis of the classification mismatch among banks for the same debtor.

The BdE carries out centralised (off-site) assessments of large corporates with exposures across the whole banking system, which are used by on-site inspection teams. Moreover, the CCR data are used by the inspection teams to compare the debtor classification (specific bank classification versus the system). During on-site inspections, the BdE also assesses the appropriateness of assumed recognised income from NPLs.

NPE-related inspections are usually conducted with on-site inspections. However, as part of the ongoing monitoring, off-site inspections are also used to analyse loan classification and LLP coverage for significant creditors. In addition, the BdE undertook a thematic review of banks' NPL management capability in 2012 (see the previous section on NPL governance) and in 2013-14 it carried out on-site inspections and specific reviews to evaluate the classification and provisioning of refinancing loans.

The NPE portfolios with highest priority are: (i) large exposures; (ii) problem loans (doubtful loans, loans on the watch list); and (iii) restructured loans. For the sampling process of the NPE portfolio review, the selection criteria follow a similar prioritisation depending on the bank. Different portfolios are segmented into tranches depending on the size of the credit risk. On-site supervision teams often include a specialist with

²¹⁵ During on-site inspections, the team members always perform the following tasks: (i) they verify that the bank complies with applicable regulations; and (ii) they analyse the bank's situation in order to identify weaknesses and deficiencies that should be corrected and to update the bank's risk profile.

NPL collection and workout experience. The number of staff members varies depending mainly on the size of the entity.

B Legal, judicial and extrajudicial framework

B.1 Sale of portfolios

Although there are virtually no legal impediments to loan sale, the Spanish market for NPE portfolios still appears to be insufficiently developed to achieve NPL resolution in Spain. Nevertheless, transactions have become more frequent over recent years and are reaching a relatively considerable volume compared with peer countries.²¹⁶ A variety of NPE disposal tools have been used, e.g. portfolio sales, transfers to AMCs, etc. The legal basis for founding AMCs is set out in a specialised law²¹⁷.

An AMC named SAREB was created in 2012 with the mission of selling problematic loans from nationalised banks over a maximum time horizon of 15 years. It was a one-off measure, only applicable to the portfolio existing at a specific moment in time. The assets transferred were foreclosed assets and RE development loans exceeding a certain carrying amount (€100,000 and €250,000, respectively) and controlling corporate holdings linked to RE developers. SAREB received almost 200,000 assets at a transfer price of €50.7 billion. Ownership of SAREB is split between the private sector (55%) and the Fund for Orderly Bank Restructuring (45%). SAREB is considered by the BdE to be a good mechanism for NPE workout because it addressed the problem of uncertainty around the valuation of RE portfolios of the banks by contributing to reducing information asymmetries and incentivising other banks to adjust the value of their assets. Additionally, SAREB has allowed banks to adjust to market stress by smoothing the economic cycle and is helping to revitalise the RE market and develop a secondary market for distressed assets by acting as a catalyst for sales by other agents.

The legal framework in Spain enables the sale of loans together with linked collateral and securities. The consent of borrowers is needed unless the sales contract only establishes the acquisition of the loans' credit rights. Purchasers can be third-party banks or institutional investors.

B.2 Debt enforcement/foreclosure

No data are available on the efficiency of out-of-court negotiation processes. These processes are regulated in the *Ley Hipotecaria*.

²¹⁶ European loan portfolio activity outlook and transactions.

²¹⁷ Law No 8/2012 of 30 October 2012 on write-downs and sales of the financial sector's RE assets.

Spain considers that there are no disincentives to realising collateral, and the average length of a foreclosure procedure is 18 months.

B.3 Corporate insolvency and restructuring

The corporate insolvency and debt restructuring regime is considered by the Spanish BdE not to be an obstacle to private debt resolution.

Although Spain does not have a scheme in place to support distressed SMEs, the Insolvency Law²¹⁸ allows for out-of-court payment agreements. “Pre-pack” procedures exist for both companies and individuals.

