

Asset Management Companies and NPL Resolution

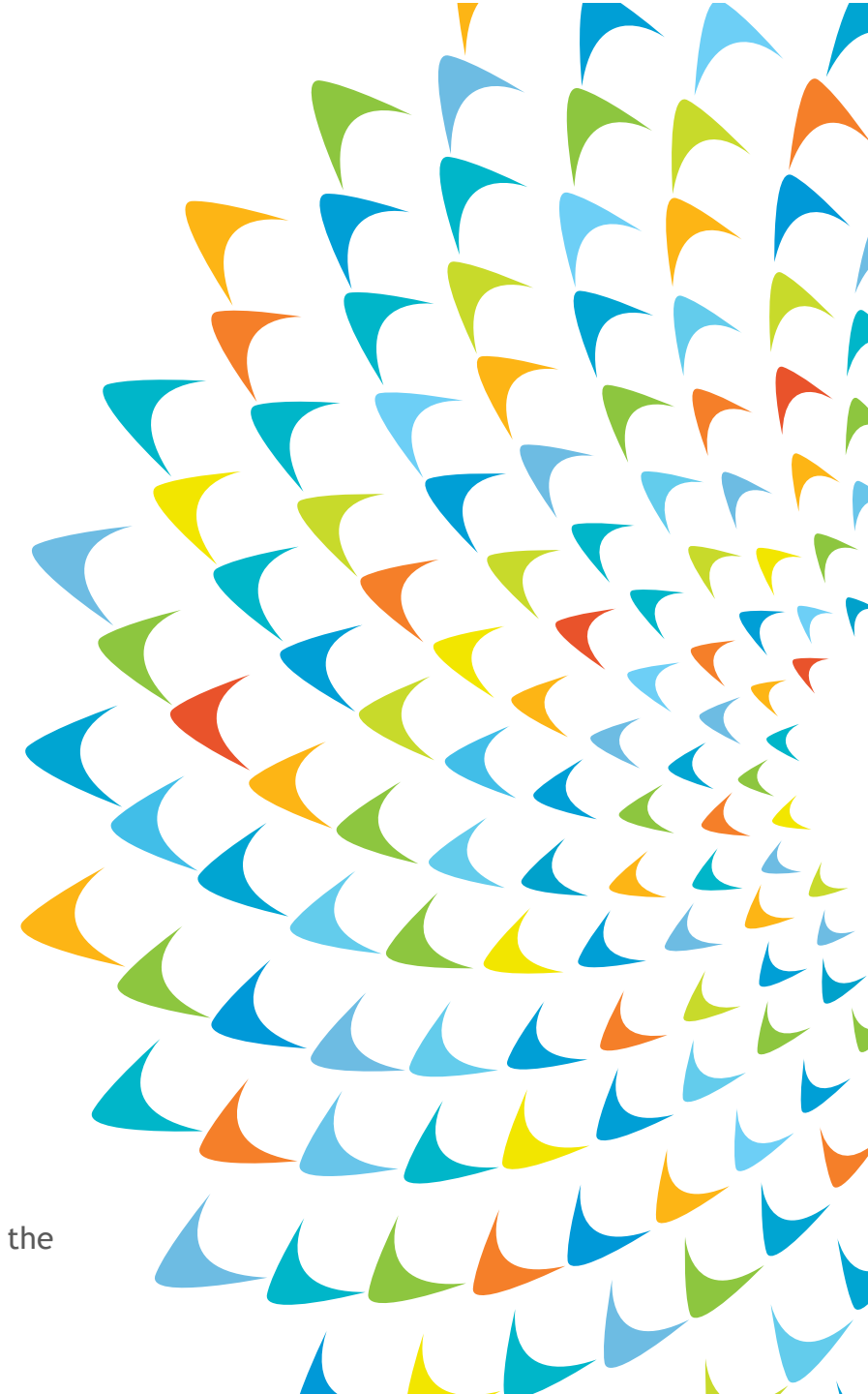
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The views expressed here are exclusively those of the presenters and do not necessarily reflect the position of the JVI or the ADB.

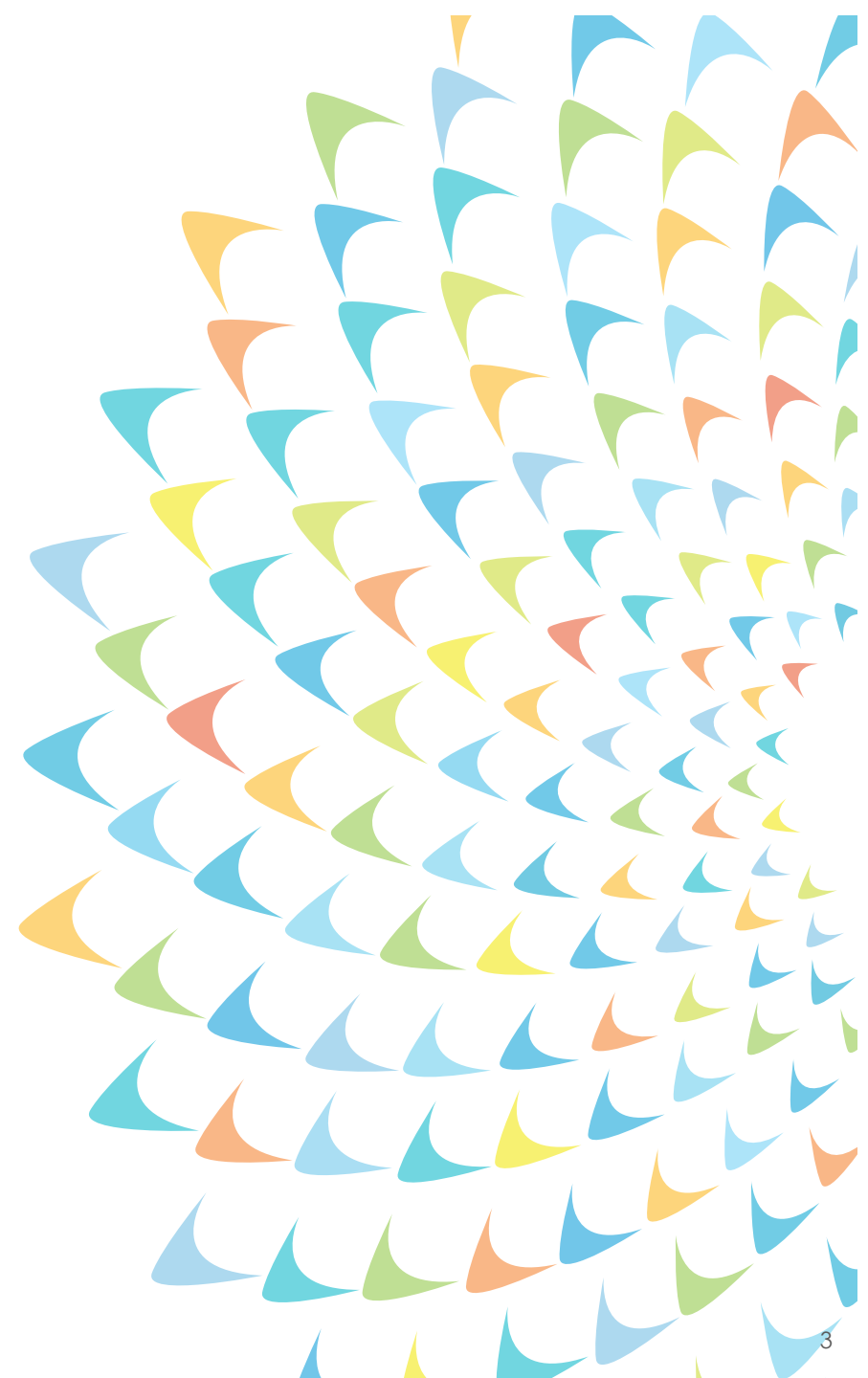




Outline

1. Introduction – potential benefits of (systemic) AMCs
2. Set-up, design and effective operation of AMCs
3. Regional examples
 1. Europe
 2. Asia
4. Conclusions

