

# NPLs – Legacy Issue & Future Prevention

Bank of Albania/SEESOX Annual Conference

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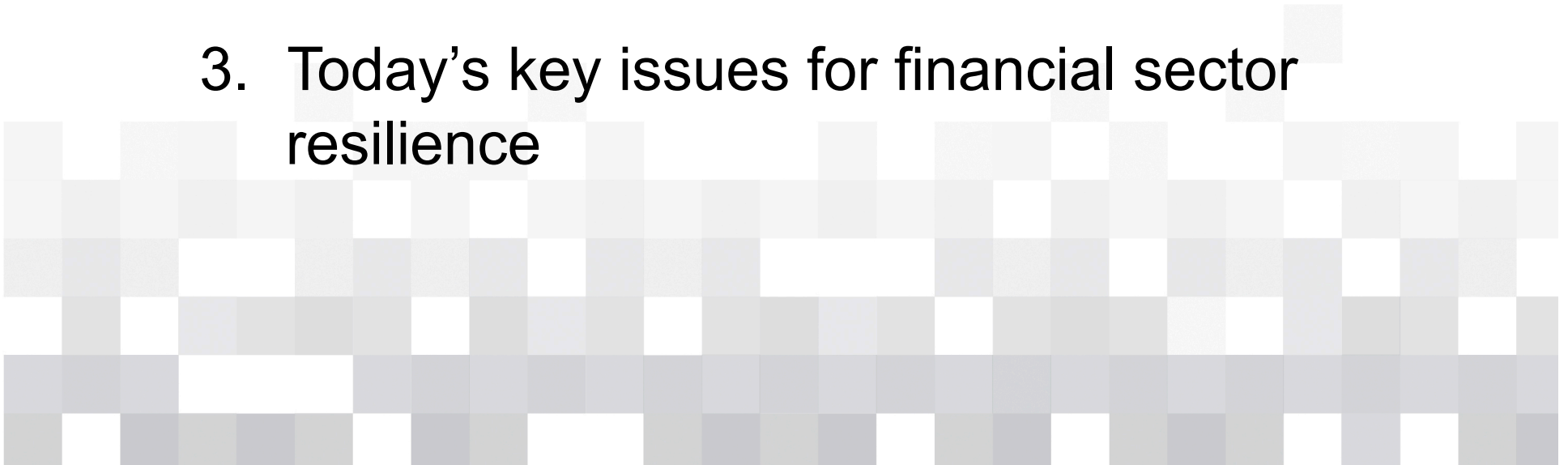
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# Outline



1. NPLs in the broader policy context – impediment to transformational finance & growth
2. Albania's NPL "Report Card"
3. Today's key issues for financial sector resilience



# New Growth Model : Policies according to level of development



- Growth is the ultimate objective even for central banks
- Getting to High Income country group requires different set of policies than before
- New Spence-Stiglitz Commission on Global Economic Transformation

Established High Income Cs



# Key: Switching from **physical investment-led** growth into **innovation-led** growth



## *Advanced economies*

- Invest in high education
- Liberalise product markets
- Liberalise labour markets
- Liberalise financial markets
- Competition, external account liberalisation

## *Emerging Economies*

- Foster technology transfers
- Reallocate factors of production
- Improve management practices
- These can be activated via:
  - Relaxing credit constraints
  - Reducing corruption
  - Improving education quality

