

# The Use of Asset Management Companies in the Resolution of Banking Crises Cross-Country Experiences

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## Abstract

In the past, asset management companies (AMCs) have been employed to address the overhang of bad debt in the financial system. Two main types of AMCs can be distinguished: AMCs set up to help and expedite corporate restructuring and AMCs established as rapid asset disposition vehicles. A review of seven AMCs reveals that AMCs have a mixed record. In two out of three cases, corporate restructuring AMCs did not achieve their narrow goals of expediting bank and/or corporate restructuring. These experiences suggest that AMCs are rarely good tools to expedite corporate restructuring. Only the Swedish AMC successfully managed its portfolio, acting in some instances as lead agent in the restructuring process. It was helped by some special circumstances: the assets acquired were mostly real estate related, not manufacturing that are harder to restructure, and were a small fraction of the banking system which made it easier for the AMC to maintain its independence from political pressures and to sell assets back to the private sector. Rapid asset disposition vehicles fared somewhat better with two out of four agencies, namely Spain and the US, achieving their objectives. The successful experiences suggest that AMCs can be effectively used, but only for narrowly defined purposes of resolving insolvent and unviable financial institutions and selling of their assets. But even achieving these objectives required many ingredients: a type of asset that is easily liquifiable—real estate—mostly professional management, political independence, a skilled resource base, appropriate funding, adequate bankruptcy and foreclosure laws, good information and management systems, and transparency in operations and processes. In the Philippines and Mexico, the success of the AMCs was doomed from the start as governments transferred politically motivated loans and/or fraudulent assets to the AMCs which are difficult to be resolved or to be sold off by a government agency susceptible to political pressure and lacking independence. Both of these agencies did not succeed in achieving their narrow objectives.

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## I. Introduction

In recent decades, many countries have experienced banking problems requiring a major and expensive overhaul of their banking system. By one count, 112 episodes of systemic banking crises occurred in 93 countries since the late 1970s (Caprio, Klingebiel 1999). Bank restructuring often has to be accompanied by corporate debt restructuring as most of the NPLs of a banking system in trouble are usually loans to non-financial enterprises which are no longer able to service their debt. Countries can adopt either flow or stock approaches to resolving banking distress and the overhang of bad debt in the financial system.

As cross country evidence indicates, stock solutions tend to be necessary, where banking distress is systemic and often include the liquidation of unviable banks, disposal and management of impaired assets and the restructuring of viable banks. For the management and disposal of bad debt, governments have made extensive use of publicly owned asset management companies (AMCs) that either dispose of assets hived off from bank balance sheets or restructure corporate debt. AMCs have become very popular including in the recent East Asian financial crises (see Claessens, Djankov and Klingebiel, 1999). While establishing AMCs is now an often recommended resolution strategy to manage and dispose of impaired assets (for example Dziobek, Pazarbasioglu 1997), little is known about the effectiveness of these centralized agencies. The paper below attempts to close this gap and has two objectives: (i) to analyze on a conceptual basis the advantages and disadvantages of AMCs in managing and disposing of impaired assets; and (ii) to gauge the effectiveness of such institutions using cross country experience. It will only focus on this aspect of systemic bank restructuring and will not discuss pros and cons of different bank recapitalization strategies including the use of AMCs as part of that strategy.

Two main types of AMCs can be distinguished: AMCs set up to help and expedite corporate restructuring and AMCs established to dispose of assets acquired/transferred to the government during the crisis—rapid asset disposition vehicles. According to a survey of 26 banking crises (Caprio, Klingebiel 1997b), centralized AMC structures were set up in nine cases. Out of the nine, seven cases, where data was publicly available for a more thorough analysis, were selected. In three out of the seven cases (Finland, Ghana, Sweden), the government set up restructuring vehicles. In four cases (Mexico, the Philippines, Spain and the US) governments set up rapid asset disposition agencies.

The results of the analysis of the seven cases can be summarized as follows: Two out of three corporate restructuring AMCs did not achieve their narrow goals of expediting corporate restructuring. These experiences suggest that AMCs are rarely good tools to accelerate corporate restructuring. Only the Swedish AMC successfully managed its portfolio, acting in some instances as lead agent in the restructuring process. It was helped by some special circumstances, however: the assets acquired were mostly real estate related, not manufacturing that are harder to restructure, and were a small fraction of the banking system which made it easier for the AMC to maintain its independence from political pressures and to sell assets back to the private sector. Rapid asset disposition vehicles fared somewhat better with two out of four agencies, namely Spain and the US, achieving their objectives. The successful experiences suggest that AMCs can be effectively used, but only for the purpose of asset disposition including resolving insolvent and unviable financial institutions. But even achieving these objectives required many ingredients: a type of asset that is easily liquifiable—real estate,

mostly professional management, political independence, a skilled resource base, appropriate funding, adequate bankruptcy and foreclosure laws, good information and management systems, and transparency in operations and processes. In the Philippines and Mexico, the success of the AMCs was doomed from the start as governments transferred a large amount of loans politically motivated loans and/or fraudulent assets to the AMCs which are difficult to be resolved or to be sold off by a government agency. Both of these agencies did not succeed in achieving their narrow objective of asset disposition, thus delaying the realignment of asset prices.

The remainder of the paper is organized as follows. Section II examines alternative strategies for the handling of problem assets in banking crises used in stock solutions and compares the decentralized approach of asset management—non-performing assets are left with the individual bank to deal with—to the centralized approach—non-performing assets are transferred to a centrally managed asset management company—and describes the different types of asset management companies – rapid asset disposition vehicles and restructuring vehicles in greater details. Section III presents the analysis of seven country cases of asset management companies. Section V draws some conclusions.

## **II. Alternative Strategies for Handling Problem Assets in Banking Crises —The Centralized versus the Decentralized Approach—**

While there is a growing literature on the do's and don'ts of banking crisis management literature,<sup>1</sup> empirical studies in this area remain sparse.<sup>2</sup> Bank restructuring seeks to achieve many—often conflicting—goals: preventing bank runs, avoiding a credit crunch, improving the efficiency of the financial intermediation process and attracting new equity into the banking industry to economize on claims on the public finances. As Dziobek (1998) notes the style of responses has also changed over time. It is therefore not surprising that there is no unique or optimal blueprint on how to manage systemic banking distress.

On a conceptual basis, countries can use either flow or stock approaches to resolving banking distress and the overhang of bad debt in the financial system. Whether a country should adopt a flow or a stock solution depends, among other things, on the degree of distress in the system and the extent of the official safety net. Flow solutions usually attempt to allow banks to strengthen their capital base over time through increased banking system profits—recapitalization on a flow basis—and do not explicitly address the stock of bad debt in a system.<sup>3</sup> Cross country evidence suggests that flow solutions are only successful when banking distress is limited, i. e. non-systemic, and the official safety net is either limited or the supervisory authority is willing to intervene in those institutions whose capital base is further deteriorating. For example, in the early 1990s, US money center banks enjoyed substantial forbearance and successfully recapitalized on a flow basis.<sup>4</sup> Contrary to that, stock solutions

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<sup>1</sup> For example, Sheng 1996, Rojas-Suarez and Weisbrod 1996, Dziobek, Pazarbasioglu 1997, Goodhardt et al (1998); and Hawkins, Turner (1999) to name a just a few.

<sup>2</sup> Caprio and Klingebiel 1997a, Dziobek and Pazarbasioglu (1997).

<sup>3</sup> Flow solutions also end up taxing either depositors and/or performing borrowers as banks would try to recapitalize from earnings, thus interest rate spreads would have to rise. Flow solutions are also inherently risky, as decapitalized banks have incentives to gamble for resurrection as was the case in the US savings and loan crisis.

<sup>4</sup> Forbearance proved to be less successful in the US savings and loan crisis and Japan's banking problems that have continued for almost 10 years. Hoshi and Kashyap (1999).

are aimed at either restoring viable but insolvent or marginally solvent institutions to solvency or liquidating unviable institutions. Stock solutions tend to be necessary in cases where banking distress is systemic.

