Supervisory Options to Strengthen a Weak Bank

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Weak Bank

Liquidity or solvency is impaired or soon will be impaired, *unless* ......

a major improvement in its financial resources, risk profile, business model, risk management systems and controls and / or quality of governance and management.
Why Deal With Weak Banks?

• Objectives of supervision
  – Safety and soundness of banks
  – Financial stability
  – Confidence in financial system

• Not dealing with them can be costly

Option 1
• Deal with it

Option 2
• Don’t deal
  • Incur costs
  • Resolution
### Option 1

#### Supervisory/Corrective Action

<table>
<thead>
<tr>
<th>Deal with deficiencies or change behavior;</th>
<th>Restore to sound condition;</th>
<th>Preserve value of assets</th>
</tr>
</thead>
</table>

Minimal disruption to operations; subject to minimizing resolution costs
Agenda

• Challenges facing supervisors
• Tools to identify weak banks
• Corrective actions
• Conclusions
Agenda

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Dealing with weak banks

- Early identification of Risk
- Early Intervention
- Effectiveness
- Flexibility
- Clear internal governance
- Consistency
Dealing with weak banks

- Transparency and cooperation
- Avoiding systemic problems
- Early preparation
Preconditions

CP 1 – Legal framework

CP 2 – Independence, accountability, resourcing and legal protection

CP 3 – Cooperation and collaboration

CP 11 – Corrective and sanctioning powers
CP 1 – Responsibilities, Objectives and Powers

- Clear responsibilities and objectives
- Suitable legal framework
- Power to address non compliance or unsafe or unsound practices
CP 2 – Independence, Accountability, Resourcing and Legal Protection

- Independence
- Internal governance
- Legal protection
- Accountability for actions
CP 3 – Cooperation and Collaboration

Domestic Authorities

Ability to deal with

Foreign Supervisors
CP 11- Corrective Action and Sanctions

- **Action**
  - Authorized
  - Timely
  - Followed up

- **Tools**
  - Range
  - Proportionate

- **Target**
  - Bank
  - Board
  - Officers
## Supervisory Challenges

<table>
<thead>
<tr>
<th>Legal framework</th>
<th>Supervisory framework</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Lack of authority</td>
<td>• Weak supervisory process</td>
<td>• Insufficient pre conditions</td>
</tr>
<tr>
<td>• Enforceability</td>
<td>• Lack of skilled personnel</td>
<td>• Interference</td>
</tr>
<tr>
<td>• Flexibility</td>
<td>• Judgment</td>
<td>• Lack of skilled personnel</td>
</tr>
<tr>
<td>• Legal protection</td>
<td>• Lack of planning</td>
<td>• Structure / foreign ownership</td>
</tr>
<tr>
<td>• Forbearance</td>
<td></td>
<td></td>
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</tbody>
</table>
Agenda

• Challenges facing supervisors
• **Tools to identify weak banks**
• Corrective actions
• Conclusions
Detecting Weaknesses

Macro surveillance

Rating system

Off site reviews

Other sources

On site exams

License
Red Flags

- Increasing NPLs
- Declining profitability, capital
- Strained liquidity
- Extended vacancies or high turnover in management positions
- Delayed prudential reports, audits
- Increasing violations, risk positions
Symptoms and Causes

- Poor asset quality
- Lack of profitability
- Loss of capital
- Excessive leverage
- Concentration of exposures
- Reputational problems
- Liquidity concerns
- Inappropriate business model
- Poor governance
- Poor decision making process
- Misalignment of incentives
Agenda

- Challenges facing supervisors
- Tools to identify weak banks
- **Corrective actions**
- Conclusions
Problems Identified – Now What?

- Surveillance
- Supervision
- Problems identified

Now what??
Supervisor’s Plan for Corrective Action

• Supervisors should have a plan to address taking corrective / supervisory action
  – Not normal circumstance

• Early remedial indicators
  – No automatic application
Supervisory Authority - Governance

Procedures exist to ensure that:
• time frames established for processing
• problems have been accurately identified and documented
• remedial actions are identified
• treatment is consistent with similar rated banks
• appropriate level authority endorses/signs off
• inform others – as needed
Developing Corrective Action

Tailored for needs of bank
- formal or informal action
- the range and type of corrective action
- timing of required action
- require management to prepare action plan
- reporting required
Tailoring To The Bank

