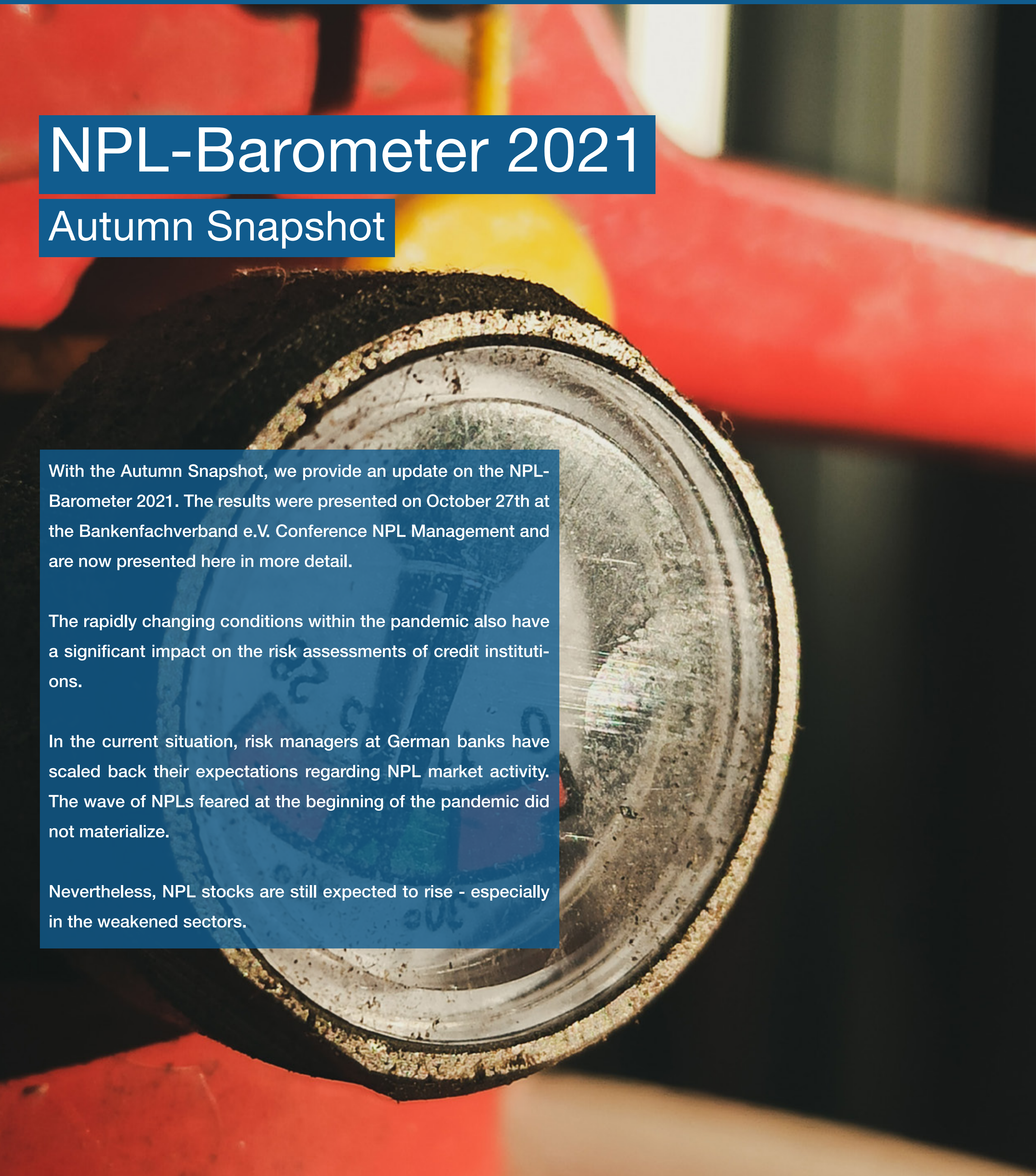
BKS | Bundesvereinigung Kreditankauf und Servicing e.V.

NPL RiskNews



NPL-Barometer 2021

Autumn Snapshot

With the Autumn Snapshot, we provide an update on the NPL-Barometer 2021. The results were presented on October 27th at the Bankenfachverband e.V. Conference NPL Management and are now presented here in more detail.

The rapidly changing conditions within the pandemic also have a significant impact on the risk assessments of credit institutions.

In the current situation, risk managers at German banks have scaled back their expectations regarding NPL market activity. The wave of NPLs feared at the beginning of the pandemic did not materialize.

Nevertheless, NPL stocks are still expected to rise - especially in the weakened sectors.

Preface

Since 2015, BKS has been using the NPL-Barometer in cooperation with the Frankfurt School of Finance & Management to accurately gauge the current mood within the risk departments of German banks. We ask about the actual development over the past twelve months and the expected development over the next twelve months, taking a close look at NPL stocks, purchase prices, the use of sales and outsourcing, the regulatory framework, and developments on the real estate markets.

For the period 2015 to 2019, the trend was more or less stagnant. After the financial crisis and the subsequent regulatory and supervisory measures, NPL stocks in banks were gradually reduced, which also kept NPL transactions in Germany at a low level compared with the crisis-ridden countries in Southern Europe.

