



EUROPEAN CENTRAL BANK  
BANKING SUPERVISION

# Stocktake of national supervisory practices and legal frameworks related to NPLs

BANKENTOEZICHT

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# Executive summary

The financial crisis of 2008 and the ensuing recession in Europe has been the main driver of elevated levels of non-performing loans (NPLs) in a number of Single Supervisory Mechanism (SSM) countries. High levels of NPLs are of particular prudential concern and, in this regard, the ECB shares the view that high NPL levels negatively impact bank profitability and resilience and constrain the utilisation of capital for more economically productive lending activity. High levels of NPLs furthermore elevate funding costs for banks. NPLs are therefore a drag on banks and on the economies in which they operate.

Some reductions in NPLs have been noted across the SSM and a number of countries have taken proactive and coordinated prudential, judicial and other measures to tackle the issue. But, in a number of SSM jurisdictions, NPL levels remain stubbornly high. The ECB recognises its role with regard to the sustained workout of NPLs and, in this regard, has established a task force to develop a consistent and coordinated approach to NPLs that seeks to identify and implement appropriate policy and supervisory responses. As part of its work, the ECB in conjunction with eight national competent authorities (NCAs) has conducted a qualitative stocktake of the range of practices in their jurisdictions to tackle NPLs, thereby providing an input to the aforementioned policy and supervisory response. With regard to the findings, the following has been identified:

- **Supervisory regime and practices**

The in-scope NCAs have implemented several strategies and undertaken many actions to tackle the high levels of NPLs, ranging from an intensification of on-site inspections and thematic reviews on NPL management to the issuance/publication of additional banking guidance/requirements. While it is clear that the in-scope NCAs have done a good job in engaging with the subject, there is also still room to give further guidance to banks on NPLs, to monitor the implementation of that guidance and to take steps should banks fail to comply.

While good progress has already been made, further development of internal NCA expertise and enhanced supervisory reporting information would also assist in addressing NPLs. In addition, banks could take further steps to bolster their expertise and resources.

Specific supervisory policies exist in relation to NPL recognition and measurement, and these are considered important to promote the proper valuation of loans. The reduction of the uncertainty associated with loan valuation would, in turn, promote the development of a distressed debt market.

- **Legal, judicial and extrajudicial framework**

In-scope countries have taken many of the important steps necessary to introduce reforms to their legal, judicial and/or extrajudicial frameworks to create a more favourable environment for NPL workout. As a result, the stocktake shows that legislative shortcomings pose challenges in a minority of in-scope countries only. These countries are currently introducing changes to address many of the outstanding issues. However, it would seem that amendments to judicial systems have not kept pace with legislative changes in a number of jurisdictions.

- **Information framework**

The majority of the in-scope countries have central credit registers (CCRs) in place, which are broadly considered to be a valuable supervisory tool for on- and off-site analysis as well as for information-sharing between banks. Other public registers are an important source of information also, although in some countries the availability of such data sources seems to be limited.

On the basis of its findings, the working group that produced this report has made recommendations to the SSM's NPL Task Force to explore the following areas:

- the development of common prudential guidance relating to NPL recognition, measurement and management, building on the existing or emerging practices of in-scope countries and having due regard for national specificities and current EU regulation;
- the establishment of an appropriate supervisory monitoring mechanism for assessing the robustness of banks' NPL management plans;
- the assessment of the value of interacting with other stakeholders, such as national authorities and other industry participants (e.g. servicing companies), to determine any contribution they may be able to make to the workout of NPLs.

# 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 eight SSM countries<sup>1</sup> taking a broad perspective as at end-2015.** 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 supplement the consultation on the NPL policy guidance.

**The stocktake was a judgement-based exercise largely completed by the NCAs on behalf of the ECB.** It also built upon work conducted in a similar exercise by the International Monetary Fund (IMF) in the first half of 2015. 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 the working group; (ii) a *consultation phase* with ECB country experts; and (iii) an *additional NCA input phase*.

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<sup>1</sup> The eight participating Member States are: Cyprus, Germany, Greece, Ireland, Italy, Portugal, Slovenia and Spain. It is however expected that this stocktake will be extended in the coming months to cover the countries that have not yet been addressed by the NPL Task Force.

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.<sup>2</sup>

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.

Nevertheless, it should be noted that some of the aspects in the report (e.g. the tax regime or insolvency law) are not in the primary scope of NCAs' responsibility. They are therefore indicative of the views of the NCA only, rather than being "hard facts".

## 1.3 How to read this report

Given its large 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.**

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<sup>2</sup> This exercise was performed by joint teams including members from the SSM's Directorate General Microprudential Supervision III (DG/MS III), the Banca d'Italia and the Banco de Portugal. At the end of this phase, the first draft of the country-specific analysis was produced.

## 2 Analysis and key findings

### 2.1 Supervisory regime and practices

This chapter provides an overview of existing supervisory practices and presents areas where an additional supervisory response could be considered.

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

All in-scope NCAs have national 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 the in-scope NCAs also have guidance in place related to accounting (e.g. impairment triggers, measurement and procedures, disclosure, collateral valuation).

In terms of NPL-specific guidance, three in-scope countries have comprehensive guidance on arrears management (all of which was published after 2013) 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.

Some of the in-scope countries have introduced or will introduce 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 in-scope NCAs have indicated that the European Banking Authority (EBA) common definitions of NPLs and forbearance have been adopted in their respective jurisdictions. The table below provides an overview of the **additional measures** that some in-scope NCAs have taken with regard to NPL recognition and classification. It should be noted that some in-scope NCAs opted for a set of criteria for NPL recognition and classification and others 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)**

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
<b>NCA has published guidance on:</b>								
additional performing loan/NPL sub-categories	x	x	✓	✓	✓	x	✓	✓
additional forbearance criteria	✓	x	✓	✓	x	✓	✓	✓
additional specific data collection requirements for forborne exposures	✓	x	x	✓	x	✓	✓	✓
additional exit criteria from NPL/forbearance category	x	x	x	x	x	x	x	x

Most countries 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.

The existence of specific predefined impairment triggers (in addition to accounting standards) also pushes banks towards the recognition of NPEs (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 countries 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. One NCA is revising its rules and guidance.

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.

**Table 2**

**Technical index of additional key supervisory guidance regarding classification**

<b>NPL/NPE classification</b>
<b>Guidance related to NPL recognition and classification:</b> increase the frequency of loan impairment assessment; require banks to define their own trigger events.
<b>Existence of PE/NPE sub-categories:</b> 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).
<b>Risk management tasks in relation to classifications:</b> 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.
<b>Forborne exposures</b>
<b>Classification of forborne exposures:</b> 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.
<b>Forborne exposure data collection:</b> 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).

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

The majority of the institutions in the in-scope countries follow provisioning practices in line with IAS (International Accounting Standard) 39<sup>3</sup>. During the financial crisis, it was recognised that the current IASB (International Accounting Standards Board) approach<sup>4</sup> could result in insufficient and delayed provisioning and could therefore be an obstacle to adequate NPL measurement within loan portfolios<sup>5</sup>.

**Table 3**

**Supervisory guidance for provisioning (beyond accounting standards)**

		Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
Additional guidelines		Yes	No	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	✗			✗		✓	✗	✓

<sup>3</sup> This is always true all across the EU for SIs and for the vast majority of LSIs too. Nevertheless, there are some countries where local institutions follow provisions set out in their national standards (national generally accepted accounting principles or nGAAPs).

<sup>4</sup> 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.

<sup>5</sup> Mainly for this reason, the IASB is introducing a new standard on financial instruments (IFRS 9), which will be phased in from 2018.

As shown in Table 3 above, the majority of supervisors across the sample 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. As shown in Table 3, only one NCA has issued binding accounting rules; in the rest of the in-scope countries, the additional issued guidelines are non-binding, meaning that their implementation is at the discretion of the institutions taking into account that the supervisor can use these guidelines to enforce provisioning for prudential purposes (e.g. through Pillar 2). Regarding the content, supervisors 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 countries in the sample 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 capital adequacy.

In two countries, banks are required to publicly disclose their impairment criteria.

**Table 4**

**Technical index of additional key supervisory guidance regarding provisioning**

Provisioning
<p><i>Impairment triggers</i></p> <ul style="list-style-type: none"> <li>• <b>Macroeconomic impairment triggers (i.e. dynamic provisioning):</b> triggers related to current macroeconomic indicators (like GDP growth or the unemployment rate) that could affect a loan's future estimated cash flows.</li> <li>• <b>Portfolio-specific triggers:</b> definition of specific sets of triggers tailored to different portfolio segments like mortgages, commercial real estate (CRE) loans or loans to small and medium-sized enterprises (SMEs).</li> <li>• <b>Triggers linked to loan vintage buckets (i.e. days in arrears):</b> definition of impairment triggers linked to dpd before NPL classification.</li> </ul> <p><i>Criteria for provisioning</i></p> <ul style="list-style-type: none"> <li>• <b>Minimum level of provisioning according to the number of days in arrears (for unsecured assets):</b> 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).</li> <li>• <b>Specific provisioning intervals according to different ranges of situations (for unsecured loans):</b> 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).</li> <li>• <b>Adjustment of collateral valuation by applying a specific level of haircuts according to the type of collateral (for secured assets):</b> 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).</li> </ul>
Accrued interest
<p><i>Criteria for accrued interest</i></p> <ul style="list-style-type: none"> <li>• <b>Specific limits on accrued interest recognition according to loan classification:</b> accrued interest is reversed if a loan is classified under the <i>doubtful</i> category.</li> <li>• <b>Specific limits on accrued interest recognition according to arrears of interest collection:</b> accrued interest is reversed if a loan exceeds 90 dpd.</li> <li>• <b>Disclosure requirements for differences between accrued and collected interest on impaired loans:</b> disclosure of interest income <b>recognised</b> arising from impaired, non-performing but not impaired and forborne loans, and interest income <b>received</b> arising from impaired, non-performing but not impaired and forborne loans.</li> </ul>

In order to achieve the main prudential objectives, it is important to ensure that the 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. A harmonised definition of a write-off would promote 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 guidelines for these purposes and with a view to promoting timelier NPL disposal and, more generally, the development of a market for distressed debt.

As shown in Table 3, supervisors have issued additional guidelines in the majority of the respondent countries. As for provisioning, these guidelines can have a different content. With regard to write-offs, they are – with 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
<i>Definition of criteria for write-offs</i>
<b>Supplementary definition of what constitutes NPL uncollectability (remote recovery):</b> 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:
<ul style="list-style-type: none"><li>• <b>Time-related (prolonged arrears):</b> i.e. unsecured transactions in arrears by more than three/four years<sup>6</sup>, 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.</li><li>• <b>Legally/judicially-related:</b> i.e. unsecured transactions for which the borrower is declared to be in bankruptcy proceedings.</li><li>• <b>Institution-specific:</b> 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.</li></ul>

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 in-scope countries. For example, tax deductibility of losses arising from write-offs is, in many 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.

<sup>6</sup> The number of years varies in different countries linked to their specific economic and legal environment.

In most of the surveyed countries, 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.

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

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
<b>NCA has published guidance on:</b>								
specific rules on valuation methods	✓	✓	✗	✓	✗	✓	✓	✓
rules on valuation frequency for NPL collateral	✓	✗	✗	✓	✗	✓	✗	✓
<b>NCA has specific requirements:</b>								
for appraisers	✓	✓	✗	✓	✗	✓	✓	✓
for data collection on collateral	✓	✓	✓	✓	✓	✓	✓	✓

With regard to valuation methods, most of the surveyed countries 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, there are several national regulations governing/restricting the use of external or internal indices. In one country, 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
<b>Appraisers' requirements:</b> (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).
<b>Higher frequency for RE collateral valuation and monitoring:</b> (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 art work); (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.
Valuation methods
<b>Guidance on methods allowed for the valuation and the monitoring of values:</b> (i) requiring the use of international valuation standards <sup>7</sup> ; (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.
<b>Specific rules for the valuation practices for foreclosed assets:</b> 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.

<sup>7</sup> Royal Institution of Chartered Surveyors ("Red Book"), the European Valuation Standards ("Blue Book") or the International Valuation Standards ("White Book").

Concerning the required frequency of collateral valuations, for performing loans, countries follow CRR rules with some exceptions for large loans secured by non-real estate collateral. For collateral related to an NPL, additional rules have been issued in most countries. 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 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.

## 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 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 regulation)

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
<b>NCA has published guidance:</b>								
on NPL workout practices/arrears management	✓	x	✓	✓	x	x	✓	x
requiring banks to have NPL strategies/action plans	✓	x	✓	✓	x	x	✓	x
on banks' NPL restructuring practices	✓	x	✓	✓	x	x	✓	✓
requiring a dedicated arrears/NPL unit	✓	✓	✓	✓	x	x	✓	x
requiring banks to have NPL operational targets	✓	x	x*	✓	x	x	✓	x
<b>The regulatory framework allows:</b>								
banks to outsource NPL management	✓	✓	✓	✓	✓	✓	✓	✓
non-banks to manage NPLs	x**	✓	x*	✓	✓	✓	✓	✓

\* changes have been implemented in the first half of 2016

\*\*possible under certain conditions

All countries have developed some form of guidance on NPL governance, some of which is rules-based and some of which is principles-based. The following was observed:

- Three 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.
- Some countries have issued specific guidance requiring banks to have NPL management strategies. In three 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, in all in-scope countries, the principle of the clear separation of functions between problem loan management and loan origination/performing loan services is established in various forms. In some countries, the creation of specialised units dedicated to these tasks is required by the regulations.
- Five countries have issued guidance on loan restructuring practices, providing indicative lists of modifications/forbearance measures to be applied, and also 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 country 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**

<b>Governance and organisation</b>
<p><b>Organisational requirements:</b> 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><b>Early warning systems (EWS) for increased credit risk:</b> 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>
<b>NPL management</b>
<p><b>NPL workout strategies:</b> 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><b>NPL targets:</b> 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><b>Restructuring/viable modifications:</b> 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><b>Resolution and closure measures:</b> 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:

- in all countries, banks have the possibility to outsource the management of NPLs, although this practice is not very common;

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

Finally, in two countries, 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.