1. INTRODUCTION – POTENTIAL BENEFITS OF (SYSTEMIC) AMCS

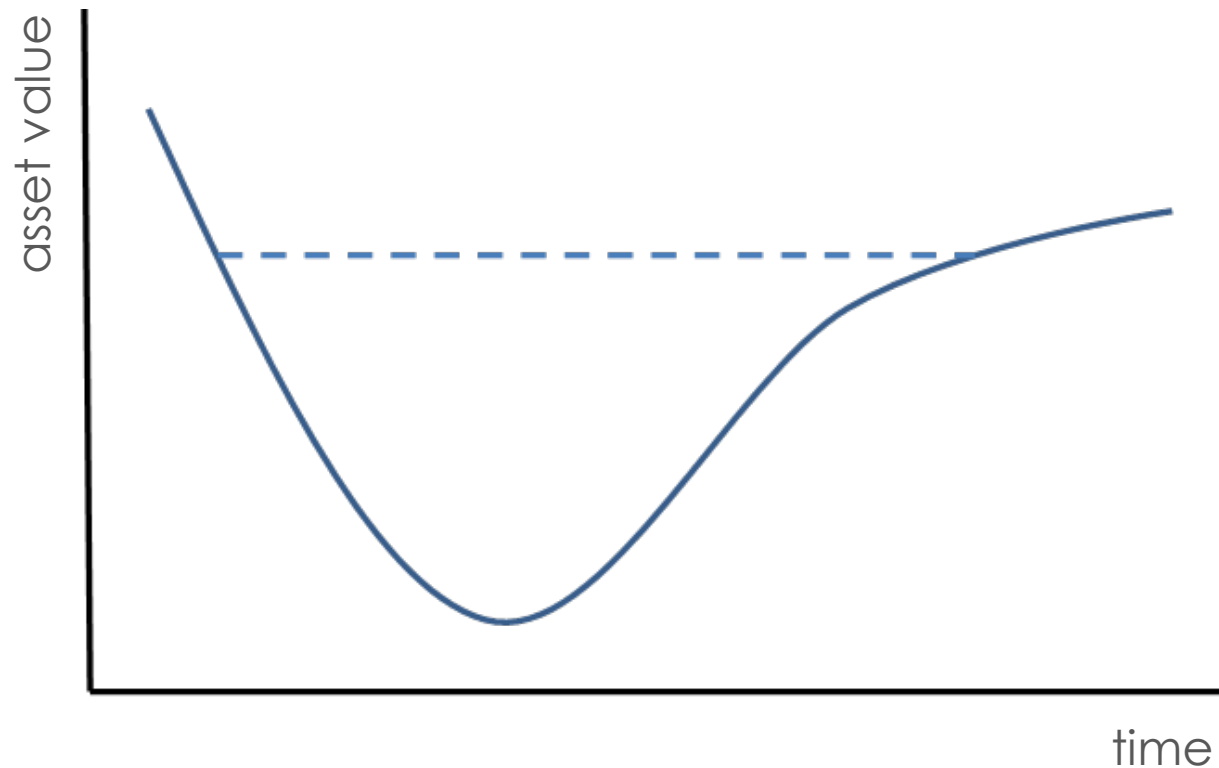




Potential benefits of systemic AMCs

A systemic AMC can be a 'Bridge to the Future'

- Maximising recoveries over the lifetime of the AMC
- Avoiding fire sales through transfers at real economic value
- Exploiting synergies from managing similar assets





Potential benefits of systemic AMCs

Benefits for the banks

- Swift removal of troubled assets from the balance sheet
- Bank can focus again on regular business
- Uncertainty about asset quality and funding costs are reduced
- Avoid fire sales and reduce costs (depending on transfer price)

'Systemic' benefits

- Reduces uncertainty and speeds up banking sector stabilisation
- Banks are more quickly able to support the real economy again
- AMCs can exploit synergies from managing similar assets and avoid market troughs – hence maximising recovery values
- Reduces total fiscal costs associated with the crisis despite initial set-up costs (if properly done)

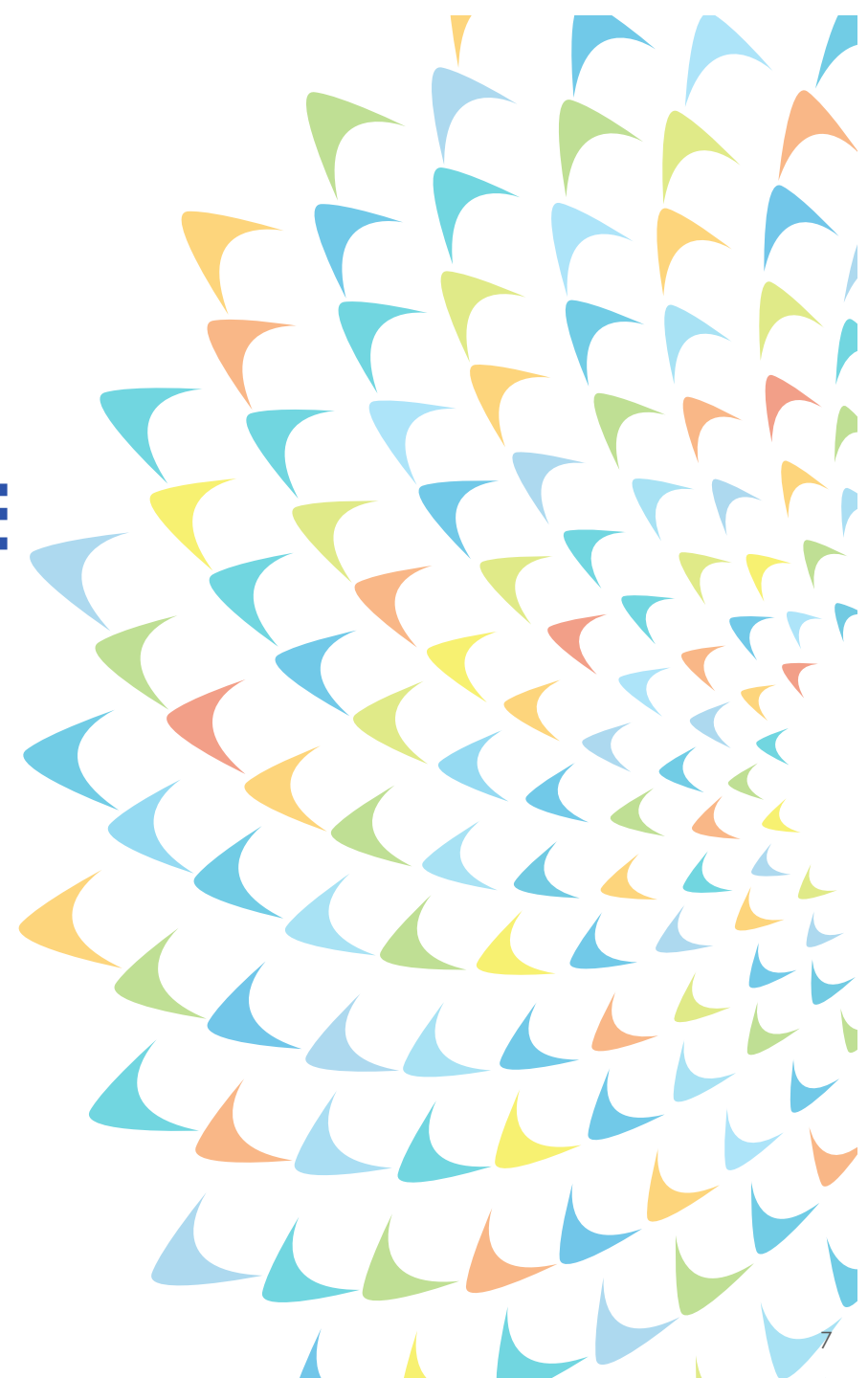
But badly designed and managed AMCs can be costly and ineffective!!



When to use systemic AMCs?

