PUBLIC ASSET MANAGEMENT COMPANIES

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Key Messages

- Public AMC is **NOT** a silver bullet for high NPLs
- Case studies show mixed track record
- Costly to establish and run, therefore pre-conditions must be met before creation
- However it can play a useful role within a comprehensive strategy (multi-track restructuring)

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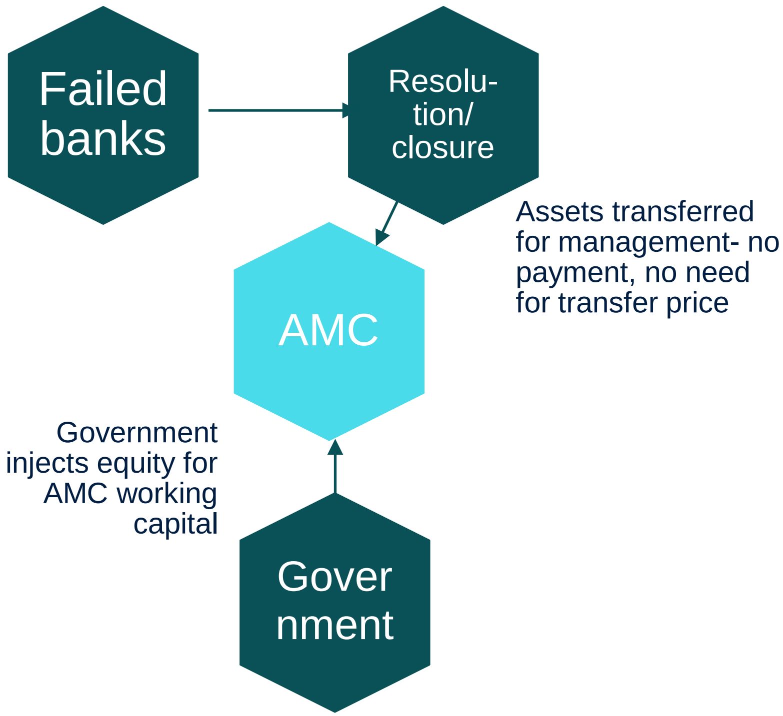
What is an AMC?

- Public, private or joint public/private entity which manages non-performing assets removed from the financial system with the goal of maximizing the recovery value of these assets thereby reducing cost of crisis (recapitalization)
- Tool to support bank resolution and troubled asset relief
- Newly-created entity, or existing entity retooled (Korea, Turkey)
- Two types of public AMCs:
  - Bank resolution entity
  - Asset purchasing entity

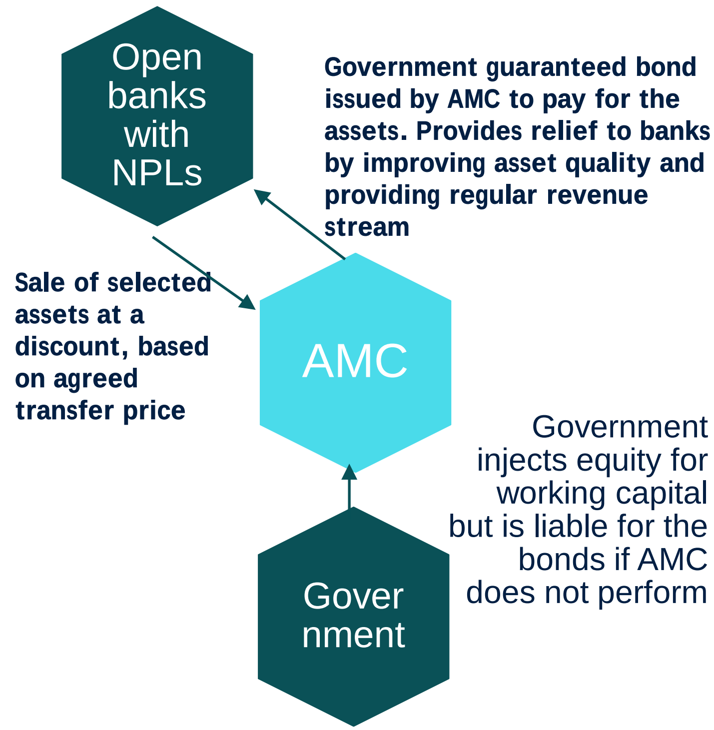
How does it work ?