The proper management and disposition of impaired assets is one of the most critical and complex tasks of successful and speedy bank restructuring. Successful asset management policies can facilitate bank restructuring by accelerating the resolution of non-performing assets and can promote corporate restructuring by providing the right incentives for voluntary debt restructuring. There is an ongoing debate over the best model for asset management and recovery: should debt restructuring and workout be done by the banks themselves—the “decentralized model”—or should bad debt be transferred to a centralized publicly owned asset management company (Garcia 1997, Claessens 1998, IMF 1999) charged with resolving the overhang of impaired assets.

Empirical studies and/or cross country analysis on the usefulness and success of the decentralized versus the centralized approach in asset management have yet to be performed. This paper is intended as a first step in this direction as it will analyze the actual performance of AMCs given its stated goals, thus providing insight in whether or not AMCs may be a useful tool in the management of distressed assets. A companion paper looks at the experience of banking crisis where the responsibility for the workout of bad debt was mainly left with the banks (Dado, Klingebiel 2000).

***Decentralized work-out of non-performing loans.*** In general, banks should be better placed to resolve NPLs than centralized AMCs as they have the loan files and some institutional knowledge of the borrower. Leaving the problem assets on banks’ balance sheets may also provide better incentives for banks to maximize the recovery value of bad debt and avoid future losses by improving loan approval and monitoring procedures. Leaving NPLs with banks also has the advantage that these banks can provide new loans in the context of debt restructuring. Successful decentralized debt workouts require, however, limited or no ownership links between banks and corporates, otherwise the same party would be both debtor and creditor, adequately capitalized banks and proper incentives for banks and borrowers. For example, the very slow speed of restructuring in Japan is in part due to the extensive ownership links among banks, other financial intermediaries, and corporations (IMF, 1999). Moreover, successful debt workout by banks requires that financial institutions have sufficient skills and resources to deal with their problem loans.

A decentralized bad debt work-out can be accomplished by establishing an internal work-out unit, or “bad banks”—separately capitalized—which are subsidiaries of banks. Sole objectives of these units/or bad banks is to focus attention on the work-out of the assets in a separate unit of the financial institution and maximize the recovery rate through active restructuring reducing drains on managerial capacity and improving overall incentives. A clean break can also help rebuild confidence in failed banks.

But there are also considerable risks associated with private AMCs that are spun off from individual banks. They can be used for “window-dressing” if assets are transferred at book value or above market value, i. e. not all losses are not taken at the bank level but some are

effectively transferred to another entity.<sup>5</sup> Even if regulations are in place that require financial institutions to transfer their assets at market value, the supervisory authority needs to have the powers and the incentives to enforce such rules. Permitting banks to establish separately capitalized workout units or bad banks, therefore needs to be supported by a well-functioning regulatory framework, appropriate disclosure and accounting regulations with strong monitoring and enforcement by the supervisory agency and the market and third party reviews.

***The centralized approach.*** The centralized asset recovery approach permits a consolidation of skills and resources—centralization of work-out skills and information technology—in debt restructuring within one agency and may thus be more efficient in recovering maximum possible value. A centralization can also help with the securitization of assets as it has a larger pool of assets. It centralizes the ownership of collateral, thus providing potentially more leverage over debtors and more effective management. Moreover, distressed loans are removed clearly, quickly and completely from banks allowing them in turn to focus on their day-to-day activities.<sup>6</sup> Centralized agencies may also have the advantage of breaking links between banks and corporates and may thus be better able to collect on connected loans. Other arguments that are sometimes advanced in favor of a single entity include: improved prospects for orderly sectoral restructuring in the real economy,<sup>7</sup> application of uniform workout practices, and easier government monitoring and supervision of workout practices. Finally, a centralized agency can be given special legal powers to expedite loan recovery and bank restructuring.<sup>8</sup>

A centralized workout unit may, however, also face problems related to its size and ownership structure. If the agency carries a large portion of banking system assets, it may be difficult for the government to insulate such an entity from political pressure especially in cases where the government is also charged with the restructuring of the assets and where a large portion of banking system assets has been transferred. Moreover, a transfer of loans can break the links between banks and corporations, links that may have positive value given banks' privileged access to corporate information.<sup>9</sup> If AMC assets are not actively managed, the existence of a public AMC could lead to a general weakening of credit discipline in the financial system and lead to a further deterioration of asset values.

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<sup>5</sup> For example, if the bank is not subject to consolidated supervision, it can transfer the problem assets at book value and "hide" the losses as the AMC's balance sheet is not consolidated with that of the bank. Or even if the accounts are consolidated, they may be obscured. For example, the bank may take a minority position (to avoid consolidation at the bank level) and may ask connected companies to put up the rest of the equity.

<sup>6</sup> Nevertheless, it is also argued that a reasonable amount of small-sized problem loans should remain within the bank's ordinary organization, even if the bulk of bad assets are transferred to a separate AMC. Apart from the argument of maintaining a level playing field among the remaining banks, leaving some non-performing assets in the banks will preserve their capability to work out loans that do not require special expertise. Also the transaction cost incurred by transferring small assets may outweigh any potential gains. See for more detail: Ingves/Lind (1996).

<sup>7</sup> The idea here is to use the AMC as a tool for industrial policy. This may, however, be tricky for two reasons: (i) it is not necessarily obvious that the government has better information than the private sector about overcapacity and future growth areas; and (ii) involving government agencies provides scope for political interference.

<sup>8</sup> Special powers, however, may not compensate for a weak judicial system and thus may prove less useful if they have to be enforced by the judicial system.

<sup>9</sup> However, the value of such information depends on the viability of the corporates they have been lending to.

Countries have employed variants of the above techniques to deal with asset and debt recovery. For either solution—centralized or decentralized management of assets—, a legal framework that facilitates the workout will be a key element in influencing the final costs of bank restructuring (Waxman 1998). A good bargaining position for the holder of the asset and power to act are essential factors for the management of non-performing loans. Well functioning legal procedures and good access to courts are therefore crucial. Equally important are laws that facilitate actions by the banks or AMCs to exercise claims on assets and to recover the proceeds of sales of such assets if debt is not serviced. Moreover, for asset management companies to maximize returns, it is of particular importance that they have access to a clean title and do not require the borrower’s consent to the sale of the assets.

**Box 1: Advantages and disadvantages of a centralized public AMC**

**Advantages**

- Economies of scale—i. e. consolidation of scarce work out skills and resources within one agency.
- Can help with the securitization of assets as it has a larger pool of assets.
- Centralizes ownership of collateral, thus providing (potentially) more leverage over debtors and more effective management.
- Breaks links between banks and corporates and thus could potentially improve the collectibility of loans.
- Allows banks to focus on core business.
- Improves prospects for orderly sectoral restructuring of economy.
- Allows the application of uniform workout practices.
- Can be given special powers to expedite loan recovery and bank restructuring.

**Disadvantages**

- Banks have informational advantages over AMCs as they have collected information on their borrowers.
- Leaving loans in banks may provide better incentives for recovery—and for avoiding future losses by improving loan approval and monitoring procedures.
- Banks can provide additional financing which may be necessary in the restructuring process.
- If assets transferred to the AMCs are not actively managed, the existence of an AMC may lead to a general deterioration of payment discipline and further deterioration of asset values.
- It may be difficult to insulate a public agency against political pressure especially if it carries large portion of banking system assets.

***The Different Types of Asset Management Companies***

There are mainly two types of centralized asset management companies: (i) asset disposition vehicles including liquidation vehicles and (ii) longer term restructuring vehicles. Whereas the typical objective of asset disposition and liquidation agencies is to sell the assets promptly, through bulk sales or securitizations—for asset disposition and liquidation agencies—and via purchase & assumption transactions—for liquidation agencies—restructuring agencies tend to have different sets of objectives.

***Asset disposition agencies.*** Centralized asset sale agencies are set up to dispose of particular classes of assets that by nature tend to be more easily liquifiable—real estate assets, commercial real estate loans, secured loans that can be either easily sold off or securitized in case of a deep

capital market—and that were transferred to the AMC during a bank restructuring and/or recapitalization exercise. To maintain value, assets need to be managed. Even good loans tend to lose value when they are taken from the originating bank unless the AMC monitors them actively.<sup>10</sup> Otherwise even good borrowers may fail to service their loans. The management of the assets can either be performed by the AMC itself, or can be outsourced to the private sector or by the originating bank if it is still in operation. In that case, a loss sharing arrangement with the AMC could provide incentives for the bank to monitor/manage the assets properly.<sup>11</sup> Liquidation agencies are set up to resolve failed financial institutions including selling of their assets through P&As, insured deposit transfers, as well as deposit payoff and sale of the performing or non-performing assets that cannot be sold in P&A transactions.

