

Central Bank of Cyprus

On November 24th the Central Bank of Cyprus published data regarding NPLs. Reference date is 30th September 2015.

The Delfi Partners Analytics team has analysed non-performing exposure data of the Cypriot banking sector, as published by the Central Bank of Cyprus (CBC). Findings are important for industry professionals, bankers and other political stakeholders.

The Cypriot banking sector's NPL's (total exposures) amounted to be €27.3 bn in September 2015 (47.8% of the total amount of loans), compared to €27.4 bn in August 2015. Despite efforts made by the State in terms of legislation, aiming for NPL reduction, either via restructuring or via other tools that would facilitate arrangements, little progress has been observed in the banks' balance sheets. However, it appears that the upward trend in NPLs observed over the last years has finally come to an end, although the resulting NPL figure is now alarmingly high.

According to the CBC, NPL's dropped slightly in September 2015, by €50 mn compared to August 2015. Household exposures did not follow the overall trend, however, as total NPLs amounted to €12.8 bn from €12.7 bn in August.

Restructuring measures were taken for €5.7 bn in September compared to €5.8 bn in August 2015. Accumulated impairment losses amounted to €4.3 bn, accounting for 33.6% of total household NPLs. For businesses, the total NPLs amounted to €13.8 bn or 57% of total loans €24.2bn. Accumulated impairment losses for NPLs reported on the banking system balance sheets amounted to €9 bn or 33% of total NPLs.

Loans restructured by the end of September 2015 amounted to €13.9bn, of which €10.4bn million are still classified as non-performing. The root cause of this is two-fold:

1. According European Banking Authority's (EBA) definition, when a non-performing loan is restructured, it is no longer considered as performing, but remains classified as non-performing for a period not shorter than 12 months, even if the loan is serviced without delay and in accordance with the new repayment schedule.
2. In addition, the use of the aforementioned definition, explains the difference observed between the amount of exposures with arrears of over 90 days (running on 30th September, 2015 to €22.1 bn), and the amount of non-performing exposures, which amounted at that date to €27.3 bn.

Restructuring & Workout

Commenting on the loans restructuring progress, the CBC stated that the directive on management of delays was adopted in order to facilitate borrowers to service loans through equity from banks, minimize divestments amount and ensure business sustainability to support the island's economy. At the start of 2015, the CBC revised the Directive to facilitate and speed up the restructuring progress, by setting time limits to both banks and borrowers in the data delivery and compilation of restructuring proposals. Furthermore, a clarification was provided to banks stating that the information they should require from customers should be limited to what absolutely necessary to assess repayment ability of the borrower. Our position remains that the information needed and the whole process is needlessly complicated and needs to be streamlined and simplified (especially considering the loan assessment framework progress from an oversimplified loan review process in 2007 contributing to NPL formation to an overly complicated and time consuming process hindering NPL workout in 2015).

Sufficient information

The CBC Directive provides a framework for managing arrears - it is up to each bank to examine each borrower's situation and offer a restructuring solution to borrowers who are cooperative and provide full details of their income, making it easier to judge their repayment ability. This approach is essential to design a suitable restructuring solution (i.e. considering repayment ability rather than just tangible collateral). It is also advisable that banks also examine

collateral's liquidity prior to mortgaging assets; while some assets might have a higher theoretical valuation, not all assets are equal as far as time required for disposal to the open market is concerned (limited exit strategies).

Therefore, the borrowers who wish to restructure their loans are encouraged to ensure that they provide sufficient information on their income, especially SMEs, which often neglect to prepare financial statements, complicating and delaying the loan assessment process.

According to CBC analysis, the progress of restructurings is slowly picking up pace. For instance, the amount of loans restructured during the first quarter of 2015 amounted to €0.9 bn, during the second quarter of 2015 to €1bn, while the third quarter of 2015 the volume of loans restructured increase further to €1.3bn.

Large volume of loans in arrears

Reviewing the CBC analysis, it appears that the assessment of restructuring progress ought to take into account the large volume of loans in arrears, which should be considered for restructuring. It is reported that during the third quarter of 2015, there were 13,924 applications for restructuring, of which about 7,672 cases or 55% of restructurings were actually agreed, while 5,284 cases or 38% were transferred for consideration in the next month and 968 cases or 7% were rejected either by the bank or the borrower. Banks are trying to utilise new tools to reduce NPEs; however, the process is still very slow and overly-complicated. Banks also need to shift more staff to these workout departments and specialised training needs to take place so that staff is amply equipped to understand the new NPE realities and dynamics.

Finally, the CBC must push for a greater volume and quality of loan restructurings in addition to halting the creation of new non-performing exposures, for which it has implemented a framework of objectives assessed through four indicators, announced and posted on the CBC website (September 2015). The implementation of these objectives will be monitored by the CBC, which will review these objectives quarterly. Banks are obliged to provide proper and ample justification for any deviations from the four goals.

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