# Yannis Stournaras: The Greek experience in dealing with Non-Performing Loans and the challenges ahead for EU banks

Speech by Mr Yannis Stournaras, Governor of the Bank of Greece, at the Non-Performing Loan (NPL) Meeting 2024 "Step Forward", organised by Banca Ifis, Cernobbio, 27 September 2024.

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I would like to thank the Chairman of Banca Ifis for inviting me in this very interesting forum.

In my short intervention today, I will share with you our experience in dealing with NPLs in Greece and I will then outline the key challenges ahead for the banking system in the euro area.

## Part A: Dealing with NPLs in Greece

As you all know, Greece suffered greatly throughout the previous decade from an acute economic crisis that reduced domestic GDP by ~25%. We experienced an economic contraction that is equivalent to some of the worse post-war crisis episodes in global economic history.

Inevitably, the economic recession took a toll on the asset quality of all Greek lenders. Within just a few years, about half of the banks' loan book was non-performing. NPLs became the largest asset class in Greece - for the Small and Medium-Sized Enterprises (SMEs) and the Small Business and Professionals (SBPs), which are the backbone of the Greek economy, about two thirds of the obligors were in default at the peak of the crisis.

Today, the picture is completely different, as banks have managed to reduce their NPLs ratio to just north of 5% (which is closer to the EU average) through a combination of measures, notably using an Asset Protection Scheme called 'Hercules' which is similar to the Italian GACS.

If I can briefly outline the key takeaways from our experience in dealing with NPLs over the past decade, these are the following:

- First, it is important to understand that dealing with NPLs in a systemic crisis requires a multi-faceted strategy that includes legal, operational, and financial aspects.
- he timely recognition of the problem and the need to take policy actions at an early stage are of utmost importance. Having said this, I fully acknowledge the difficulty to address legacy loans in a recessionary environment. NPL reduction is more feasible in a growing economy (e.g. improving financial position of households and non-financial corporates, increasing collateral value, etc.).
- Strengthening the legal framework for bankruptcy and insolvency procedures is essential. Streamlining processes such as collateral enforcement and speeding up judicial procedures significantly contribute to reducing NPLs. In a nutshell, all

kind of impediments to NPL workout should be removed. That was a very important lesson learnt during the past decade.

    - To give you an example: in the early years of the crisis, it became evident that some kind of protection for the primary residence was necessary, to ensure social cohesion and the protection of vulnerable obligors. In 2010, the then government introduced a Law that aimed to protect homeowners from foreclosure by offering protection to primary residences under certain conditions. However, some deficiencies in the design of the measure resulted in the erosion of the payment culture and encouraged the emergence of the so-called 'strategic defaulters'.

Since then, Greece has reformed its insolvency laws, making it easier for banks to recover assets. The new insolvency framework aimed to accelerate proceedings, reducing the time it takes for banks to recover funds from insolvent borrowers. In addition, the introduction of electronic auctions for foreclosed properties streamlined the process, allowing banks to recover funds more quickly and efficiently.

- Banks also need to have an adequate NPL governance function to deal with the problem. They should also have the proper capital and provision cushions to absorb the losses associated with NPL management.

The role of the supervisor is important here. Continuous and rigorous supervision by authorities ensures that banks adhere to NPL reduction plans. Supervisors must monitor banks' progress and impose corrective actions when targets are not met. The SSM also played a critical role in pushing banks to offload their NPLs through the application of the so-called 'prudential backstop' as a Pillar 2 measure.

- Facilitating the development of secondary markets for NPLs, where these assets can be sold to investors, is vital. This includes creating a regulatory environment that attracts investors and ensures transparency and fairness. On transparency, I would like to point out that having publicly available data on recoveries is useful (I understand that such data is available in Italy).
- Another important lesson is that it is impossible to address quickly the problem without a systemic solution for NPLs (such as an Asset Protection Scheme (APS) or an Asset Management Company (AMC)). The design of the scheme is of equal importance, to ensure minimum impact on taxpayers.
    - The clear benefit in Greece from the introduction of the Hellenic Asset Protection Scheme ('Hercules') was the quick clean-up of banks' balance sheets. Before the introduction of HAPS, banks were unable to deliver a material improvement in their asset quality, and the key driver of NPL reduction was loan write-offs. The introduction of HAPS changed completely the landscape (also for the LSIs, where it is typically even more difficult to deal with NPLs). Banks of course recorded a substantial loss, but this loss was lower compared to an outright sale. At the same time, banks got capital relief, since the senior notes they hold bear the Greek government guarantee and thus have a zero risk weight.
- Effective coordination among the government and supervisory authorities is crucial. The implementation of reforms and frameworks (like the NPL reduction plans) needs alignment between these entities to be successful.