### 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 is broadly consistent with the rules of the EBA ITS, providing data on forborne exposures and NPEs at an exposure class level.<sup>8</sup> To acquire more detailed NPL-related information, supervisors usually require additional data beyond the standard prudential reporting. The survey shows that all respondents 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 in-scope countries. Some 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 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 3.3 on the information framework). In this regard, one country has recently started collecting loan-tape data at a biannual frequency containing detailed information at the individual position level.

Regarding the transparency of institutions' workout strategies, a minority of countries discloses or requires the disclosure of institutions' NPL targets.

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<sup>8</sup> EBA ITS reporting:

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) PEs with forbearance measures; and (ii) NPEs with forbearance measures. For each of them, the forbearance measures have to be specified (i.e. the instruments with modifications in their terms and conditions/refinancing).

For both of the above categories, 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.

Regarding the quality assurance of additional reporting, the majority of in-scope supervisors rely primarily on on-site inspections to check the accuracy of the information received. A smaller proportion of respondents conduct benchmarking analysis 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 countries publicly report statistics usually via their central banks. This information is usually available online, with a reporting update frequency that varies from annual to monthly. The granularity of the data provided is, on average, acceptable across the sample, but could be enhanced for some countries.

**Table 10**

**Technical index of additional key practices regarding supervisory reporting**

Examples of additional NPL-related reporting requirements
<p><b>Information on portfolio segmentation:</b> 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><b>Information on key portfolio performance statistics:</b> 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><b>Disclosure of instrument-level information on collateral and other guarantees</b></p> <p><b>Disclosure of NPL targets and workout strategies (key performance indicators (KPIs) on debt restructuring):</b> information on NPL portfolio-specific operational and quantitative targets (e.g. average number of NPLs handled per business unit).</p> <p><b>Disclosure of provisioning and write-off policy and differences arising from prudential and accounting reporting:</b> 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><b>Benchmark analysis:</b> 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><b>Analysis of supervised entities' balance sheets:</b> this could highlight inconsistencies with regulatory reporting.</p> <p><b>On-site inspections:</b> 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><b>Granular and segmented disclosure related to NPLs:</b> 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- 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 are performed in all in-scope countries, and in the period 2012-14 many banks have been subject to granular, on-site asset quality reviews (at a minimum during the SSM comprehensive assessment) 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, almost all NCAs have issued supervisory manuals on NPL management. In addition, inspection teams usually include experts on NPL collection and workout and some countries reported that they have even used external consultants during inspections. One country made reference to the use of external auditor reports or, in general, to the possibility to mandate them to verify the adequacy of classification and provisioning.

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

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
<b>NCA carries (carried) out:</b>								
on-site inspections on NPEs	✓	✓	✓	✓	✓	✓	✓	✓
thematic reviews on NPL management (2012-15)	✓	x	✓	✓	✓	✓	✓	✓
<b>NCA has:</b>								
specific supervisory methodologies to assess banks' practices to handle NPEs	x	✓	x	✓	✓	✓	✓	✓
used CCR for on-site and off-site supervision	x	✓	n.a.	n.a.	✓	✓	✓	✓
used CCR for feedback for banks	x	✓	n.a.	n.a.	✓	✓	✓	✓

Many of the countries 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, the banks' NPE portfolios are subject to off-site analysis in all in-scope countries. 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
<b>Assessment methodologies:</b> 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.
<b>Use of granular data on loans for supervisory purposes:</b> 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 of the in-scope countries 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.

## 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.

### 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

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
Is the sale of portfolios an obstacle to NPL resolution?	<b>YES</b>	<b>YES</b>	<b>YES</b>	<b>NO</b>	<b>YES</b>	<b>YES</b>	<b>YES</b>	<b>NO</b>
Existence of a developed NPL market?	<b>No</b>	<b>No</b>	<b>No</b>	Medium	<b>No</b>	<b>No</b>	<b>No</b>	Medium
Does an AMC exist?	<b>No</b>	n.a.	<b>No</b>	Yes	<b>No</b>	<b>No</b>	Yes	Yes
Transfer of loans (and collateral) without borrower's consent?	Yes	Yes	<b>No*</b>	Yes	Yes	Yes	Yes	Yes
<b>Banks are allowed to sell NPLs to third parties</b>								
to non-banking institutions	Yes**	Yes	<b>No*</b>	Yes	Yes	Yes	Yes	Yes
to foreign investors	Yes**	Yes	<b>No*</b>	Yes	Yes	Yes	Yes	Yes

\* changes have been implemented in the first half of 2016

\*\* possible under strict conditions

AMCs have been established in some jurisdictions. 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 in-scope countries. The survey shows that the market stagnation is seldom caused by specific obstacles in the legal and regulatory framework as the majority of the countries have a favorable environment for NPL transfer and the entry of specialised investors into the local market. The few countries that still have legal impediments to the sale of portfolios, such as portfolio transfer restrictions on non-banking institutions or barriers to the entry of foreign investors, are currently amending their regulatory framework to overcome most of these issues.

### 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 from the credit. Weak enforcement mechanisms are an obstacle to NPL reduction.

**Table 14**

**Main features of debt enforcement/foreclosure**

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
Is debt enforcement/foreclosure an obstacle to NPL resolution?	YES	NO	YES	NO	YES	YES	YES	NO
Legal techniques to enable out-of-court enforcement of collateral?	Yes*	Yes	No	Yes	No	No**	Yes	Yes
Bilateral sales of repossessed assets permitted?	Yes	n.a.	No	Yes	n.a.	Yes	Yes	Yes
Blanket bans (moratoria) on sales/auctions/foreclosures?	No	No	Yes*	No	Yes	Yes	No	Yes***

\* changed recently, the effectiveness has yet to be tested

\*\* just on financial collateral

\*\*\* just on foreclosures

The overall perception of the legal framework for collateral enforcement across the sample is divergent. One-third of the countries consider the topic as being a challenge for NPL resolution, mainly due to the lack of a modern legal framework enabling timely out-of-court collateral enforcement.<sup>9</sup>

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 countries are making efforts to set up fast out-of-court procedures for the main purpose of alleviating the burden on the judicial system. The NCAs consider the inefficiencies of the court systems a challenge for NPL resolution in the majority of the surveyed countries (see Section 3.2.5).

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 in-scope countries have undertaken initiatives to update their corporate insolvency frameworks in recent years. Almost all surveyed countries have a “pre-pack” (i.e. fast-track resolution or rehabilitation) process and half of the sample has an out-of-court mechanism, although, in some cases, this is de facto not operational.

<sup>9</sup> Mainly following the instructions of Directive 2002/47/EC as amended by Directive 2009/44/EC.

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. This aspect is developed in Section 3.2.5.

**Table 15**  
Main features of the corporate insolvency and restructuring framework

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
Is the corporate insolvency framework an obstacle to NPL resolution?	<b>YES</b>	<b>NO</b>	<b>YES</b>	<b>NO</b>	<b>YES</b>	<b>NO</b>	<b>NO</b>	<b>NO</b>
Process for clearance of arrears to public sector?	<b>No</b>	<b>No*</b>	Yes**	Yes	Yes	Yes	Yes*	Yes
Possible to limit shareholders' decision on a business restructuring?	Yes***	Yes	<b>No</b>	Yes	Yes	Yes*	Yes	<b>No</b>
Possible to change company management in all debt restructuring?	<b>No*</b>	n.a.	<b>No</b>	Yes	<b>No</b>	Yes	<b>No*</b>	<b>No</b>
Can assets of a company under debt restructuring be sold?	<b>No*</b>	Yes	<b>No*</b>	Yes	Yes*	Yes	Yes	Yes
Is there an out-of-court mechanism?	<b>No</b>	<b>No</b>	<b>No</b>	<b>No</b>	Yes	Yes	Yes	Yes
Is there a pre-insolvency restructuring regime?	Yes	<b>No</b>	Yes	Yes	Yes	Yes	Yes	Yes
Is there a fast "pre-pack" restructuring procedure?	<b>No</b>	Yes	Yes	Yes	Yes	Yes	Yes	<b>No*</b>
Average length of the pre-pack procedure (months)	-	<12	n.a.	1-6	6-12	6-12	6-12	-

\* with some exceptions  
\*\* but very poor and dysfunctional  
\*\*\* possible under the examinership scheme

## 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

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
Is the household insolv./restr. fram. an obstacle to NPL resolution?	<b>YES</b>	<b>NO</b>	<b>YES</b>	<b>NO</b>	<b>YES</b>	<b>NO</b>	<b>NO</b>	<b>NO</b>
Out-of-court mechanism?	Yes*	<b>No</b>	<b>No</b>	Yes	<b>No</b>	Yes	<b>No</b>	Yes
Bankruptcy regime for consumers/households?	Yes	Yes	Yes*	Yes	Yes	Yes	Yes	Yes
Insolvency/bankruptcy discharge period (years)	3	6***	3	1	1**	5	2-5	5
Average time for insolvency/bankruptcy proceedings (months)	n.a.	12-24	n.a.	n.a.	n.a.	n.a.	24-48	n.a.

\* with strong limitations  
\*\* after liquidation  
\*\*\* 3 or 5 years under certain conditions

The survey shows that the main challenge identified for household insolvency proceedings is not so much related to the framework, but instead to the duration of court cases. Inefficiencies related to the judicial system have considerable

repercussions also for this segment. This is the reason why, as mentioned above, many countries are putting effort into setting up fast out-of-court procedures for the main purpose of easing some of the pressure on the judicial system. Nevertheless, the survey shows that out-of-court mechanisms are not widespread across the sample.

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.

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

Judicial issues represent a key challenge for 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

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
Is the judicial system an obstacle to NPL resolution?	YES	NO	YES	YES	YES	YES	YES	NO
Specialised courts or judges to deal with insolvency issues?	No	Yes	Yes*	Yes**	No	Yes	Yes	Yes
Set time requirements for insolvency process?	No	Yes	No	Yes**	Yes	Yes	Yes	Yes

\* with strong limitations

\*\* personal insolvency

The survey shows that the vast majority of the sample considers the inefficiencies of the judicial system as 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 it is seldom that there are time requirements for insolvency procedures.

## 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 in-scope countries 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-offs<sup>10</sup> and collateral sales, as well as tax loss carry-forward mechanisms.

**Table 18**

Main features of the tax regime

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
Is the tax regime an obstacle to NPL resolution?	NO	NO	YES	NO	NO	YES	NO	NO
Tax deductions for LLPs?	Yes	Yes	Limited	Yes	Yes	Yes	Yes	Yes
Tax loss carry-forward mechanism (e.g. DTA)?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Tax deductions for loan write-offs?	Yes	Limited	Limited	Yes	Yes	Limited	Limited	Yes
Tax deductions for collateral sales?	Yes	n.a.	n.a.	Yes	Yes	Yes	No	Yes
Debtors taxed upon favourable debt write-off/restructuring?	No	n.a.	No	No	No	Yes	Yes	Yes

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.

## 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

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
<b>Legend:</b>	<div style="display: flex; align-items: center;"> <div style="width: 20px; height: 10px; background-color: #4CAF50; margin-right: 5px;"></div> Adequate           <div style="width: 20px; height: 10px; background-color: #FFC107; margin-right: 5px; margin-left: 20px;"></div> Adequate with room for improvement           <div style="width: 20px; height: 10px; background-color: #F44336; margin-left: 20px;"></div> Room for improvement         </div>							
<b>Central credit registers</b>	Adequate with room for improvement	Adequate with room for improvement	Adequate with room for improvement	Room for improvement	Adequate	Adequate with room for improvement	Adequate with room for improvement	Adequate
<b>Other public asset registers*</b>	Room for improvement	Adequate with room for improvement	Room for improvement	Adequate with room for improvement	Adequate	Adequate with room for improvement	Adequate with room for improvement	Adequate
<b>Debt counselling and outreach</b>	Room for improvement	Adequate	Room for improvement	Adequate with room for improvement	Adequate with room for improvement	Adequate	Room for improvement	Adequate with room for improvement
<b>Consumer and data protection</b>	Room for improvement	Room for improvement	Adequate with room for improvement	Adequate with room for improvement	Adequate with room for improvement	Adequate with room for improvement	Room for improvement	Room for improvement

\* 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 countries<sup>11</sup> all respondents have established a CCR. The register is mainly operated by the public sector (the central bank is the competent authority in

<sup>10</sup> 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.

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), but the majority of in-scope countries have recently established CCRs.

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 just 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 where they just 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 is a threshold in a minority of jurisdictions and it varies from €50 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 could 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.

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 is a real estate transaction register in seven in-scope countries. In almost all cases, it provides 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 countries in the sample. In fact, in some countries there is no free or subsidised financial and legal advice for household debtors. Also on the SME side, many countries do not provide credit management training and advice apart from a few exceptions<sup>12</sup>.

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<sup>11</sup> In one country, the process is under development and will be finalised in 2016.

<sup>12</sup> Some countries do have debt counselling and outreach mechanisms in place, but they are not free/subsidised.

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.

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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.

