

The Legal Framework for Non-Performing Loans in Greece

Yiannis G. Sakkas and Yiannis G. Bazinas report on the new Law 4354/2015 in Greece



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Introduction

The Greek Parliament has passed legislation (Law 4354/2015) to govern the assignment and/or the transfer of Non Performing Loan claims (NPLs), including provisions on:

- Obtaining a license from the Bank of Greece for Debt Management Companies and Debt Transfer Companies (DTCs) for Non-Performing Loans;
- The agreements assigning the management of claims; and
- The sale and transfer of claims from non-performing loans and credit agreements.

The growing rate of non-performing loans in the Greek financial system represents one of the major obstacles in the country's effort for economic recovery. Since the beginning of the financial crisis, the NPL rate has increased dramatically, from 9.1% in 2010 to 35% in 2015¹. In absolute terms, non-performing exposures in the domestic banking system currently amount to €107b², undermining the capacity of banks to lend in the recovery. As a result, the Third Economic Adjustment Program for Greece naturally placed NPL resolution at the epicentre of attention and identified it as a key reform, necessary to unlock the disbursement of subsequent tranches of economic assistance³.

So far, the effort to tackle the ever growing NPL problem of the Greek economy revolved around management policies within balance sheet and off-balance sheet. These measures however failed to slow down the rise of NPLs and when in 2015 banks

began facing serious threats to their viability, a new approach was required. In this respect, Law 4354/2015⁴, which came in force on 16 December 2015, represents the country's first attempt to foster a secondary market, regulating the management, disposal and refinancing of NPLs through Asset Management Companies (AMCs) and DTCs.

The definition of NPLs: exclusion of certain categories of bad debt

The law adopts a 90 day past due threshold to define Non-Performing Loans. This falls in hand with the universal understanding of impairment and default according to the International Financial Reporting Standards (IFRS) and Regulation (EU) No 575/2013 (CRR).

However, law 4354/2015 provides for an express carve out, excluding from its ambit certain categories of bad debt. The legislation does not apply to Small and Medium Sized Enterprise⁵ loans, state guaranteed debt as well as consumer and primary residence loans. These categories of NPLs were left to be regulated separately. The deadline to enact the corresponding framework was initially set for 15 February 2016 but was subsequently deferred for 15 April 2016.

Incorporation and licensing requirements

Assets Management and Debt Transfer Companies could be either *sociétés anonymes* seated in Greece or in a Member State of the European Economic Area, acting through a local branch.

The law also provides for a minimum paid up capital of €100,000 but only for companies acquiring debt receivables. Legal entities managing claims will have to put together a minimum share capital of €24,000, the amount provided for *sociétés anonymes* incorporated in Greece. Otherwise, companies seated in a Member State of the European Economic Area will need to satisfy the company law requirements at their place of origin.

The entry share capital is admittedly miniscule compared to the exorbitant amount of bad loans in the country. However, a reduced paid up capital requirement lowers the cost of access to the NPL market and allows for greater specialisation, a crucial component in the operation of the distressed debt framework, which can only proceed as far as the market infrastructure allows⁶.

To conduct the activity regulated under the NPL law the companies will need to obtain a license from the Bank of Greece (BoG)⁷. The statute provides for a decision within twenty (20) days as of the submission of a complete file. The information required includes a record of all direct or indirect participators to the applicant company, a list of all shareholders holding ten percent (10%) or more of its share capital, as well as details of all BoD members⁸.

As part of the licensing process, the above named persons will also need to complete and submit suitability assessment questionnaires based on criteria formulated by the Bank of Greece⁹. To determine eligibility, the BoG further requests a special



committee to opine within the above prescribed period. The short time limits provided clearly purport to expedite and disentangle the process from procedural delays. However, the law is not explicit on all matters pertaining to licensing, which are left to be determined by an Act of the Bank of Greece. Two months after the voting of the law, the BoG has prepared an Act with the particulars on the establishment and operation of the regulated companies, issued on 10 March 2016 (Act No.82/8.3.16).