***Restructuring agencies.*** Restructuring agencies are usually set up on a longer term basis and are aimed at restructuring and liquidating NPLs of non-viable borrowers prior to their sale. Typically, as a first step in the restructuring process, the assets transferred to the AMC are grouped either into viable claims that need to be restructured or into non-viable claims for which borrowers will be forced into bankruptcy.<sup>12</sup> The overall objective of the AMC, if it is pursuing a commercial objective, usually is to make the assets financially viable and thus attractive for a buyer. The restructuring of viable assets can include—in case of an industrial company—selling off non-core assets and improving the overall efficiency of operations by reorganizing and reducing staff, cutting other costs, restructuring product lines, etc. In case of commercial real estate and residential homes, measures to increase the attractiveness of the properties can include renovation of the properties to adapt them to current market demand or reducing the vacancy ratio, which is a crucial factor in improving the cash-flow. As restructuring often requires new lending, the AMC needs to have the capacity to lend.<sup>13</sup> After the restructuring process is completed, assets are sold to investors in various ways.

***Ownership Structure.*** Large privately held centralized AMCs are rare. If a substantial amount of bad loans and assets were transferred to an AMC, it is usually difficult to find private investors willing to assume the ownership of such an AMC without requiring far reaching state guarantees covering the future value of the asset portfolio. In that case, the government may be in a more favorable position if it owns the AMC rather than providing such guarantees since it might then benefit from any upward price movement of AMC assets. Moreover, under such a scenario, it may be difficult to structure the guarantee in such a way that it preserves the private owners' incentives to sell the assets at best prices. Public ownership could also be warranted if the value of impaired assets could be destroyed through “fire sale” liquidations. In that instance, the gradual sale by a specialized public agency may be better able to preserve the asset value.

***The timing of assets sales.*** The warehousing of assets in the hopes of obtaining higher prices later may not prevent prices from tumbling since the future supply of assets will be discounted in current prices (Shleifer and Vishny 1992; Lang, Poulsen and Stulz 1995). This is especially

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<sup>10</sup> To fulfill this role, the AMC need to set up internal information and operations systems and procedures and need to track assets and catalogue them.

<sup>11</sup> In the Mexican case, the management of the assets was left with the originating banks. Despite loss-sharing agreements aimed at incentivizing the originating bank to continue to manage the assets properly, assets transferred to the AMCs were managed inadequately resulting in a further deterioration of asset values. This suggests that it may not be an easy undertaking to develop incentive compatible contracts to prevent this from happening.

<sup>12</sup> To increase transparency and depoliticize the process, these assessments should be done by third parties.

<sup>13</sup> For more detail see: Ingves/Lind 1996.

the case for real estate assets, where fire sale losses need not imply an economic loss of value. At the same time, selling assets rapidly establishes floor prices that will promote a speedier recovery from the economic crisis. This may especially be so for public AMC's which typically have limited market insights.

***Evaluating the success of centralized AMC's.*** The success of centralized AMC's can be assessed on two dimensions: (i) Did they achieve their narrow objectives for which they were set up; and (ii) at a broader level, did the banking system return to solvency, did banking problems not reappear, and did credit extension resume as banks are presumably cleaned up and the problem of recuperating bad loans is decoupled from the business of making fresh loans.<sup>14</sup>

***Narrow objectives of AMC's.*** The success of rapid asset disposition and liquidation agencies will be measured by the speed of asset disposition. Here, an AMC is judged to be successful if assets, including banks, are disposed of rapidly that is within a five year timeframe. In the case of restructuring agencies it is more difficult to gauge whether they have indeed achieved their narrow objectives of accelerating corporate restructuring—because of the dearth of data and lack of the counterfactual. Thus, they will be considered successful if they sold off 50 percent of their assets within a five year time frame, indicating that the existence of a public AMC did not delay corporate restructuring.

***Broader objectives.*** To assess whether AMC's accomplished their broader objectives of restoring the banking system back to health, two criteria are used: (i) did the financial system/or bank experience repeated financial distress; and (ii) did real credit to the private sector resume and was aggregate credit growth positive in real terms?

### III. Cross Country Experience

***Sample Selection and Information Sources.*** While setting up centralized asset management companies has become a popular component of banking distress resolution strategies in the recent East Asian financial crises—Indonesia, Malaysia and Korea all set up centralized AMC structures—they were a less frequently used tool in the past. According to a survey of 26 banking crises<sup>15</sup>, centralized AMC structures were only set up in nine cases. AMC's proved to be particularly popular in Africa as four out of the nine AMC's were launched in Africa.<sup>16</sup> Out of these nine, seven cases, where sufficient data was publicly available, were selected for more detailed analysis. In four out of the seven cases (Mexico 1994; Philippines 1981-86, Spain 1977-85; US 1984-91); the governments set up rapid asset disposition vehicles, and in three cases (Finland 1991-94; Ghana 1982-89; Sweden 1991-94) restructuring agencies were established. As data sources, published reports, Annual Reports of AMC's if available or World Bank reports, or interviews with experts familiar with the individual cases were employed.

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<sup>14</sup> Some facilities also pursued the explicit objective to minimize fiscal costs. However, as we do not have information as to the counterfactual, we cannot evaluate whether AMC's have achieved that objective.

<sup>15</sup> Caprio/Klingebiel 1996.

<sup>16</sup> Benin, Cote d' Ivoire, Ghana and Senegal all set up centralized AMC's as part of their bank restructuring mechanisms. The other cases were Finland, Philippines, Spain, the US, and Uruguay.



**Structure of Analysis.** The analysis is structured as follows. In a first step, objectives and the main characteristics of the AMCs are briefly laid out including the amount of assets transferred relative to banking system assets, the sectoral breakdown of assets, criteria authorities used for the transfer of assets (if any) and the transfer price. Then, the attempt is made to gauge the success of those entities and analyze key factors for the success and/or impediments to the success of the AMC structure.

Except for the US, all banking systems in the sample suffered from systemic banking system crisis, i. e. the aggregate banking system’s capital had been exhausted (see Annex for more details on crises). In all country cases, the financial sector restructuring mechanisms adopted by authorities included the setting up of a centralized AMC structure.