- **Size:** Impaired assets affect a large part of the banking system
- **Composition:** Impaired assets mainly in 'suitable' asset classes
- **Set-up costs:** Country is able to (at least partly) fund and operate
- **Framework conditions:** Insolvency, bankruptcy and foreclosure laws are – or become – sufficiently robust
- **Systemic AMC are no panacea and should be part of a package**
 - Emergence of new NPLs to be addressed (underwriting practices)
 - Improve bank's on-balance sheet resolution capacity
 - Improve secondary NPL markets by ensuring a high degree of NPL transparency and data availability

2. SET-UP, DESIGN AND EFFECTIVE OPERATION OF SYSTEMIC AMCS





Success factors for systemic AMCs (1)

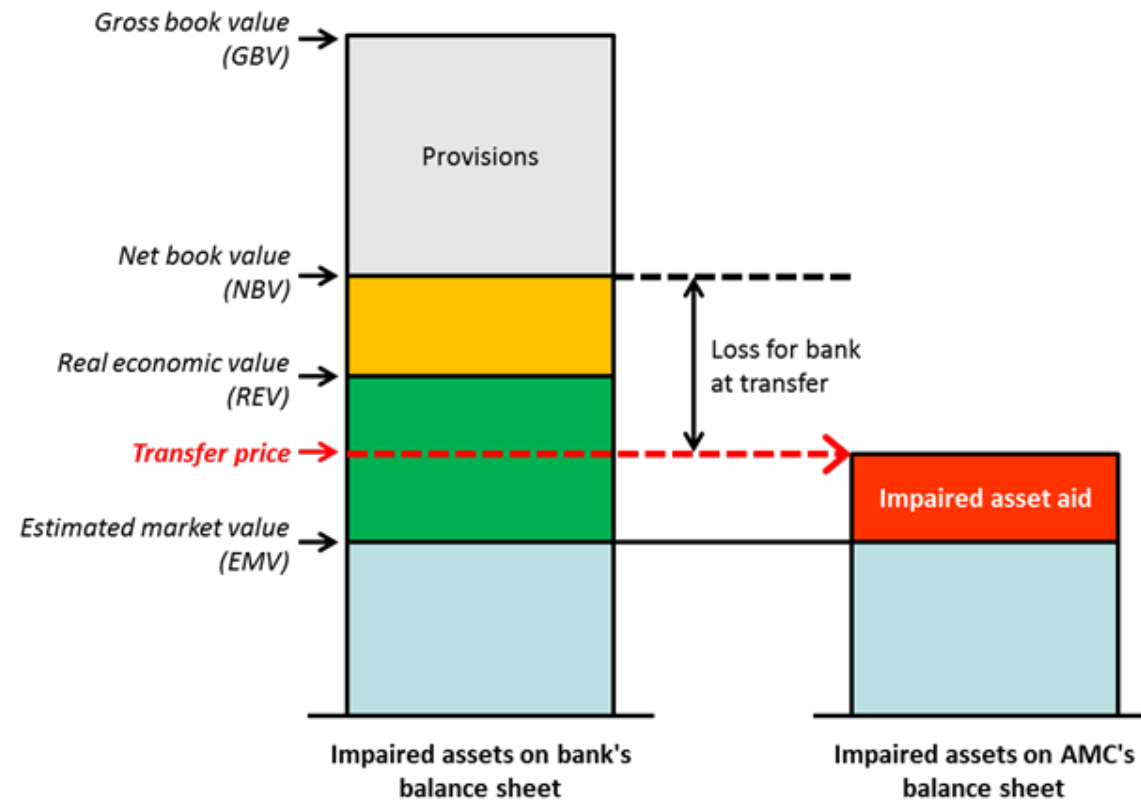
- **Need for thorough diagnostic exercise (ideally AQR and stress test) to help determine**
 - the banks that should transfer assets to the AMC (compulsory?),
 - the type of assets to be transferred and
 - the terms and conditions of the transfer, including the transfer price
- **Diagnostic exercise may be limited to asset classes that are likely to be transferred**
- but it should be conducted at individual debtor level
- **Difficult trade-off between speed, thoroughness and credibility**
 - Euro area countries needed between 6-12 months – but country differences were (and probably will be in future) large
 - ‘Cutting corners’ tended to be counterproductive



Success factors for systemic AMC's (2)

Determining the transfer price – who pays the bill?

- In EU typically between 'Estimated (current) market value' (EMV) and 'Estimated real (long-term) economic value' (REV)





Success factors for systemic AMC (3)

- **Key objective of the AMC should be clear**
 - Euro area AMCs – maximise recovery value of assets, thus minimising taxpayer's costs
 - Significant profits or losses likely to signal incorrect transfer prices, management mistakes (losses) or positive upsides (profits)
 - Secondary objectives are not helpful for the success of the AMC - unless clearly subordinated to its primary objective
- **Lifetime of the AMC**
 - 'European view' – dominated by moral hazard concerns:
 - Clearly defined, realistic lifetime, normally 5-10 years
 - Asset transfers from banks ideally completed in a single round
 - 'Asian view' – AMCs part of financial crisis infrastructure
 - Retaining infrastructure and expertise
 - Requires safeguards to prevent moral hazard problems



Success factors for systemic AMCs (4)

- **AMCs as banks?**
 - Banking license significantly increases regulatory compliance costs and disclosure requirements
 - Increases likelihood of AMCs morphing into banks
- **Legal toolkit**
 - Restricting recovery options, e.g. by foreclosure prohibitions for collateral, comes at a commercial cost for the AMC
 - Special powers (e.g. compulsory purchase powers) help to ensure debtor cooperation but can be politically sensitive
- **Independence**
 - Key features (objective(s), oversight, etc.) ideally based on legislation
 - Full budgetary independence
 - Protection from political interference
- **Oversight** – can be performed by different individual parts of government (Central Bank, Supervisor, MoF, etc.) or a dedicated committee



Asset perimeter and size of the AMC (1)

- **Optimizing economies of scale and scope for the AMC**
 - AMC can achieve specific expertise and economies of scale when taking over a large share of impaired assets in a certain asset class
 - Complexity of very large systemic AMCs and the initial set-up costs for the government are counterbalancing factors
- **Principles regarding asset transfers to the AMC**
 - Commercial Real Estate (CRE) and property development loans are seen as particularly suitable to be worked out by systemic AMCs
 - Scope to consider other portfolios for transfer – notably NFC / SME loans - keeping in mind operational efficiency and political sensitivity
- **‘Debtor-level approach’ useful** - all exposures of a debtor, including performing and ‘out-of-scope’ assets are transferred to the AMC



Asset perimeter and size of the AMC (2)

Exposure class	Heterogeneity	Granularity	Collateral quality	Political sensitivity	Typical resolution approach	Suitability for an AMC
Commercial real estate	Low	Low	High	Low	Sell collateral	Yes
Residential property development	Medium	Low	Medium to high	Low	Restructure/ sell collateral	Yes
Large corporate	High	Low	Low to medium	Medium	Restructure/ liquidate	Depending on industry
Small and medium enterprises (SME)	High	High	Low to medium	Medium	Restructure/ liquidate	Depending on size and industry
Residential mortgage	Low	High	High	High	Restructure	In limited cases
Unsecured consumer	Low	High	None	Medium	Liquidate	No
Governments and government agencies	Low	Low	Low	High	Restructure	No

- For unsuitable asset classes other resolution strategies, either on- or off-balance sheet appear economically superior to AMCs!



Ownership and funding structure

- **Ownership**

- Private sector (majority) ownership prevents public sector interference in operations – but banks as shareholders may create conflicts of interest
- In many instances public ownership may be the only realistic option

- **'Baseline' funding structure used for systemic euro area AMCs**

- AMC issues senior unsecured bonds to transferring banks
- Senior bonds carry full and irrevocable guarantee of the national treasury and are eligible for use as collateral in Eurosystem credit operations
- Capital position of originating banks improved as senior bonds are a quasi-sovereign asset
- Senior bonds structured against expected (back-loaded) cash flow generation of the AMC



