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Non-performing Loans - New risks and policies?

What factors drive the performance of national asset management companies?

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Non-performing Loans - New risks and policies?

What factors drive the performance of national asset management companies?

Abstract
In this study we examine the experience of Member States with Asset Management Companies (AMCs) to understand their opportunities and risks, and deeper determinants of performance, and draw some lessons for exploring potential solutions at an EU level.

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LIST OF ABBREVIATIONS

AMC	Asset Management Company
AMCO	Asset Management Company (Italian)
BRRD	Bank Recovery and Resolution Directive
CRE	Commercial Real Estate
DUTB	Družba za upravljanje terjatev bank (Slovenian Bank Asset Management
EBA	European Banking Authority
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EGOV	Economic Governance Support Unit
EEA	Erste Abwicklungsanstalt (AMC used to take assets of WestLB)
EP	European Parliament
FMSA	Bundesanstalt für Finanzmarktstabilisierung (Federal Agency for Financial Market
GDP	Gross Domestic Product
IMF	International Monetary Fund
IRR	Internal Rate of Return
LGD	Loss-Given Default
MARK	Magyar Reorganizációs és Követeléskezelő Zrt (Hungarian AMC)
MPS	Monte dei Paschi di Siena
NAMA	National Asset Management Agency (Ireland)
NPAs/ NPLs	Non-Performing Assets/Non-Performing Loans
PD	Probability of Default / Past Dues
REV	Real Economic Value
RRE	Residential Real Estate
SAREB	Sociedad de Gestion de Activos procedentes de la Restructuración Bancaria
SPV	Special Purpose Vehicle
SRB/SRM	Single Resolution Board/Single Resolution Mechanism
SSM	Single Supervisory Mechanism
UTP	Unlikely to Pay

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EXECUTIVE SUMMARY

Background

The context of this briefing paper are the strategies for dealing with the expected surge in Non-Performing Loans (NPLs) as a result of the COVID-19 crisis, specifically the efficiency of Asset Management Companies (AMCs) as a possible element of those strategies, and, if so, their performance drivers. To properly frame the questions asked, it is important to understand their context.

NPLs strategies are now the subject of discussion but have been in the spotlight of EU policymakers for some time, with immediate precedents of current efforts found in the initiatives by regulatory and political bodies between 2016-2018. After the COVID-19 crisis NPLs have become a priority again for the Commission, which has emphasised the importance of well-functioning secondary markets, securitisations and AMCs, ideas echoed by the Single Supervisory Mechanism (SSM) Chair, Mr. Andrea Enria, who – building on ideas he had already voiced in the past - has advocated for an EU-level AMC or a EU network or mechanism of national AMC. Yet, NPLs crises, NPLs strategies in general, and AMCs in particular are controversial, and despite the different nature of the current crisis (exogenous and not self-inflicted) the old tensions may resurface again. This sets the stage for this in-depth study.

Aim

The aim of this in-depth study is to provide an assessment of the national experiences with AMCs to draw lessons for a possible EU-level strategy for dealing with NPLs in the post COVID-19 scenario, and more specifically to analyse the risk that AMCs perceived advantages may be the result of hidden costs in the form of steep discounts, anti-competitive conditions, or socially harmful practice.

The more specific findings are synthesised below. The main message is that the conceptual framework to assess AMCs is relatively: (i) compartmentalised, thus seeing AMCs, as a mechanism “opposed to”, or “alternative to” securitisation, or the handling of NPLs by single banks; (ii) “microprudential”, thus focusing on individual bank behaviour; (iii) short-to-medium term, in terms of returns, with very little however in terms of national or European public data and database to inform objectively and calibrate the mid-to-long term evolution of recovery rates, and to offer the needed granular information on the recovery rates associated to different clusters of loans in the portfolio; and (iv) focused on rates of recovery and disposal, with less attention to social impact or side effects. This stylised approach may have been necessary when it was a priority to highlight certain messages (e.g., the need to insulate an AMC from political pressure, or to ensure an independent assessment of transfer prices). Yet, a side effect of this narrower view is that AMCs may appear harder to justify whenever they are presented as polar opposites of NPLs management by banks (where the latter have a relational advantage) or securitisation (where pooling and tranching present clear advantages in terms of enabling secondary markets), instead of (i) exploring the complementarities and synergies between them and (ii) acknowledging the last resort role as final backstop for NPLs’ disposals that AMC may be called to provide in a worst case scenario where market’s appetite for NPLs as an asset class dries up (as it may well be if the magnitude of the surge of NPLs as a consequence of the COVID-19 crises were extremely significant). A second side effect is that certain broader processes, like the social impact of NPLs management, and the interplay between the social dimension and financial stability are overlooked. Again, this may have been a necessity at times where urgent, drastic solutions were needed, but the relevance of the issue seems to demand a deeper look, now that sufficient experience has been accumulated. A third side effect is that the emphasis on market prices and "real economic value” (REV), although not in itself imposing punitive transfer prices, has anchored the debate in a short-to-medium

term assessment of financial profitability, leaving out a longer-term assessment of economic-and-social benefits. A more comprehensive approach is possible. This could combine (i) key principles to provide clarity in AMC design (AMC independence and professional management, timely recognition of losses, creation of secondary NPLs markets); (ii) a role for AMCs that exploits their advantages (centralisation, operational consistency, limited improvisation, possible lower funding costs and less aggressive profit maximization mandates – i.e. more moderate expected rates of return on capital – which translate into less punitive transfer prices for disposing banks) but also (iii) the search for synergies with other mechanisms (e.g., enlisting individual banks' expertise with a competitive allocation of servicing; using securitisation's pooling and tranching to facilitate NPLs distribution etc.) to (iv) insert AMCs and accompanying mechanisms within a more comprehensive NPLs strategy that reconciles the emergence of EU-sized secondary NPLs markets, with a technically sound approach to maximize economic and social, returns, and focus on long term value.

These views should be considered with caution. They are based on a technical assessment, to the best of the knowledge of the authors, of past NPLs crises and AMCs experience, based on the information publicly available. Regretfully, however, the NPL market is still a quite opaque market. Nonetheless, sidestepping the opaqueness of this market and the complex, multi-dimensional nature of NPLs problems does not promise any good if the old tensions resurface again.

The main findings are the following:

Finding	Substance of the finding
Efficiency	AMCs are adequate tools to deal with NPLs, but their efficiency varies between simpler tasks (e.g., disposal) and complex ones (e.g., restructuring). Less attention has been given to the need to fit AMCs to the actual NPLs crisis. The perceived advantages and disadvantages of AMCs are partly influenced by an approach that focuses on AMC in isolation, when their performance is largely determined by their combination with other NPLs-management tools.
Controversy, unfair advantages	There is no clear evidence that AMCs' efficiency stems from "unfair" advantages, such as excessively discounted transfer prices, anti-competitive operating conditions or socially aggressive practices. The controversy around AMCs can have several causes: (i) there are different expectations about an AMC's goals and outcomes; (ii) perceptions about the urgency of the situation change; (iii) controversy surrounds AMCs' funding, especially if a common European funding mechanism were to be adopted.
Deeper issues	The deeper problem is twofold. One, the NPLs market is at the moment an opaque market, with insufficient public data (on a national or European level) to objectively calibrate the mid-to-long term evolution of recovery rates and offer granular information on those recovery rates associated to different clusters of loans within each portfolio. Two, NPLs strategies sidestep relevant issues to avoid controversy. This results in a relatively narrow approach to AMCs. There are important information gaps about, e.g., (i) the interplay between social and financial performance and stability; or (ii) the interplay and synergies between AMCs and securitisation schemes. An open discussion of AMCs as part of a comprehensive strategy would be preferable, but complex. Several ideas could help: first, the possibility for state-owned or state-

