



# **Financial Sector Restructuring**

## ***Lessons from International Experience***

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# Outline

- Why restructure? Where to Start?
- Lessons from Global Experience
- Identifying an Approach
- Focus on Bank Resolution and NPLs
- Need to be Prepared
- Vietnam Financial Sector Restructuring Challenges



# Why Restructure?

## Where to Start?



## Why restructure? *The Motivation*

- Financial and Economic Crisis – Real sector problems
- Rising NPLs (real sector stress and excessive exposures to real estate, FX, loss making enterprises (including SOEs), connected party lending, etc.)
- Weak capitalization of banks relative to risk profile -- Fear of insolvency
- Inefficient intermediation - insufficient credit flows, excessive risk taking by banks (rapid, unchecked credit growth), interest rate distortions, hot money etc.
- Weak legal, regulatory and supervisory framework
- Lack of confidence in the banking system



## Why restructure? *Objectives*

### ***Short-term/ Immediate***

- Maintain stability of banking system → Ensure solvency, liquidity and uninterrupted financial intermediation
- Address problems in a timely manner → Prevent contagion or systemic concerns
- Restore confidence in banking system → Prevent deposit runs

### ***Longer-term/ Structural***

- New governance framework
- Improve Operational Efficiency/ Consolidation
- Build competition and resilience
- Strengthen overall infrastructure of financial system
- Improve access to financial services

*Build strong legal, regulatory and supervisory framework and related institutional and enforcement capacity*



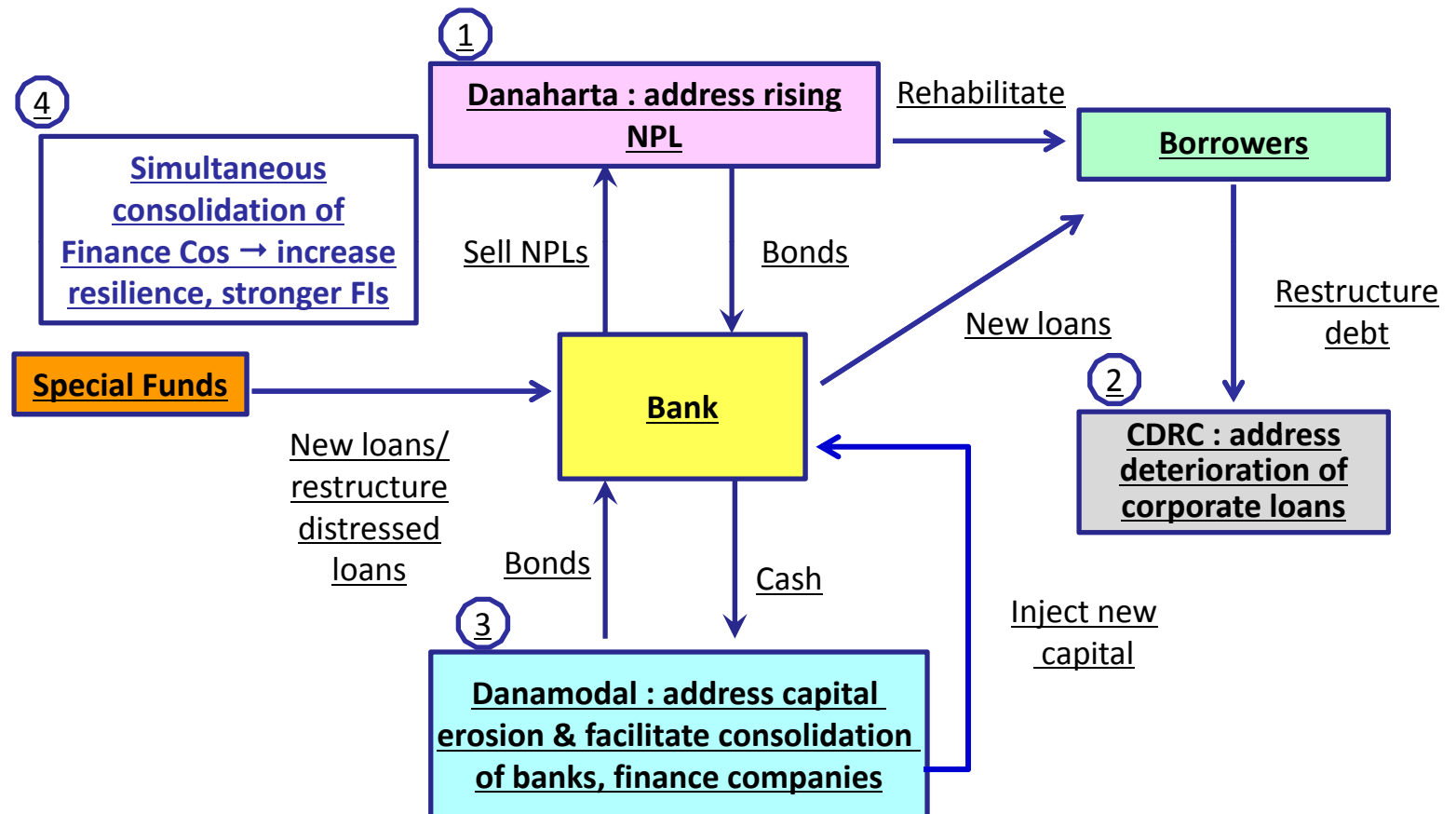
## Where to Start?

