A new reality for borrowers

cyprus-mail.com/2018/09/09/a-new-reality-for-borrowers/

Elias Hazou September 9, 2018

‘You wouldn’t believe what kind of breaks they used to get from banks’

By Elias Hazou

LOAN defaulters expecting more flexibility from debt collection agencies rather than their bank, could be in for a rough ride while the state’s new Estia loan relief scheme likely is to benefit strategic defaulters above genuine cash-strapped borrowers, economists say.

For decades, as seen following the collapse of the Co-op, Cypriots have found it easy to acquire loans, and in thousands of cases, failed to pay them back, many because they didn’t want to and seemingly didn’t have to, and the bigger the default, the less chance the bank had to recoup what they were owed. However, the banks have now offloaded their bad loans, and the debt collection agency has become a new addition to the Cypriot landscape.

Currently there is a single credit acquiring company registered and operating on the island: B2Kapital Cyprus Ltd. It is a wholly owned subsidiary of B2Holding ASA, a Norwegian corporation listed on the Oslo Stock Exchange.

Back in June of this year, Hellenic Bank sold a loan portfolio of €145m to B2Kapital. The transaction, according to a press release, related to 1,082 borrowers and 1,809 facilities.

Though it’s not known how much B2Kapital actually paid for the loans, it goes without

saying that they got them for a heavily marked-down price.

In case of any doubts, in late August Bank of Cyprus sold Apollo Global Management, a US private equity firm, a portfolio of non-performing loans (NPLs) for €1.40bn. The portfolio had "a gross book value of €2.80bn, secured by real-estate collateral, and a contractual balance of €5.70bn."

Effectively, Bank of Cyprus sold the tranche of loans at a 75 per cent discount (€1.4bn is about 25 per cent of €5.7bn).

Strictly speaking, Apollo Global Management is an asset manager, not a credit acquiring company like B2Kapital.

Once a bank decides to sell off an NPL to a third party, it merely notifies the affected client/debtor via letter of its intention. The standard-format letter gives the client 45 days in which to challenge this decision.

During the 45 days, the client and the bank may try to reach an accommodation on the repayment of the loan. If no agreement is achieved, the obligation along with all attached securities and guarantees are transferred to the credit acquiring company (CAC).

However in practice, it's expected that in almost all cases the transfer of assets (debt) will take place regardless, as for one thing it's obvious the bank has concluded before sending the letter that a certain loan is unsalvageable. For another, the bank is in contact with the CAC before the 45 days have lapsed.

From then on, clients will deal with the CAC alone. They will receive a new letter by post from the CAC informing them of the said loan transfer, and advise them that such-and-such company officer has been assigned to their case.

The bank also passes on to the CAC all the client's relevant financial data.

Some in the industry assert that, depending on the CAC, debtors can anticipate more flexible treatment than from the banks.

They say that commercial banks, subject to ever more stringent EU regulations, are under pressure to raise capital when their equity situation isn't looking good. So they put the squeeze on their clients, demanding immediate payment.

Unlike banks, CACs are not subject to capital provisions requirements. They thus have more leeway, the argument goes, and are able to extend repayment periods.

But economist Savvakis Savvides says he is "categorically against the idea that asset-management companies will make life easier for borrowers."

Cyprus face a gargantuan private debt, standing at 350 per cent of GDP. It is easily the single largest threat to the economy.

And NPLs are at staggering levels.

"So why, you may ask, don't the banks offer their clients the same or similar discount that they offer the CACs or the AMC? The answer is simple: because by transferring these bad

assets, they wipe the slate completely clean, clearing their books."

By removing the bad debt off their books, lenders are then not obliged to raise as much capital. What's more, says Savvides, one has to keep in mind that the EU-wide bank stress tests are just around the corner.

Effectively, he says, this demonstrates loud and clear that banks in Cyprus have given up on the economy – they don't expect clients to settle their debts.

"People aren't repaying their loans; if they were, we would be in a deep recession right now, because the money wouldn't be coming out the other end, namely the banks, because they aren't issuing new loans as there is no demand for them.

"Perversely that is the reason for the so-called 'success story' in Cyprus following the 2013 meltdown. No one is paying their loans, so consumption is still going strong."

As for the CACs and AMCs, Savvides points out that these are profit-making businesses – "not charities" – and will use all the tools at their disposal to recover debt from delinquent borrowers.

"It's just business for them," he notes. But, he adds critically, hedge funds and equity management firms do not create wealth, they only manage and transfer wealth.

"The reason banks don't restructure loans is that the assets will remain on their books, necessitating the raising of provisions. That's understandable.

"But what's not understandable is why they are not compelled to first offer the client the option to pay back the debt with a similar discount as that which is given to Funds in order to entice them to buy these loans. I bet a lot of borrowers could repay if offered, say, a 70+ per cent markdown on their debt balance." The impact of this on the economy, unlike the sale of loans to third party intermediaries, would be tremendous as it will also reduce private debt and enable its economic agents to borrow again as they become more credit worthy.

Also, a key problem in the Cypriot financial sector is over-securitisation.

"It's become the fashion lately to talk of strategic defaulters," comments Savvides.

"The received wisdom is that these borrowers will exploit to the hilt the mooted loan repayment subsidy scheme known as Estia. But what you need to understand is that these strategic defaulters – like the big-name developers – have always had it good, not just now. You wouldn't believe what kind of breaks they used to get from banks. For example, a bank might extend a major construction company a loan based solely on the personal guarantee of the corporation's main shareholder.

"There are just too many securities and guarantees floating around in the system."

In July parliament amended the insolvency framework, concerning those borrowers whose loans are viable, that is, a where a debt restructuring scheme is in place.

Eligible for insolvency schemes are borrowers with a house with a market value of up to €350,000 – up from €300,000 previously.

This applies to non-consensual schemes – schemes that are imposed on banks.

Another change applies to individuals and companies alike: borrowers who have received state assistance, but do not service their loan for three months, are no longer protected by insolvency proceedings.

Where the insolvency process cannot proceed, then the Estia scheme kicks in.

For Andreas Milidonis, associate professor of finance at the University of Cyprus, the Estia scheme – expected to be rolled out next year, as it is still pending approval from the European Commission – is a dream for borrowers who can afford to repay their debt but won't.

Estia will in effect be a 50 per cent haircut of the loans of debt defaulters Those entering the scheme will only have to repay 50 per cent of their loan, the taxpayer would cover about a third of it, and the bank will take a 20 per cent loss.

The defaulters will also benefit from an extension of their loan repayment to up to 25 years, depending on their age, and will be guaranteed interest rates of between 2.5 and 3.5 per cent.

Estia can be used by a household with gross income of €50,000, a first residence property worth up to €350,000 and additional property of €350,000 x 125 per cent (or €438,000).
So the total value of the eligible household's property would be €350,000 + €438,000 = €788,000.
The estimated annual cost to the taxpayer is €30m.

"Imagine a household where the husband and wife are making €2,000 each per month, they've got other assets – like a second residence which they could sell to pay off their debt – and yet they get to be subsidised by the taxpayer.

"Meanwhile, folks on half that salary who have forsaken a home loan in order to live in a modest rental, or people who have no debt or who do have debts but are consistent with their payments, are supposed to bail out the aforementioned strategic defaulters. Is this fair?"

The only safeguards in the scheme are that only covers loans that were already classed as non-performing in September of 2017 and not those that became delinquent later, and that the subsidy is conditional on borrowers not failing payments over 12 months.

Milidonis proposes that both the assets and income criteria be lowered, to reflect the average Cypriot household.