Disposal strategies

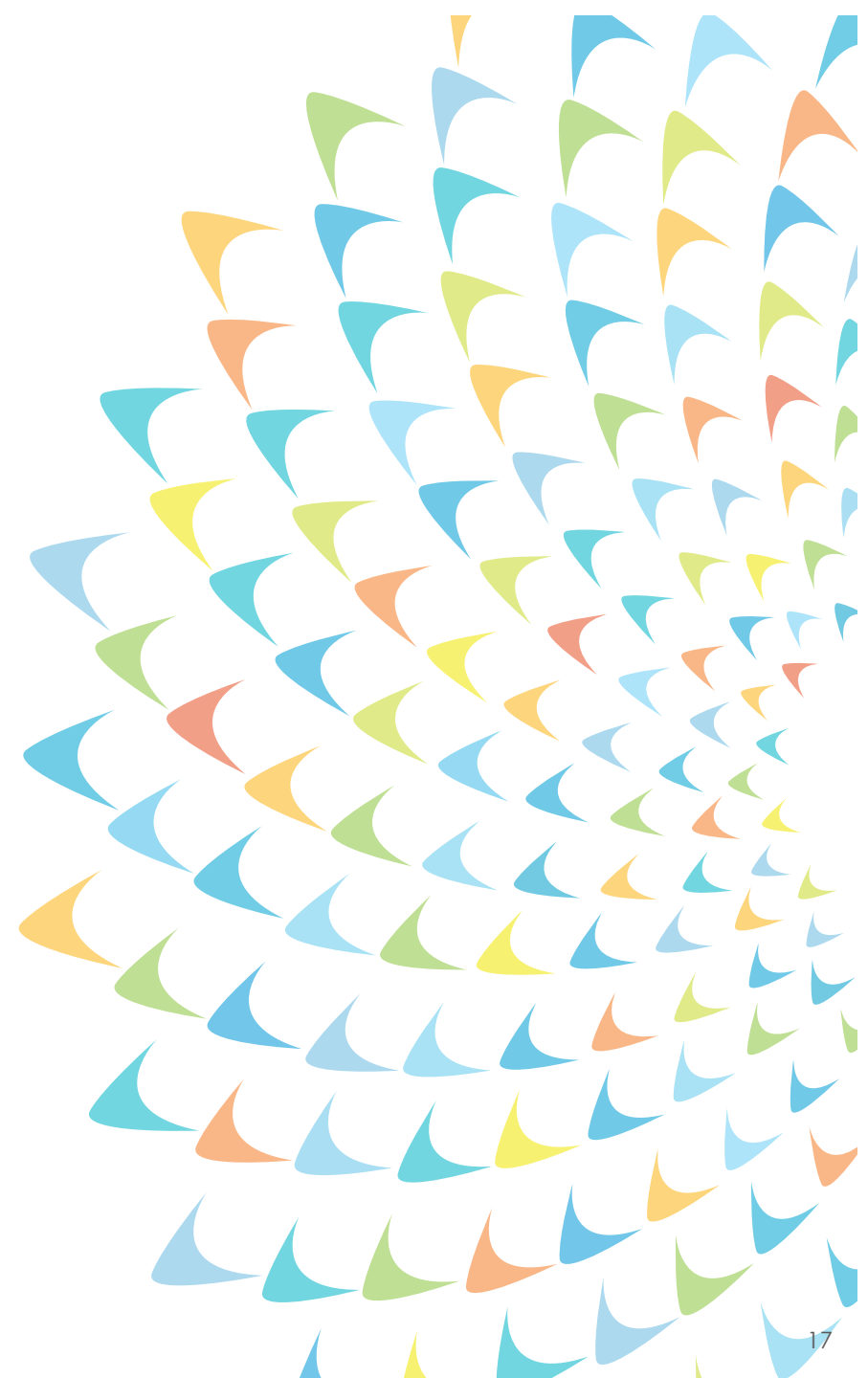
- **Starting point of the process should be a thorough viability assessment of the borrowers**
- **Depending on the outcome, five main strategies are available**
 - Foreclosure and sale of collateral
 - Insolvency proceeding and liquidation
 - Sale of the loan
 - Restructuring (traditional, debt-to-equity swap)
 - Accelerated recovery using out-of-court arrangements
- **Warehousing vs. factory approach**
 - The 'Warehousing Approach' is based on 'wait and sell' whereas the 'Factory Approach' is based on 'repair and sell'
 - Choice determined e.g., by asset structure, market situation, capital constraints



Other organisational aspects

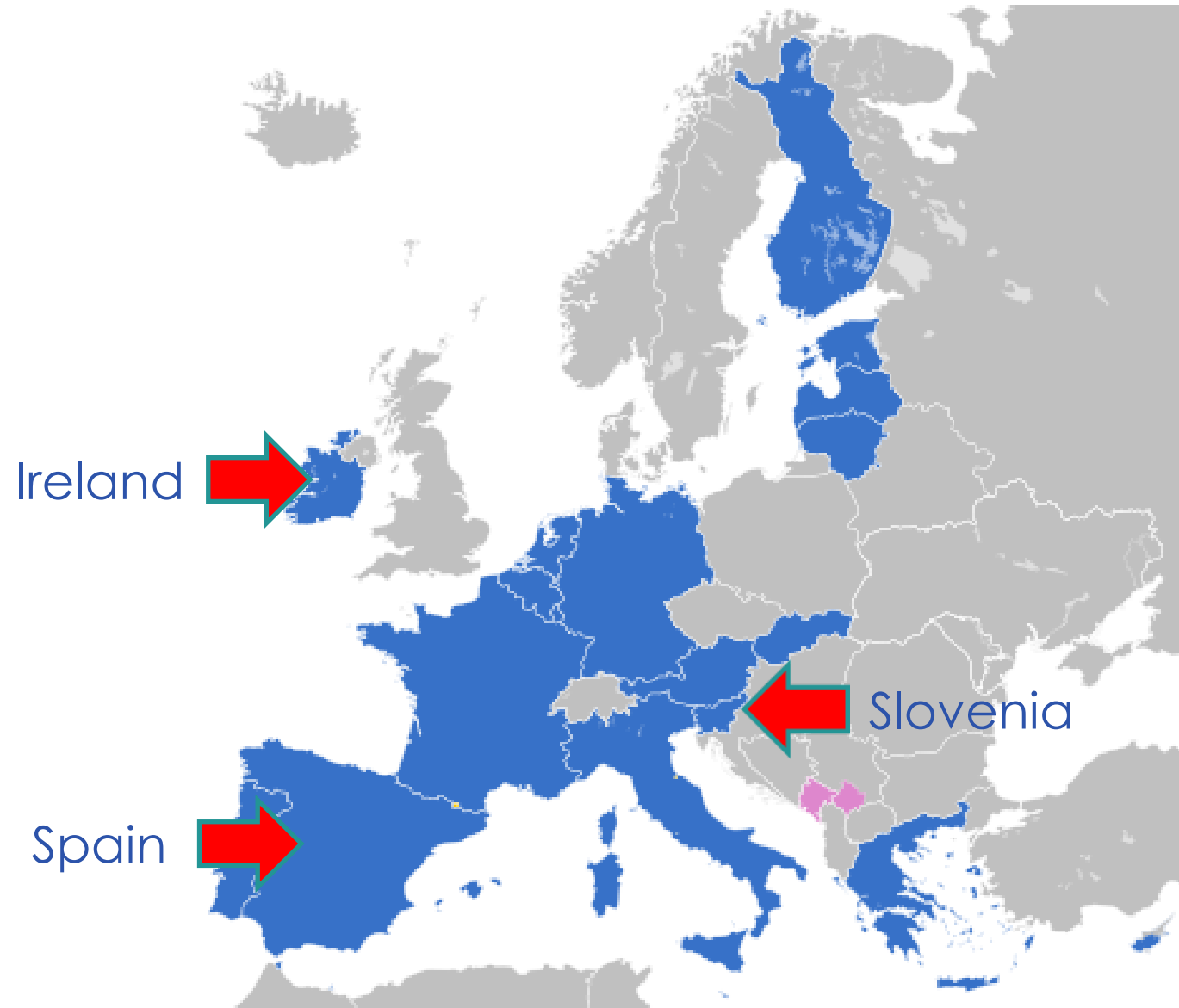
- **Managerial appointments should be based on merit and experience**
- **AMC should be able to hire and adjust staff as needed** – paying market prices for specialized skills (challenging during the wind-down period)
- **Use of existing servicing platform solutions avoids time-consuming, in-house platform solutions**
- **Originating banks servicing AMC loans creates conflicts of interest** – but may be unavoidable during the set-up period of the AMC
- **Well-defined transparency and disclosure requirements to the public** – proved helpful for public acceptance of AMC in euro area cases

3.1. REGIONAL BEST PRACTICE EXAMPLES - EUROPE





Setting the scene – the crisis context





Key features of the three AMCs

	Nama (Ireland) 2008	Sareb (Spain) 2012	BAMC (Slovenia) 2012 / 2013
Special Powers	Yes (but not used in practice)	None	None
Lifespan	Expected to close in 2020 (running ahead of schedule)	15 years (until 2027)	10 years (until 2022)
Average asset transfer price (book value discount)	57% (including REV uplift of 8.3%)	52.4% (including REV uplift of 18%)	68% (including REV uplift of around 10%)
Transfer price valuation method	Appraisals	CB and independent diagnostic exercise (AQR and ST)	Independent diagnostic exercise (AQR and ST)
Main asset classes	Large RE loans	Large and mid-sized RE loans	Almost only corporate loans, often multi-lender loans



Key features of the three AMCs

	Nama (Ireland) 2008	Sareb (Spain) 2012	BAMC (Slovenia) 2012 / 2013
Total assets transferred (in bn EUR)	74 (44% of GDP)	50.8 (10% of GDP)	5.8 (16% of GDP)
Portfolio concentration	High (19% of debtors had 78% of nominal debt acquired)	Relatively low (around 200.000 assets)	Relatively high but multi-lender loans (minimum 500.000 EUR)
Geographical dispersion	Mainly Ireland but 38% in UK	Only Spain (57% in Madrid, Catalonia and Valencia)	Mainly Slovenia
Recovery from face value	54% as of June 2017	19% as of June 2017	23% as of June 2017
Debt redemption	Senior debt redeemed in 2017 (ahead of schedule)	25% of government guaranteed debt at end-2017	Around 50% at end-2017



Specific reasons for success – or lack thereof

- **Ownership and management**
 - NAMA and Sareb are majority private-sector owned. Public sector interference in operations (even if possible) did not occur but banks as shareholders may create conflicts of interest
 - BAMC is 100% state-owned. Early years were plagued by governmental interference as well as high management turnover. By now operational independence well established
- **Servicing**
 - Sareb initially relied on the transferring banks to service the assets, resulting in conflicts of interest and lack of incentives on the side of the servicers. In 2015 it moved to 4 independent servicers.
 - NAMA and BAMC did not use the originating bank as servicers. Building up the needed capacity required, however, time and resources.