Management of Claims

Once duly established and licensed, AMCs and DTCs can focus their activities on the three main pillars of the NPL law: management or transfer of debt receivables and refinancing. Only claims from loan and/or credit agreements are eligible for assignment. Nevertheless, the 90-day delinquency period is not an

absolute criterion, given that the law permits AMCs to also service performing loans. This is on the condition that the management company will also be assigned non-performing loans of the same debtor. All assignment agreements are notified to the BoG and should contain at the minimum provisions on the legal and accounting monitoring of debt receivables, collection, negotiations with the debtors, settlement agreements as well as the applicable fee for servicing the loans, which cannot be passed on to the debtor. Upon receipt of a copy, the agreements are subject to the prudential supervision of the Bank of Greece before entering into force.

The management company is further empowered by law to proceed to all judicial actions necessary for the collection of claims as well as to take part in pre-insolvency corporate turnarounds, pure insolvency proceedings or para-insolvency

emergency measures recently introduced to offer out of court and simplified in-court solutions for distressed debtors¹⁰, with *res judicata* also applying to the beneficiary of the claims and not just the AMC. However, by express reference in the law, the substantive and procedural position of debtors and guarantors cannot be worsened by the assignment or sale of the corresponding NPLs.

Transfer of Claims

Law 4354/2015 also provides for the disposal of debt receivables¹¹. Claims eligible for transfer will need to be *in arrears* for 90 days, a deviation from the corresponding wording for the assignment of management which requires that claims have to be “*non-performing*” for 90 days.

As an additional condition, NPLs may be offered for sale only after inviting the relevant borrower and any guarantors to



THE LAW ADOPTS A 90 DAY PAST DUE THRESHOLD TO DEFINE NON-PERFORMING LOANS





THE LAW ALLOWS THE TRANSFER OF CLAIMS UNDER LOANS THAT ARE STILL PERFORMING ON THE CONDITION THAT NPLS ARE ALSO INCLUDED



restructure or settle their outstanding obligations within twelve (12) months prior to the disposal. This is a very crucial provision, given the practical significance in the screening of qualifying NPLs. Nevertheless, the relevant article 3 (3) is not stipulated with the utmost clarity required to determine whether the twelve (12) months period will have to expire in full for the notice to be effective or an invitation at any point within a year prior to the proposed disposal will satisfy the condition imposed.

In any case, the said notice is not a prerequisite for disputed or adjudicated claims as well as claims against *non-cooperative debtors* in the meaning of the Banking Code of Conduct¹². This is very much expected to increase the number of debtors for which the notice requirement is waived, given that the definition of a *cooperative debtor* is rather onerous, requesting the prompt production of documents and the

furnishing of information within strict deadlines.

The Debt Transfer

Companies can acquire both individual claims or claims in groups, with the NPL law expressly forbidding the application of article 479 of the Greek Civil Code. This is a provision that applies to the disposal of asset pools and provides that the transferee is liable for obligations relating to the assets transferred for an amount equal to the value of the transaction.

This is a substantial deviation from the civil code provisions that could otherwise dissuade participation of DTCs. In the same line of enticing investments and precipitating further involvement in the secondary market, the law also allows the transfer of claims under loans that are still performing on the condition that NPLs are also included in the pool. Security rights are also transferred with the

receivables they secure.

Refinancing NPLs

Finally, both AMC and DTCs can have a more active role in the funding of NPLs. A license will have to be issued by the Bank of Greece for the specific activity, upon which DTCs could provide loans and credit only for the purpose of refinancing the NPLs they have acquired, whereas AMC could grant new loans provided that the owner of the claim consents. Therefore, rather than just removing the bad debt from the balance sheets of credit institutions, AMC and DTCs can look to turn around distressed companies by investing directly in the firm, restructuring their debt, and reorganising their operations¹³.

