NON-PERFORMING LOANS
TECHNICAL ASSISTANCE

Brochure

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Non-performing loans technical assistance

The World Bank’s Financial Services Advisory Centre (FinSAC) can help client countries evaluate and resolve their non-performing loans (NPL), and provide a toolkit for NPL resolution taking into account country specific needs.

With limited capital market borrowing possibilities, bank lending remains the main channel of financing the economy in Central, Eastern, and Southeastern European (CESEE) countries. The recent buildup of NPLs in different economic sectors of the region serves as a cap to generation of new loans and further economic development. Furthermore, it is blocking the smooth operation of monetary policy transmission in FinSAC client countries, including Southeastern Europe (SEE). Arrangements that were in place during the rapid economic expansion phase might not be suitable in an environment of slower growth or even recession. Some countries have not yet upgraded frameworks and arrangements to reflect the latest changes in regulations and legislation in order to deal with their outstanding NPLs.

The World Bank Group can provide comprehensive yet targeted assistance to help clients develop tailor-made solutions for their specific cases. FinSAC expertise can help authorities evaluate the NPL situation in their country; ensure that NPL levels are adequately provisioned and do not pose a threat to the overall financial system; identify and help implement appropriate solutions for impaired contractual obligations between borrowers and lenders; and provide a toolkit for NPL resolution taking into account country specific needs. FinSAC can also draw upon the broader skills within the World Bank Group Finance & Markets Global Practice to address the full set of issues that impact NPL resolution.

NPL resolution

The basic components of NPL resolution are:

- Timely NPL recognition
- Adequate provisioning
- Loan resolution: (i) restructuring (a) in court, or (b) out-of court (ii) foreclosure and write-off
- Transfer of loan collection rights to other entity: (i) sale of individual loan, or (ii) sale of loan portfolio

NPL resolution involves many national institutions and is a complex exercise which should strike a balance between the rights and interests of lenders and borrowers. To be successful it requires: (i) an appropriate regulatory framework, (ii) an adequate legal environment, (iii) an operational judicial system, (iv) a conducive tax environment, and (v) an efficient NPL market.
FinSAC technical assistance with NPL resolution

FinSAC experts can provide advisory services on the overall framework and on each of the following different stages of NPL workout, tailored to the needs of clients and adjusted to accommodate local and regional distinctions. This technical assistance includes:

NPL recognition and early warning systems

Advising prudential supervisors on minimum requirements for early warning systems in banks, designed to identify potential problems with the performance of loans. This is equally important during both recession and growth economic cycles. For successful bank/borrower relationships, the bank must be able to identify potential client liquidity or solvency problems. An early warning system can channel clients to appropriate pre-arrears or early-arrears strategy implementation. The earlier potential difficulties are identified, the higher are chances that a mutually acceptable solution can be found. The prudential regulator plays a very important role in setting minimum requirements and reviewing arrangements for credit risk management. FinSAC can advise on credit risk management frameworks.

Good practice in NPL identification

Reviewing regulatory standards and advising on improvements to align with international good practice and incorporate recent guidelines. Definitions within the area of NPLs are sometimes ambiguous and can differ substantially among jurisdictions and banks. FinSAC can undertake a gap analysis of local regulation with EU/international requirements, such as the EBA technical standards on NPLs and forbearance (providing definitions of forbearance and non-performing exposures), and the latest NPL-related guidelines of the Basel Committee, to highlight areas for focus. However, these standards address only part of the outstanding ambiguities in existing regulation. FinSAC can work with regional or local authorities to encourage further initiatives in order to create a comprehensive regulatory and supervisory framework.

NPL provisioning

Advising on the appropriate provisioning of NPLs to ensure the safety and soundness of banks and help safeguard financial stability. Provisioning can be complex, with different interpretations in prudential regulation, local and international accounting standards. Appropriate prudential provisioning has a significant influence on the development of the NPL market, and is therefore an important factor in successful NPL resolution. FinSAC in collaboration with other World Bank experts can provide advisory services in the area of NPL provisioning, offering examples of global good practice and helping to reconcile accounting and prudential perspectives.
Loan resolution is a complicated procedure and includes many components which could be applied in combination or individually. The resolution process comprises: restructuring (forbearance) implemented in court or out-of-court, enforcement, write-off, and NPL sales.

Advising on loan resolution frameworks for NPLs and improvements to judicial and non-judicial processes for corporate and personal bankruptcies. Banks often have several options to resolve NPLs, each of which are highly dependent upon the quality of the legal and regulatory environment. Loan restructuring (forbearance), out-of-court workout and judicial reorganization programs offered by banks could be effective solutions for borrowers facing temporary liquidity difficulties, based on the individual credit profile of the borrower. Similarly, enforcement mechanisms for both secured and unsecured claims provide a baseline set of tools that underpin the risk profiles of each loan and set the environment in which negotiations take place. FinSAC, including wider expertise from other World Bank Group experts, can recommend different tools and approaches to loan restructuring for households and corporate entities. Foreclosure is an ultimate tool that the lender can apply, but in most cases it is not efficient due to gaps in legislation and judicial system shortcomings. FinSAC can advise on whether legislation for corporate and personal bankruptcies is in line with international standards and good practice.

Assisting local authorities establish an out-of-court mediation body to act in material and complicated multi-lender cases. Out-of-court settlements can be a better option than judicial process as they (i) lighten the work of courts, (ii) shorten resolution time, (iii) potentially save the costs of lengthy legal process, and (iv) address socially sensitive issues (e.g. repossession of primary residence). The most complicated cases are those where multiple lenders and even multiple borrowers are involved in one industry (e.g. steel industry where suppliers and consumers of the final product are involved in financing). For such cases a special restructuring committee could be created that would apply a predefined template of proportional liability management. Internationally recognized INSOL principles as well as the “London approach” could be used to resolve these situations. FinSAC can offer national authorities advice on implementing/improving out-of-court options.

External NPL asset management models

Contributing to discussions on the benefits and constraints of external NPL management arrangements. Depending on the sophistication of the bank and available resources, banks can opt for internal or external NPL workout. In case of systemic nature of the NPL problem, national authorities might opt for a national or specialized asset management company (AMC). FinSAC can assist decision makers in selecting appropriate solutions suitable to local situation.
Providing a toolkit for NPL resolution

Helping authorities to create guidelines for NPL resolution. Each country has distinct issues that need to be tackled to decrease the amount of NPLs. Burdensome regulatory, tax, and legal requirements can impede effective NPL resolution. FinSAC can help authorities assess and prioritize NPLs, and help draft guidelines for NPL resolution taking into account country specific needs. FinSAC, in cooperation with other World Bank experts, can provide tailor made expertise on the available out-of-court resolution options.

Corporate governance arrangements for NPL resolution

Advising on corporate governance arrangements in banks for NPL resolution. Under the direction and oversight of the Board, bank senior management is responsible for the prudent and day to day management of the bank. Banks should have NPL resolution strategies and effective internal arrangements in place. A dedicated NPL resolution unit, operating independently, can be instrumental in achieving good results. FinSAC expertise can help to develop good practice corporate governance arrangements for the establishment, performance, and reporting of NPL workout units in banks with state capital.