- Once there are clear overall objectives and direction for the restructuring – “**where you want to go**”, it is important to understand nature, scope and extent of the issues - “**establish where you are starting from**”
  - **Diagnostic / Assessment**
    - Review of financial health of the institutions (capital position, NPLs, liquidity, profitability, etc)
    - Understand structural and institution specific issues such as limitations in risk management systems, governance and internal controls, IT system architecture, etc.
    - Review legal, regulatory and supervisory framework
    - Understanding of institutional capacity at institutions and regulatory bodies
- Prepare an appropriate **Restructuring Plan** with clear targets, milestones, responsibilities & financing options

# Malaysia: Financial Sector Restructuring Plan

Late 1990s & 2000s

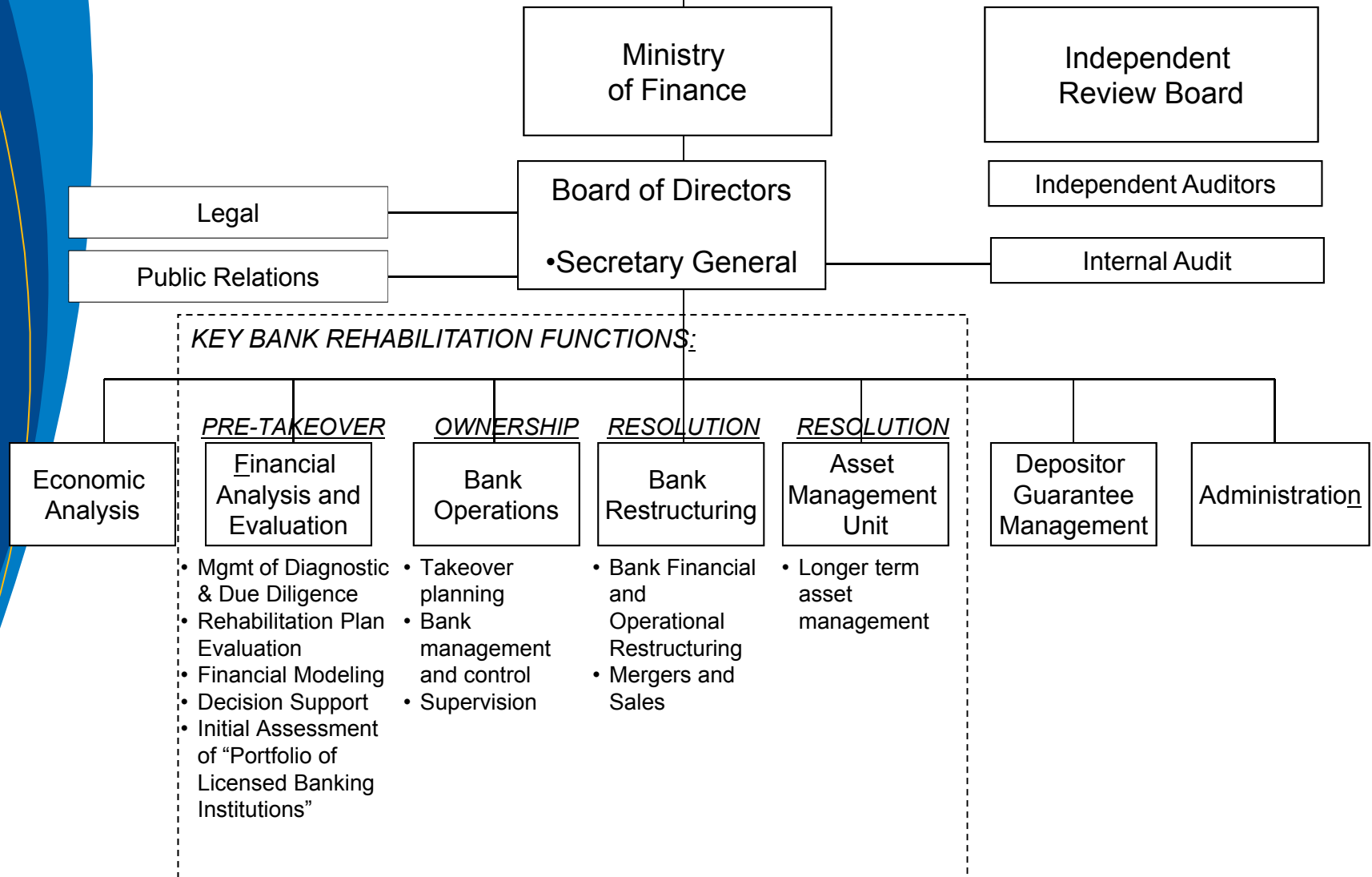
## A Four Pronged Approach



Undertaken on back of comprehensive measures to restore FS stability & comprehensive pro-recovery measures & initiatives

# INDONESIAN BANK RESTRUCTURING AGENCY (IBRA)

## ORGANISATION STRUCTURE (when established)







# Lessons from Global Experience



## Global experience in Financial Sector Restructuring

### *Success Factors*

- **Restructuring goal** : Restore stable financial conditions for economic growth ⇒ go beyond “cleaning up” banks’ balance sheet. Restructuring of banks is **not in isolation** ⇒ part of financial sector development and economic transition
- Restructuring of banks **accompanied by development of bond & other capital market for balanced distribution of risks** through diversified sources of financing economic activities
- Establish comprehensive well **sequenced plan with clear targets**, time lines & final outcomes. Mode of restructuring should be based on **reducing fiscal burden**
- Implementing bank restructuring must be **based on technical & economic considerations**, undertaken by teams with strong technical expertise. There must be **adequate preparation for staff** likely to be affected by restructuring
- Restructuring accompanied by **measures to ensure monetary & financial stability** during restructuring period



## Global Experience in Financial Sector Restructuring

### *Political Economy*

***Financial Sector Restructuring will require hard choices and is bound to face strong resistance from various stakeholders as it is never costless.***

- Management of the financial institutions, due to vested interests, will have an incentive to postpone resolution and not shoulder the costs
- The owners will try to put political pressure on the government to bail them out.
- The Government (Ministry of Finance) will usually not have resources or wants to pay for the costs of bank resolution
- Depositors (households and companies) will make every effort to minimize their losses and get someone else to bear the costs of the problem
- Politicians will try to minimize the problem in the hope that it will not hurt their “image”