Specific reasons for success – or lack thereof

- **Accounting framework**

- Sareb started with General Company Accounting Standards – IFRS compliant
- In October 2015 Banco de Espana released updated special rules for the valuation of Sareb's assets
- Move from average valuation used at time of transfer (200 buckets) to asset-specific valuation
- Asymmetric impact, additional provisions needed for assets priced below average but no gains for assets above average
- Change in valuation contributed to near depletion of Sareb's capital
- Public perception in Spain that Sareb was a 'failure'
- Sareb's sales focus shifted to assets above valuation price to generate profits, possibly compromising a more 'strategic' sales approach



Specific reasons for success – or lack thereof

The Single Debtor Approach (NAMA)

- AMC debtors may have multiple creditors; performing & non-performing loans
- AMC may not have exclusive access to the resources of the debtor ('imperfect excludability problem')
- As a result AMC may compete with other creditors, resulting in complicated (misaligned incentives) & costly coordination among creditors
- NAMA successfully employed the 'Single Debtor Approach'
- All exposures of its debtor, including performing and out-of-scope (non-CRE) exposures were transferred to NAMA



Specific reasons for success – or lack thereof

Special legal powers (NAMA)

- The NAMA act gave NAMA a number of special legal powers
 - Vesting and compulsory purchase orders
 - Right to unilaterally change the language of loan contracts
 - Disposal of assets at its discretion
 - Entitlement to obtain tax information on its debtors
 - Preference / priority over payments made by insolvent borrowers
- NAMA didn't use these special legal powers. They were, however, useful to ensure cooperation by its debtors



Specific reasons for success – or lack thereof

Warehousing vs. factory approach

- The ‘Warehousing Approach’ is based on ‘wait and sell’ whereas the ‘Factory Approach’ is based on ‘repair and sell’
- NAMA benefitted initially from rapid sales in UK. For its Irish assets it used extensively the ‘Factory Approach’ (to a point that other developers launched complaints)
- Sareb relying mainly on ‘warehousing’, only later and less on the ‘FA’
 - capital constraints complicated both the ‘warehousing approach’ (time pressure and asset selection) and the ‘factory approach’ (restrictions on expenditures for asset enhancement)
- BAMC, given its mandate and portfolio, had to rely mostly on the ‘factory approach’ (restructurings)
 - Complexity of the task and need to build up expertise resulted in relatively slow start
 - In later stage lead in high-profile restructurings

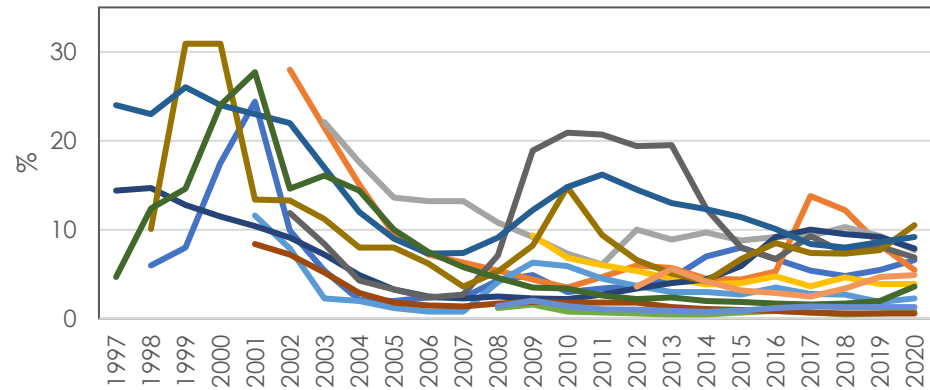
3.2. AMC EXAMPLES AND LESSONS FROM ASIA



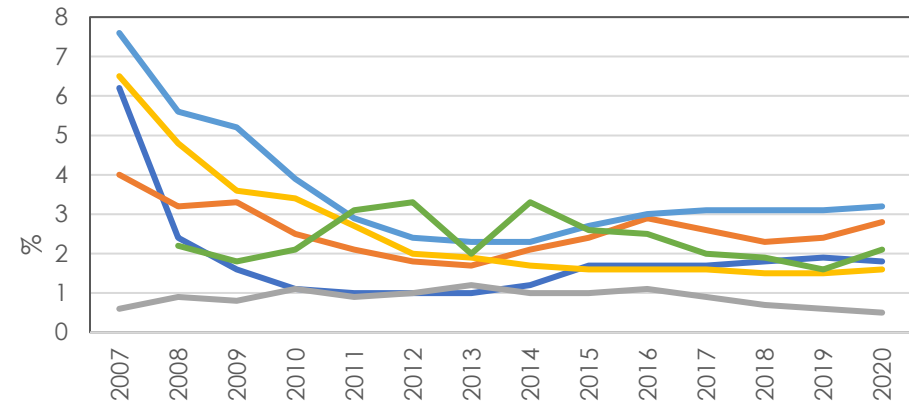
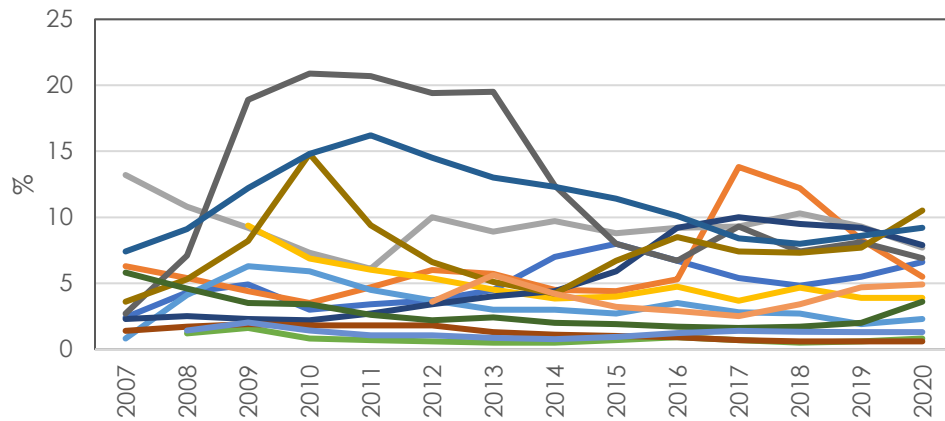
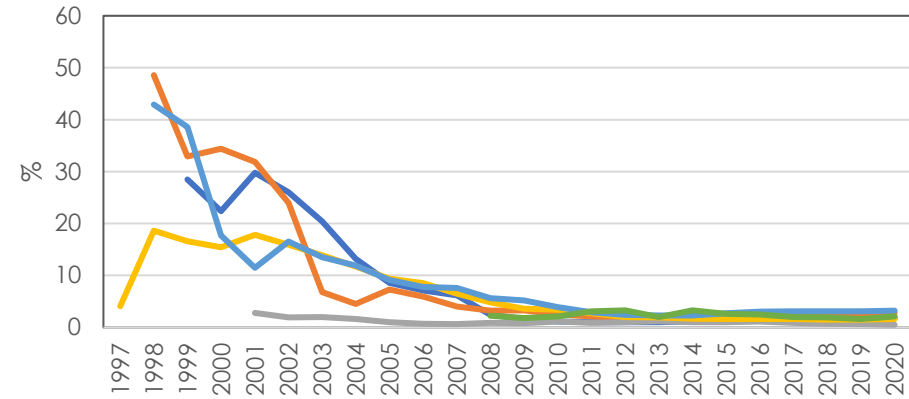


Evolution of NPL ratios in Asia (with and w/o public AMCs)

NPL ratio of Asian economies **without** public AMCs or with limited roles of PAMC



NPL ratio of Asian economies **with** active roles of PAMC



- Armenia
- Azerbaijan
- Bangladesh
- Brunei
- Georgia
- Hong Kong, China
- India
- Japan
- Kazakhstan
- Kyrgyz Republic
- Pakistan
- Philippines
- Singapore
- Sri Lanka

