



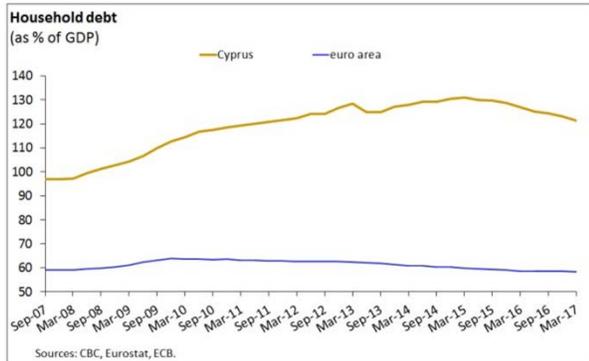
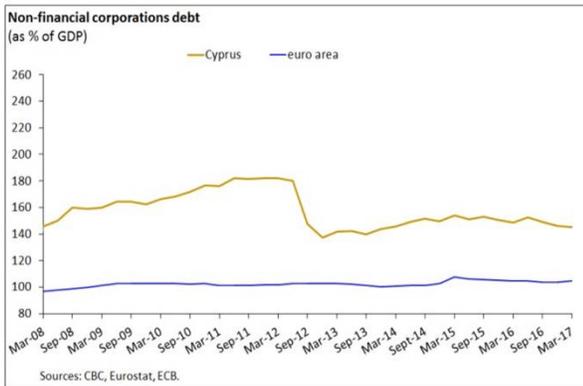
The case for ‘Private Debt and NPLs Strategisation’

A. In the midst of the storm

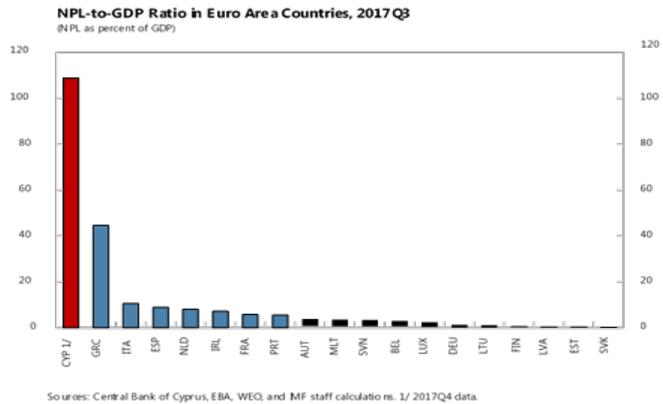
When Cyprus was embarking upon its turbulent journey into the unknown territory of elevated Non-Performing Loans (‘NPLs’) and excessive private debt, little did we know that more than five years later we would still be facing the same ‘whims of the weather’ and the same hardships, with no sight of a safe harbour yet.

The private sector debt is still unsustainably high and the country’s NPLs to GDP ratio is by far the highest in the Euro zone. The real economy, represented by households and SMEs, continues to be in extreme distress with the respective NPL ratios lingering well into the fifties (refer to the diagrams and table below - sources CBC, IMF).

Private Debt



NPLs



The Development of NPLs	31.12.2014		28.02.2018	
	in 000s Euro	%	in 000s Euro	%
Total	27.328.292	47,8%	21.992.456	45,3%
Non-Financial Corporates sub-total	4.858.139	49,9%	910.561	26,1%
Non-Financial SMEs sub-total	8.809.200	63,7%	9.238.750	58,5%
Households - sub-total	12.579.419	52,7%	11.357.815	54,9%

B. Steering through the storm

Steering through the storm invariably needs a captain at the steering wheel to provide directions, a compass to guide us through and a number of executors who will implement instructions. In other words, we need an authority to take overall and undisputed responsibility and accountability of the issues at hand, we need the guidance of thorough and diligent planning, and we need knowledgeable and dedicated implementers to convert plans into actions.



It is time for our country to take a long-term, holistic and forward looking approach, learning from the lessons and experiences of the past five years. The safe harbour we are longing for can be reached by proactively designing a strategic blueprint, as opposed to the fire-fighting, piecemeal tactics of the past which have been, to a great extent, retrospectively imposed upon us as a result of our inertia.

