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EIFR Webinar on “Non-Performing Loans”

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Agenda

1. One year into Covid - overall assessment
2. Crisis management under COVID-19
3. Assessing asset risk
4. Q&As

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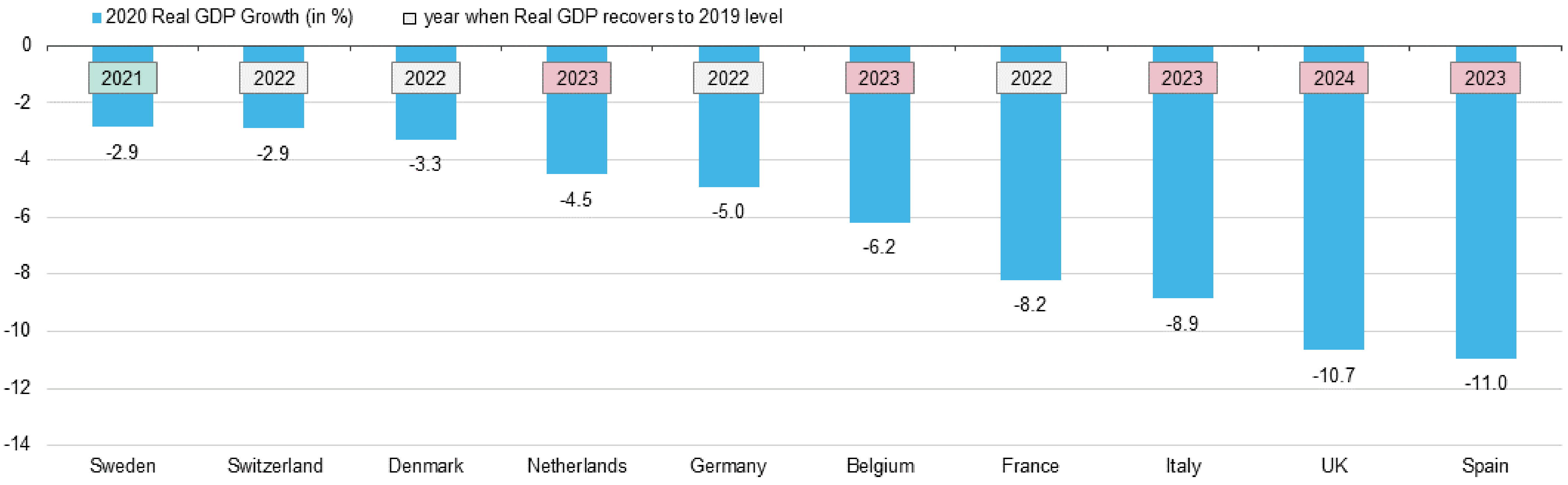
One year into Covid - overall assessment

Operating environment

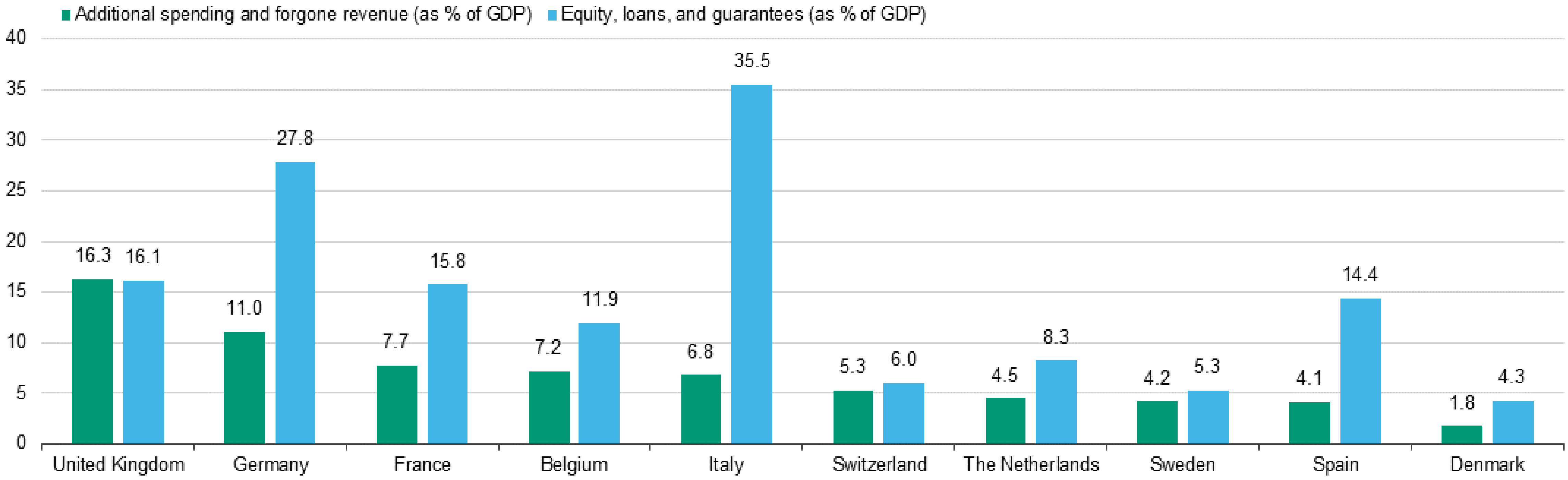
Real GDP decline (%) in 2020 + length of recovery



