

Book launch:  
“Non-Performing Loans and Resolving Private Sector Insolvency:  
experiences from the EU periphery and the case of Greece”

LSE – Hellenic Observatory | Monday 16 October 2017

Nikolaos Karamouzis  
Chairman of the Hellenic Bank Association  
Chairman of Eurobank Ergasias S.A.

Good afternoon Ladies and Gentlemen,  
Dear colleagues,

I would like to thank the Hellenic Observatory of the London School of Economics for their invitation and for hosting this very interesting event.

It is a privilege for me to have the opportunity to speak in front of such a distinguished audience, at one of the best universities in the world.

Special thanks to Professor Dimitris Vayanos for chairing tonight’s event.

Foremost, however, I would like to thank and congratulate the editors of this book, Christos Gortsos and Platon Monokroussos.

I had, and still have, the opportunity to work with both of them closely on different occasions and I very much appreciate both their high-level professionalism and their outstanding qualities as individuals.

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It is also a great asset of the book that such a distinguished group of market practitioners and academicians have contributed their work to this highly valuable and very interesting research project.

The book, entitled: “Non-Performing Loans and Resolving Private Sector Insolvency”, provides a comprehensive review of the challenges arising from a sharp increase in non-performing loans, a very topical and multifaceted issue for several Euro area periphery economies, like Greece.

The book draws conclusions from the European experience so far and the lessons learned, including

- the need to introduce an effective legal framework for NPE/NPL management,
- and the difficult issues of strategic defaulters, moral hazard, market distortions and the potential implications of unfair competition.

We all agree that a substantial reduction of the stock of NPEs/NPLs is a critical prerequisite

- for restoring financial stability,
- improving market confidence and trust in the financial sector, and

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- enhancing the ability of the banking sector to finance the economy, and
- thereby a sustainable economic recovery.

Several comments on my part relating to Greece’s significant NPE/NPL problem and in grappling with the highest NPE ratio in the Eurozone today (along with Cyprus).

The problem was created mostly by adverse macroeconomic conditions and an unprecedented crisis and not by idiosyncratic characteristics of the Greek banking system, which played a minor role.

First, let me briefly describe the sheer size of the NPE/NPL problem in Greece and explain the lines of defense and the buffers available to Greek banks in dealing with such an acute problem.

Greek banks today, based on second quarter 2017 data, reported NPEs of €102bn, €73bn of NPLs, and total outstanding private sector loans of €190bn.

Therefore, close to half of total loans reported are either NPLs or NPEs – with the latter representing a broader definition of non-performing loans.

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Against this sizable stock of NPEs/NPLs, the four significant Greek banks have already taken €53bn worth of provisions, reaching an average coverage ratio of 50% for NPEs and 69% for NPLs.

Those coverage ratios are above average, compared to other Eurozone countries

In addition, Greek banks maintain today among the highest core Tier I ratios in the Eurozone, 17.2% on average, or €33bn of capital, while on a fully loaded basis, the capital ratio stands close to 16,3%, again among the highest in the Eurozone.

As such, the Greek banks have a sizable capital buffer well above the minimum required by the SSM estimated around 12.25%.

Admittedly, part of the capital base of Greek banks is in the form of DTAs/DTCs, a lower quality capital asset, especially if financial losses are recorded by the banks the years ahead.

Clearly, this is a risk factor, but note that, this is a common characteristic in the capital structure of other European banks.

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Moreover, both the SSM and DG Comp have ruled on the issue by recognizing that DTAs/DTCs are accepted as part of the capital structure.

It's also worth noting that, approximately 60% of NPEs are secured mostly by real estate assets valued at currently very depressed prices (some 40% lower than their pre-crisis peak).

In addition, in contrast with Italian banks, Greek banks boast strong pre-provision income levels forecast at €4.2bn annualized based on first half 2017 results.

This is an extremely important characteristic of the Greek banking system, because on a three year horizon that constitutes an additional €12.6bn buffer of potential provisions to deal with NPEs/NPLs before the capital base of the Greek banks is hit or affected.

Furthermore, note the following points on Greek banks:

- Capital ratios are organically on an upward trend in recent quarters.

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- Banks have returned to organic profitability after 10 consecutive years of losses.
- NPL/NPE stocks are slowly declining (i.e. NPE stock down by €5bn today from the peak).
- NPE/NPL formation has stabilized and is on a declining trend.
- Three Asset Quality Reviews and stress tests have been conducted in the last seven years by the supervisory authorities.  
These have led to three recapitalizations totaling €64bn for the sector and with the most recent capital increase close to €15bn - in November 2015 – based on an adverse stress test scenario the assumptions of which have not materialized.  
On the contrary, macro and financial conditions are steadily improving and are today quite better than the assumptions made in the adverse stress test scenario.
- The upcoming new stress tests in spring 2018, to be performed under the EBA uniform methodology, it is not a pass or fail test. The results will be reflected by the regulator in the SREP CET1 requirements for each bank.