However, before a secondary market financing regime is up and running there are some tax issues involved that need further consideration, particularly the applicable duties and taxes for

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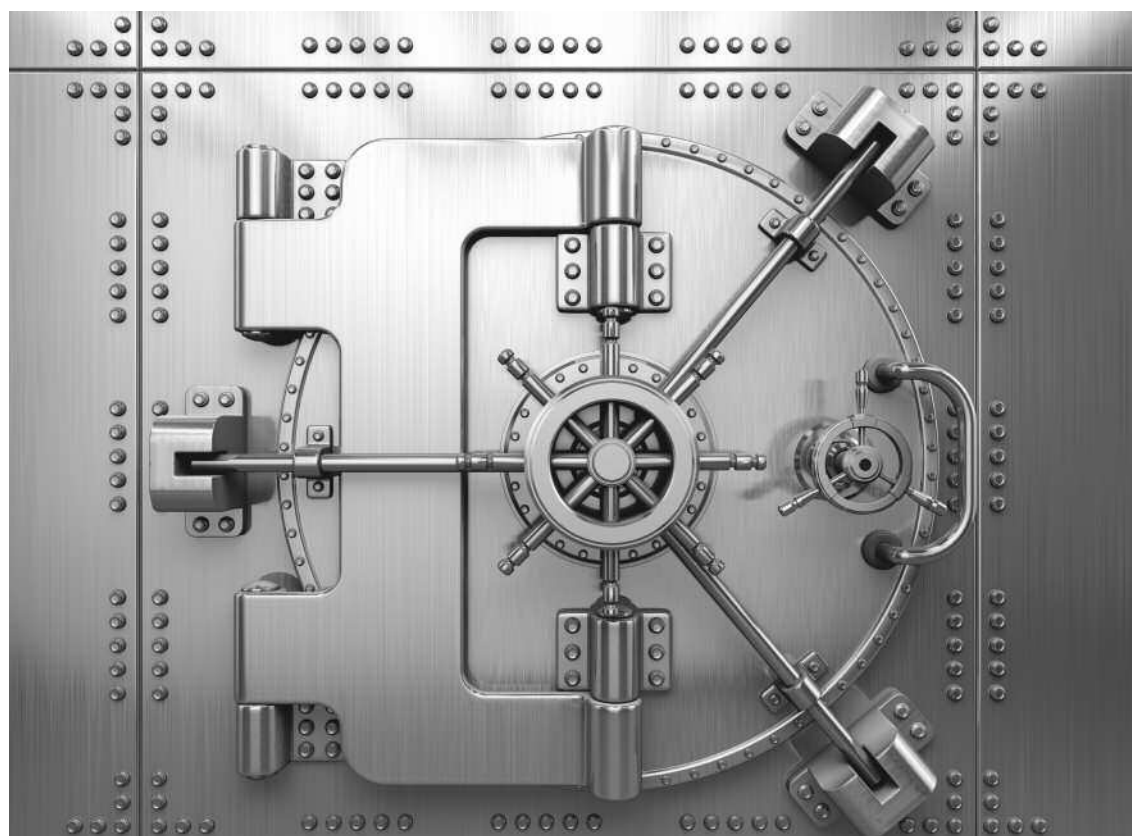
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such lending, a pivotal factor in determining the cost of funding for investors and borrowers alike. The NPL legislation does not contain provisions on the matter at this stage.

Conclusion: The importance of a comprehensive approach to NPL resolution

Unlike similar attempts in southern European countries, Greece did not follow a “bad bank” model to deal with the problem of non-performing loans¹⁴. Instead of assigning NPL resolution to a central body, the current law adopts a more decentralised approach and seeks to attract private investors, specialised in distressed loan management, to resolve NPLs. By facilitating asset disposals, the new law could provide a solution to the pressure that the banking system has experienced over the past years and allow banks to free up valuable capital and resources to support new lending. Considering the ability of AMC and DTCs to refinance NPLs, a liquid secondary market for distressed debt could also expand non-bank sources of financing thereby increasing access to credit.

