

REPORT TO THE BANK OF GREECE

Policies and procedures required to ensure effective management and recovery of assets left in liquidation following the resolution of Greek credit institutions:
Assessment and recommendations

Athens - 28 February 2013

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FOREWORD

This report corresponds to the deliverable mentioned in § 20.3 of the latest Memorandum of Economic and Financial Policies: *“By end-February 2013, the Bank of Greece will publish an assessment report prepared by an international expert regarding policies and procedures required to ensure effective (liquidating) bank asset management and recovery.”*

It has been prepared by Bain & Company (“**Bain**”), a leading international consulting firm, under the guidance of, and with the approval from the Bank of Greece (“**BoG**”), with the exception of (i) the legal and supervisory framework assessment and limitations set out in sections 3.1 and 3.3, and (ii) legal and supervisory recommendations included in the section 5.5 which have been drafted by BoG.

EXECUTIVE SUMMARY

The objective of this report is to assess the policies and procedures in place to manage the assets left in liquidation following the resolution of seven Greek banks and to provide recommendations in order to improve the current frameworks and practices based on international practices.

The amount at stake (€5,6Bn of net assets left for liquidation following the resolution of seven banks) makes it paramount that these assets are managed based on international practices:

- Today's situation is the result of an unprecedented economic and fiscal crisis that hit the entire Greek banking sector: From October 2011 to February 2013, seven banks had to be resolved—including ATE bank in July 2012, the largest bank to be resolved under a purchase and assumption (“P&A”) scheme in Europe—leaving €5,6Bn of net assets for liquidation. Strictly applying the existing legal framework, BoG has appointed one individual special liquidator (“liquidator”) per each resolved bank (or “entity under liquidation”) to manage the assets for liquidation and claims.
- Most of these assets are loans (which represent 87% of net assets excluding deferred tax assets), mainly non-performing loans (“NPLs”). Of those, most are corporate loans (68% of total loans¹) and are held mainly by two resolved banks (ATE and Hellenic Postbank). There is a significant share of sub-performing loans² (approximately 30% of total corporate loans, according to the preliminary estimates of the liquidators³), among which are loans to companies operating in key sectors in Greece (e.g., tourism, agriculture).
- After several months of existence of most of these entities under liquidation and according to the latest Memorandum of Economic and Financial Policies (“MEFP”), BoG assigned a leading international consulting firm (Bain) to perform an assessment of the existing frameworks and practices.

In order to maximize asset recovery, a first step should be to enhance the existing legal and supervisory frameworks under which these entities under liquidation operate and align their operating practices to international ones:

- The current legal liquidation framework—applied only in two exceptional cases before the current crisis—gives powers to a single individual liquidator under BoG's supervision. The current framework provides limited standardized procedures and guidelines to the liquidator about how to perform its tasks. Unlike Greece, other European countries, such as Italy and Ireland, provide a governance framework to support and control the individual liquidators.

¹ Excluding Hellenic Postbank

² Loans that are past due (with irregular or suspended payments) from companies that are in temporary distress, but that could be turned back into going concerns with a proper loan restructuring or other support

³ Excluding Hellenic Postbank

- Regardless of the scheme that each entity under liquidation has put in place for loan management and recovery (either by using internal teams or rental agreements with the “good bank”⁴), current operating practices are below common international ones and therefore cannot guarantee the lowest possible cost. Based on the information available, this is the result of:

A lack of clear segmentation of portfolio and related strategies for each segment.
An unclear specialization of the recovery teams, sub-scale structures and for the most part, the absence of dedicated teams to manage sub-performing loans.
Undefined collection objectives, which provide no incentive to maximize loan collection.
Insufficient IT and performance monitoring systems.

In parallel to this first step, it should be tested if there is an appetite among going concern banks and/or international recovery specialists to create a centralized servicing unit (“ServiceCo”) that would service all NPLs from the entities under liquidation. This is likely to be the most effective solution to manage NPLs, providing economies of scale and scope in particular.

- Centralizing NPLs servicing into a ServiceCo should ensure the application of international practices at a lower cost and provide the benefit of scale. This should be a privately led initiative that must be evaluated through a formal bidding process. Responsibilities for setting up the scheme should be determined.
- The decision to sell part of the loan portfolio is disconnected from the servicing of that portfolio and needs to be evaluated on a case-by-case basis to protect the interests of the claimholders. This decision should also seek the right balance between the immediate materialization of the losses (already incumbent in the portfolio) and the possibility of injecting liquidity from private funds into the entities under liquidation.

A specific approach for sub-performing loans should be set up as quickly as possible:

- Several options exist to preserve the value of sub-performing loans. One option is to sell these loans to a going concern bank, which can use its existing internal restructuring capabilities and possibly lend funding.

Conclusion:

Moving forward will require proceeding along the following lines: (i) Secure some enhancements to the legal framework, enhance the supervisory framework and mandate that the entities under liquidation apply an improved set of operating standards to deal with NPLs; (ii) In parallel, test the appetite of a local bank and/or an international recovery specialist to build a ServiceCo; (iii) Meanwhile, define an appropriate approach for sub-performing loans that includes restructuring capabilities and temporary refinancing.

⁴ The bank to which the good assets and liabilities, including IT systems and branches, were transferred

CHAPTER 1. Context and objectives of this report

1.1. Context

The recent developments in the Greek banking sector have left seven entities under liquidation as of February 2013⁵.

- Starting in 2009, macroeconomic and fiscal conditions in Greece deteriorated significantly (e.g., a sharp GDP decrease, a rise in unemployment and a high level of debt over GDP, which caused loss of market confidence) leading to a major financial crisis with significant repercussions on the Greek banking sector.
- To support Greece, several financial packages were successively negotiated with international lenders between 2010 and 2012, including a large-scale restructuring of Greek sovereign debt (known as “PSI”).
- The entire Greek banking sector has been severely affected by the combined effects of the PSI and the adverse macroeconomic conditions, which resulted in the deterioration of the quality of banks’ assets, significant impairments and deposit outflows. By the end of 2011, most banks’ liquidity and capital bases were under pressure, posing a serious threat to their short-term survival and their long-term sustainability.
- To deal with the prospect of potential banks failures, the Greek authorities, in cooperation with national and international authorities, established a legal framework for bank resolution in 2011, which introduced two main schemes: temporary credit institutions (“**bridge bank**”) and P&A, also known as “transfer of assets”⁶. This framework was first activated in October 2011, with the successive resolution of seven banks under either the P&A or the bridge bank schemes by February 2013.
- The solvent or “**good assets**” of these failed banks were transferred either to another bank (in the case of P&A) or to a bridge bank, leaving the remaining assets (“**bad assets**”) and liabilities in seven entities under liquidation – each of them under the responsibility of a liquidator.

The following table includes an overview of the seven banks resolved from October 2011 to February 2013:

⁵ Not including Bank of Crete

⁶ Article 63D and 63E of the Law 3601/2007

Table 1 – Overview of the seven banks resolved from October 2011 to February 2013

Bank resolved	Type of bank	Resolution method	Resolution date
Proton Bank	Commercial	Bridge bank	09/10/2011
T-Bank	Commercial	P&A with Hellenic Postbank	17/12/2011
Achaia	Cooperative	P&A with NBG	19/03/2012
Lamia	Cooperative	P&A with NBG	19/03/2012
Lesvos-Limnos	Cooperative	P&A with NBG	19/03/2012
ATE	Commercial	P&A with Piraeus bank	27/07/2012
Hellenic Postbank	Commercial	Bridge bank	18/01/2013

Source: BoG

1.2. Objective of this report and key questions addressed

The objective of this report is to assess the policies and procedures in place to manage the assets left in liquidation and provide recommendations in order to improve the current frameworks and practices based on international ones. To do so, it addresses the following four key questions:

- What are the financial stakes involved in the liquidations (*see chapter 2*)?
- Do current policies (i.e., the legal and supervisory framework) effectively support the work of liquidators in managing the bad assets (*see chapter 3*)?
- Are current procedures (i.e., operating practices) in line with international practices (*see chapter 4*)?
- What are the options and recommendations for moving forward to implement the necessary improvements (*see chapter 5*)?