Our most recent ‘Russian roulette’ crisis, which led to a typical pandemonium of last-minute deliberations and recriminations and a bank run of our own making, must be abolished from our lives once and for all. This can only be achieved by, at last, advocating a fully comprehensive, proactive strategic framework. This is what I call ‘Private Debt and NPLs Strategisation’.

It is crucial to appreciate at this point that shifting NPLs onto an asset management company or selling off to third parties, albeit a helpful addition to the toolkit, cannot be considered to be a panacea in the absence of other complementary actions, given that the level of private debt will remain substantially unaffected.

C. What does Private Debt and NPLs Strategisation entail?

Essentially, a Government-espoused Private Debt and NPLs National Strategy aiming at a comprehensive, structured and multi-faceted resolution of the excessive private debt and the massive number of outstanding SME and household NPLs.

Specifically, the Strategisation approach is envisaged to take the form of a country-wide, bank-wide project (‘the Project’), which shall give rise to:

- i. independent and objective borrower segmentation across all NPL portfolios (all banks, non-terminated and terminated accounts). This segmentation will distinguish viable borrowers, over-leveraged but viable borrowers, non-viable borrowers, non-cooperative borrowers and will provide a solid and fair definition and identification of those truly vulnerable / deprived borrowers who are in real need of social assistance (whether they are classified as NPL or not),
- ii. the design of portfolio-based strategies on the basis of the borrower segmentation, the primary objective being to match the level of debt with the sustainable debt servicing capacity of viable borrowers,
- iii. professional execution of these borrower strategies.

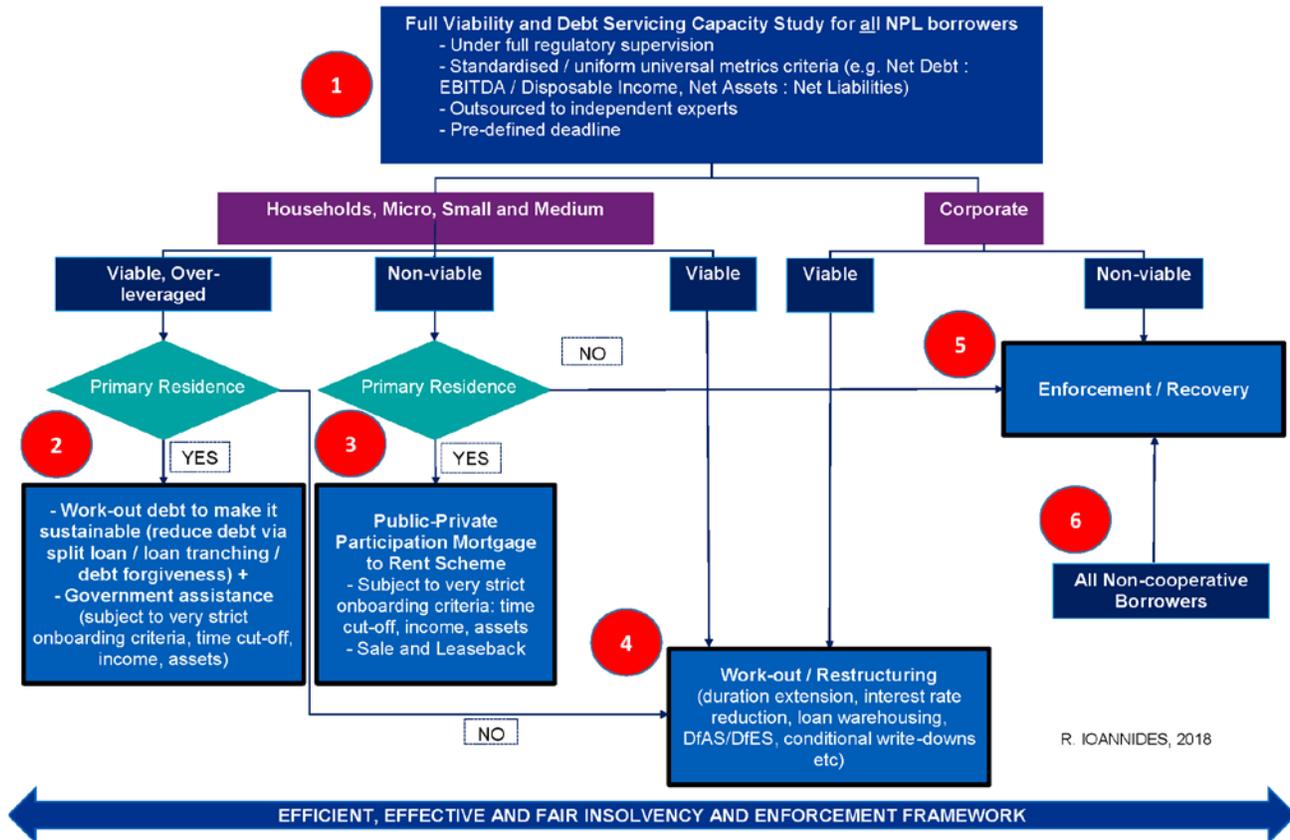
The above must be backed up by an effectively operational insolvency framework and judicial system which will facilitate and promote timely and cost-effective enforcement resolutions where necessary (non-viable, non-cooperative borrowers), combined, at the same time, with targeted protection of genuinely vulnerable borrowers. Importantly, the enhancement of the framework will lead to the natural uncovering of all those strategic defaulters, who have usurped the insolvency framework’s inefficiencies to date.