Two schematic types of public AMC

Bank resolution AMC



Asset purchasing AMC



NB: In recent years in Europe, the trend has been to create public-private AMC so the government is not the only source of funding
This graph reflects the most recent generation of asset-purchasing AMCs

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Possible benefits of an AMC

- Force banks to recognize losses → restore confidence in the financial system
- Improve asset quality, liquidity (if bonds can be used for collateral at central bank) and provide income to banks
- Strengthen the financial system (exit of non-viable banks, restructuring of viable banks)
- Economies of scale and bargaining power→ more efficient asset sale and recovery process
- Allow banks to focus on financial intermediation rather than asset recovery

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AMCs can do more harm than good if not designed properly

- Undue political interference
  - Preferential treatment of certain borrowers; Inappropriate asset purchases

  → solution: protection in the founding law (e.g. NAMA)

- Failure to dispose of assets in a timely manner “warehousing” (trade-off)

  → solution: sunset clause (Danaharta 7 years, SAREB 15 years)

- Changes in mandate “mission creep”
  - Designed to prolong life of institution and maintain employment (e.g. purchase strategic performing loans)

  → solution: narrow mandate defined in law; strict definition of eligible assets

- Weakened credit discipline
  - Frequent asset purchases at inflated prices which do not force banks to recognize losses provide little incentive to strengthen credit underwriting

  → solution: transfer price based on thorough valuation process; one time purchase; strong servicing arrangements

- Public AMCs can generate significant losses for the taxpayer

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Pre-conditions for Public AMCs

- Systemic crisis and public funds at risk
- Solid diagnostic, critical mass and homogeneity of non-performing assets (when purchasing assets)
- Tradition of institutional independence and public accountability
- Robust legal framework for bank resolution, debt recovery and creditors' rights

Successful AMCs have strong commercial focus

- Professional distressed asset management + strong governance practices + robust transparency requirements + frequent external reporting & strong internal controls:
  - Independent boards with strong private sector/international presence;
  - Documentation of key decisions
  - Internal staff rules & codes of conduct; key performance indicators (KPI)
  - Periodic progress evaluations conducted by external auditor

- Strategic and operating plans aligned with mandate:
  - Asset purchases have clear rationale and all assets have well defined resolution plans and exit strategies
  - Social mandates which conflict with commercial focus were minimized

- Adequate, timely funding and lifespan which provides time to realize value of assets (avoids “firesales”) but prevents permanent warehousing of bad loans.