1.3. Definition, scope and methodology

The scope of this report is as follows:

- *In terms of banks:* The report deals with all seven entities under liquidation (*see table 1*). The assessment of current operating practices does not include T-Bank, due to the marginal amount of assets left in liquidation⁷ (*see table 1*), or Hellenic Postbank, given the recent timing of its resolution (18 January 2013).
- *In terms of assets:* The analysis focuses on loans left in liquidation (“**bad loans**”), which represent the vast majority of the assets left for liquidation. They include:

Very limited amount of performing loans (i.e., past due less than 90 days) from cooperative banks not transferred at the time of resolution⁸

⁷ Total assets left in T-bank: €14k

⁸ As per BoG’s decisions on the resolution: In the case of the three resolved cooperative banks, all assets were left in the entities under liquidation; in the case of Proton, ATE and Hellenic Postbank, all

Sub-performing loans: Loans that are past due at least 90 days (with irregular or suspended payments) from companies that are in temporary distress, but that could be turned back into going concerns with a proper loan restructuring or other support

NPLs: for the sake of the report we define NPLs as all the other loans in the entities under liquidation excluding sub performing loans and performing loans

This report does not address NPLs in the going concern banks.

The following approach was used to prepare this report:

- A series of data requests on the financial position of each entity under liquidation within scope (including balance sheet, loans portfolio, current collection performance and actual costs) was submitted by BoG⁹ to liquidators. An assessment of the legal and supervisory framework for liquidation in Greece was performed by BoG legal experts in section 3.1 and then compared with selected elements from the respective frameworks in place in France, Italy and Ireland.
- A questionnaire on the current operating practices in place at the entities under liquidation was submitted by BoG¹⁰ to liquidators. The collected survey results were then supplemented as needed by interviews with the liquidators.
- The current operating practices in place to manage bad loans in the entities under liquidation were compared with international practices (based on European experience)¹¹.

With regards to data and qualitative information included in this report, it should be noted that:

- Data includes unaudited figures and was provided electronically to BoG by the liquidators, without any due diligence or verification of the data sources or methodology used to produce them.
- The assessment of the operating practices in place is based solely on the information provided by the liquidators to BoG, and no on-site visits to the entities under liquidation have been made.

The report does not include any asset quality review of the loan portfolio (e.g., the existence, status or location of the documentation).

All assumptions, methodologies, deliverables and recommendations included in this report were reviewed and accepted by BoG.

performing loans were transferred respectively to Nea Proton, Piraeus bank and New Hellenic Postbank

⁹ Data request not submitted to Hellenic Postbank

¹⁰ Questionnaire not submitted to T-bank and Hellenic Postbank

¹¹ T-Bank and Hellenic Postbank not included in the assessment

CHAPTER 2. Financial stakes involved in the liquidations

This chapter provides an overview of the financial stakes involved in the seven entities under liquidation.

Key findings: It is paramount that the bad assets are managed effectively to protect their recovery value and ultimately the interests of the claimholders, starting with the Hellenic Financial Stability Fund (“HFSF”).

- The amount of bad assets – mainly loans – is significant (€5,6Bn net book value) and concentrated in ATE (66%) and Hellenic Postbank (21%) - *see section 2.1.*
- This report focuses only on the loans that represent the majority of assets under liquidation (87% of net assets excluding deferred tax assets) - *see section 2.1.*
- The value of assets under liquidation is less than the corresponding claims – mainly from HFSF and TEKE. This underscores the need to manage these assets in order to maximize their value and avoid any further deterioration of their value and quality - *see section 2.2.*
- The composition of the corporate portfolio left in liquidation (68% of total gross loans) is different from the assets transferred to other national asset management and recovery schemes, such as Ireland’s NAMA and Spain’s SAREB¹² (which are both focused on real estate-related assets), and contains a significant portion of sub-performing loans, among which are loans to companies operating in key sectors in Greece (e.g., tourism, agriculture) - *see section 2.3.*
- The loan portfolio contains a significant share of small tickets (92% of the number of files and 29% of the value of the total excluding consumer loans and credit cards¹³) - *see section 2.4.*
- Finally, the cost of managing these assets is significant - *see section 2.5.*

2.1. Composition of the assets

- The amount of bad assets is significant (€5,6Bn net):

Loans represent €4,0Bn of net value (70% of total net assets, 87% excluding deferred tax assets), mainly from corporate clients (€4,1Bn gross value, 68% of total gross loans¹⁴).

¹² National schemes to deal with bad assets established in Ireland and Spain

¹³ Excluding Hellenic Postbank

¹⁴ Excluding Hellenic Postbank

Other assets (after deduction of deferred tax assets) are limited (€586Mln). They include equity participations (€61Mln of net book value at the time of resolution) and very few fixed assets (€30Mln of net book value).

- ATE represents by far the largest entity under liquidation: €3,7Bn or 66% of total assets.

Table 2 – Composition of the assets

All data at resolution date €Mln	Total
Gross loans, of which¹⁵:	6 066
- Corporate	4 118
- Mortgages	1 109
- Consumer	543
- Credit cards	296
Total net loans	3 996
Other net assets ¹⁶	1 636
Total net assets	5 632

Source: Unaudited data provided by the liquidators. All data refers to resolution date.

Note: Data on gross loans exclude Hellenic Postbank

- These assets represent a total of 134k borrowers/dossiers (especially corporate clients¹⁷):

Table 3 – Number of borrowers in the loans portfolio

All data at resolution date #	Total
Corporate	73 184
Mortgages	18 440
Consumer	42 593
Total borrowers (excluding credit cards)	134 217
Credit cards (number of plastic cards)	106 741

Source: Unaudited data provided by the liquidators. All data refers to resolution date.

Note: This table excludes Hellenic Postbank

¹⁵ The value of gross loans does not include Hellenic Postbank

¹⁶ Of which €1 050Mln are deferred taxes assets

¹⁷ Excluding Hellenic Postbank and credit cards (number of borrowers not available)

2.2. Composition of the claims

- The value of assets under liquidation is less than the corresponding claims, the largest of which are HFSF (€12,4Bn) - which “represents” taxpayers - and TEKE¹⁸ (€1,3Bn). This underscores the need to manage these assets in order to maximize their recovery value and avoid any further deterioration of their value and quality.

Table 4 - Composition of the claims

All data at resolution date €Mln	Total
Due to HFSF	12 374
Due to TEKE	1 312
Subordinated debt	448
Other claims	419
Total	14 553

Source: Unaudited data provided by the liquidators. All data refers to resolution date.

2.3. Composition of the corporate loan portfolio¹⁹

- The composition of the corporate loan portfolio left in liquidation (68% of total gross loans) is different from the assets transferred to NAMA and SAREB²⁰: There is a limited presence of construction and real estate companies (6% of the total), and most of the portfolio comes from retail, agriculture or manufacturing:

Table 5 - Composition of gross corporate loan portfolio by sector

All data at resolution date €Mln	Total
Retail (commerce, retail and wholesale)	1 217
Manufacturing (production of goods)	739
Construction and real estate companies	259
Agriculture	946
Other sectors ²¹	957
Total	4 118

Source: Unaudited data provided by the liquidators to BoG. All data refers to the resolution date.

Note: This table excludes Hellenic Postbank.

