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# Breaking the back of NPLs – the Romanian experience

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Deputy Governor

# I. Current state of the Romanian banking sector

## Size

- Number of banks: 37
  - of which 8 branches of foreign banks
- Bank intermediation level:
  - Loans to domestic private sector: 29% of GDP (38% of GDP in 2008)
  - Net assets: 51.7% of GDP (61% of GDP in 2008)

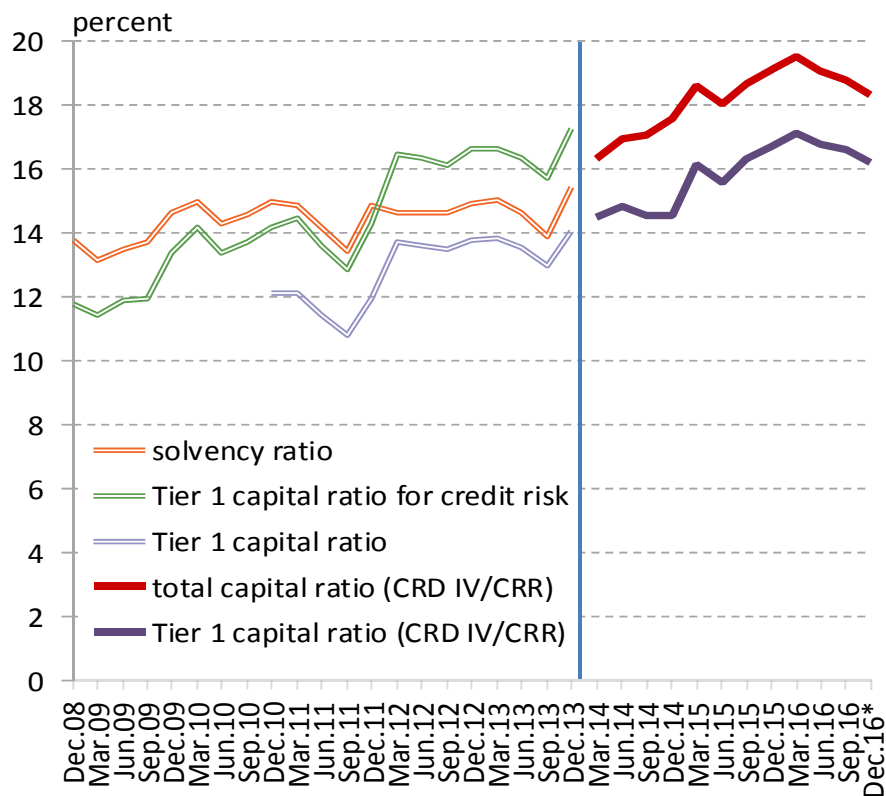
## Capital and risk indicators

- Adequate capital (both quantity and quality):
  - Total capital ratio: 18.3%
  - Tier 1 ratio: 16.2%
  - Common Tier 1 ratio: 16.2%
- Strong liquidity: Loan-to-Deposit ratio of 80%
- Lower NPL ratio (EBA definition): 9.5% in December 2016, from 21.5% in September 2014)

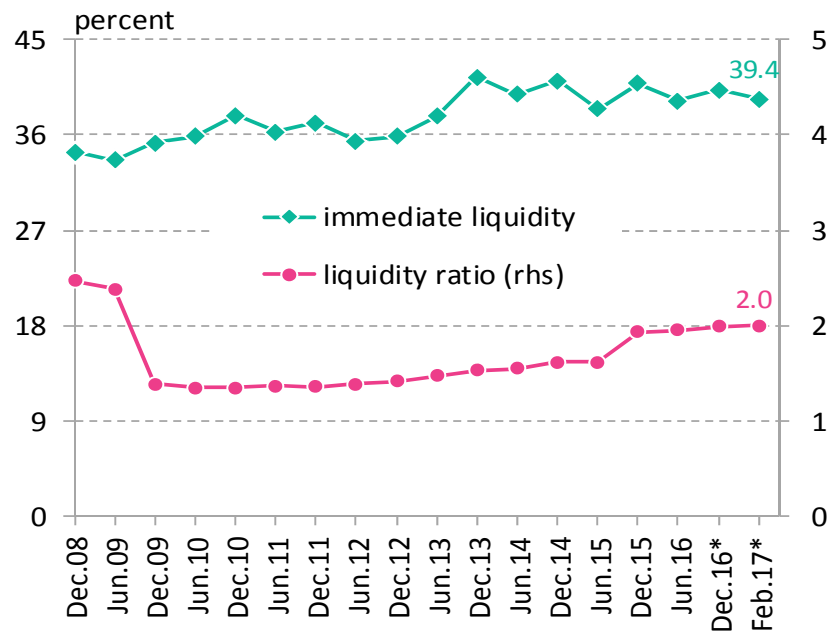
# Banking sector is well capitalized

## Analysis Ratios for the Banking System

### Capital adequacy indicators



### Liquidity indicators



**Immediate liquidity** = (cash, demand deposits and time deposits with banks+ unpledged government securities)/ Total liabilities (prudent level > 30%)

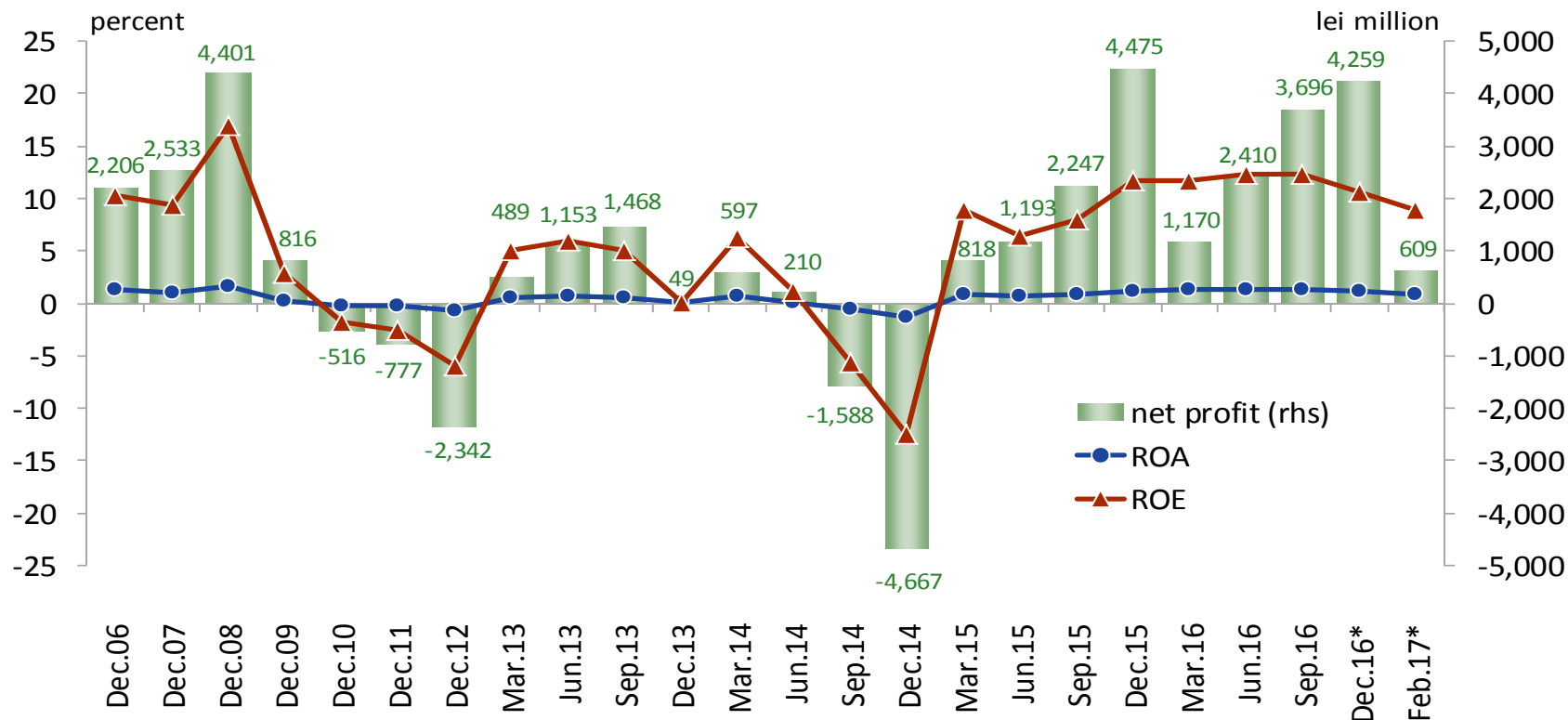
**Liquidity ratio** = effective liquidity/required liquidity (regulated threshold = 1)

\*) indicators are calculated based on data in prudential reports, prior to submission of audited annual accounts

