

Problematic Loans: The Cure for the Disease

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Countries under economic adjustment programmes have adopted various methods to tackle the problem of delinquent loans, giving over-indebted households and businesses the chance to pay down debt. The Bank of Greece, for example, has announced a series of measures, which include lower instalment payments, lower interest, considerable grace periods, temporary deferment of instalments, extending the loan repayment period for households and businesses, or allowing homeowners to turn tenants in their primary residence.

The Bank of Greece has introduced the following main methods for loan restructuring:

1. Short-term solutions (five years or less): Payment of interest only, or lower interest payments during a short-term period; grace periods; deferment of instalments; repayment of the balance that is in arrears; and debt rescheduling;
2. Long-term solutions: These are adjustments with a duration of over five years, and include a permanent reduction to the interest or on the contractual margin rate; switching the type of interest (e.g. from variable to fixed); and extending the loan repayment period;
3. Splitting a loan in two: The first portion of the loan is tied to physical collateral, where the borrower

pays in instalments. For the second portion, or the balance on the loan (the unsecured amount), no interest is charged for a period agreed with the bank. On the latter, borrowers are subject to re-evaluation should their finances improve, otherwise they are required to take out a mortgage on another immovable property, that is to say, to put up other assets as collateral;

4. Operational restructuring: Concerns business loans for which a businessman is required to curtail spending and implement cost-cutting measures. Also debt/equity swaps;

5. Definitive restructuring: This involves drastic actions aimed at definitively tackling debt. Debtors voluntarily sign over to the bank their mortgaged property as part of a broader adjustment;

6. Conversion into a leasing contract, whereby borrowers transfer ownership of immovable property to the bank and sign a leasing contract for a minimum duration (usually five years).

In Ireland, the authorities have drawn up a list specifying the 'reasonable living cost' for households (families with children, couples, etc.) The list outlines monthly expenses for food, housing, healthcare, education and so on. An average reasonable cost of living has been calculated, which lenders and borrowers alike refer to for debt settlement. The list cannot be questioned as it is based on data furnished by the country's statistical agency.

In addition, the Irish authorities have devised the concept of "cooperative borrowers" (i.e. borrowers who do not conceal information – such as income, assets etc – from banks). By defining what a cooperative borrower is, a bank can no longer arbitrarily deem a borrower as being non-cooperative and therefore refuse to restructure his or her debt. Thus, banks are obliged to examine each case separately, provided certain basic conditions are met. Moreover lenders may write off large chunks of debt once they find that a loan cannot be serviced due to the lack of income (or any prospect for income) on the part of the debtor.

In Spain, a house may be transferred to the bank, and the debtor may continue to reside in the house as a tenant for as long as it takes him/her to repay the debt. During the leasing period in question, ownership of the immovable property passes to the bank, and the borrower-tenant can repossess the house upon repayment of the loan at the period end. This is known as a leaseback.

The banks and the government have agreed a code of conduct, which all lenders have adopted. Eligible for these adjustments are persons whose income places them below the so-called 'social exclusion' line.

Spanish banks likewise grant grace periods, loan repayment extensions, etc. In addition, where the value of a property is currently lower than that at which it was purchased, the difference is split among the bank and the borrower. In the most extreme cases, a bank will take possession of a house but allow the borrower to keep residing there for two years as a tenant.

These are the sort of sensible solutions to which we here in Cyprus should look to if we really want to escape the vicious cycle of depression.