	sponsored AMCs to negotiate with disposing banks less discounted transfer prices (yet preserving AMC profitability) based on long term vs. short term value-creation objectives and less aggressive expected returns on capital (IRR). Second, to ensure that AMCs can use open, competitive processes to enlist third-party expertise to aid servicing, recovery or restructuring efforts, or even real estate development when needed, and that contacts with public authorities are fluid, but also open and accountable. Third, to explore the synergies between AMCs (that aid centralisation and learning economies) and mechanisms like securitisation (that use pooling and tranching to facilitate distribution). Fourth, to strengthen information gathering on the NPLs market, recovery rates and trends, with special attention to the social and gender impact, to make AMCs part of a broader, technically sound strategy that maximises economic value while bolstering social trust.
Performance drivers	There are certain factors that drive AMCs performance. Some are a matter of choice (e.g., ownership and governance). Others depend on the nature of the crisis (e.g., managing certain classes of NPLs may be harder for an AMC, but taking them off the banks' balance sheets may be needed to restore confidence). Rather than a one-size-fits-all approach, AMCs should fit different types of crises.
Information gaps	It is important to fill the gaps in publicly available data (on a national or European level) to objectively calibrate the mid-to-long term evolution of recovery rates and offer granular information on those recovery rates associated to different clusters of loans within each portfolio. This would help to calibrate the social impact of NPLs strategies, and the synergies between AMCs and securitisation or other strategies. In general, it would help to adapt some aspects of design to fit different contexts and crises.

Source: Authors [1]

[1] The authors wish to thank the team at the European Parliament (EP) Economic Governance Support Unit (EGOV), especially Marcel Magnus, Cristina Sofia Pacheco Dias and Kristina Grigaite, for their extremely useful suggestions and comments, and to Carlos Bosque and Pier Mario Lupinu for their assistance in specific tasks. All errors remain the authors' own.

1. GENERAL INFORMATION

KEY FINDINGS

AMCs have become a key instrument to deal with Non-Performing Assets (NPAs) or Non-Performing Loans (NPLs) especially at a systemic level, and they will likely be part of any NPL strategy to deal with the sequels of the COVID-19 crisis. AMCs can be effective tools to deal with certain aspects of an NPL crisis but can pursue different strategies, and in any event need to be accompanied by other measures.

Evidence does not suggest that AMCs' success is the result of some "unfair" advantages conferred by steep initial discounts, non-competitive conditions, or socially aggressive enforcement strategies. Yet, controversy may still arise due to changing perceptions about the urgency of the situation or the functioning of the markets, and to deeper disagreements about the role that an AMC is supposed to perform. A more comprehensive strategy, and more transparent information about the NPLs market would help allay concerns.

Two main gaps remain. One is about the social dimension of NPLs crises and strategies, the social side-effects of AMCs, and the interplay between social and financial instability. Social aspects are considered a threat or a distraction for AMCs and sidestepped in AMCs strategies. Another is about the synergies between AMCs and other tools, including securitization schemes (to use pooling and tranching to facilitate distribution), or third-party expertise.

2. NON-PERFORMING ASSETS, GOVERNMENT SCHEMES AND THE EUROPEAN UNION. AN OVERALL PERSPECTIVE

2.1. Scope of the Briefing Paper: the institutional context

The context of this briefing paper are the strategies for dealing with the expected surge in NPLs as a result of the COVID-19 crisis, specifically the efficiency of AMCs as a possible element of those strategies, and, if so, their performance drivers. To properly frame the questions asked, it is important to understand their context.

NPLs strategies are now the subject of discussion but have been in the spotlight of EU policymakers for some time. The immediate precedents of current initiatives can be found in the initiatives by regulatory and political bodies between 2016-2018 amid substantial debate.[2] These included a Report by the European Banking Authority (EBA[3]), and European Central Bank (ECB) – SSM Guidelines,[4] as well as an Action plan to tackle NPLs in Europe, agreed by the ECOFIN Council,[5] followed by the European Commission Communication on completing the Banking Union, where NPLs played a salient role,[6] and were subsequently followed in 2018 by an "NPLs package",[7] which included proposals to amend banks' capital requirements,[8] and to harmonise the rules for credit servicers, purchasers and the recovery of collateral,[9] as well as a Blueprint for national asset management companies (AMCs).[10] These proposals were accompanied by EBA Guidelines in 2018.[11]

NPLs management is a controversial issue, as it entails dealing simultaneously with debtor-creditor relationships, banks' financial health, and inter-country concerns of macroprudential stability. Any of these issues would elicit social and political disagreement. Together, they form an even more complex mix. Indeed, there are examples in the past that illustrate these difficulties. The ECB Guidelines on NPLs led to an open disagreement with the European Parliament (EP), which challenged the supervisor for arguably overstepping its mandate.[12] The Commission proposal on credit servicers, purchasers and the recovery of collateral has not yet resulted in actual law. The Commission document regarding AMCs is a mere "Blueprint" for "national AMCs", which is distinctly underwhelming when compared with

[2] See e.g., the special issue of European Economy (2017). https://european-economy.eu/book-series/banks-regulation-the-real-sector/. We also contributed to the debate with a distinguished co-author. See Marco Lamandini; Giuseppe Lusignani; David Ramos Muñoz "Does Europe Have What it Takes to Finish the Banking Union? Non-Performing Loans (NPLs) and Their Hard Choices, Non-Choices and Evolving Choices". European Banking Institute Working Paper Series no. 17 (2017). A later version of the same paper was published in the Columbia Journal of European Law (2017) pp. 233-291 (hereafter: Lamandini; Lusignani; Ramos Muñoz, 2017). Some of our findings in this in-depth analysis are based on previous research.

[3] EBA Report on the Dynamics and Drivers of Non- Performing Exposures in the EU Banking Sector 22 July 2016. https://www.eba.europa.eu/risk-analysis-and-data/npls

[4] ECB Guidance to banks on non-performing loans, March 2017. https://www.bankingsupervision.europa.eu/banking/priorities/npl/html/guidanceonnpls.en.html

[5] Council conclusions on Action plan to tackle non-performing loans in Europe. 11 July 2017. https://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/.

[6] European Commission Communication on Completing the Banking Union . Brussels, 11.10.2017 COM(2017) 592 final (hereafter: Commission Communication on Completing the Banking Union).

[7] https://ec.europa.eu/info/publications/180314-proposal-non-performing-loans_en

[8] Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures. COM/2018/0134 final - 2018/060 (COD).

[9] Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral. COM/2018/0135 final - 2018/063 (COD).

[10] Commission Staff Working Document AMC Blueprint Accompanying the Second Progress Report on the Reduction of Non-Performing Loans in Europe COM(2018) 133 final. Brussels, 14.3.2018 SWD(2018) 72 final (hereafter: European Commission AMC Blueprint).

[11] EBA Final Report Guidelines on management of non-performing and forborne exposures. 31 October 2018. EBA/GL/2018/06.

[12] See, e.g., Letter by Antonio Tajani (President of the European Parliament) of 9 October 2017, and response by Danielle Nouy of 13 October 2017. See https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter171013_tajani_dn.en.pdf

proposals intended to change the law, or at least place the initiative at an EU level. This suggests that bolder approaches, like a proposal to e.g., set up an EU-wide AMC (or network of AMCs), or other alternatives to comprehensively deal with NPLs at a European level, were (at the time) discarded.