## Global Experience in Financial Sector Restructuring *Political Economy (2)*

### **Successful restructuring requires:**

- **Commitment and participation** at the highest levels
- Clear and robust **institutional structure to implement the plan** – including clear objectives, powers, assignment of responsibilities, resources, reporting and accountability
- Strong focus on **building capacity of regulatory bodies**
- **Cooperation between stakeholders** – within/between industry, regulatory bodies, Government and the political regime
- **Transparent Communication Strategy** with consistent messages
- **Leveraging global expertise and investors** to speed up reforms
- Clarity on **role of the State** in the banking sector (as owner of banks; equal treatment; level playing field)



# Identifying an Approach

# Identifying Restructuring Approach

- **Countries have used multiple options to address specific problems**

<b>Sign/ Indication</b>	<b>Possible Response/ Approach</b>
Systemic rise in NPLs	Higher capital and provisioning requirements; Address bad debt (AMCs, Bad bank-Good bank model, Bridge Bank); corporate restructuring
System capital low (fear of insolvency)	Force owners to inject more capital; Facilitate investor access (e.g, allow higher foreign investors participation), Conditional access to recapitalization funds
Banks having difficult raising funds (deposits)	Temporary provision of liquidity windows (lending of last resort function of central bank); Enhanced depositor protection to restore confidence (e.g., 2008 crisis prompted several countries to increase Deposit Insurance limits)



# Identifying Restructuring Approach

**The approach or response a Government chooses depends on several factors**

- Political economy
- Economic conditions
- Governments Fiscal situation
- Scale and severity of the problem and financial health of specific banks/system
- Limitations of the legal and regulatory framework
- Institutional/technical capacity of the involved institutions, etc.

→ ***Unusually multiple options have to be considered to address specific circumstances***



# Bank Resolution and NPLs Management





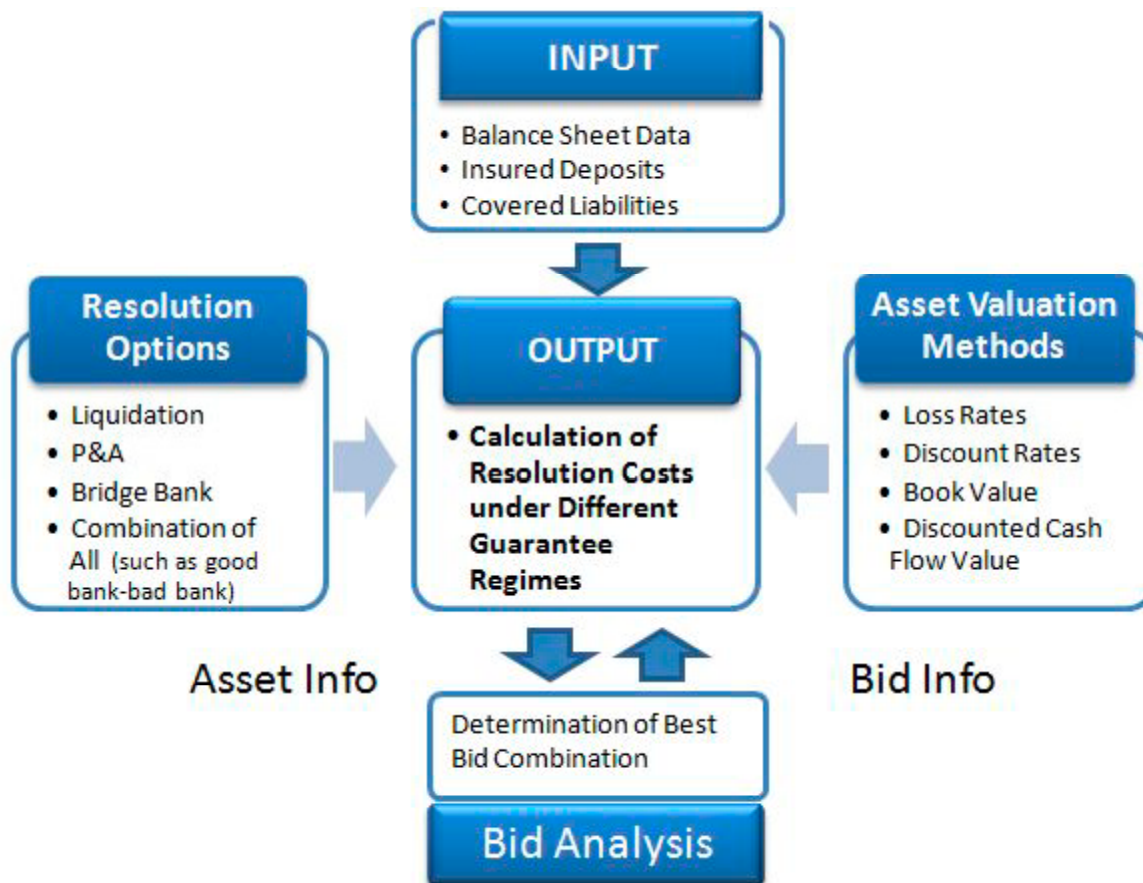
# Problem Bank Resolution

## *Mechanisms for Resolution*

When forbearance, government encouraged mergers and temporary Govt. support is not enough / problem is severe

