EBRD SUPPORT FOR NON-PERFORMING LOAN RESOLUTION

"It is essential for both economic well-being and financial sector stability that financial regulators and banks take pre-emptive action to deal with non-performing loans."

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The EBRD has been leading policy dialogue on non-performing loan (NPL) resolution with banks and banking regulators in its regions since the global financial crisis. Under the NPL chapter of the Vienna Initiative, the Legal Transition Programme has developed NPL resolution strategies for banking regulators in Hungary and Serbia to improve banking sector resilience. Recently our work has expanded to include legal reforms aimed at activating private NPL markets. With credit risks rising, now is a good time to take stock of recent NPL management best practices in Europe and beyond, and to develop effective strategies to reduce the accumulation of future NPLs.[1]

BACKGROUND

NPLs are highly relevant for policymakers and have been in the spotlight for the last 15 years. NPLs occur when a borrower under a bank loan has defaulted by being overdue on principal or interest payments, or is unlikely to pay its credit obligations in full without recourse to actions such as the sale of any assets. There are divergences, however, in national definitions with respect to the period or timeframe when a defaulted loan qualifies as an NPL. In the EU, this period is usually 90 days from when the payment is past due.[2]

Further complexities arise with respect to NPLs owing to other relevant definitions. For instance, supervisory authorities refer to a broader definition of "non-performing exposures" (NPEs), introduced by the Basel Committee, to help supervisory authorities and banks adopt a consistent approach to monitoring and assessing banks' asset quality.

1 With special thanks to Eric Cloutier, Senior Adviser to the EBRD on the Vienna Initiative 2.0, Vassiliy Zenov, Partner, Dentons Kazakhstan LLP, Namgee Han, Secondee from KAMCO to the EBRD, and Natalia Pagkou, Legal Consultant, EBRD, for their comments and suggestions.

2 The 90 days past due definition is also the reference point for the IMF Financial Soundness Indicators, a set of key macro-financial indicators that assess the soundness of a country's financial system and are used by country authorities when reporting to the IMF.

3 See https://www.bis.org/bcbs/publ/d403.pdf for further details, (last accessed on 19 September 2023).

4 Maria Balgova, Michel Nies and Alexander Plekhanov (October 2016), "The Economic Impact of Reducing Non-Performing Loans", EBRD Working Paper No. 193. Available at: https://www.ebrd.com/publications/working-papers/economic-impact.html, (last accessed on 19 September 2023).

5 See, for instance, https://www.ecb.europa.eu/pub/economic-research/resbull/2020/html/ecb.rb200527~3fe177d27d.en.html#:~:text=The%20results%20underscore%20that%20NPL%20resolution%20is%20critical,percentage%20points%20lower%20than%20in%20countries%20that%20don%E2%80%99t, (last accessed on 19 September 2023).

The NPE definition includes 90 days past due but also considers factors, such as forbearance measures, that would return an NPL to performing status.[3] In addition, NPL specialists must contend with the prudential definition of "default" in the EU, which helps to ensure a sound identification of credit-impaired assets on bank balance sheets and enable banks to control risks and hold adequate capital, as well as the accounting definition of "impaired" (International Accounting Standard 39) for financial reporting purposes.

While the risk of non-performance is a part of every banking transaction, when those risks materialise and multiply, they can result in high volumes of NPLs in the banking sector. The consequences of high NPL volumes can then extend beyond the banking sector and have negative effects on the real economy. NPLs restrict the supply of fresh credit to businesses, reduce market confidence and slow economic growth.[4] Evidence suggests that countries experience deeper and more protracted recessions when they do not act to contain the level of NPLs in the banking sector.[5]

NPLs trigger losses, which undermine bank profitability. Therefore, regulators typically require banks to provision against losses. A bank will estimate an expected future loss on the loan in its accounts and will use its capital to absorb these losses. In high volumes in a single bank, NPLs can even endanger the solvency of that bank, posing a risk to the entire financial system. Consequently, it is essential for both economic well-being and financial sector stability that financial regulators and banks take pre-emptive action to deal with NPLs. This means ensuring that effective legal and regulatory tools are in place to enable – and in some cases require – banks to address the NPL cycle. As part of this exercise, national authorities and policymakers can benefit from strategic technical cooperation offered by the EBRD and partner international organisations to improve their NPL resolution frameworks and underlying processes for managing NPLs.

WHY ARE NON-PERFORMING LOANS NOT INCREASING GIVEN THE RECENT CHALLENGING ECONOMIC CONDITIONS?