After, due to the COVID-19 crisis, future NPLs have become a priority again for the Commission, which has highlighted the importance of well-functioning secondary markets, securitisations and AMCs.[13] These ideas have been echoed by the SSM Chair, Mr. Andrea Enria (who had already advocated an EU initiative in this context in the past), in an EP hearing,[14] and simultaneously in the press, where he advocated an EU-level AMC.[15] Despite the changes in the economic outlook, it is possible that some of the old tensions may resurface again.

This sets the stage for this Briefing paper, which seeks to provide a technical assessment of the arguments for and against AMCs, in light of their efficiency in dealing with NPLs, namely:

a) whether we share the perception that AMCs are efficient tools for facilitating the management and recovery of NPLs, and (if so),

b) what the performance drivers of AMCs could be.

More specifically, we are asked to consider some specific factors of AMCs performance, including the following:

i. whether only favourable transfer price requirements (potentially to the detriment of the banks selling the NPLs) enable AMCs to profitably run down the portfolio of NPLs;
ii. whether AMCs pursue more efficient/more aggressive strategies than the originating banks to increase the recovery value of the NPL portfolio (potentially to the detriment of the debtors in default or in distress); and
iii. whether state-sponsored AMCs directly or indirectly command of other tools to increase the recovery value of the NPL portfolio, e.g. by support for planning and building permissions, public lease contracts etc. (potentially to the detriment of competitors in the market).
iv. Also, we were asked to consider whether the use of AMCs can have significant socio-economic consequences or raise concerns from a gender point of view. In such case, experts could provide recommendations on how to mitigate such concerns.

We begin by analysing the arguments that may justify public intervention in dealing with NPLs, and the arguments that may justify AMCs in general (2.2.) and describe the national experiences with AMCs within the EU (2.3.) In a subsequent section (3), we offer a breakdown of existing evidence regarding the questions we are asked to consider (3.1.) and discuss what are the determinants of success in NPLs management by AMCs on a deeper level (3.2.). Finally, we synthesise the analysis in a brief section of Conclusions (4).

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[13] Commission Communication. Tackling non-performing loans in the aftermath of the COVID-19 pandemic. Brussels, 16.12.2020 COM(2020) 822 final, pp. 6, 10-11.

[14] "Authorities should also prepare to help deal with the expected rise in NPLs. I fully support the Commission's work on a new action plan on NPLs, in particular to improve the functioning of secondary markets, and the securitisations could also play a role. Asset management companies have also proven to be efficient tools for facilitating the management and recovery of NPLs and a European initiative, for instance connecting in a network national AMCs, via common funding mechanisms and harmonised pricing, could be a useful tool for addressing the expected rise in NPLs and ensuring a level playing field within the banking union." Andrea Enria ECON Hearing. 27 October 2020. https://www.europarl.europa.eu/cmsdata/215274/CRE_SSM_Hearing_EN.pdf

[15] Andrea Enria "ECB: the EU needs a regional 'bad bank'" Financial Times October 26, 2020. https://www.ft.com/content/cc3a9a51-4d9a-4c73-9ff0-9f623ecf4065

2.2. Non-Performing Assets, government intervention and AMCs in the EU

If we must analyse the arguments that may justify policy-driven strategies for dealing with NPLs by means of AMCs in the EU, this means considering three separate questions. One, what is the rationale for (public) policy intervention in NPLs, or, more generally, "legacy assets", what is the rationale for setting up an AMCs, and what are the additional constraints within the EU context.

On the first question, the rationale for government intervention in the field of "legacy assets" (i.e., assets that have been in the company's balance sheet for a long time) is the market failure of a "market for lemons".[16] For NPLs, buyers perform a due diligence, but this is based on samples of the NPLs portfolio, and banks lack the information buyers need to accurately price the NPLs portfolio. This is compounded by uncertainty on recovery ratios, which depends on other factors (e.g., time for recovery, judicial efficiency, or macroeconomic conditions), which widen the bid/ask spread at the time of NPLs' sale. Tirole developed also a model to illustrate the effects of credit constraints,[17] where government optimally overpays for the weakest legacy assets to clear the market of "lemons," leaving firms with the strongest legacy assets in the market, thus reducing adverse selection enough to let the market rebound (but not excessively), to limit taxpayers' cost,[18] while other models argue that government intervention can have positive intertemporal effects, by subsidising trades only at an initial time.[19] All hinges on market liquidity and transparency. If both are severely undermined, government action may have less impact.

Under these premises, government intervention can address adverse selection and liquidity constraints, subsidising trade to restore confidence and incentivize the parties to trade,[20] while limiting it in time, so that parties do not postpone the decision to trade, and thus taxpayer losses are minimized. *This means that government intervention should help the market to close the gap between bid/ask prices created by negative information or shocks, which requires it to be of a certain scale to ensure markets' "thickness" to attract sufficient investors,[21] and conditions that minimize moral hazard.*[22]

On the second question, when dealing with NPLs, segregating non-performing assets in "bad banks" or AMCs is associated with a sharp reduction in the volume of NPLs.[23] The literature has identified a

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[16] Asymmetric information (sellers have more information about their assets than buyers) results in an adverse selection problem where holders of good assets are gradually driven away, leaving only lemons. George Akerloff, The Market for Lemons: Quality, Uncertainty and the Market Mechanism, 84 Q.J. Econ. 488 (1970).

[17] Tirole's model features firms (or sellers) that do not have enough cash to finance a new project but hold legacy assets with values unknown to a competitive financial market and are (the firms) credit-constrained by agency costs in the project, which means they must sell a share of the legacy asset. Potential buyers will be concerned about the quality of the legacy asset, which means that small adverse news in the market for legacy assets may generate a discontinuity in the volume of trade and prevent firms from accessing the funds they need to finance their project. See Jean Tirole, Overcoming Adverse Selection: How Public Intervention Can Restore Market Functioning, 102 Am. Econ. Rev 29 (2012) pp. 29 – 59.

[18] Id. See also Thomas Philippon & Vasiliki Skreta, Optimal Interventions in Markets with Adverse Selection, 103 Am. Econ. Rev. 1 (2012).

[19] Fuchs and Skrzypacz conclude that under a sufficient condition it is optimal to subsidize trades only at time zero while imposing prohibitively high taxes afterwards. See William Fuchs & Andrzej Skrzypacz, Government Interventions in a Dynamic Market with Adverse Selection, 158 J. Econ. Theory 371 (2015).

[20] Vitor Constâncio, Vice President of the ECB, Keynote Speech at Tackling Europe's Non-performing Loans Crisis: Restructuring Debt, Reviving Growth, Resolving Europe's NPL Burden: Challenges and Benefits, (Feb. 3, 2017). See also John Fell et al., Addressing Market Failures in the Resolution of Non-performing Loans in the Euro Area, in ECB Financial Stability Review 134 (Nov. 2016). Also the economic conjuncture may lead to very negative forecasts in terms of recovery values, despite government intervention.

[21] Giorgio Barba Navaretti et al., Getting Rid of NPLs in Europe, 2017 Eur. Econ.: Banks, Reg. & Real Sector, no. 1, 2017, at 11.

[22] Some authors, however, have argued that the risk of moral hazard tends to be overstated. Douglas Arner et al., Overstating Moral Hazard: Lessons from Two Decades of Banking Crises (Hong Kong University Faculty of Law Working Papers No. 2017/003, 2017) (hereafter: Arner et al.)