¹⁸ Hellenic Deposit and Investment Guarantee Fund

¹⁹ The analysis does not include Hellenic Postbank

²⁰ National schemes to deal with bad assets established in Ireland and Spain

²¹ Including hotels, transportation and logistics services for €93Mln

- The corporate loan portfolio contains sub-performing loans: Preliminary analysis by each liquidator estimates them to represent about 30% of the total corporate portfolio (the actual figure should be confirmed by a more accurate and specific study, which is not included in the scope of this report), including loans to companies from key sectors for Greece (e.g., tourism or agriculture).

2.4. Proportion of small tickets in the loan portfolio²²

The loan portfolio contains a significant share of small tickets (29% of the total, excluding consumer loans and credit cards).

- On corporate loans: 95% of borrowers and 25% of the total value consist of individual files below €100k each:

Table 6 - Composition of gross corporate loan portfolio by size

All data at resolution date	Borrowers #	Gross value €Mln
Loans size <€100k	69 144	1 029
Loans size €100k-€500k	3 439	666
Loans size €501k-€1,0Mln	312	225
Loans size >€1,0Mln	289	2 198
Total	73 184	4 118

Source: Unaudited data provided by the liquidators to BoG. All data refers to the resolution date.

Note: This table excludes Hellenic Postbank.

- On mortgages portfolio: 80% of the total borrowers and 42% of the total value consist of individual files below €100k each:

Table 7 - Composition of gross mortgage portfolio by size

All data at resolution date	Borrowers #	Gross value €Mln
Ticket size <€100k	14 826	466
Ticket size €101k-€200k	2 729	377
Ticket size >€200k	885	266
Total	18 440	1 109

Source: Unaudited data provided by the liquidators to BoG. All data refers to the resolution date.

Note: This table excludes Hellenic Postbank.

2.5. Estimation of the costs for the liquidation²³

²² The analysis does not include Hellenic Postbank

²³ The analysis does not include Hellenic Postbank and T-bank

- The actual cost of liquidation amounts to €14,3Mln (from the resolution date to 30 November 2012). This includes the cost of the employees (staff expenses), the cost of the employee and infrastructure rental agreement (in the case of ATE and Proton), and the cost of legal services and other third parties (e.g., utilities, accountants, software developers).
- Based on the data received by the liquidators, linearly extrapolated over the number of months since the resolution, the estimated annual cost of running the liquidation is approximately €26Mln²⁴.
- The actual cost of liquidation could end up being significantly higher due to the extensive use of external lawyers (approximately 120-125 lawyers, of which about 100 are employed by ATE).

Table 8 - Estimated costs of liquidation²⁵

From the resolution to 30 November 2013 €Mln	Total
Staff expenses (employees)	2,6
Employees and infrastructure rental agreement	6,3
Other costs	5,5
Total costs since resolution (as reported by the liquidators)	14,3
Linear estimate of the annualized cost of liquidation (based on actual data provided by the liquidators)	~26

Source: Unaudited data provided by the liquidators. All data refers to resolution date.

Note: This table excludes Hellenic Postbank

²⁴ Not including Hellenic Postbank

²⁵ Actual data refers to the period from the resolution to 30 November 2012 for all the entities under liquidation except for ATE (from resolution date to 31 December 2012). Estimate of the annualized cost of liquidation based on data received from the liquidators linearly extrapolated over the number of months since the resolution

CHAPTER 3. Legal and supervisory framework

This chapter is based on information provided by BoG regarding the current legal and supervisory frameworks for bank liquidations in Greece and compares them with selected international examples. This chapter includes:

- A description of the current Greek legal and supervisory framework.
- A selection of highlights from international frameworks.
- An identification of the limitations of the current framework.

Key findings: After comparing several recent liquidations with international examples, the current legal and supervisory framework for bank liquidations can be enhanced to improve the efficiency and effectiveness of the entire process.

- The current legal framework gives the responsibility of the liquidation to a single individual liquidator per entity under liquidation under the supervision of BoG with limited standardized procedures and guidelines - *see section 3.1.*
- Other countries provide a governance framework to support and control the individual liquidators - *see section 3.2.*
- Considering the stakes, the workload to be performed and the associated operational risks, entities under liquidation lack adequate standardized procedures and guidelines (not provided by the law) to support them in performing their tasks in the best interest of the claimholders - *see section 3.3.*

3.1. Description of current framework

- This specific framework is described in three main reference laws:

Article 68 of Banking Law 3601/2007
BoG's Credit and Insurance Committee ("CIC") decision 21/2/4.11.2011
Bankruptcy code (Law 3588/2007)

- The bankruptcy code is applied to the special liquidation of credit institutions to the extent that it does not contradict the aforementioned article and CIC's decision.
- BoG withdraws the bank's license and appoints the liquidator (responsible for the management of the entity under liquidation).

- The liquidation is supervised by BoG, which also pre-approves certain liquidation measures (e.g., settlements of more than €15 000, disposal of certain assets, signing of specific contracts and provisional distributions).
- As defined by the CIC's decision, the liquidator should favor the disposal of the institution's assets over their restructuring or resolution.
- In cases where CIC's decision does not have a specific reference, the bankruptcy code applies (e.g., in the case of judging disputes).
- The liquidator must make an inventory of the assets and estimate their liquidation value. In order to realize this value, the liquidator can enter into settlements, subject to authorization by BoG, or dispose of assets through a sale process, as long as BoG is notified five days in advance.
- The executives and employees of the entities under liquidation are obliged to cooperate with the special liquidator, the special liquidation bodies and Resolution Guarantee Fund and must follow the orders and instructions of BoG in order to ensure the smooth liquidation of the credit institution and the satisfaction of the public interest.
- The liquidator submits a report every three months explaining the progress of the liquidation process.
- If the liquidation period extends beyond a total of five years, the liquidator is required to submit a plan to accelerate the process. No specific deadline is currently in place for the completion of the liquidations.

3.2. Selected highlights from international frameworks

This section provides fact-based highlights of selected elements from frameworks for bank liquidation in France, Italy and Ireland²⁶ and gives a snapshot overview of the implications of the upcoming European directive on bank resolutions²⁷.

Review of the legal and supervisory frameworks of France, Italy and Ireland

A high-level review of the main characteristics of the three local legal and supervisory frameworks²⁸ has been performed along four dimensions:

- Appointment of liquidator.

²⁶ The examination of the framework for insolvency framework for households and SMEs, as well as the framework for out of court negotiations between banks and troubled borrowers, is not covered in this section

²⁷ Proposed European directive on collection and resolution of financial institutions (Directive COM 2012 280/3)

²⁸ France: "Code Monétaire et Financier," Book 6, Chapter 3, Section 2; Italy: Testo Unico Bancario (TUB) 385/1993 as amended articles 80-95 and Law 267/1942 as amended ("Legge fallimentare") art. 194-215; Ireland: Central Bank and Credit Institutions (Resolution) Act n.27 2011; Irish Bank Resolution Corporation Bill 2013

- Governance of the entity under liquidation.
- Guidance on the execution of the liquidating activities.
- Supervision of the liquidator.

Description of the legal liquidation framework in France

In past years, the Banque de France has requested the liquidation of a very limited number of small problematic banks. No bank has been put under liquidation since 2003.

- *Appointment of the liquidator:* Involves two liquidators, one of which is appointed by the Autorité de contrôle prudentiel (“ACP”, the bank supervisory authority) with the responsibility to deal with all banking affairs (e.g., loans, derivatives, portfolio and deposits) and one from the court to deal with the rest of the assets.
- *Governance of the entity under liquidation:* No committees are mandated by law in the entity under liquidation.
- *Guidance on the execution of the liquidating activities:* The law outlines very strict rules on how to manage assets recognition (i.e., exact composition of the assets), claims recognition (i.e., exact composition of the claims) and distribution processes (i.e., priorities of the claimholders and rules to distribute the liquidation proceeds). No specific provision is defined regarding operating practices to be applied.
- *Supervision of the liquidator:* The ACP is responsible for supervising the liquidator.