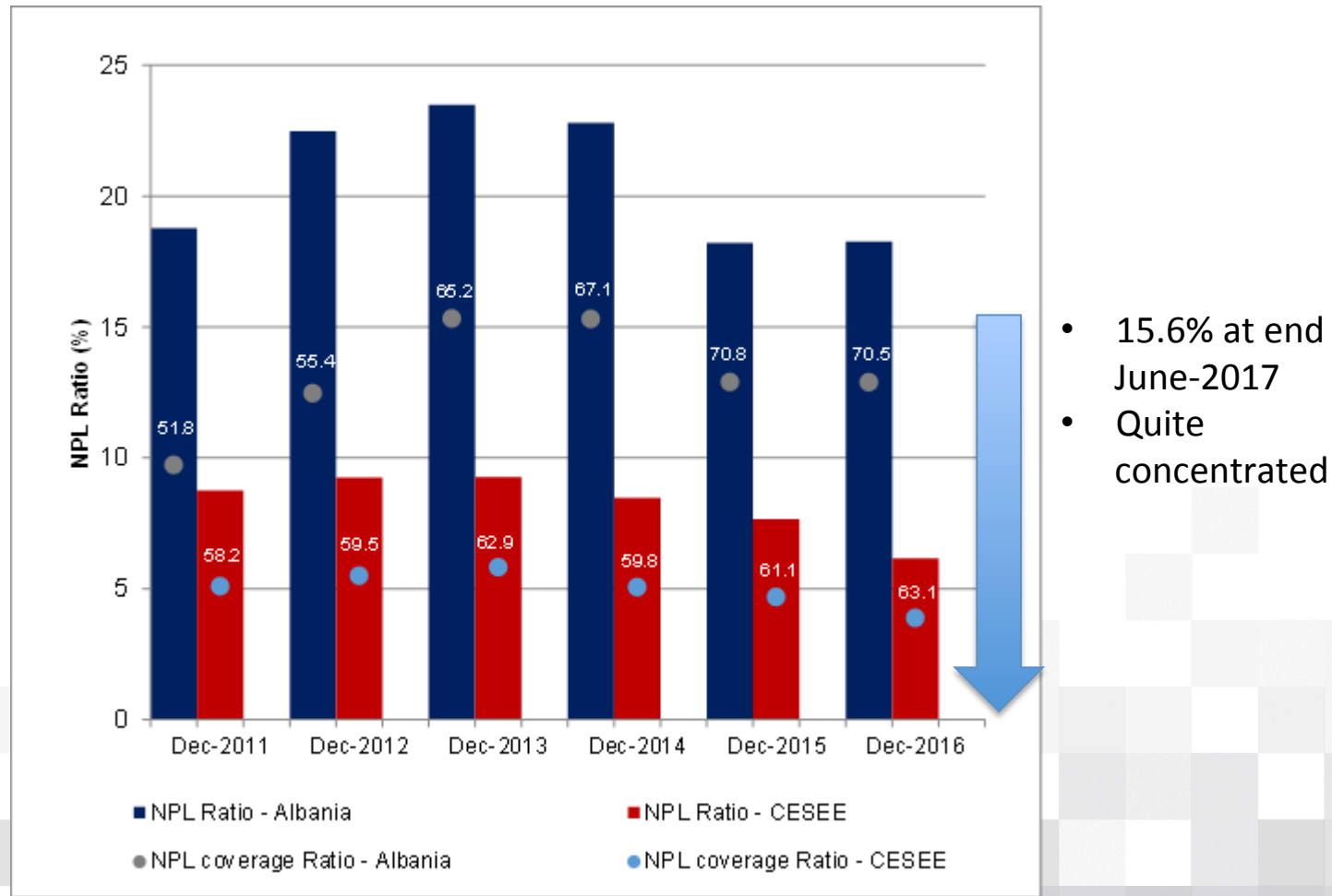
*Most to do with  
transformational  
finance*

# Benefits of NPL reduction



- Increased bank profitability
  - ECB simulation: up to 5% increase on ROE
- Capital relief that can spur lending growth
  - ECB: if NPL elimination leading to freed up capital could raise credit growth between 2 ½ -6 %
  - Higher the NPL the higher the credit benefit
- Benefits from confidence boost
  - Difficult to quantify but there
- Freeing up managerial time
  - As they say – “priceless”

# An unfinished business: NPLs in Albania coming down but still too high



Source: NPL Monitor 2017, EBRD, Vienna Initiative (forthcoming)

# Albania's "NPL Report Card"



- **NPL Working Group (NPL WG) and action plan**, November 2015
- **Bankruptcy law**: Prepared in collaboration with IFC and approved by the Parliament in October 2016. Implementation limited
- **Upgrade of Credit Register and establishment of a credit bureau**, April 2016: BoA's credit register was upgraded; Albanian Association of Banks has proposed the setup of a private credit bureau with EBRD assistance
- **Regulatory write-off**: BoA regulation from 2015 mandating the write-offs of loans of NPLs over 3 yrs (ECB's latest: 2 yrs for unsecured, 7 yrs secured loans)
- **Out-of-Court debt Restructuring (OOCR)**: Guidelines on "corporate OOCR" and "OOCR for individuals" issued by BoA in 2013; in 2016 BoA unified and revised these. The final draft, prepared with the World Bank, is yet to be made official by BoA.
- **Series of Amendments to the Civil Code & Civil Procedure Code, Private Bailiffs Law and Law on Judicial Bailiff Service, Law on securing charges**, October- November 2016

# Menu of solutions is clear. Not all but several applicable in Albania

## A wide range of solutions to the NPL problem is available

On-balance sheet



Off-balance sheet

- Internal workout**  
workout by originating bank; many restructuring options
- Asset protection scheme**  
risk-sharing agreement to limit further losses, usually state-backed; usually short horizon; potential large losses but with low probability
- Securitisation incl. synthetic**  
an alternative to outright sale; partial risk transfer
- Asset management company**  
complete separation of asset from originating bank; often state-backed; usually long horizon; large losses typically already realised
- Direct sale**  
assets sold directly to investors; sufficient liquid markets

Source: Fell, Grodzicki, Martin and O'Brien (2016), "Addressing market failures in the resolution of non-performing loans in the euro area", Special Feature B in Financial Stability Review, ECB, November 2016.



