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

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

13 December | Book Launch | Virtual
Book Overview

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

2. Empirical Analyses of the Macrofinancial Implications of Nonperforming Loans in Asia and Europe

3. Country Case Studies on Nonperforming Loan Resolution in Asia and Europe

4. Policy Strategies for Nonperforming Loan Resolution and Market Development in Asia and Europe
Asia and Europe went through NPL surges in the last two decades

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

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

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

Note: data for Ireland and Cyprus available from 2000 and 2008 only.
Source: IMF, ECB.
High NPLs can impair banking sector stability and its ability to financially intermediate

- Chapter 3: Harmful macrofinancial implications of NPLs across Asian economies.
- Chapter 4: Increases in NPL ratios depress bank lending in the euro area, widen bank lending spreads, and lead to a fall in GDP growth and residential real estate prices.

Considerable economic benefits of dealing swiftly with elevated NPL levels, especially for bank-based financial systems such as in Asia and Europe

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

Source: Chapter 3.
NPL resolution is often hampered by multiple impediments

**Supply Side**
- First mover disadvantage
- Unwillingness to realize losses
- Accounting recognition of cost of recovery
- Bans/restrictions on loan sales
- Lack of expertise in asset management and asset valuation

**Demand Side**
- Information asymmetries
- Barriers to investor entry
- Imperfect excludability: creditors compete with each other

**Structural & Legal Issues**
- Weak and unpredictable insolvency frameworks
- Opaque and lengthy collateral enforcement
- Lack of debt enforcement capacity
Elements of a comprehensive approach to NPL resolution

- **Internal workout**: workout by originating bank; includes various restructuring options
- **Asset protection scheme**: risk-sharing agreement to limit further losses, usually state-backed; usually short horizon; potential losses large but with low probability
- **Securitization and synthetic securitization**: an alternative to outright sale; partial risk transfer only; possibly with co-investment by the state
- **Asset management company**: complete separation of asset from originating bank, often state-backed; usually long horizon; large losses typically already realized
- **Direct sale**: assets sold directly to investors, where sufficiently liquid markets exist

Source: Chapter 7.
Different problems require different solutions

Resolution methods and characteristics of NPL problems

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

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<tr>
<th>Nature of shock</th>
<th>APS</th>
<th>Public AMCs</th>
<th>Securitization</th>
<th>Direct Sales</th>
<th>Debt Restructure</th>
<th>Out-of-Court Workout</th>
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Note: AMC = asset management company, APS = asset protection scheme. Source: Chapter 8.
Success factors for systemic AMCs

- Strong track record for some asset classes – if properly designed and managed
- Normally don’t require large start-up costs; publicly owned AMCs are, however, (contingent) liabilities for the public sector
- Asset transfers to AMCs should be informed by diagnostic exercises, ideally both an Asset Quality Review as well as a stress test.
- Such exercises are important to determine the appropriate transfer price and the scope of assets to be transferred
- Finding the optimal scale and scope of assets is important. Economies of scale to be weighed against complexity.
- Operational independence and professional management improve business results.
- Differing views between many Asian and European economies on whether AMCs should be permanent or temporary entities
Bid-ask spreads can be significant

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

Notes: For Cambodia and Kazakhstan, only the total NPV loss is reported.
Source: Chapter 8.
Multi-pronged strategy needed to unlock potential of NPL markets

A strategic framework to develop NPL markets

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

Note: AMC = asset management company, CRC = corporate restructuring company, CRV = corporate restructuring vehicle.
Source: Chapter 8.
Key take-aways

✓ Context-specific, bespoke combinations of resolution approaches are the best way forward

✓ Identify and realistically assess the NPL problem early on

✓ Boost capacity to deal with NPL problem

✓ Address obstacles to NPL market development

✓ Reform legal frameworks – ideally proactively before NPL problems build up
Thank you!

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