The NPL-Barometer is plotted on a scale from -1 to +1. Values in the negative range of the scale indicate a less active NPL market, while a positive value indicates higher NPL stocks, more transaction activity, and lower sales prices. Even though 2019 already indicated a slight increase in expectations for the upcoming twelve months, it never-

theless remained in negative range.

This changed only with the May/June 2020 survey and the outbreak of the coronavirus pandemic. Expectations increased rapidly from -0.02 to +0.42 - the first positive value in the history of the barometer and the highest swing either direction had ever shown. Risk managers in German banks expected massive credit defaults and thus rising transaction activities in the context of the global lockdowns and supply chain issues. Fortunately, the states in general and the German government in particular reacted quickly and effectively.

The aid packages launched with emergency aid, liquidity and credit programs (KfW), short-time working allowances, payment moratoria and the suspension of the obligation to file for insolvency brought the number of defaulted loans down to even lower levels than before the pandemic.

This was reflected in the NPL-Barometer survey of February 2021. Although participants were still under the impact of the pandemic situation that prevailed during the winter, relief measures and advanced vaccine approvals have raised hopes for a rapid recovery.

With this autumn snapshot outside the usual annual cycle, we would like to provide an update that considers current developments within the rapidly changing environment. The snapshot was conducted in the course of October 2021 among the risk management departments of the German credit institutions.

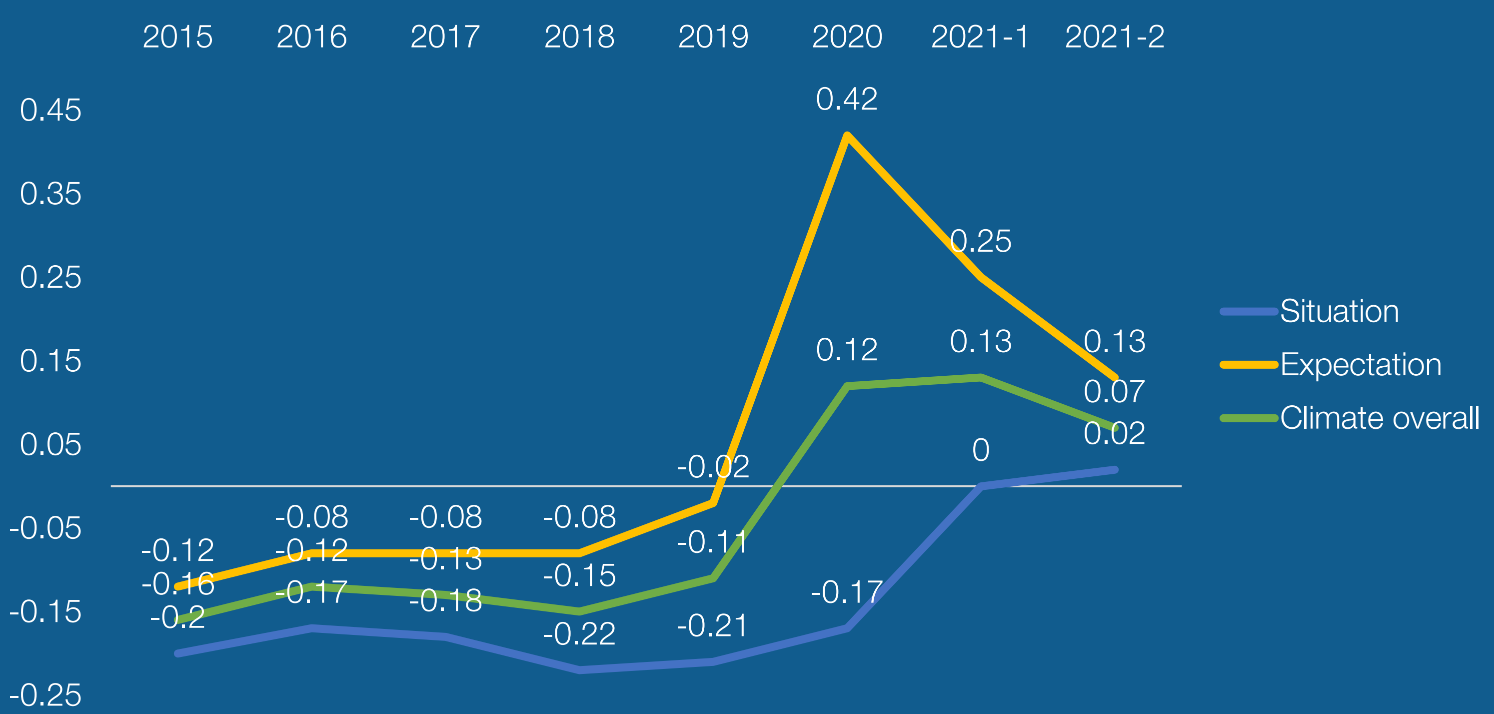
Most of the respondents were board members (16 percent) and business unit managers (60 percent), primarily from large private banks (46 percent), followed by cooperative banks (21 percent) and savings banks (13 percent). This broad selection allows us to draw a thoroughly representative overview of NPLs and risk management within the financial sector.