In short, the new legal framework holds promises for improving the stability of the banking system and supporting a faster economic recovery by facilitating the exit of non-viable firms and encouraging the growth of viable ones. The legal and institutional framework for insolvency and specifically on how quickly and cost effectively NPL companies will be able to recover their investment is crucial in this perspective. The Greek insolvency law offers tools to facilitate this, including early restructuring opportunities with a pre-pack route and debt-equity swaps but there is room for improvement especially in the field of expediting proceedings, reducing the cost of enforcement and emphasising on a framework to support out-of-court arrangements. Within such



comprehensive regime the new law could prove vital in the resolution of distressed debt and in strengthening the banking system and the credit environment in the country. ■

Footnotes:

- 1 World Bank Databank, World Development Indicators, available online at <http://data.worldbank.org/data-catalog/world-development-indicators>. The Bank of Greece reports a 43.6% NPE rate, which includes NPLs as well as loans that, even though performing, are considered unlikely to be repaid.
- 2 Bank of Greece “Report of the Governor of the Bank of Greece”, 2015, p. 186.
- 3 After the conclusion of the recapitalisation of the banking system at the end of 2015, the introduction of Law 4354/2015 was the essential next step to ensure the viability of the banking system and restore its ability to finance economic growth, on the recapitalization see *Y. Bazinas, Y. Sakkas, The Creditor Participation in the Recapitalization of the Greek Banking System—Part I*, Banking Law Journal Volume 133, Number 3, March 2016, p. 153 (in print).
- 4 Law 4354/2015, State Gazette A 176, 16.12.2015, for complete English translation see, http://www.bazinas.com/_uploads/c3f413925345eb7c234cf72f03d98346.pdf
- 5 As defined by Recommendation no. 2003/361/EC of European Commission of 6th May 2003 (Official Journal L 124 of 20.05.2003).
- 6 Euro Area Policies: IMF Country Report No. 15/205, July 2015, p. 70.
- 7 The BoG also has a supervisory role and can suspend or revoke licenses for infringements including fraud or money laundering etc.
- 8 A Report on the basic principles applied for the management of debt receivables is also required, making a special reference to socially vulnerable debtors in accordance with the provisions of the Banking Code of Conduct, article 1 para 2 of L. 4224/2013 (A 288) and the law on consumer bankruptcies, see law 3869/2010 (A130).

the management of debt receivables is also required, making a special reference to socially vulnerable debtors in accordance with the provisions of the Banking Code of Conduct, article 1 para 2 of L. 4224/2013 (A 288) and the law on consumer bankruptcies, see law 3869/2010 (A130).

- 9 These will be based on the guidelines of the Committee of the European Banking Supervisors and the assessment criteria for the suitability of members of the management body and key function holders of the European Banking Authority, as provided in an Act of the BoG.
- 10 See article 61 et seq. of law 4307/2014 often touted as para-insolvency proceedings given that they are not regulated by the insolvency code.
- 11 The sellers of debt receivables are exclusively listed in the law and include entities with a banking license in Greece, local branches of foreign credit institutions, SPVs of the law on securitisation of claims (3156/2003) as well as DTCs under the NPL legislation. The transfer is effective upon registration of a summary of the sale agreement, see article 3 of law 2844/2000.
- 12 Law 4224/2013 and BoG Act dated 27/08/2014, as in force.
- 13 N. Jassaud, K. Kang, *A Strategy for Developing a Market for Nonperforming Loans in Italy*, IMF Working Paper, WP/15/24, p. 25.
- 14 International Monetary Fund, *Policy Options For Tackling Non-Performing Loans In The Euro Area* in “Euro Area Policies, IMF Country Report No. 15/205, July 10, 2015 available online at <http://www.imf.org/external/pubs/cat/longres.aspx?sk=43127>



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