Source: National Bank of Romania

# Profitability of the banking sector consolidated in 2016

## Banking System Profitability



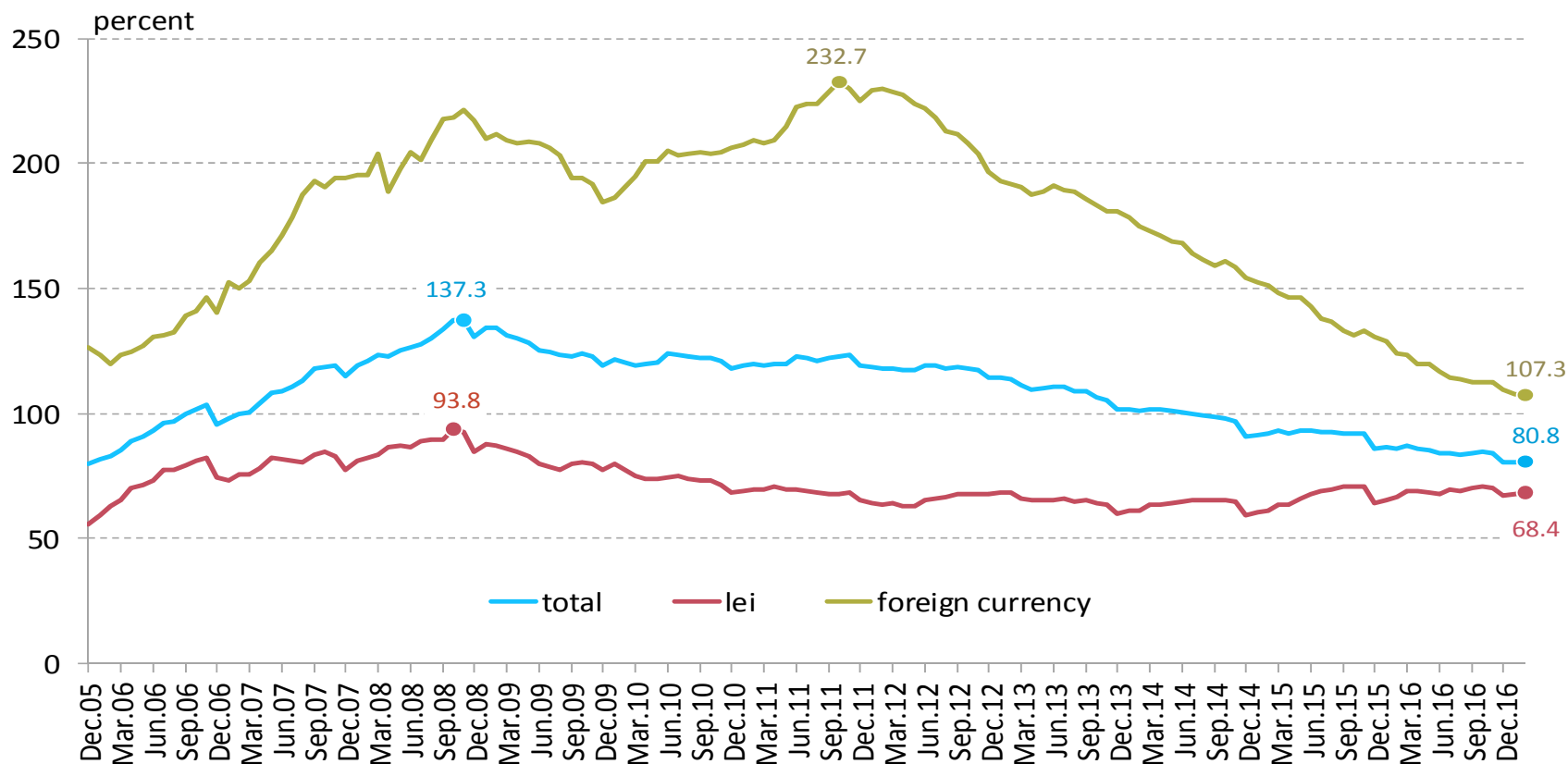
\*) indicators are calculated based on data in prudential reports, prior to submission of audited annual accounts

Note: Starting January 1, 2012, Romanian credit institutions apply the IFRS for accounting purposes.

Source: National Bank of Romania

# Sustainable LTD ratio

## Loan-to-Deposit Ratio\*

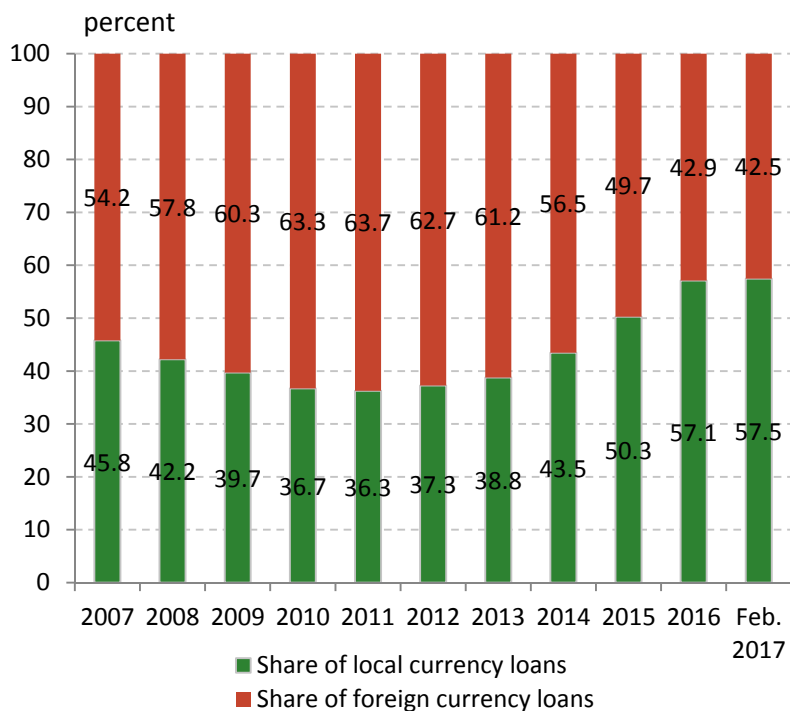


\*) based on data in the monetary balance sheet

Source: National Bank of Romania

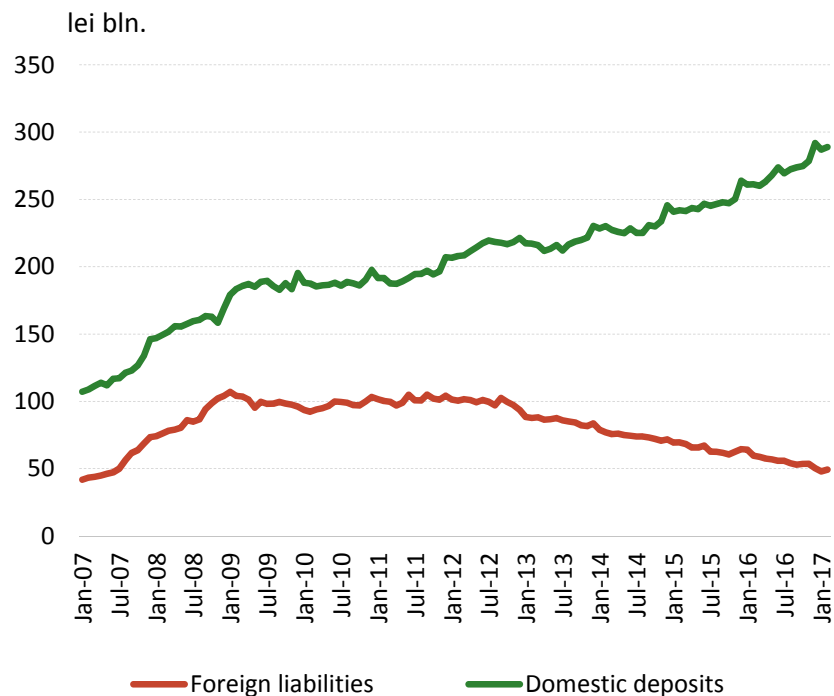
# Lower contagion risk

## Structure of banks' credit portfolios by currency (end of year)



Source: NBR

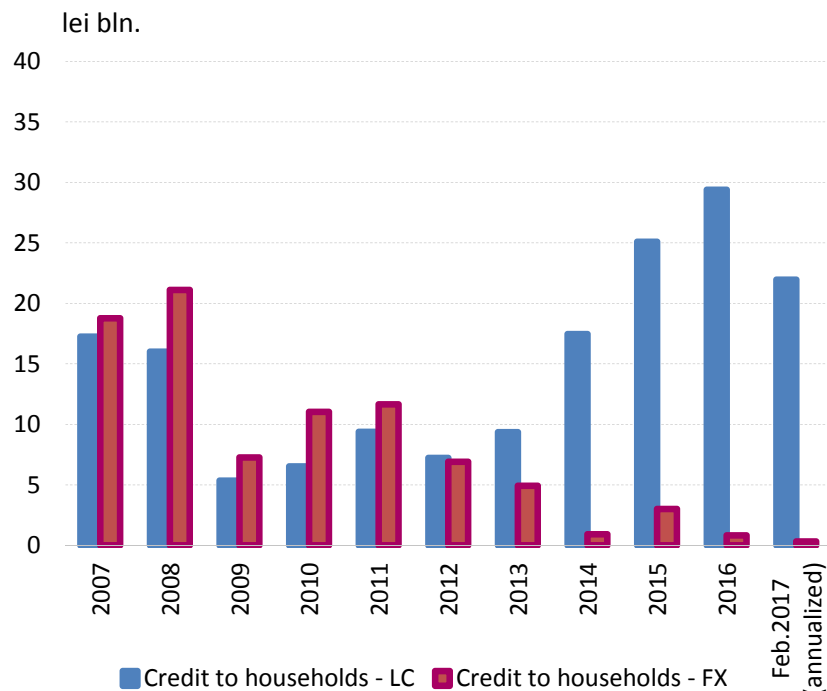
## Banks' funding (annual change)