Outcomes

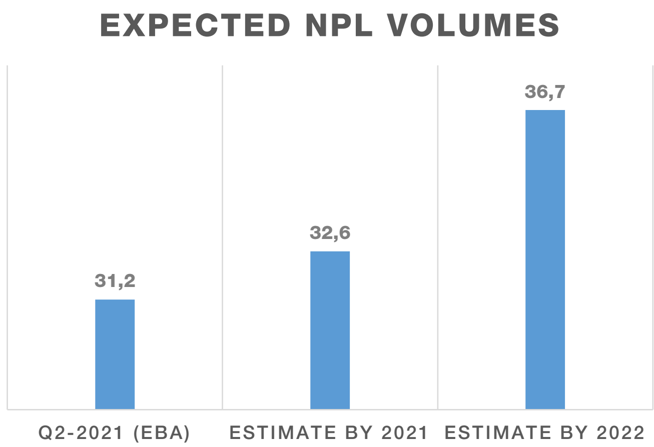
Overall, respondents expect less activity in the NPL market over the next twelve months (0.13) than showed in the March 2021 (0.25) and May to June 2020 (0.42) surveys. However, the value remains in positive range, indicating that respondents still expect activity in the market to grow. Looking at the actual market activity observed over the past twelve months, the value has hardly changed from the March survey this year (now 0.02 vs. 0).

In all previous years - including 2020 - the value was continuously between -0.22 and -0.17. This means that in 2021, for the first time, no majority decline in market activity was observed. According to the European Banking Authority (EBA), the current stock of non-performing loans in German credit institutions lies at EUR 31.2 billion in the second quarter of 2021.

The risk managers estimate an average of EUR 32.6 billion by the end of this year and EUR 36.7 billion by the end of 2022.



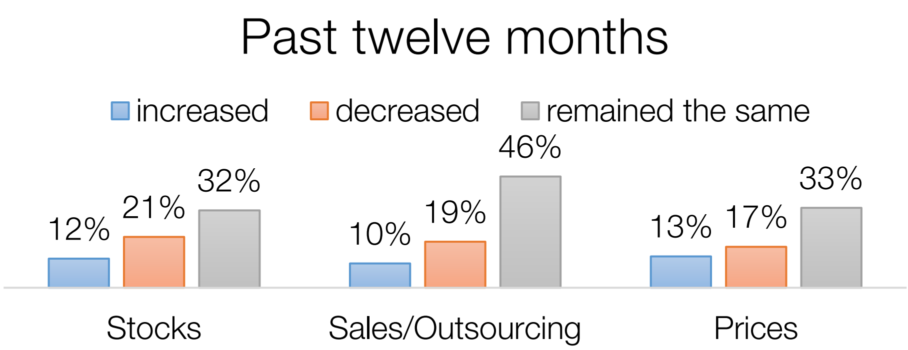
This shows that it is now expected that the support measures will continue to have a positive impact on bank balance sheets over the upcoming months. According to the estimate in spring 2021, 40.6 billion euros were still expected for 2021 and 46.7 billion euros for 2022. During the crisis, in May and June 2020, respondents even estimated that 59 billion euros in NPLs could have been occurred by the end of 2021 alone.

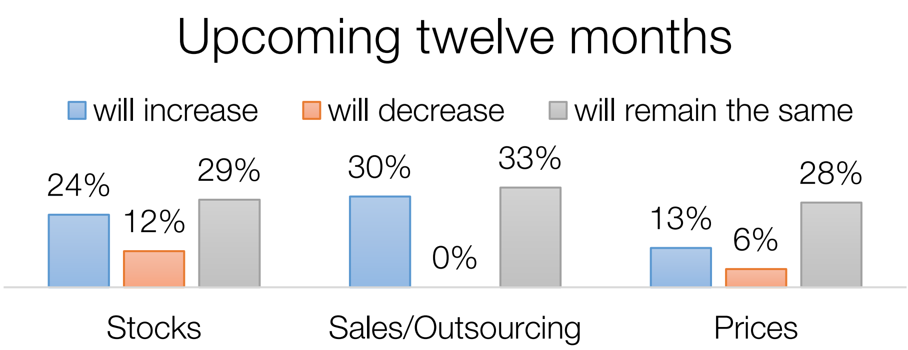


Consumer loans: focus on outsourcing and the sale of receivables

Consumer loans default primarily when individual life situations deteriorate unexpectedly, for example due to divorce or unemployment. Whereas at the beginning of the pandemic 69 percent of respondents still expected rising NPL stocks in the consumer sector, the figure dropped to 24 percent in fall of 2021. Rising unemployment figures were delayed or even prevented, not least by short-time work. Looking at the past twelve months, 19 percent of respondents noticed a decrease in sales and outsourcing of NPL stocks in this sector. However, no one expects a decrease in the next twelve months: 30 percent anticipate an increase and 33 percent a stable level. In terms of selling prices a less clear picture emerges from the survey. In the past twelve months, were observed mostly stagnating prices and those are also expected for the coming twelve months.

According to the Schufa Credit Compass (Kreditkompass) 2021, around 2.1 percent of all consumer loans are currently in default. The average estimates of respondents to the NPL-Barometer lies at 2.9 percent for 2021 and 3.2 percent for 2022.

