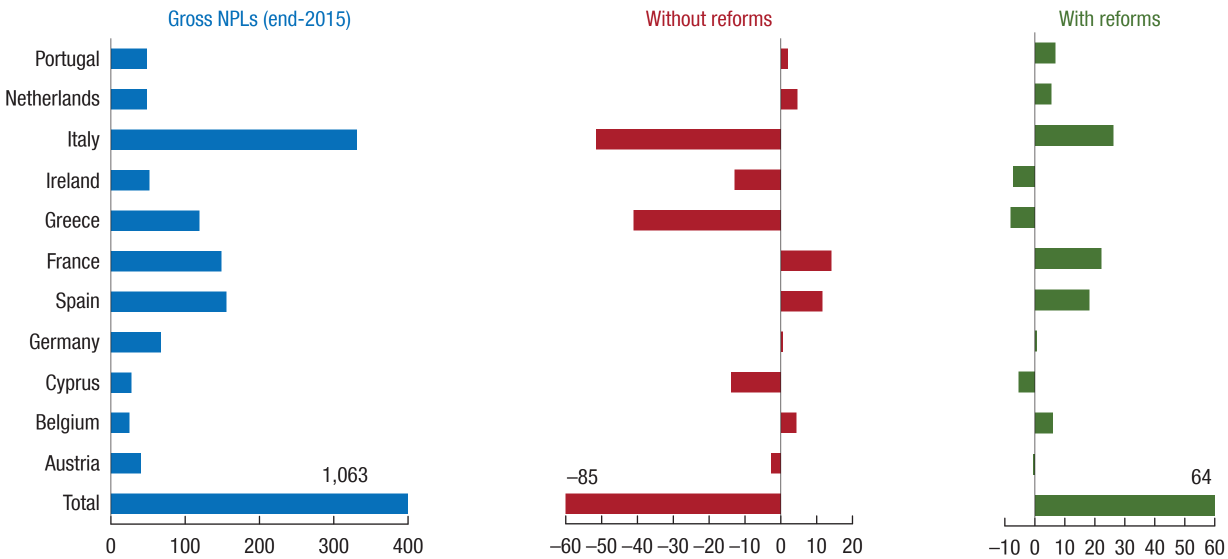
Figure 1.14. Stylized Net Capital Impact of Nonperforming Loan Disposal at Euro Area Banks

Faster bankruptcy processes and lower investor return requirements could support balance sheet cleanup.

1. Gain (Loss) in Regulatory Capital Relative to Statutory Minimum
(Billions of euros)



Sources: Bankscope; European Banking Authority (EBA); European Central Bank (ECB); Haver Analytics; SNL Financial; World Bank, Doing Business project; and IMF staff calculations.
Note: The "Without reforms" scenario assumes nonperforming loans (NPLs) are sold at the price implied by a distressed loan valuation model using current country-specific asset recovery times and an internal rate of return of 15 percent, whereas the "With reforms" scenario uses the price implied by an improvement in asset recovery time by up to two years (for countries where current asset recovery time exceeds two years, i.e., Cyprus, Greece, Ireland, and Italy) and an internal rate of return of 6 percent. In both cases, losses on the sale of NPLs are offset by a reduction in the minimum level of required capital associated with lower risk-weighted assets and the potential increase in capital requirements related to higher loss-given-defaults for banks using internal models. The net capital impact shown does not consider other potentially important factors, such as deferred tax assets/credits and hidden reserves that could reduce potential losses. Calculations are based on bank-level risk-weighted assets and provisioning data from the EBA Transparency Exercise 2015 and ECB-reported, country-level data for NPLs, with NPLs assumed to be sold down to restore the country-level NPL ratio as of end-June 2009. The specified regulatory minimum is a ratio of 16 percent total regulatory capital to risk-weighted assets. Asset recovery times are based on World Bank statistics. For further details, please see Jobst and Weber 2016.