

# Asset Management Companies Observed best practices

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# There are four models available for asset management companies dealing with non-performing loans

## 3<sup>rd</sup> parties involvement

		No 3 <sup>rd</sup> parties involvement	Private investors and/or public support
Number of banks involved	Single bank	<p><b>Single name AMC</b></p> 	<p><b>Privately/Publicly co-funded single name AMC</b></p> 
	Pool of banks/system	<p><b>Private pooled AMC</b></p> <p>Has not occurred</p>	<p><b>Privately/Publicly co-funded pooled AMC</b></p> 













Pooled AMC models offer economies of scale when dealing with multiple banks

## The typical mandate for a privately / publicly co-funded AMC is at least 10 years, depending on the type of assets, strategy and size of the AMC

Year	Country	AMC	Initial size	Type of asset	Length of mandate
2015	Hungary	MARK	€1bn	<ul style="list-style-type: none"> <li>• CRE NPL, foreclosed RE</li> <li>• Project finance NPL</li> </ul>	<ul style="list-style-type: none"> <li>• Expected 10 years</li> </ul>
2014	Austria	HETA	€18bn	<ul style="list-style-type: none"> <li>• CEE NPL exposure including foreclosed assets</li> </ul>	<ul style="list-style-type: none"> <li>• To be decided</li> </ul>
2013	Slovenia	DUTB / BAMC	€2bn	<ul style="list-style-type: none"> <li>• Corporate and state owned enterprises NPL</li> </ul>	<ul style="list-style-type: none"> <li>• Initially 5 years</li> <li>• Extension likely</li> </ul>
2012	Spain	SAREB	€107bn	<ul style="list-style-type: none"> <li>• Non-performing RE development loans</li> </ul>	<ul style="list-style-type: none"> <li>• 15 years</li> </ul>
2010	Germany	FMS	€176bn	<ul style="list-style-type: none"> <li>• Public sector loans</li> <li>• Structured lending</li> </ul>	<ul style="list-style-type: none"> <li>• Initially 10 years</li> <li>• Time frame extended</li> </ul>
2010	UK	UK Asset Resolution	£58bn	<ul style="list-style-type: none"> <li>• Loan books of two failed building societies</li> </ul>	<ul style="list-style-type: none"> <li>• No statutory limit</li> <li>• New business not allowed</li> </ul>
2009	Ireland	NAMA	€74bn	<ul style="list-style-type: none"> <li>• Non-performing RE development loans</li> </ul>	<ul style="list-style-type: none"> <li>• Up to 10 years</li> </ul>
2009	Germany	EAA	€180bn	<ul style="list-style-type: none"> <li>• Structured securities</li> <li>• Real estate loans</li> </ul>	<ul style="list-style-type: none"> <li>• 18 years (wind down period)</li> </ul>
1996	Italy	SGA	€9bn	<ul style="list-style-type: none"> <li>• Non-performing loans</li> </ul>	<ul style="list-style-type: none"> <li>• 85% unwound after 17 years</li> </ul>
1989	US	Resolution Trust Corporation	\$400bn	<ul style="list-style-type: none"> <li>• Mortgage loans of insolvent savings associations</li> </ul>	<ul style="list-style-type: none"> <li>• 7 years</li> </ul>

Source: Company websites, Oliver Wyman

# AMC set up leads to significant benefits for the health of the banking system

Benefit	Description	NAMA	SAREB
<b>Reduce P&amp;L drag of NPLs</b>	<ul style="list-style-type: none"> <li>Removal of non-interest earning assets from balance sheet improves banks' profitability</li> <li>Smaller balance sheet makes banks less vulnerable to funding squeeze and reduces interest expense</li> </ul>		
<b>Lower cost of funding</b>	<ul style="list-style-type: none"> <li>Removal of doubtful assets from balance sheets reduces uncertainty for debt and equity investors</li> <li>Bank funding cost highly related to sovereign funding cost</li> </ul>		
<b>Encourage front-book lending</b>	<ul style="list-style-type: none"> <li>Asset transfer frees up balance sheet capacity for new lending</li> <li>Allows bank management to divert attention from asset work-out to normal banking business</li> </ul>		
<b>Higher market valuations for participating banks</b>	<ul style="list-style-type: none"> <li>Removal of distressed assets increases attractiveness of participating banks for traditional bank investors / reduces uncertainty</li> </ul>		
<b>Improved value extraction from NPLs and reduced moral hazard</b>	<ul style="list-style-type: none"> <li>Loan workout process receives full attention within AMC whose NPL portfolio is large enough to warrant highly specialised team</li> <li>AMC can be more flexible in debtor negotiations than banks, reducing its exposure to debtors' moral hazard (speculating on a debt write-off)</li> </ul>		
<b>Greater transparency and improved credibility of assets value</b>	<ul style="list-style-type: none"> <li>Involvement of third parties in setting up and valuing the transferred assets increases accuracy and credibility in prices of the assets</li> <li>AMC is well placed to report on market trends and progress in cleaning up the NPL, increasing transparency in entire sector</li> </ul>		