In 2014 €6.4 billion of corporate debt was restructured/settled out of court. In 2008 there were 2,871 insolvency proceedings, with the number growing every year and peaking in 2013 at 9,705. In 2014 there were 7,270 cases.

B.4 Household insolvency and restructuring

Spain has approved legislative measures to facilitate debt restructuring taking into account mortgagors’ protection. Between 2013 and 2015 the government undertook several legislative reforms with the aims of helping firms’ and individuals’ recovery and maintaining borrowers’ payment culture and the social protection of the most disadvantaged sectors.

In this context, Spain approved amendments to the Insolvency Law to facilitate out-of-court payment agreements in terms of both procedural and practical implementation. Moreover, it has been extended to individuals. It also includes a debt exemption procedure for debtors (self-employed natural persons and households) once their entire assets have been settled for the benefit of their creditors. Spain also approved measures to strengthen the protection of mortgagors and on debt restructuring and social rentals, including the suspension of habitual residence evictions of vulnerable sectors until 2020.

The national legal framework dealing with insolvency and recovery of households in hardship is set out in the Code of Good Practices for mortgage debtors in vulnerable circumstances which was established in March 2012. Between then and June 2016, there were 33,765 restructuring plans, seven debt reductions and 6,674 deeds in lieu of foreclosure.²¹⁹ The total value of the debt settled is not available. In addition, in May 2013 a four-year moratorium on evictions of families considered to be especially vulnerable was enacted as an exceptional temporary measure.²²⁰

²¹⁸ Law No 22/2003.

²¹⁹ Compliance report.

²²⁰ Law No 1/2013 of 14 May 2013 considers especially vulnerable families to be those that are facing personal and economic hardship (household income between €22,000 and €37,000 depending on family circumstances; significant change in financial situation over the last four years; annual mortgage payments > 50% of household net income and mortgage on main and only residence).

Personal bankruptcy is traditionally very uncommon in Spain, but the use of this legal instrument may become more widespread after the changes to the Insolvency Law in February 2015.²²¹ The Insolvency Law establishes rules according to which the natural person debtor may be exonerated from unpaid liabilities when he or she is in good faith and his or her assets have been liquidated or the bankruptcy proceedings are deemed concluded due to insufficient assets. The insolvency/bankruptcy discharge takes place immediately after all of the assets of the debtor have been settled for the benefit of the creditor, but when a payment plan²²² is agreed, the debt can be reinstated if the plan is violated within a period of five years.

Finally, the new regulation stipulates that a natural person debtor in a situation of insolvency may commence a procedure to reach an out-of-court agreement on payments with his/her creditors, as long as the initial estimation of the liabilities does not exceed a €5 million threshold.

B.5 Judicial system

In terms of the judiciary, in Spain both civil courts and specialised mercantile courts are competent for insolvency proceedings. Civil courts are competent where a natural person (debtor), who is not an entrepreneur, is involved. Mercantile courts are competent for any other insolvency proceedings.

B.6 Tax regime

Spain does not assess its tax regime as being an obstacle to private debt workout. According to the BdE, there are no other legal acts that pose an obstacle in this regard. Tax deductibility does not depend on the measure used.

In Spain, tax deductions are available for loan write-offs, for collateral sales and for LLPs, and there is also a tax loss carry-forward mechanism (DTA).

C Other information framework

C.1 Public registers (central credit registers, cadastral system, asset register)

There is a low degree of concern in Spain about deficiencies in public registers (including the CCR), which are not seen as an obstacle to private debt resolution.

²²¹ Royal Decree-Law No 1/2015 of 27 February 2015 and Law No 25/2015 of 28 July 2015.

²²² A payment plan is needed when the debtor does not meet the following requirement: all the credits against the assets, privileged bankruptcy credits and at least 25% of the amount of ordinary bankruptcy credits have to be satisfied, if no prior attempt has been made to reach an out-of-court payment agreement.