Source: NBR

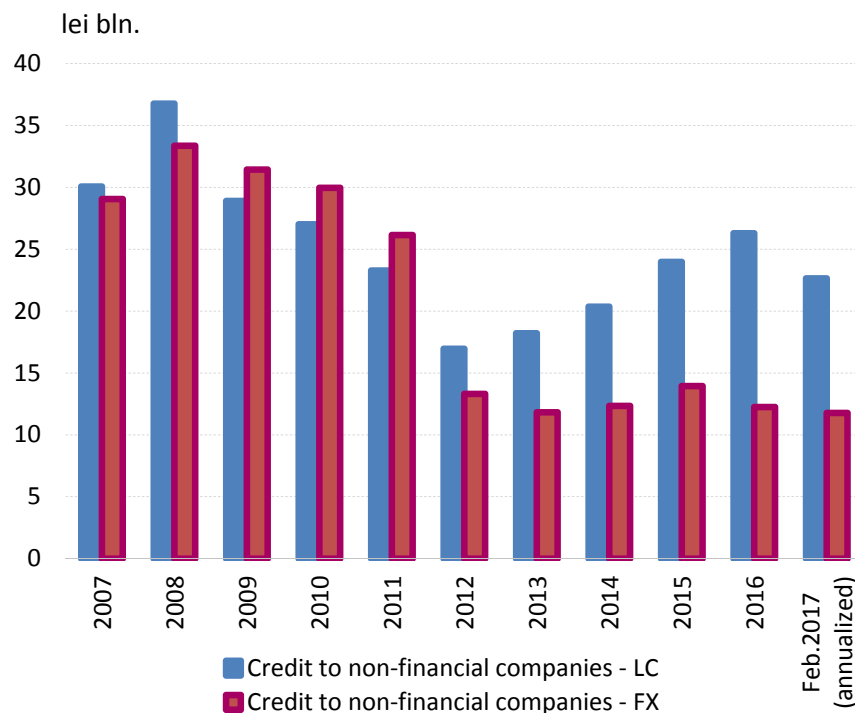
# Lending in local currency has accelerated

## New loans to households, by currency



Source: NBR

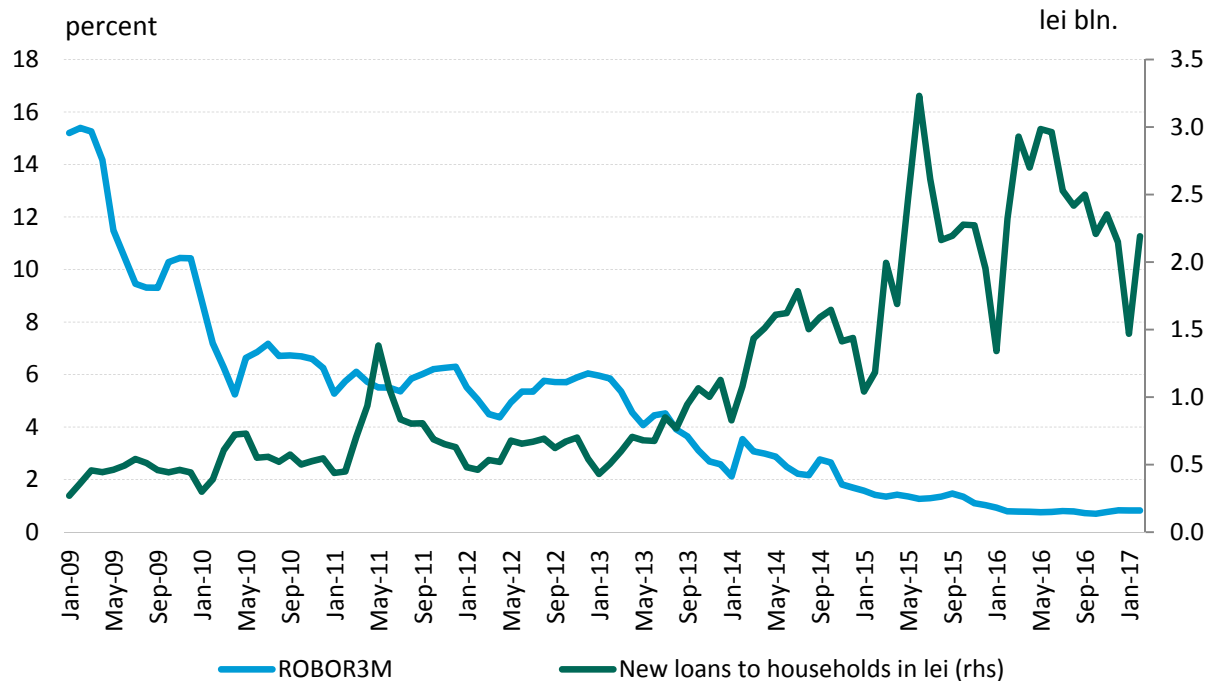
## New loans to non-financial companies, by currency



Source: NBR

# Lower interest rates has stimulated lending in local currency

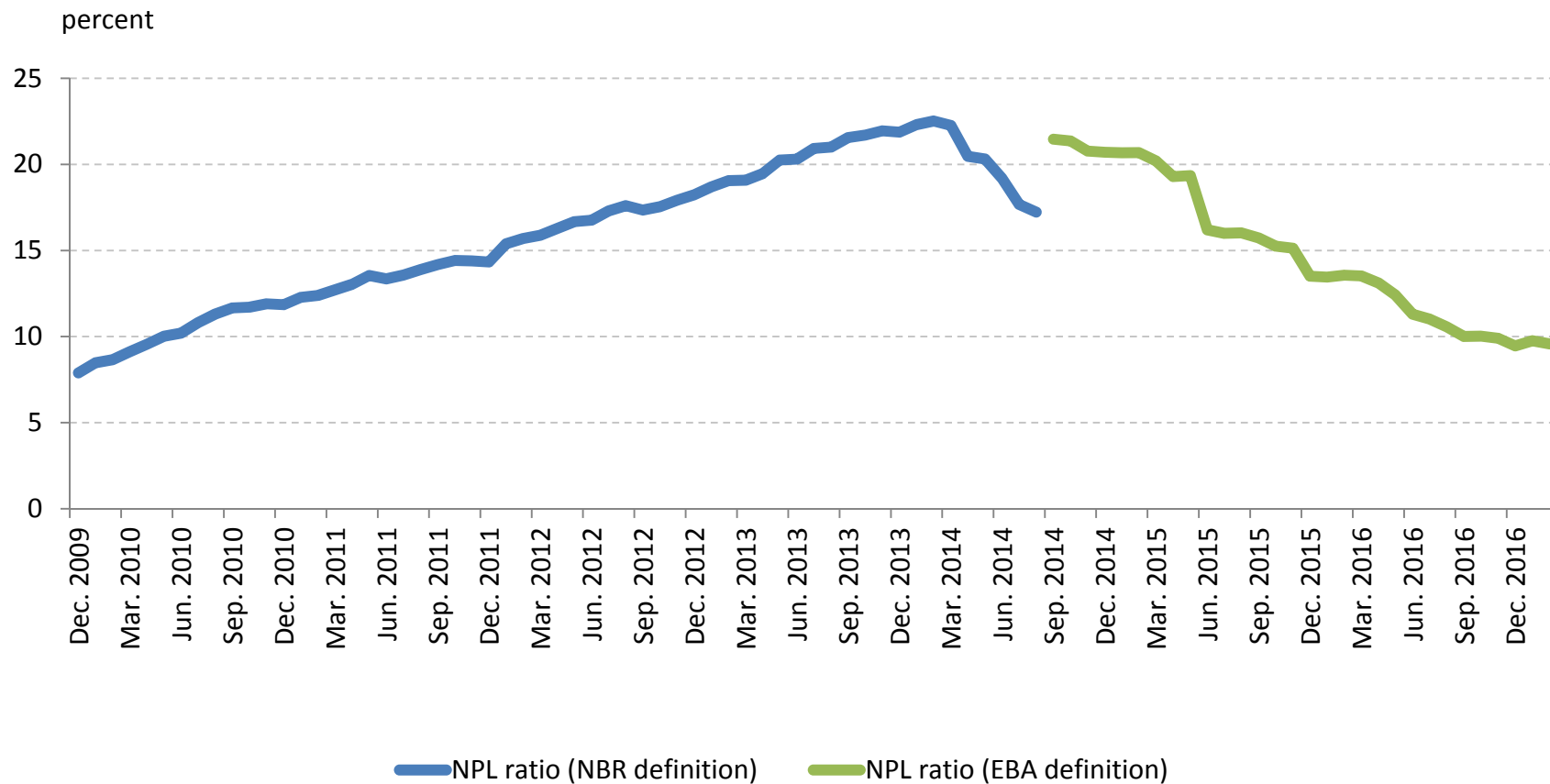
## Money market interest rate and credit growth in local currency