Description of the legal liquidation framework in Italy

In past years, Banca d’Italia has put some problematic small banks—most of them were cooperatives—into liquidation, typically after the appointment of a commissioner and the transfer of the good part (e.g., assets and liabilities or branches) to another bank. In 2012, Banca d’Italia requested that two small banks be put into liquidation²⁹.

- *Appointment of the liquidator:* Usually one liquidator is appointed by Banca d’Italia, which has the option to nominate three liquidators when the liquidation process presents a high level of complexity. Banca d’Italia defines the minimum professional requirements.
- *Governance of the entity under liquidation:* Banca d’Italia nominates a Supervisory Committee (three or five members) within the entity under liquidation with the mission to support and control the liquidator. Banca d’Italia defines the minimum professional requirements.
- *Guidance on the execution of the liquidating activities:* The law outlines very strict rules on how to manage assets recognition (i.e., exact composition of the assets), claims recognition (i.e., exact composition of the claims) and distribution processes (i.e.,

²⁹ After a P&A of the “good” part

priorities of the claimholders and rules to distribute the liquidation proceeds). No specific provision is defined regarding operating practices to be applied.

- *Supervision of the liquidator:* Supervision Committee, established within the entity under liquidation, and Banca d'Italia.

Description of the legal liquidation framework in Ireland

The Irish liquidation framework was amended in 2011, during the financial crisis. Since the new framework was established, the only bank put in liquidation was IBRC³⁰ in early 2013. Given the size of this entity³¹, the Ministry of Finance implemented a “Resolution Bill,” which included some exceptions to the established legal liquidation framework.

- *Appointment of the liquidator:* Usually one liquidator is appointed by the court after nomination by the Central Bank of Ireland, which has the ability to nominate more liquidators when the liquidation process presents a high level of complexity.
- *Governance of the entity under liquidation:* A Liquidation Committee of three members (two appointed by the Central Bank of Ireland and one by the Minister of Finance) is established to supervise the liquidation process.
- *Guidance on the execution of the liquidating activities:* The law outlines very strict rules on how to manage assets recognition (i.e., exact composition of the assets), claims recognition (i.e., exact composition of the claims) and distribution process (i.e., priorities of the claimholders and rules to distribute the liquidation proceeds). In a recent case, the Irish Ministry of Finance has given precise instructions on how to manage the liquidation.
- *Supervision of the liquidator:* the Liquidation Committee, established within the entity under liquidation, and the Central Bank of Ireland.

The following table presents a summary of the comparison of legal and supervisory frameworks for bank liquidations, with main differences highlighted in grey:

³⁰ Put in liquidation on 6 February 2013

³¹ About €18Bn of impaired loans as of December 2011

Table 9 – Liquidation legal and supervisory framework in selected countries

	Greece	France	Italy	Ireland
Reference laws	3601/2007, art. 68 BoG's Credit and Insurance Committee Decision 2011 Bankruptcy code	Code Monétaire et Financier Book 6, Chapter 3, Section 2	TUB 385/93 art. 80-95 and Law n.267/42 art. 194-215 as amended	Central Bank and Credit Institutions (Resolution) Act n.27/2011
Appointment of liquidator	Single liquidator: One individual appointed by BoG	Two liquidators: One individual appointed by ACP (supervisory authority) to deal with bank-related activities (loans and deposits) and another appointed by the court to deal with the rest of assets	Possibility of several liquidators: One to three individuals appointed by Banca d'Italia after bankruptcy is declared by a court	Possibility of several liquidators: One or several individuals approved by the Central Bank of Ireland and appointed by a court
Governance of the entity under liquidation	No mandatory committees Liquidator can organize its operations freely	No mandatory committees Liquidator can organize its operations freely	Mandatory committees Supervisory committee (three to five members) appointed by Banca d'Italia	Mandatory committees Liquidation committee (three members: two appointed by central bank, one appointed by minister) to supervise the liquidation process
Guidance on the execution of the liquidating activities	Claims recognition and proceeds distribution process No constraints on operating policies/procedures	Claims recognition and proceeds distribution process No constraints on operating policies/procedures	Claims recognition and proceeds distribution process No constraints on operating policies/procedures	Claims recognition and proceeds distribution process No constraints on operating policies/procedures
Supervision of the liquidator	BoG	Banking supervisor (ACP)	Supervision Committee, Banca d'Italia	Liquidation Committee, Bank of Ireland

Source: Analysis of local reference laws

Proposed European directive dealing with recovery and resolution of credit institutions

On top of the national legal liquidation framework at the country level, the European Commission has published a draft proposal directive on recovery and resolution, which includes harmonized provisions for the establishment of an asset management vehicle in order to deal with bad assets in case of resolution. The recommendations in this report are not in contradiction with this draft directive.

3.3. Specific limitations to the existing framework

The current legal and supervisory framework for bank liquidation can be strengthened with regard to the following dimensions:

- *Appointment of the liquidator:* BoG can currently appoint one individual liquidator who acts as the institution's sole legal representative.
- *Governance of the entity under liquidation:* The liquidator currently acts without any specific provision under the law to establish a minimal level of internal governance (e.g., internal committees).
- *Guidance on the execution of the liquidating activities:* There are no specific guidelines applicable for all liquidators, such as how to execute the asset recognition or negotiate service-level agreements ("SLAs") with external servicers.
- *Supervision of the liquidation:* The actual performance of the liquidation and the evolution of assets and claims must be enhanced. BoG is called to pre-approve most of the liquidators' acts (e.g., settlements of more than €15 000).

CHAPTER 4. Current operating practices

This chapter provides a review of the current operating practices in place to manage bad loans compared with selected international practices. It covers:

- An overview of international practices.
- A summary of the current operating practices in place within the entities under liquidation.
- A gap analysis with international practices.

Key findings: Based on information received, current operating practices in place in most entities under liquidation appear to be below international practices.

- Given the absence of operating guidelines in the legal framework (see *chapter 3*), the entities under liquidation have organized the management of bad loans in various ways.
- On NPLs: Based on information received, most entities under liquidation lack a collection strategy for each NPLs cluster (e.g., small tickets, large or collateralized) and have not put in place the appropriate organization, reporting and incentives required. In the case of external servicers, the existing legal agreements cannot guarantee effective performance at a lower cost or any protection against potential conflicts of interest.
- On sub-performing loans: By their own design, entities under liquidation are not in a position to support temporarily distressed companies in their portfolio. They lack the ability to provide short-term refinancing, and most have not put in place dedicated processes or the organizational structure required tackling these very specific situations.

4.1. Overview of international practices

For the purposes of this report, common international practices to manage bad loans can be summarized around six key dimensions:

- Loan clustering and strategy: Segmentation of the loan portfolio by relevant criteria (e.g., type of client, industry of the client, size of the loan, presence of collateral) in order to define the pertinent strategy and business case for collection.
- Team organization: Organizational structure of the teams to manage the collection of the different loan clusters.
- Collection activities/processes: Activities and processes performed to collect the loans (e.g., phone calls, solicitations, negotiation and collateral repossession).

- Objectives and incentives: Performance targets for collections and incentive systems established.
- Data and reporting: IT infrastructure, monitoring and management support system to support the collection.
- Contractual framework (when applicable): Contractual scheme that can be applied when using third parties.

To define international practices, several examples of current practices on NPLs and sub-performing loan management at the bank level in Europe were analyzed, and a set of principles for each of the six key dimensions were defined with specific regard to collection effectiveness (i.e., the ability to maximize the amount recovered) and cost efficiency (i.e., the ability to minimize the cost to perform the collection activities).