Many analysts and commentators predicted a rise in NPLs (and insolvencies) in response to the major economic shock caused by the Covid-19 pandemic, which led to a 2.4 per cent contraction in output across the EBRD regions in 2020.[6] When this did not materialise immediately, there was an expectation that NPLs would increase in 2022. The war on Ukraine led to a surge in energy and food prices, driving inflation into the double digits for 80% of the economies where the EBRD invests.[7] However, NPLs have remained low and the banking sector in many EBRD and European economies has proved to be largely resilient in the face of these challenges, with stronger capital buffers and regulatory safety valves and more profitable and liquid banks than at the time of the 2009 global financial crisis. Another factor preventing an increase in NPLs has been the unprecedented levels of emergency government assistance and liquidity, as well as the legislative and non-legislative moratoria (standstill) on loan repayments provided to businesses and consumers during the pandemic.

While many of the Covid-19 emergency support measures have been phased out, they unquestionably kept a number of weaker businesses artificially alive for a period.[8] A 2022 survey by the EBRD LTP on NPL-related emergency measures introduced as a Covid-19 response in the EBRD regions revealed that 85 per cent of EBRD economies introduced temporary banking and tax related emergency measures to mitigate the negative impacts of the pandemic. Banking measures included capital injections, prohibitions on the payment of dividends to bank shareholders, grace periods for loan servicing for households and businesses (including full or partial relief from repaying loan principal), capitalisation of interest, prohibition on increasing interest rates, interest-rate subsidies and state credit guarantee programmes. Tax measures, on the other hand, covered temporary tax relief or reductions in personal and corporate income tax, in particular for micro, small and medium-sized enterprises, as well as the waiver of fines for late submission of tax declarations and late payment of taxes.[9]

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NON-PERFORMING LOANS ARE DECLINING IN MANY COUNTRIES

In Europe, NPLs have been on a downward trajectory since 2015, but credit risks are rising due to higher interest rates and a challenging business environment. In most countries where the EBRD invests, the stock of NPLs is low, with the notable exception of Ukraine, where the Russian invasion has wiped out the country's success in recent years in reducing NPL levels.[10] In the central, eastern and south-eastern Europe (CESEE) region, NPLs have continued to decline despite the Covid-19 crisis and the recent economic downturn. As of the third quarter of 2022, the average ratio of NPLs in the banking sector across the CESEE region, while higher than the EU average, was at a record low 2.5 per cent. Overall, this mirrors a decreasing trend in NPLs across Europe in the first half of 2022, which

6 EBRD regions include Central Asia, central Europe and the Baltic states, Greece, eastern Europe and the Caucasus, south-eastern Europe, the southern and eastern Mediterranean and Türkiye. See https://www.ebrd.com/where-we-are.html, (last accessed on 19 September 2023).

7 Regional Economic Prospects, EBRD, February 2023. According to this forecast, the average rate of inflation in the EBRD peaked at 17.5 per cent in October 2022 and dropped to 16.5 per cent in December 2022.

8 See https://2022.tr-ebrd.com/corporate-debt-and-business-dynamism/, (last accessed on 19 September 2023).

9 See https://npl.vienna-initiative.com/assets/Uploads/2022/NPL-Monitor-H1-2022-fv.pdf, (last accessed on 19 September 2023). Annex 3-2 NPLs – Covid-19 response in the EBRD regions. Not all of the 33 countries that introduced banking sector emergency measures introduced tax measures and vice versa.

10 A comprehensive assessment of asset quality in the Ukrainian banking sector will only be possible once hostilities cease and will be complicated by the level of destruction and damage to bank collateral. See page 11 of https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4327054. The Kyiv School of Economics has been assessing the level of Russian damage to the Ukrainian economy: https://kse.ua/about-the-school/news/zbitki-naneseni-infrastrukturi-ukrayini-v-hodi-viyni-skladayut-mayzhe-63-mlrd/, (last accessed on 19 September 2023).

the European Banking Authority (EBA) attributed in large part to NPL securitisations and asset disposals in its November 2022 Financial Stability Review.[11]

In some countries, the decrease in NPL ratios in recent years has been remarkable. In Serbia, NPL levels dropped from about 20 per cent of total bank assets to about 3 per cent from 2012 to 2022. In Greece, on the other hand, where NPLs reached systemic levels after the 2007-08 global financial crisis, the government-sponsored NPL securitisation scheme appeared to have yielded positive results. As of the second quarter of 2022, the Greek NPL ratio stood at 5.2 per cent, with the Bank of Greece reporting a 40 per cent reduction in the corporate NPL ratio between June 2018 and June 2022.[12]

Nonetheless, there is an expectation that new NPL flows will increase across some EBRD economies in 2023 and 2024. This is in line with the trend in the central and eastern European region in relation to the accounting classification of "Stage 2 loans", which rose by 0.95 per cent from 11.2 per cent in December 2021 to 12.15 per cent in December 2022.[13] According to the International Accounting Standards Board's International Financial Reporting Standard 9 on recognition and measurement of financial assets, these loans are not yet impaired (Stage 3) and are therefore not NPLs, but they are loans where the credit risk has increased significantly.[14] As interest rates remain high and economic uncertainties linger, there is an expectation that some of these Stage 2 loans will deteriorate further, becoming Stage 3 non-performing exposures.