- **Liquidation/Closing** (license withdrawn, assets sold to pay its liabilities/depositors/creditors; deposit insurance covers depositors up to limit; Bank owners usually recover only for the loss of their ownership interests after all other bank creditors have been paid)
- **Conservatorship/Temporary Administration/ “Bridge Bank”** (appointment of a manager who substitutes for the bank’s own senior executive; goal to reform its operations to improve its financial health or prepare it for a sale or merger with another institution)
- **Purchase and Assumption (P&A)/ “Good bank-Bad bank”** (transfer of a troubled bank’s operations to healthy bank; withdrawal/cancellation of license, termination of owners’ rights, the assumption of the troubled bank’s deposits and good assets, take-over of the bank’s problem assets by the resolution authority. A form of a P&A is a Bridge Bank, where the government forms a bank into which all or parts of a failing bank can be transferred, with the goal of effecting a sale to a private party at some future date)
- **Nationalization** (government assumes temporary ownership)

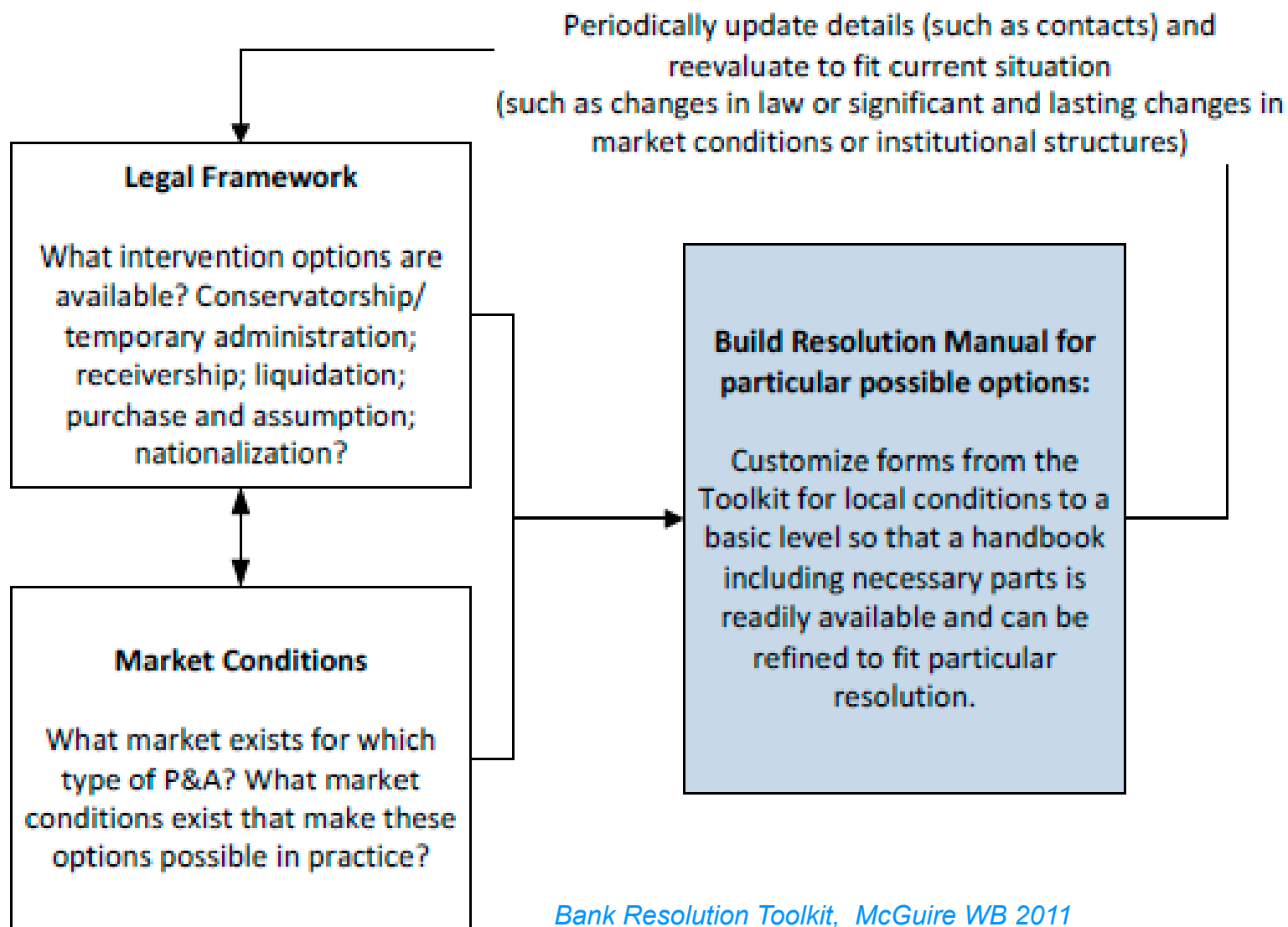
# The Least Cost Test Model (WB)



- LCTM can be used by supervisory authorities to determine the relative cost of various resolution options, such as liquidation, purchase and assumption, Bridge Bank (including recapitalization), or any combination of such options.