The following table summarizes these international practices to manage bad loans:

Table 10 – International practices to manage bad loans

	Collection effectiveness	Cost efficiency
1. Loan clustering and strategy	<i>Segment the loan portfolio and define a collection strategy by loan clusters (“business case”)</i>	
2. Team organization	<i>Organize teams based on loan clustering and strategy</i>	
	<ul style="list-style-type: none"> - Attribute clear internal responsibility to manage each loan cluster 	<ul style="list-style-type: none"> - Leverage economies of scale - Clearly allocate the expenses per team/file
3. Collection activities/ processes	<i>Define activities and processes consistent with loan clustering, strategy and organization</i>	
	<ul style="list-style-type: none"> - Specialize processes and activities for each cluster to limit complexity management - Centralize administrative and repetitive activities into dedicated centralized support functions 	<ul style="list-style-type: none"> - Formalize collection activities
4. Objectives and incentives	<i>Define clear objectives for the collection activities and ensure the teams are consistently incentivized</i>	
	<ul style="list-style-type: none"> - Define detailed performance targeting and monitoring on the entire portfolio, from macro aggregates to single asset manager’s/bank’s portfolio. This is enabled by a consolidated database and flexible monitoring system (that focuses on different targets for each loan cluster). Strictly align incentives to performance. 	<ul style="list-style-type: none"> - Define clear targets and incentives in terms of collection costs for each cost item (e.g., workload and cost per asset manager, cost of staff, external lawyers/outsourcers)
5. Data and reporting	<i>Establish an adequate monitoring/ management support system</i>	
	<ul style="list-style-type: none"> - Establish an effective monitoring and management support system 	<ul style="list-style-type: none"> - Monitor the incidence of IT investments and operating costs
6. Contractual framework	<i>In case of external servicer, establish an SLA with clear scope, objectives and incentive system</i>	

Standard #1 - Segment the loan portfolio and define a collection strategy by loan clusters ("business case")

- The loan portfolio must be clearly segmented with the appropriate level of clustering.
- Each loan cluster deserves a dedicated collection strategy with the associated business case (e.g., expected amount of the collection over time, associated costs).

Standard #2 - Organize teams based on loan clustering and strategy

- Assign clear internal responsibilities. Each loan cluster's collection strategy will require different competencies, so teams have to be specialized, likely around sub-performing loans and NPLs. Within NPLs, additional specialization is required. At a minimum, this should include a split between small loans (with more "technical" collection competencies required) and large/collateralized loans (with more "legal" and "relationship" competencies necessary).
- The organization should leverage economies of scale where appropriate.
- Operating costs and expenses have to be allocated clearly per team/file in order to lower managerial costs and increase bargaining power with external lawyers and accountants involved in the collection process.

Standard #3 - Define activities and processes consistently with loan clustering, strategy and organization

- Processes and activities for each loan cluster need to be specialized to limit complexity management and administrative activities for each asset manager.
- Administrative and repetitive activities could be managed by dedicated and centralized support functions.
- Collection activities need to be formalized in order to reduce:
 - Cost of complexity (specialized collection processes).
 - Cost of control (effective and efficient monitoring tools).
 - Cost of HR (maximized workloads for each specialized asset manager and focused admin support).

Standard #4 - Define clear objectives for collection activities and ensure the teams are consistently incentivized

- Detailed performance targeting and monitoring need to be defined for the entire portfolio, from macro aggregates to single asset manager’s/bank’s portfolio. This is supported by a consolidated database and flexible monitoring system.
- Clear targets and incentives regarding the collection costs for each cost item have to be assigned (e.g., workload and cost per asset manager, cost of support staff, external lawyers/outsourcers).

Standard #5 - Establish an adequate monitoring and management support system

- An adequate monitoring and management support system has to be established. For illustration purposes, this table summarizes the main components that could be included:

Table 11 - Main components of the IT system (illustration)

Main component of the IT system	Description
Data model and IT platform	Structured database in terms of “raw data” and a repository of data, which is used to feed all of the Management Information System tools
Collection monitoring system	An enabler to manage the workflow at each single position level and a dedicated front-end tool for asset managers, supporting their day-to-day activities
Digital files archive	A digital repository of the file documentation, accessible by the collection teams
Performance monitoring system	Tool to verify performance in terms of collection effectiveness (i.e., collection rate) and process efficiency (i.e., “lead” time to management positions)

- The incidence of the IT system costs on total collection must be monitored.

Standard #6 - In case of external servicer, establish an SLA with clear scope, objectives and incentive system

- The SLA is the contract between the asset owner and the servicer to define and formalize the scope, administrative actions and authorizations, fee structure, performance thresholds and other obligations. The table below summarizes a possible checklist for the establishment of an SLA:

Table 12 – Typical contents of SLA for NPLs collection (illustration)

Area to be covered in the SLA	Checklist of the main contents
Scope of activities	<ul style="list-style-type: none"> – Definition of the assets to be managed by the servicer (e.g., open or closed portfolio, assets classes) – Definition of the collection processes to be performed – Clear split of the activities and procedures to be performed by the servicer and by the asset owner and definition of a clear interface
Administrative actions and authorizations	<ul style="list-style-type: none"> – Definition of all administrative actions to be performed by the servicer on behalf of the asset owner (e.g., accounting, business plan) – Identification of servicer autonomies in providing servicing activities, including collateral management
Fees structure (fixed, variables and penalties)	<ul style="list-style-type: none"> – Definitions of all the components of the fixed fees, to be minimized in order to generate clear incentives for collection maximization – Identification of the drivers and the calculation methodology of the variable fees – Possible presence of penalties in case of poor service levels
Performance thresholds	<ul style="list-style-type: none"> – Agreement on minimal performance to be guaranteed by servicer for asset owner’s satisfaction – Standard service-level definition to be provided in terms of quantity, quality, time and conditions
Management of conflict of interests	<ul style="list-style-type: none"> – Clear rules to avoid potential conflicts of interest between the different parties
Reporting	<ul style="list-style-type: none"> – Standard service-level definition to be provided in terms of quantity, quality, time and conditions
Maintenance	<ul style="list-style-type: none"> – Review and amendment procedures must lead to continuous improvement
Litigation rules	<ul style="list-style-type: none"> – Formalization of dispute settlement process

4.2. Summary of current operating practices in place

Given the absence of operating guidelines in the framework (*see chapter 3*), the entities under liquidation have organized the management of the bad assets in various ways. As liquidations are relatively recent, most entities under liquidation are still in the process of organizing their activities. The following description reflects the situation as of January 2013³².

ATE

ATE was resolved on 27 July 2012 with a P&A to Piraeus Bank. At the time of the resolution, all facilities, including IT systems, and branches were transferred and all employees were rehired by Piraeus Bank. At the time of the assessment, the liquidation process was in its initial six-month period, dealing with carve-out perimeter finalization and valuation

³² The following high-level summary of the current operating practices is based on information provided by the liquidators. See section 1.3

following the resolution of the credit institution, with relevant implications for the operating practices applied. To this end, as of January 2013, the liquidator:

- Took an inventory of the assets and liabilities under liquidation and submitted a report to BoG.
- Invited the creditors of the credit institution to lodge their claims, verified them and submitted a report on the verification to BoG.
- Set an organizational structure for the liquidation (advisor, management and audit committees).
- Started to divest equity participations through the organization of auctions (e.g., Dodoni).
- Signed a temporary rental agreement for the provision of IT services and use of Piraeus bank's personnel by the liquidator (collection services are provided through Piraeus bank's personnel).

As a result, the ATE liquidator currently manages its loans using employees and infrastructure rented from Piraeus bank (per the temporary rental agreement mentioned above).

Proton

Proton was resolved on 9 October 2011 by the implementation of a bridge bank (Nea Proton). At the time of the resolution, all facilities, including IT systems, employees and branches, were transferred to Nea Proton. As a result of the resolution:

- An agreement with Nea Proton was signed in order to use employees, former IT systems³³ and branches of former Proton to perform collections. Thanks to this agreement, the liquidator is located within the Nea Proton premises. This agreement is still in place.
- The liquidator completed the recognition of all assets and liabilities and verified the claims of the creditors.

