‘Questions and Answers’ in relation to the transfer of Non-Performing Loans by Bank of Valletta to a third party

What is a non-performing loan (NPL)?

A non-performing loan (“NPL”) is a loan where the borrower is no longer making regular payments on the loan and is therefore in default. This can be due to a variety of reasons including but not limited to situations of financial difficulties or bankruptcy.

Bank of Valletta considers an exposure to be non-performing/defaulted when either or both of the following criteria have taken place:

(i) Exposures which are 90 or more days past due.
(ii) The debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral.

What type of loans is Bank of Valletta transferring?

Supported by external advisors, Bank of Valletta (the “Bank”) followed a rigorous process in selecting loans for the portfolio to be transferred (the “Portfolio”). In all cases the Bank has attempted various recovery methods and there is still no clear repayment plan by the debtor. In all cases the Bank is either engaged in court proceedings or preparing to enter such.

The Portfolio is comprised of 707 non-performing loans across 245 borrowers, the majority of which have been granted commercial loans to finance business activities across a number of different industries. The Portfolio also includes personal loans, credit card loans, home loans, encroached savings and current accounts and other debts. The Portfolio is significantly biased towards loans and facilities that have been in default for a long period of time, with 90% of the Portfolio comprised of loans and facilities that have been in default for 5 years or longer.

Who is Bank of Valletta transferring these loans to?

Bank of Valletta will be transferring the portfolio of NPLs to a Malta-registered securitisation cell company (the “Acquirer”) and the transaction will be financed predominantly by an investment fund, established in Malta and licenced by the MFSA to invest in the acquisition of non-performing assets. The fund will be managed by a fund manager that is regulated by the MFSA in terms of the Alternative Investment Fund Management Directive.

The Acquirer was selected on the basis of a formal offer which it submitted after a bidding process in which other professional firms operating in the field of distressed debt have participated. The Acquirer was selected by the Bank based on the offer submitted for the acquisition of the Portfolio and based on extensive due diligence conducted by the Bank.

If a home loan, personal loan, a credit card loan or a business loan defaults on a few payments for justifiable reasons, will the Bank transfer the relationship to another party through an NPL sale?

If there is a default on a payment, the Bank approaches the customer within a few days to investigate the reasons behind the missed payment. Customers who have only a few payments in arrears are given a chance to get back in line with their repayment schedule. If a customer has long-term issues, that in the eyes of the Bank are justified, the Bank grants the customer a new repayment schedule, reducing the amount to be paid on each installment or granting a moratorium in accordance with the customer's situation. On the other hand, if the Bank has lost communication with the customer or the customer is not cooperating, the Bank may call-in the facility after 90 days from first default, demanding immediate payment of all facilities. Even beyond this stage, the Bank continues to seek a workable solution but eventually, unless the customer agrees to a repayment plan, it will pursue the matter in court. The Portfolio only includes loans which have defaulted on multiple occasions and in respect of which the Bank has no clear and acceptable repayment plan by the debtor and/or there is an expectation that the recovery of debt will take longer than originally intended.

How would I know if I am being impacted?

The Bank will send a letter to all impacted customers containing all relevant details. If customers are not contacted by the Bank, then their accounts are not affected and there is no need for them to contact the Bank.

What will happen with the relationships that the Bank has with the customers whose loans are being transferred?

Upon completion of the assignment of the Portfolio, the Acquirer will replace Bank of Valletta as lender/creditor in respect of the relevant NPLs. In this regard, it is the Bank's expectation that the loan agreements between the Bank and the relevant borrowers will be honoured and adhered to by the Acquirer in accordance with all applicable Maltese laws and regulations, and that they will act in a professional manner and treat all borrowers fairly during the process of recovery.

Customers whose loans are being transferred will need to collaborate with the Acquirer to explore a way forward. The transfer should not affect the customers' credit score. In the letter which it will be sending to impacted customers, Bank of Valletta will also provide the Acquirer's contact details.

Will the banking relationship of the impacted customers cease, and all their accounts closed?