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# Annex: Country reports

## Annex I: 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 process of reforms (e.g. introducing new insolvency and foreclosure frameworks) to remove from its framework the main legal impediments to private debt resolution, in a context exacerbated by unprecedentedly high levels of NPLs (in December 2015 the total NPL ratio stood at 45% (of which by segment: households 55%; NFCs 55% of which SMEs 63%; and CRE 44%)).<sup>13</sup> It is an extensive package of legislation, introducing new concepts to Cypriot law, with 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, given the fact that some of them have just recently been introduced, their efficiency has not yet been tested. The **main challenges to NPL workout in Cyprus** were identified in the following areas:

- **Sale of portfolios and market capacity:** the Law allowing the transfer of loans to public/private AMCs<sup>14</sup> entered into force recently 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 the lack of independent servicing capacity in the market.
- **Corporate insolvency and restructuring:** agreements on debt restructuring are difficult, also taking into account the high amounts due to the public sector. The current framework does not include a process for the clearance of public

<sup>13</sup> Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities. For SMEs and CRE, off-balance-sheet exposures are also excluded.

<sup>14</sup> In this report, AMC should be understood as a credit-acquiring firm (see also the list of abbreviations).

arrears. For micro and small enterprises, 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 restructuring, it is not possible to change the company's management or to sell the assets of the company through auctions or open-market bilateral sales without the shareholders' consent.<sup>15</sup> 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.<sup>16</sup>

- **Household insolvency and restructuring:** although a voluntary out-of-court settlement/mediation mechanism ("Financial Ombudsman") was introduced in 2014 with new legislation, it has been applied in few cases. 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. The recent changes made in the insolvency reform could also mitigate the mentioned factors, particularly through the implementation of the Personal Repayment Plan (PRP), which allows an insolvent debtor, with the mandatory help of a licenced insolvency practitioner, 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.<sup>17</sup> 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 micro company. 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, since 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 made<sup>18</sup> by the banks in terms of establishing dedicated structures and procedures for **NPL management and**

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<sup>15</sup> 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.

<sup>16</sup> More specifically, secured property has been included in the liquidation procedure for companies which are under 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.

<sup>17</sup> Under specific criteria, but restricted for the purpose of protecting debtors' primary residence.

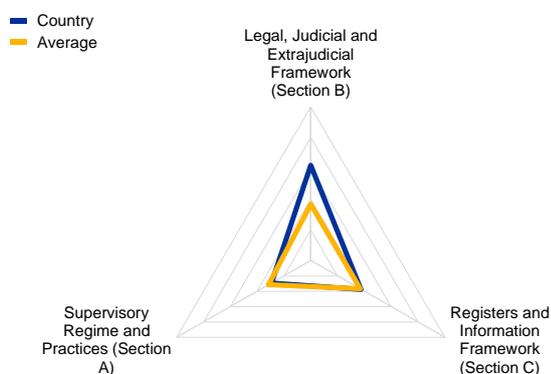
<sup>18</sup> Preliminary results for end-September 2015 indicate that, while in aggregate terms the banks still did not meet their targets, the pace of restructuring has further increased, and that greater use has been made of long-term restructuring solutions. In addition, the CBC has reported improved re-default rates.

**restructuring**, there is still room for improvement regarding the experience, expertise and resources of banks which influences the pace and 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.

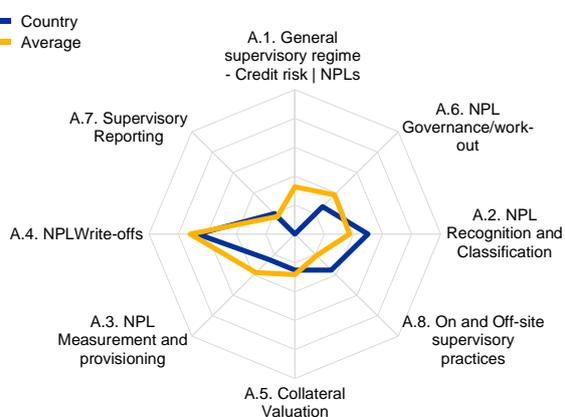
## Chart 1 Country overview

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-2015; 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 2.3 for more detailed explanations).

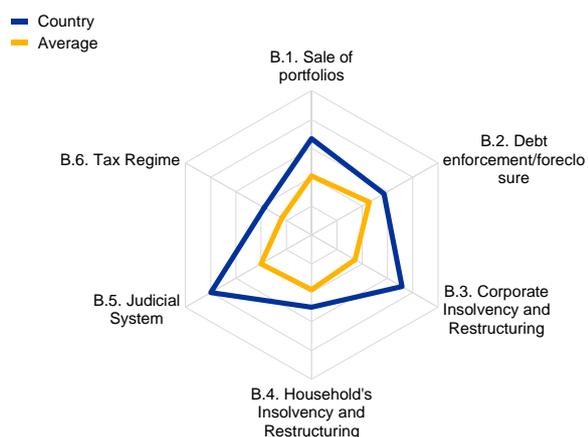
### NPL Framework Overview



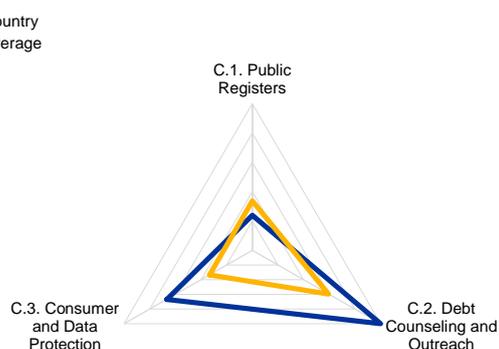
### Supervisory Regime and Practices (see section A)



### Legal, Judicial and Extrajudicial Framework (see section B)



### Information Framework (including CCR) (see section C)



On the other hand, **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 some trigger events in line with the general principle of IAS 39 and also macroeconomic triggers, which may 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 of the institutions. Within this framework, the CBC has defined (based on proposals from the banks) quarterly bank-by-bank targets and assesses on a six-monthly basis reports by external auditors regarding banks' debt restructuring arrangements and strategies.
- **Valuation of foreclosed assets:** for valuing foreclosed assets on the foreclosure date, specific requirements 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 in 2015 an additional extensive framework aimed at supporting the assessment of the activities of each bank. It provides detailed information on bank performance relative to the targets set, the types of solutions proposed, the reasons that impeded the 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 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 is entrusted with the adoption of 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 loan-to-value (LTV) ratio and debt-servicing capacity), in accordance with its risk appetite, to avoid excessive concentration.

## A Supervisory regime and practices

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

In addition to the requirements set in the CRR/CRD IV, the CBC has issued the following specific Directives regarding credit risk management practices and processes:

**Table 20**  
Main sources of NPE-related regulation

Type	Scope	Topic	Summary description	Entry into force
Directive (binding)	All credit institutions	Loan origination and review of existing loans <sup>19</sup>	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	2013-15
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.	2013-15
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 NCA has issued guidance, according to which 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 limits have been set for the ratio of the debt-servicing amount to the debt-servicing capacity of the borrower and for the maximum LTV ratio 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), also from the CCR, in order to properly assess the risks taken, the borrower's ability to repay the credit facility within the set time limit, the adequacy of collateral and the purpose of the loan.

<sup>19</sup> A revised directive has been in effect since 18 March 2016. In addition to this, a new 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.

## A.2 NPL recognition and classification

For regulatory reporting purposes, banks are legally required to comply with the EBA ITS regarding the definition/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)<sup>20</sup> is provided in the reporting.<sup>21</sup> Following 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, including for determining the adequacy of provisions and reserves. Following 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.<sup>22</sup> The Directive formulates some trigger events in line with the general principle of IAS 39, although banks additionally assess the presence of macroeconomic triggers<sup>23</sup> which may affect the estimated cash flows of the borrowers. Moreover, the Directive requires banks to define their own additional 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.

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<sup>20</sup> LNMatrix return.

<sup>21</sup> 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.

<sup>22</sup> Directive issued to credit institutions on loan impairment and provisioning procedures.

<sup>23</sup> 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.

The CBC does not have specific accounting powers but, under the Capital Requirements Directive (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 its authorisation. 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 in the bank's approved panel. Only appraisers licenced 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 remain or not on the mentioned panel. The panel should include expertise in various areas of the property sectors, as appropriate to the lending business of the bank. A single appraiser should not exceed 20% of all valuation reports of a single bank, although this threshold does not constitute an absolute limit. 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 done at regular intervals and reflects current market conditions. In all cases it has to comply with the minimum Capital Requirements Regulation (CRR) requirements (commercial real estate (CRE)  $\leq$  12 months; residential real estate (RRE)  $\leq$  3 years). The method of the valuation 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, in order to define suitable and sustainable solutions, banks have to conduct an independent professional valuation to determine the open market value and forced sale value of properties. 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. Recently, the CBC introduced a circular allowing limited exceptions to this rule. Banks have to record all supporting documentation for each individually assessed credit facility. With reference to the data collection to assess collateral recovery, banks need to have in place appropriate models to calculate the loss given default (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, the disposal of collateral has been done through auctions organised by the land registry department of the government, but banks are now in the process of applying the new Foreclosure Law, which permits auctions that can be directly arranged by banks without any intervention by the land registry.

Some remaining obstacles relate to a securitisation framework and leasing legislation, which are in the process of being established.<sup>24</sup>

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<sup>24</sup> As of January 2016, the draft securitisation law is under discussion/consultation with the various stakeholders and has not yet been enacted. The draft leasing law is under legal vetting and has not yet been enacted.

## A.6 NPL governance/workout

Given the unprecedented level of the NPL ratio, the strategy adopted in the recent years by the authorities was aimed at enhancing the efforts to restructure loans in arrears in a sustainable way. Within 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 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 on the effectiveness of debt restructuring arrangements and strategies is performed based on information from various sources: CBC on-site visits, banks' appointed auditors/consultants that are requested to submit a specific report on a six-monthly basis on their restructuring arrangements and strategies, and banks' internal audit reports.

Currently, the Cypriot banks can outsource NPL management to third parties only after obtaining the approval of the CBC. For NPLs, non-banks are allowed to provide loan-collection services, but not loan servicing and there are no companies operating in the NPL-servicing sector.

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 and the proposed targets for NPL reduction (focusing on an increase in sustainable restructurings) and the performance against them. 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. The follow-up done so far shows that the experience, expertise and resources of banks still have room for improvement, which influences the pace and effectiveness/sustainability of NPL workout/restructuring plans. Considering that the restructuring process started from the simpler cases and that banks are currently assessing the more complex situations, it is crucial that further steps are taken to enhance the effectiveness of the proposed solutions.

In the NPL monitoring of individual debtor cases, the current mechanism for interbank coordination is not effective, nor is the coordination between private and public creditors (e.g. tax authorities, social security authorities) on individual debtor cases. Banks are required to develop internal systems (key performance indicators – 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 data<sup>25</sup>, the CBC set up an information framework harmonised with its NPE classification categories (see Section C). Apart from that, the 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; and (iv) MRTG – auctions. 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 indicators (e.g. the success rate for loans that went through a restructuring, distinguished according to how many times they were restructured and the vintage of current arrears; cash flows collected by restructured loan; types of solutions proposed; reasons why an agreement with the client was not reached); and (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- and off-site supervisory practices and methodologies

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

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 having significant experience with NPL collection and workout.

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<sup>25</sup> Directive for the operation of a system or a mechanism for the exchange, collection and provision of data of 2015.

Given that the CBC does not yet have access to data from the CCR (work on this is ongoing), the CCR is currently not 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.<sup>26</sup>

## 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.

Last November, the Parliament approved a new Law on the sale of credit facilities and other related issues, enabling the sale of all loans. Loans to individuals and micro/small SMEs not exceeding €1 million<sup>27</sup> can only be sold to selected types of investors: (i) Cypriot authorised credit institutions; (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 above-mentioned institutions, or to other entities with a prior written approval of the CBC. A non-bank company wishing to buy loans needs to be incorporated in Cyprus and obtain a licence from the CBC. The CBC is required to supervise on an ongoing basis the company's management, its books and records, and its financial reporting. In addition, all credit institutions have to report their loan sales to the CBC semi-annually.

Prior<sup>28</sup> 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. 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, 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.

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<sup>14</sup> 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](#).

<sup>27</sup> Specifically exempt from the scope of the Law are loans to non-residents, loans to finance operations and/or investments outside Cyprus, loans secured by property located outside Cyprus, and loans governed by foreign law.

<sup>28</sup> Directive on the notification of borrowers and guarantors of 2016.

## B.2 Debt enforcement/foreclosure

In order to enable a rapid out-of-court enforcement/foreclosure of the collateral, new laws and regulations have recently been introduced, and their effectiveness has not yet been tested.

The new insolvency framework provides for a procedure which 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 to be 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 the cases. In addition, the large scale of the problem was a disincentive for Cypriot banks to liquidate the collateral because a high volume of properties sold in auctions could have led to a further drop in RE prices. The new foreclosure framework allows creditors to arrange a private auction that 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.

Given 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, even when arrears to the public sector are linked to the private sector restructuring. Both the Personal Insolvency Law and the new corporate restructuring mechanisms (examinership), which were introduced in 2015, now provide procedures that cover debt owed to the public authorities. These procedures will 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.<sup>29</sup>

For micro and small enterprises, banks could perform restructurings under the provisions of the Arrears Management Directive, although the process is lengthy due to a lack of financial data and information or non-cooperation of certain borrowers. In

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<sup>29</sup> Outside the insolvency framework, and on an ad hoc basis, public creditors can agree on a 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.

the context of a business/loan restructuring, it is not possible to limit shareholders' decisions, to change the company's management, or to sell the assets of a company through auctions or open-market bilateral sales.<sup>30</sup> Furthermore, special in-court procedures are not considered successful.

The insolvency law was reformed to facilitate a 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 the creditors, as well as enhance 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 new mechanism is a tool for secured creditors that is supplementary to the new Foreclosure Law tool.

## B.4 Household insolvency and restructuring

An out-of-court voluntary settlement/mediation mechanism was introduced only in 2014 ("Financial Ombudsman"), and so far it has only been used in a small number of cases.

Banks could 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 or 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.