The CCR is a public service offered by the BdE²²³ and it contains data series on NPEs since 1984 and forbearance since April 2015. The information reported in the CCR ensures almost full harmonisation with accounting and supervisory reporting rules after the latter were modified to align the definitions.

The agents required to report to the CCR are: (i) domestic banks, foreign subsidiaries of domestic banks and local subsidiaries of foreign banks; (ii) mutual guarantee and counter-guarantee companies; (iii) SAREB; (iv) the BdE; (v) the deposit guarantee fund of credit institutions; and (vi) the State Limited Surety Company Agraria (SAECA). These agents report information on loans, debt securities, financial guarantees, loan commitments and other commitments bearing credit risk and security lending to the CCR at an individual level (as opposed to the consolidated level). There is no minimum threshold regarding exposures to be included in the CCR and information is reported at an instrument level. Currently, the CCR covers almost 100% of the total amount of loans in Spain. Annex IX of this report gives a detailed overview of the main features of and information collected by the CCRs.

The cadastral system and the land registry²²⁴ are managed by two related organisations: the Ministry of Finance and the Department of Justice, respectively. Together, they provide information to the public on the RE owner and characteristics.

RE transactions (both for commercial and residential assets) are reported in a fairly comprehensive way. The general public can conduct searches on transactions and collect the main information, such as the price and characteristics of the asset. Information on upcoming sales/auctions is also publicly available. Regarding the updating frequency, the register is updated continuously, whenever an entry is recorded. The register contains prices for all RRE and CRE transactions.

The Public Asset Registry (e.g. for road vehicles, ships, aircraft, plant, heavy equipment and intellectual property) is publicly available and includes information on the owner and the characteristics of the asset.

C.2 Debt counselling and outreach

Spain is taking significant steps to promote debt counselling. The Insolvency Law (Article 231 et seq.) sets out the rules for out-of-court payment agreements for insolvent individuals and provides that they should have free access to their domicile notary, who will appoint an insolvency mediator. The mediator proposes to the creditors a payment plan for the outstanding debts. Moreover, some local and regional authorities and municipalities have included these mediation efforts in the services provided to their citizens.

²²³ In Spain, there are two types of credit registers: CIRBE (a public credit register managed by the BdE, containing information provided by credit institutions and accessible by them when assessing the risk of a credit operation) and private credit bureaus (for instance, Asnef and Rai), which can only provide negative credit information related to all types of payments (taxes, utilities, trade credits, etc.), but not public payments.

²²⁴ In Spain, there is both a cadastral system (*Cadastr*) and a land register.

C.3 Consumer and data protection

In Spain, there are no restrictions on recording/sharing personal information for debt workout purposes. The Spanish regulation on customer protection may be a hurdle for the foreclosure of collateral, delaying repossession. At national level, Law No 1/2013 gives Spanish courts new powers to delay or freeze the eviction of home buyers who have fallen behind on their mortgage payments because they are facing personal hardship (see Section B.4). In other cases, even if home buyers are not protected by Law No 1/2013, banks try to minimise the evictions, given the social repercussions and the visibility of anti-eviction campaigners. However, this issue mainly concerns low-income households' mortgage loans, which account for a small part of total NPLs. To conclude, as regards conduct issues, increased consumer protection prevents or hampers the enforcement of debts and mitigates reputational risk. There is therefore a certain degree of concern about consumer protection potentially being an obstacle to NPL resolution.