**Figure 1 Assets transferred to AMCs**

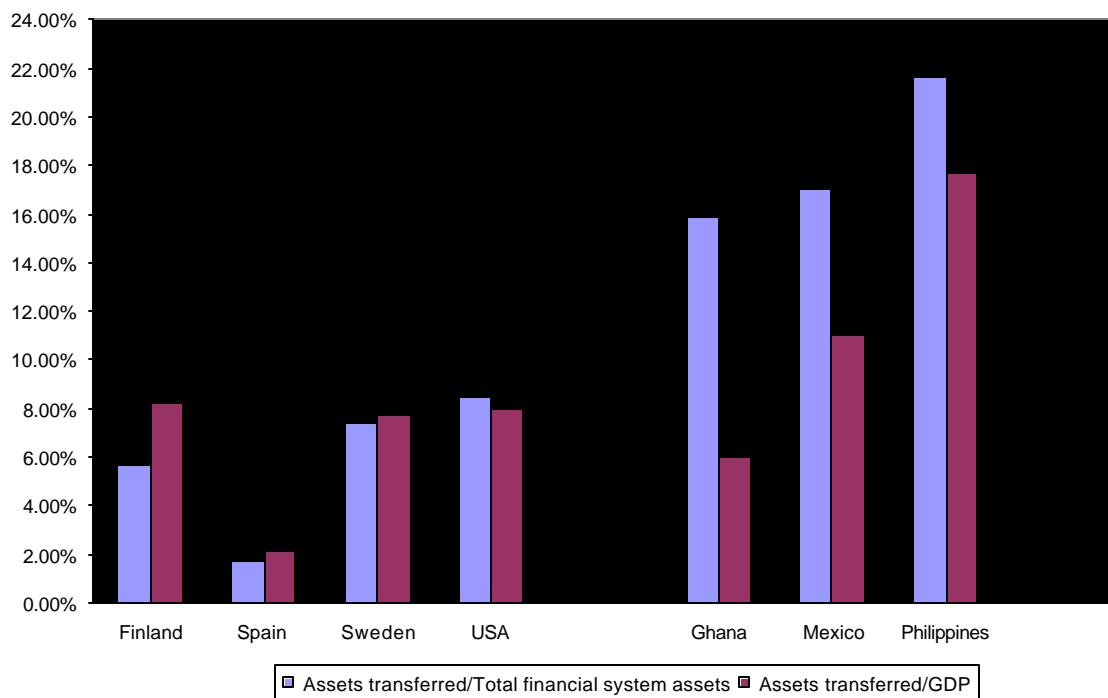
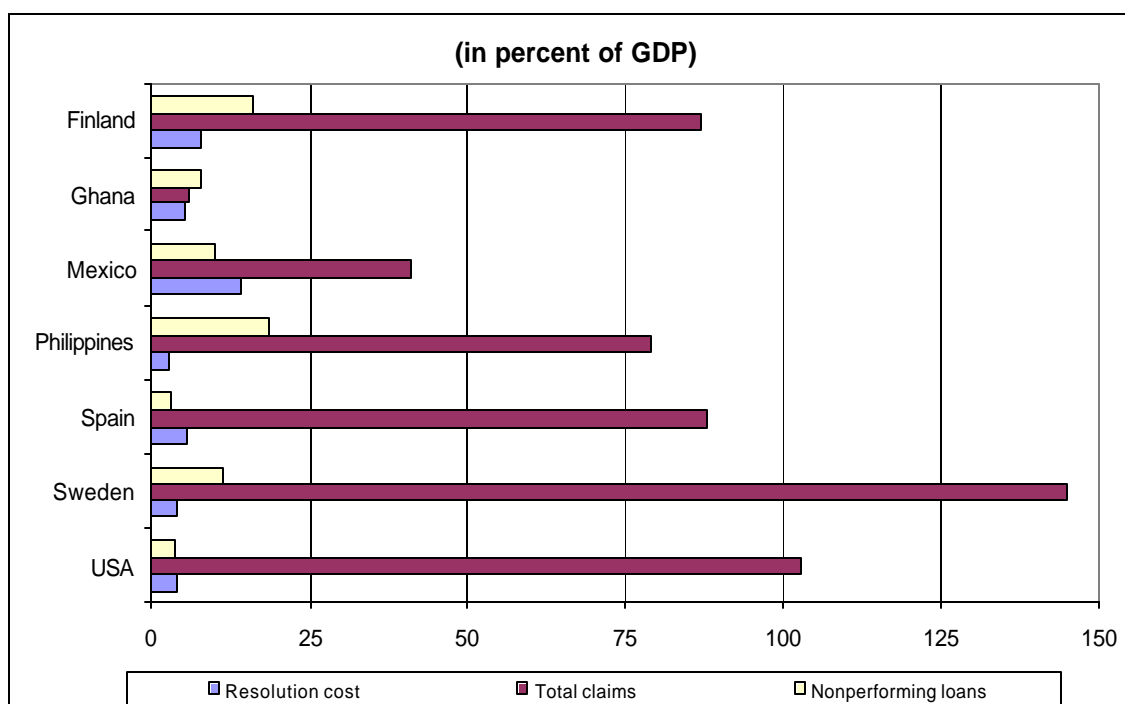


Figure 1 provides an overview of the share of banking system assets transferred to AMCs in the seven country case studies. While the comparability of the data across countries may be limited due to differences in accounting standards, the figure nevertheless illustrates that the share of financial system assets managed by the respective AMCs as a result of the asset transfers varied widely among the countries. Both as a share of assets to total system assets but also as a percentage of GDP, the Philippine AMC had to deal with the largest share of NPLs as assets transferred amounted to almost 22 percent of financial system assets and 18 percent of GDP. At the other end of the spectrum, Spain’s AMCs had to deal with only 1.0 percent of financial system assets which was equivalent to 1.3 percent of GDP. With the exception of the US case, all assets transferred to the AMCs had been previously classified as non-performing.

Figure 2 provides preliminary information on the scope of the financial sector crisis in the seven countries by providing information on the peak level of non-performing loans in the financial system. Since the level of non-performing loans is a reflection of the performance of the real sector, this number can also be used as a rough proxy for the extent of corporate distress. Spain and the US were the only countries in the sample, where the extent of non-performing loans in the system remained limited, i. e. below ten percent as a share of gross loans. In the Philippines and Finland, official NPLs reached substantial proportion accounting for over or close to 20 percent of financial system assets.<sup>17</sup> In Ghana, more than half of banking system loans were non-performing. In the Mexican case, it should be noted that official numbers recorded the level of NPLs at around 11 percent of banking system loans. However, non-performing assets transferred to Fobaproa amounted to 23 percent of financial system loans or 17 percent of financial system assets at end 1996.

**Figure 2 Magnitude of Crisis and Resolution Costs**



Source: Caprio and Klingebiel (1999) and IMF, International Financial Statistics.

## 1. Cross Country Experience with Rapid Asset Disposition Agencies<sup>18</sup>

Table 1 provides an overview of the main characteristics of the four country examples with rapid asset disposition vehicles. Two of the agencies—the Mexican and the Spanish AMCs—were housed in an existing public agency, the Deposit Guarantee Agency. Contrary to this, the Philippine and the US agencies were set up as stand alone agencies with a limited life

<sup>17</sup> As the accounting conventions differ among the countries in the sample, these figures should be treated with caution. Among the countries, Spain, the US, Finland and Sweden have stricter classification regulation compared to Ghana, Mexico and the Philippines.

<sup>18</sup> It should be noted that the analysis of the Mexican rapid asset disposition agency Fobaproa reflects available information until the end of 1998.

span. All four agencies pursued similar objectives. The main goal of Fobaproa (Mexico), the Asset Privatization Trust (APT), the Spanish Deposit Guarantee Fund and the US RTC was to dispose of the assets that were transferred to them as fast as possible while maximizing the recovery value of the assets. APT was solely focusing on the disposition of non-performing assets that had been transferred in a one off transaction. In contrast, Fobaproa was also involved in the clean up and recapitalization of the banks that were still in operation, as assets were purchased by Fobaproa at above fair market value, and continued to acquire assets through several rounds of loan purchases in exchange for government securities. By end 1997, the assets to be disposed of by Fobaproa amounted to 17 percent of banking system assets compared to 22 percent on ATP's books.<sup>19</sup> The Spanish Guarantee Fund and the RTC operated as centralized liquidation agencies and as such they were responsible for resolving financial institutions including their liabilities that had been previously taken over or were intervened in—through different mechanisms. Moreover, the amount of bad debt that was effectively managed and sold by these entities was small relative to financial system assets; 1 percent in the case of the Spanish agency and 8.0 percent in the US case.

***Evaluating Success.*** Fobaproa and ATP did not achieve their narrow objective of rapid asset disposition. By early 1999, four years after it had been established, Fobaproa only sold 0.5 percent of its assets and APT still has 50 percent of its original assets on its book twelve years after it started operations. In both cases, rapid asset sales were not hampered by negative or sluggish GDP growth (Table 2) as GDP growth was positive. Rather, the disposition efforts of these agencies were hampered by a variety of reasons (see Table 1) most important of which was the type of assets transferred (politically motivated and/or fraudulent loans). As government agencies with limited independence and susceptible to political pressure, both agencies were not equipped to resolving assets whose initial extension was based more on political connections than due diligence on the merits of the projects to be financed. Asset disposition was also hampered by a weak legal framework. For example, in Mexico, the government, at the time of asset transfer, had restricted financial institutions, including Fobaproa, from foreclosing on assets. Moreover, the rapid sale of assets was further hindered by the fact that the agency was insufficiently funded. As assets were transferred from banks at above market values, the disposition of these assets would have revealed the true losses of the banking system. Finally, the considerable amount of impaired assets under FOBAPROA's ownership impeded effective corporate restructuring in at least three ways: (i) it depressed market value of bank assets generally; (ii) continued government control of such a large share of total indebtedness encouraged continued politicization of asset restructuring process; and (iii) repeated non-performing asset sales limited banks' incentives to engage in corporate restructuring.