As a result, Proton's liquidator currently manages its loans using employees and infrastructure rented to Nea Proton (per the temporary rental agreement mentioned above).

Cooperative banks

The three cooperative banks were resolved on 19 March 2012 with a deposits-P&A to National Bank of Greece. All three liquidators have progressed similarly. They have:

- Taken account of all assets and proceeded with the formation of an initial balance sheet (with the assistance of an external auditor). They invited all creditors to lodge their claims, verified them and have already completed the payment of the first 50% of staff compensation (as provided by the relevant Ministerial Decision).

³³ For the historical information related to client, the liquidator of Proton has implemented a proprietary IT system, which includes all the information since the resolution

- Closed all branches, laid off half the bank personnel and assigned duties to the remaining staff.
- Started to divest assets and equity participations³⁴.

The three entities under liquidation currently manage their loans using the same organization as prior to the resolution (internal employees and infrastructure).

In conclusion, the entities under liquidation have so far applied two different models to manage their loans: (i) a semi-externalized scheme through a “rental” agreement (former employees provided by the acquirer with IT systems and infrastructure rented at a fixed cost) and (ii) pure internalization (former internal servicing unit).

4.3. Comparison of current practices with international practices

Since the date of the resolutions, all entities under liquidation have put in place a specific scheme to manage the assets in their portfolio. The comparison of the detailed information provided by liquidators with most international practices shows clear common gaps. It should be acknowledged that some of these gaps were inherited from the previous organizations of the former bank and may not reflect the course of actions taken from the liquidators.

The following elements present an aggregated view of the common gaps with international practices.

NPLs

Based on the information received by the liquidators, existing operating practices to deal with NPLs fall short of international practices:

- Loan clustering and strategy: Liquidating entities lack a clear segmentation of the portfolio (e.g., collateralized vs. non-collateralized loans). For this reason, they are not able to define a strategy for each of the loan clusters. Most entities under liquidation also have significant difficulty clearly separating NPLs and sub-performing loans.
- Team organization: Because of the small size of the team and the absence of a clear segmentation strategy (*see above*), most of the entities under liquidation are not organized to ensure the sufficient specialization required for collection tasks (e.g., none have dedicated teams for “soft collection activities,” such as phone calls, solicitations or negotiation). Moreover, because of the parallel existence of several entities and their associated small teams (less than 20 individuals on the collection teams for all the entities under liquidation except for ATE), none of the entities benefits from scale or expertise.
- Objectives and incentives: Most collection teams do not seem to have clearly identified collection objectives and therefore are not directly incentivized to maximize loan collection.

³⁴ Limited by the restriction measures imposed by the Court after an appeal initiated by several parties/stakeholders opposing the revocation of the license

- Data and reporting: The data provided shows that entities under liquidation are experiencing a lot of difficulty monitoring performance. This has likely been inherited from the situations that existed before the resolution.
- Contractual framework: Among those liquidators that have agreements with other banks, current “rental” agreements do not protect their financial interest in maximizing collections:

Activities and objectives of collections are not defined in the contract.

Remuneration schemes are not linked to collection activities and actual performance.

There are limited protections against conflict of interest.

Sub-performing loans

Based on information received from liquidators, existing operating practices to deal with sub-performing loans fall short of international practices:

- The sub-performing loans are not clearly set apart in the loan portfolio. Due to lack of time, a top-down estimate of sub-performing loans was provided by the liquidators based on a case-by-case evaluation on the part of the corporate portfolio. Considering the specific treatment these loans require and the preliminary evaluation provided (around 30% of total corporate loans), it is paramount that the liquidators have a clear understanding of these loans.

By their own design, entities under liquidation are not in a position to manage sub-performing loans properly. Under the current legal framework, liquidators do not have the ability to support temporarily distressed companies with either loan restructuring or temporary financing facilities. In most cases, entities under liquidation do not have dedicated or specialized resources to manage these loans.

CHAPTER 5. Options and recommendations

The assessment described in the previous chapters shows that current policies and procedures in place are not in line with international practices. This chapter provides recommendations on how to improve the current situation by:

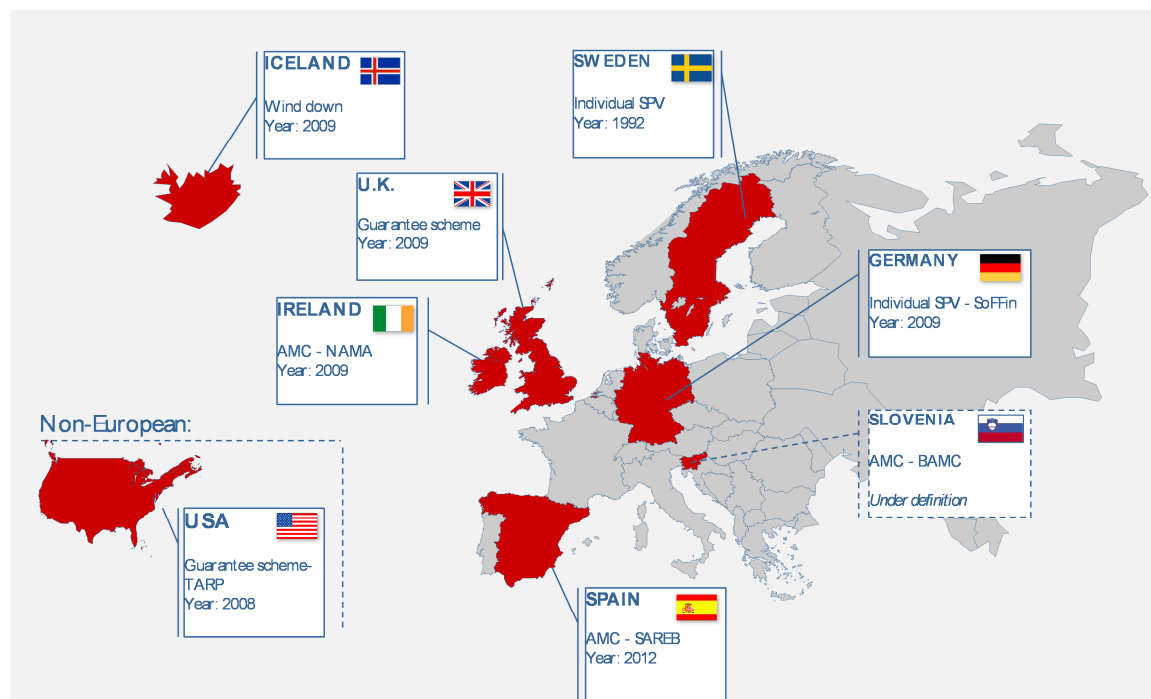
- Reviewing the different models applied at the national level to deal with bad assets.
- Presenting different models applicable to NPLs management.
- Presenting the different options for sub-performing loans.
- Providing recommendations on the way to move forward.

Key findings: Moving forward will require proceeding along the following lines: (i) Secure some mandatory enhancements to the legal framework, enhance the supervisory framework and mandate that the entities under liquidation follow an improved set of operating standards to deal with NPLs; (ii) In parallel, test the appetite of a local bank or an international recovery specialist to build a ServiceCo; (iii) Meanwhile, define an appropriate approach for managing sub-performing loans that ensures that restructuring capabilities and temporary refinancing are available.