Source: NBR

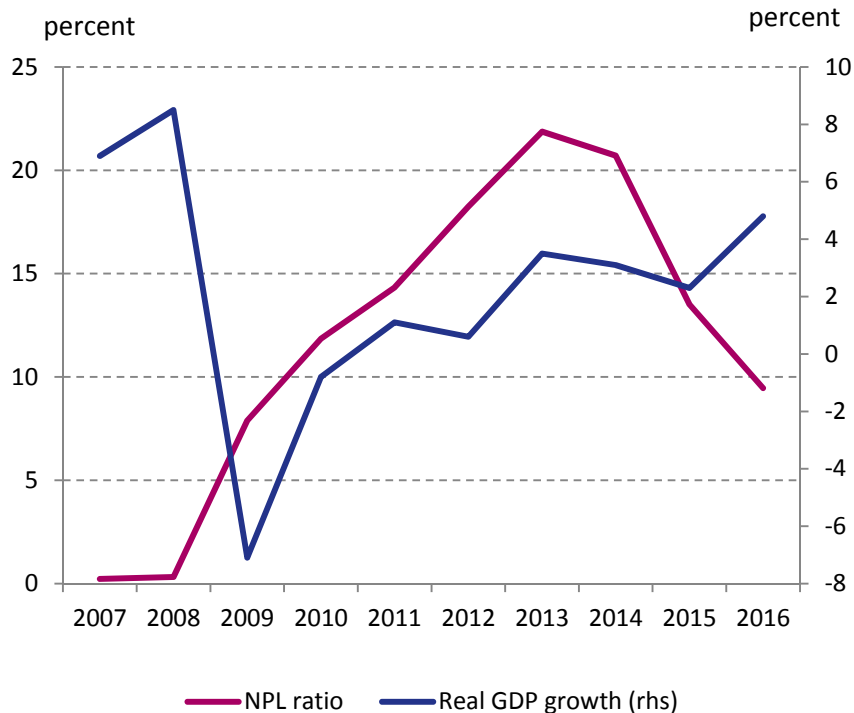


## II. The rise and fall of NPLs



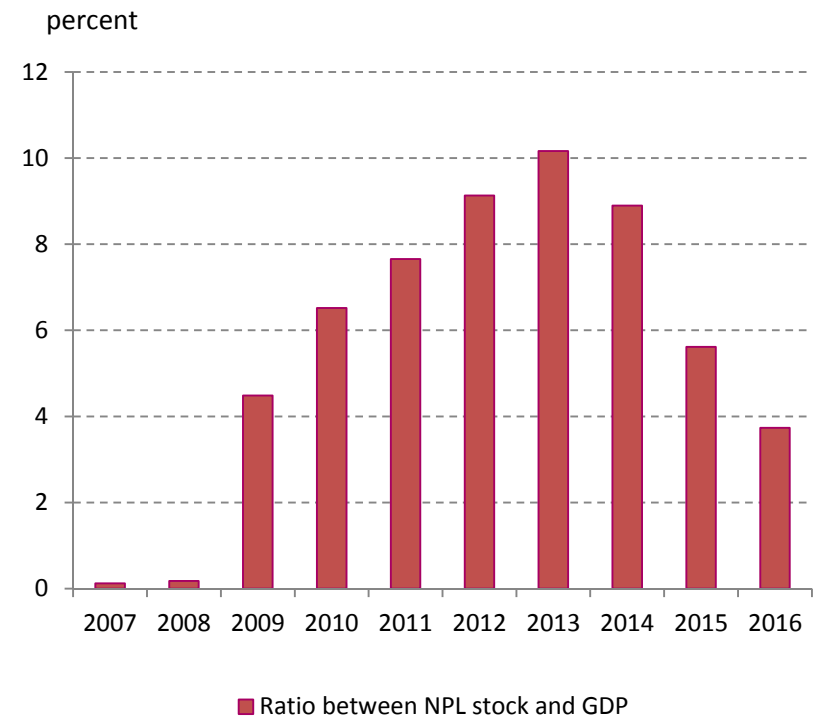
# NPLs and GDP: negative correlation

## NPL ratio and GDP growth



Source: NBR, NIS

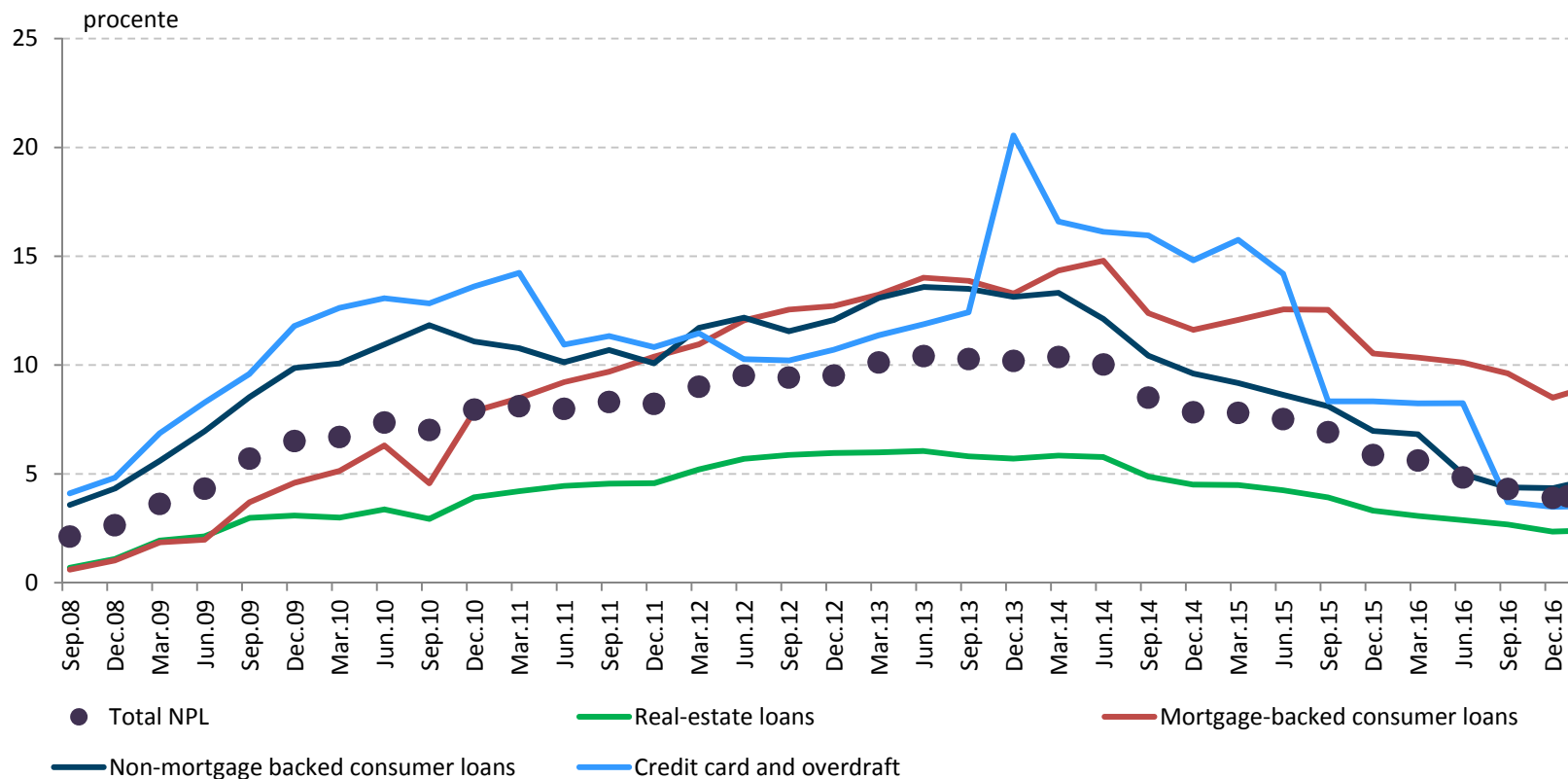
## NPL stock-to-GDP ratio



Source: NBR, NIS

# Households are more resilient

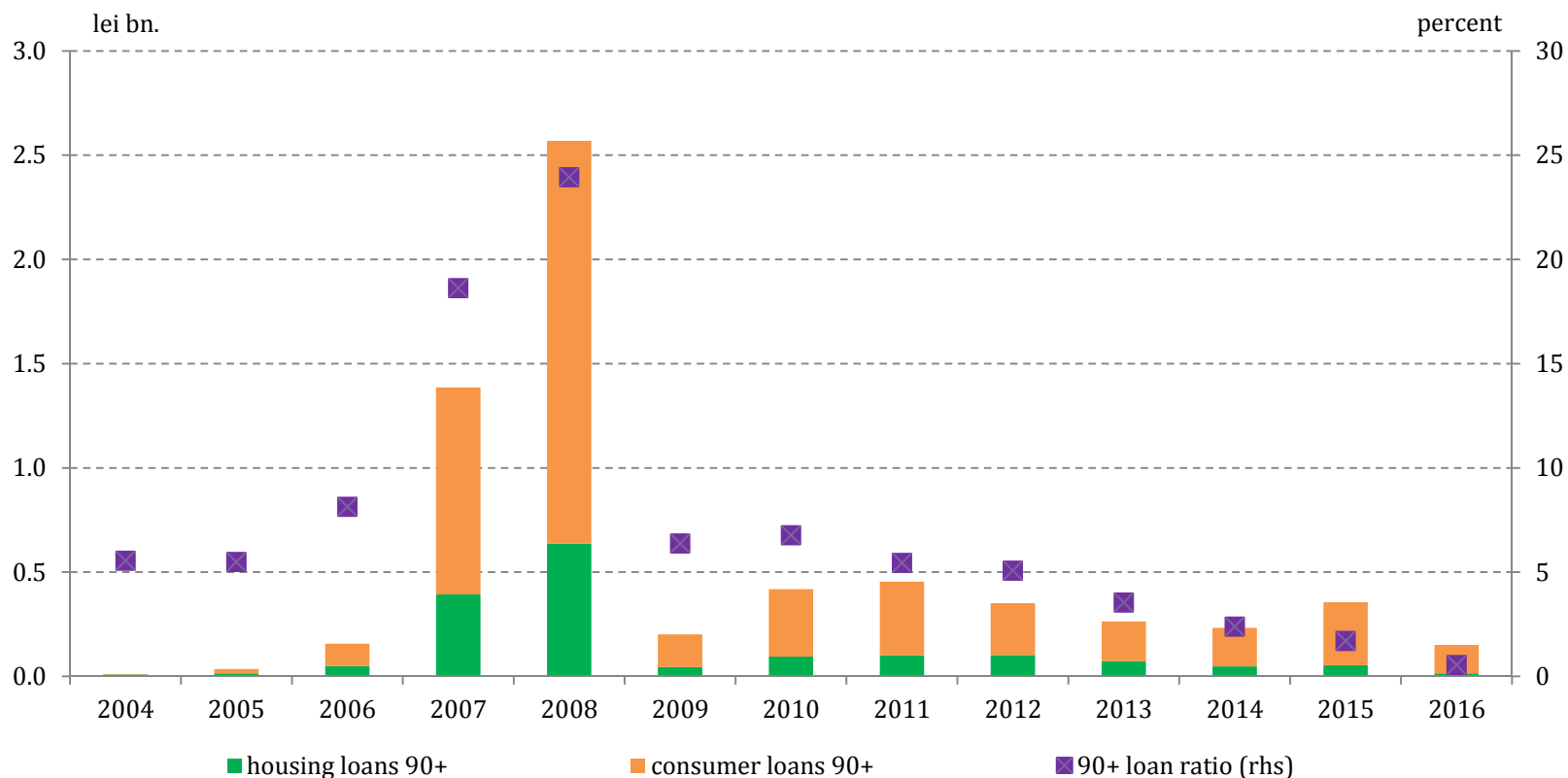