Contrary to that, the Spanish and the US agencies met their narrow objectives as both of them disposed of 50 percent of assets within the five year time period. The Spanish Guarantee Fund and the RTC, after some initial problems, were successful in developing fair, credible and transparent processes and mechanisms for the resolution and sale of financial institutions and managed to sell those institutions in a relatively short period of time minimizing disruptions for depositors and borrowers (Sheng 1996; GAO 1997). One key factor for the success of the Spanish Deposit Guarantee Fund was that the banks that were to be resolved were relatively small, which may have made it politically easier to deal with them. Moreover, the largest

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<sup>19</sup> Further details of the respective AMCs can be found in the Annex.

commercial banks in the system were sound enough to assist substantially in the resolution of the small banks. The RTC's success was helped by the fact that most of the assets to be disposed of were real estate loans/or assets or mortgage loans that could relatively easily be bundled and securitized or sold via bulk sales. Moreover, a deep and sophisticated capital market and a recovery in the real estate market also proved advantageous for the RTC as did an effective organizational and governance structure and skilled personnel. Despite succeeding in selling the 26 banks, the Spanish Guarantee fund proved to be less successful in disposing of the assets that had been carved out prior to the sale of the institutions, and part of the assets remain with the Fund even today. Despite an overall benign macro-environment and rising real estate prices, asset disposition was hampered by an inadequate legal framework and administrative obstacles (Table 2). For examples, the fund did not have the legal title or they were not registered for some of the real estate assets.

Both Fobaproa and APT were also not successful in achieving their broader objectives, i. e. helping to build a more robust banking system as the Mexican banking system remains weak and one of the two banks that were cleaned up in the Philippine case appears to be in financial distress again. In addition, Fobaproa's repeated loan purchases at Mexican banks coupled with debt relief for borrowers, led to a general deterioration of the payment discipline and asset prices. Moreover, loan growth did not recover and remained strongly negative in Mexico. In contrast, banking sector solvency problems did neither reoccur in Spain nor in the US.

**Table 2 GDP and Real Credit Growth**

	Year of AMC establishment	GDP growth (in percent)				Real credit growth (in percent)			
		One year prior	Year of set up	One year after	Two years after	One year prior	Year of set up	One year after	Two years after
Finland	1993	-3.55	-1.18	4.55	5.06	-8.95	-10.59	-10.63	-3.82
Ghana	1990	5.09	3.32	5.31	3.89	100.44	-16.73	-20.55	41.76
Mexico	1995	4.42	-6.17	5.18	6.71	27.93	-30.70	-36.70	19.56
Philippines	1987	3.42	4.31	6.75	6.21	-21.12	17.04	5.26	11.41
Spain *	1980	0.04	1.30	-0.18	1.57	-0.60	2.20	2.00	2.79
Sweden	1992	-1.66	-1.42	-2.22	3.34	-9.21	-2.38	-23.06	-6.23
USA	1989	3.82	3.36	1.23	-0.93	5.63	5.35	0.23	-2.10

*Source:* IMF, International Financial Statistics. \* For Spain: Year when the Deposit Guarantee Fund was granted legal powers for bank restructuring.

**Table 1 Rapid Asset Disposition Agencies**

Rapid Asset Disposition	Objectives of Rapid Asset Disposition Agency	Asset Transfer	Outcome	Key Factors
<p>Mexico: FOBAPROA</p> <ul style="list-style-type: none"> <li>Set up in 1995; continues to operate. No pre-established duration limit.</li> <li>Public ownership.</li> <li>Centralized entity.</li> <li>FOBAPROA set up as bank restructuring agency.</li> </ul>	<ul style="list-style-type: none"> <li>Clean up and restructure banks.</li> <li>Sell off or recover assets as quickly as possible, through auction, securitization, or other market mechanisms. (Management and administration of assets until then sale was left with the banks.)</li> </ul>	<ul style="list-style-type: none"> <li>Amounts of Assets Transferred: P142 billion (P119 billion net of reserves for loan losses) equivalent to 17% of banking system assets.</li> <li>Sectoral Breakdown of Assets: NPLs transferred included consumer, mortgage and corporate loans.</li> <li>Criteria for Asset Transfer: Non-transparent and repeated process led to perceptions that some of the banks received more favorable treatment than others.</li> <li>Asset Price: Transfer at book value as assets were not valued prior to transfer.</li> </ul>	<ul style="list-style-type: none"> <li>Transfer of loans did not succeed in restoring the banking system to solvency as capital deficiency was underestimated and institutions remained weak even after repeated rounds of loan repurchases at above market price. Moreover, operational restructuring remained limited and bank management was left unchanged.</li> <li>As weaknesses in the banking sector remained, loan growth did not recover and remained strongly negative.</li> <li>By end 1998, FOBAPROA had sold only 0.5 % of transferred assets. The huge overhang of impaired assets under FOBAPROA's ownership impeded effective restructuring in at least three ways: (i) it depressed market value of bank assets generally; (ii) continued government control of such large share of total indebtedness encouraged continued politicization of asset restructuring process; and (iii) repeated non-performing asset sales limited banks' incentives to engage in corporate restructuring.</li> </ul>	<p>Favorable Factors:</p> <ul style="list-style-type: none"> <li>Strong economic recovery.</li> </ul> <p>Unfavorable Factors:</p> <ul style="list-style-type: none"> <li>Type of asset transferred, i. e. politically connected loans assets that are difficult to handle for a government agency susceptible to political pressure.</li> <li>Lack of independence and weak governance as FOBAPROA was not separately managed but was under central bank management. Moreover, policy decisions were made by technical committee comprising the minister of finance, the central bank governor and the president of the financial supervisory body.</li> <li>Substantial deficiencies in bankruptcy and foreclosure code; moreover, at the time that assets were transferred to FOBAPROA, the government restricted financial institutions, including FOBAPROA, from foreclosing on assets.</li> <li>Insufficient funding of FOBAPROA. Sale of assets would have revealed the size of banking system losses.</li> </ul>
<p>Philippines: Asset Privatization Trust (APT)</p> <ul style="list-style-type: none"> <li>Set up in 1987, intended to be closed in 1991. Still in operation.</li> <li>Public ownership.</li> <li>Set up as centralized stand alone entity.</li> </ul>	<ul style="list-style-type: none"> <li>Orderly and fast transfer of non-performing assets to the private sector.</li> <li>Administration of the assets pending disposal.</li> <li>In 1991, APT was also charged with divestiture of very large government corporations.</li> </ul>	<ul style="list-style-type: none"> <li>Amounts of Assets Transferred: Assets of about P108 billion equivalent to 21.7 percent of banking system assets.</li> <li>Sectoral Breakdown of assets: Everything from mining ventures, ships, textile plants and food processing to luxury hotel resorts; 70 percent of value was held in 15 percent of assets; 75 percent of assets constituted financial claims for which foreclosure procedures had not been completed.</li> <li>Criteria for Asset Transfer: Size and nature of accounts (i. e. non-performing); potential for sale; and any special expertise required for disposition of the assets.</li> <li>Transfer Price: Book value.</li> </ul>	<ul style="list-style-type: none"> <li>ATP did not reach its objective of "orderly and fast transfer" of assets to private sector as 40 to 50 percent of assets remain in APT's portfolio to date, including those of the largest account, i.e., National Construction Corporation, despite conducive macro-economic environment.</li> <li>One of the recapitalized banks again faced solvency problems in the late 1990s. Nevertheless, credit growth rebounded relatively strongly.</li> </ul>	<p>Favorable Factors:</p> <ul style="list-style-type: none"> <li>Strong economic recovery.</li> </ul> <p>Unfavorable Factors:</p> <ul style="list-style-type: none"> <li>Type of asset transferred, i. e. politically connected loans and/or fraudulent assets that are difficult to handle for a government agency susceptible to political pressure.</li> <li>Rapid asset disposition was severely hampered by legal problems despite the fact that APT had temporary extra-judicial powers</li> <li>In addition, weak governance and insufficient funding. APT was neither privately managed nor an independent agency and budgetary pressures, i. e. avoidance to reveal losses, reduced APT's commitment towards rapid sale.</li> <li>While APT had to submit quarterly reports on performance and financial status to the President and Congress, it did not disclose any information on its activities and financial situation to the public and the process of asset sales remained non-transparent.</li> </ul>