# Problem Bank Resolution

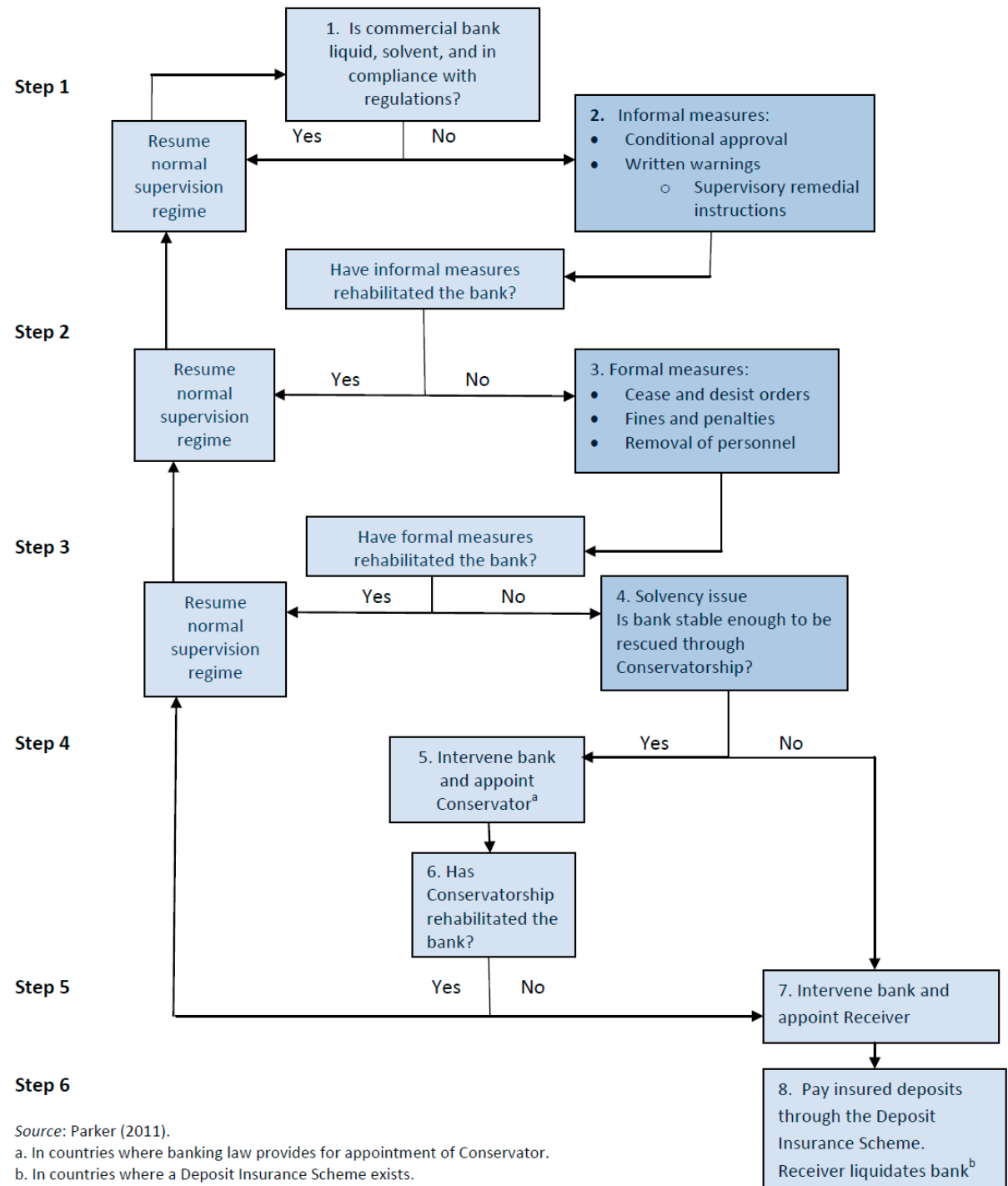
Very Important to Evaluate Readiness for Resolution → Take into account Legal Framework & Market Conditions





# Decision Tree for Problem Bank Resolution

→ developing such protocols can be useful in clarifying the process and save time in times of stress.



Source: Parker (2011).

a. In countries where banking law provides for appointment of Conservator.

b. In countries where a Deposit Insurance Scheme exists.



# Problem Bank Resolution

## “Bridge Bank” (variation of traditional P&A)

- Resolution authority creates a new, temporary, full-service bank;
- Used when the failure of a bank happens without significant advance notice (fraud, liquidity crisis);
- Operational for a limited period preparing bank (or parts of the bank) for sale
- Not designed to save a bank that has no real franchise value; the better option for such a bank would be liquidation.

### **Advantage:**

- Allows the supervisory authority to move quickly when required
- Can help maintain the value of bank with serious but not fatal problems in its operations.

### **Disadvantage:**

- Operating a Bridge Bank is a very labor-intensive process
- May require ongoing liquidity support from the government
- Cost of operating the Bridge Bank may exceed cost of liquidation



# Problem Bank Resolution

## Open Bank Assistance

- The government keeps the troubled bank open by providing solvency and/or liquidity support. However, it should be established that this assistance is the least costly of all possible methods of resolving an institution (unless systemically important bank), and government funds should not be used to benefit any shareholder of the institution or its management.

### ***Advantage:***

- Preserves bank operations
- Avoids the cost of bank closure (at least temporarily)

### ***Disadvantage:***

- Can be very costly for the Government
- May increase the final cost of resolution
- Does not fully attack the primary problems
- Moral hazard



# Problem Bank Resolution

## Mergers & Acquisitions (a form of P&A)

M&A are similar to P&A but no failure of a bank, rather a change in the troubled bank's organization and/or ownership.

**Unassisted Mergers:** Supervisory authority encourages mergers between a troubled and a healthier institution. No financial assistance; Nonfinancial incentives (e.g. forbearance).

- **Advantage:** No cost to the resolution authority, customer services not disrupted
- **Disadvantage:** healthy institution overly burdened

**Assisted Mergers:** Government markets the institution to an acquirer with an offer of direct financial assistance.

- **Advantage:** Acquiring bank takes over entire book; no break in service for the customers
- **Disadvantage:** Need for close monitoring by Govt; ensure acquirer is managing the acquired operations effectively; appropriateness of incentives

# Addressing NPLs

## Asset Management Companies - *Different Approaches*



*De-centralized*

*Centralized*

	<u>Banco Latino</u> <u>Den Norske Bank</u> <u>Foreningsbanken</u> <u>Swedbank</u> <u>Nordbanken, "Securum"</u> <u>Gota-Retriva</u>
<u>Thailand "FRA"</u> <u>Indonesia IBRA "AMU"</u> <u>USA "RTC"</u>	<u>Thailand "AMC"</u> <u>Indonesia IBRA "AMU"</u> <u>Korea "Kamco"</u> <u>Malaysia "Danaharta"</u> <u>Finland "Arsenal"</u>