- Based on international experience, two models (which are not mutually exclusive) seem possible for Greece: (i) model #1 - "Modernization of the current liquidation, entity by entity." This would involve applying an improved set of international collection practices to each entity, which would remain responsible for those activities; (ii) model #2 - "Centralize servicing into a ServiceCo." This would apply international practices at a lower cost by exploiting the scale effects of a consolidated servicer - *see sections 5.1 and 5.2.*
- The decision to sell part of the loan portfolio is disconnected from the servicing of that portfolio and needs to be evaluated on a case-by-case basis to protect the interests of the claimholders. This decision should also seek the right balance between the immediate materialization of the losses (already incumbent in the portfolio) and the possibility of injecting liquidity from private funds into the entities under liquidation - *see section 5.2.*
- Several options exist to preserve the value of sub-performing loans. One option is to sell these loans to a going concern bank, which can use its existing internal restructuring capabilities and possibly lend new funding - *see section 5.3.*

5.1. Review of the different models applied at the national level

Before Greece’s banking crisis, several other countries had to deal with systemic issues involving bad assets, including Germany, Ireland, Iceland, Spain, Sweden, the UK and the US.



Source: Lit search

Not including “on-balance sheet solutions”³⁵, international experience offers two main types of schemes: (i) an entity-by-entity model and (ii) a centralized model.

- These schemes follow different logics and vary along two main dimensions:

The type of asset ownership or structure hosting bad assets: They range from a national vehicle (e.g., Asset Management Company) to special-purpose vehicles owned by individual banks.

Servicing model: Collection activities can be internalized or outsourced, partially or fully. In case of externalization, an SLA is needed between the asset owner and the servicer.

The following table represents the main features of the two possible schemes:

³⁵ Not applicable given the current scope: Following this scheme, the State issues a guarantee on the bad assets, which remain on the going concern bank balance sheet

Table 13 – Different national schemes to deal with bad assets

	“Entity by entity ” model	Centralized model
Examples	<ul style="list-style-type: none"> - Germany - Sweden - Iceland 	<ul style="list-style-type: none"> - Ireland – NAMA - Spain – SAREB
Logic	<ul style="list-style-type: none"> - Segregate the bad assets in a dedicated vehicle, bank by bank - Can be an existing vehicle or a new one 	<ul style="list-style-type: none"> - Remove all eligible assets from all eligible banks, and transfer them into a single dedicated vehicle
Assets ownership	<ul style="list-style-type: none"> - At entity level 	<ul style="list-style-type: none"> - Mixed private/public ownership
Servicing model	<ul style="list-style-type: none"> - Bank-by-bank servicing, following the guidelines issued by the local authorities 	<ul style="list-style-type: none"> - At least partial centralized servicing (for NAMA) and under construction (for SAREB)

Source: Literature search

5.2. Possible models to manage NPLs

Given the current situation (with several entities already in liquidation) and the insights gained from international experiences, two main models can be applied in order to align operating practices with international ones:

- **Model #1 – Modernization of the current liquidation, entity by entity:** This model consists of imposing two types of improvements: (i) a modernization of the legal and supervisory framework regarding bank liquidation to correct the weaknesses identified in chapter 2 and (ii) an improved set of operating standards to match international practices.
- **Model #2 – Centralize service into a ServiceCo:** This model would consolidate the servicing into a dedicated entity (i.e., the ServiceCo) run by local bank or an international recovery specialist with the necessary capabilities, carefully selected by a tender. Since entities under liquidation will continue to operate under this model, a modernization of the legal and supervisory framework also will be necessary.

The next section provides a detailed review of each of the models.

Model #1 – Modernization of the current liquidation, entity by entity

High-level description

Model #1 involves improving collection effectiveness by asking all entities under liquidation to adopt an improved set of international practices and enhancing the legal and supervisory framework for liquidation.

The improved set of international practices could be:

- **Standard #1** – Mandate that each entity under liquidation clearly defines its loan clusters (e.g., collateralized NPL, retail NPL) and related strategy for each.
- **Standard #2** – Mandate that each entity under liquidation has a clear team organization and governance structure reflecting the necessary expertise to manage the identified clusters.
- **Standard #3** – Mandate that teams follow formalized collection procedures and practices, and execute their activities with adequate specialization.
- **Standard #4** – Mandate the entities under liquidation to assign clear objectives and incentives to the collection team in order to maximize collection.
- **Standard #5** – Mandate standardized periodic reporting with information on loans’ composition and collection performance, and whether both are meeting objectives.
- **Standard #6** – In the case of an external servicer, mandate the structure of a standard SLA, with clear objectives, collection activities, a remuneration scheme linked to the performance and clear management of conflict of interests.

The application of these standards will be subject to verification by BoG.

Main pros and cons

This model would represent a significant improvement over the current situation. The implementation of international practices will require significant effort and likely external support by experts.

However, this model may remain insufficient for the following reasons:

- Sub-scale processes: These enhancements would be implemented at each entity under liquidation (currently, there are seven), so there will be no benefit from their aggregated scale. Instead, they will continue to duplicate operating processes.
- Likewise, in the case of future resolutions and liquidations, the operational effort to align the operating practices of new entities under liquidation to international practices will have to be repeated.

Model #2 – ServiceCo

High-level description

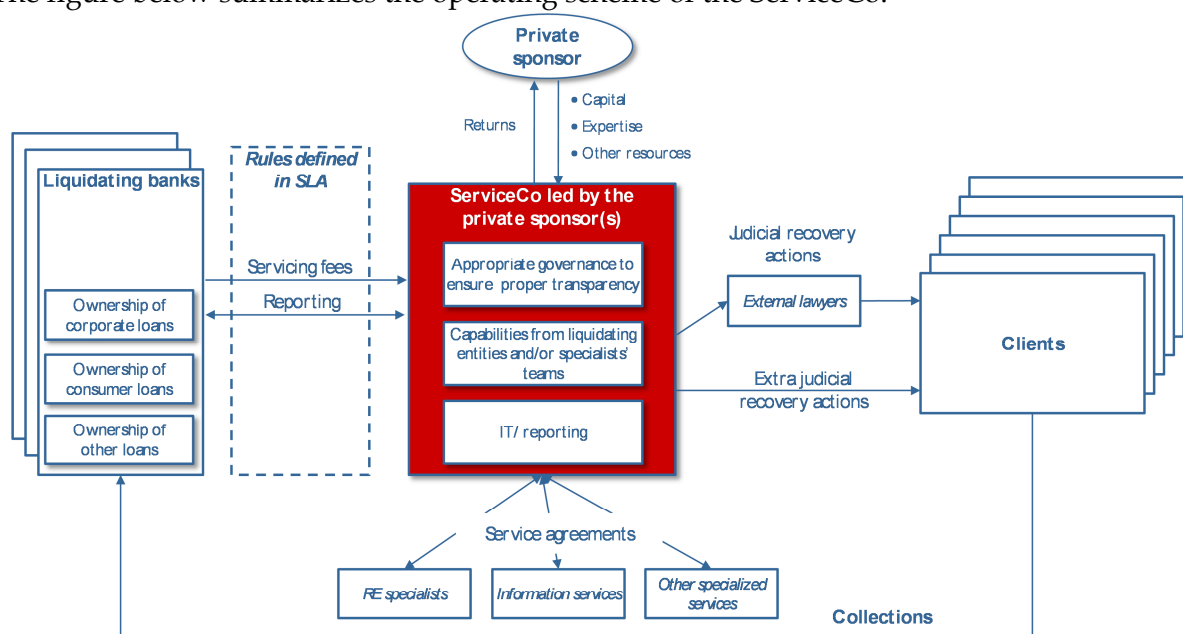
This model involves creating a centralized “ServiceCo” sponsored by a local bank and/or an international recovery specialist. The ServiceCo may have the following high-level characteristics:

- **Mandate:** The ServiceCo will service bad loans from the entities under liquidation, applying international practices in the name of the entity under liquidation under strict SLAs. The entity under liquidation will remain the owner of the loans. At a minimum, it

would handle loans from any future liquidations and potentially also could serve as a resource for other local banks.