# Bottomline on NPLs



It is clear

**Why** to do it...

**What** to do and

**How** to do it ...



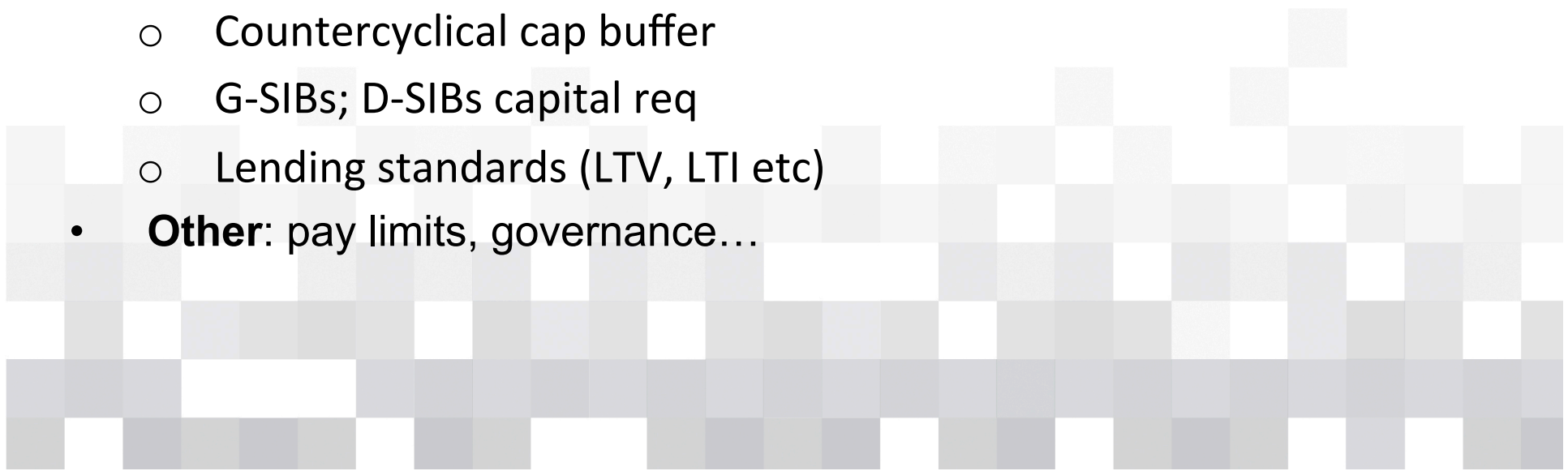
“Just Do It”



# Crisis Prevention: Extensive post-crisis regulatory reform...



- **Micro-prudential**
  - Quality and quantity of capital (RW)
  - Leverage ratio (LR)
  - Liquidity coverage ratio (LCR)
  - Net stable funding ratio (NSFR)
  - Resolution mechanism/Total loss absorbing capacity (TLAC)
- **Macro-prudential**
  - Countercyclical cap buffer
  - G-SIBs; D-SIBs capital req
  - Lending standards (LTV, LTI etc)
- **Other:** pay limits, governance...



# .... yet big issues persist



- **Too much regulation?**

- Multiple problem – multiple instruments
- Compliance issue for small bank & entry
- Maybe also MacroConduct not only MacroPru (Kevin James et al 2017)

- **Is regulatory capital sufficient?**

- “Optimal”: Tier 1 ~ 16-19% - Today 2/3 of G-SIBs and D-SIBs have less
- Does higher capital result in less lending? Good news: No (Cecchetti 2014)
- Trade-off: capital – credible resolution mechanism TLAC (Holdane 2017)
- Maybe it is all about leverage by “small” & “large” (Hyuan Song Shin 2017)

- **Is the Too-Big-To-Fail problem solved?**

- No
- Big size does not help performance only bank lobby power (Hubert 2017)

- **Complicated political economy of central banks**

- Deeper into political territory; joint tasks with fiscal authority
- Central bankers are primary target of populism

# Conclusion: What this all means for Albania?



- **Do your own homework:** finish the job of legacy issues and do your best on domestic policies
- **Beyond that choices are limited for a small open economy next to the Eurozone** and banking sectors deeply integrated with it - but not a bad situation. EBA, ECB, EU
- **Make alliances in EZ/EU for growth-friendly,** transformational, innovation-promoting monetary and regulatory policies
- **Strengthen ex ante bank resolution commitments** (to the extent possible). BRRD is enforced for smaller players (only)
- **Fight insurgent populism in the region with more accountability** and communication.

# THANK YOU!



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