[23] Michael Brei, Leonardo Gambacorta, Marcella Lucchetta; Bruno Maria Parigi "Bad bank resolutions and bank lending" BIS Working Papers No 837 January 2020 (hereafter: Brei; Gambacorta; Lucchetta; Parigi); Maria Balgova, Alexander Plekhanov; Marta Skrzypinska "Reducing non-performing loans: stylised facts and economic impact, mimeo (2018); Stephanie Medina Cas; Irena Peresa "What Makes a Good 'Bad Bank'?

number of advantages associated with these strategies. Asset segregation reduces uncertainty over the asset values of the “good bank”, and improves its credit ratings, investors’ confidence, and thus its chances of access to funding.[24] It also helps the good bank managers to focus on “standard” bank lending.[25] Furthermore, since NPLs may have involved imprudent lending, separating them from the originating bank can lead to a more objective assessment of their value and subsequent strategies to deal with them.[26] Yet, authors also point out that their performance can vastly differ, and their implementation details matter greatly.[27]

On the third question, within the EU it is also important to do not only what is economically efficient, but also what is legally feasible. In this regard, the main constraints result from rules on State aid, which have had heavily influenced Member States’ manoeuvring space in dealing with NPLs. Transfer prices should not exceed the real economic value (REV) of NPLs (valuation band). REV is a term used by DG COMP to evaluate the existence of state aid (e.g., when transfer prices exceed REV) and it is based on a prudent estimate of an asset future cash flows, net of workout costs, discounted using an interest rate that also includes a risk premium.[28] Furthermore, NPLs value should be assessed through an independent valuation exercise applying a valuation methodology that is compliant with the requirements of the European Commission (independent valuation). Finally, bank losses should be shared among equity holders and subordinated creditors of the banks involved (burden sharing).[29]

2.3. AMCs and NPLs schemes in EU Member States. Idiosyncratic features

Despite our attempt to systematise performance drivers below, each NPLs crisis is different, and must be considered in its own merits. First, we describe the “first stage” AMC strategies, prior to the adoption of BRRD, including Germany (2.3.1.) Austria (2.3.2), Ireland (2.3.3.) Spain (2.3.4.) and Slovenia (2.3.5.), then “second stage” strategy of Hungary (2.3.6.) leaving in last place the Italian experience as a unique (and insightful) case, due to the diversity of strategies having been tried, and the long-time span during which they were implemented (2.3.8.).

2.3.1. First-stage schemes (I). AMCs and nationalization schemes (Germany/Austria)

The German example of NPLs management is too idiosyncratic to be used as a model for any EU-level scheme, but its peculiarities are also useful to understand which non-systematic factors can be crucial in designing an NPL strategy. The strategy that was adopted early in the financial crisis (2008) and was heavily reliant on Germany’s seemingly unlimited financial resources and sovereign bonds’ rating. The October 2008 *Finanzmarktstabilisierungsfondsgesetz* (StFG) established a state-guaranteed Fund (SoFFin), with up to 400 billion euro liquidity guarantees and up to 100 billion euro capital, managed

The Irish, Spanish and German Experience European Commission Discussion Paper 036 September 2016 (hereafter: Medina Cas; Peresa, 2016); S. Aiyar; W. Bergthaler; J. Garrido; A. Ilyina; K. Jobst; D. Kang; Y. Kovtun; D. Liu, D. Monaghan; M. Moretti “A Strategy for Resolving Europe’s Problem Loans”, IMF Staff Discussion Note No. 15/19 (2015) (hereafter: IMF 2015). For a reference of comparative analysis, see Daniela Klingebiel “The Use of Asset Management Companies in the Resolution of Banking Crises. Cross-Country Experiences. World Bank. Policy Research Working Paper 2284 (2001) (hereafter: Klingebiel, 2001).

[24] Brei; Gambacorta; Lucchetta; Parigi 2020.

[25] Medin; Peresa, 2016.

[26] IMF 2015.

[27] Klingebiel; Medina Cas; Peresa, 2016; Lamandini; Lusignani; Ramos Muñoz, 2017.

[28] See Christophe Galand, Wouter Dutillieux, and Emese Vallyon “Non-Performing Loans and State Aid Rules” European Economy 2017.1 p. 147 (Galand, Dutillieux, Vallyon, 2017); or Yassine Boughdene; Stan Maes “Relieving Banks from Toxic or Impaired Assets: The EU State Aid Policy Framework” Journal of European Competition Law & Practice, 2012.

[29] Communication from the Commission on the treatment of impaired assets in the Community banking sector (2009/C 72/01); Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (‘Banking Communication’) (2013/C 216/01).

by the newly established agency for financial stabilization (FMSA).[30] Together with the powers to nationalize failing institutions to facilitate liquidation (*Rettungsübernahmegesetz*)[31] a new Article 8(a) in the StFG granted FMSA and SoFFin the possibility to set up specialized winding down agencies to acquire and manage NPAs (*Abwicklungsanstalten*).[32] The *Erste Abwicklungsanstalt* (EAA), was established in December 2009 to manage the WestLB NPAs, and its ownership structure reflected the credit institutions under the program.[33] Yet, the *FMS Wertmanagement* (FMS-WM), was the most important in size and complexity, and was created to manage the NPAs of Hypo Real Estate (HRE) Holding,[34] as a subsequent step to its nationalization, and was thus established by the SoFFin, in the name and on behalf of the Federal Republic of Germany, and thus with a 100% public ownership. The transfer took effect through a company division or spin-off (*Spaltung*) (under which original companies remain liable[35]), but the original owners were squeezed out by FMSA before the FMS-WM's split off took effect, which made it possible to extend a public guarantee, which helped to stabilize it immediately,[36] and to transfer NPLs to the bad banks at their book value.[37]

Therefore, more than 'pure' cases of AMCs, the German experiences with "single purpose AMCs" exemplifies the use of AMCs as a second-step tool in a two-step nationalization or market exit process, where they are used as a specific mechanism to wind down all or a large portion of the assets of a specific financial institution that has been subject to nationalization or closure. Other examples of this approach include the use of HETA Resolution AG in Austria to manage the nationalization of Hypo Alpe Adria.

2.3.2. First-stage schemes (II). The Irish NAMA

The National Asset Management Agency was established by the homonymous Act of December 2009 (NAMA Act),[38] taking advantage of Eurostat rules, which considered the debt of special purpose vehicles (SPVs) that were majority-private-owned as not part of government debt[39] if temporarily established to address the financial crisis. The 51/49% public/private ownership was balanced out by a shareholders agreement granting NAMA veto power over certain decisions.

This also permitted NAMA DAC to operate as a "professional" bad bank, using different companies, specialized in different areas and services, e.g. separating loan management and property management.[40] NAMA's funding was structured through National Asset Management Limited

[30] Finanzmarktstabilisierungsfondsgesetz [FMStFG], Oct. 17, 2008, BGBl I, at 1982 (Ger.).

[31] Rettungsübernahmegesetz [RettungsG], Apr. 7, 2009, BGBl I, at 725 (Ger.).

[32] Finanzmarktstabilisierungsfortentwicklungsgesetz [FMStFEntwG], July 17, 2009, BGBl I, at 1980 (Ger.).

[33] This was in accordance with the special rules set out in FMStFG, art. 8(1), 1, 8. In the WestLB case, the EAA was established by Sparkassenverband Westfalen-Lippe (25%), by Rheinisher Sparkassen and Giroverband (25%), and by the Land of North Rhein Westfalen and its related entities for the other 50%.

[34] https://www.fms-wm.de/de/.