> Despite increasing credit risks, many national banking regulators are better prepared to address and deter a rise in non-performing loans in the banking system than they were 10 years ago.

THE VIENNA INITIATIVE HAS CONTRIBUTED TO BETTER CRISIS PREPAREDNESS AND COUNTRIES ARE BETTER PREPARED THAN DURING THE GLOBAL FINANCIAL CRISIS

Despite increasing credit risks, many national banking regulators are better prepared to address and deter a rise in NPLs in the banking system than they were 10 years ago. The 2007-08 global financial crisis tested the resilience of financial institutions and the reactiveness of financial regulators across the world. It resulted in large levels of NPLs accumulating on banks' balance sheets over the following years, as borrowers struggled to fulfil their original repayment obligations and threatened bank solvency as well as the financial system at large. Many countries turned to the IMF for assistance and loans, as the crisis spread and access to the financial markets became restricted.[15] At the same time, many governments sought to safeguard their national banking systems by providing extensive liquidity measures to credit institutions. The global financial crisis and its aftermath had a severe impact on the regions where the EBRD invests and challenged the Bank's core mandate of fostering the transition to well-functioning market economies in its regions of operations.[16] However, it also galvanised regulators to action and boosted efforts to find both national and cross-border regulatory solutions.

11 See https://www.ecb.europa.eu/pub/financial-stability/fsr/html/ecb.fsr202211~6383d08c21.en.html#:~:text=The%20November%202022%20Financial%20Stability%20Review%20%28FSR%29%20sets,increased%20the%20risks%20to%20euro%20area%20financial%20stability, (last accessed on 19 September 2023). Based on a sample of 93 significant institutions. The ECB notes, however, that the default rates on credit risk exposures to Russia and Ukraine rose sharply in the first half of 2022, particularly in the second quarter.

12 See page 36 of https://npl.vienna-initiative.com/assets/Uploads/2022/NPL-Monitor-H2-2022-fv.pdf, (last accessed on 19 September 2023).

13 EBA Risk Dashboard 2022 Q4.

14 For more details see https://www.ifrs.org/issued-standards/list-of-standards/ifrs-9-financial-instruments/, (last accessed on 19 September 2023).

15 See https://www.imf.org/en/News/Articles/2015/09/28/04/53/sonew041511a, (last accessed on 19 September 2023). The first wave of countries seeking the IMF's assistance from 2008 to mid-2009 included EBRD economies Armenia, Belarus, Bosnia and Herzegovina, Georgia, Hungary, Latvia, Mongolia, Romania, Serbia and Ukraine (as well as non-EBRD countries Costa Rica, El Salvador, Guatemala, Iceland, Pakistan, Seychelles and Sri Lanka). The second wave of IMF financial assistance from late 2009 to 2011 extended to EBRD economies Greece, Kosovo, Macedonia and Moldova (as well as Angola, Antigua and Barbuda, Dominican Republic, Honduras, Iraq, Ireland, Jamaica and Maldives).

16 For further details on the EBRD's transition mandate, see the Agreement Establishing the European Bank for Reconstruction and Development dated 29 May 1990 https://www.ebrd.com/news/publications/institutional-documents/basic-documents-of-the-ebrd.html%20, (last accessed on 19 September 2023).

In response to the global financial crisis, the EBRD launched the Vienna Initiative, together with the European Commission, the European Central Bank (ECB), the European Investment Bank, the EU, the IMF and the World Bank to help coordinate regulatory decision-making in emerging Europe and prevent a systemic banking crisis. By 2011, with significant deleveraging across the banking sector, the Vienna Initiative 2.0 was established and expanded to support national regulators with the resolution of NPLs in the banking sector to protect the countries' economies and re-activate bank lending. At the end of 2014, a dedicated regional NPL initiative was created (as a subset of the broader Vienna Initiative 2.0), for the EBRD central and South-eastern Europe region. This initiative focused on resolving the high stock of NPLs in EBRD partner countries.[17] Vienna Initiative 2.0 activities relating to NPLs continue to be relevant today, with regulators in the EBRD CESEE region meeting periodically to exchange ideas and best practices and consult, sharing the latest NPL information on the EBRD Vienna Initiative website, including the NPL Monitor – a biannual publication of the NPL initiative.