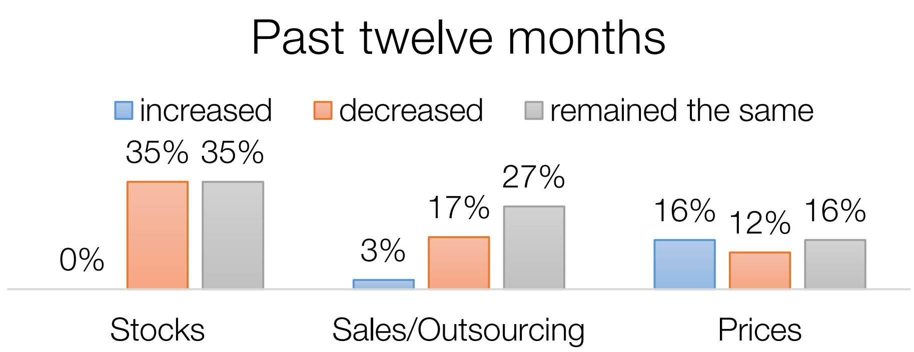


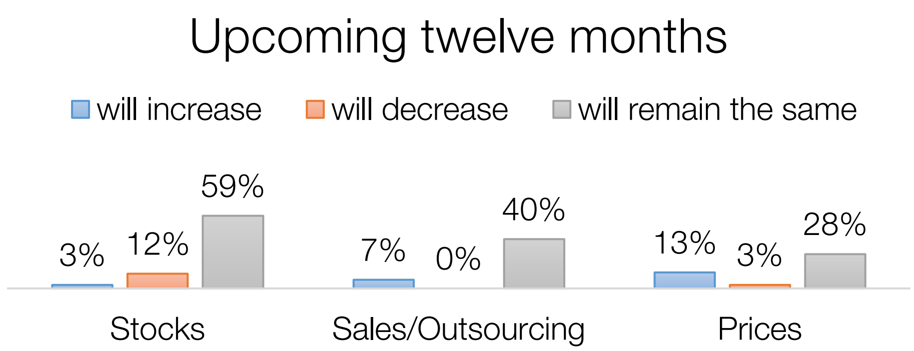


Residential NPLs were reduced

In the NPL-Barometer 2020, 56 percent of risk managers expected NPL stocks to increase in the future. Following the stabilization of the economy, 59 percent anticipate stocks to remain at the same level. Only three percent still estimate NPL stocks in the residential sector to rise. Most participants also expect sales and sales prices to stagnate. Moreover, the high real estate prices were used to further reduce NPL stocks: 35 percent reported that they had reduced NPL stocks in the past twelve months.

In the second quarter of 2021, according to the EBA the NPL ratio in the residential real estate sector was 0.9 percent.. The estimates from the NPL-Barometer recorded on average 1.4 percent for 2021 and 1.5 percent for 2022 and were thus at the lower end among all asset classes.

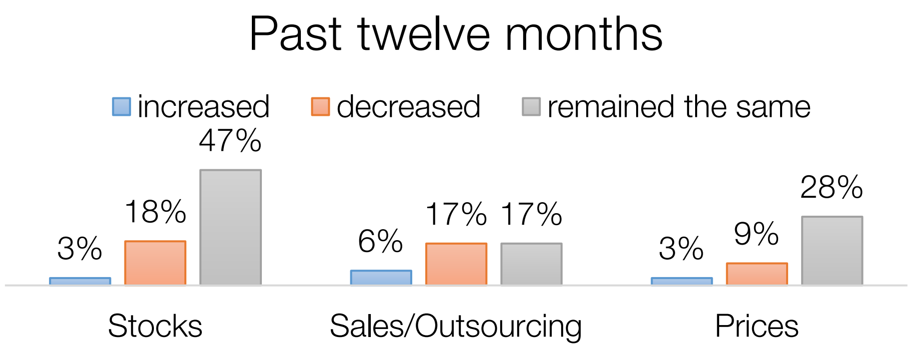


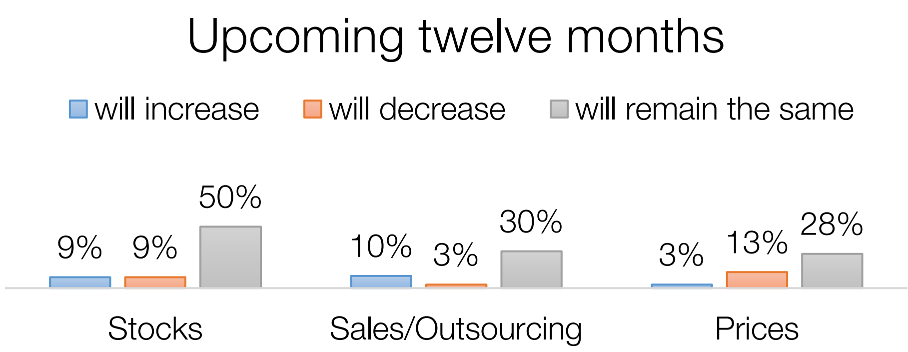


Commercial real estate loans were stabilized

The crisis directly affected various sectors of the commercial real estate industry where defaults were particularly feared. However, here too, the government support measures have shown their effects: Almost half of all respondents saw no change in the NPL stocks of commercial real estate loans over the past 12 months. In 18 percent of cases, these have even been reduced. For the coming 12 months, half again expect no change while nine percent each expect increasing or decreasing stocks. Furthermore, hardly anyone expects sales or outsourcing in this sector to decline in the next 12 months. Nevertheless, a need for action remains in many places, especially in the segment of commercial real estate. Home offices are increasingly becoming the „new normal“, downtown retail continues to be in transition, and the tourism industry must reinvent itself. Moreover, disruptive developments in industry as well as severe splits in the global economy can clearly leave their marks in this sector.