Source: Moody's

Operating environment

Government support measures (as % of GDP)



Source: [IMF]

Resilient Banking Systems one year after Covid began

EU banking systems resisted to exogenous stress thanks to :

» their own strength (higher capital and liquidity buffers)
» government/EU support (“high for longer”)
» ECB (“low for longer”)
» amended rules (accounting/prudential rules)

Impact on banks’ soundness is starting materializing yet will surface more clearly once all forms of support have been unwound

Yet unwinding support could take time….

Banking System Outlooks

Outlooks changed to stable from negative for several large systems

Current

	Belgium	Denmark	France	Germany	Italy	Netherlands	Spain	Sweden	Switzerland	UK
Overall outlook	Stable	Stable	Stable	**Negative**	Stable	Stable	Stable	Stable	Stable	**Negative**
Operating environment	Stable	Improving	Stable	Stable	Stable	Stable	Stable	Improving	Stable	Stable
Asset risk	Stable	Stable	Deteriorating	Deteriorating	Deteriorating	Stable	Deteriorating	Stable	Stable	Deteriorating
Capital	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable
Profitability & efficiency	Improving	Improving	Stable	Deteriorating	Stable	Stable	Stable	Improving	Stable	Deteriorating
Funding & liquidity	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable
Government support	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable

Previous BSO

	Belgium	Denmark	France	Germany	Italy	Netherlands	Spain	Sweden	Switzerland	UK
Overall outlook	**Negative**	**Negative**	**Negative**	**Negative**	**Negative**	**Negative**	**Negative**	**Stable**	**Stable**	**Negative**
Operating environment	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating
Asset risk	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Stable	Deteriorating
Capital	Stable	Stable	Stable	Stable	Deteriorating	Stable	Stable	Stable	Stable	Stable
Profitability & efficiency	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating
Funding & liquidity	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable
Government support	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Deteriorating

Source: Moody's

Data has not (yet) fully revealed solvency/asset quality deterioration

EBA's Q4 risk dashboard reflects a mixed picture

NPL ratio continued contracting to 2.6%
Cost of risk : 75 bps with material variations between banks

Stage 2 loans represent 9.1% of total loans (a 110 bps increase QoQ

Loans under moratorium : 320 bn down from Q3 (590 bn) ; represent 26.4% of S2 loans

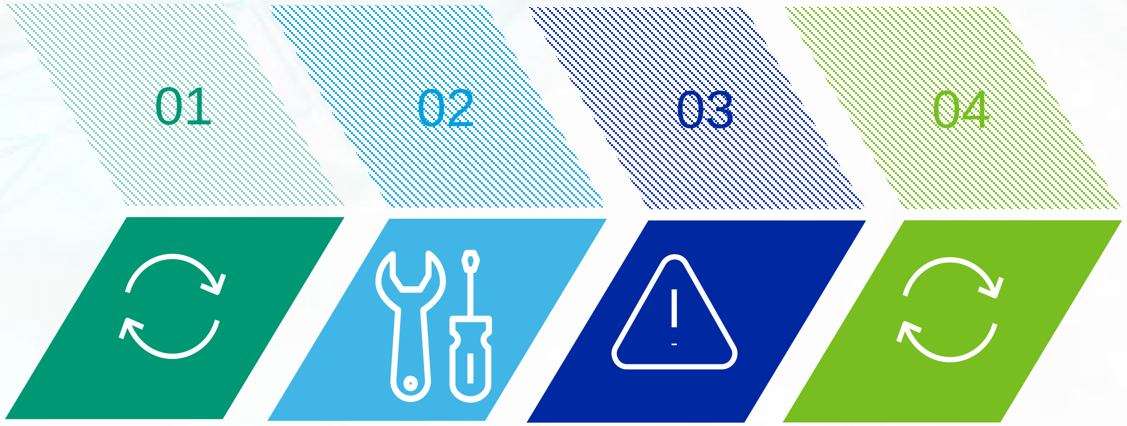
CET1 fully loaded at an all time high : 15.5%