[35] Bad banks were classified as non-banks, which enabled them to draw up their balance sheet under German accounting principles instead of the International Financial Reporting Standards (IFRS).

[36] For EAA the guarantee also worked because the North Rhein Westfalen had a rating as high as that of the federal government.

[37] Thus, EAA was the recipient of participations, loans and securities in its banking book with a notional value of EUR 155 Billion, and a trading book composed mainly of derivatives (primarily interest rate and currency transactions) with a notional value of EU 1 trillion. See Erste Abwicklungsanstalt (EAA) Annual Report 2014, p. 5. FMS-WM was the recipient of assets with a nominal value of EUR 175.7 Billion and derivatives with a notional value of about EUR 350 Billion. See FMS Wertmanagement AöR Annual Report 2011 pp. 44, 53, 122.

[38] Available at http://www.irishstatutebook.ie/eli/2009/act/34/enacted/en/pdf. This was more than a year after the adoption of the 2008 Financial Support Act, when the Irish government stepped in and guaranteed all deposits and liabilities of Irish banks for about 375 billion euro, more than double the Irish GDP. The Act granted the Ministry's power to issue binding directions (see https://www.nama.ie/about-us/governance/legislation/) and regulated NAMA's annual accounts and quarterly reports.

[39] Medina Cas & Peresa, at 16.

[40] For further detail, see https://www.nama.ie/about-us/group-structure.

(NAML):[41] its securities, conveyed to the transferring banks in exchange for the NPLs, received a state guarantee and could be used as collateral in central bank refinancing operations.[42]

2.3.3. First-stage schemes (II). The Spanish SAREB

Spain established its AMC, the *Sociedad de Gestion de Activos procedentes de la Restructuración Bancaria* S.A. (SAREB) as a special condition of the Memorandum of Understanding (MoU) signed in July 2012 with the European Commission, which governed the 100 billion euro loan to support the banks' restructuring. The MoU required that assets, in the balance sheets of banks that received aid, have to be swiftly removed, and placed in an AMC, which could hold them to maturity. The banks sold the assets (80% loans, 20% real estate) in exchange for a "suitably small" equity participation in the AMC, which could hold them to maturity. SAREB was set up according to the special provisions of Act No. 9/2012 and of Royal Decree No. 1559/2012, with a duration of 15 years, and is currently composed of 25 private investors holding 54% of its share capital and by the Spanish resolution fund holding the remaining 46%.[43] SAREB issued equity and subordinated debt for about 4.8 billion euro and all additional funding was collected through the issuance of senior debt assisted by a state guarantee, so that it could be used as collateral in central bank refinancing. The SAREB equity and debt was acquired by the nine banks listed in Article 48 of the Decree No. 1559/2012 against the NPLs transferred to SAREB, an overall consideration of about 50 billion euro at a discount price on the relevant book value of about 63% for real estate and 45.6% for credits. The management of the transferred assets remained with the transferors under an appropriate service agreement until December 2014 and was then assigned to four specialized entities on January 1, 2015.[44] SAREB's winding down has been complex, including additional provisioning and conversion of subordinated debt into capital (2016), inroads into "active" strategies like development, or the use of SOCIMIs, i.e., Real-Estate Investment Trust-like vehicles (2017-2019) and sale of real estate for social housing (2019-2020).[45]

2.3.4. First-stage schemes (IV). The Slovenian DUTB

The Slovenian NPL crisis was focused primarily in businesses, not households. State-owned banks obtained funding in wholesale European markets and fueled an increase in corporate debt. Once such wholesale funding dried up abruptly in 2009, it exposed unsustainable debt levels. The stress test of the country's main banks showed vulnerabilities, which made it necessary a recapitalization by the State, which, in turn, showed the need for a market-wide NPLs strategy. The response was to set up the Družba za upravljanje terjatev bank (DUTB - Bank Assets Management Company BAMC[46]), which was

[41] Since the scheme transferred from the banks' balance sheet NPEs for a total price of EUR 31.2 Billion, senior debt was issued for about EUR 30.2 Billion (95% of the total); the remaining 5% was subordinated debt. Senior debt is expected to be fully repaid by the end of 2017 (at May 2017, 98% of senior debt was already repaid). Subordinated debts are expected to be repaid by March 2020, and the scheme is currently targeting a profit of about EUR 2 Billion.

[42] The full text of the state guarantee is available at https://www.nama.ie/fileadmin/user_upload/GuaranteeOfTheMinister ForFinance.pdf.

[43] Act 9/2012, of 14 November, of Restructuring and Resolution of Credit Institutions, and Royal Decree 1559/2012, of 15 November, which establishes the legal regime of asset management companies. The information on SAREB's shareholders is available on https://www.sareb.es/es_ES/conoce-sareb/que-es-sareb/accionistas-y-bonistas.

[44] The four entities were Altamira Asset Management, which was awarded the portfolios of Catalunya Caixa, BMN and Caja3, representing over 49,000 real estate and financial assets and 29% of SAREB's total portfolio value; Haya Real Estate, which was awarded the 49,500 property sector loans originated by Bankia and later acquired by SAREB, which represent 39.7% of the total value of the Company's portfolio; Servihabitat, which was awarded the entire portfolios of Banco de Valencia, NovaGalicia Banco and Liberbank, with a combined total of over 32,000 loans and properties; and Solvia, which was awarded the portfolios of Banco Gallego and Banco Ceiss, as well as the real estate assets of Bankia, with a combined total of 46,500 assets. See SAREB, Annual Activity Report 2016 at 122 (2016), https://www.sareb.es/file_source/web/contentInstances/documents/files/Annual%20report%202016.pdf.

[45] See the summary in SAREB Informe de Actividad. Semestre 1 2020. https://www.sareb.es/file_source/web/contentinstances/documents/files/informe_actividad_1s_2020.pdf.

[46] https://dutb.eu/en/.

established in 2013, with planned closure in 2022. BAMC manages a diverse asset portfolio, consisting of claims, equity and real estate, coming from systemically important banks. Its capital (funded by the State) started low in March 2013, but in December 2013 it was increased with a €200 million transfer of government bonds from the Ministry of Finance. BAMC, however, is mostly funded by debt, which is guaranteed by the Republic of Slovenia. Slovenia's main problem is corporate lending, and thus BAMC was created to facilitate the restructuring of banks with systemic importance that were facing severe solvency and liquidity problems. Nonetheless, it seems that this restructuring task has been difficult, due to the political sensitivity of restructuring large companies.[47]

2.3.5. Second-stage schemes. The Hungarian MARK

The effects of the Great Financial Crisis (GFC) in Hungary were compounded by its high public debt: private consumption declined more, but investment recovered more quickly (possibly due to the fact that it was part of the German supply chain, and received structural and cohesion funds[48]). Although, technically, it did not experience a financial crisis, the slow recovery, subdued lending and rise in NPLs (accompanied by increased litigation) corresponded to those of a financial crisis.[49] NPLs rose accordingly. One challenge was dealing with consumer loans, which were particularly contentious. For this purpose, a new Personal Bankruptcy Law was adopted, which ended a moratorium on evictions. Another challenge was dealing with NPLs secured by commercial real estate. For this purpose, the central bank set up a centralized AMC, the Magyar Reorganizációs és Követeléskezelő Zrt. (MARK – Hungarian Reorganization and Receivables Management Ltd.)[50] It was established in 2016, with planned closure in 2026, as already said to deal with NPLs secured by commercial real estate and real estate assets. The different strategies to deal with NPLs were effective in reversing the NPL ratio, and achieving low NPLs rates in new loans.[51]