Rapid Asset Disposition	Objectives of Rapid Asset Disposition Agency	Asset Transfer	Outcome	Key Factors
<p>Spain: Deposit Guarantee Fund</p> <ul style="list-style-type: none"> <li>• Set up in 1977 and still in existence. Was given legal capacity in 1980 to assume bank ownership to initiate bank restructuring. Had no pre-established duration limit.</li> <li>• Public ownership.</li> <li>• No stand alone entity but part of entity set up to resolve failed banks.</li> </ul>	<ul style="list-style-type: none"> <li>• Restructure banks for prompt resale by carving out bad assets that new investors were unwilling to take on.</li> <li>• Prompt sale of carved out assets with the aim of maximum recovery value.</li> </ul>	<ul style="list-style-type: none"> <li>• Amounts of Assets Transferred: Fund took over 26 banks with assets amounting to 1 percent of financial system assets. These banks were restructured and then sold off to new investors. In some instances, large amount of assets were taken off bank balance sheet and remained for rapid asset disposition in Guarantee Fund. Sectoral Breakdown of Assets: Real estate: 8.2 percent; other assets: 72.5 percent; shareholdings: 19.4 percent.</li> <li>• Criteria for Asset Transfer: Assets that acquirers of banks were unwilling to take on.</li> </ul>	<ul style="list-style-type: none"> <li>• Successful in selling intervened banks in relatively short period of time upon acquisition. Banks were sold off on average within one year, indicating that Deposit Guarantee Fund managed to accelerate the bank restructuring process.</li> <li>• Moreover, banks resumed lending in 1980, and credit to the private sector by banks grew in real terms.</li> <li>• However, the Fund was much less successful in achieving its aim of “rapid disposal of bad assets” that had been carved out from banks’ balance sheets.</li> <li>• Fund was not involved in resolution of 20 small and medium size banks of the Rumasa groups. Due to the scope of the problems of the Rumasa group, the government decided to nationalize the banks and the 200 industrial firms belonging to the group. The government adopted a two pronged strategy: (i) take over control of companies and (ii) resale of the companies as soon as possible.</li> </ul>	<p>Favorable Factors:</p> <ul style="list-style-type: none"> <li>• Fund operated as independent public agency under private law with appropriate funding and had appropriate powers (could change management immediately, purchase assets, offer guarantees or counter-guarantees on behalf of restructured banks, grant long-term loans at subsidized rates or permit temporary regulatory forbearance) for resolving institutions.</li> <li>• Banks to be resolved were small banks which made it “politically easier” to resolve and the Fund was not involved in resolution of political sensitive RUMASA group.</li> <li>• The largest commercial banks in the system were sound enough to assist substantially in resolving the small banks albeit under considerable state pressure. Also, competition in the home market from foreign banks provided incentive for Spain’s private banks to acquire recapitalized banks sometimes even assuming losses.</li> <li>• In terms of disposition of non-performing assets, amount of those assets small (1 percent of banking system assets).</li> <li>• Overall, benign macro-environment.</li> </ul> <p>Unfavorable Factors:</p> <ul style="list-style-type: none"> <li>• The framework for foreclosures and seizures of collateral was deficient and impeded rapid sale of assets.</li> <li>• Moreover Deposit Guarantee Fund encountered problems with transfer of titles.</li> <li>• Lackluster demand for real estate assets.</li> </ul>

Rapid Asset Disposition	Objectives of Rapid Asset Disposition Agency	Asset Transfer	Outcome	Key Factors
<p><b>USA: Resolution Trust Corporation</b></p> <ul style="list-style-type: none"> <li>Set up in 1989, RTC was to operate until 1996. It ended operations in 1995.</li> <li>Public ownership.</li> <li>No stand alone entity but part of entity set up to resolve failed banks.</li> </ul>	<ul style="list-style-type: none"> <li>Social as well as commercial: RTC was to maximize the net value proceeds from S&amp;L crisis resolution, but also had a broader mandate of minimizing the impact on local real estate and financial markets, and of maximizing available and affordable housing for low to moderate income individuals.</li> </ul>	<ul style="list-style-type: none"> <li>Amounts of Assets Transferred: RTC resolved 747 thrifts with total assets of US\$ 465 billion. These assets accounted for roughly 23.2 percent of S&amp;L's assets or 8 percent of total bank and thrift assets in 1989. Of these, RTC sold US\$ 153 billion through asset disposition not connected to the sale of the financial institution.</li> <li>Sectoral Breakdown of Assets: RTC acquired performing and non-performing assets; sectoral breakdown of assets transferred: 42% mortgage loans; 7% real estate; 8% other loans; 35% cash &amp; securities; 8% other assets.</li> <li>Criteria for Asset Transfer: Insolvency of the financial institution as determined by the Central Bank.</li> </ul>	<ul style="list-style-type: none"> <li>Yes. RTC successful in resolving 747 thrifts and disposing of assets that were carved out prior to bank sale.</li> <li>Overall, RTC recovered 87 cents to the dollar.</li> </ul>	<p>Favorable Factors:</p> <ul style="list-style-type: none"> <li>Amount of assets transferred were relatively small (8.5 percent of financial system assets) and a large part of those assets were performing. Moreover, it should also be noted that S&amp;L problem affected only a fraction of the US financial system leaving sound institutions in the market as potential buyer of the assets.</li> <li>The type of assets – as mostly performing real estate related assets and consumer loan assets were transferred – could be sold off through wholesale disposition mechanisms (bulk sales, securitization and auctions).</li> <li>Deep and sophisticated capital markets.</li> <li>Adequate governance structures; professional management and extensive use of private sector contractors for asset disposition. RTC relied on a detailed set of directives and guidelines to its staff and contractors that covered a wide range of operations, including asset management and disposition, contract policies, bidding procedures and marketing. While this reduced RTC's flexibility in handling individual cases, they minimized the possibility of fraud and made policy and cost evaluation more transparent and expedited resolution process.</li> <li>Effective organizational structure including information management systems that can handle large amount of information and management of assets which allowed RTC to collect 31% of the total assets transferred and reduced by one third the amount of assets needed to be sold.</li> </ul> <p>Unfavorable Factors:</p> <ul style="list-style-type: none"> <li>Sporadic funding of RTC (several pieces of legislation were required to approve funding) hampered speedy resolution of failed S&amp;Ls and increased resolution costs.</li> <li>Rapid asset disposition was hampered by inconsistent objectives of agency. In addition to cost minimization and expeditious disposition objective, the RTC was also supposed to structure and time its asset sales to minimize any impact on local real estate and financial markets.</li> </ul>

## 2. Cross Country Experience with Restructuring Agencies

Arsenal in Finland, NPart in Ghana, and Securum in Sweden were restructuring agencies for non-performing assets of banks that were either still in operation and recapitalized through the purchase of loan program at above fair market value—Ghana— or of banks that needed to be cleaned up prior to their sale to new investors—Finland and Sweden—(see Table 3). The narrow objective of all three entities was to manage and liquidate non-performing assets and accelerate corporate restructuring

***Evaluating Success.*** Securum, the Swedish asset management agency was successful in achieving its narrow objective of restructuring and/or selling off the assets in a relatively brief period of time and may have expedited restructuring in the broad real estate sector by acting in some cases as a lead agent enhancing creditor coordination (Bergren 1998). It closed its doors in 1997, five years after it had been established having sold off 98 percent of its assets. The following factors contributed to the success of Securum. Firstly, the government transferred mostly commercial real estate assets which may be easier to restructure as they may involve politically less sensitive issues—layoff of factory workers. Secondly, the assets that were transferred to Securum were mostly large and complicated assets for which it could be argued that Securum may have had a comparative advantage of resolving them. Thirdly, the government only transferred a limited amount of total banking system assets. Securum total assets amounted to 8 percent of total banking system assets. In addition, Securum had professional management, enjoyed political independence and was provided with appropriate funding. Finally, the economy and the real estate market recovered over that period (Table 2).