- Private debt resolution is also important from a macroeconomic perspective. Even if the NPLs are off the banks' balance sheets, the debt is still there and should be duly addressed. The role of NPL servicers is very important in this respect – debt needs to be restructured and/or forgiven to allow obligors a second chance. If this is not done, the result will be that a significant proportion of economic agents are no longer bankable.
- Finally, I would like to stress the importance of governance and transparency. As there is no cloud without a silver lining, the crisis forced Greece to implement the most advanced governance and transparency measures in its financial institutions, Systemic as well as Less Significant ones. Among other things, even the smallest cooperative bank in Greece is now applying International Accounting Standards, while there are no exceptions to European directives or SSM rules.

## Part B: Challenges ahead for EU banks

Now, let's move on to the EU banking system and the challenges ahead.

EU banks have currently solid fundamentals that were gradually built up after the Global Financial Crisis. To give you some more colour on this, based on the EBA Risk Dashboard[1]:

- In December 2009, the Total Capital Ratio (TCR) of EU banks was 13%. Since then, banks executed several capital accretive actions and now enjoy wide capital buffers with an average TCR at 20% in March 2024.
- The most impressive improvement was in asset quality, as banks lowered the average NPE ratio from levels close to 7% (in 2016) to 1.9% in March 2024.
- Banks' profitability has also improved lately, as the net interest income of most lenders benefited from the increase in interest rates. Recall that, at some point in time over the previous decade, the average Return on Equity (RoE) for EU banks was barely positive. With March 2024 data, the average RoE for EU banks reached 10.6%.
- Finally, EU banks enjoy ample liquidity with a solid deposit base and full access to the wholesale and capital markets. In March 2024, the average Liquidity Coverage Ratio (LCR) of EU banks was 161.4%, well above the supervisory minimum of 100%.

The positive macroeconomic environment is also supporting the financial fundamentals of EU lenders. However, risks to financial stability have been rising:

- Geopolitical risk remains high for some time now, since the Russian invasion of Ukraine, and is further fuelled by the tensions in the Middle East. Political developments in the US and the EU are also creating uncertainty. Geopolitical risk is an exogenous risk factor which could potentially have immense repercussions on the banking sector.
- A reassessment of risk premia following a sudden shift in market sentiment could put asset prices under strain with potential implications for the sector of non-bank financial institutions (NBFI). Past events showed us that the non-bank financial sector can amplify worsening markets conditions through forced asset sales to

address margin calls or potential liquidity needs. Risks and vulnerabilities in the non-bank financial sector could essentially create spillovers to banks (via loans, securities, etc.) and to the real economy.

- The recent rise in interest rates alongside high inflation rates put the balance sheet of some firms and households under strain. Against this backdrop - and despite the recent drop in the interest rates -, a deterioration in asset quality and a rise in loan loss provisions for European lenders with a time lag cannot be ruled out.
- In addition, weakening economic growth along with high interest rates could weigh heavily on the demand for new loans and the implementation of banks' business plans. Note that the improved profitability following the rise in interest rates masked structural deficiencies in many banks, such as in terms of cost efficiency and digitalisation.
- The increase in borrowing costs over the past few quarters has led to a cooling of the real estate market in the euro area, notably the commercial real estate segment. A fall in real estate prices could expose some property developers to losses and consequently impact the cost of credit risk for some European lenders.
- Several new risks have recently emerged in our risks heatmap, such as the climate change risk and the risks stemming from cyber-attacks. The latter is closely linked to the rising geopolitical risk.

Concluding, despite the progress so far, there is no room for complacency. As risks to financial stability remain, supervisors should ensure that financial institutions are cautious in their business decisions and preserve ample capital and liquidity buffers, while upholding top governance standards. Macroprudential supervisors should also preserve capital buffers with the aim to increase resilience in the system.

Finally, we need to revamp our crisis management framework and complete the Banking Union. The adoption of a common European Deposit Insurance Scheme (EDIS) at the level of the banking union is necessary to strengthen depositors' confidence, especially in case of cross-border turmoil and systemic crisis. The completion of the Banking Union with the adoption of a common framework for Crisis Management and Deposit Insurance (CMDI) will facilitate the integration of the, so far, fragmented banking sector in the European Union along the lines suggested by the Draghi Report and achieve level playing field in European banking regulation and resolution.

Thank you.

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[1] https://www.eba.europa.eu/risk-analysis-and-data/risk-dashboard