2.3.6. Italy's trial-and-error experience until the setting up of AMCO, and lessons learned

The Italian experience with NPLs is possibly the most prolific of a European country in terms of experimentation. Thus, it is worth talking about asset-management schemes (AMS) rather than AMCs in a stricter sense, to encompass a broader range of solutions, and learn from them. It is also especially pertinent to explore the complementarities between two mechanisms often seen as alternatives, such as AMCs and securitisation schemes, as we will do below.[52]

Italy was a latecomer in addressing the NPLs challenge. Part of this occurred because, even though the slowdown of its economy began in fall 2011, the full scope of the slowdown did not become apparent in the overall quality of its banks' assets until the beginning of 2013. In November 2015, the Bank of Italy adopted a resolution scheme under BRRD for four mid-size banks under temporary administration,[53] transferring NPLs to a bespoke AMC, REV-Gestione Crediti S.p.A with 136 million euro in capital wholly subscribed by the national resolution fund. However, the real economic value (REV)

[47] The workings of DUTB were subject to different parliamentary debates. See Alexander Lehmann Carving Out Legacy Assets: A Successful tool for bank restructuring? March 2017, p. 12.

[48] Hungary: Selected Issues. IMF Country Report No. 17/124. May 2017.

[49] Ibid p. 7. Nonetheless, growth in GDP per capita recovered faster than in other Southern or central European countries.

[50] http://www.markzrt.hu/index.html

[51] Hungary. IMF Country report No. 17/124.

[52] Infra 3.3.5.

[53] Banca delle Marche, Banca dell'Etruria, Cassa di Risparmio di Chieti, and Cassa di Risparmio di Ferrara. The banks totalled 30 billion euro in assets and 1% of Italian deposits.

applied to the portfolio transfer was perceived as overly severe[54], far from solving the problem, stirred a system-wide fall of investor and depositor confidence. On the assumption that a similar REV could be applied as benchmark to evaluate the NPLs of all other Italian banks this prompted a market's a reassessment of Italian banks' balance sheets under the benchmark of NPLs' REV and a general mistrust, also prompted by a perception of recovery procedures (and the judicial system) as inefficient, and of recovery ratios as unstable.[55] Thus, the government's next move were individually-based securitisation transactions to segregate impaired assets with a state guarantee over senior securities (a measure based on Irish and Spanish experiences[56]) where approval by the Commission was conditional on the issuance of two tranches of notes or more[57] (which meant that some market party had to acquire the junior tranche), plus the supervision of a monitoring trustee, and the outsourcing of collections to a service provider other than the transferor (or companies in its group).[58]

These transactions had an in-built weakness: despite the state guarantee, the NPLs could only be subject to de-recognition from banks' balance sheets if the majority of junior and mezzanine securities were sold,[59] which compounded a problem of loss recognition (upon transfer) with one of finding willing purchasers.[60] Public authorities and publicly-owned companies were also banned from investing.[61] This led to minimize as much as possible the junior and mezzanine components of these transactions (admittedly, adopting an overly optimistic approach in the tranching exercise) and to identify a buyer of last resort for the more risky notes. Thus, in late April 2016 the Fondo Atlante (or Atlas Fund) was created, a government sponsored "hybrid" Alternative Investment Fund (AIF) established by Quaestio SGR to invest in bank shares and NPLs securitisations tranches. Despite the fund's impressive name, however, its resources were modest.[62] Thus, these measures were accompanied by further legislative reforms on the law of secured transactions to address the

[54] The NPLs transferred amounted to 8.5 billion euro (Gross Book Value). The Italian government supported the initiative with Decreto Legge 22 novembre 2015, n.183, G.U. Nov. 23, 2015, n.273 (It.) The consideration was 1,5 billion euro, a 17.65% of their gross value, a REV reportedly dictated by DG COMP. Ignazio Visco, Governor, Banca d'Italia, Statement to the Indagine conoscitiva sulle condizioni del sistema bancario e finanziario italiano e la tutela del risparmio, anche con riferimento alla vigilanza, la risoluzione delle crisi e la garanzia dei depositi: Hearing on Senato della Repubblica, IV Commissione Permaente (Finanze e Tesoro) (Apr. 19, 2016), https://www.bancaditalia.it/pubblicazioni/interventi-governatore/integov2016/audizione-governatore-19042016.pdf, subsequently adjusted, after a final independent expert valuation to 1.8 Billion. See Banca d'Italia, Rendiconto del Fondo nazionale di risoluzione: Anno 2015, at 7 (2016).

[55] Luisa Carpinelli, Giuseppe Cascarino, Silvia Giacomelli; Valerio Vacca "The management of non-performing loans: a survey among the main Italian banks" Questioni di Economia e Finanza Banca d'Italia no. 311 February 2016, p. 15, point to a downward trend of 8% in recovery rates between 2011 and 2014, from 45% and 37%.

[56] Decreto Legge 14 febbraio 2016, n.18, G.U. Feb. 15, 2016, n.37 (It.), converted into Legge 8 aprile 2016, n.49, G.U. Apr. 14, 2016, n.87 (It.).

[57] Articles 3–13 L. n. 49/2016 (It.). The guarantee could be granted once the overall scheme was approved by the Commission (and under the on-going supervision of a monitoring trustee) and required that: (i) NPLs were transferred to a SPV for a price not exceeding their net book value; (ii) the SPV, to finance the deal, had to issue at least two different tranches of securities, one senior and one junior, unless one or more mezzanine classes are also issued with an intermediate level of subordination; (iii) only senior securities are eligible to the state guarantee, provided they receive an investment grade rating by a credit rating agency accepted by the ECB. The state guarantee was at the time issued by CONSAP S.p.A., a state-owned company.

[58] Article 5(4) L. n. 49/2016 (It.).

[59] Article 8 L. n. 49/2016 (It.).

[60] Needless to say, forced sales are not desirable deals for the seller and a dramatic gap between bid and ask prices is its inescapable rule. As for the pricing of the State guarantee on senior notes, the European Commission confirmed that its being completed on market terms ensured that the proposed scheme was indeed aid-free, as it also included remuneration in line with market conditions for the risks taken by the State that also depends on the maturity of the notes: all in all, this should not confer any undue advantage to the participating banks and SPVs. Commission Decision in Case SA.43390 (2016/N) – Italy – Italian Securitisation Scheme, C (2016) 873 final (Feb. 10, 2016).

[61] Article 8(3) L. n. 49/2016 (It.)