Compared with the other asset classes the expected NPL ratios are accordingly high. In the second quarter of 2021, the EBA reported a ratio of 2.1 percent. The risk managers estimates were 2.4 percent for 2021 and 2.6 percent for 2022.


Past twelve months
increased
decreased
remained the same
3%
18%
47%
6%
17%
17%
3%
9%
28%
Stocks
Sales/Outsourcing
Prices

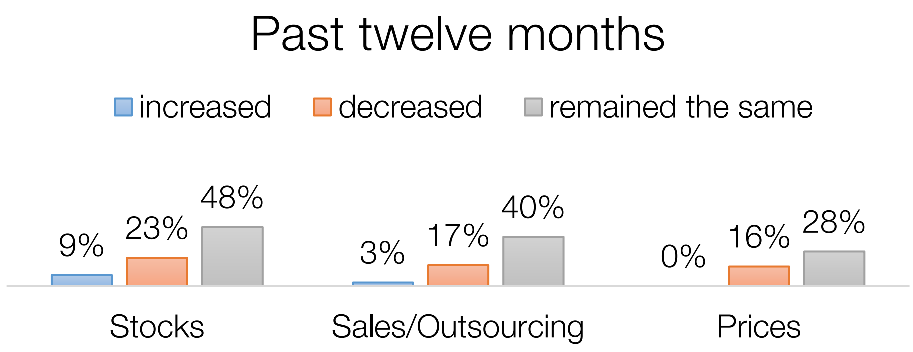

Upcoming twelve months
will increase
will decrease
will remain the same
9%
9%
50%
10%
3%
30%
3%
13%
28%
Stocks
Sales/Outsourcing
Prices

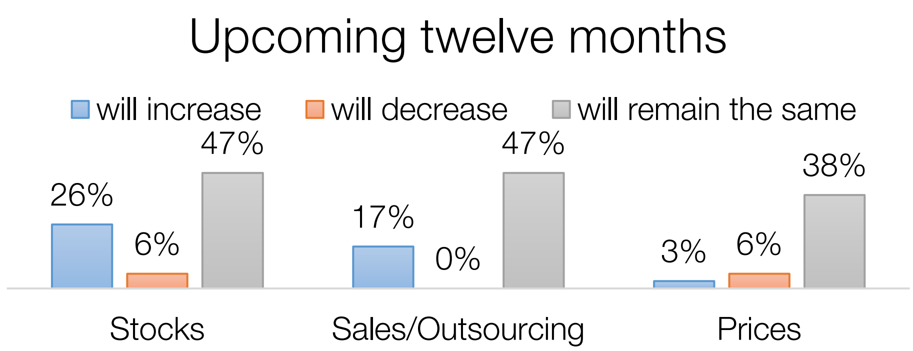

Helaba

Problem loans still to be feared mainly in SMEs sector

Small and medium-sized enterprises (SMEs), which include many business sectors affected by the lockdowns, could suffer the most from loan defaults. As of the 2020 NPL-Barometer, 77 percent of respondents still expected rising defaults in this segment. In fall 2021, this figure fell to 26 percent. Around half of the respondents estimate NPL stocks to remain stable in the future. Looking at the past twelve months, a quarter of respondents were even able to reduce their stocks, while for half of the respondents these remained constant. As 17 percent observed a decline in sales and outsourcing over the past twelve months, 17 percent expect an increase in sales. Further on, prices for NPL portfolios in this sector went down for 16 percent of respondents and up for none. In this respect too, it remains to be seen whether the state aid measures will have a lasting and sustainable impact effect or whether persistent economic difficulties will lead to downstream loan defaults.

The EBA reported a default rate of 2.8 percent for the second quarter of 2021, which is fully consistent with the data of the NPL-Barometer. For 2022, risk managers expect a rate of 3.4 percent.





Real estate markets

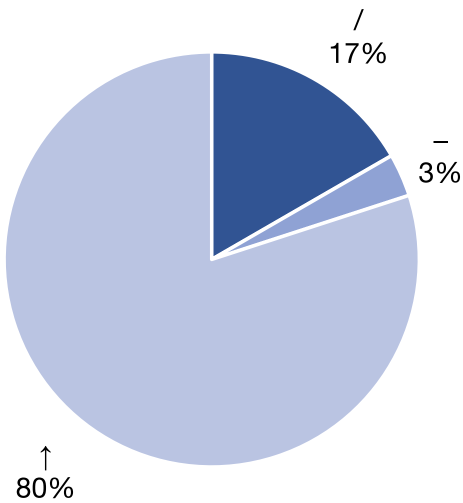
The development of real estate prices is already partly indicated by the assessments of the corresponding credit sectors, but we asked about real estate prices once more separately. In the first place transpires that for real estate in Germany most respondents observed rising prices in the residential sector, and more than half of those surveyed expect prices to rise in the next twelve months as well. Excessive liquidity saved income during the lockdowns and hitherto secure jobs appear to have facilitated this development.