The Bank does not necessarily intend to stop providing basic banking services to the customers whose loans are being transferred, such as deposit accounts, solely on the basis of such transfer of loans, as long as the conditions set by the Bank around the provisions of those facilities are met. The Bank reserves the right to transfer other facilities in the future and the customer will be notified accordingly.

What information will be shared with the third-party entity taking over the NPLs?

In accordance with the Bank's Privacy Notice, which can be accessed by following the link https://www.bov.com/content/privacy, the Bank will only be transferring the information required by the Acquirer for it to enforce its rights as the new creditor. During the transfer process, the Bank will continue to ensure the confidentiality of any personal data and give affected customers notice before personal data is transferred.

What is an NPL Sale transaction and who buys these assets?

NPLs can be transferred by the original lenders (generally banks) to third party entities. This transfer would effectively result in the third-party entity replacing the bank in the relationship with the debtor. NPLs can be transferred through a variety of methods such as loan auctions, bilateral negotiations, or through intermediaries such as brokers.

Why do banks enter in such a transaction?

The transfer of NPLs to third-party entities helps banks reduce their risk exposure and free up capital to use in other areas of their business by recovering some of their lost capital and reduce future provisions on these NPLs. It also helps banks improve their financial standing, maintain regulatory compliance, and may lead to a positive impact on a bank's credit rating.

In case of Bank of Valletta, the transfer will improve the Bank’s NPL ratio in line with regulatory requirements, aligning itself to peer European banks. In addition, the transaction is expected to render other benefits to the Bank, such as an improvement in the asset quality of the Bank’s credit portfolio, effectively improving its capital position. The transaction is expected to have positive impact on the Bank’s profitability in 2023 and in future years, as it will remove the need for further provisioning against these debts. It will also improve the Bank’s operational efficiency due to a release of resources which are currently dedicated to complex debt collection processes, court proceedings and the ongoing management of the collateral held by the Bank, including their eventual disposal.

How do financial services regulators look at NPL sales?

In recent years, the sales of NPLs by European banks have reached tens of billions of euros. This was in part driven through targeted efforts by some European governments to facilitate such transactions in a relatively new market. The sale of NPLs is seen as an effective means by which banks can improve their capital position and free up resources to lend to new customers and invest in other areas of the bank. Transfers of NPLs through sales is considered as one of the structural measures needed to prevent the accumulation of NPLs on banks’ balance sheets. In fact, in 2022 the European Commission published a set of guidelines regarding sales of NPLs on secondary markets.

How do banks ensure successful completion of such transactions?

Banks can ensure a successful transfer of such loans by conducting thorough due diligence on the Acquirers, having a clear understanding of the value of the NPLs, and having experienced legal, regulatory, and financial advisors to support the process. Bank of Valletta has also carried out extensive due diligence on the Acquirer. Moreover, Bank of Valletta has put in place robust processes for the selection of the NPLs included in the Portfolio and their respective valuations. A thorough assessment of the regulatory landscape has also been carried out and all legal aspects evaluated.

How are NPLs valued?

Banks can use various criteria to value their NPLs, such as the age of the loan, the expected time to recovery, the borrower creditworthiness, and the collateral securing the loan. In case of Bank of Valletta, the valuation assumed that the projected recoveries would emanate from the sale by judicial means of the collateral held and the NPLs have been valued and stressed for different assumptions including but not limited to the time to recovery of these NPLs, the revaluation of the local property market going forward, the property liquidation costs, and the loan servicing costs.

Is the Bank transferring these loans at a lower amount than the balance due to it and why?

Yes. Against a cash consideration today, Bank of Valletta will be relinquishing the amount that may theoretically be recovered in the future from these loans, at a discount which reflects the current creditworthiness of the underlying borrowers and thus the inherent recovery risk, together with the cost to acquire and manage the NPL portfolio over the recovery period. Provisions against these loans have been charged to profits in previous years, in line with regulatory requirements and therefore the transaction is expected to have a positive impact on the Bank's profitability for financial year 2023, representing the difference between the accumulated expected credit loss (provisions) and the actual realised loss following the transaction.