Annex XX

Table 41

Overview of CCR characteristics by country

	CY	GR	IE	IT	PT	SI	ES	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
Central credit register																			
CCR manager																			
National central bank	x	x	x	✓	✓	✓	✓	✓	✓	✓	x	x	✓	✓	✓	x	✓	x	✓
Private company	✓	✓	✓	✓	x	x	✓	x	x	✓	✓	x	x	x	x	x	x	✓	✓
More than one CCR (private and public)	x	x	x	✓	x	x	✓	x	x	✓	x	x	x	x	x	x	x	x	✓
Reporting agents																			
Domestic banks	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	x	✓	✓	✓	x	✓	✓	✓
Foreign subsidiary of domestic banks	x	x	✓	x	✓	✓	✓	x	✓	✓	✓	x	✓	x	✓	x	x	x	x
Local branches of foreign banks	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	x	✓	✓	✓	x	✓	✓	✓
Central bank discretion	x	x	x	x	✓	x	x	x	✓	x	✓	x	x	x	✓	x	x	x	x
Non-deposit taking institutions	x	✓	✓	✓	✓	x	✓	✓	✓	✓	✓	x	✓	✓	✓	x	x	x	x
Reporting level																			
Solo only	✓	✓	✓	x	✓	✓	x	✓	✓	x	x	x	✓	✓	x	x	✓	x	✓
Consolidated only	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
Both ¹	x	x	x	✓	x	x	✓	x	x	✓	✓	x	x	x	✓	x	x	✓	x
Granularity of reporting																			
Instrument level	✓	✓	x	✓	x	✓	✓	x	✓	x	x	x	x	✓	✓	x	✓	✓	✓
Borrower level	✓	✓	✓	✓	✓	x	✓	✓	✓	✓	✓	x	✓	x	✓	x	x	x	x
Type of assets included																			
Loans	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	x	✓	✓	✓	x	✓	✓	✓
Debt securities	x	x	x	✓	x	✓	✓	✓	x	✓	✓	x	x	x	x	x	x	x	x
Financial guarantees (and other off-balance sheet) assets	✓	✓	x	✓	x	✓	✓	✓	✓	✓	✓	x	✓	x	✓	x	✓	✓	✓
Derivatives	x	x	x	✓	x	✓	x	✓	x	✓	✓	x	x	x	x	x	x	x	x
Other	✓	x	x	✓	x	✓	✓	✓	x	✓	✓	x	✓	✓	✓	x	✓	✓	✓
Information included - Instrument																			
Collateral related																			
Type	x	x	x	✓	✓	x	✓	✓	x	x	x	x	x	✓	✓	x	✓	✓	✓
Amount	x	x	x	✓	✓	x	x	✓	✓	✓	✓	x	x	✓	✓	x	✓	✓	✓
Other information	x	x	x	✓	x	x	x	✓	x	x	✓	x	x	✓	x	x	x	✓	x
NPE related																			
Status	✓	x	✓	✓	✓	✓	✓	x	x	✓	x	x	x	x	✓	x	✓	✓	✓

	CY	GR	IE	IT	PT	SI	ES	AT	BE	DE	EE	FI	FR	LV	LT	LU	MT	NL	SK
Time past-due	✓	x	✓	✓	✓	✓	✓	x	✓	x	✓	x	x	✓	✓	x	✓	✓	✓
Other information	x	x	x	✓	x	x	x	x	x	x	✓	x	x	x	x	x	x	✓	✓
Forbearance related																			
Forbearance type	x	x	x	x	✓	x	✓	x	x	x	x	x	x	x	x	x	x	x	x
Date	x	x	x	x	x	x	✓	x	x	x	✓	x	x	x	x	x	x	x	x
Past-Due	x	x	x	x	x	x	✓	x	x	x	✓	x	x	✓	x	x	✓	x	x
Other																			
Loan loss provisions	✓	x	x	✓	x	✓	x	✓	x	✓	x	x	x	✓	✓	x	x	x	x
Write offs	x	x	✓	✓	✓	x	✓	x	x	x	x	x	x	✓	✓	x	✓	x	x
Information included - Borrower																			
Specific ID	✓	✓	x	✓	✓	✓	✓	✓	✓	✓	✓	x	✓	✓	✓	x	✓	✓	✓
Country	✓	x	✓	✓	x	✓	✓	✓	✓	✓	✓	x	✓	✓	✓	x	✓	✓	✓
Sector	✓	x	✓	✓	x	✓	✓	✓	✓ ³	✓	✓	x	✓	✓	x	x	✓	x	x
Default Status	✓	✓	✓	✓	x	✓	✓	✓	✓	✓	x	x	✓	x	✓	x	✓	✓	x
Rating/PD	✓	x	x	x	x	✓	x	✓	✓ ³	✓	✓	x	x	✓	x	x	x	x	x
tax and social security	x	x	x	x	x	✓	x	x	x	x	✓	x	x	x	x	x	x	x	x
payment to utility companies	x	x	x	x	x	✓	✓	✓	x	x	✓	x	x	x	x	x	x	x	x
Information on connected borrowers	✓	x	x	✓	x	✓	✓	✓	✓ ³	✓	✓	x	✓	x	x	x	✓	x	x
Trade credits	✓	x	x	✓	x	✓	✓	x	✓ ³	x	x	x	✓	x	x	x	✓	x	x
Credit scoring	x ²	x	✓	x	x	x	✓	✓	x	✓ ⁴	✓	x	✓	x	x	x	x	x	x