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<sup>30</sup> 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.

The application of the bankruptcy regime for consumers/households has registered a constant decline in numbers (from 1,083 in 2008 to 112 in 2014), partially 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 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 insolvency practitioners 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 discharge of uncollectable personal unsecured debt<sup>31</sup> 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 licenced insolvency practitioner, 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 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 as well as for his/her micro business (company) utilising the corporate examinership scheme. In this context, one can conclude that for the insolvency law to be effective, the judiciary, the Insolvency Service and the insolvency practitioner profession need to have sufficient capacity and capability to implement it. Delays in the court decisions can have an adverse effect on the value of the assets or on the viability of the plan.

## B.5 Judicial system

The judicial system is considered by the Cypriot authorities as an obstacle to private debt resolution, since court procedures are lengthy; courts or judges are not

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<sup>31</sup> 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.

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). Practical application of the tax regime is, however, somewhat uncertain with regard to 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 mechanisms<sup>32</sup> that are operated by private organisations<sup>33</sup>, but under its monitoring and supervision.<sup>34</sup> In the future, the two mechanisms will submit the data (received by the reporting agents) to the CBC. The CCR covers the so-called 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 required to report at the moment. ACIs are required to submit data at a 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 and the information collected by the CCRs.

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<sup>32</sup> Aiantas and Artemis.

<sup>33</sup> 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 had 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.

<sup>34</sup> According to the Directive for the operation of a system or a mechanism for the exchange, collection and provision of data of 2015.

The disclosure of data collected is regulated by the CBC.<sup>35</sup> Only authorised members of ACIs, the credit bureaus and the CBC itself are allowed to access the database.

The current CCR mechanism has been set up relatively recently, with the intervention of the international creditors. The CCR could 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 to conduct a credit search are reasonable both for an individual and for a business (€20 each). It contains the prices of RRE and CRE transactions, as well as a description of property characteristics. The general public is not allowed to conduct searches (except for prospective property buyers, with the consent of the seller, and simple searches such as printing of topographical plans). Information on upcoming forced sales/auctions is publicly available.

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

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<sup>35</sup> Business of Credit Institutions Law of 1997 to 2015.

# Annex II: Germany

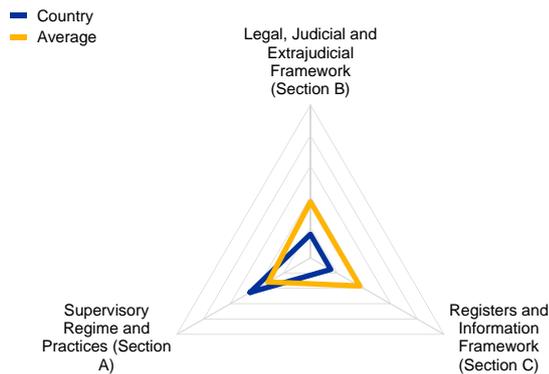
## Executive summary

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.

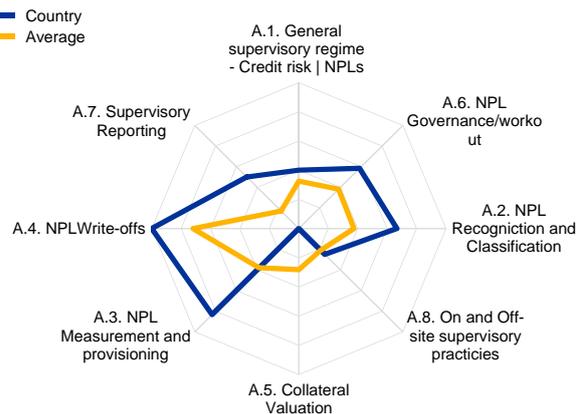
### Chart 2 Country overview

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-2015; 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 2.3 for more detailed explanations).

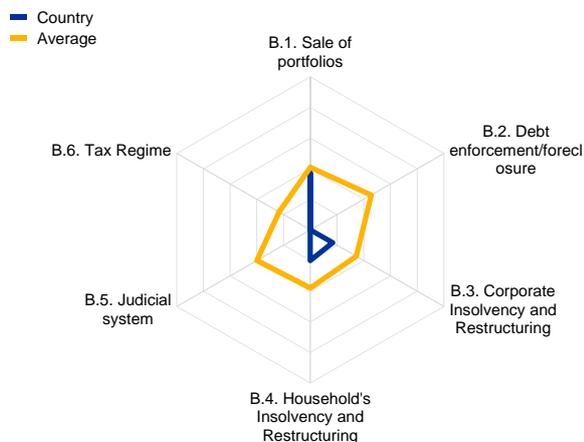
#### NPL Framework Overview



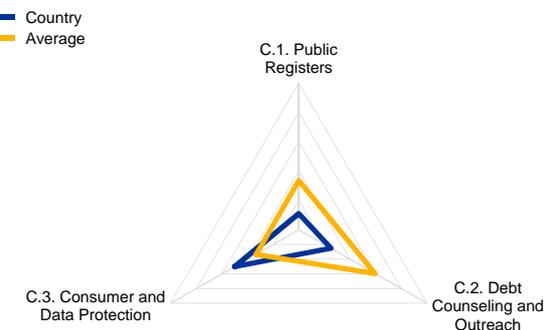
#### Supervisory Regime and Practices (see section A)



#### Legal, Judicial and Extrajudicial Framework (see section B)



#### Information Framework (including CCR) (see section C)



In December 2015 Germany had a total NPL ratio of 2% (of which by segment: households 2%; NFCs 4% of which SMEs 8%; and CRE 5%).<sup>36</sup>

In view of the comparatively low overall NPL ratios in the past years, the German authorities had reason to pursue a less pervasive strategy to tackle the NPL workout issue. The German regulatory framework – especially MaRisk<sup>37</sup> (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 in case of need. 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.<sup>38</sup>

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 workout as the standardised management

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<sup>36</sup> Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities. For SMEs and CRE, off-balance-sheet exposures are also excluded.

<sup>37</sup> 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.

<sup>38</sup> 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.

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- 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 (national GAAP (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 the CRR/CRD IV, the NCA has issued the following specific guidelines/requirements regarding credit risk management practices, processes and reporting:

**Table 21****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)	06/2015	All credit institutions	Audit of annual accounts	The Audit Report Regulation ( <i>Prüfungsberichtsverordnung – PrüfV</i> ), which is issued by the <i>Bundesanstalt für Finanzdienstleistungsaufsicht</i> (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)	11/2015	All credit institutions	General Banking Act	General Banking Act of Germany	1961
SolvV (binding)	12/2013	All credit institutions	National specificities (e.g. capital buffers)	Before the CRR came into force, the <i>Solvabilitätsverordnung</i> (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)			Collateral valuation	The <i>Beleihungswertermittlungsverordnung</i> (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)	12/2013	All credit institutions	Large exposures	The <i>Großkredit- und Millionenkreditverordnung</i> 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 its contractual obligations forms the basis for determining provisions (if the borrower is not able to meet all the contractual obligations, provisions have to be made for the amount of the projected losses); more detailed classifications are left up to the bank's discretion. However, banks have to develop a risk classification procedure (see MaRisk BTO<sup>39</sup> 1.4) and review the risk score (even for low risk exposures), at least annually and should a risk-related event occur. MaRisk provides that institutions should identify loans that

<sup>39</sup> Section in MaRisk regarding the organisational and operational structure.

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 audit 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 substantial). As another general principle, banks are invited to formulate stricter requirements in terms of identification of potential losses and increased risks and set early indicators based on quantitative and qualitative risk features.

Although the German NCA 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 filter<sup>40</sup>, 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”)<sup>41</sup> 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 its accounting policy. 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.

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<sup>40</sup> 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.

<sup>41</sup> 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 senior management. 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- 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 CRR<sup>42</sup> requirements (CRE ≤ 12 months; RRE ≤ 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). 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 standard for internal use (e.g. limiting the loan to 60% of the mortgage lending value).

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<sup>42</sup> Article 208(3).

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 did not provide 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 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- 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 credit institutions have to give information on an annual basis in relation to the annual supervisory data catalogue SON01 of the Audit Report Regulation (PrüfbV).<sup>43</sup> This information is normally compiled by the institutions but has to be checked by the auditors in accordance with PrüfbV (SON01).

Regarding the disclosure of NPL-related information, the 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 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 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.

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<sup>43</sup> Component of the BAKIS (the Bundesbank's prudential database).

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 notably covers 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 PrüfbV. In addition, the NCA 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 of 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, the NCA uses the CCR for both on- 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, to which the total amount of indebtedness of their borrowers is notified;
- 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 Value Management 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 AMC's 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: (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; and (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 BGB). Furthermore, after the application for insolvency, German Insolvency Law<sup>44</sup> provides, under certain conditions, the possibility for the debtor to

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<sup>44</sup> § 270 b of the *Insolvenzordnung* (InsO).

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, a debtor has in the case of consumer insolvency the 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

Regarding tax deductibility, a partial amount of 60% is accepted; according to the tax regime, an annual contribution to the general provision of 40% is not accepted for tax purposes. 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 or DTA).

## C Other information framework

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

NPL information based on the EBA definition is available since March 2015 and published quarterly. Previously classification was done 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 the *Gutachterausschuss* (Committee of Valuation Experts) in the context of the RE valuation. 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 III: Greece

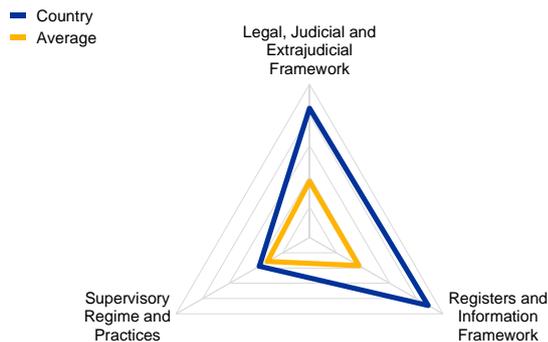
## Executive summary

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.

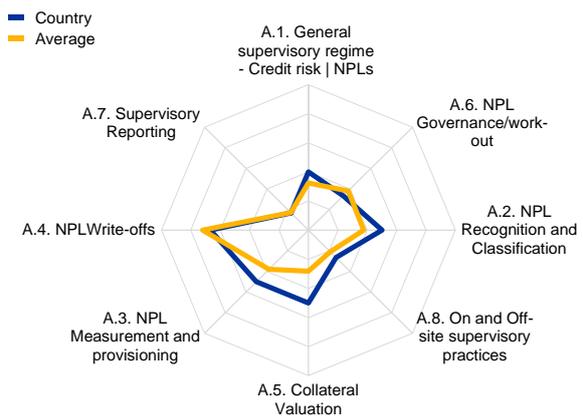
**Chart 3**  
Country overview

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-2015; 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 2.3 for more detailed explanations).

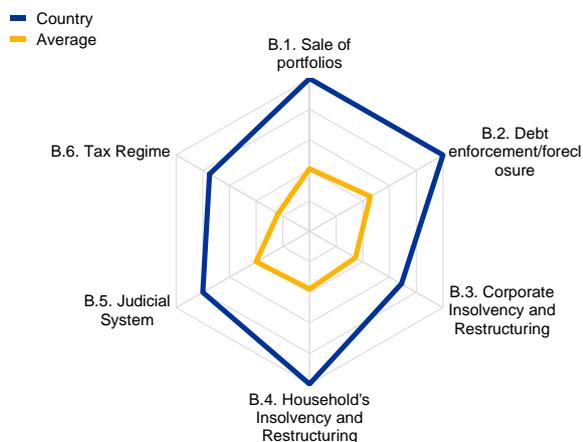
### NPL Framework Overview



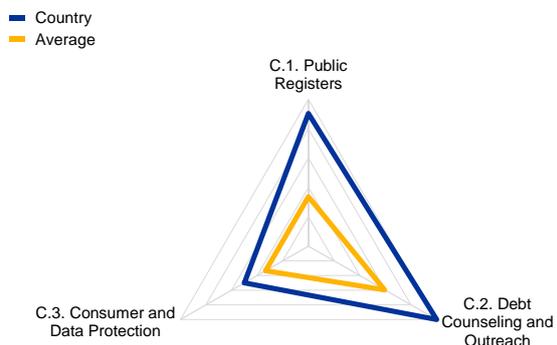
### Supervisory Regime and Practices (see section A)



### Legal, Judicial and Extrajudicial Framework (see section B)



### Information Framework (including CCR) (see section C)



Greece has taken a number of measures to tackle the high NPL ratio. In December 2015 Greece had a total NPL ratio of 47% (of which by segment: households 44%; NFCs 47% of which SMEs 66%; and CRE 61%).<sup>45</sup>

Greece has taken considerable steps towards commencing a programme of reforms, including an independent diagnostic study<sup>46</sup> 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 framework<sup>47</sup> for the management of loans in arrears and NPLs**; and (ii) **a guideline<sup>48</sup>** 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 the second half of 2015, 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.

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<sup>45</sup> Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities. For SMEs and CRE, off-balance-sheet exposures are also excluded.

<sup>46</sup> Troubled asset review (TAR).

<sup>47</sup> Executive Committee Acts 42 and 47.

<sup>48</sup> Code of Conduct on NPL Management, Credit and Insurance Committee Decision 116/I/2014.