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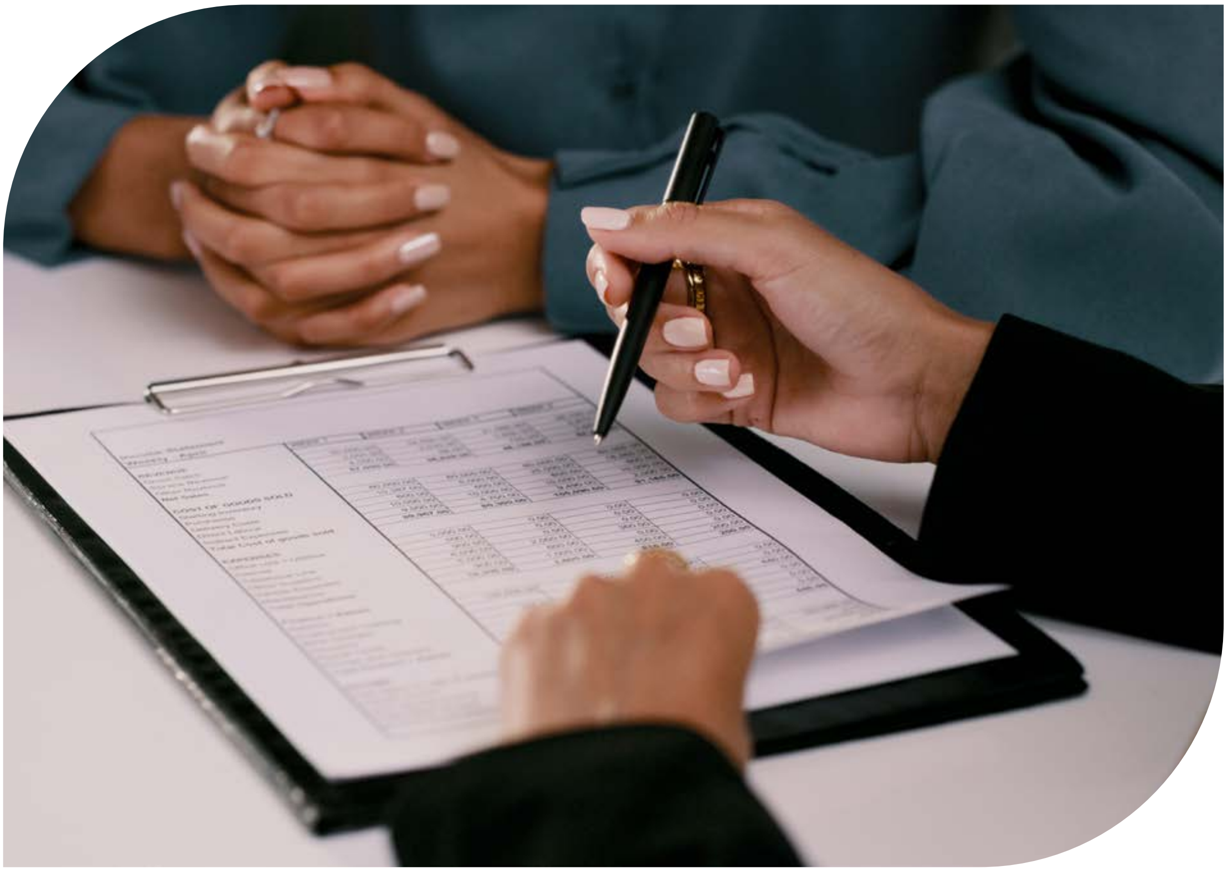
Following the global financial crisis, EU institutions have led a number of important legislative and regulatory initiatives in the NPL field. These have been a source of inspiration for national authorities in EU accession countries and beyond.

17 EBRD partner countries for the NPL Vienna Initiative 2.0 include Albania, Croatia, Hungary, Montenegro and Serbia.



THE 2017 EU NON-PERFORMING LOAN ACTION PLAN

In response to the threat to financial stability caused by NPLs in the EU, the European Council in 2017 approved an action plan to address the problem of accumulating NPLs in the banking sector. The plan outlined different policy actions to help reduce the stocks of NPLs and prevent their future emergence.

As part of this plan, the initial focus was on better understanding the scale of the NPL problem through the standardisation of bank financial reporting for comparability and supervisory assessment purposes. Regulatory scrutiny was on the accumulation of NPLs on banks' balance sheets, for which multiple priorities were set, including ensuring the existence of adequate data on NPLs, improving NPL provisioning and defining the supervisory expectations from banks with regard to NPL management and prevention. EU authorities also placed strong emphasis on the further development of the EU secondary market for NPLs. Following the approval of the 2017 EU NPL Action Plan:

1. The EBA developed voluntary NPL data templates for NPL sales to improve the standardisation of data in the EU and to facilitate the NPL transaction process.[18]
2. The ECB developed provisioning calendars to accelerate provisioning with respect to NPL stocks for banks under its supervision. It also introduced possible (Pillar 2) implications for non-compliance. This was then further standardised and expanded to all EU credit institutions, with a provisioning backstop (that is, a Pillar 1 mechanism) in the EU Capital Requirements Regulation and applicable to exposures originated from 17 April 2019 and subsequently becoming non-performing.[19]
3. Several EU policy and regulatory actions were introduced with the aim of improving the banks' management of NPLs and preventing a future NPL build-up. These included (in order of delivery): the ECB's *Guidance to banks on NPL management*,[20] the EBA's *Guidelines on the management of non-performing and forborne exposures*,[21] the EBA's *Guidelines on loan origination and monitoring*,[22] and additional NPL reporting and disclosure templates produced by the EBA.[23]