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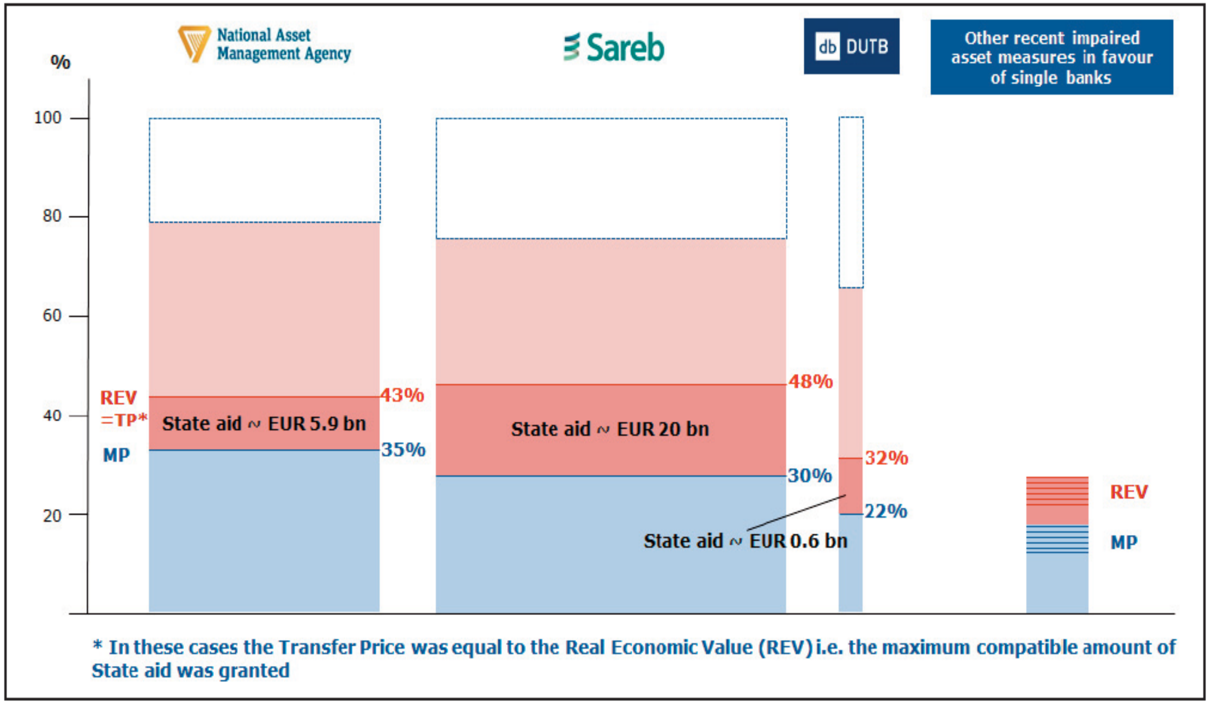
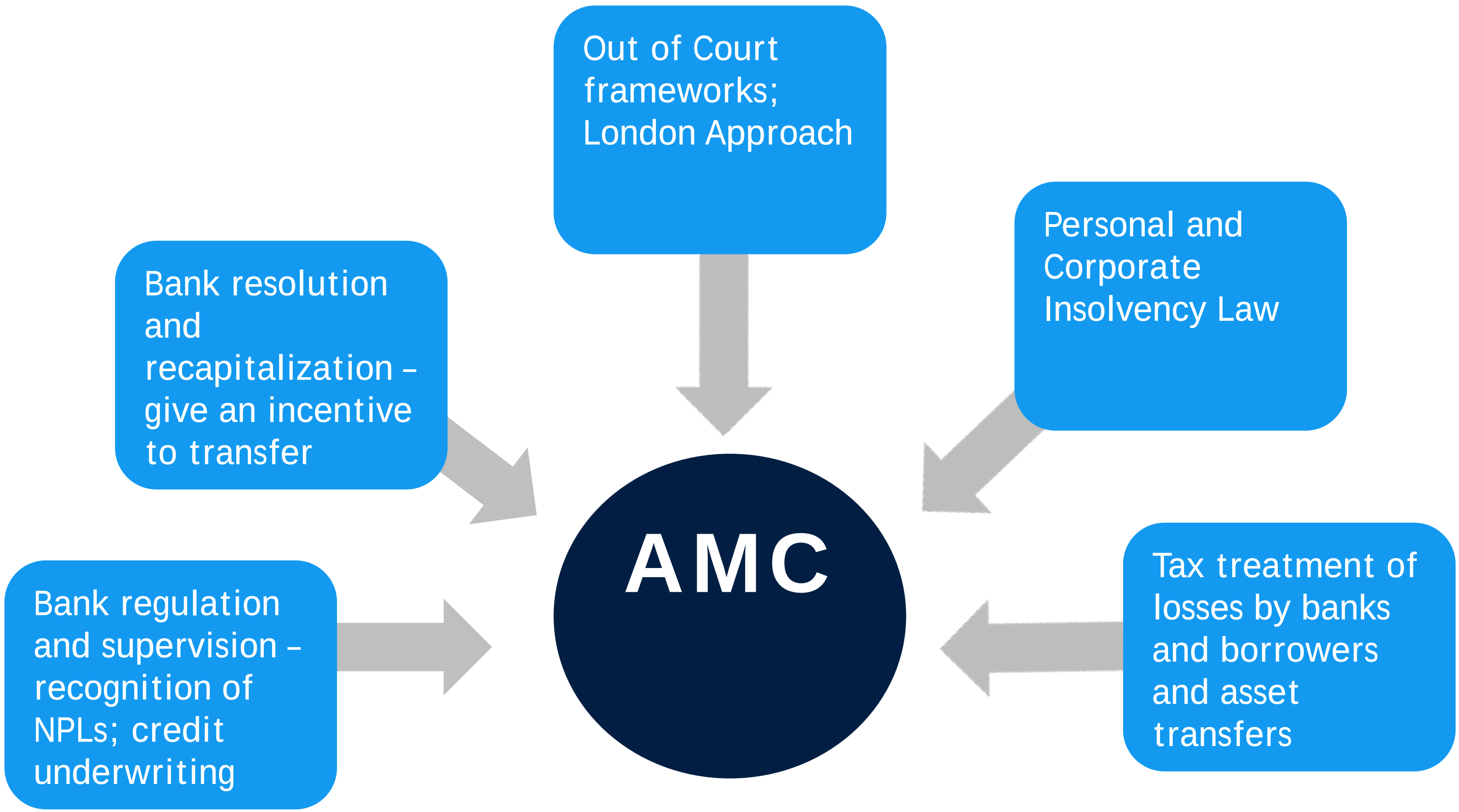
Transfer price is a key issue