Although such segmentation and execution strategies may have been adopted by banks, these have been arguably followed on an ad-hoc, individual basis and have invariably been impacted by each bank’s specific embedded, and possibly limiting, legacy structures, policies, procedures, criteria and biases and have had disappointing results so far (households and SMEs). What Strategisation proposes, instead, is a fully comprehensive country-wide strategy and action plan – the diagram below depicts an indicative Strategisation



blueprint. The power of this model lies in its uncomplicated simplicity, its directness and robustness and its all-encompassing penetration.

STRATEGISATION BLUEPRINT



D. How will Strategisation work?

A strategic mix of independent expert resources will be required to work through the inter-dependent components:

- A governing body of independent experts with overall and undisputed responsibility and accountability for the Strategisation Project (the captain): this body will set the terms of reference, the objectives, the Project milestones (short to long term) and will overview and monitor implementation and adherence.
- Knowledgeable, specialised technocrats who will carry out the foundational part of the Project: a complete segmentation analysis of, and corresponding strategies for, all NPL borrowers across all banks, utilising uniform analytical tools and criteria and pre-defined time cut-off criteria (the compass).



- iii. Dedicated executors: independent debt servicing and real estate asset management specialists. These will be the experts who will be implementing the strategies on a day-to-day basis.
- iv. Specialised legal and insolvency experts: will build upon our existing insolvency and judicial / enforcement frameworks, the essential facilitators of the Strategisation approach, with a view to re-designing them for maximum effectiveness and efficiency. Although the recent changes in a handful of laws are a move in the right direction, so much more is required: a widespread upgrading in a multitude of inter-related legislations and regulations (the tools) and a simultaneous comprehensive overhaul of the foundational infrastructure and set-up of our judicial system (the mode of execution).

E. What are the benefits of this approach?

- i. A truly holistic approach linking all inter-interdependent parts of the puzzle.
- ii. Unbiased independence and objectivity.
- iii. Zero tolerance to political or third party intervention.
- iv. Undisputed Project responsibility and accountability.
- v. Project management approach, with milestones and strict monitoring.
- vi. Standardized collection and analysis methods, processes and procedures.
- vii. Tested tools and methodologies, uniform and consistent criteria, universally acceptable results and reporting.
- viii. Well-informed, fair and sustainable portfolio-based strategies for each category of borrowers.
- ix. Expertise, dedication and objectivity in the day-to-day dealing with each NPL case.
- x. Uncovering of strategic defaulters and targeted protection of vulnerable borrowers.
- xi. Costs to be borne by lenders and the State.

F. Conclusion

Our fragile economy is not able to withstand the weight of the excessive private sector debt nor the massive volume of NPLs for much longer. What's more, if we simply continue to passively react to emerging hurdles, this will inevitably lead to a shipwreck when the next storm (crisis) hits our country.

Nevertheless, the proverbial safe harbour *is* a real destination. The route to take us there is a truly forward-looking and persistent Strategisation approach underpinned by a proactive all-inclusive and multi-disciplinary strategic framework.

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