THE 2020 EU NON-PERFORMING LOAN ACTION PLAN

Another phase of NPL activity followed the pandemic. In December 2020 the European Commission published a new NPL action plan due to the Covid-19 crisis and expected rise in NPLs.[24] Under the 2020 EU NPL Action Plan:

1. In October 2022 the European Commission and members of its NPL Advisory Panel published a set of practical, non-binding guidelines on a best execution process for NPL sale transactions on secondary markets.[25] These guidelines aim to fill a gap in relevant market experience and knowledge.
2. The EBA produced new standardised and mandatory data templates, based on its previous (voluntary) 2018 templates. All EU credit institutions are now required to complete these templates and provide a certain minimum level of information to purchasers when selling NPLs.[26] It is not entirely clear how the use of templates will be monitored from a banking supervisory perspective. Furthermore, it remains to be seen to what extent the templates will encourage banks to improve ex ante their data collection systems from the point of origination and their loan documentation.

18 See https://npl.vienna-initiative.com/assets/Uploads/2020/334602ac2d/NPL-Monitor-2020-H2.pdf, (last accessed on 19 September 2023).

19 Regulation (EU) 2019/630 amending Regulation (EU) No 575/2013 for minimum loss coverage for non-performing exposures

20 See https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.cs.pdf, (last accessed on 19 September 2023).

21 See https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2425705/371ff4ba-d7db-4fa9-a3c7-231cb9c2a26a/Final%20Guidelines%20on%20management%20of%20non-performing%20and%20forborne%20exposures.pdf, (last accessed on 19 September 2023).

22 See https://www.eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-loan-origination-and-monitoring, (last accessed on 19 September 2023).

23 For example, the Commission Implementing Regulation (EU) 2021/637, in effect since 28 June 2021, includes requirements to disclose information on non-performing and forborne exposures, which apply to large and other listed institutions and thereby implement the disclosure requirements in Article 442 of Regulation (EU) No 575/2013. The guidelines on disclosure of non-performing and forborne exposures (EBA/GL/2018/10) apply only to listed small and non-complex institutions and to other institutions, that is, medium-sized institutions that are non-listed.

24 See https://npl.vienna-initiative.com/assets/Uploads/2021/5f15903737/npl_monitor_2021_h1.pdf, (last accessed on 19 September 2023).

25 See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2022:405:FULL&from=EN, (last accessed on 19 September 2023).

26 Final EBA draft ITS on NPL transaction data templates (EBA/ITS/2022/05), (last accessed on 19 September 2023).

In addition to these measures, the EU authorities published the 2021 Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers (the Credit Servicing Directive).[27] This represents yet another important EU innovation in the NPL field, with its focus on the professional management of NPLs. In its initial form, the proposal adopted by the European Commission in March 2018 proved quite controversial as it also included a so-called accelerated enforcement mechanism. The mechanism recognised the effectiveness of out-of-court enforcement and sale for NPLs where contractually agreed between commercial parties, but was unpopular with a number of EU member states. In its current and final form, the directive focuses on harmonising the secondary markets for NPLs (consumer and business) and improving professional standards concerning the management of NPLs. For instance, the directive establishes certain requirements across the EU regarding the sale of NPLs to non-EU credit institutions and the activities undertaken by so-called credit servicers, which will require a licence to carry out their activities. The definition of credit servicing activities in the directive is broad and includes debt collection activities involving the collection or recovery from the borrower, in accordance with national law, of any payments due related to a creditor's rights under a credit agreement or to the credit agreement itself. From previous studies in the consumer field, it is clear that there are gaps in the existing EU member state domestic legal and regulatory frameworks concerning the management of NPLs, including in the consumer sphere.[28]

In December 2020 the European Commission published a new non-performing loan action plan due to the Covid-19 crisis and expected rise in non-performing loans.

It is widely expected that the Credit Servicing Directive will result in consolidation of the existing (fragmented) credit servicing market as only larger, more professional service firms will be able to afford to make the changes needed to comply with the increasing regulatory requirements in the industry. The deadline for the transposition of the directive is set for 29 December 2023. However, as of April 2023, only France had taken steps to align its legal framework with the provisions of the directive. For a discussion on current trends and an interview with a leading NPL industry professional, see page 62.

More recently, the EBA has published a consultation paper for draft guidelines to assess the knowledge and experience of the management or administrative body of a NPL credit servicer. The final form of these guidelines is expected to be published by the end of 2023 and enter into force from early 2024. The guidelines would constitute an important step for the implementation of the requirements of the Credit Servicing Directive.