- PRC
- Indonesia
- Korea, Rep.
- Malaysia
- Thailand
- Viet Nam



Public AMCs in Asian economies

		Peak NPL ratio [t=0]	NPL ratio [t+5]
People's Republic of China	<ul style="list-style-type: none"> 1999, four centralized public AMCs (Big 4) established to initially take over assets of PRC's four largest banks: Orient for Bank of China; Great Wall for Agricultural Bank of China; Cinda for China Construction Bank; and Huarong for Industrial and Commercial Bank of China. Big four Chinese banks held nearly 70% of the market share 2020: Fifth national AMC China Galaxy Asset Management Multiple provincial AMCs existing, incl. IPAF member Zhejiang Province Zheshang Asset Management. 	(1999) 28.5	(2004) 13.2
Indonesia	<ul style="list-style-type: none"> Public AMC Indonesia Bank Restructuring Agency (IBRA) established in 1998 and closed in 2004. In its lifetime, IBRA only sold 60% of its NPL portfolio. 2004: PT Perusahaan Pengelola Aset (Persero) (PPA) established, initially to manage ex-IBRA assets, with scope widened in 2008. 	(1998) 48.6	(2003) 6.8



Public AMCs in Asian economies

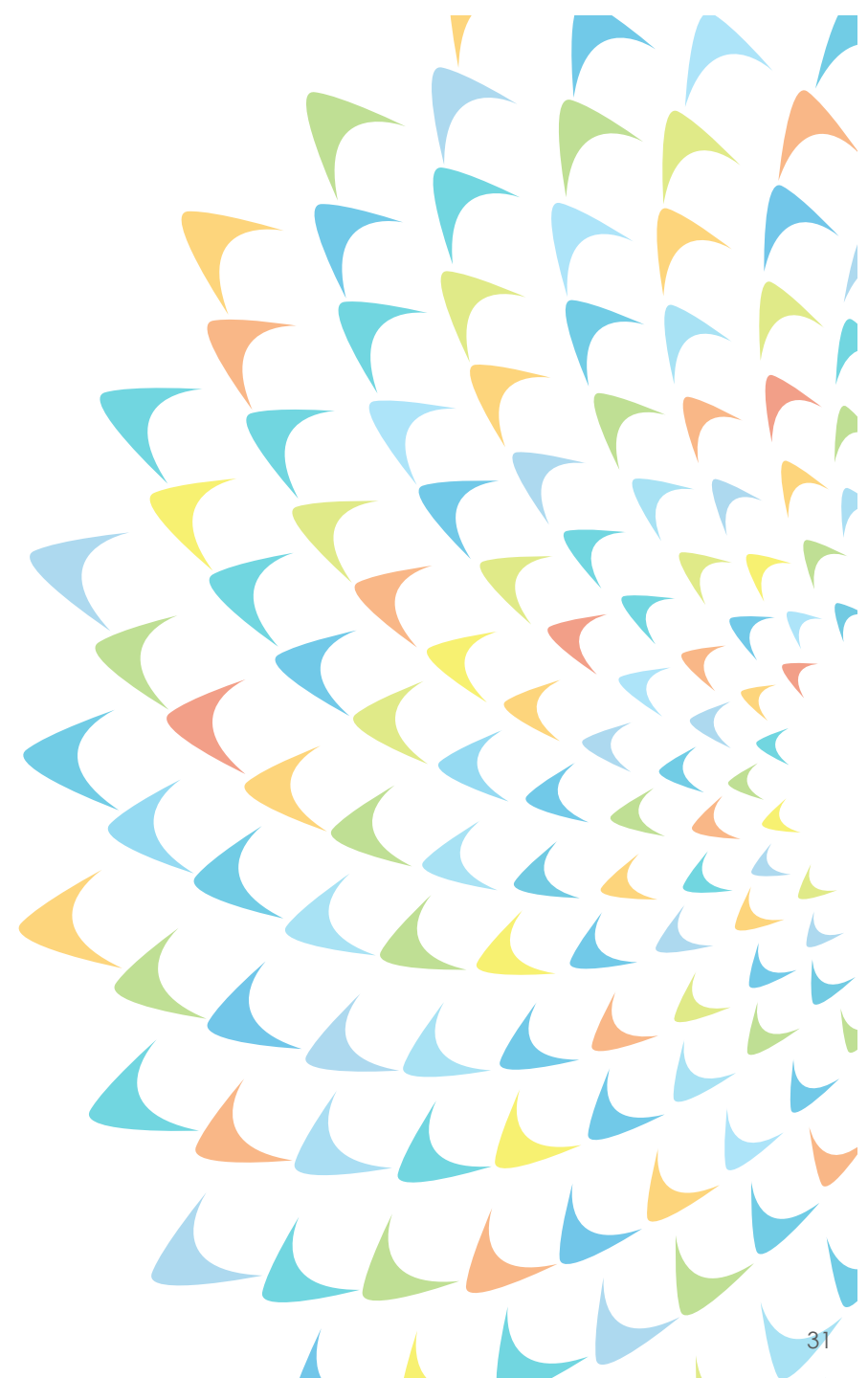
		Peak NPL ratio [t=0]	NPL ratio [t+5]
Malaysia	<ul style="list-style-type: none">Public AMCs, Danaharta established in 1998 and closed in 2005.Danaharta acquired Malaysian ringgit (RM) 20 billion from private financial institutions (priced at RM9 billion) and RM28 billion NPL (no transfer price) managed on behalf of the government.By the end of its operations in 2005, recovery rate was at 58%, with almost 100% disposed	(1998) 18.6	(2003) 13.9
Republic of Korea	<ul style="list-style-type: none">Established in 1962, Korea Asset Management Corporation (KAMCO) was reorganized in 1997 to handle the non-performing Asset Resolution Fund (NPARF).From 1997 to 2002, KAMCO acquired about Korean won (W) 111.4 trillion in NPLs in face value (more than 300,000 NPL accounts) at an average haircut of 64.8%, or W39.1 trillion.By 2013, recovery rate 43.2% with 100% of NPL portfolio soldDisposal methods helped created secondary NPL markets	(2000) 8.9	(2005) 1.2



Public AMCs in Asian economies

		Peak NPL ratio [t=0]	NPL ratio [t+5]
Thailand	<ul style="list-style-type: none"> Asset Management Company Emergency Decree in 1998 facilitated the establishment of 12 private and 4 public decentralized AMCs. Four decentralized AMCs—Bangkok Commerce AMC, Sukhumvit AMC, Petchburi AMC, Radhanasin AMC—were effective and removed Thai baht 977.24 billion in NPLs from five of the country's state-owned corporate banks from 1998–2001. Public AMC, Thai Asset Management Company (TAMC), was established in 2001. By 2006, TAMC had resolved 99.98% of its NPL portfolio. 58.37% value recovery of the acquired NPLs. After TAMC's closure in 2013, BAM and SAM took over its assets 	(1998) 42.9	(2003) 13.5
Viet Nam	<ul style="list-style-type: none"> Public AMC, Vietnam's Debt and Asset Trading Company (VDATC) was established in 2003 under the Ministry of Finance for SOE restructuring. Public AMC, Vietnam Asset Management Company (VAMC) was established in 2013 under the State Bank of Vietnam (SBV) to purchase NPLs from banks, but its NPL resolution function is limited. 	(2012) 3.3	(2017) 2.0

4. CONCLUSIONS





Roles of public AMCs: Traditional vs. recent roles

- Establishing a public AMC is one strategy for dealing with distressed assets in the financial sector
 - Resolution of insolvent and nonviable financial institutions
 - Restructuring of distressed but viable financial institutions
 - Privatization of government-owned banks and government-intervened banks

- **Public AMCs were used as an exit strategy tool** in a number of crisis episodes previously (e.g., savings and loans crisis in the US, Swedish banking crisis, Central Asia banking crisis, and Asian financial crisis)

- In response to the GFC, **public AMCs were used as effective tools to support economic activities and credit growth** and to recover private sector lending by alleviating balance sheets of banks, corporates, and households



Public AMCs: Lessons

1

Public AMCs can be an effective tool to ease credit frictions in times of (systemic) crisis, acting as a 'bridge to the future'. They can speed up banking sector stabilization and recovery while reducing the costs for both banks and taxpayers

2

They are, however, no panacea, and not necessarily suitable for all asset classes

3

Possible pitfalls when setting up and operating systemic AMCs are numerous. Some AMCs did not turn out to be success stories and/or had a difficult start. E.g. excessively high transfer prices should be avoided. The EU's AMC Blueprint brings together lessons learned—positive and negative—in this field

4

A market-friendly resolution approach **with clear roles of centralized PAMCs** has worked particularly well for Asia

5

Recent experience suggests that real sector recovery is closely tied with financial sector recovery; fiscal and monetary intervention, even if done at large scale, may not be sufficient. It is hard to ensure sustained economic recovery while the financial system is in crisis



Public AMCs: Lessons

6

Public AMCs can serve as financial safety nets to avert the massive cost of crisis resolution (“**peace time financial army**”). Though perspectives differ in Europe and Asia with regard to the lifetime of a PAMC (temporary vs. permanent)

7

A ‘**one size fits all**’ solution is, however, impossible and not intended! Bespoke, country-specific, approaches are the way forward, informed by the lessons from the past

8

Developing NPL markets domestically (and eventually regionally) while the conditions are still favorable is crucial. This can greatly benefit some of the Asian economies whose NPL ratios remain relatively elevated

9

Public AMCs can be instrumental in **developing private NPL markets** (e.g., linking buyers and sellers, promoting securitization of NPLs, etc.)