- If “too high” AMC cannot break even. If “too low” banks need recapitalizing
- Principle: transparent, market-based, due diligence process conducted by an independent third party experienced in valuation.
- EU “real economic value”: underlying long-term economic value of the assets, on the basis of underlying cash flows and the broader time horizon



Source: Galand, Dutillieux, Vallyon; DUTB is the same as BAMC

AMCs should be part of comprehensive bank restructuring and NPL management strategies



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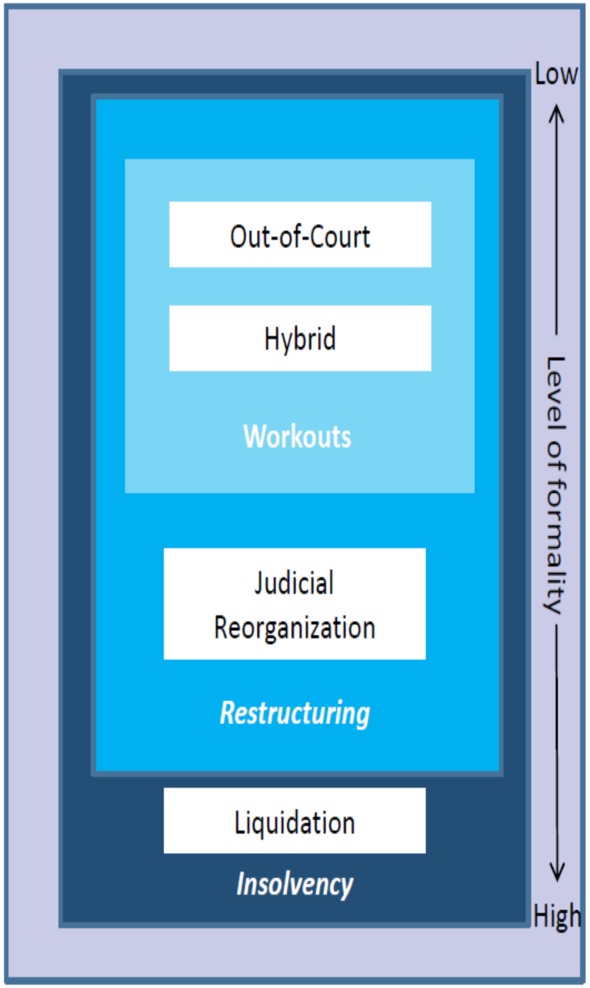
Importance of workouts framework and insolvency reform