**Table 22****Main barriers to NPL workout and adopted/foreseen measures**

Area	Impediment	Measures adopted in H2 2015 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	Limited stay and full documentation required prior to the hearing to determine eligibility, following amendments to the Household Insolvency Law
	3. Blanket moratorium on auctions of (almost) all household residential properties until end-2014	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	(measures foreseen) In July 2016 the Hellenic Financial Stability Fund (HFSF) conducted a related study, outlining a coordination mechanism and priority sectors. Study communicated to banks. Implementation pending.
	5. Insufficient coordination between banks and public authorities	(measures foreseen) Ongoing study on distressed borrowers with arrears above €1 million to both banks and the public sector; specific proposals pending
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	Primary legislation that allows the operation of credit-servicing firms and AMCs (credit-acquiring companies), as well as the sale of certain NPLs to AMCs. Secondary legislation to fully operationalise the new framework has been issued (Executive Committee Act 82/2016)
Tax regime	7. No deductions on restructuring measures	(measures foreseen) Proposed tax exemption of loan write-offs for borrowers
	8. Large volume of arrears to the public sector. No public debt write-off	Ongoing consultations under the most recent programme. Proposal for a 36-month instalment scheme for arrears to the public sector. Possibility to write off overdue charges and related fines
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 also expected following the completion <sup>49</sup> of the comprehensive review of the corporate insolvency framework

**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 reach 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 have been hired in 2016 as a measure to reduce bottlenecks, especially in the provinces where problems persist.

<sup>49</sup> Tentatively by June 2016.

### **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 were made recently such as the introduction of regular meetings among 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 and priority sectors. The study has been communicated to banks and the implementation of proposals is pending. An additional study with a focus on borrowers with arrears above €1 million is ongoing.

**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. The primary legislation adopted in the second half of 2015 allows for 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) 82/2016 regarding the secondary legislation that specifies the licensing procedure and other issues to operationalise the new framework. The scope of servicing includes all NPLs, whereas currently their sale would be restricted to large NFCs and mortgages on non-primary residences.<sup>50</sup> The new measures adopted are expected to gradually create a 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 is considered taxable income. By July 2016, a full tax exemption of loan write-offs for borrowers (both households and

<sup>50</sup> The recent Laws No 4389/2016 and No 4393/2016 allow the sale of all kinds of NPL. They envisage a derogation only for loans collateralised by the primary residence of the borrower with an objective value of up to €140,000 until end-2017. The BoG has already issued ECA 95/2016 amending the secondary legislation accordingly.

NFCs) had been implemented. The BoG will review the tax treatment for banks and creditors and will make proposals to the government. Regarding the volume of arrears to the public sector, the super-seniority of public claims leaves little room for banks to come up with viable recovery plans in instances where arrears to private and public creditors co-exist.

**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) 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.

**Operational targets for NPL management:** in the course of 2016 the BoG, in cooperation with ECB Banking Supervision, will request the Greek significant banks and high-priority less significant institutions (LSIs) to set operational targets for NPL management. The BoG has identified nine NPL operational targets and requested banks to submit their proposals for the target values. In 2016 it has already 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. The banks also 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”. These NPL operational targets will be monitored on a quarterly basis by the BoG and ECB Banking Supervision.

**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 A.1 Supervisory regime (credit risk/NPLs)

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

**Table 23****Main sources of NPE-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 forbearance measures and the reporting templates	2015
Code of Conduct on NPL Management (binding)	116//25.8.2014	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	31/12/2014

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 forbore exposures<sup>51</sup>, 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 broadly distinguished between 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.

<sup>51</sup> ECA 47/2015.

## A.4 NPL write-offs

Law No 3869/2010 provides a framework for the protection of over-indebted personal borrowers and potential (partial) 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. Write-offs are also discouraged owing to their unfavourable tax treatment.

## 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 NPLs<sup>52</sup>, 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 non-performing. However, RE revaluations are a 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 requirements<sup>53</sup>: 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), 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, 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

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<sup>52</sup> ECA 42/2014.

<sup>53</sup> Article 208(3).

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);
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, will request 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 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. The study has been communicated to banks and the implementation of proposals is pending. 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 quarterly the required COREP/FINREP reporting templates, which contain information relating to the EBA ITS requirements on forbearance and NPEs. In addition, pursuant to ECA 42/2014 (prior to the implementation of the EBA guidelines) as amended by ECA 47/2015, 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- and off-site supervisory practices and methodologies

Greek banks were subject to granular asset quality reviews (AQRs) and thematic reviews on NPL management during 2011-15. 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 during 2012-14 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 is currently in a transitional phase within the context of reforms required by the MoU. Up until 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 as of December 2015 allowed 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 very recently, the new framework only allowed for the sale of two other 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 EC/ECB/ESM/IMF in June 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 4335/2015<sup>54</sup> was adopted, significantly reducing the seniority of public claims. In particular, under the new Law, at least 65% of the proceeds from collateral liquidation are paid to secured creditors.

Furthermore, the lengthy foreclosure procedures constitute another disincentive for banks to proceed with collateral enforcement. The average length of a foreclosure procedure is 18 months (even longer for full execution).

## 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 envisaged for the smooth facilitation of 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 as late as 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%).

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<sup>54</sup> Amendment to the Greek Civil Procedure Code.

“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.

A bankruptcy and insolvency regime exists, but it does not pose a credible threat. In particular, 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 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 are aimed at removing 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 as of 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 which 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 moved from general to stricter protection, but currently there is broader moral suasion not to proceed with sales or auctions until the international creditors and the Greek State conclude the review. In addition, the BoG, in its regulatory capacity, issued Executive Committee Act 54, 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 country,<sup>55</sup> 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 current tax regime is considered a significant impediment to private debt resolution in Greece. In particular, there are no tax deductions for specific resolution measures or for collateral sales. An illustrative example is the potential and 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. A proposed amendment foresees the tax exemption of loan write-offs for borrowers.<sup>56</sup> Furthermore, write-offs of public debt are not foreseen, unless the debtor challenges the tax authority in – still lengthy – legal procedures. The

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<sup>55</sup> Between 2011 and 2013 company bankruptcy filings increased almost eight-fold, from 418 to 3,076 cases.

<sup>56</sup> Following legislative amendments in 2016, consensual write-offs are no longer taxable on the borrower side.

virtually inexistent possibility for 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. Notwithstanding the impediments identified, there is an average tax deduction of 1% of the banks' loan book for LLPs<sup>57</sup>, which is considered adequate by the BoG in the medium term, 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)<sup>58</sup> above their level in the second quarter of 2015.

## 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 are considered highly problematic, as they are not centralised and they do not cover the entire country. Other public asset registers may be centralised but only cover some parts of the country. However, they do not identify the owner and the asset's characteristics and they are not available for public searches. Public registers of RE transactions also do not exist, whereas 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.

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<sup>57</sup> The BoG estimates that the Greek significant banks have provisioned 3-4% of their (gross) loan book on average in recent years.

<sup>58</sup> State-guaranteed DTAs.

### 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 IV: Ireland

### Executive summary

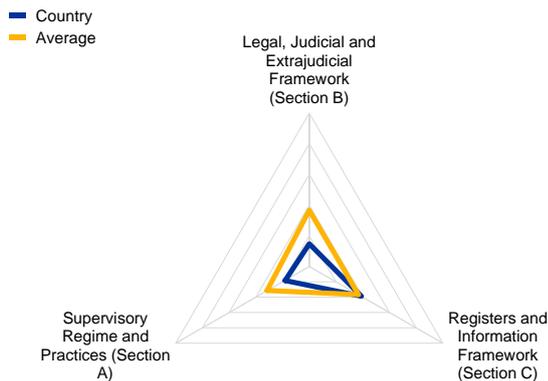
This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake, applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections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

#### Chart 4

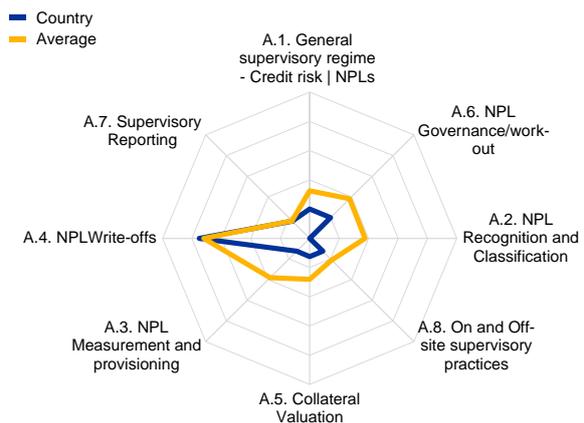
##### Country overview

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-2015; 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 2.3 for more detailed explanations).

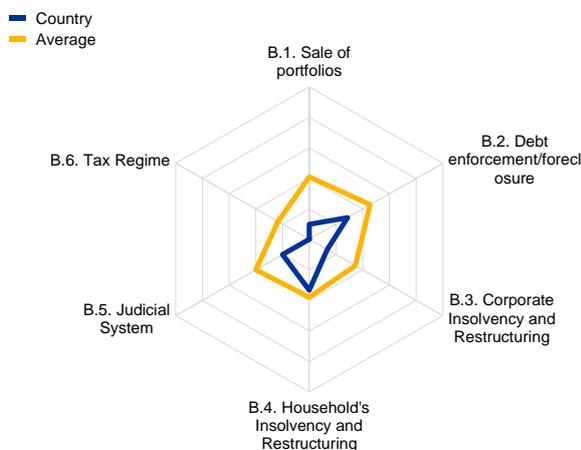
##### NPL Framework Overview



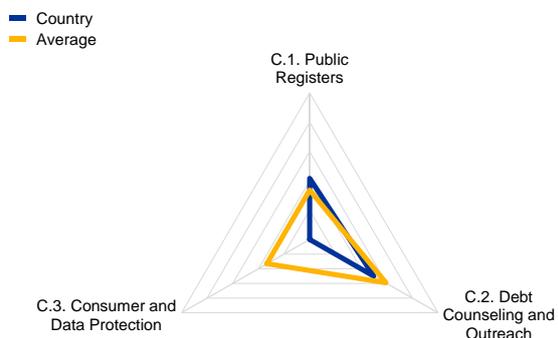
##### Supervisory Regime and Practices (see section A)



##### Legal, Judicial and Extrajudicial Framework (see section B)



##### Information Framework (including CCR) (see section C)



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 2015 Ireland had a total NPL ratio of 19% (of which by segment: households 18%; NFCs 26% of which SMEs 38%; and CRE 44%).<sup>59</sup>

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 bank Mortgage Arrears Resolution Targets and non-public SME targets; and (iv) the publication of banking guidelines and frameworks on provisioning, valuation, governance and sustainability.

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 €40 billion reduction in NPLs in the two-year period from year-end 2013 to year-end 2015, the scale of the issue in Ireland remains high, with over €50 billion of NPLs as at year-end 2015. 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 probation periods for example); 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 a key challenge for

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<sup>59</sup> Information provided by the NCA; NPL refers to NPE (as defined by the EBA ITS), excluding debt securities. For SMEs and CRE, off-balance-sheet exposures are also excluded.

Irish banks and their ability to repossess and sell PDH collateral in an efficient manner.<sup>60</sup> 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 Institutions<sup>61</sup> 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 moving 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 NCA 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 effective until end-2014. The targets required the banks to move

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<sup>60</sup> The ability to resolve the large 720 dpd mortgage NPL cohort is a challenge for Irish banks. As at the fourth quarter of 2015, 33% of total mortgage NPLs were in arrears by more than 720 days.

<sup>61</sup> The term "Covered Institutions" refers to the credit institutions that have received financial support under the Covered Institutions (Financial Support) Act 2008.

distressed SME borrowers from short-term forbearance to longer-term solutions.

- **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, during 2011-14 the Irish retail banks were subject to three granular asset quality reviews (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 the CRR/CRD IV, the NCA has issued the following specific guidelines/requirements regarding credit risk management practices and processes:

**Table 24**  
Main sources of NPE-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 the mortgage value of PDHs and a limit of 70% LTV for BTLs; these limits are on a proportionate cap basis, i.e. the total aggregate monetary amount of loans for PDH purposes should not exceed 15% of the total aggregate monetary amount of loans advanced for that purpose by a lender during a 12-month period; (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 guidelines<sup>62</sup> 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 forbearance 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 forbearance loan pools, the PD will increase (as forbearance 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 guidelines<sup>63</sup> 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.

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<sup>62</sup> Impairment Provisioning and Disclosure Guidelines (2013), page 14 et seq.

<sup>63</sup> 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 NPLs<sup>64</sup>, 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 guidance<sup>65</sup> 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

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<sup>64</sup> Impairment Provisioning and Disclosure Guidelines, page 17.

<sup>65</sup> “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.<sup>66</sup>

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 (1st line) function and should report to the credit risk control (2nd line) function.

The required frequency for the valuation of immovable property collateral follows CRR<sup>67</sup> requirements (CRE ≤ 12 months; RRE ≤ 3 years).

The following guidance is outlined in respect of collateral valuation for credit monitoring purposes: (i) 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; (ii) 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; and (iii) 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 should be based on the risk profile of the exposure and its impact on the credit institution’s capital position.

CBI guidance<sup>68</sup> on the valuation of RE indicates that for valuations of RRE mortgages, only an external index is an appropriate method for review, provided the

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<sup>66</sup> “Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future”, page 19.

<sup>67</sup> Article 208(3).

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.<sup>69</sup>

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 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 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.<sup>70</sup>

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<sup>68</sup> The guidance is called "Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future".

<sup>69</sup> Impairment Provisioning and Disclosure Guidelines, page 3 et seq.

<sup>70</sup> 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.

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 cooperating<sup>71</sup>.

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 guidelines<sup>72</sup>, 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 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.

<sup>71</sup> 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.

<sup>72</sup> Internal Guideline – Sustainable Mortgage Arrears Solutions.

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 portfolios<sup>73</sup>; (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 if 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 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

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<sup>73</sup> 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.

published in the semi-annual Macro-Financial Reviews. NPE statistics according to the EBA ITS are not published.

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

During 2011-14 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 the SSM (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 are 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 the recent years (2014-15) there was 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 repossessions 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”<sup>74</sup> 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 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 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

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<sup>74</sup> 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.