10

This can go hand-in-hand with **regional financial cooperation and integration**, including harmonizing standards, definitions, regulations, and practices



Public AMCs: Issues

1. Centralized or Decentralized?
2. Sunset or No Sunset?
3. Legal and Institutional Environment
4. Financial Expertise, Pricing and Profitability
5. Moral Hazard
6. Distressed Asset Markets: Demand and Supply

Thank you for your attention!

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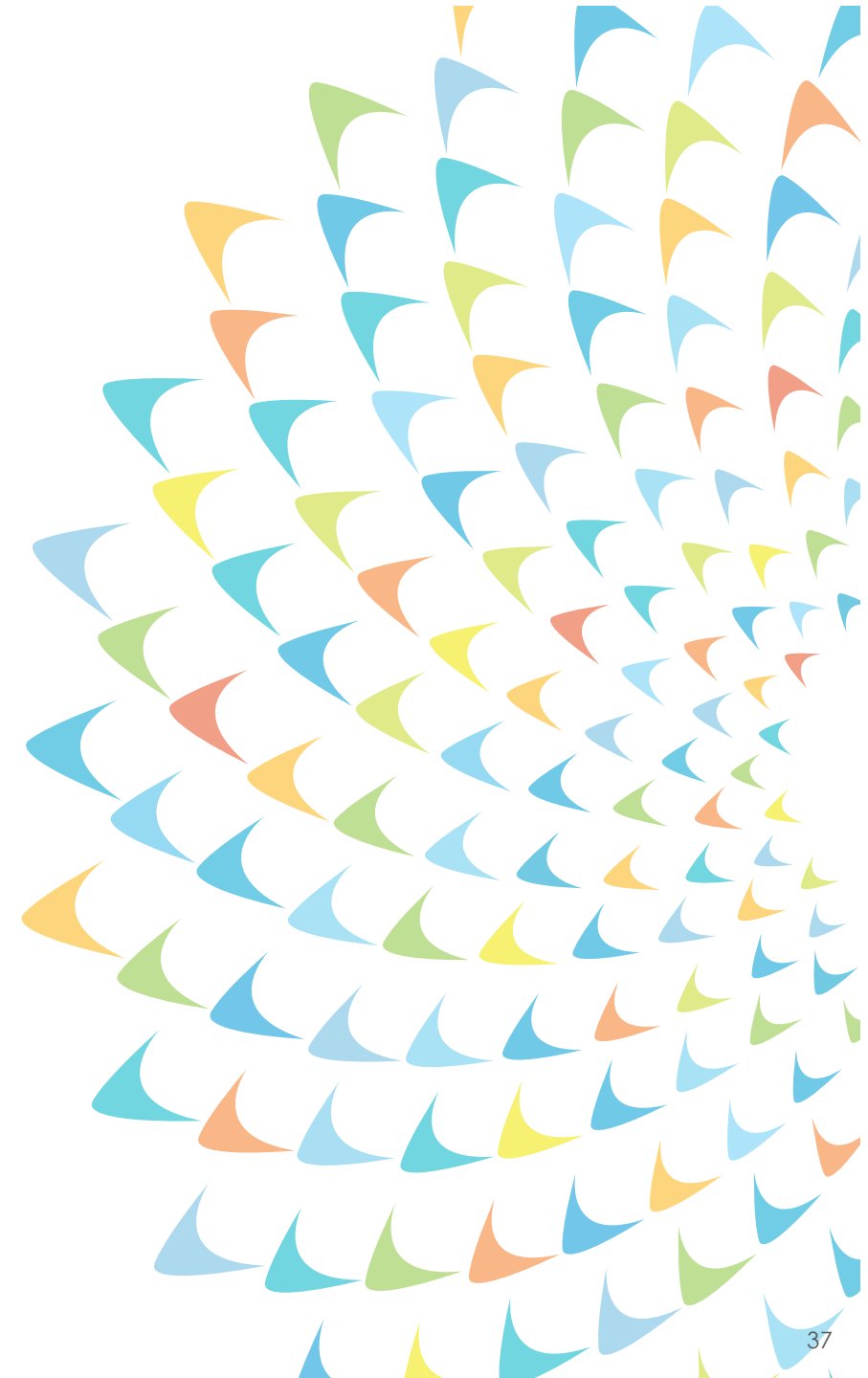
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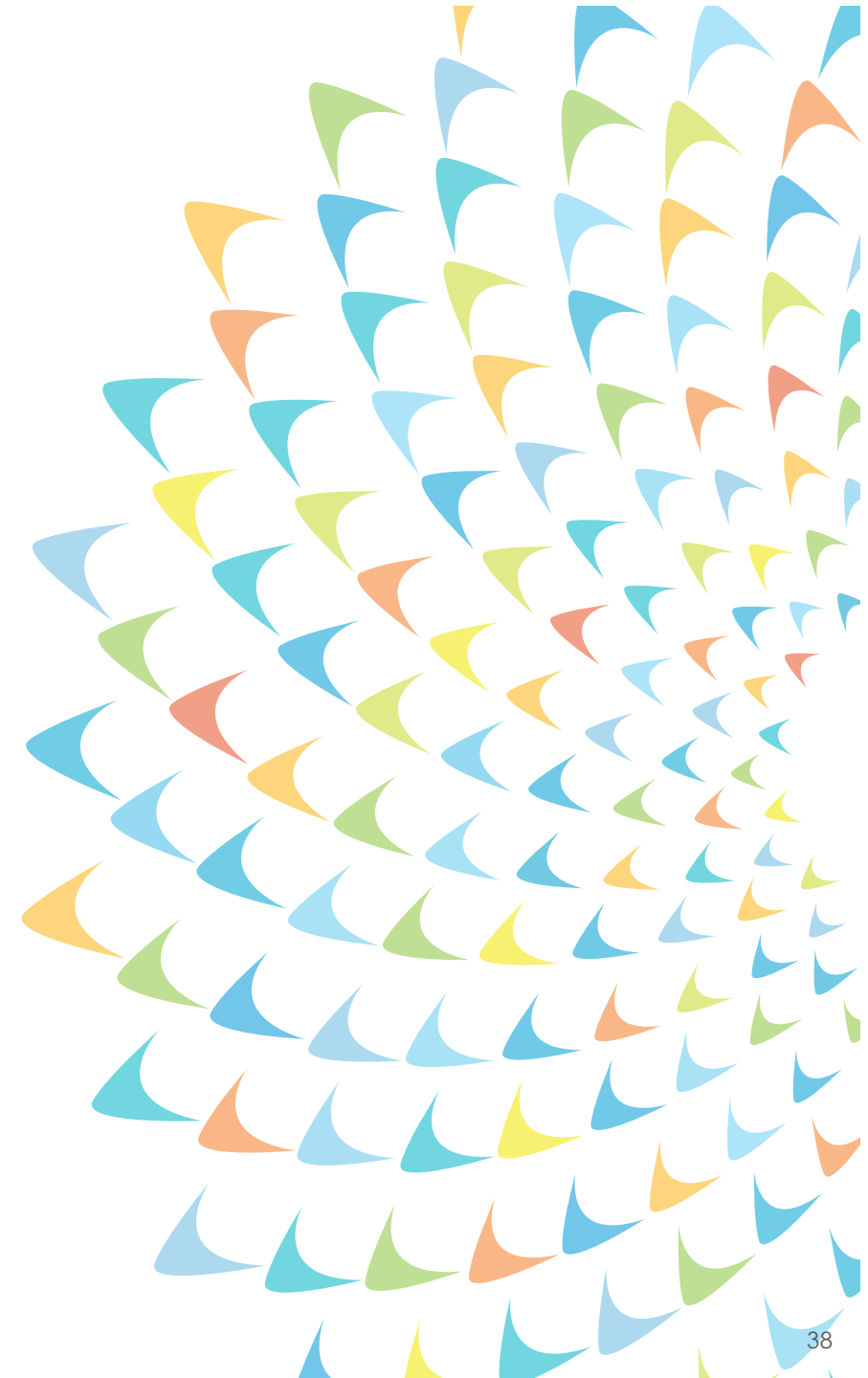
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Extra Slides