Arsenal had disposed of more than 50 percent of assets after five years in operation, and thus did not appear to have delayed corporate restructuring. Yet, it is difficult to gauge whether the agency was an important agent in corporate restructuring and indeed accelerated the process. Factors that worked in Arsenal's favor were the following. Firstly, Arsenal only had to resolve a relatively small amount of banking system assets as assets transferred amounted to 5.2% of banking system assets. Secondly, a large amount of the assets transferred were loans to real estate or loans secured by real estate. Thirdly, Arsenal was provided with appropriate funding, had professional management and a skilled human resource base. And finally asset resolution and disposition may have been helped by a strong economic recovery as the economy expanded at 4 and 5.1 percent in 1994 and 95. On the negative side, because Arsenal had received NPLs regardless of type and size of asset, it may have been more difficult for the agency to use wholesale divestiture techniques and also required it to build up expertise in different areas.

Contrary to Securum and Arsenal, N-PART did not achieve its narrow objective of performing a substantial role in the restructuring of the corporate sector and expediting the restructuring process. In the end, the agency engaged mostly in cosmetic financial restructuring extending maturity, and lowering interest rates and functioned as a collection agency. Factors that contributed to that outcome were the fact that the agency lacked political independence and professional management at the highest level of the institution. In addition, N-Part not only had to resolve a large share of outstanding banking system assets but also more than 50 percent of assets transferred were loans to state-owned enterprises, assets that are typically difficult to restructure for a government



agency lacking independence. Importantly, the work of N-Part was hampered by a weak legal framework. The government attempted to mitigate the implications of a weak legal framework for N-Part by granting it legal super-powers. Yet, this strategy proved largely ineffective because the courts were debtor friendly and N-Part needed the approval of the borrower before it could proceed with the liquidation process.

The track record of all three institutions regarding achieving their broader goal is mixed, at best. Sweden and Finland did not record any renewed banking system distress but real credit to the private sector contracted significantly in both countries in the years that followed the establishment of the AMCs, indicating that the restructuring of banks was not yet complete (Table 2). While banks' lending to the private sector increased significantly in Ghana, state-owned commercial banks, that had been cleaned up through the loan purchase program, again appeared to experience problems in the mid 1990s.

**Table 3: Restructuring Agencies**

Restructuring	Objectives of Restructuring Agency	Asset Transfer	Outcome	Key Factors
<p>Finland: Arsenal:</p> <ul style="list-style-type: none"> <li>Began activities in 1993 and is still in operation. Expected to close in year 2000. Set up to absorb non-performing assets.</li> <li>Public ownership.</li> <li>Stand-alone entity.</li> </ul>	<ul style="list-style-type: none"> <li>Established as a clean up mechanism for the Savings Bank and Skopbank.</li> <li>Manage, restructure and liquidate NPLs and other holdings, in an orderly manner and at minimum cost.</li> </ul>	<ul style="list-style-type: none"> <li>Amounts of Assets Transferred: Assets transferred had a book value of FIM 42.9 billion.</li> <li>Sectoral Breakdown of Assets: Only non-performing loans were transferred; real estate assets amounted to 34%; client receivables 41%; assets under management and other assets 25.3 percent.</li> <li>Criteria for Asset Transfer: All non-performing assets were transferred to Arsenal regardless of type and size of loans.</li> <li>Transfer Price: Book value.</li> </ul>	<ul style="list-style-type: none"> <li>At end 1997, Arsenal still managed 46.5 percent of the assets that were transferred to it.</li> <li>By end 1997, Arsenal had disposed of 78 percent of the real estate assets it had taken over.</li> <li>Unclear to what extent Arsenal accelerated corporate restructuring and how active Arsenal was in corporate restructuring..</li> <li>Real lending to the private sector remained strongly negative in real terms in the years after the establishment of Arsenal.</li> </ul>	<p>Favorable factors:</p> <ul style="list-style-type: none"> <li>Large amount of real assets transferred, including client receivables made it easier to restructure and/or dispose as they are less “politically” sensitive issues involved (real estate considered more to be cyclical industry)</li> <li>Appropriate funding allowed Arsenal to mark assets to market value after transfer.</li> <li>Arsenal’s professional management and adequate skilled resources.</li> <li>Benign macro-environment. In 1994-95, real GDP rebounded strongly and the economy expanded at 4- 5 percent.</li> </ul> <p>Unfavorable factors:</p> <ul style="list-style-type: none"> <li>Transfer of all types of NPLs regardless of type and size of assets may have made it more difficult to use wholesale divestiture techniques and also required Arsenal to build up expertise in different areas.</li> </ul>
<p>Ghana: NPART.</p> <ul style="list-style-type: none"> <li>Initiated operations in 1990 and closed in 1997, 2 years later than stipulated.</li> <li>Wholly owned government agency.</li> <li>Set up as centralized stand-alone agency.</li> </ul>	<ul style="list-style-type: none"> <li>Restructure and recapitalize publicly owned government banks.</li> <li>Restructure companies and expedite corporate restructuring.</li> <li>Maximize recovery value to reduce fiscal burden on the Government.</li> </ul>	<ul style="list-style-type: none"> <li>Amounts of Assets Transferred: About 13,000 accounts were transferred to NPART.</li> <li>Sectoral Breakdown of Assets: Corporate loans from state and private sector companies across industrial and service sectors; most loans were collateralized by plant, equipment and machinery.</li> <li>Criteria for Asset Transfer: Non-performing assets otherwise process of asset transfer non-transparent.</li> <li>Transfer Price: Book value of assets excluding accrued interest.</li> </ul>	<ul style="list-style-type: none"> <li>NPART failed to play a substantial role in expediting or enabling corporate restructuring..</li> <li>NPART functioned effectively as a collection agency and restructured its loan portfolio via extension of maturities or modifications to terms and conditions.</li> <li>While government owned banks were cleaned up through transfer of assets, and banks were operationally restructured, state-owned commercial banks in Ghana appeared to be in financial difficulties again in the late 1990s. At end 1997, government state-owned commercial banks had NPLs exceeding 15 percent.</li> <li>Yet, lending to the private sector did recover and turned strongly positive in 1992.</li> </ul>	<p>Favorable factors:</p> <ul style="list-style-type: none"> <li>While inadequate legal framework hampered the restructuring and sale of assets, an extra-judicial tribunal was set up to mitigate the problem. However, NPART was slow to make use of the tribunal which turned out to often side with the debtor.</li> <li>NPART received substantial foreign aid in the form of money and technical support. A team of expatriate experts, among which two former US RTC officials, managed the operations of NPART.</li> </ul> <p>Unfavorable factors:</p> <ul style="list-style-type: none"> <li>Large amount of banking system loans transferred (assets transferred amounted to 51 percent of banking system assets) and no clear eligibility criteria for the type of assets to be transferred so that NPART ended up with disparate set of assets.</li> <li>Type of asset transferred. Over 50% of assets transferred were loans to state-owned enterprises, assets that are typically difficult to restructure for a government agency that lacks independence.</li> </ul>
<p>Ghana: NPART.</p>				