2

Crisis management under Covid-19

COVID supervisors'/regulators' strategy in four steps

Use of capital to absorb asset quality deterioration



01	**Deploying regulatory/supervisory flexibility**
02	**Regulatory forbearance ("CRR2 quick fix")**
03	**"Preparing for the worst" : bad bank solution**
04	**Exit from government support**

2020 EU NPL Action Plan’s objectives

Tackling NPL in the aftermath of COVID

Addressing structural weaknesses

Getting prepared to take actions ….in case of need

Addressing Structural Shortcomings

NPL transactions require sound market underpinnings

Draft directive on “credit servicers, credit purchasers and recovery of collateral”

EBA data template : to be streamlined to facilitate NPL sales

NPL data hub : fostering market transparency

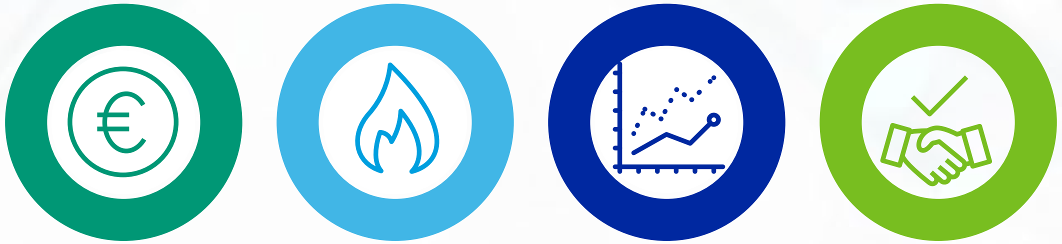
Insolvency regimes : CMU

Getting prepared to tackle a rise in NPLs

“Si vis pacem par bellum”

Current NPL amount in the EU is close to €600 billion

ECB forecasts NPL to increase up to 1.4 trillion under an adverse scenario



Most banks will be able to absorb a rise in NPLs, yet some banks will be under pressure