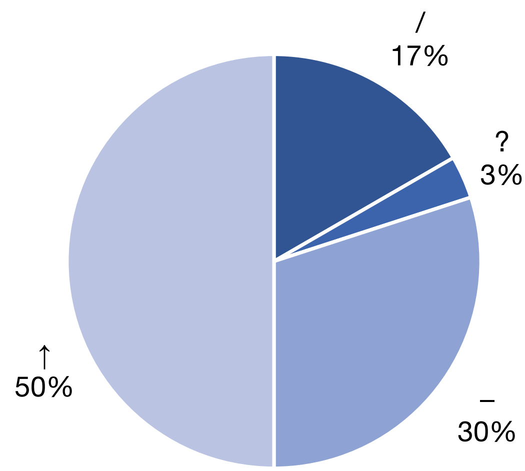
The situation is much different in the commercial real estate segment: Only 20 percent of risk managers estimate rising prices in this segment, while 44 percent expect no change and 13 percent presume falling prices. For the coming twelve months, as many as 20 percent anticipate decreasing prices, while only seven percent increasing prices and 47 percent expect no change. This reflects the current and structural challenges in the commercial real estate segment as mentioned earlier. For real estate abroad, the picture looks similar across all sectors (not illustrated).

Prices on the real estate market (Germany)

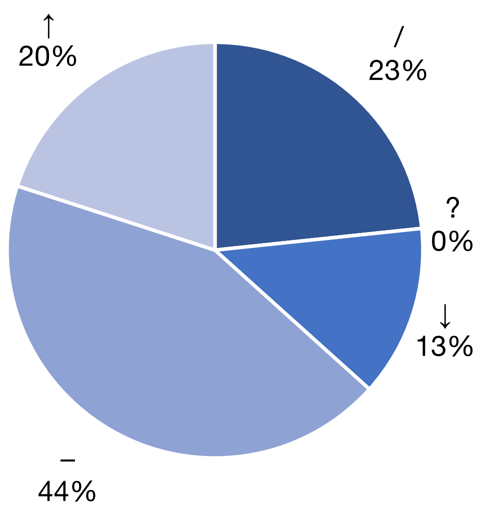
Past twelve months | Upcoming twelve months

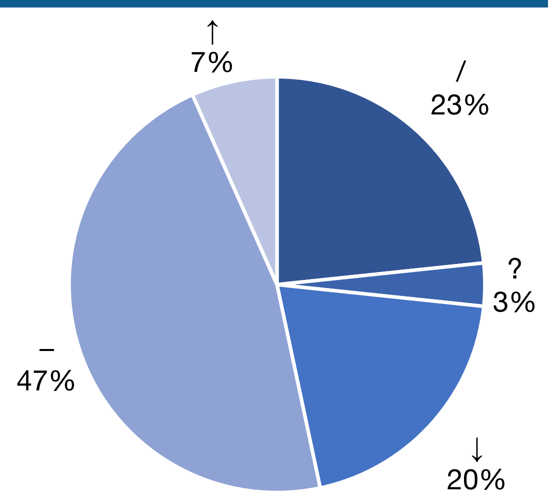
Residential real estate





Commercial real estate





/ Not applicable to our business   ? cannot say   – remained/will remain the same
↓ has decreased or will decrease   ↑ has increased or will increase

Regulatory environment

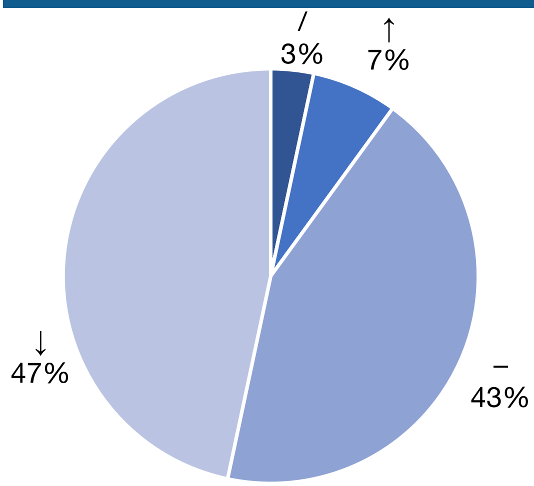
In view of the requirements imposed by policymakers and regulators, we asked the risk departments about developments in capital requirements and the burdens generated by additional administrative tasks.