27 See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021L2167&from=EN, (last accessed on 19 September 2023).

28 See, for example, "Regulation of Abusive Debt Collection Practices in the EU Member States: An Empirical Account", C.-G. Stănescu, *Journal of Consumer Policy* (2021) 44:179–216. Available at: https://link.springer.com/article/10.1007/s10603-020-09476-8, (last accessed on 19 September 2023).

ONGOING CHALLENGES TO NON-PERFORMING LOAN RESOLUTION AND NON-PERFORMING LOAN RESOLUTION STRATEGIES

Banking regulators have a key role to play in setting NPL resolution strategies and ensuring that banks properly recognise their NPLs and provision for any potential losses. Nevertheless, while many national regulators seek to align with the standards proposed by the Basel Committee on Banking Supervision by the Bank for International Settlements, there is no universally accepted definition of NPLs or NPEs globally. Outside of the EU, the approach of different national regulators to various NPL-related matters can diverge greatly.

Since 2011, the EBRD's LTP has led several country-specific NPL diagnostics and strategies in conjunction with EBRD economists and policymakers. These projects have included the provision of advice and country legal, tax, financial and regulatory analysis to the Hungarian National Bank, the National Bank of Serbia and the Banking Regulation and Supervision Agency in Türkiye. Most recently, the EBRD has collaborated with the Agency for Regulation and Development of the Financial Market and the National Bank of the Republic of Kazakhstan (NBK) to develop a strategy and concept to create a market for distressed assets (see page 63).

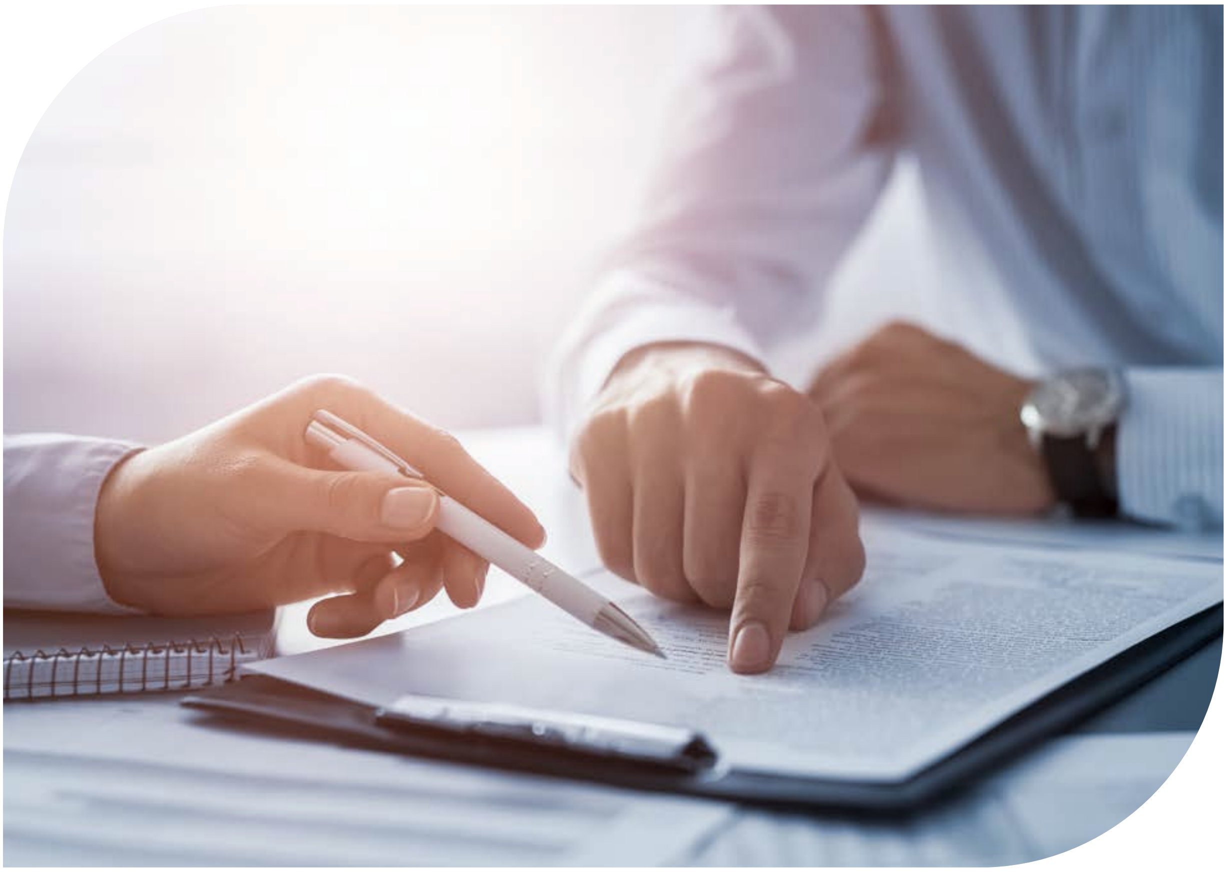
Many common ongoing challenges remain to the development of NPL markets across EBRD economies, notwithstanding national differences. Broadly, these can be grouped under two main categories. The first is *specific NPL resolution issues* – in other words, the various strategies available to an NPL holder or purchaser to resolve or work through its NPLs. These include restructuring, compromising or postponing the loan maturities and voluntarily selling any underlying secured asset, collecting or enforcing the loan (whether unsecured or secured) and, in some cases, where all the forgoing are unsuccessful or where it cannot otherwise be avoided, insolvency. In many emerging markets and jurisdictions, and even in the EU, an NPL holder wishing to implement a resolution strategy faces major limitations and costs. These include high procedural requirements, such as in-court