<table>
<thead>
<tr>
<th>Informal vs. Formal Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Severity and depth of problem</td>
</tr>
<tr>
<td>Scope and breadth of problem</td>
</tr>
<tr>
<td>Management’s response/attitude</td>
</tr>
<tr>
<td>Board of Director’s response</td>
</tr>
<tr>
<td>‘Auto-triggers’</td>
</tr>
<tr>
<td>Immediacy of threats to capital and solvency</td>
</tr>
<tr>
<td>Expectation of need to enforce</td>
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</tbody>
</table>
## Range and Type of Action

<table>
<thead>
<tr>
<th>Impact on Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Changes in legal structure of bank</td>
</tr>
<tr>
<td>Removal /suspension of officers and directors</td>
</tr>
<tr>
<td>Enhance governance, internal controls and risk management</td>
</tr>
<tr>
<td>Bank to submit a plan of corrective action</td>
</tr>
<tr>
<td>Limit compensation, management fees, bonus</td>
</tr>
<tr>
<td>Require supervisor’s pre-approval for major expenditures, commitments or contingent liabilities</td>
</tr>
<tr>
<td>Impact on bank operations and expansion</td>
</tr>
<tr>
<td>----------------------------------------</td>
</tr>
<tr>
<td>Capital injection or capital change</td>
</tr>
<tr>
<td>Upgrade liquidity and strategic planning</td>
</tr>
<tr>
<td>Enhance loss provisioning and processes</td>
</tr>
<tr>
<td>Restrict concentrations or expansion of bank operations</td>
</tr>
<tr>
<td>Downsize operations, sell assets</td>
</tr>
<tr>
<td>Prohibit or limit lines of business, products or customers</td>
</tr>
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</table>
Range and Type of Action (3)

<table>
<thead>
<tr>
<th>Impact on cash availability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Call for cash injection by shareholders</td>
</tr>
<tr>
<td>Call for new borrowing, bond issue or roll over of liabilities</td>
</tr>
<tr>
<td>Limit payments of bonus, dividends, etc</td>
</tr>
</tbody>
</table>
Range and Type of Action (4)

<table>
<thead>
<tr>
<th>Impact on shareholders’ rights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Suspend – all or some – shareholder rights – including voting rights</td>
</tr>
<tr>
<td>Prohibit dividends or other withdrawals by shareholders</td>
</tr>
<tr>
<td>Appoint administrator or conservator</td>
</tr>
</tbody>
</table>
## Timing of action (some examples)

<table>
<thead>
<tr>
<th>Single/immediate action</th>
<th>Process or extended action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash injection</td>
<td>Upgrade risk management activities</td>
</tr>
<tr>
<td></td>
<td>Establish contingency funding plan</td>
</tr>
<tr>
<td>Establish / book loss reserves</td>
<td>Establish and execute workout plan for each problem loan &gt; X value</td>
</tr>
<tr>
<td>Removal / suspension of officers</td>
<td>Upgrade internal audit program in a specific area</td>
</tr>
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</table>
Meet With Management/Board

- Explain basis of action
- Gain commitment from Board
- Corrective Action
- Identify points of contact
Post – Corrective Action Placement

**Follow up by supervisor**
- Modify supervisory strategy
- Periodic contact with bank

**Monitor**
- Compliance with required actions
- Implementation of action plan

**Determine**
- If bank’s condition has been restored and can be sustained; OR
- If bank is still weak
Determine

Still Weak

Resolution

Restored & sustainable

Enforce

Escalate

Remove
# Dealing with Different weakness

<table>
<thead>
<tr>
<th>Business Strategy</th>
<th>Capital Adequacy</th>
<th>Asset Quality</th>
</tr>
</thead>
</table>
| • Deviations from Budget  
  • Unrealistic assumptions  
  • Plans incompatible with scale | • Symptom  
  • Reasons for decline  
  • Different options to restore ratios | • May indicate poor management  
  • Market confidence  
  • Forward looking AQR  
  • Remedial action |
Dealing with Different weakness

- Governance / Management
  - Fit and proper
  - Compensation plans
  - Removal / Intervention
  - Risk Management

- Earnings
  - Decline may have several reasons
  - Restructure unprofitable activities

- Liquidity
  - Cash flow projections
  - Address short term resilience
  - Private solutions
  - Public support

Decline may have several reasons
Restructure unprofitable activities
Cash flow projections
Address short term resilience
Private solutions
Public support
Conclusions

• Be prepared
  – Clear objectives/operating framework
• Prevention is better
  – Don’t wait for violations
• Banks do fail
  – Effective resolution
• Cooperate
  – Spill over is common
Thank You