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-2015 the number of cases through either a PIA (ISI) or a bankruptcy of consumers/households was limited, at 840 cases and 985 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 (ca. 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 V: Italy

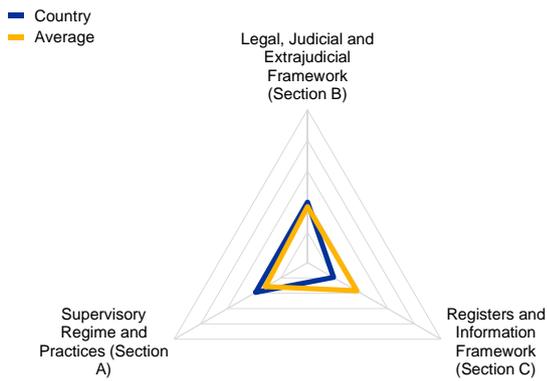
## Executive summary

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.

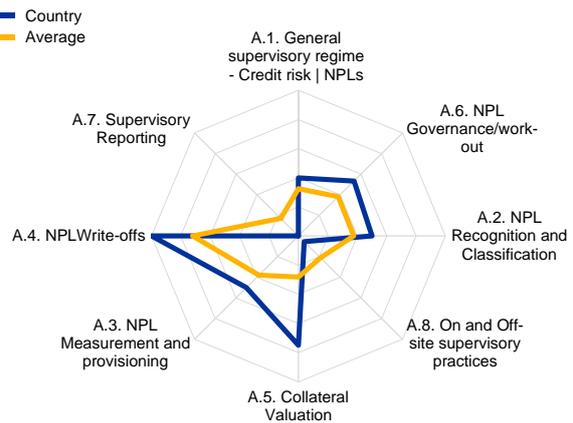
**Chart 5**  
Country overview

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-2015; 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 2.3 for more detailed explanations).

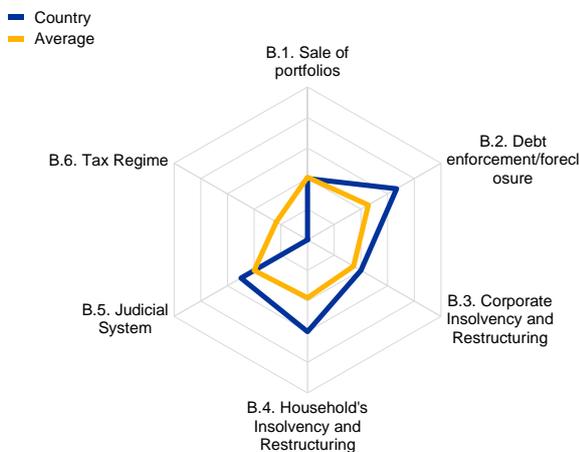
### NPL Framework Overview



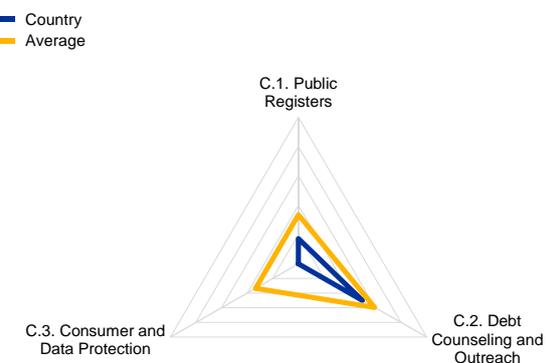
### Supervisory Regime and Practices (see section A)



### Legal, Judicial and Extrajudicial Framework (see section B)



### Information Framework (including CCR) (see section C)



In December 2015 Italy had a total NPL ratio of 12% (of which by segment: households 12%; NFCs 16% of which SMEs 30%; and CRE 36%).<sup>75</sup>

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.<sup>76</sup> With the same law, the government has approved a revision of the tax treatment of LLPs which permits their immediate full deductibility<sup>77</sup> (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 will be a State guarantee scheme, open to all banks on a voluntary basis. The State guarantee will cover 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.

**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 procedures. As a result of the 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.
- **A very limited NPL secondary market and a still inadequate size of the 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

<sup>75</sup> Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities. For SMEs and CRE, off-balance-sheet exposures are also excluded.

<sup>76</sup> 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>.

<sup>77</sup> Includes provisions/impairments and write-off losses.

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 loans<sup>78</sup> above €250 and other NPLs above €30,000).<sup>79</sup> The BdI makes extensive use of the CCR for off- and on-site supervision.<sup>80</sup> The BdI has recently introduced a new 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 BdI 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

<sup>78</sup> This relates to borrowers in a state of insolvency.

<sup>79</sup> See Section C for a detailed overview.

<sup>80</sup> See the note entitled "[The recent asset quality review on non-performing loans conducted by the Bank of Italy: Main features and results](#)".

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 NCA, 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.<sup>81</sup> 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.

## A Supervisory regime and practices

### A.1 Supervisory regime (credit risk/NPLs)

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

**Table 25**  
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, 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

<sup>81</sup> The Banca d'Italia has recently published for consultation rules relating to the valuation of real estate guarantees.

The Bdl issued<sup>82</sup> 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 NCA 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.

## 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 reporting<sup>83</sup> 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

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<sup>82</sup> Circular No 285, part 1, title 4, chapter 3, annex 4, paragraph 2.

<sup>83</sup> Circular No 272.

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.

#### 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.<sup>84</sup> 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 2011<sup>85</sup> 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 CRR<sup>86</sup> requirements (CRE ≤ 12 months; RRE ≤ 3 years) and does not depend on/change if the loan is classified as an NPL. The Bdl does not prescribe the methodologies

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<sup>84</sup> 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.

<sup>85</sup> This was updated in December 2015.

<sup>86</sup> Article 208(3).

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 published for consultation 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-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 NCA 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- 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:

**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.

**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.<sup>87</sup>

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 entered into force 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

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<sup>87</sup> "The changes of the Italian insolvency and foreclosure regulation adopted in 2015", *Notes on Financial Stability and Supervision*, Banca d'Italia, November 2015.

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).

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). 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 only data available refer to the number of bankruptcy cases, which more than doubled from 7,272 cases in 2008 to 14,880 cases in 2013.

### 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 reform (Decree No 83/2015) 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 VI: Portugal

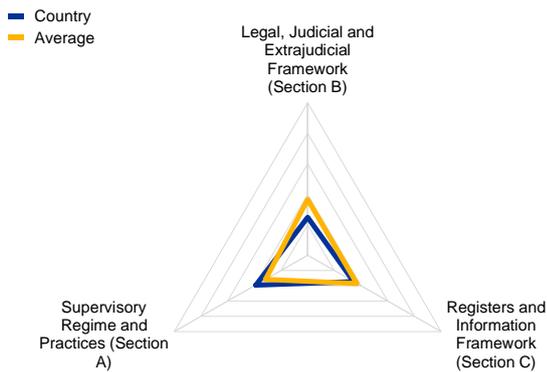
## Executive summary

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.

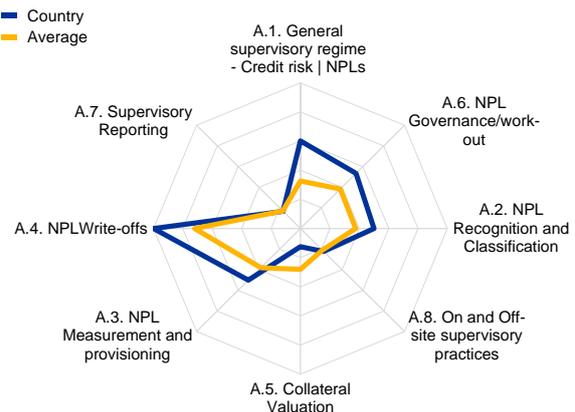
**Chart 6**  
Country overview

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-2015; 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 2.3 for more detailed explanations).

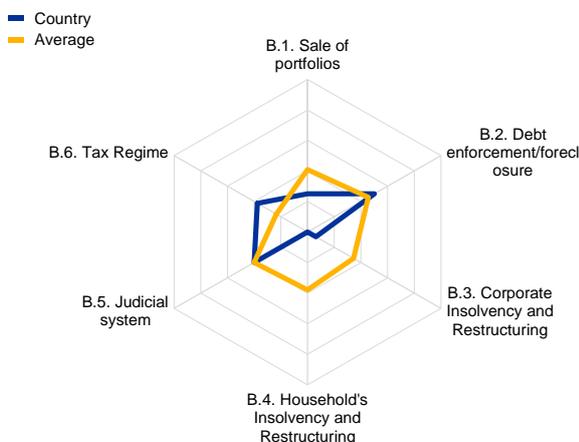
### NPL Framework Overview



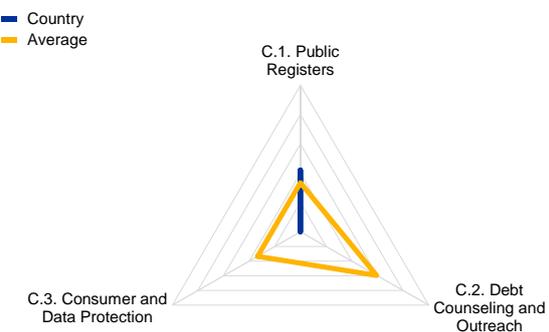
### Supervisory Regime and Practices (see section A)



### Legal, Judicial and Extrajudicial Framework (see section B)



### Information Framework (including CCR) (see section C)



In December 2015 Portugal had a total NPL ratio of 15% (of which by segment: households 8%; NFCs 23% of which SMEs 31%; and CRE 41%).<sup>88</sup>

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- 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 impairment is adverse in that losses are tax deductible only if all the legal claims are extinct.
- **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 guidance<sup>89</sup> for consolidated accounts that summarises and discloses the criteria used by the NCA 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 provisioning for NFC loans under specific conditions (under these conditions, impairment intervals are provided); (iii) criteria to be considered in the provision

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<sup>88</sup> Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities. For SMEs and CRE, off-balance-sheet exposures are also excluded.

<sup>89</sup> Circular No 02/2014/DSP.

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 the CRR/CRD IV, the NCA has issued the following specific guidelines/requirements regarding credit risk management practices and processes:

**Table 26**  
Main sources of NPE-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 NCA 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 guidance<sup>90</sup> 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 guidance<sup>91</sup> 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 guidance<sup>92</sup> 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 NPEs 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 measuring the impairment loss. This notwithstanding, the BdP issued an instruction<sup>93</sup>, 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

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<sup>90</sup> Instruction No 32/2013. This instruction contains criteria for the recording of forbearance, for exit and for the identification of concessions towards a debtor.

<sup>91</sup> Circular No 02/2014/DSP.

<sup>92</sup> Circular No 02/2014/DSP.

<sup>93</sup> Instruction No 6/2005.

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 guidance<sup>94</sup> 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). With the exception of consumer lending exposures, banks in general do not write off loans owing to the tax regime and legal impediments (see the section on the tax regime).

#### 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 (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 CRR<sup>95</sup> 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.

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 value<sup>96</sup>; and (ii) for other types of

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<sup>94</sup> Circular No 15/2009/DSB.

<sup>95</sup> Article 208(3).

<sup>96</sup> Except for mortgage loans pledged as collateral for a covered bond.

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/criteria<sup>97</sup> 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. There is no interbank coordination on individual debtor cases, but CCR information allows banks to take preventive measures to address future NPLs.

## A.7 Supervisory reporting

Credit institutions in Portugal provide the required COREP/FINREP reporting templates, including information relating to the EBA ITS requirements on

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<sup>97</sup> Circular No 44/2009/DSB.

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 risk<sup>98</sup> 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 NCA, 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- 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 guidance<sup>99</sup> 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.

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

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<sup>98</sup> “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.

<sup>99</sup> Circular No 2/2014/DSP.

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 Directive<sup>100</sup> 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 created to provide technical and financial support to enterprises, in particular SMEs. In 2012 the Portuguese Government created the *Programa Revitalizar* to improve

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<sup>100</sup> Directive 2002/47/EC, as amended by Directive 2009/44/EC.

the national legal framework for dealing with the insolvency and recovery of companies<sup>101</sup> 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.

## B.4 Household insolvency and restructuring

The household insolvency and debt restructuring regime is considered by the Portuguese NCA 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 regime<sup>102</sup>: 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 regime<sup>103</sup>: 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 that started before 31 December 2015; and (iii) the credit mediator<sup>104</sup> 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 Portuguese NCA to be one of the main obstacles to NPL resolution. The complex and lengthy in-court procedures could

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<sup>101</sup> Decree-Law No 105/2004, as amended.

<sup>102</sup> Decree-Law No 227/2012.

<sup>103</sup> Law No 58/2012, as amended by Law No 58/2014.

<sup>104</sup> Decree-Law No 144/2009.

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 February 2014 the Tax Administration Authority (*Autoridade Tributária e Aduaneira*) issued a binding interpretation regarding write-offs of doubtful loans and receivables, considered as a strong impediment for banks to write off loans. According to this interpretation, losses are tax deductible only if all of the legal claims are extinct, i.e. the tax deductibility of write-offs is subject to the following cumulative conditions: (i) the credit is overdue by more than two years; (ii) the credit is fully provisioned/impaired; and (iii) the derecognition was driven by the extinction of the creditor's rights (IAS 39, paragraph 17(a)), which is considered to occur only in the ways of extinguishing obligations, other than settlement, provided for in the Civil Code. It should be noted that the previous regulation recognised the tax deductibility of loan write-offs irrespective of whether they were claimed in a court or whether there was a special process for business recovery and creditor protection, or enforcement, bankruptcy or insolvency proceedings.

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 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 ( $\approx 98\%$  of loans in the MFI<sup>105</sup> balance sheet), but information is

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<sup>105</sup> Monetary financial institution.

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 Consumers<sup>106</sup> (*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.