## NPL ratio for households



Source: NBR, Credit Bureau

# Majority of NPLs were granted in 2007 - 2008

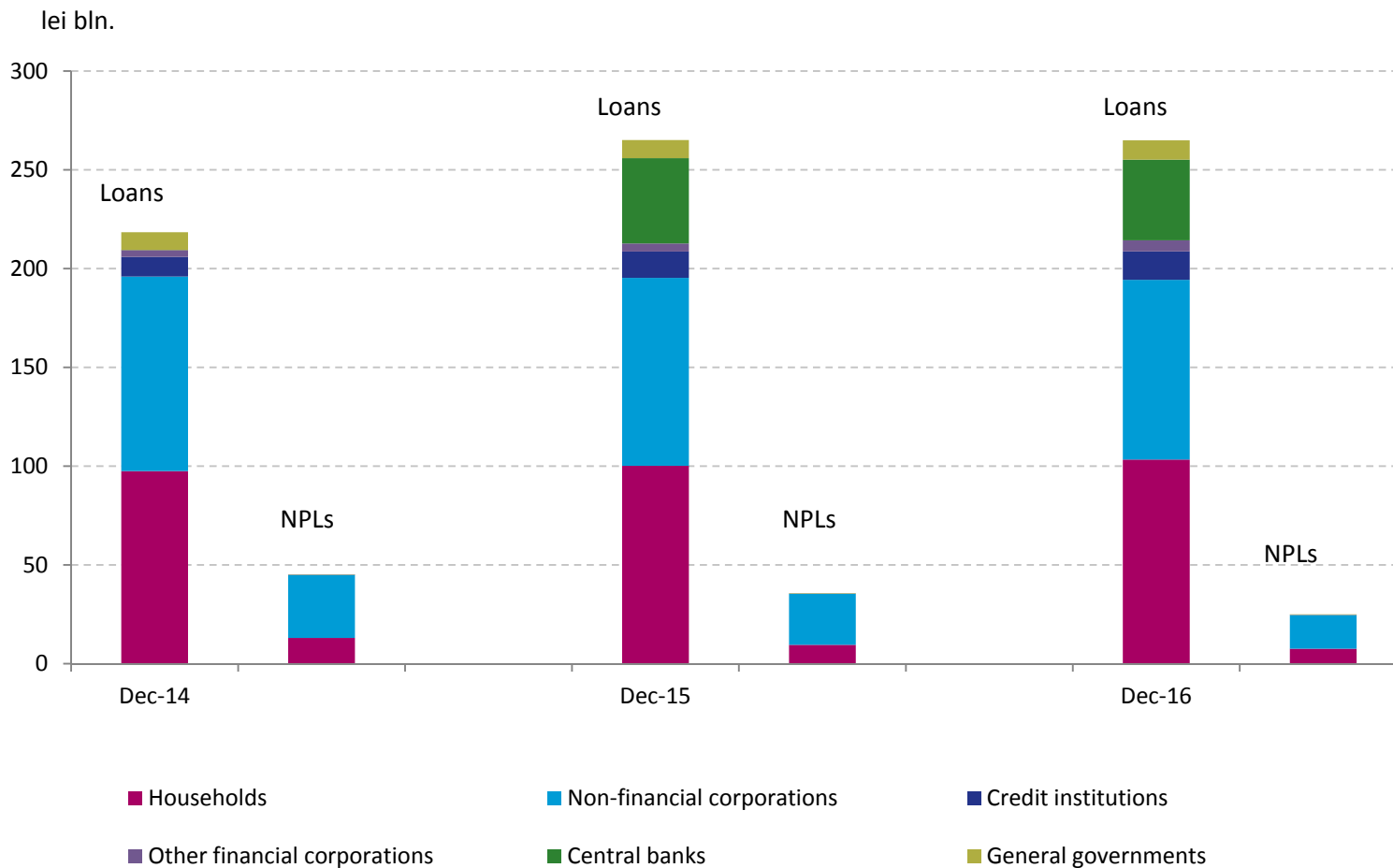
**NPLs for households by originating year and type of loan  
(December 2016)**



Source: NBR, Credit Bureau

# Non-financial firms have the majority of NPLs

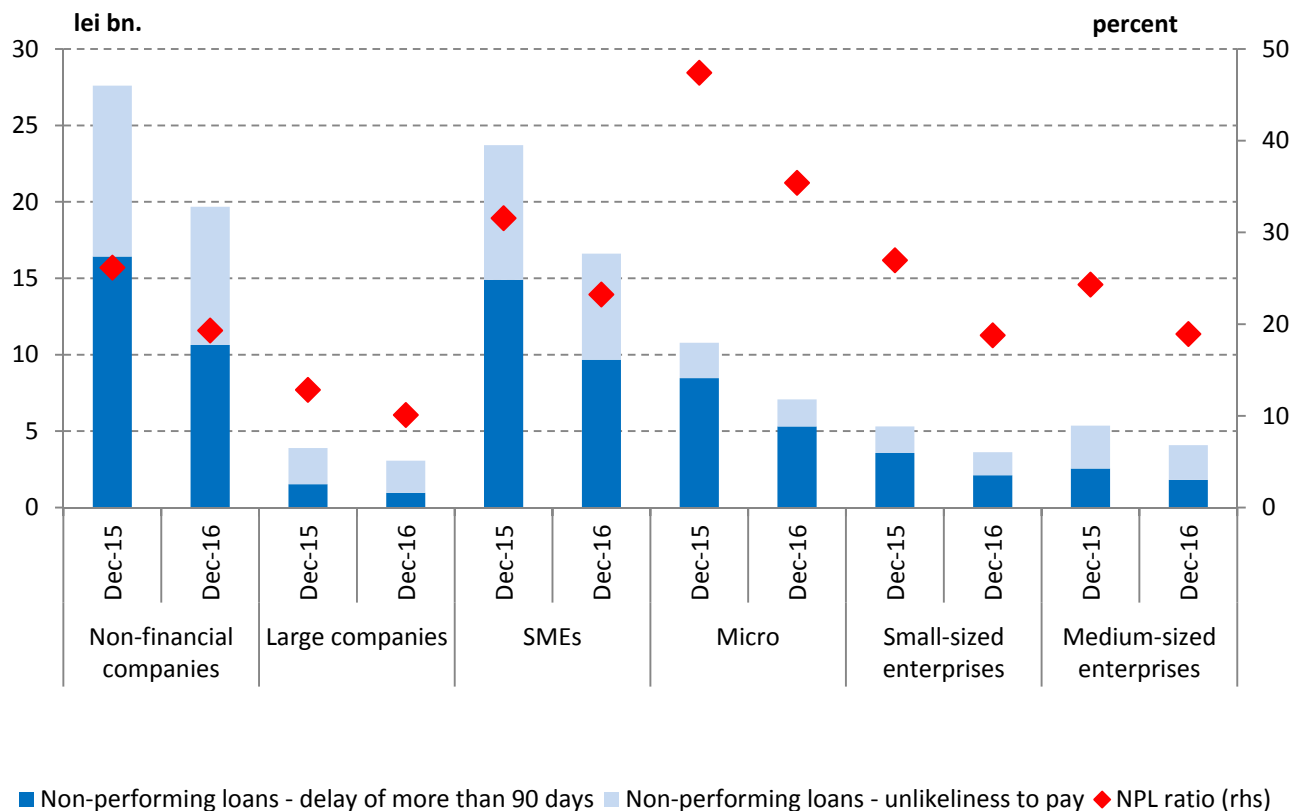
## Structure of total loans and NPLs by sector



