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)
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**
- Failed banks
- Government
  - Government injects equity for AMC working capital
  - AMC
  - Resolution/closure
    - Assets transferred for management-no payment, no need for transfer price

**Asset purchasing AMC**
- Open banks with NPLs
  - Government
  - Government injects equity for working capital but is liable for the bonds if AMC does not perform
  - AMC
  - Sale of selected assets at a discount, based on agreed transfer price
  - Government guaranteed bond issued by AMC to pay for the assets. Provides relief to banks by improving asset quality and providing regular revenue stream

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.
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
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**
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.
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

- Bank regulation and supervision - recognition of NPLs; credit underwriting
- Out of Court frameworks; London Approach
- Personal and Corporate Insolvency Law
- Bank resolution and recapitalization - give an incentive to transfer
- Tax treatment of losses by banks and borrowers and asset transfers
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
## Examples of Public AMCs – early stage

<table>
<thead>
<tr>
<th></th>
<th>RTC (US) 1989</th>
<th>Securum (Sweden) 1993</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Mandate</strong></td>
<td>Resolve thrifts (banks)</td>
<td>Restructure NPLs of state-owned Nordenbanken, later expanded to include Gota bank</td>
</tr>
<tr>
<td><strong>Special powers</strong></td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td><strong>Life span</strong></td>
<td>7 years</td>
<td>10-15 years envisioned, reduced to 5 years</td>
</tr>
<tr>
<td><strong>Asset transfer</strong></td>
<td>Did not purchase</td>
<td>Did not purchase</td>
</tr>
<tr>
<td><strong>Eligible loans</strong></td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td><strong>Recovery (from face value)</strong></td>
<td>87% (on assets only)</td>
<td>n.a.</td>
</tr>
<tr>
<td></td>
<td>KAMCO (Korea) 1997</td>
<td>IBRA 1998 (Indonesia)</td>
</tr>
<tr>
<td>--------------------------------</td>
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<td>----------------------</td>
</tr>
<tr>
<td>Mandate</td>
<td>Asset management</td>
<td>Resolve banks, administer deposit guarantee, recover misused liquidity support</td>
</tr>
<tr>
<td>Special powers</td>
<td>None</td>
<td>Yes</td>
</tr>
<tr>
<td>Life span</td>
<td>None specified</td>
<td>6 years</td>
</tr>
<tr>
<td>Asset transfer</td>
<td>Internal pricing based on DCF Discount = 64%</td>
<td>Did not purchase</td>
</tr>
<tr>
<td>Eligible loans</td>
<td>Priority to sizeable NPLs &amp; with multiple creditors</td>
<td>n.a.</td>
</tr>
<tr>
<td>Recovery (face value)</td>
<td>46.8%</td>
<td>22% (on NPLs)</td>
</tr>
</tbody>
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### Examples of Public AMCs – current ones

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