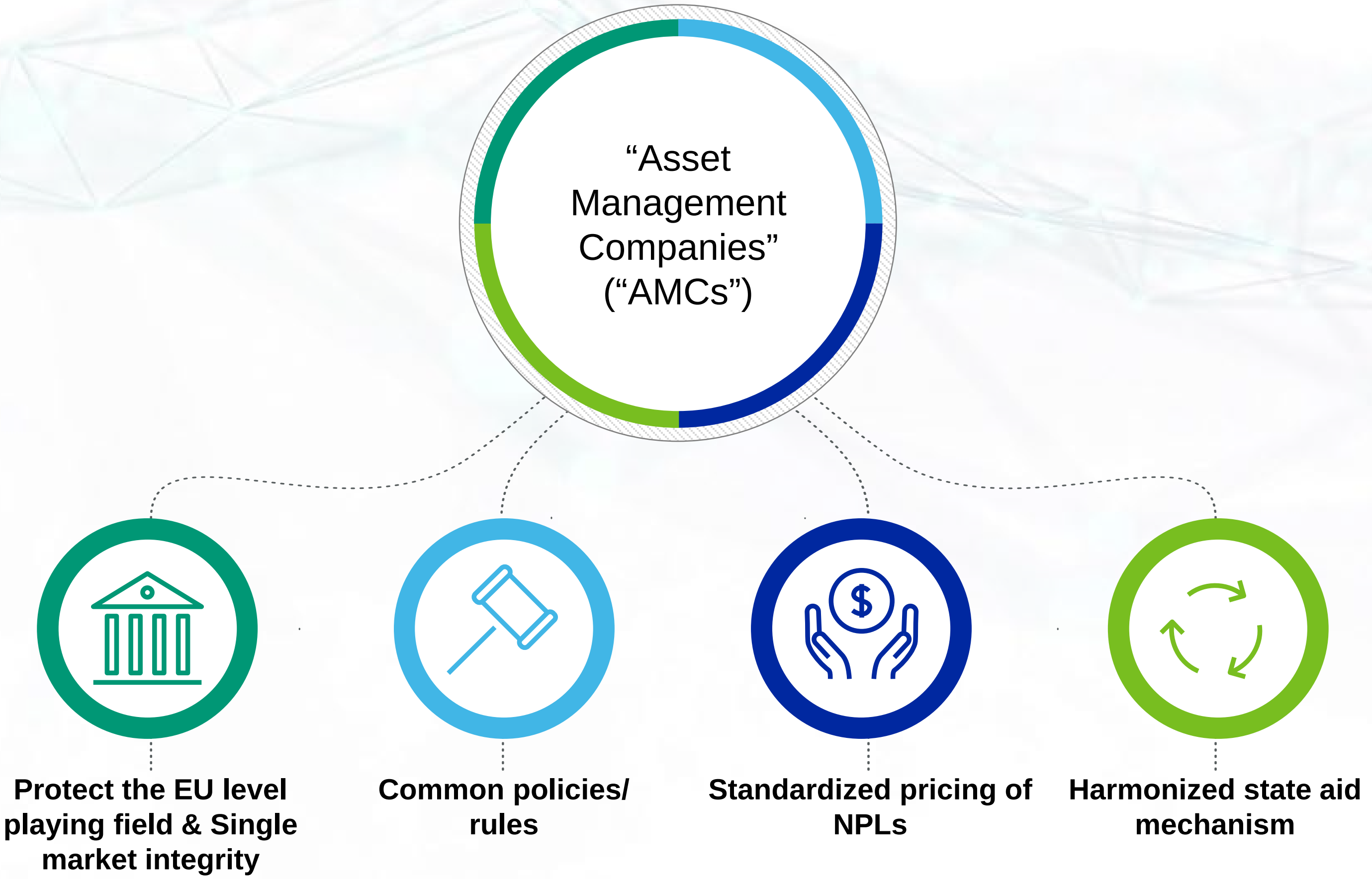
“Bad bank” (referred to as Asset Management Company – AMC) could be a suitable solution in case of dramatic NPL increase

Bad bank(s) would tackle soaring NPLs

New Action Plan on NPL in Response to COVID-19

Limited support for ECB's preferred solution i.e. Single entity. EC suggests a network of
"Asset Management Companies" ("AMCs")

Supporting unviable banks seen as a risk



State aid extended in accordance with existing rules

Objective is to protect financial stability

Government support could be needed to protect financial stability/banks' intermediation role

Preferred tool : precautionary support (BRRD art. 32 (4) (d))
This tool entails the following consequences :

1. **Bank will not be declared FLTF**
2. **Supported bank is to be solvent & viable**
3. **State aid not to used to cover actual or latent losses**
4. **Support should be temporary**
5. **Calibration of support based on stress test**

Forms of state aid contemplated in the Action Plan

Direct support to banks

Support in the form of equity at AMCs

Guarantees for the AMCs' funding

State aid is equal to the difference between the so-called "Real Economic Value" and the value eventually collected

EC's Action Plan doesn't contemplate a "claw-back" provision (yet details are not known)