## 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).

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<sup>106</sup> Decree-Law No 227/2012 (general regime).

## Annex VII: Slovenia

### Executive summary

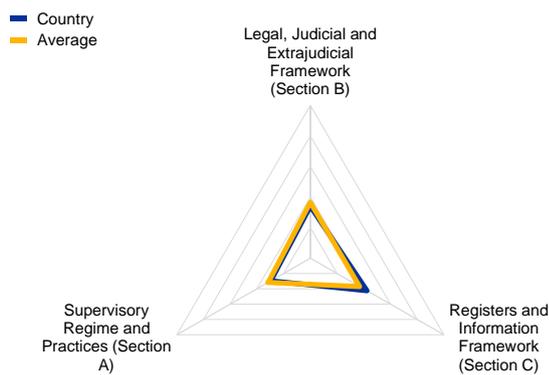
This country report is composed of four sections. The executive summary describes the main findings of the stocktake; the graphs presented reflect the findings of the stocktake applying the methodology explained in Chapter 2 and should be viewed in conjunction with the conclusions presented. Sections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

### Chart 7

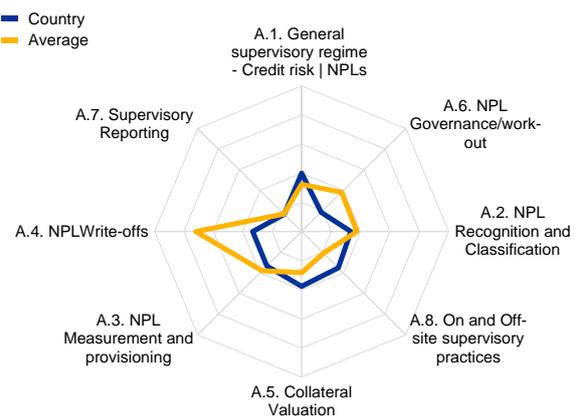
#### Country overview

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-2015; 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 2.3 for more detailed explanations).

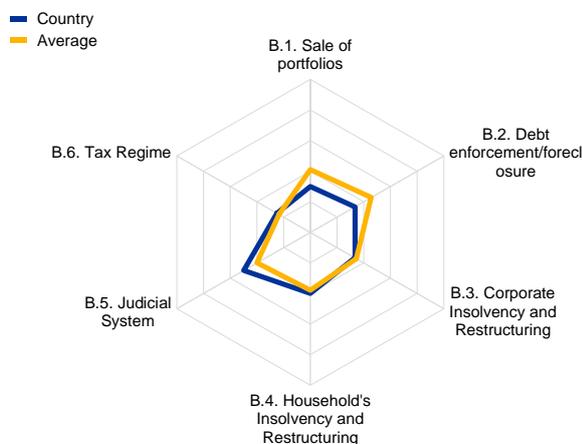
#### NPL Framework Overview



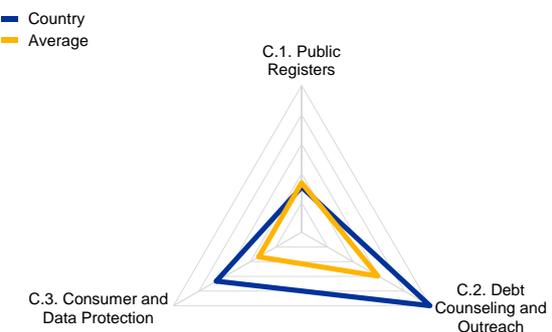
#### Supervisory Regime and Practices (see section A)



#### Legal, Judicial and Extrajudicial Framework (see section B)



#### Information Framework (including CCR) (see section C)



In December 2015 Slovenia had a total NPL ratio of 16% (of which by segment: households 6%; NFCs 30% of which SMEs 43%; and CRE 47%).<sup>107</sup>

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.<sup>108</sup> 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.

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<sup>107</sup> Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities. For SMEs and CRE, off-balance-sheet exposures are also excluded.

<sup>108</sup> 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 (AMC<sup>109</sup>):

- **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 (Bank of Slovenia – 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 the 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 the 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 the 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. The BoS also provided banks with a recommended toolkit of indicators, such as

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<sup>109</sup> In this report, AMC should be understood as a credit-acquiring firm (see also the list of abbreviations).

cash flow (steep decline in or negative EBITDA), creditworthiness (financial liabilities/EBITDA) and capital adequacy (insufficient/negative equity).

- **Supervisory guidance:** in December 2014 the 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.
- **Write-off regulation:** the BoS has issued guidelines on banks' write-off policy, where inter alia the derecognition timeline is included for specific segments and loss events.<sup>110</sup>

**Other frameworks:** there is good cooperation between the major stakeholders (i.e. the BoS, the Bankers' Association and the Ministries), as well as a communication channel between the 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 the CRR/CRD IV, the BoS has issued specific guidelines/requirements regarding credit risk management practices and processes 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".

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<sup>110</sup> Regulation on the assessment of credit risk losses of banks and savings banks.

**Table 27****Main sources of NPE-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

The 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, the 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 defined<sup>111</sup>:

**Table 28**  
BoS classification categories according to dpd

Categories	Non-defaulted exposures			Defaulted exposures	
	A	B	C	D	E
Dpd	None, exceptionally up to 15	Up to 30	Up to 90	91-360	Over 360

The 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. The BoS has

<sup>111</sup> Regulation on the assessment of credit risk losses.

developed additional guidance for forbore exposures.<sup>112</sup> 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. The 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 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.

The BoS may enforce appropriate provisioning through on-site inspections and the Supervisory Review and Evaluation Process (SREP).

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<sup>112</sup> Guidelines for setting up impairments and provisions for exposures to restructured clients.

## A.4 NPL write-offs

The BoS has issued specific guidance<sup>113</sup> 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.

The 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.

## 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, the 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.

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<sup>113</sup> Regulation on the assessment of credit risk losses of banks and savings banks.

Regarding the frequency of valuation, the banks regularly monitor the value of the RE collateral in accordance with CRR<sup>114</sup> 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, the BoS guidance<sup>115</sup> 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 the 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 GURS<sup>116</sup>, the Surveying and Mapping Authority of the Republic of Slovenia) and internal. In practice, public indices are 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 the 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.

The BoS has issued specific recommendations<sup>117</sup> 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).

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<sup>114</sup> Article 208(3).

<sup>115</sup> Guidelines for the management of doubtful claims.

<sup>116</sup> *Geodetska uprava Republike Slovenije*.

<sup>117</sup> Recommendation letter sent to the banks and savings banks in 2013 and 2014.

## 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. The BoS has issued a Regulation<sup>118</sup> 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 required to formulate a recovery strategy and an approximate timetable for collection.<sup>119</sup>

The BoS has issued formal guidelines to banks on NPL management practices. In addition, the 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, the BoS indicated<sup>120</sup> that NPLs should be quickly reduced (banks should prepare individual timetables for reducing NPLs) to a level that is sustainable in the long term.

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<sup>118</sup> 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).

<sup>119</sup> To this end, the 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.

<sup>120</sup> BoS letter dated 23 December 2014.

The 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 the 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. 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)<sup>121</sup>; 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. The BoS applies manual validation rules to ensure the quality of banks' NPL-related reporting.

Regarding the disclosure of NPL-related information, the 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 the 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- and off-site supervisory practices and methodologies

During 2012-14 the Slovenian banks were subject to granular asset quality reviews. The 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.

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<sup>121</sup> 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.

The BoS has developed a methodology to assess the policies and procedures used by banks to handle NPLs. The criteria/framework that the 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 the NCA on specific debtors. Furthermore, the NCA 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, the BoS also uses the CCR for supervisory purposes, namely for on-site and off-site supervision and for SREP purposes. The NCA 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.

## 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 provisions<sup>122</sup> 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).

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<sup>122</sup> Act governing the rescue of and restructuring aid for companies in difficulty.

## 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 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.<sup>123</sup> Leasing companies also currently report information to the credit register for individuals. The reporting agents submit information at a solo level. However, the 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.

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.

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<sup>123</sup> Instructions for implementing the Regulation on the assessment of credit risk losses of banks.

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.

# Annex VIII: Spain

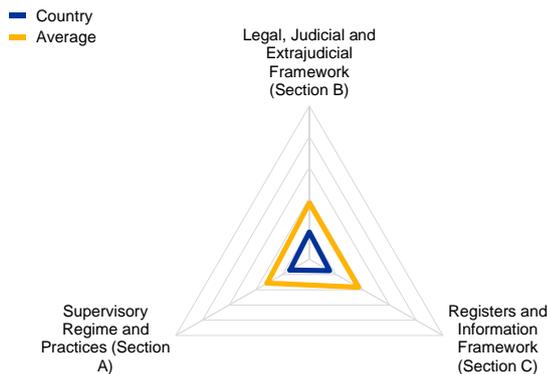
## Executive summary

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.

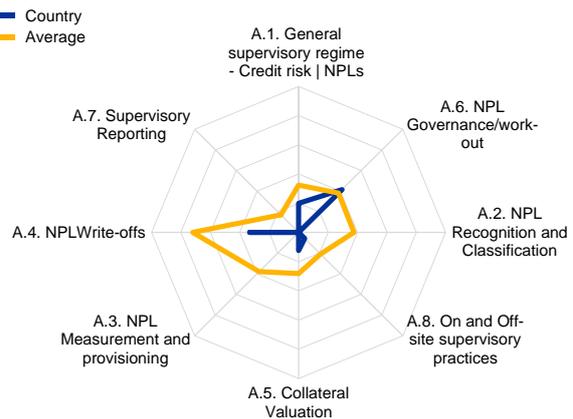
**Chart 8**  
Country overview

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-2015; 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 2.3 for more detailed explanations).

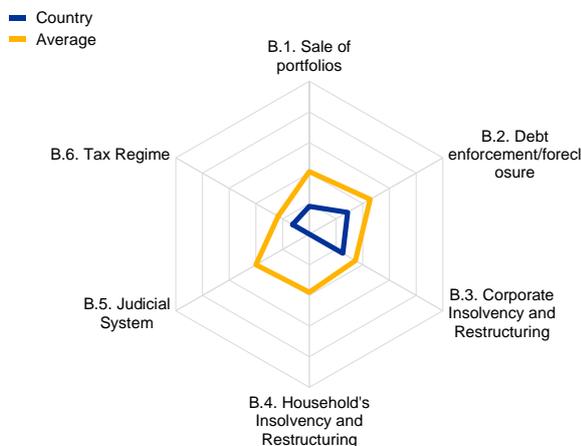
### NPL Framework Overview



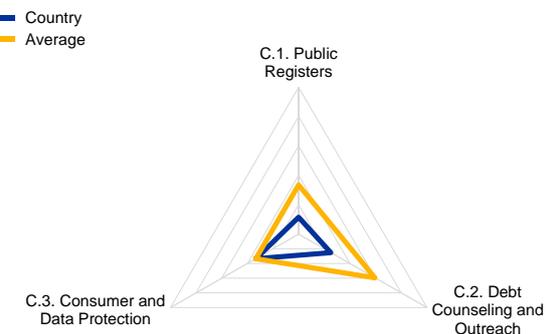
### Supervisory Regime and Practices (see section A)



### Legal, Judicial and Extrajudicial Framework (see section B)



### Information Framework (including CCR) (see section C)



In December 2015 Spain had a total NPL ratio of 5% (of which by segment: households 4%; NFCs 9% of which SMEs 18%; and CRE 27%).<sup>124</sup>

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. Spanish courts have a new 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 BdE gives Spanish banks incentives to resolve NPLs by issuing specific provisioning rules, which set the floors for provisions. For NPLs in arrears, the minimum provisioning is 25% of the amount of the exposure not covered by the amount recoverable from the effective collateral, with a 25 p.p. increment for every additional quarter of arrears. The floor of 25% applies to most other NPLs. Collateral values are adjusted by applying haircuts that range between 10% and 50%, depending on the type of collateral, to the lower of cost or market value<sup>125</sup>. Moreover, in 2013 the BdE sent a letter to banks which set requirements and classification rules for loan refinancing or restructuring transactions so that Spanish banks follow a uniform approach in the interpretation of regulatory requirements for these transactions.
- **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

<sup>124</sup> Information provided by the NCA; NPLs refer to NPEs (as defined by the EBA ITS), excluding debt securities. For SMEs and CRE, off-balance-sheet exposures are also excluded.

<sup>125</sup> These provisioning requirements have been revised by BdE Circular No 4/2016, which will enter into force on 1 October 2016.

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 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 2017.

- **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 forbore 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 the CRR/CRD IV, the BdE has issued the following specific requirements regarding credit risk management practices and processes:

**Table 29**  
Main sources of NPE-related regulation

Type	Ref.	Scope	Topic	Summary description	Entry into force
Circular	4/2004 (Annex IX)	All credit institutions	Risk analysis and management	Requirements regarding credit risk analysis, allowances and provisions	2005
Communication	April 2013	All credit institutions	Loan refinancing and restructuring	Criteria for the documentation, monitoring and review of refinanced and restructured loans	2013

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. Current guidance is being revised, introducing an LTV limit of 80% 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 issued detailed criteria<sup>126</sup> 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., and also additional qualitative criteria<sup>127</sup> like the appropriateness of previous refinancing/restructuring transactions.

The BdE has also developed additional guidance for the classification of forbore exposures<sup>128</sup> in terms of additional situations that are treated as forbearance

<sup>126</sup> Point II of Annex IX, Circular No 4/2004.

<sup>127</sup> April 2013 BdE formal communication to banks (criteria on refinancing and restructuring).

<sup>128</sup> [Criteria for the application of Circular No 4/2004 in respect of loan refinancing and restructuring](#); this communication contains criteria for the recording of forbearance, for exit and for the identification of concessions made to a debtor, but mainly replicates the criteria of the EBA ITS on supervisory reporting on forbearance.