Since 2011, the EBRD's Legal Transition Programme has led several country-specific non-performing loan diagnostics and strategies in conjunction with EBRD economists and policymakers.

enforcement and mandatory public auction sale (especially for immovables such as land), advisory and long court processes for both enforcement and insolvency.[29]

The second category of challenges focuses on *NPL market development issues*, which determine the level of access and opportunities available to both a potential NPL seller, such as a bank, and an NPL purchaser or investor. These include matters such as market size and the potential volumes needed to attract professional investors, information quality and the availability of the necessary data for an investor to invest and/or to avoid a substantial discount, and macroeconomic factors such as the stability of the currency that have an impact on investor appetite. Moreover, the development of the NPL market depends on legislation and regulations, which often restrict the type of entity that may acquire a loan. It is common for NPLs to be transferable only to other domestically licensed banks, especially in the consumer sphere. In new NPL markets, there is always an additional level of uncertainty and unpredictability for an NPL investor. This can be exacerbated by the relative lack of local experience – for instance, in the local credit servicing industry. The right regulatory approach and market signals from regulators and targeted legal reforms can overcome some of these obstacles, however, providing opportunities for the international

29 See, for example, the EBA report on the benchmarking of national loan enforcement frameworks: https://bit.ly/3LhPDoz , (last accessed on 19 September 2023).



> While the focus may have shifted to prevention rather than cure, support for the management of non-performing loans across the EBRD regions remains an important policy goal for the Bank.

or regional investor. Furthermore, there is potential for the development of digital, cross-border solutions, including electronic platforms for the sale of distressed loans and related assets. Coupled with standardised information on NPLs, these may increase transparency for investors and, hopefully, investor participation.

While the focus may have shifted to prevention rather than cure, support for the management of NPLs across the EBRD regions remains an important policy goal for the Bank. The Vienna Initiative continues to be an active forum for regulators to convene and exchange information. This was the case in the 2020 regulatory response to the coronavirus and may be the case again, as credit risks materialise and NPLs follow their inevitable, cyclical increase. In this context, it is positive to note that the level of awareness and thinking on potential NPL solutions is high. There have been many new standards and ideas, including those emanating from regulators and national governments, such as Greece and Italy, in the EU. National regulators in the EBRD regions can consider and evaluate these different initiatives, as part of developing their own tailored approach and country strategy for the resolution and sale of NPLs.

Interview with Eric Cloutier, Partner, KPMG and Senior Adviser to the EBRD Vienna Initiative by Dejan Vasiljev, Acting Director, Financial Sector Policy, Capital and Financial Markets Development, EBRD

Eric, what do you think are the most important current policy trends in NPL resolution?

The most relevant policy trends are, at least in the EU, around further improving and standardising the existing rules for sound NPL transactions, including rules related to credit purchasing and servicing, NPL data and NPL securitisation. There has also been a lot of discussion within the EU on harmonising the enforcement regimes and insolvency laws of different member states, but this will likely take time. We can also observe a very rapid evolution of policies around ESG themes, with increasing consideration of climate risks in NPL portfolio assessments and investment decisions. There is also a concern to ensure that NPL resolution is socially responsible. Further regulating the use of blockchain and crypto in the financial service industry is also relevant for advances in NPL transactions and securitisation. And artificial intelligence (AI) is very topical for credit management and NPL resolution – we can anticipate that AI policy discussions will develop in the coming years.

How are advisory firms like KPMG supporting clients on NPL matters?

Overall, firms like KPMG are providing a wide range of services to support their clients on NPL matters, helping them to navigate the complex and rapidly evolving landscape of distressed debt transactions and resolution. We provide advice on regulatory and compliance matters related to NPLs, as well as helping clients implement best practices for credit risks and NPL management. One of the key areas where KPMG operates is as a “sell” and “buy side” adviser to banks and investors, providing support on due diligence and loan portfolios structuring strategies. We also provide advisory services on NPL portfolio management, helping clients to develop strategies for managing their NPLs, including restructuring and workout plans, loan sales and securitisation. As a large advisory firm, KPMG has its own data management technology and data analytics to support NPL transactions and loan management.