Source: NBR

# NPL ratio is higher for small and medium enterprises

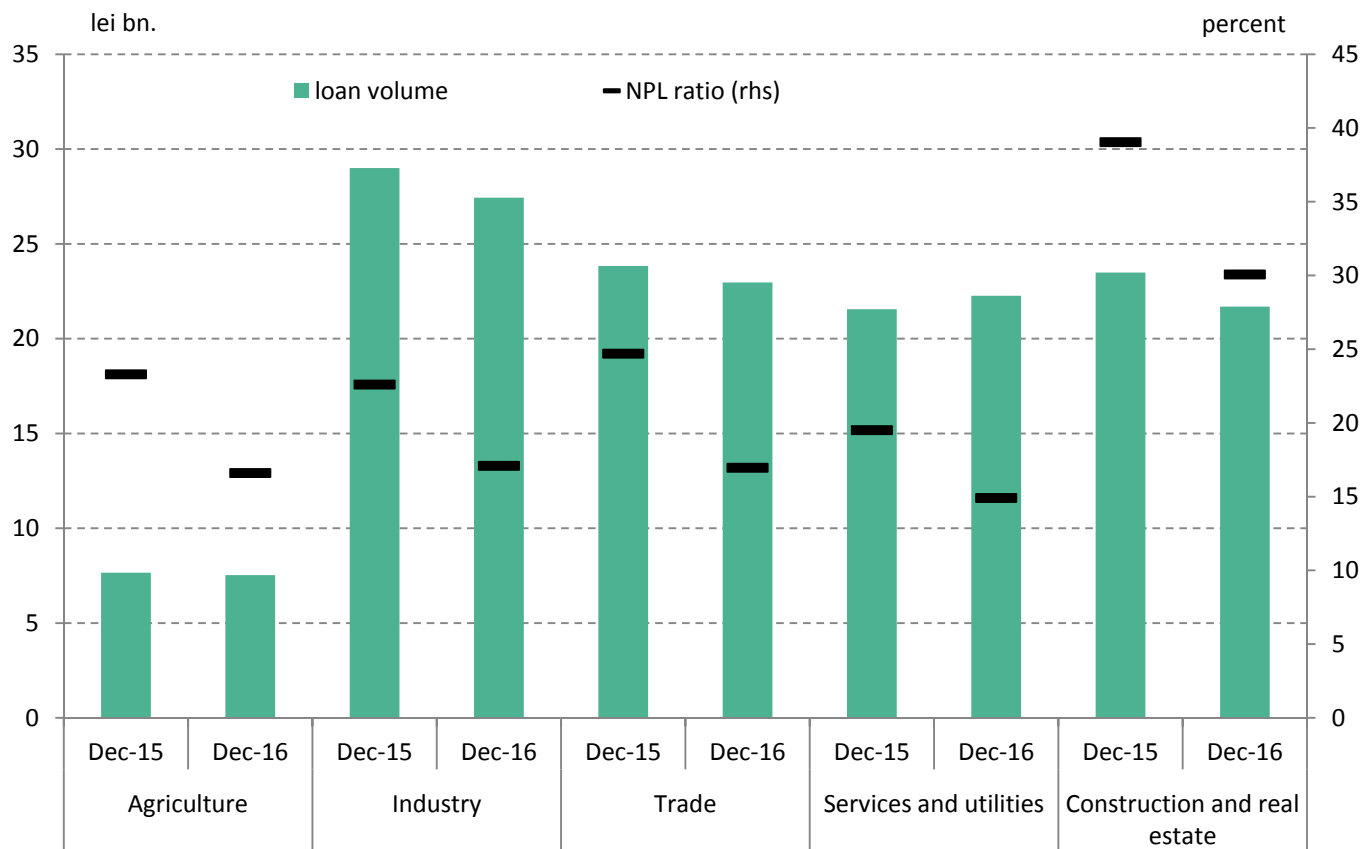
## NPL ratio by the size of companies



Source: MPF, NBR

# NPLs distribution by sector is dominated by construction and real estate

Credit stock and NPL ratio by sector



Source: MPF, NBR

## III. How we did it

- The first steps:
  - I. Vienna Initiative (2009)
    - Prevented large capital outflows
    - Stabilized the exchange rate volatility
    - Prevented further deepening of economic recession
  - II. Collateral valuation (2013)
    - Performed by independent auditors
    - Accompanied by NBR stress tests (EBA methodology)
    - The resulted gap was closed by year-end



## Acknowledging the role of IFIs

*“ (...) an NPL resolution action plan will be prepared by end-May 2014 (structural benchmark) and implemented by end-June 2014. The plan will establish the role of the NBR in the process, set out the responsibilities of supervised entities, and foresee changes to prudential regulations so as to avoid moral hazard and provide appropriate incentives for a timely balance sheet clean-up from unrecoverable loans.”*

(Romania: Letter of Intent, para 32, March 2014 )

## How we did it: Main steps to reduce NPLs

### III. Regulatory and supervisory measures (2014) (cont.)

- NBR recommendations to banks:
  1. to **remove the exposures** representing non-performing loans fully covered by provisions.
  2. to **fully cover with provisions** the exposures **having debt service over 360 days** without initiation of legal proceedings to recover debts, followed by their removal.
  3. to **establish provisions in order to cover at least 90% of the exposures against borrowers in insolvency.**
  4. to **carry out an external audit** on the IFRS provisions established by banks to cover losses for the existing loans, and also on the banks' collateral
  5. to **fully cover by provisions the unsecured NPLs overdue for more than 180 days**, followed by their removal.

## How we did it: main steps to reduce NPLs

IV. Collateral valuation – third revision 2015

V. Supervisory measures (2016)

- NBR recommendations to fully cover with IFRS provisions of unsecured NPLs overdue by more than 180 days, followed by the removal of exposures from on-balance sheet

VI. **NBR's ownership of fighting NPLs:** the process continued after the completion of IMF and EC agreements

## How we did it: the supporting factors

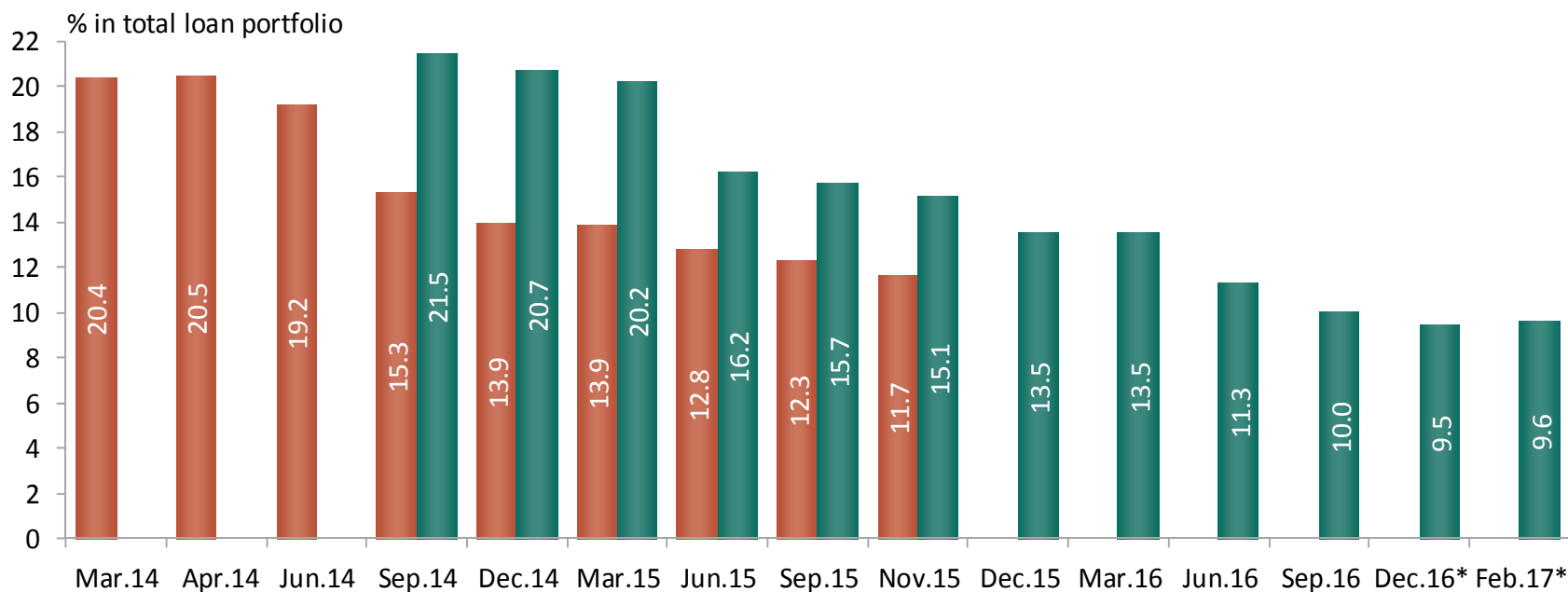
The successful resolution of NPLs was favored in Romania by:

- (i) an already high NPL coverage by provisions;
- (ii) the proper capitalization of banks;
- (iii) the active secondary NPL market on the backdrop of a strong economic outlook (with successful transactions reaching billions of euro in 2015 and 2016);
- (iv) the joint approval of the resolution exercise by all credit institutions, which alleviated their concerns raised in light of the reputational risk.

## IV. Results of the NBR's action plan

- Total loans sold and loans removed to off-balance sheet (2014 – 2016): 17.64 billion lei (3.96 billion euro)
  - NPL ratio declined from 21.5% in September 2014 to 9.5% in December 2016 (EBA definition)
- Total costs with provisions (2015 – 2016): 20.8 billion lei (4.7 billion euro)
  - NPL coverage ratio increased from 54.1% in September 2014 to 57.7% in December 2016

## Developments in Non-Performing Loans



\*) indicators are calculated based on data in prudential reports, prior to submission of audited annual accounts

Indicator calculated based on prudential reports submitted by all banks (both banks that determine the minimum capital requirement for credit risk based on the standardised approach and banks using internal models-based approach) for loans meeting the non-performance criteria (debt service longer than 90 days and/or where judicial proceedings have been initiated).