- Legal structure: This entity will be a dedicated company with private ownership and possibly a public stake.
- Governance: Governance of the ServiceCo must be irreproachable to avoid any possible conflict of interest and ensure the necessary transparency of its operations and results. International and independent board members should be considered as well, as possible monitoring boards.
- Business case: ServiceCo's profitability will depend on the performance achieved vis-à-vis the objectives set for all the entities under liquidation.
- Implementation: If an appetite to build such scheme is confirmed, the task of creating a ServiceCo should be handled by a local bank or an international recovery specialist selected through a proper tender. They may leverage existing resources and their own expertise (e.g., management skills, relationships with lawyers). The exact implementation timeframe is likely to be between 6 and 12 months, to be confirmed with the selected ones. Responsibilities to set up the scheme should be determined.
- Organization: The local bank or international recovery specialist selected will have to design ServiceCo. International benchmarks suggest that managing €6,1Bn of gross loans³⁶ will require approximately 180-240 collectors (to be confirmed depending on the operating model).

The figure below summarizes the operating scheme of the ServiceCo:



Note: Illustrative. Organization of the teams depending on the specific asset clustering implemented

A minimal modernization of the liquidation framework will be required since the entities under liquidation/liquidators will remain in place.

³⁶ Hellenic Postbank not included

Main pros and cons

This model would have several advantages:

- A homogeneous implementation of international practices and a rationalization of operational complexity.
- A structured and standardized reporting system that would allow all liquidators to monitor performance.
- The achievement of economies of scale in the IT infrastructure (including the monitoring, reporting and management support system).
- The adoption of common processes and the possibility of gaining an improved view of the position of the borrowers (in case of loans from multiple banks).
- Stronger bargaining powers with key external partners (e.g., lawyers and accountants).
- The reduction of the “complexity costs” related to the supervision and coordination of several parallel stand-alone liquidations.

At the same time, this model also involves some challenges that:

- As a prerequisite, this scheme requires the appetite of a local bank and/or an international recovery specialist – to lead this ServiceCo.
- It will require some effort and time to create or spin off this activity (e.g., infrastructure, IT systems, collection teams, transfer of physical files).

Possibility of selling the NPLs

It should be noted that the question of whether or not to sell off part or the entire portfolio to a third party is independent of the recommendations above.

- The decision to sell part, or all, of the loan portfolio – which must be evaluated with the interests of the claimholders as the primary consideration – presents a trade-off between the immediate materialization of the losses and the possibility of injecting liquidity into the entities under liquidation from private funds.
- Based on international experience, the option of selling assets is often implemented in order to clean the balance sheets of banks that are going concerns by removing bad assets and injecting liquid assets to support the rescue.

5.3. Approach to sub-performing loans

A dedicated approach has to be rapidly designed and implemented for managing the sub-performing loans still in the assets for liquidation.

- These loans require a different approach than the NPLs. Applying a rigid and aggressive NPLs collection scheme to companies with sub-performing loans may push them down the path to bankruptcy, with two negative consequences: (i) additional harm to the Greek economy and (ii) lower collections in the long term.
- These loans represent a substantial portion of the assets under liquidation (30% of the total loans in the preliminary estimation from the liquidators) and the situation is deteriorating quickly.
- These loans will require specific competences, capital, access to funding and a dedicated monitoring system.

Given the current legal and supervisory framework and operating scheme in place, it is very unlikely that the entities under liquidation will be able to manage these loans effectively. This is because:

- Most entities under liquidation do not have an accurate view of the size of sub-performing loans in their portfolio (*see chapter 2*).
- Managing these assets requires “restructuring” competencies, which are not necessarily within the current mission of the liquidators (*see chapter 3*).
- Restructuring those positions might require renegotiation of the financing schemes or new lending, which requires funding and capital (*see chapter 3*).

In order to preserve the value of sub-performing loans, three main options exist:

- One option is to sell these loans to a core bank that can use existing internal restructuring capabilities and possibly lend new funds.
- If this option is not possible, two other options merit investigation:

The possibility of creating a dedicated special-purpose vehicle with the necessary restructuring capabilities and adequate funding.

As last resort, the current legal and supervisory framework can be adapted in order to allow adequate support within the entities under liquidation.

5.4. How to move forward

The different models presented in this chapter are not mutually exclusive, and the recommendations in this report can best be implemented by addressing the following priorities:

Priority #1 – Starting as soon as possible, secure some enhancements to the legal and supervisory framework³⁷ and mandate that liquidators follow an improved set of operating standards to deal with NPLs.

- Ensure the proper assessment of the loans portfolio per segment, possibly with the support of an external expert.
- Improve the effectiveness and the efficiency of NPLs collection by mandating an improved set of operating standards at the entity level (Model #1).
- Take all necessary steps to enhance the current legal and supervisory framework.

To move forward, BoG has already prepared a proposal including the necessary enhancements to launch the implementation of the above recommendations.

Priority #2 – In parallel, test the appetite of a going concern bank and/or an international recovery specialist to build a ServiceCo.

- It is recommended that the appetite of a local going concern bank and/or an international recovery specialist to lead the construction of a ServiceCo (Model #2) be tested and that this bank and/or international recovery specialist make the final decision about the viability of that model. Responsibilities to set up the scheme should be determined.
- If confirmed, the initiative to establish such ServiceCo will be implemented by the selected local bank and/or the international recovery specialist.
- Over the long term, the services of this ServiceCo could be also extended to other going concern banks.

Priority #3 – Meanwhile, define an appropriate approach for sub-performing loans to make restructuring capabilities and temporary refinancing available to the affected companies.

- A specific approach for sub-performing loans should be established:

Sub-performing loans require a different approach than NPLs. The goal must be to protect their value by not putting additional pressure on the temporarily distressed companies that took these loans. Applying a rigid and aggressive NPLs collection scheme to these companies may push them into bankruptcy and further damage critical areas of the Greek economy.

³⁷ Based on BoG recommendations

Instead, the goal should be to ensure that sub-performing loans are separated from the rest of the portfolio and managed in a way that supports the underlying companies with appropriate restructuring and refinancing options.

- As a way to move forward:

Launch a more precise identification of the size of sub-performing loans in the entities under liquidation.

As soon as possible, determine if there is a going concern bank with the necessary resources (capital, funding, capabilities), that is willing to buy these sub-performing loans.

In parallel, investigate the opportunity to create a special-purpose vehicle to own and manage sub-performing loans.

The most pragmatic solution is to sell sub-performing loans to a going-concern bank or to a special-purpose vehicle.

5.5. Actions proposed by BoG on legal and supervisory framework

To move forward from the current situation, BoG is in the process of proposing amendments to the legal and supervisory framework, primarily in the following areas:

- *Allow specialized companies to act as liquidators.* Both legal entities and individuals should be allowed to assume the special liquidation duties.
- *Reinforce the governance of the entity under liquidation.* To avoid delays and maximize returns, a clear corporate governance structure should be in place, which allows the liquidator to make (and be responsible for) all required decisions (e.g., by setting up committees).
- *Give liquidators clear guidance on the execution of the liquidating activities.* The liquidator's mandate should provide clear guidelines on how to manage the liquidation process, including:

Instructions on how to perform asset recognition, with particular regard to loans segmentation.

Uniform guidelines for negotiating the outsourcing of collection activities (including the establishment of an SLA with the external servicer), including the necessary incentives to maximize the recovery and minimize timing of collection.

- *Introduce clear restructuring rules.* The liquidators should be provided with clear restructuring rules (e.g., by reviewing the timing of the payments) for cases in which the amount collected can be increased.
- *Enhance the supervision of the entities under liquidation.* These enhancements cover in particular:

Establishing a dedicated unit within BoG in charge of supervising the entities under liquidation.

Strengthening the reporting obligations to BoG to ensure proper monitoring of the current recovery performance and the evolution of the assets.

Increase the threshold of settlements that do not require pre-approval by BoG in order to speed up the process and minimize the cost for taxpayers.

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