How do NPL management standards compare with leading markets outside the EU, for example, North America and Asia?

While there are many similarities, I would say that the EU has a more structured and comprehensive framework for NPL management. In other markets, the approach is more decentralised and varies by country or regulator. This is partly due to how the EU, with its 27 countries, is structured, and the need to ensure harmonisation of rules and practices across member states. Over the last few years, significant progress has been made by EU regulators and supervisors in setting clear regulatory expectations with regard to how banks manage their credit risks and NPLs and close monitoring of bank compliance. We are also seeing an evolution in the regulatory approach within the EU to standardise credit purchasing and servicing. In my view, the EU is now leading on NPL policymaking globally and, consequently, we see a lot of interest from other countries to learn from what are considered as “EU best practices”.

How important will technology be for future NPL markets?

Technology is very important for the future of the NPL markets, and we have already witnessed fundamental changes in recent years. Looking forward, we can expect that the use of technology will further drive innovation, reduce costs, increase efficiency and improve the overall quality of NPL portfolio management. As technology continues to evolve, including with the broader and more mainstream use of AI and machine learning, we can only anticipate further (and significant) streamlining and automation across all aspects of NPL management and transactions. There has been a substantial growth in advanced analytics tools for portfolio assessment, data remediation, pricing and investment decisions. While not new, the role of online NPL marketplaces and platforms is likely to continue to increase, as new tools become available. However, due to the high level of tailoring needed during a live transaction, I expect that human involvement in the deals will remain necessary for some time.

What do you see happening at the EU level over the next few years?

In the next few years, we can expect continued innovation in NPL management and transaction practices, driven by technology and regulatory changes. However, the pace of the changes depends on the volume of new NPL flows. The lagging effects of the pandemic and the current macroeconomic and geopolitical environment are still yet to translate into more NPLs, and NPL levels have stabilised at a low NPL ratio of 1.8 per cent in the EU (EBA Risk Dashboard Q4 2022). Regulators are warning of residual risks related to the end of over a decade of very low interest rates – this makes a deterioration in asset quality and a rise in NPLs still likely. The evolution and duration of the war in Ukraine will also have an impact on the NPL environment. Only time will tell, but we can expect that the EU banking regulators and supervisors will continue to monitor the situation closely to avoid any new accumulation of NPLs in the European banking system. As a minimum, the ongoing regulatory activities related to NPLs will continue, including the implementation of the requirements of the European Commission Credit Servicing Directive on NPLs and the EBA NPL templates.[30] We also expect a broad range of new regulatory initiatives in response to technological innovations and ESG, as discussed previously, which will shape the future of NPL markets.

30 Directive (EU) 2021/2167 of the European Parliament and of the Council of 24 November 2021 on credit servicers and credit purchasers and amending Directives 2008/48/EC and 2014/17/EU, (last accessed on 19 September 2023).

Developing the distressed assets market in Kazakhstan

In October 2020 the Agency for Regulation and Development of the Financial Market of the Republic of Kazakhstan (the Agency) and the NBK requested the EBRD's assistance in promoting the sale and transfer of distressed assets in Kazakhstan to private investors. The first phase of the project, funded by the EBRD's Special Shareholder Fund and the NBK, resulted in a legal, financial and regulatory analysis of the NPL landscape in Kazakhstan, benchmarked against EU best practices, and recommendations for opening the NPL market to domestic and international investors. In particular, the most important and urgent recommendations were to (1) expand the list of buyers that are authorised to purchase impaired loans in Kazakhstan and (2) establish a new regulated entity, and associated legal concept, of "credit servicer". These recommendations were reflected in the law On Amendments and Additions to Certain Legislative Acts of the Republic of Kazakhstan on the Development of the Market of Distressed Assets No. 133-VII, which was adopted by the government in July 2022 and came into effect in September 2022. The EBRD then followed up with further technical cooperation to the Agency and the NBK to support the alignment of the Agency's regulations with ECB guidance to banks on the management of NPLs.

In January 2022 the president of Kazakhstan ordered the creation of a secondary market for banks' distressed assets and tasked the Agency and the government with the establishment of a digital platform and the necessary infrastructure for the online sale of distressed assets. In response, the EBRD team began to develop a model for an electronic platform to sell NPLs and foreclosed assets and to stimulate the development of the private NPL sales market. The EBRD is finalising this model, tailored to the requirements of the Kazakh market. As part of this exercise, the working team led by the EBRD has developed data templates, aligned with the NPL data templates recently mandated by the EBA but with mandatory fields suitable for the Kazakh banking sector. It is expected that these data templates will be used, subject to some specific exceptions, for the sale of all impaired loans and foreclosed assets by Kazakh banks via the digital platform. The use of such data templates will improve the availability of information and the transparency of sales in Kazakhstan for potential investors.