# The Governments / Financial Authority's perspective: Our analysis of historical crises suggests that a centralised policy response is vital to address a systemic financial problem

## Overview of main crises researched

### A. Nordic crisis (1991)

- Sweden seen as “best practice” response, based on timely, low cost crisis resolution using multiple AMCs (both state owned and bank-led) supported by political consensus
- Bank restructuring and macro-economic solutions required to resolve other FX-led causes of the crisis



### B. Asian crisis (1997-8)

- Thai government's initial ad hoc efforts did not work, and – although state coordinated restructuring efforts were ultimately successful – resolution delayed by poor process
- Korean government's centralised AMC (KAMCO) viewed as more successful and innovative approach



### C. US Savings and Loans (1980s)

- Federal government's initial approach of forbearance (the result of aggressive lobbying by S&Ls) proved unsuccessful and led directly to larger losses
- Crisis only resolved 5 years after initial failure, with political coordination required to establish RTC



### D. The Credit Crunch (2008)

- Although governmental responses have varied, there have been unambiguous efforts both to “clean up” bank balance sheets (e.g. US TARP, UK government guarantees) and to limit impact of financial crisis on the “real” economy (e.g. loans to car industry, German fiscal stimulus packages)



## Summary of key success factors

### ▪ Political

- Government takes prompt and decisive action
- Broad political support for crisis interventions and political consensus on solutions
- Long term implications of political decisions are considered

### ▪ Legal / Regulatory

- Adequate legal framework for government interventions (e.g. deposit guarantees, right to liquidate banks and to write down shareholders)
- Adequate corporate bankruptcy laws to maximise asset recoveries
- Clear regulatory framework backed by adequate number of high quality staff

### ▪ Asset Management Companies

- Assets promptly transferred to AMC to prevent unnecessary asset deterioration, with all distressed assets included in programme
- Responsibility for both restructuring of doubtful assets and recovery from bad assets