Setting the scene – the crisis context

Ireland

- Extended period of strong economic growth and 'catching up'
- One of the largest real estate bubbles in advanced economies in recent times
- Substantial lending to property developers (CRE and RRE) and retail mortgages
- Overvaluation in the property market until 2008
- Significant maturity mismatches in the banking system
- Blanket government guarantee on liabilities of main domestic banks, recapitalisations and establishment of National Asset Management Agency (NAMA)
- IMF / EU financial assistance programme 2010 - 2013



Setting the scene – the crisis context

Spain

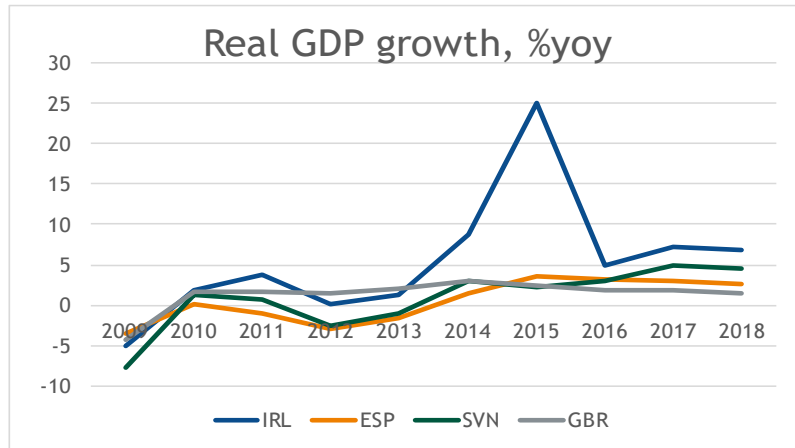
- Extended period of strong economic growth and 'catching up'
- Substantial lending to retail RRE as well as developers
- Overvaluation in the property market until 2008
- Tiered banking system with 'cajas' as weakest part
- Banking consolidation as of 2009
- IMF / EU financial assistance programme 2012-13
- In this context establishment of SAREB

Slovenia

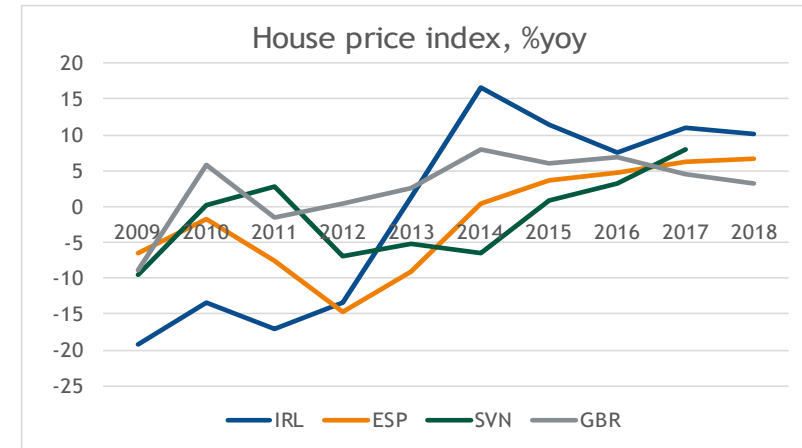
- Strong economic growth and 'catching up' after EU accession in 2004
- Substantial lending to SMEs as well as retail RRE
- Highly interconnected banking system with lots of syndicated / multi-lender loans
- Some overvaluation in the property market
- Launch of DUTB/BAMC (Bank Asset Management Company) and start of banking sector consolidation in 2012-13
- Financial assistance programme narrowly avoided



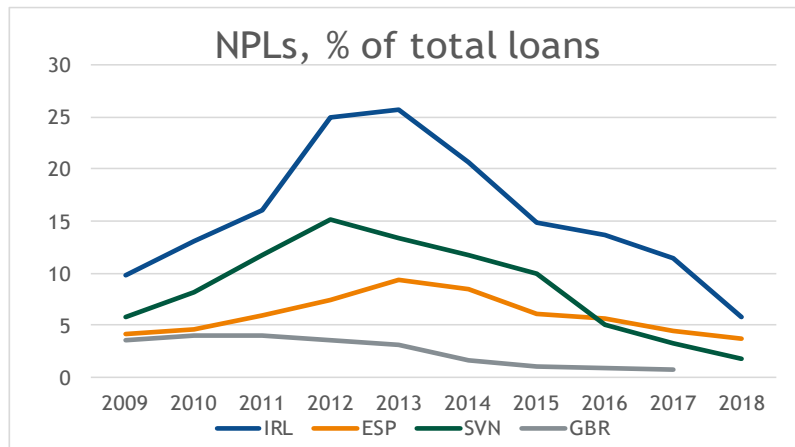
Setting the scene – the recovery pattern



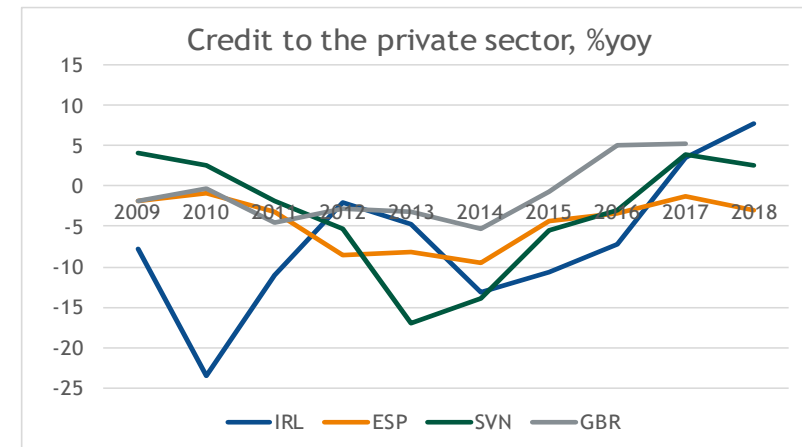
Source: IMF WEO



Source: Eurostat



Source: IMF FSI



Sources: IMF IFS, Haver



Public AMCs in Asian economies

		Peak NPL ratio [t=0]	NPL ratio [t+5]
Japan	<ul style="list-style-type: none">Public AMCs, Resolution and Collection Corporation (RCC) and Industrial Revitalization Corporation of Japan (IRCJ) established in 1999 and 2003, respectively.IRCJ was liquidated in 2007, while RCC is still operational.	(2002) 7.2	(2007) 1.5
Kazakhstan	<ul style="list-style-type: none">Public AMC, Fund of Problem Loans (FPL) was established in 2012 by the National Bank of Kazakhstan. Banks can also establish their own private AMCs called OUSA.In 2014, the Resolution 71 of National Bank of Kazakhstan (NBK) allowed commercial banks to establish a subsidiary (OUSA) that is dedicated to NPL resolution. Banks such as Kazkommet Bank and Forte Bank have taken advantage of this law and have transferred KZT 111,059 million and KZT 32,524 million, respectively.	(2010) 20.9	(2015) 8.0



Empirical findings of effectiveness of AMCs

- **Data:** 76 economies from 1996-2016 (global)
- **Findings** suggest a positive association of the existence of an AMC and the probability of experiencing a sharp drop on NPLs.
- **Average treatment effects** (i.e., a sharp drop in NPL ratio) indicate improved macroeconomic conditions, including higher GDP growth and lower unemployment rates.

Probit model

Dependent variable: sharp drop in NPL ratio

Change in NPL ratio (lagged)	0.0256
Growth	0.0371**
Inflation	0.0290
Exchange rate	-0.0017
Volatility Index	-0.0638**
AMC	0.9037**

AMC = asset management company.

Notes: * and ** denote that the coefficients are different from zero at 5% and 1% significance levels. A sharp drop in the NPL ratio is defined as a more than 4 percentage drop in a given a year.

Source: Park, Lee, and Rosenkranz (forthcoming). Data from Bloomberg; Bova et al. (2016); CEIC database; Cerutti, Claessens, and Laeven (2015); Hallerberg and Gandrud (2015); International Monetary Fund; Standard & Poor's Global Market Intelligence; and World Bank World Development Indicators (accessed August 2018).