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 “normal loans” (including “watch loans”, which require special monitoring, e.g. forbearance during the probation period) and “sub-standard loans” (loans to customers that reveal weaknesses and loans not properly documented). 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”.<sup>129</sup> 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. 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, states that the reclassification of restructuring loans (≈ forborne) from “doubtful” to “normal loans” or “sub-standard loans” can occur if commitments have been met for a minimum of one year from the date when the restructuring was entered into (six months for loans with monthly instalments and mortgages on the borrower’s principal residence, a possibility not envisaged in the EBA ITS), or when the loan principal has been reduced by at least 10%. Current guidance has been revised in 2016 to fully align curing rules with the EBA ITS (requiring that a year has elapsed since forbearance, that the borrower has complied in time and form with all of the regular repayments and interest payments, and that there are no other transactions with the same borrower with amounts more than 90 dpd).

### 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.

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<sup>129</sup> According to the new draft Annex IX, the classification categories will be somewhat changed. Instead of “sub-standard exposures”, “standard exposures under special monitoring” will be introduced. These are exposures to debtors showing signs of weakness, including high debt levels, a drop in revenue and narrowing of operating margins. The draft also lists numerous factors in the debtor’s environment which also need to be considered. Finally, these exposures include the pre-arrears (31 to 90 days overdue), which were previously included in the “doubtful for reasons other than in arrears”.

Circular No 4/2004 establishes minimum allowances to cover the credit risk of NPLs and prescribes allowances according to a calendar which sets fixed provision rates depending on the number of dpd. For example, (i) for loans classified as “doubtful in arrears”, provision rates depend on the number of days a loan is past due: a 25% provision rate for loans with 91-180 dpd, 50% for 181-270 dpd, 75% for 271-365 dpd, and 100% for more than 365 dpd; when determining the specific allowances for collateralised transactions, the adjusted<sup>130</sup> value of the collateral is taken into account to determine the basis for impairment; and (ii) for loans classified as “doubtful for reasons other than in arrears”, a minimum specific coverage ratio of 25% of the total exposure net of collateral is required<sup>131</sup>.

Apart from Circular No 4/2004, one-off measures<sup>132</sup> – only applicable to the credit portfolio existing at a specific moment in time – were implemented in 2012 at the system level and related to new provisioning requirements for RE loans and assets received as a consequence of the foreclosure of mortgages and other arrangements.

The percentages for provisioning in Circular No 4/2004 were estimated by the BdE based on their experience of and information on the Spanish banking sector. No interest is accrued on loans classified as “doubtful loans” since impairment has been identified.

Annex IX (Analysis and estimation of allowances and provisions for credit risk) of Circular No 4/2004, which sets the provisioning rates and haircuts to calculate the adjusted collateral value (see Section D for the current rates and haircuts), will be replaced in 2016 by the new Annex A, which inter alia sets new provisioning rates for loans classified as “doubtful as a result of arrears”. The new Annex A also sets new haircuts to be applied to collateral when determining the net exposure.

In this regard, the exposure not covered by collateral (valued incorporating a haircut) is required to be fully provisioned in one year.

## 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. Entities are then responsible for defining their own write-off policy, with due consideration to the aforementioned criteria.

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<sup>130</sup> More details on the calculation are contained in Section D of the Circular on NCA practices beyond current regulation/accounting.

<sup>131</sup> As mentioned before, this treatment has been modified by BdE Circular No 4/2016. No minimum specific coverage ratio is required in the revised accounting regime.

<sup>132</sup> Royal Decree-Laws No 2/2012 (3 February) and No 18/2012 (11 May).

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.

There is no prescribed minimum frequency of collateral valuation, except for “doubtful loans” and “foreclosed assets” collateralised by RE, for which collateral valuation has to be conducted by an independent appraisal company (using the methodologies indicated in the next paragraph) at least every three years, or more often in the event of major changes in market conditions.<sup>133</sup>

In addition to CRR<sup>134</sup> 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 below €500,000; 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.

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.

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<sup>133</sup> This regime has recently been modified. The revised accounting Circular, which enters into force on 1 October 2016, prescribes minimum frequencies for collateral valuations for all exposures and an increase in the minimum frequency for doubtful loans and foreclosed assets to at least yearly.

<sup>134</sup> Article 208(3).

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 Practices<sup>135</sup> 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.

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.<sup>136</sup> 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: the minimum haircut on the appraised value is 10%, with a 10 p.p. increase for every year after the foreclosure date (up to 40%). In this sense, capital is impacted through higher impairment.

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<sup>135</sup> Royal Decree-Law No 6/2012 (9 March).

<sup>136</sup> Royal Decree-Law No 4/2014 (7 March).

## A.7 Supervisory reporting

Besides the basic EBA ITS prudential reporting, Spain follows the provisions of Circular No 4/2004 (amended by Circular No 6/2012<sup>137</sup> and Circular No 1/2013, and enhanced by the letter “Criteria on Refinancing and Restructuring” of 2013<sup>138</sup>) to formulate additional reporting requirements, e.g. for mortgage loans the banks are required to report their exposures broken down into six LTV brackets<sup>139</sup>.

On the disclosure side, the BdE adopted a number of measures to provide more detailed information on NPLs to the markets. These measures are: (i) publishing, on a regular basis, 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 from institutions quantitative and qualitative disclosures<sup>140</sup> related to exposures to the construction and RE sectors, housing mortgages and foreclosed assets (including data on forborne loans); and (iv) requiring, in the notes to the institutions’ annual accounts, information on policy and strategy to deal with troubled assets and risk concentration by geographical area and business segment, and also information on good practices for responsible lending.

For the quality assurance of the supervisory reporting, the BdE 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. 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- and off-site supervisory practices and methodologies

Following the rules of Circulars No 4/2004 and No 6/2012, when the BdE (now the SSM for SIs) carries out a supervisory activity related to credit risk, it analyses banks’ policies and procedures (reviewing internal manuals, interviewing senior

<sup>137</sup> 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.

<sup>138</sup> According to the press release attached to the letter, on the basis of the information obtained following the publication of Circular No 6/2012, the BdE has observed differences in institutions’ accounting policies with respect to refinancing. The letter sought to establish general uniform criteria.

<sup>139</sup> up to 40%, >40% and <=60%, >60% and <=80%, >80% and <=100%, >100% and <200%, and >200%.

<sup>140</sup> Required by rules 4 and 5 of Circular No 4/2004, which were modified by Circulars No 5/2011 and No 6/2012.

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 inspections<sup>141</sup>. 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 NCA 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 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

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<sup>141</sup> 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.

countries.<sup>142</sup> A variety of NPE disposal tools have been used, e.g. portfolio sales, transfers to private AMCs, transfers to a public AMC, etc.

An AMC named SAREB was created in 2012 with the mission to recover problematic loans related to 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 developers 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. The SAREB ownership is 55% private and 45% by the Fund for Orderly Bank Restructuring (FROB). 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 and is helping to revitalise the RE market. The legal framework in Spain 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. Loan buyers can be third-party banks or institutional investors. Additionally, the legal basis for founding AMCs is set out in a specialised law<sup>143</sup>.

## 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*.

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 NCA not to be an obstacle to private debt resolution.

Although Spain does not have a scheme in place to support distressed SMEs, the Insolvency Law<sup>144</sup> 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.

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<sup>142</sup> [European loan portfolio activity outlook and transactions](#).

<sup>143</sup> Law No 8/2012 of 30 October 2012 on write-downs and sales of the financial sector's RE assets.

<sup>144</sup> Law No 22/2003.

## 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 2017.

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 December 2015, there have been 24,900 restructuring plans, six debt reductions and 6,031 deeds in lieu of foreclosure.<sup>145</sup> 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.<sup>146</sup>

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.<sup>147</sup> 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 plan<sup>148</sup> 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.

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<sup>145</sup> [Compliance report](#).

<sup>146</sup> 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).

<sup>147</sup> Royal Decree-Law No 1/2015 of 27 February 2015 and Law No 25/2015 of 28 July 2015.

<sup>148</sup> 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.

## 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.

The CCR is a public service offered by the BdE<sup>149</sup> 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

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<sup>149</sup> 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.

report gives a detailed overview of the main features of and information collected by the CCRs.

The cadastral system and the land registry<sup>150</sup> 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.

## 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. 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.

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<sup>150</sup> In Spain, there is both a cadastral system (*Cadastrre*) and a land register.

## Annex IX

**Table 30**  
Overview of CCR characteristics by country

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
<b>Central credit register</b>								
<b>CCR manager</b>								
National central bank	x	✓	x	x	✓	✓	✓	✓
Private company	✓	✓	x	✓	✓	x	x	✓
More than one CCR (private and public)	x	✓	x	x	✓	x	x	✓
<b>Reporting agents</b>								
Domestic banks	✓	✓	x	✓	✓	✓	✓	✓
Foreign subsidiaries of domestic banks	x	✓	x	✓	x	✓	✓	✓
Local branches of foreign banks	✓	✓	x	✓	✓	✓	✓	✓
Central bank discretion	x	x	x	x	x	✓	x	x
Non-deposit-taking institutions	x	✓	x	✓	✓	✓	x	✓
<b>Reporting level</b>								
Solo only	✓	x	x	✓	x	✓	✓	x
Consolidated only	x	x	x	x	x	x	x	x
Both	x	✓ <sup>1</sup>	x	x	✓ <sup>1</sup>	x	x	✓ <sup>1</sup>
<b>Granularity of reporting</b>								
Instrument level	✓	x	x	x	✓	x	✓	✓
Borrower level	✓	✓	x	✓	✓	✓	x	✓
<b>Type of assets included</b>								
Loans	✓	✓	x	✓	✓	✓	✓	✓
Debt securities	x	✓	x	x	✓	x	✓	✓
Financial guarantees (and other off-balance-sheet assets)	✓	✓	x	x	✓	x	✓	✓
Derivatives	x	✓	x	x	✓	x	✓	x
Other	✓	✓	x	x	✓	x	✓	✓
<b>Information included - Instrument</b>								
<b>Collateral-related</b>								
Type	x	x	x	x	✓	✓	x	✓
Amount	x	x	x	x	✓	✓	x	x
Other information	x	x	x	x	✓	x	x	x
<b>NPE-related</b>								
Status	✓	✓	x	✓	✓	✓	✓	✓
Time past due	✓	x	x	✓	✓	✓	✓	✓
Other information	x	x	x	x	✓	x	x	x
<b>Forbearance-related</b>								
Forbearance type	x	x	x	x	x	✓	x	✓
Date	x	x	x	x	x	x	x	✓
Past due	x	x	x	x	x	x	x	✓

	Cyprus	Germany	Greece	Ireland	Italy	Portugal	Slovenia	Spain
Other								
Loan-loss provisions	✓	✓	x	x	✓	x	✓	x
Write-offs	x	x	x	✓	✓	✓	x	✓
Information included - Borrower								
ID	✓	x	x	x	✓	✓	✓	✓
Country	✓	✓	x	✓	✓	x	✓	✓
Sector	✓	✓	x	✓	✓	x	✓	✓
Default status	✓	✓	x	✓	✓	x	✓	✓
Rating/PD	✓	x	x	x	x	x	✓	x
Taxes and social security	x	x	x	x	x	x	✓	x
Payments to utility companies	x	x	x	x	x	x	✓	✓
Information on connected borrowers	✓	x	x	x	✓	x	✓	✓
Trade credits	✓	x	x	x	✓	x	✓	✓
Credit scoring	x <sup>2</sup>	✓	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.

## Abbreviations

AMC	asset management company (in this report, this should be understood as a credit-acquiring firm)	ICAAP	Internal Capital Adequacy Assessment Process
AQR	asset quality review	IFRS	International Financial Reporting Standards
BdE	Banco de España	IMF	International Monetary Fund
BdI	Banca d'Italia	JST	Joint Supervisory Team
BdP	Banco de Portugal	KRIs	key risk indicators
BoG	Bank of Greece	LGD	loss given default
BoS	Bank of Slovenia	LLP	loan loss provision
BTL	buy-to-let	LSI	less significant institution
CBC	Central Bank of Cyprus	LTI	loan-to-income
CBI	Central Bank of Ireland	LTV	loan-to-value
CCR	central credit register	MIS	management information system
COREP	common reporting framework for capital adequacy information	MFI	monetary financial institution
CRD IV	Capital Requirements Directive IV	MoU	Memorandum of Understanding
CRE	commercial real estate	MRA	Master Restructuring Agreement
CRR	Capital Requirements Directive	NCA	national competent authority
dpd	days past due	NCB	national central bank
DTA	deferred tax asset	NFC	non-financial corporation
DTC	deferred tax credit	nGAAP	national GAAP
EBA	European Banking Authority	NPE	non-performing exposure
EBA ITS	EBA Implementing Technical Standards on supervisory reporting on forbearance and non-performing exposures	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)
EBIT	earnings before interest and tax	NPV	net present value
EBITDA	earnings before interest, tax, depreciation and amortisation	OBS	off balance sheet
EC	European Commission	PD	probability of default
ECB	European Central Bank	PDH	private dwelling house
ED	exposure at default	PE	performing exposure
ESM	European Stability Mechanism	RAS	risk assessment system
EU	European Union	RE	real estate
EWS	early warning system	ROE	return on equity
FINREP	reporting framework for financial information	RRE	residential real estate
FTE	full-time equivalent	SI	significant institution
GAAP	Generally Accepted Accounting Principles	SMEs	small and medium-sized enterprises
HFSF	Hellenic Financial Stability Fund	SPV	special-purpose vehicle
IAS	International Accounting Standards	SREP	Supervisory Review and Evaluation Process
IASB	International Accounting Standards Board	SSM	Single Supervisory Mechanism
		TAR	troubled asset review

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