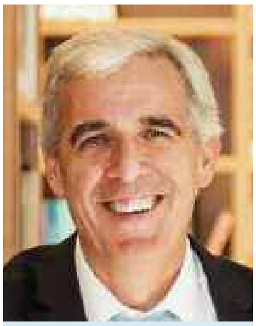
The mounting 'non performing loan' problem in Greece

Stathis Potamitis discusses the recent attempts by the Greek government to deal with the mounting non-performing-loan (NPL) problem



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Greece entered its current economic downturn nearly six years ago. Since then, it has given up more than 25% of its GDP while unemployment and especially youth unemployment is skyrocketing.

At the end of 2014 we saw the first indications of a return to growth but the recovery remains fragile and uncertain. Political uncertainty, to which the recent change of government is a significant contributor, adds further complexity to the recovery effort.

The crisis has served to highlight the problems of the Greek insolvency laws. For instance, while the crisis (and the liquidity crunch) unfolded, debtors stopped paying but very few amongst them, and very few creditors, resorted either to insolvency or one of the pre-insolvency proceedings. It actually appears (statistics are informal and unreliable) that there have been fewer insolvency petitions in the crisis years on an annual average than previously. As a result, we now have a great number of practically insolvent debtors in Greece who remain outside any kind of formal insolvency proceeding. A recent study by PriceWaterhouse Coopers[1] shows that a very large percentage of Greek companies can be described as "zombies" (54% of their sample, employing 46% of the total number of employees and 42% of the total revenues) and that at least one quarter of the outstanding debt is held by debtors which are incapable of servicing their debt and are even beyond restructuring. The study also shows that the largest portion of the overall debt is held by entities that require debt restructuring. Nevertheless, creditors and debtors rarely resort either to liquidation or restructuring. This means that unserviceable debts continue to pile up, productive means remain trapped in the hands of inefficient or inactive producers, and yet there is no general trend towards the use of insolvency and pre-insolvency tools as a solution.

The reform of the insolvency laws is an outstanding item of the bail-out agreement between the Greek state and the official creditors' group; some initial steps have been taken in defining the direction of these reforms and the areas of greater emphasis. A related reform that has advanced closer to implementation is the Greek Code of Civil Procedure as regards the execution of security interests and the ranking of creditors, especially the super-priority currently enjoyed by public creditors and employees. The fate of these reforms is now uncertain given the change of government at the end of January 2015 and the formation of a new cabinet by a coalition of fervently anti-austerity radical left and extreme right wing parties united in their commitment to renegotiate the bail-out agreement and revisit the agreed reforms.

However, just before the elections of January 2015, a series of emergency measures to address the NPL crisis were adopted by the Greek Parliament. These measures were intended to provide stop-gap solutions to debtors and creditors that were unable or unwilling to resort to the normal insolvency and pre-insolvency proceedings and provide a mix of out-of-court and simplified in-court solutions. These emergency measures fall into two categories.

The first category includes a set of fiscal and other incentives to encourage banks to forgive and/or reschedule small enterprise debt ('small' meaning having an annual turnover of up to €2.5 million). These incentives dovetail with a new installment plan for the repayment of tax and social security debt by the private sector. The rescheduling of that debt also includes the writing off or writing down of surcharges and penalties for delinquent debtors. The fate of these measures has been rendered uncertain by the election of the new government that has promised to introduce new, and possibly, more drastic measures for private debt restructuring.

The second category includes two new court proceedings for larger debtors. The first is a ratification process for restructuring agreements agreed between the debtor and more than half of its creditors and of the secured creditors (in terms of amount of debt); consenting creditors must include at least two financial institutions. The proceedings are similar to the "*pre-pack*" ratification under the Bankruptcy Code, but significantly simplified and streamlined by comparison thereto. In particular, the ratifying court need not assess the viability of the debtor as a precondition for providing its ratification. Similarly, the court need not establish that treatment of the non-consenting creditors (who are crammed down) meets the best interests test,

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but any such creditors have a short period within which to sue for any deficit between what they are entitled to receive under the ratified plan and what they would be able to receive in liquidation. The second type of proceedings, styled as "*special administration*", is an expedited public sale of the insolvent entity's business upon the application of at least 40% of its creditors (by amount of outstanding debt), that includes at least one financial institution. The statute provides that this sale must be completed within 12 months, otherwise being converted into a bankruptcy liquidation.

The emergency court proceedings that were just introduced are intended to deal with a number of problems that plague the standard Insolvency Code proceedings. Insolvency liquidation is extremely inefficient. As the most recent World Bank "*Doing Business Report*" shows,[2] compared to other European jurisdictions (including Italy which is similar to Greece in terms of delays in the judicial process), the Greek proceedings are much slower (more than two times), relatively cheap (less than half the cost in Italy but twice as expensive as in Belgium), and securing far lower returns to the creditors (approximately half of those in Italy and less than half compared to Belgium and Spain).

Greek bankruptcy liquidation is therefore exceedingly time-consuming while providing very low returns to creditors. As a result, debtors do not perceive bankruptcy as a credible threat and resist reasonable restructuring offers by creditors. In addition, pre-insolvency proceedings are procedurally complex and overly sophisticated for the general jurisdiction courts that are called upon to try them. This results in great delays and unpredictable outcomes which discourage their use. The new emergency proceedings try to address both the hold out and the time and complexity problem. They also provide banks with a pivotal role and their customers with a special tax and other incentives for debt relief.

It is still too early to gauge the success of the new measures; external factors, such as the rate of economic growth and the liquidity in the market, will surely be significant contributing factors. Nevertheless, it is a safe bet that as Greece struggles to deal with the crisis and its impact and the ever growing mountain of private debt, we will see continuing efforts to reshape and improve Greek insolvency and pre-insolvency tools. ■

Footnotes:

1 http://www.pwc.com/en_GR/gr/publications/assets/stars-zombies-eng.pdf

2 http://www.doingbusiness.org/~/media/giawb/doing%20business/documents/profiles/country/GRC.pdf.

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