[62] This fund had a 4.3 Billion endowment, a duration of five years (extendable to eight), was participated in by 67 financial institutions and other qualified investors, including Cassa Depositi e Prestiti, and was authorized to invest up to 70% of its assets in ailing banks and at least 30% in distressed debt. Quaestio Capital Management SGR S.p.A., Atlante Fund Presentation 4, 5 (Apr. 29, 2016) http://www.quaestiocapital.com/sites/default/files/Quaestio_Atlante_Presentation_29_4_2016EN_0.pdf. Article 17 of the same L. n. 49/2016 (It.) expressly authorized Italian AIF to invest in loans, detailing the applicable rules.

inefficiencies in recovery and restructuring procedures,[63] although the situation with two Venetian banks (Banca Popolare di Vicenza and Veneto Banca) threw markets into turmoil again.[64]

One of the ancillary provisions of the 2016 secured transactions law transferred to the Ministry of Economy the entire share capital of SGA-Società per la Gestione di Attività S.p.A., the AMC established in 1996 to give effect to the Banco di Napoli bail-out, the largest Italian bank rescue before the 2007-2013 financial crisis.[65] The AMC's "resurrection" shows that, for purposes of NPLs strategies, using existing structures may be better than improvising (much time could have been saved if SGA had also been used for the 2015 management of the 4 banks' NPLs, instead of creating a bespoke AMC from scratch). Second, the experience with SGA's 1996 assets invites reflection about NPLs transfer prices.[66]

Another batch of measures were those referred to Monte dei Paschi di Siena (MPS), which included a precautionary recapitalization with burden sharing,[67] but only after cleansing its balance sheet from 27.7 billion euro NPLs (gross-terms at March 30, 2016) through an SPV-based securitisation with a senior tranche (covered by cash flows from higher quality secured assets, with investment grade ratings and a state guarantee); a mezzanine tranche (backed by flows from unsecured assets), underwritten by Fondo Atlante 2,[68] and a junior tranche, backed by flows from lower-quality unsecured assets, allocated free of charge to existing MPS shareholders, to ensure de-recognition of NPLs from MPS's balance sheet and leaving shareholders the possibility of an upside.[69]

On June 25, 2017 Law Decree No. 99 provided for the winding up of Banca Popolare di Vicenza and Veneto Banca, and all NPLs and other assets *not* transferred to Intesa San Paolo under the scheme were transferred by the Treasury to SGA.

By then, it seems, the lesson was learnt. A sounder policy that combined centralisation with building on experience resulted in SGA's full transition from bad bank to full credit management company, which came along also with the change in the company name (now AMCO). The major steps of this evolution can be summarized as follows:

(a) on February 2019, the AMC successfully placed, via a private placement, its first tranche of senior unsecured bonds for 250 Million (listed at the Luxembourg Stock Exchange), in October 2019 a second tranche for 800 Million, in July 2020 two additional tranches for 2 Billion (receiving demands for over 5 Billion);

(b) on 29 November 2019, its capital was increased to 600 Million (plus 400 Million surcharge). This was necessary to support Banca Carige restructuring and the acquisition of its NPL assets (including those of Banca Monte Lucca and Banca Cesare Ponti in the group) in December 2019, for which there was scarce appetite in the market;

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63 See the discussion at infra 3.2.3.

64 The undersubscribed capital increase of Banca Popolare di Vicenza (needed to prevent insolvency) made it necessary for Fondo Atlante to step in and subscribe the entire capital increase, followed by the bank's temporary administration, followed by that of Veneto Banca. To prevent public institutions from calling on additional private moneys to support a resolution via the resolution fund, banks and other market players anticipated a bail-in, footing the bill of the attempted rescue and retaining the governance of the ailing bank in an attempt to prevent contagion and additional reputational damage. This was insufficient to save both banks, because of hidden losses and malpractice in equity financing in violation of prudential requirements, and both banks were liquidated in June 2017, with Intesa San Paolo acquiring the assets under Decree No. 99/2017.

65 Decreto Legge 24 settembre 1996, n.497, G.U. Sep. 1996, 25, n.225 (It.) converted into Legge 19 novembre 1996, n.588, G.U. Nov. 21, 1996, n.273 (It.). At the time of the transfer SGA had become a liquidity chest (more than 500 Million, expected to become at run off of all recovery activities almost 700 million). Its capital was previously held by Intesa San Paolo, but pledged in favor of Bank of Italy.

66 Infra 3.2.1.

67 Decreto Legge 23 dicembre 2016, n.237, G.U. Dec. 23, 2016, n.299 (It.) then converted into Legge 17 febbraio 2017, n.15, G.U. Feb. 21, 2017, n.43 (It.).

68 This was a second AIF specialized in NPLs established by Quaestio in July 2016.

69 See Bruno Inzitari, Crediti deteriorati (NPL), aiuti di stato nella BRRD e nella Comunicazione sul settore bancario del 30.7.2013 della Commissione europea, LXIX Banca, borsa e titoli di credito, 641, 650 n.10 (2016).

(c) from 2018 to date AMCO entered into a series of major NPLs transactions as follows:

Table 1: Securisation transactions by AMCO

Date	Seller	Type of transaction for AMCO	Type of assets (non-performing loans, unlikely to pay and past dues)	Gross book value
April 2018	Veneto Banca Banca popolare Vicenza	Portfolio acquisition pro soluto with segregated assets (patrimoni destinati) via Article 58 TUB – primary servicer	NPLs, UTP, PD	18 Billion
June 2019	Banca del Fucino	Securitisation Master servicer Special servicer	NPLs, UTP, PD	300 Million
December 2019	Istituto Credito Sportivo	Portfolio acquisition pro soluto via Article 58 TUB – primary servicer	NPLs	50 Million
December 2019	Banca Carige Banca Monte di Lucca Banca Cesare Ponti	Portfolio acquisition pro soluto via Article 58 TUB – primary servicer	NPLs, UTP, PD	2,8 Billion
December 2019	Ampre SPV (Cuvéè)	Securitisation Master servicer Special servicer	UTP	450 Million
March 2020	Creval	Portfolio acquisition pro soluto via Article 58 TUB – primary servicer	NPLs	177 Million
June 2020	Banca Popolare di Bari	Portfolio acquisition pro soluto via Article 58 TUB – primary servicer	NPLs, UTP	2 Billion
August 2020	Creval	Portfolio acquisition pro soluto via Article 58 TUB – primary servicer	NPLs UTP	270 Million
December 2020	MPS	Demerger of MPS NPEs in a compendium with other assets, liabilities and equity	NPs, UTP PD	8,1 Billion

The last regulatory intervention in the field is, so far, Law 17 July 2020, No 77, whose Articles 168-172 provide a bespoke public support for the orderly liquidation of small banks (assets up to 5 Billion), inclusive of state guarantees and fiscal advantages for the acquirer (not yet applied, to the knowledge of the authors).

3. AMCS' EFFICIENCY AND PERFORMANCE DRIVERS. FACTORS TO CONSIDER IN A HYPOTHETICAL EU-LEVEL SCHEME

Having analysed the instances where AMCs have been used in the past to deal with NPLs crises in Member States, the current section provides a critical analysis of those experiences.

- First, we briefly provide a context for the analysis, explaining why NPLs strategies, including AMCs are back, in light of past, underwhelming initiatives (3.1);
- Second, we provide some stocktaking of AMCs initiatives in Member States in light of the specific questions presented to us, and the risks of State-backed AMCs that those questions pointed at (3.2); and
- In third place, we try to go beyond the concrete questions and risks, to analyse the factors underpinning AMCs success, or failure (3.3).

3.1. Why AMCs, why now: the shortcomings of past, underwhelming proposals

There has been no shortage of EU policies and proposals to deal with NPLs in the past. Thus, a legitimate question is whether a new emphasis on the issue is needed, and why past efforts are insufficient to deal with the problem. The answer is twofold. *One set of factors concern the new, and unique situation presented by the COVID-19 crisis.* Unlike the GFC, followed by the European sovereign debt crisis, the COVID crisis is prompted by an exogenous shock, which means that the ensuing financial distress cannot be attributed to past regulatory failures at the Member State level. This makes EU-level solutions more acceptable in principle, as it has happened with the Recovery and Resilience Facility.[70]

However, a second set of factors is related to the fact that past policy proposals to deal with NPLs arguably failed to provide a decisive response. In some cases, the microprudential approach followed by, e.g., the ECB, encountered political resistance. In others, the proposed reforms were stalled, as it happened with the proposal to harmonise the rules for credit purchasers, services, and the recovery of collateral. Yet, even if these initiatives apply in full, they still represent an exclusively microprudential approach to the issue. *Since NPLs pose microprudential and macroprudential problems,*[71] *one leg of the problem would be overlooked.* The unwillingness to deal with this leg may be due to the reluctance to any measure that could look like a hidden "transfer" of resources between Member States (e.g., mixing some States' 'good' credit with other states' 'bad' credit). How much this factor weighed in the discussion cannot be stated with certainty. However, the fact is that, in contrast with proposals for a *regulation* to amend the CRD, and of a *directive* on credit purchasers, servicers, and recovery of collateral, when it came to AMCs the Commission settled with a "Blueprint", which left full discretion to Member States.