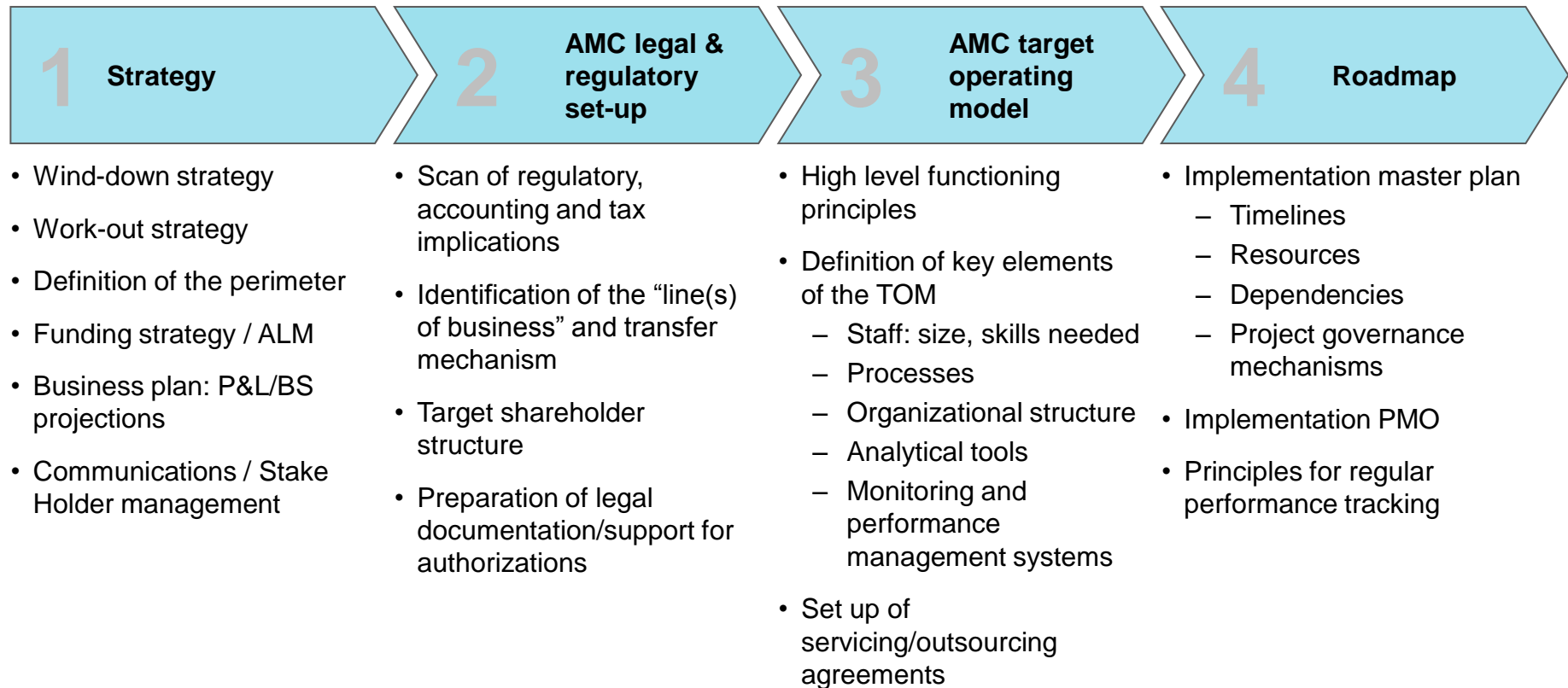
### ▪ Restructuring

- Swift and sharp restructuring plans based on viability, not politics or special interests
- Resources not wasted on non-viable businesses

# The AMC's perspective:

Based on our experience, we believe there are 4 key success factors to get right when constructing the AMC

## Key success factors for AMCs



# The cost/benefit assessments of asset sales are changing over time

## Traditional business case for asset sale

+	Sales price
-	Book value
<hr/>	
=	<b>P&amp;L impact</b>
-	Future earnings lost
+	Cost of funding
<hr/>	
=	<b>Business case (old)</b>

## Basis for new business case for asset sale

+	Sales price
-	Book value
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=	<b>P&amp;L impact</b>
-	Future earnings lost
+	Cost of funding
<hr/>	
=	<b>Business case (old)</b>
-	Reduced tail risk (e.g. stress testing)
-	Reduced complexity of organization
-	Reduced servicing expenses
-	Reduced future expected losses
<hr/>	
=	<b>Business case (new)</b>



New factors are being priced in evaluating whether to sell an asset or not

Open debates whether the cost of capital should be included to form more realistic price expectations and narrow the bid – ask spread of prices observed



Backup

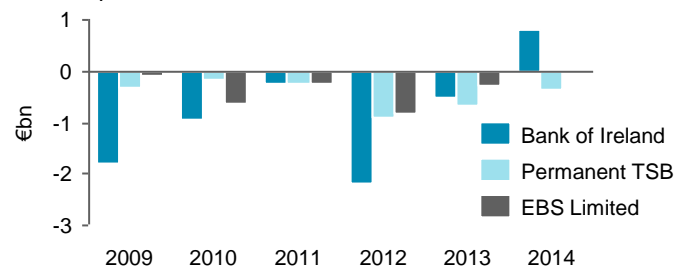
# There is evidence that the two largest, recent privately/publicly co-funded pooled AMC's have achieved many but not all of these objectives (1/2)



**NAMA (established in 2009)**

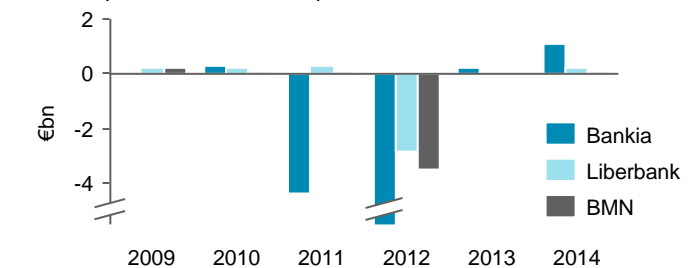
**Reduce P&L drag of NPLs/  
improve capital ratios**

Pre-tax profits of selected Irish banks<sup>2</sup>



**SAREB (established 2012)**

Pre-tax profits of selected Spanish banks<sup>2</sup>



**Lower cost of funding**

Yield on Irish 10 year government bonds

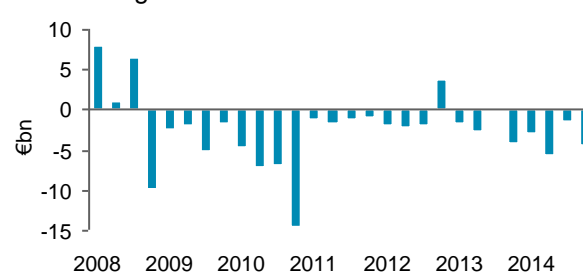


Yield on Spanish 10 year government bonds

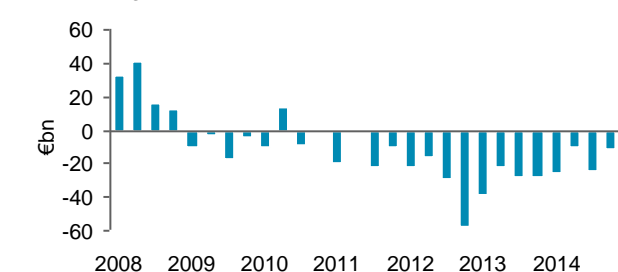


**Encourage  
front-book lending**

Net lending to Irish households and NFC<sup>1</sup>



Net lending to Spanish households and NFC<sup>1</sup>



Sources: ECB, Bankscope, Datastream, Oliver Wyman.