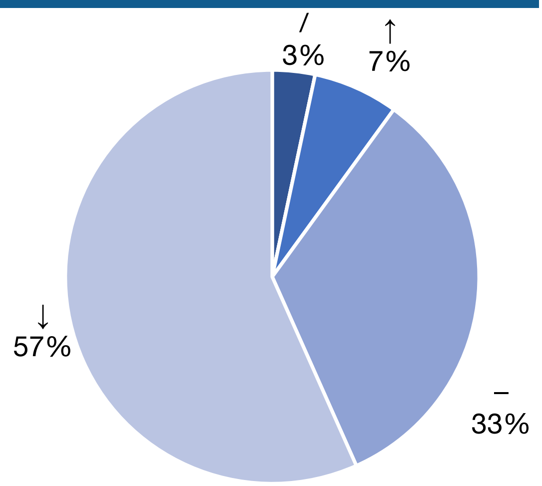
The regulatory requirements in the field of capital requirements were rated rather negatively by the participants both for the past twelve months (47 percent) and for the next twelve months (57 percent). Only seven percent noted a positive development. Asked about the administrative burden, as many as 73 percent saw a deterioration in the past twelve months while 57 percent expect this to continue in the upcoming year. The relevant factors for these assessments could have been the new legal requirements in the context of private insolvencies as well as the payment moratoria applied in the context of the pandemic emergency.

Two current projects within the framework of the European Commission's NPL Action Plan are so-called NPL Data Templates and an NPL Data Hub, for which were recently conducted two public consultations. BKS submitted its opinion on both documents by presenting a critical stance. In this context, 30 percent of the risk managers surveyed admitted that they would find an EU-wide data

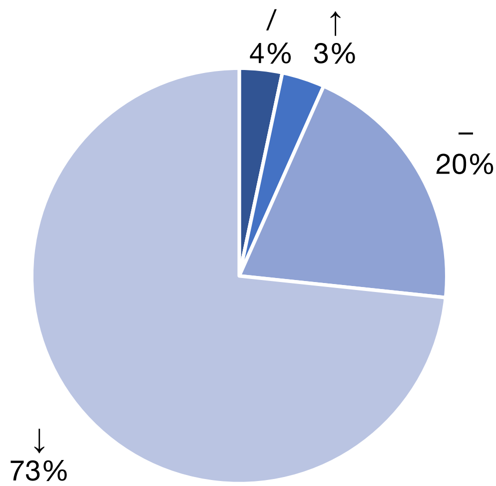
Past twelve months | **Upcoming twelve months**

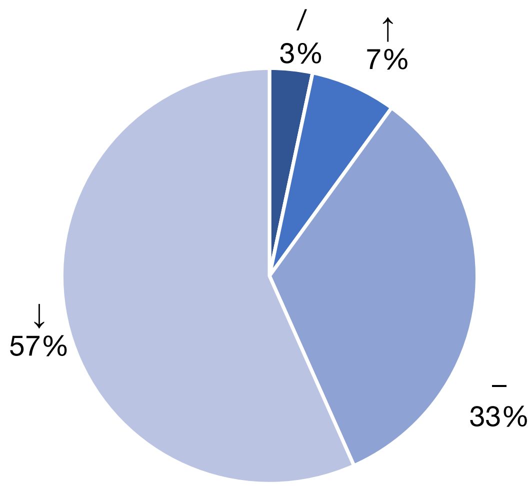
In view of capital requirements



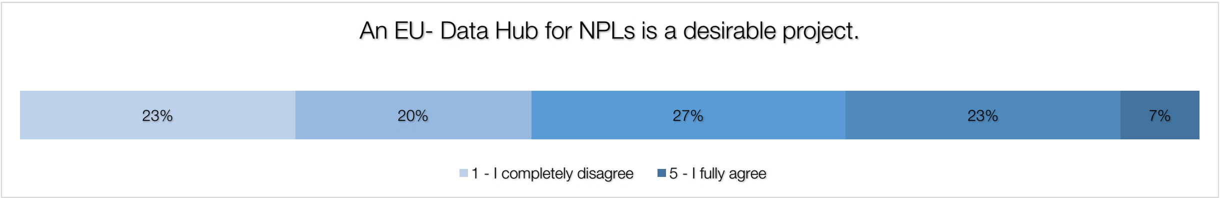


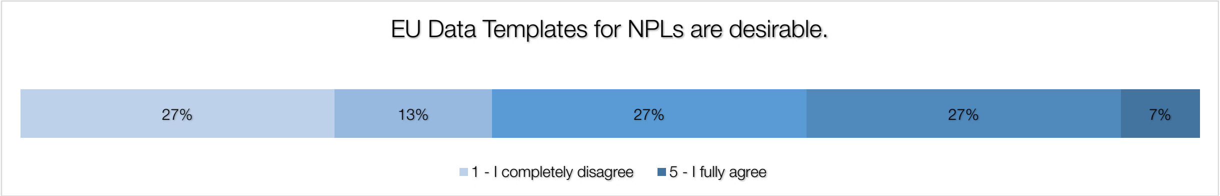
In view of administrative burden





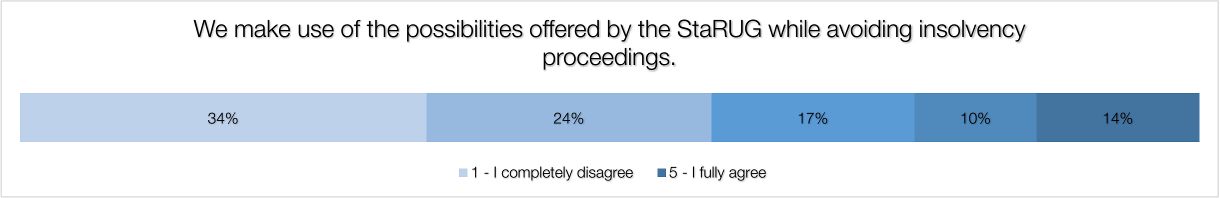
/ Not applicable to our business ? cannot say – remained/will remain the same
↓ negative development ↑ positive development