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Assessing asset risk

Harmonized definition of default (DOD) since January 2021

Impact is not always disclosed

A common EU-wide definition of default is timely as NPLs will increase

DOD has a bearing on the amount of stage 3 loans

DOD used to estimate PD/LGD hence banks' RWAs

Internal models are to be recalibrated by year end 2021

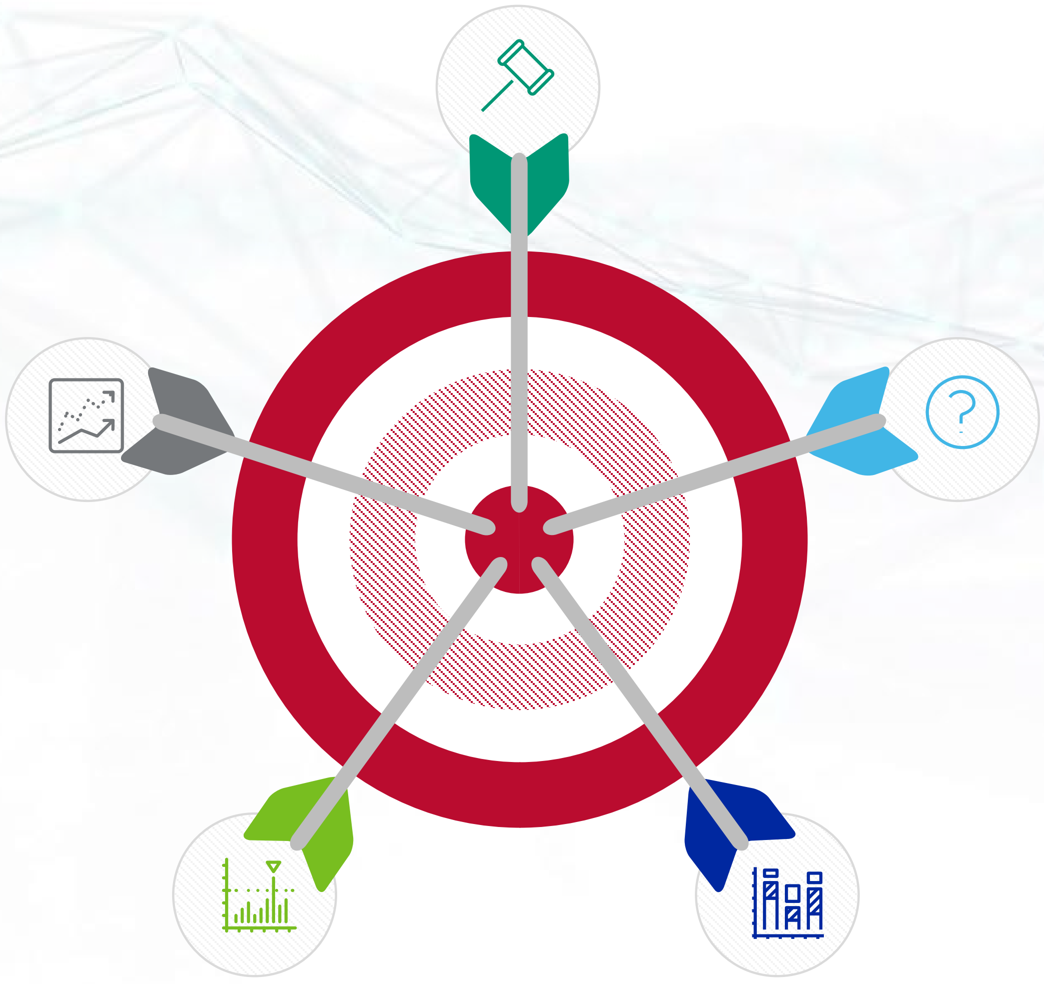
Default is deemed to have occurred if the two criteria below have been both observed during more than 90 days:

» Absolute threshold defined as the sum of all past due amounts related to the credit obligations of the borrower towards the institution, the parent undertaking or any of its subsidiaries; threshold is above €100 for retail and €500 for corporate.

» Relative threshold defined as a percentage (EBA suggests 1% for both retail and non-retail) of a credit obligation past due in relation to the total on-balance-sheet exposures to the obligor, excluding equity exposures.

Assessing asset risk has become more challenging

- **Accounting rules have been amended (on moratorium)**
- **IFRS 9 assumes forward looking provisions based on economic scenarios**
- **Staging of loans might lack consistency across the banking industry**
- **Modelling itself could be a source of variations between banks**
- **Impact of unwinding of government support is difficult to predict**



NPL is a lagging metric under IFRS9 in times of crisis

IFRS9 first time ever used in times of crisis

Cost of risk is driven by stage 3 provisions and more intensively by stage 2 provisions reflecting anticipated losses

ECB expressed concerns about stage 2 loans and adequacy of provisions

NPL remains a critical metric of bank's soundness

ECON calls for more forbearance

Current rules are not all fit for purpose (COVID-19)

- Moratoria should be extended as long as needed
- Definition of default should be temporarily revisited
- Italian MPs submitted a resolution with the aim of amending the so-called provisioning “backstop”
- Internal work-outs should be preferred over a bad bank solution (last resort)

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Q&A

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