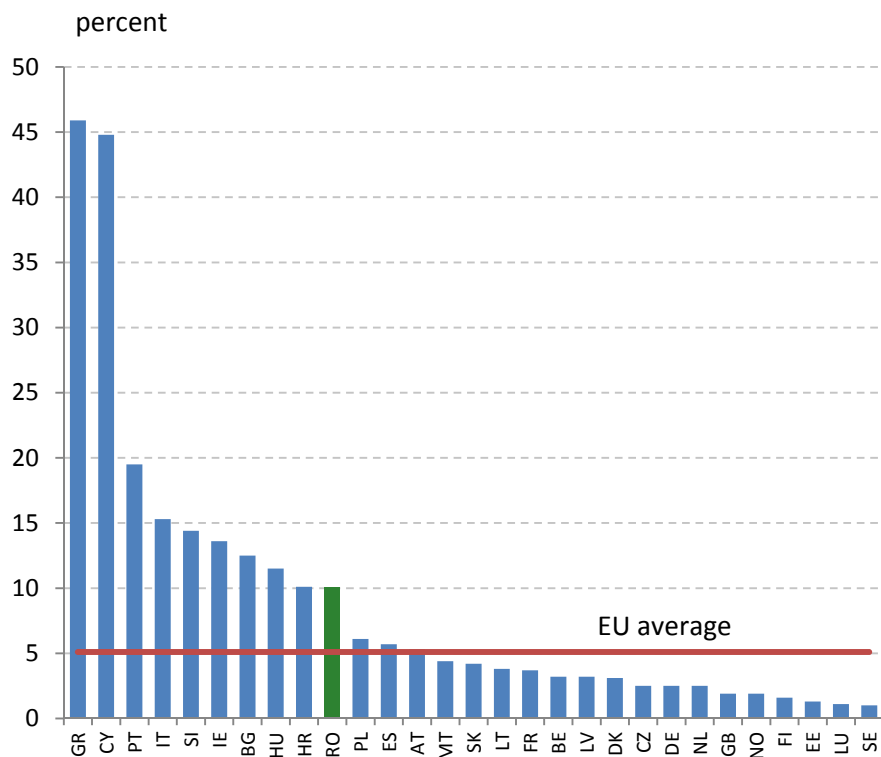
EBA – defined indicator, determined as the ratio between **a) the total non-performing exposures represented by loans and advances** (where non-performing exposure is defined as any exposure satisfying any of the following criteria: (i) material exposures which are more than 90 days past due; (ii) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past due amount or of the number of days past due) and **b) total exposures represented by loans and advances**.

In June 2015, the methodological notes on the FINREP framework at solo level were amended so as to include cash balances with the central bank and other demand deposits with credit institutions in the non-performing exposure report form.

Source: National Bank of Romania

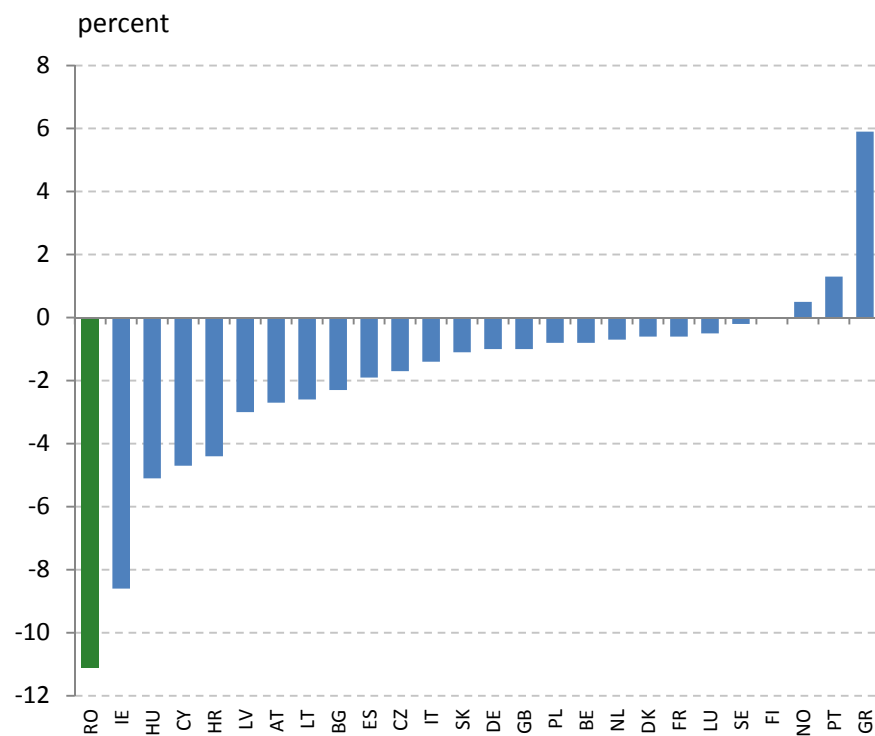
# Largest decline of NPL ratio in EU

## NPL ratio in EU (2016 Q4)



Source: EBA Risk Dashboard - 2016 Q4

## Change of NPL ratio between March 2015 and December 2016 (EBA definition)



Source: EBA Risk Dashboard – 2015 Q4 and 2016 Q4

# NPLs selling increased after 2014

## Total NPLs sold by banks

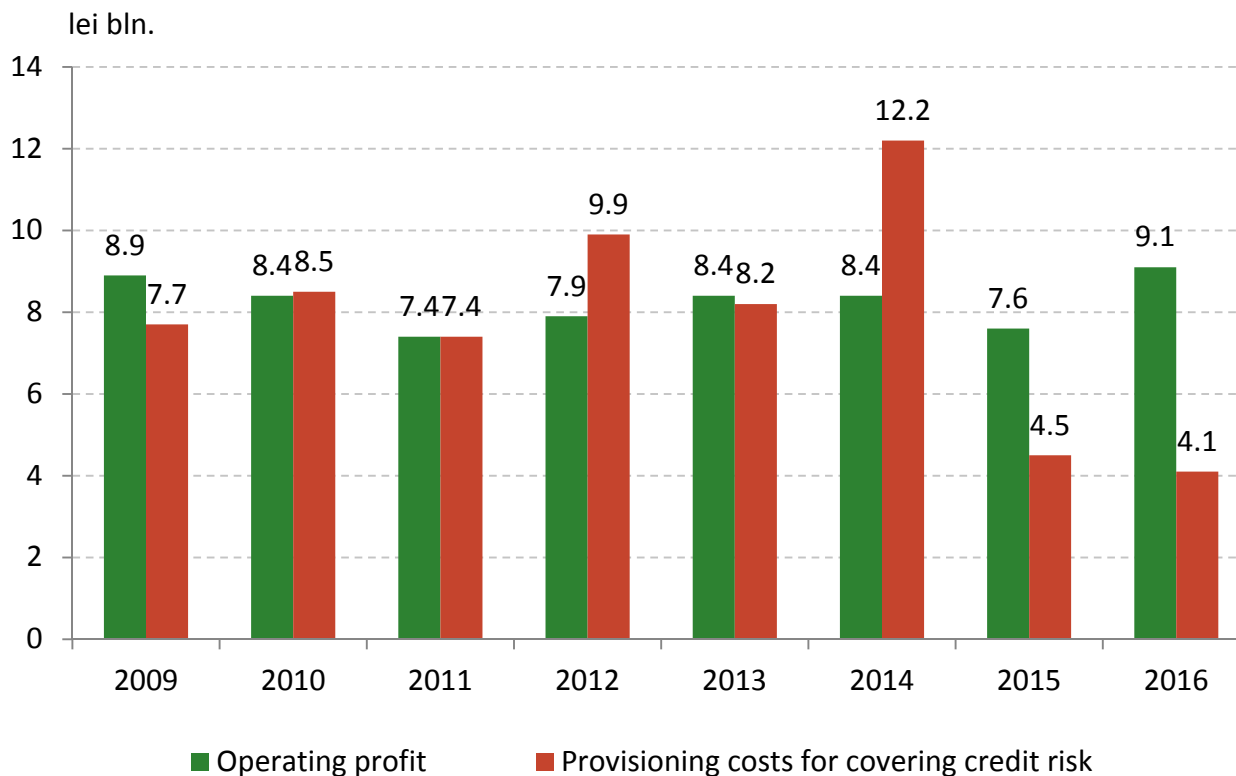
Year	No. of loans	of which households	of which non-financial companies	Value of loans (lei billion)	of which households	of which non-financial companies
2013	20,296	19,645	651	0.92	0.78	0.14
2013	48,160	46,779	1,381	1.74	0.74	1.00
2014	14,877	10,850	4,027	4.18	1.46	2.72
2015	10,589	8,721	1,868	1.16	0.31	0.85
2016	20,565	10,065	10,500	3.90	0.52	3.38