AMC only purchases a portion of NPLs in the system. Not effective for retail NPLs. Most were complemented by out-of-court frameworks and insolvency reforms (Korea, Ireland, Spain)

Workout: reorganization effected by agreement among creditors rather by arrangement under insolvency framework (preserves the business/confidential/ less costly but … does not bind dissenting creditors)

Hybrid: pre-packaged bankruptcies (US, UK)

Insolvency Law: to provide for efficient liquidation of unviable firms and reorganization of viable ones; allow for workouts

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Examples of Public AMCs – early stage

	RTC (US) 1989	Securum (Sweden) 1993
Mandate	Resolve thrifts (banks)	Restructure NPLs of state-owned Nordenbanken, later expanded to include Gota bank
Special powers	None	None
Life span	7 years	10-15 years envisioned, reduced to 5 years
Asset transfer	Did not purchase	Did not purchase
Eligible loans	n.a.	n.a.
Recovery (from face value)	87% (on assets only)	n.a.

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Examples of Public AMCs – Asian Crisis and aftermath

	KAMCO (Korea) 1997	IBRA 1998 (Indonesia)	Danaharta (Malaysia) 1998	SDIF (Turkey) 1999
Mandate	Asset management	Resolve banks, administer deposit guarantee, recover misused liquidity support	Asset management Receiver for 2 banks	Resolve banks, administer deposit guarantee, recover misused liquidity support
Special powers	None	Yes	Yes	Yes
Life span	None specified	6 years	7 years	None specified
Asset transfer	Internal pricing based on DCF Discount = 64%	Did not purchase	Appraisals Discount=54%	Did not purchase
Eligible loans	Priority to sizeable NPLs & with multiple creditors	n.a.	Large and industrial loans	n.a.
Recovery (face value)	46.8%	22% (on NPLs)	58%	16% (NPL sales only)

Examples of Public AMCs – current ones

	NAMA (Ireland) 2008	AMCON (Nigeria) 2010	SAREB (Spain) 2012	BAMC (Slovenia) 2013
Mandate	Asset Management (AM)	AM; recapitalize failed banks; invest in equities	Asset management	Asset Management
Special powers	Yes (but not used)	Yes	None	None
Life span	Expected to close in 2020	None specified in the law	15 years	10 years (till 2022)
Asset transfer	Appraisals. REV uplift of 8.3% Discount from Book Value= 57%	Guidelines from Central Bank Discount = 54%	BoS+independent valuation. REV with uplift ~18% Discount = 52.4%	Independent valuation. REV with uplift~10% Discount = 68%
Eligible loans	Large real estate loans	Any loan reasonably expected to become substandard	Large real estate loans	Large loans multi-sector
Recovery (from face value)	54% (as of Dec 2017)	N.A.	20% (as of Dec 2017)	26% (as of Dec 2017)

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Lessons from case studies

- Political will and consensus (e.g. RTC, KAMCO, NAMA)
- Upfront loss recognition – asset valuation (e.g. NAMA, SAREB)
- Sunset Clause (e.g. Danaharta, SAREB)
- Rapid asset disposition (e.g. Securum, RTC, KAMCO) – but function of markets
- Strong governance and transparency (counter-example IBRA)
- Staff with specialized skills and KPI (e.g. Danaharta)

Thank you!

Public Asset Management Companies : A Toolkit

http://documents.worldbank.org/curated/en/293361467996695247/pdf/105984-PUB-PUBDATE-5-24-16-PUBLIC.pdf

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