hub for NPLs desirable, while 43 percent objected the proposal, and 27 percent were ambivalent. The EU-wide data templates were rejected by the majority, albeit by a slightly smaller margin. A good third of respondents considered the templates desirable.

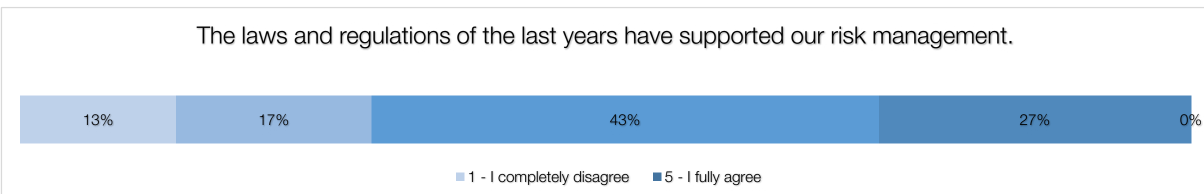
The New Act on the Stabilization and Restructuring Framework for Companies (StaRUG) created despite some resistance the basis for the implementation and enforcement of reorganizations while avoiding insolvency proceedings as of January 1, 2021. In the course of the NPL-Barometer statistical evaluation only 24 percent of the risk managers surveyed responded that they make use of this possibility. More than half gave a negative answer. It should be mentioned, however, that this new instrument is likely to be used primarily in the area of large corporate financings, which have not been until now considered by the NPL-Barometer.

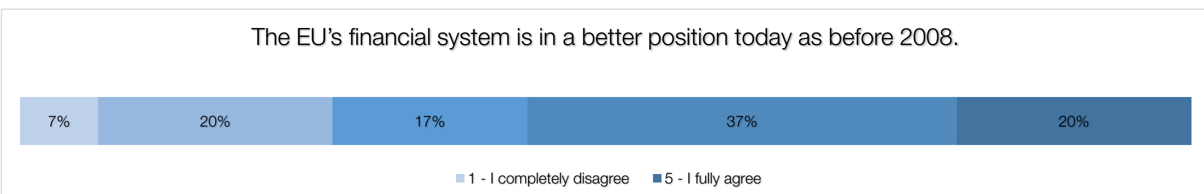


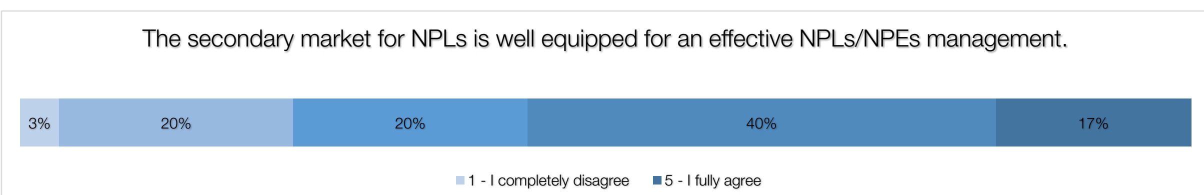
Overall, most respondents would neither agree nor disagree that the laws and regulations of the past years have supported their risk management. This looks surprising regarding the rather negative view of regulatory provisions with an impact on administrative expenses and equity capital, but it reveals that the respondents definitely find a justification for the complex requirements.

This is also reflected in the inputs of 57 percent of the respondents agreeing that the EU‘s financial system is in a better position today than it was before 2008. However, the central bank‘s loose monetary policy is viewed quite critically, with 60 percent fearing a „zombie economy“ caused by the bond and credit boom of recent years.

The secondary market for non-performing loans, on the other hand, was evaluated as well equipped for effective NPL management with 57 percent positive feedback and 23 percent seeing need for improvement.







Outcome

The present macroeconomic environment does not yet give the all-clear signal when it comes to risk management for non-performing loans. While de facto NPL ratios remain at a low level, it could be suspected that the extensive support measures taken by governments and the loose monetary policies of central banks conceal the true extent of the current situation.

Accordingly, the ECB‘s senior banking supervisor, Andrea Enria, regularly warns about a rapid reduction of provisions.

In addition, the potential impact of the current dramatic Corona development through restrictions on public and economic life will also further increase the risk to the financial sector.

The secondary market for NPLs has been acknowledged in the ECB‘s and EBA‘s NPL guidelines as well as the credit servicers and credit puchasers directive and thereby plays an important role as an instrument for crisis management.

Jan Dzieciol

Senior manager for politics & communication at BKS

jan.dzieciol@bks-ev.de

Av. Cristina Bachmeier, LL.M.

Legal advisor at BKS

cristina.bachmeier@bks-ev.de