*Rapid Disposition*

*Longer-term Asset Mgmt*

*Though used widely, AMC's have shown mixed results*  
**→ In considering any option, it is critical to look at international experience as well as domestic factors**



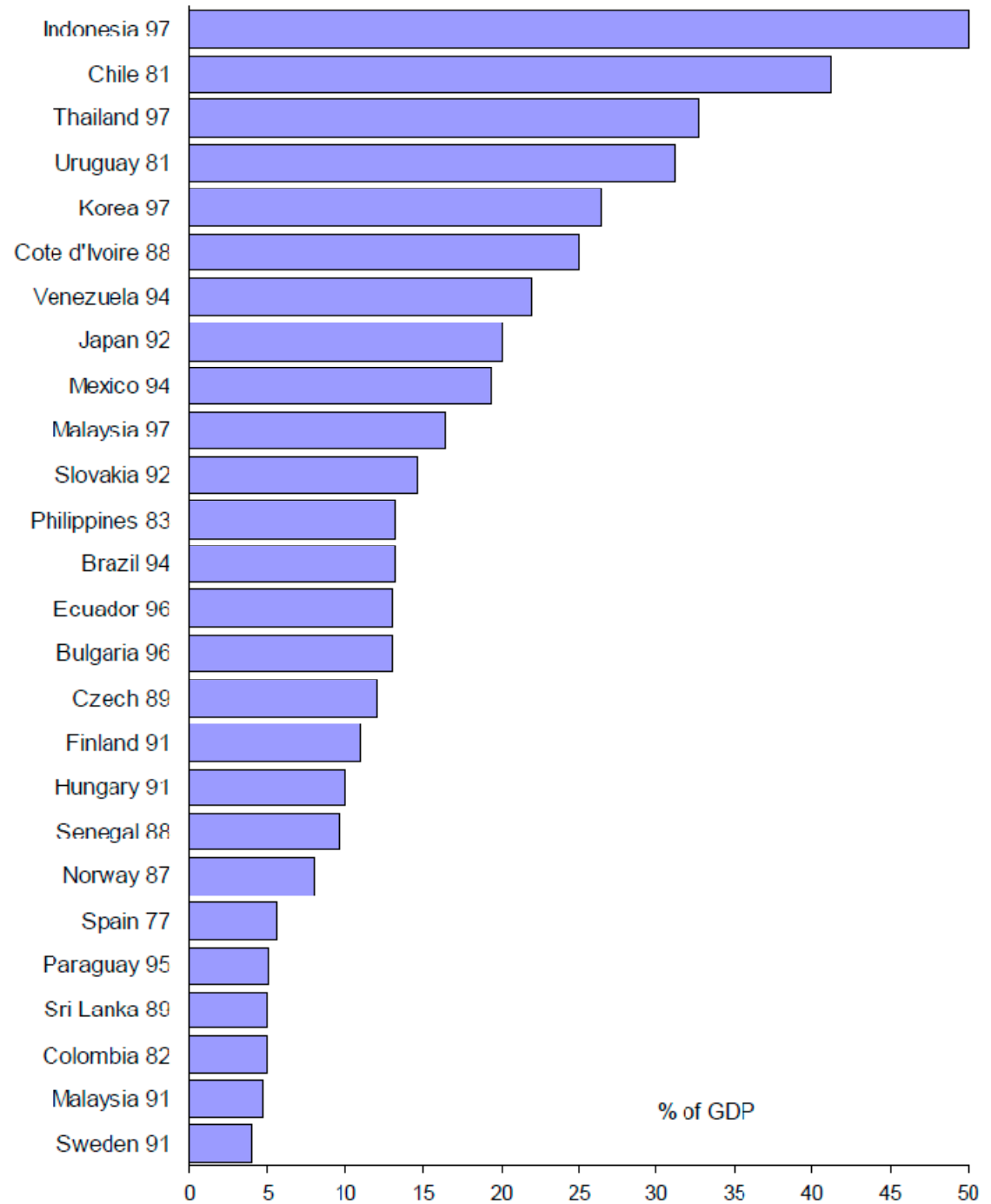


**Be Prepared**

# Fiscal Cost of addressing a Banking