1. NFC = Non-Financial Corporations. 2. 2014 numbers are annualised from H1 2014 results

# There is evidence that the two largest, recent privately/publicly co-funded pooled AMC's have achieved many but not all of these objectives (2/2)



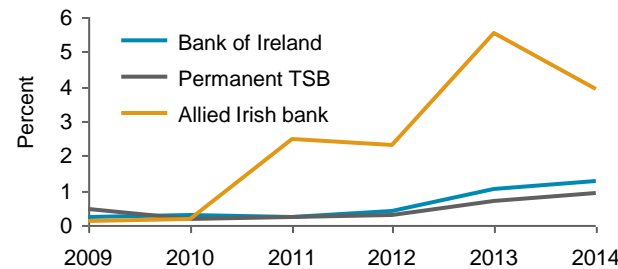
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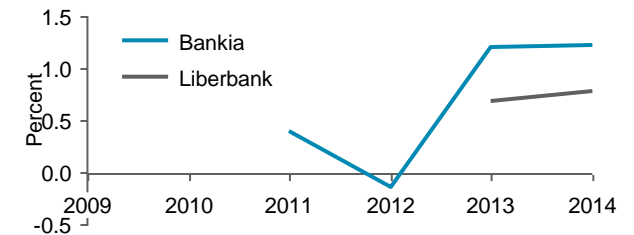
**SAREB (established 2012)**

Higher market valuations for participating banks

Price to book ratios of selected Irish banks

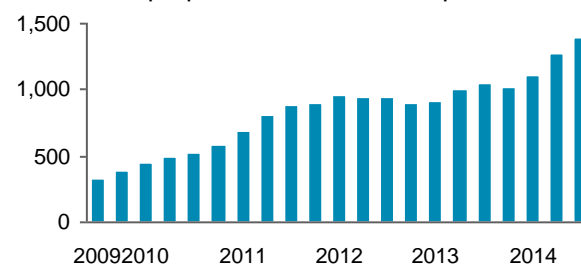


Price to book ratios of selected Spanish banks

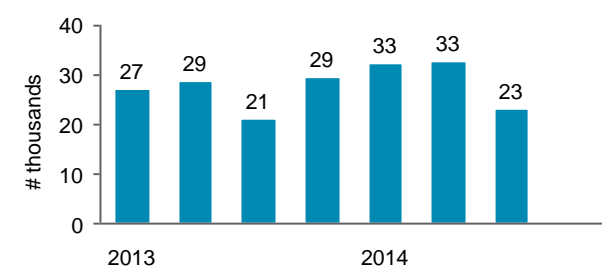


Improved value extraction from NPLs, reduced moral hazard

Residential properties in Irish banks' possession

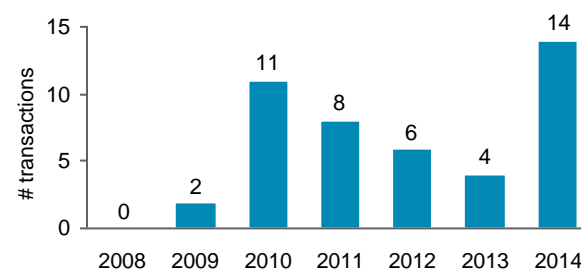


Foreclosures begun in Spain, by quarter

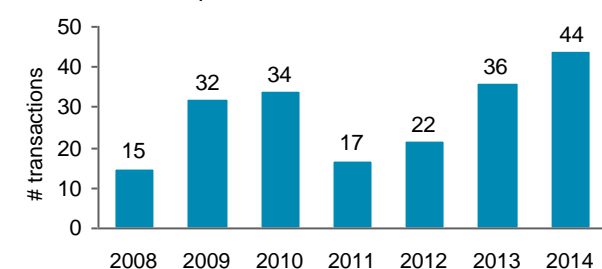


Greater transparency and improved credibility of asset values

Transactions in Irish RE and Finance sector



Transactions in Spanish RE and Finance sector



Sources: Datastream, Foreclosure Statistics from National Statistics Office in Spain, Central Bank of Ireland, Dealogic, Oliver Wyman.