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That means that, in case a bank needs further capital strengthening, that bank will have time to submit a plan to meet those stricter requirements first through capital enhancing initiatives and balance sheet actions and then, if necessary, via a capital increase.

- Despite capital controls and uncertainties, banking liquidity conditions are steadily improving.  
Deposits up by €3.5bn in recent months,  
dependency on ELA financing is down to €28bn today from the peak of €86bn in the summer of 2015, lowered by the impressive € 58bn,  
international market repos and primary covered bond issues outstanding exceed €20bn today, signifying improving market access,  
while all banks have been able to cancel government guarantees utilized for ELA borrowing, valued at €50bn at the peak.
- Interest rates are falling slowly
- The economy is projected to grow at around 1,5% in 2017 and 2,6% in 2018, based on recent IMF estimates, while unemployment is steadily declining in recent quarters close to 21% today.

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However, despite these positive developments, there is still a number of challenges for banks ahead of us the next 9 months.

These include demanding new regulatory compliance requirements like IFRS9, TAR, TRIM, calendar provisioning, 2018 NPE reduction targets, as well as the upcoming spring 2018 stress tests, all of which could still have a negative impact on Greek banks' capital positions.

But the impact of all the above capital risk factors is not additive. Rather, there is good degree of complementary. Note that, Greek banks do have an NPE/NPL reduction plan. They have committed to regulator and shareholders to reduce NPEs by €40bn or by 38% between 1H 2016 and end-2019. That is a challenging but achievable target.

Banks seem very likely to meet their 2017 NPE reduction targets.

It is also encouraging that, after years of delay in Greece, the proper legal framework for managing NPLs/NPEs is finally in place, from the option to sell loans to the market to electronic auctions, new OCW framework, new business insolvency law and third party NPL servicers.



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It is critical for electronic auctions to take place uninterrupted, because they discourage strategic defaulters, are more transparent, but most importantly they improve the liquidation value of collaterals in modeling NPE provisioning levels.

Greek banks are currently actively reducing NPE stocks by writing off loans, selling assets, selling loans and assigning management of NPEs to third party servicers.

A word about the upcoming stress tests and the recent institutional debate about how they should be conducted.

- We should not turn a hypothetical future recapitalization issue, which has not been documented, into a loose public debate, as IMF had done recently, publicly requesting another AQR and speculating that additional capital injection is needed.

Doing so could backfire on the banks and the economy by

- encouraging strategic defaulters (estimated at 25% of NPEs),
- fuelling speculative market behavior,

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- undermining deposit gathering efforts and
  - increasing moral hazard behavior.
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- We should put our trust in the ECB Single Supervisory Mechanism (SSM) that has the responsibility within the Eurozone to evaluate and determine each bank’s financial and capital position.
  - SSM based on its own assessment would discuss with each bank’s management and board separately and privately potential capital needs and they would request the submission of a plan of actions to rectify any possible capital shortfall based on facts and proper analysis.
  - Greek banks are open to authorized audits and transparent. As Eurobank’s CEO, Mr. Karavias, stated in his recent article in the Financial Times, we are open to any asset quality review and stress test that the SSM and the Bank of Greece may request.

All stakeholders, regulators, boards, management are cooperating to effectively address the NPE/NPL issue.

We have agreed with SSM on the means and the roadmap to address the NPE/NPL problem.

We have committed to a timetable and specific targets.

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Let’s all stick to what has been agreed.

The issue of Greek NPE/NPLs cannot be resolved overnight.  
There is no credible overnight solution.

We have to follow a gradual but accelerated approach in  
addressing the NPE/NPL problem.

Any fire sales approach, given the unprecedented size of the  
problem, especially in the current uncertain environment of

- limited credibility and market access,
- high interest rates and risk premia discount factors,
- limited secondary NPE market,
- and slow growing and fragile economy,
- could destabilize the banking system and expectations,  
create unnecessary burdens and, at the end, the  
economy.

In closing, I would like to say that, a critical factor in  
determining the Greek banks’ ability to meet their NPE/NPL  
reduction targets for 2018 and 2019 and strengthen banks’  
financial positions is an accelerated return to sustainable  
economic growth and regular market and economic  
conditions.

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### Improving economic conditions would

- improve collateral values,
- enhance the viability of troubled assets,
- lower expected discount rates,
- facilitate the growth of a secondary NPL market,
- disincentivize strategic defaulters
- and stimulate loan growth and bank profitability.

A growing economy is therefore the key to ultimately reducing the size and impact of the NPE/NPL problem.

### Ladies and gentlemen,

Macro and market conditions in Greece and Greece’s attractiveness as an investment destination are gradually improving.

We have a unique opportunity to turn things around, turn the vicious cycle into a virtuous cycle, which should not be wasted.

There are lingering factors that contaminate investor sentiment and growth prospects, which ought to be addressed by policy makers:

- high tax rates and unstable tax system,
- low level of policy credibility and market trust,

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- inefficient and ineffective public administration,
- capital controls,
- hostility towards private investment and entrepreneurship,
- high public debt,
- a handicapped financial sector, and
- a slow privatization process.

Thank you for your attention.