Crisis is usually high

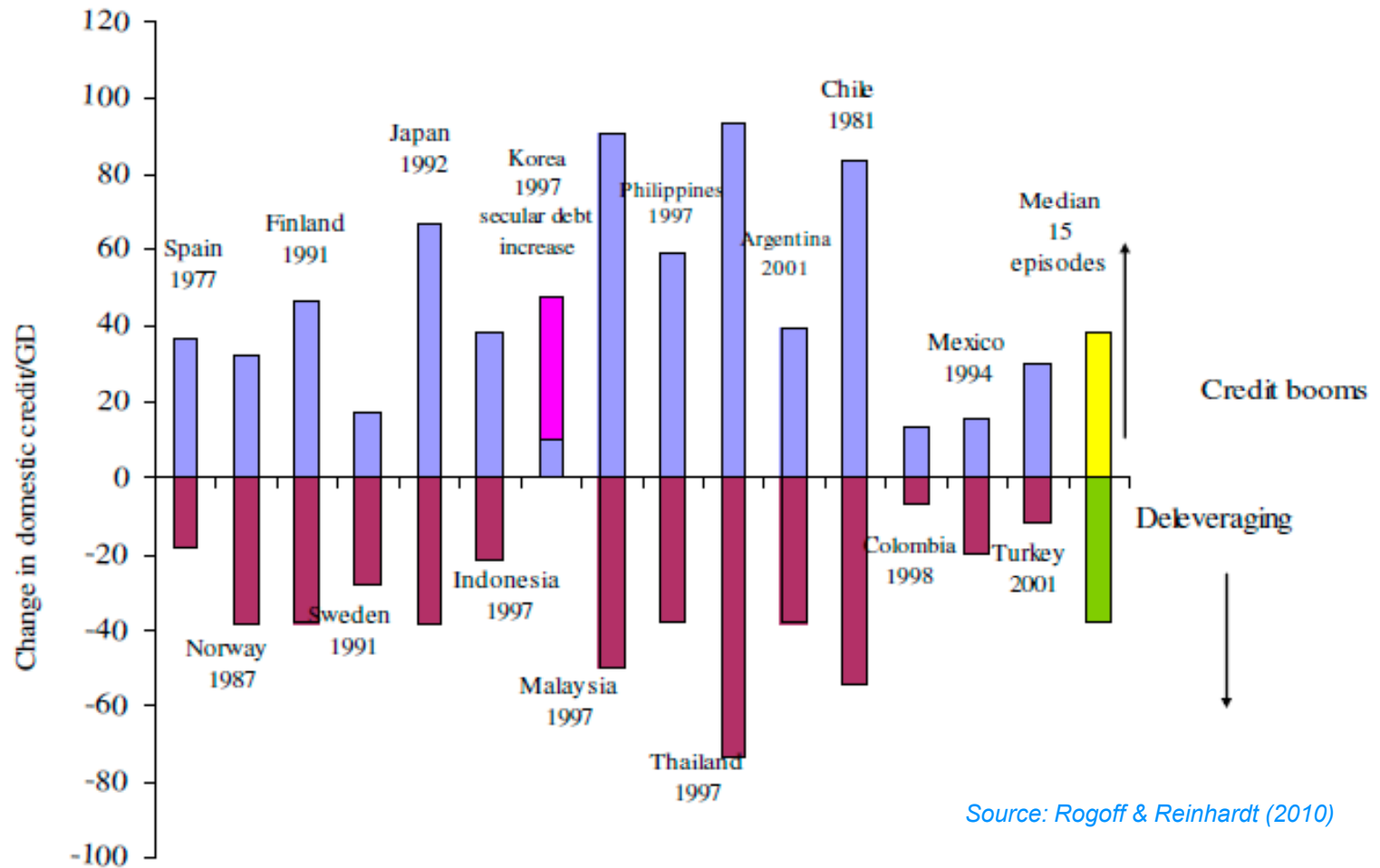


Honahan and  
Klingebiel, 2000, WB



# Deleveraging can be significant after credit booms

## Amplitude of Boom-Bust Credit Cycles (10 yrs before & 10 yrs after)



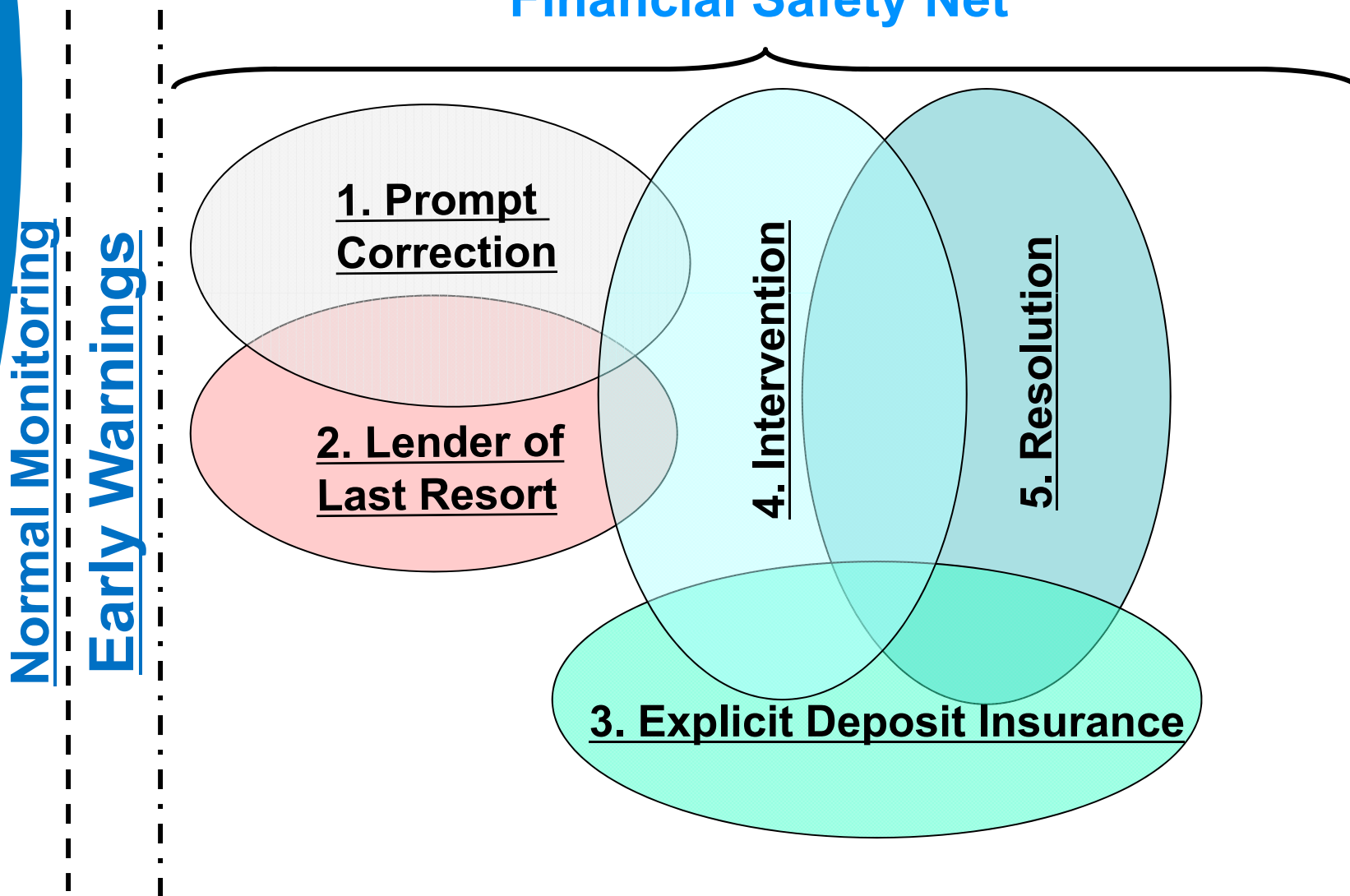
## Lesson: Best to avoid a Systemic Crisis