Restructuring	Objectives of Restructuring Agency	Asset Transfer	Outcome	Key Factors
<p>Sweden:</p> <p>Securum:</p> <ul style="list-style-type: none"> <li>Set up in 1992 and expected to operate between 10 and 15 years. Closed operations successfully in 1997.</li> <li>Public ownership.</li> <li>Set up as a stand-alone agency.</li> </ul> <p>Retriva:</p> <ul style="list-style-type: none"> <li>Set up in 1993, was absorbed by Securum in 1995. Public ownership.</li> <li>Set up as a stand-alone agency.</li> </ul>	<p>Securum/Retriva:</p> <ul style="list-style-type: none"> <li>Established as clean-up agencies/bad banks for Nordbanken (Securum) and Gotha Bank (Retriva), two banks that government had taken over.</li> <li>Recover maximum values of NPLs transferred to it, establish “best practice” in corporate restructuring for private banks.</li> </ul>	<ul style="list-style-type: none"> <li>Amounts of Assets Transferred: Securum: Gross value: SEK 67 billion, 4.4 percent of total banking assets. Retriva: Gross value SEK 45 billion or 3.0 percent of banking assets.</li> <li>Sectoral Breakdown of Assets: 80 percent of assets were related to the real estate market. Securum: Loans 91.1 percent; share portfolio 6.2 percent; real estate: 2.7 percent. Retriva: Loans 86.2 percent; real share portfolio 1.6 percent; real estate 12.3 percent.</li> <li>Criteria for Asset Transfer: Mainly size and complexity of loan: only loans over SEK 15 million were transferred, and they typically consisted of corporation with operations in different countries or complicated structures in terms of subsidiaries. Both companies did not take over assets that could be securitized.</li> <li>Transfer Price: Assets were transferred at book value.</li> </ul>	<ul style="list-style-type: none"> <li>Securum/Retriva succeeded in managing and selling assets in relatively short period of time.</li> <li>Most of Securum’s and Retriva’s assets were real estate assets. Shareholdings were mostly concentrated in construction companies. Thus, while Securum may have helped to expedite restructuring in the real estate and construction industry by enhancing the coordination among debtors, its impact on the restructuring efforts in other sectors of the economy appears limited.</li> <li>In terms of restructuring of Nordbanken and Gotha Bank, management was changed, they were operationally restructured and were successfully sold to private investors.</li> <li>Real lending to private sector by banks did not recover. In 1993/94 real credit to the private sector contracted significantly.</li> </ul>	<ul style="list-style-type: none"> <li>Initial funding problems slowed down the establishment of NPART and the building up of professional expertise.</li> <li>Senior management consisted of political appointees.</li> <li>Lack of political independence of the agency.</li> <li>Failure to coordinate corporate restructuring efforts being undertaken by various government agencies and NPART.</li> <li>Weak legal framework. For example, asset sale was impeded by the fact that debtor had to agree with sale of assets.</li> </ul> <p>Favorable factors:</p> <ul style="list-style-type: none"> <li>Type of assets – mostly commercial real estate – made it easier to restructure as the assets were less politically sensitive (layoffs); high concentration of the economy may have made industrial restructuring easier. Also, transferred assets that were of particular type, size, and structure limited the amount of assets Securum had to deal with and made it a more manageable exercise.</li> <li>Private management and strong governance mechanisms which ensured the agency’s independence.</li> <li>Prompt structured appraisal of assets and transparent process of asset management, restructuring and sale.</li> <li>Adequate legal framework.</li> <li>Adequate funding.</li> <li>Adequate skilled resources.</li> <li>Limited amount of assets being transferred (7.7 percent of banking sector assets).</li> <li>Recovery of real estate market.</li> <li>Recovery of economic growth. In 1994, real GDP growth turned positive.</li> </ul> <p>Unfavorable factors:</p> <ul style="list-style-type: none"> <li>Sporadic bouts of scandal due to the incentive-compensation scheme for employees.</li> </ul>

## V. Lessons from Cross-Country Experience

Table 4 summarizes the main characteristics of the country cases including the size of the banking system and the depth of the capital market, the quality of the legal framework as measured in the enforcement of creditor rights and the amount of assets transferred to the respective AMCs. As the Table indicates, initial conditions for AMCs were significantly weaker in the developing economies while at the same time AMCs in these countries had to deal with a notably larger problem as assets transferred to these agencies accounted for a large amount of banking system assets. For example, the legal framework was considerably weaker in developing countries and capital markets were less developed, as indicated by the low bond market capitalization. Governments in Ghana and the Philippines tried to compensate for the weak legal framework by granting superpowers to their respective AMCs (see Table 5). In both cases this strategy proved ineffective as despite strengthened creditor rights the courts remained either debtor friendly—Ghana—or the overall efficiency of the court system did not improve—Philippines.

**Table 4 Characterization of Country Cases**

	Initial Conditions				
	Enforcement of creditor rights <sup>a</sup>	Private sector claims in percent of GDP <sup>b</sup>	Bond market capitalization in percent of GDP (Private) <sup>b</sup>	Peak level of NPLs (in percent of financial system assets)	Amount of assets transferred (in percent of financial system assets) <sup>d</sup>
Finland	18.0	87	39.7	18.7	5.2
Ghana	1.0	6	NA	60.0	50.8
Mexico	6.0	41	1.1	18.9	17.0
Philippines	7.7	79	16.6 <sup>c</sup>	23.1	21.7
Spain	8.0	88	43.2 <sup>d</sup>	5.7	1.4
Sweden	24.0	145	58.5	10.8	7.4
USA	18.0	103	50.5	4.1	8.0

*Source:* a. The product of an index of how well the legal framework protects secured creditors and a law and order index. Creditor right index taken from Porta et al (1997) and law and order index taken from International Country Risk Guide, various editions. The index ranges from 0 to 24 with 0 as the lowest and 24 as the highest score. d. author's calculation. b. IMF, International Financial Statistics. Private sector claims and bond market capitalization are shown at the onset of the financial crises in these countries. c. 1983. D. 1990.

Table 5 presents an overview of the main characteristics of the AMCs established including its narrow objective, type of assets transferred—real estate assets or assets or loans to politically motivated loans—the independence of the agency, legal superpowers and funding resources. The table highlights that the success of the AMCs in developing countries was mainly hindered by the following factors. Firstly, AMCs in developing countries mostly received non-real estate, state-owned enterprise assets, or assets reflecting political connections. All of these types of assets tend to be harder to restructure especially for a government agency. Secondly, many AMCs in developing countries had to resolve large amounts of banking system assets and received assets regardless of their size. Thirdly, AMCs in developing countries were not set up as independent institutions and thus were susceptible to political pressure. Finally, they

often lacked appropriate funding to dispose of assets quickly. None of the developing countries outsourced the management of the assets to the private sector, including foreign investment banks and advisors which could have compensated for the lack of independence and could have curbed the scope for political interference.

**Table 5 Characteristics of AMC established**

	Real estate assets (in percent of transferred assets)	Transfer of politically motivated assets	Agency is independent	Agency has legal superpowers	Outsourcing of management to private sector	Agency has appropriate funding
Finland	34	No	Yes	No	No	Yes
Ghana	Negligible	Yes	No	Yes	No	No
Mexico	NA	Yes	No	No	No	No
Philippines	Negligible	Yes	No	Yes	No	No
Spain	8.2	No	Yes	No	No	Yes
Sweden	80	No	Yes	No	No	Yes
USA	49	No	Yes	Yes	Yes	Yes, after initial problems

a. Business strategy includes type, size and amount of assets transferred. It is judged to be appropriate if it is in line with the resources of the agency including its funding, its institutional capacity and independence from political pressure and the development of the capital markets.

As a result, as Table 6 indicates, two out of three corporate restructuring AMCs did not achieve their narrow goals of expediting corporate restructuring. These experiences suggest that AMCs are rarely good tools to expedite corporate restructuring. Only the Swedish AMC successfully managed its portfolio, acting in some instances as lead agent in the restructuring process. It was helped by some special circumstances: the assets acquired were mostly real estate related, not manufacturing assets that are harder to restructure, and were a small fraction of the banking system, which made it easier for the AMC to maintain its independence from political pressures and to sell assets back to the private sector. Rapid asset disposition vehicles fared somewhat better with two out of four agencies, namely Spain and the US, achieving their objectives. The successful experiences suggest that AMCs can be effectively used, but only for narrowly defined purposes of resolving insolvent and unviable financial institutions and selling off their assets. But even achieving these objectives required many ingredients: a type of asset that is easily liquifiable—real estate—, mostly professional management, political independence, a skilled resource base, appropriate funding, adequate bankruptcy and foreclosure laws, good information and management systems, and transparency in operations and processes. In the Philippines and Mexico, the success of the AMCs was doomed from the start as governments transferred large amount of loans that had initially been extended by the originating banks based on political connections and/or fraudulent assets to the AMCs which are difficult to be resolved or to be sold off by a government agency. Both of these agencies did not succeed in achieving their narrow objectives.

**Table 6 Evaluating the Country Cases**

<u>Type/Objective of AMC established</u>		<u>Corporate restructuring/ asset disposition</u>			<u>Health of banking system</u>	
		<u>Share of assets disposed</u>	<u>Have AMCs achieved their narrow objective</u>	<u>Recurrent problems</u>	<u>Growth of real credit</u>	<u>Have AMCs achieved their broader objectives</u>
Finland	Restructuring	>64	Unclear	No	Negative	Unclear
Ghana	Restructuring	Not applicable	No	Yes	Positive	Unclear
Mexico	Rapid Asset Disposition	0.1	No	Yes	Negative	No
Philippines	Rapid Asset Disposition	<50	No	Yes	Positive	Unclear
Spain	Liquidation	Majority	Yes	No	Positive	Yes
Sweden	Restructuring	86	Yes	No	Negative	Unclear
USA	Liquidation	98	Yes	No	Negative	Unclear

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