Notes

- 1) Solo-level reporting, but consolidation is possible using automatic tools
- 2) CCR data are processed using different automatic tools that provide 14 different risk classifications
- 3) only for corporates
- 4) only for privately managed credit register

Abbreviations

AMC	Asset Management Company is used in the meaning of a SPV, agency or organization specifically set up to use primarily public funds to remove non-performing assets from a the balance sheets of a number of banks.	IASB	International Accounting Standards Board
AQR	asset quality review	ICAAP	Internal Capital Adequacy Assessment Process
BdE	Banco de España	IFRS	International Financial Reporting Standards
BdI	Banca d'Italia	IMF	International Monetary Fund
BdP	Banco de Portugal	JST	Joint Supervisory Team
BoG	Bank of Greece	KRIs	key risk indicators
BoS	Bank of Slovenia	LGD	loss given default
BTL	buy-to-let	LLP	loan loss provision
CBC	Central Bank of Cyprus	LSI	less significant institution
CBI	Central Bank of Ireland	LTI	loan-to-income
CCR	central credit register	LTV	loan-to-value
COREP	common reporting framework for capital adequacy information	MIS	management information system
CRD IV	Capital Requirements Directive IV	MFI	monetary financial institution
CRE	commercial real estate	MoU	Memorandum of Understanding
CRR	Capital Requirements Directive	MRA	Master Restructuring Agreement
dpd	days past due	NCA	national competent authority
DTA	deferred tax asset	NCB	national central bank
DTC	deferred tax credit	NFC	non-financial corporation
EBA	European Banking Authority	nGAAP	national GAAP
EBA ITS	EBA Implementing Technical Standards on supervisory reporting on forbearance and non-performing exposures	NPE	non-performing exposure
EBIT	earnings before interest and tax	NPL	non-performing loan (should be understood as non-performing exposure in accordance with the EBA ITS on forbearance and non-performing exposures; excluding debt securities)
EBITDA	earnings before interest, tax, depreciation and amortisation	NPV	net present value
EC	European Commission	OBS	off balance sheet
ECB	European Central Bank	PD	probability of default
ED	exposure at default	PDH	private dwelling house
ESM	European Stability Mechanism	PE	performing exposure
EU	European Union	RAS	risk assessment system
EWS	early warning system	RE	real estate
FINREP	reporting framework for financial information	ROE	return on equity
FTE	full-time equivalent	RRE	residential real estate
GAAP	Generally Accepted Accounting Principles	SI	significant institution
HFSF	Hellenic Financial Stability Fund	SMEs	small and medium-sized enterprises
IAS	International Accounting Standards	SPV	special-purpose vehicle
		SREP	Supervisory Review and Evaluation Process
		SSM	Single Supervisory Mechanism
		TAR	troubled asset review

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