- take early action to preempt a crisis and higher cost
- be prepared to detect and address problems proactively

# Lesson: Be Prepared

→ *Have a Safety Net in Place*

## Financial Safety Net





## Lesson: Be Prepared

→ *Develop a Contingency Plan*

- Contingency planning consists of devising a plan to deal with the consequences of potentially destabilizing events
- Properly handled, the closing of a bank need not be destabilizing
- If you prepare for a bank closing you will be better able to manage it when needed and mitigate any negative impacts



Vietnam – Financial  
Sector  
Restructuring  
*Challenges*

# Financial Sector – Achievements

**In past decade**, Vietnam's banking sector has recorded a host of improvements and enhancements, which reflect the rising level of formal financial intermediation and deepening.

- In 2001, credit cards were uncommon and ATM machines were hardly seen anywhere. By mid 2011, 24 million cards have been issued and there are more than 11,000 ATMs and 37,000 points of sales (POS).
- Broad money (M2) accounted for only 58.1 percent and banking credit for 39.3 percent of GDP before the reforms started to accelerate at the beginning of the century. By the end of 2011, broad money accounted for approximately 108 percent and banking credit approximately 120 percent of GDP.
- There are 38 joint-stock banks and 5 state-owned/controlled banks (SOCBs); the share of SOCBs has declined steadily though they continue to dominate.
- The inter-bank payment system has vastly improved, though operations remain weak. Timing for clearing and settlement of a typical inter-province interbank payment has been cut from 7 days to minutes
- Domestic banks have also upgraded their core banking systems to improve their services delivery and operational efficiency.
- Banks are also making some efforts, albeit slowly, to improve corporate governance and risk management.
- Capitalization of stock market grown to over 35% of GDP



## Financial Sector – Stress is building up

- Following rapid credit growth (over 30-40% per year for past few years), portfolio quality of banks under stress
  - NPLs = 3.3% (VAS) → but could be over 3 times by IAS/IFRS
  - Exposure to Vinashin / financially weak SOEs is unknown
  - Risks from non core/other businesses (finance/leasing companies, etc) not well captured (no consolidated supervision; limited multi-agency coordination)
  - Several banks have recently faced liquidity problems
  - Lower growth expectations, SME concerns, continuing RE problems
- Given stress, Capital Adequacy is questionable/banks have limited buffers
- Non bank financial sector also under stress (e.g., Securities Companies, Finance/Leasing Companies)
- Health of Policy Banks (VDB and VBSP) uncertain







## Financial Sector – Restructuring Challenges

- Banking legal, regulatory and supervisory framework continues to be behind int'l stds/ practices (incl., creditor rights, insolvency, bankruptcy)
- Adequacy of Technical Expertise/ Capacity (esp. NPL resol'n) – regulators, banks, market
- Contingency planning framework/ preparedness to address problems / safety net (including deposit insurance function/role) not developed
- Limited Transparency and Disclosure adds to uncertainty
- Commercial banks assets are over 1.5 times GDP → major restructuring effort will likely require large resources (different from past); Government does not have much fiscal space
- Balancing monetary policy and credit demand (esp. SMEs) (avoid Credit Crunch situation)
- Coordination (multi agency effort-SBV, MOF, SSC; stake holder/ industry consultations)



# Financial Sector – Restructuring Plan

***Government has recognized need to take action***

## **Key Government Actions so far**

- Curtailed lending growth in 2011 through tight monetary policy
- Merged 3 weak banks with liquidity problems and high NPLs (assigned to BIDV)
- Restructuring Plan Prepared (Classification of banks; Credit growth targeting)
- PM Decision 254 on Restructuring of Credit Institutions (2011-15) (*March 1, 2012*)

## **Restructuring Plan Implementation – Next Steps (Short Term)**

- Focus in 2012 on addressing liquidity in the banking system
- Weak banks → tighter supervision → encouraged to address problems immediately or merge/ restructure ownership
- Encourage all banks to increase capital; equalization of SOCBs to continue
- Credit Institutions to start addressing NPLs



## Financial Sector – Restructuring Plan

The CI Plan provides some guiding principles → Several issues need further discussion/consideration – some open questions remain.

- What is the Specific timeline for preparing actionable plan for specific institutions?
- What would be the conditions for mergers?
- How will the ownership rights be handled?
- What will be the terms of transfer of NPL to AMCs?
- What about restructuring of VDB and VBSP? Cost?
- How will the various actions/options be financed?

# Some Concluding Thoughts

- Maintain consumer confidence / uninterrupted services
  - Communication Strategy - Overriding objective: maintain public confidence (consistent message, acknowledgement of problems and possible solutions)
- Hard choices – structural restructuring is costly and someone has to pay → setting principles is very important (hold owners accountable first)
- Improving Corporate Governance is must – bad management leads to weak institutions (overleveraging, risky lending, NPLs, etc etc)
- Regulatory and supervisory upgrade essential (including related Capacity / Expertize)
- Stakeholder and interagency coordination is very important
- Prepare for the worst and hope for the best





Thank you!

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