Source: NBR



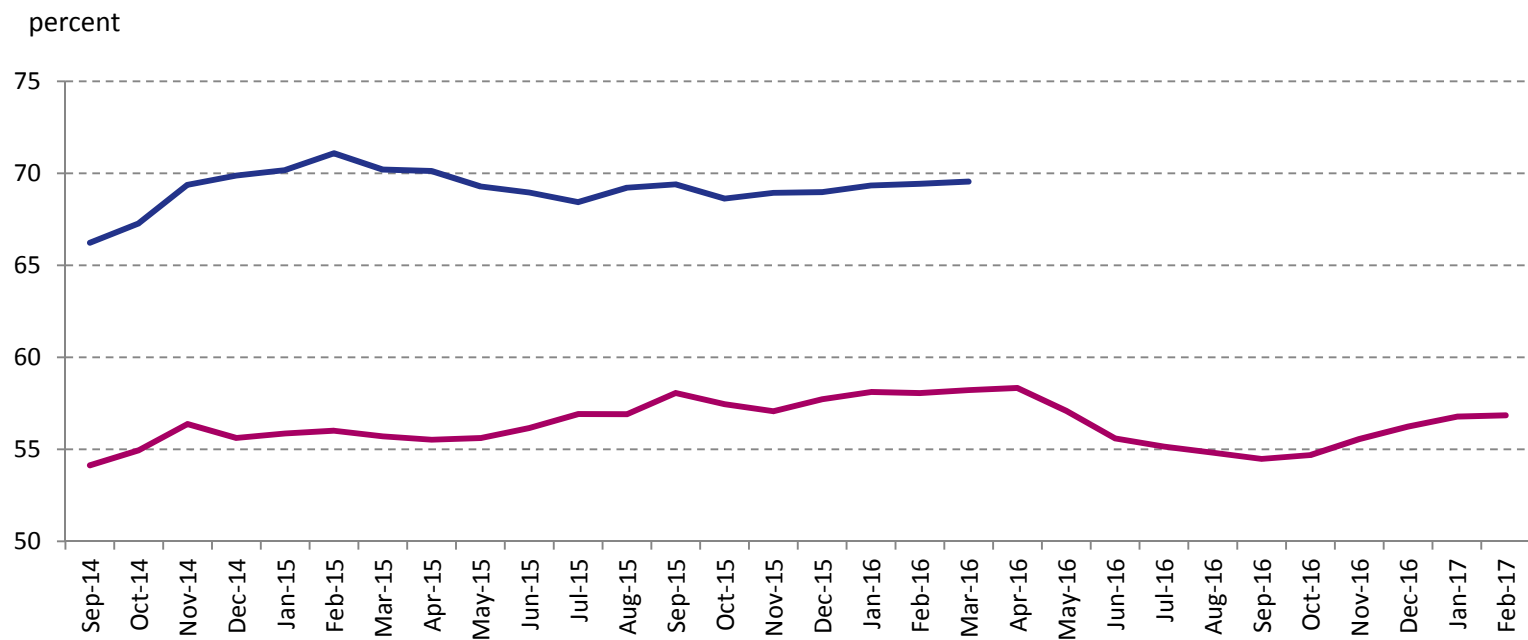
# Provisioning cost for covering credit risk

## Cost for banks to cover the non-performing loans



Source: Florin Georgescu, 2016, National Bank of Romania's experience in dealing with the NPLs challenge; NBR

## Coverage ratio of NPLs (NBR and EBA definitions)



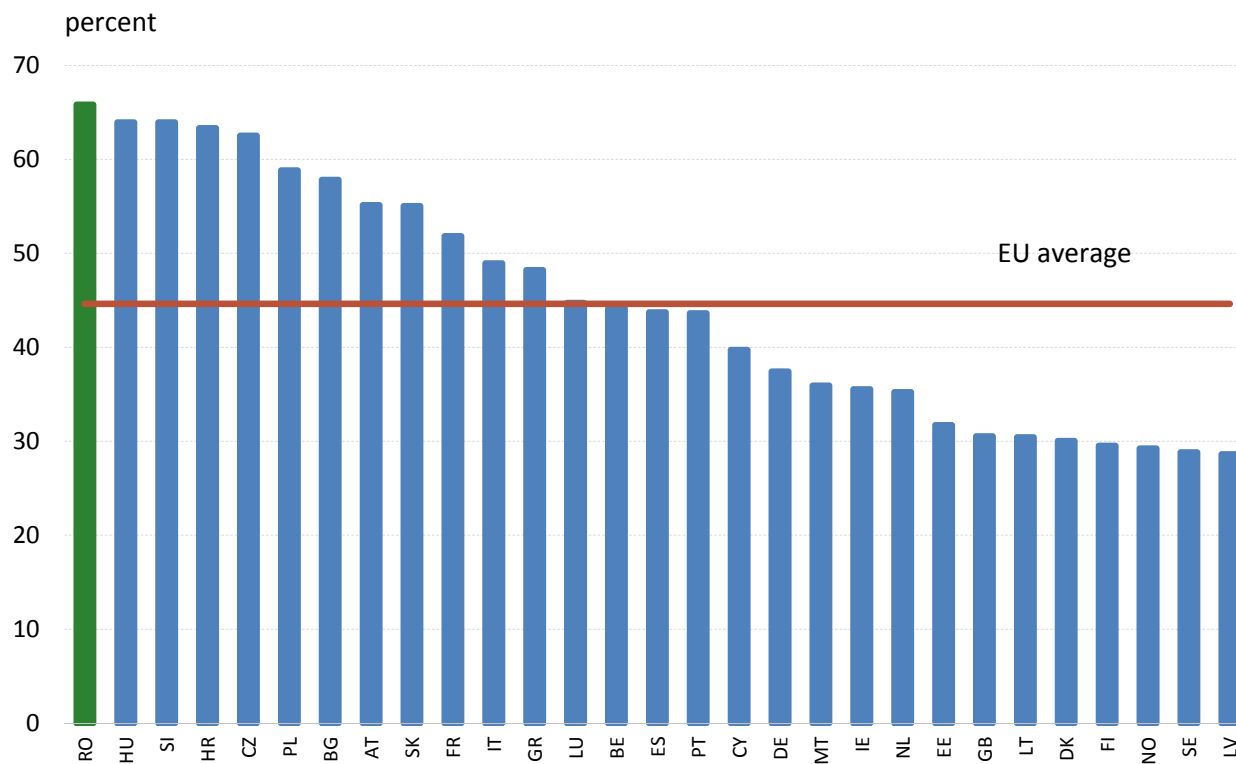
— NPL Coverage Ratio - NBR definition (Specific IFRS adjustments for non-performing loans/ Exposure to non-banking loans overdue for more than 90 days and/or for which legal proceeding were initiated, irrespective of credit risk assessment approach)

— NPL Coverage Ratio - EBA definition (Adjustments for non-performing loans and advances/ Non-performing loans and advances)

Source: NBR

# Romania has the highest coverage ratio of NPLs in EU

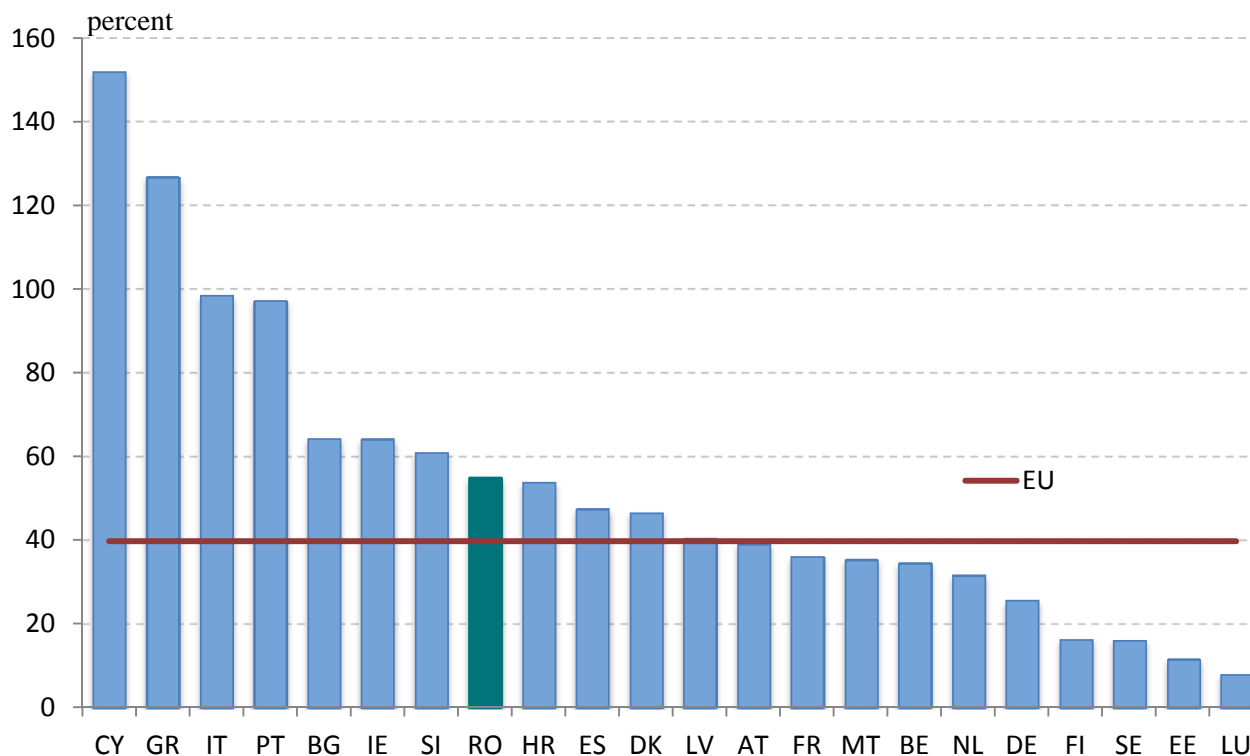
Coverage ratio of NPLs in EU (2016 Q4)



Source: EBA Risk Dashboard - 2016 Q4

# NPLs coverage with capital and provisions is above the EU average

Texas ratio in EU (September 2016)



Note: Texas ratio = non-performing loans/(Tier 1 capital + provisions)

Source: ECB, consolidated data

# Outstanding issues

- Creditless recovery
- Insolvency of firms
- Permanence of debt after NPLs are written off
- Communication between banks and customers needs improvement
- Implementing new EBA guidelines for NPLs

## Next steps

- FSAP starting soon.
- AQR and stress test with EBA and EC support , and IMF observer status, in 2018. Steering Committee already established, terms of reference agreed.
- Macro-prudential policies (pillar 1 and/or pillar 2) are more effective and faster tools to prevent new accumulation of structural strains.