Furthermore, the Blueprint's language is also eloquent. It refers only to the "domestic", "national" or "Member State" banking "system",[72] and not once to the EU or Eurozone as a "system" of its own. The

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[70] See Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility.

[71] Lamandini; Lusignani; Ramos Muñoz 2017.

[72] European Commission AMC Blueprint, pp. 5, 8, 10, 22, 24, 40, 41, 44, 48.

Blueprint does not make any reference to the Single Market, or the Capital Markets Union (CMU), despite securitisation is discussed in the Blueprint's menu of solutions,[73] and is also a prominent part of the CMU plan.[74] Securitisation is presented by the Blueprint as an alternative to AMCs,[75] based on individual banks. Both are inserted in an overall vision where the market is fragmented, rather than one that tries to deepen the Single Market.

The fact that this initial NPL package was based on providing Member States with the means to deal with NPLs but did not deal itself with the problem at an EU-level, together with the COVID crisis' unique features, justifies re-visiting the issue. Nonetheless, that does not mean that AMCs or other centralized strategies should be pursued uncritically. In this regard, EU Member States have sufficient experience dealing with AMCs to be aware of the opportunities and risks they present.

3.2. Stock-taking of AMCs and their risks: transfer prices, subsidies and social impact

The aggregate analysis of different experiences with AMCs shows that certain features depend on the nature of the NPLs problem, while others tend to be associated with good results across the board. Nonetheless, a legitimate question is whether AMCs offer genuine benefits, i.e., they constitute mechanisms to create value, or they are simply mechanisms to shuffle losses around. This general concern can be sub-divided into three specific issues, which we were asked to consider. First, we analyse the risk of punitive transfer prices for NPLs (3.2.1.) Second, we consider the risk of hidden subsidies that skew competition (3.2.2.) Finally, we consider together the risk of aggressive recovery strategies and the broader social impact of NPLs strategies (3.2.3.) For each issue, we open with a summary table, and close with a possible exemplary question.

3.2.1. Transfer price requirements: the role of State aid rules

Table 2: Summary of findings on transfer prices

Issue	Punitive transfer prices
Evidence	No clear evidence of excessively steep discounts. Criticism in Ireland for average discounts of 58% (above market price). In Spain, despite discounts of 52%, subsequent write-offs. Problem: short valuation process, complex portfolio, uncertainty of some assumptions (e.g., development plans). Slovenia: 71% discounts, objective valuation process. Hungary: market prices.
Deeper issues	Problems: (i) anchoring effect of loans' accounting value; (ii) sale under distressed conditions; (iii) emphasis on market values in presence of market failure. The issue seems to be the focus on market values or short-to-medium term REV in a context where markets have failed, and recovery may be long-term.

In this report we were asked to consider whether only favourable transfer price requirements (potentially to the detriment of the banks selling the NPLs) enable AMCs to profitably run down the portfolio of NPLs. Nonetheless, to provide an adequate answer, three introductory considerations are in order. First, the risk associated to transfer prices is not one-sided, i.e., it is important to consider not only the risk of excessive discounts for the transferring banks, but also the risk of excessively generous prices (which could for instance fail to incorporate the, albeit necessary, recovery volatility risk

[73] European Commission AMC Blueprint p. 76.

[74] Commission Communication. Action Plan on Building a Capital Markets Union. Brussels, 30.9.2015 COM(2015) 468 final, p. 21. See also Commission Communication. A Capital Markets Union for people and businesses-new action plan. Brussels, 24.9.2020 COM(2020) 590 final, Action 6.

[75] AMCs Belueprint p. 76.

premium). *Thus, any assessment needs to consider both possibilities*. Second, any *ex post* assessment of transfer prices is prone to hindsight bias. It is tempting to attribute an AMC's subsequent benefit to the initially large discounts in transfer prices, but what matters is whether the assets seemed under-priced when they were transferred or were transferred using a flawed valuation mechanism. Third, even if there is controversy over the haircuts received by the assets, this may be due (i) partly to the anchoring effect of their valuation in the balance sheet of the transferor, which, in turn, may be due more to the bank's reluctance to acknowledge losses than to the NPLs' actual value[76] and (ii) partly to the acquirer's expected rate of return on capital (if this is significant, it needs to build from the outset on a favourable REV). Transfers to publicly-backed AMCs are considered impaired asset measures (IAMs) and thus have to be compatible with State aid rules and the Impaired Assets Communication (IAC), which requires that the asset transfer price does not exceed the REV, but does not set any floor for a market value lower that the REV; REV should in principle reflect the long-term economic value of the assets based on underlying cash flows and broader time periods, and assessed (with all limitations which by necessity constrain any, albeit technically sound, future telling exercise) by independent experts.[77] This puts a ceiling (REV) on the transfer price to account for the risk of overpricing the NPLs, while relying on the transferor's incentives not to underprice them. This works when the transferor retains some bargaining or decision-making power, but less so when the sale is obligatory, prompted by a decision by the regulator or competition authorities, which makes it doubly important that valuation procedures are adequate, a market for NPLs is liquid and efficient, and if this is not the case, a fair backstop solution remains available (as it could typically be an efficient state sponsored AMC, with a profitable business not oriented however to double digit returns on capital, as it is often the case with market players like hedge funds or restructuring funds). Still, a remaining challenge is to calculate a market price in the absence of a market.[78] The Commission tends to use **adjusted benchmarking**, i.e., to take the price observed for assets similar to those affected by the impaired asset measure, and then adjust it pursuant to the quality of the assets.[79] *The different AMC schemes have all passed the test of State-aid rules, and there seems to be no obvious evidence of excessively punitive valuations,* and although there are some examples of possibly optimistic valuations this may be due to the intrinsic characteristics of the asset portfolio and the valuation process.

In the case of **Germany**, the schemes and restructuring plans for WestLB and HRE were deemed compatible with State aid rules because of the functional and organizational separation between beneficiary bank and the assets (to prevent conflicts of interest), and the burden-sharing ex ante with the equity write-off of bank capital (and squeeze out of shareholders), and ex post with the presence of claw-back clauses and completion of in-depth restructuring, and the inclusion of an adequate remuneration for the state, taking into account the risks of future losses exceeding those projected in the determination of the REV of the portfolio.[80]

In the case of **Ireland**, the Commission found that the asset relief scheme was apt to remedy a serious disturbance in the Irish economy, and that the implemented measures abided by the requirements of ex ante transparency and disclosure of impairments, as well as by rules on burden sharing of the costs

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76 Brei; Gambacorta; Lucchetta; Parigi, 2020.

77 Communication from the Commission on the treatment of impaired assets in the Community banking sector (2009/C 72/01) para. 40-43. Furthermore, they must lead to the restoration of the long-term viability of the bank, include a sufficient contribution (burden sharing) by the aid beneficiary itself, and include the installation of sufficient measures to limit any distortion of competition. Commission Communication on the Return to Viability and the Assessment of Restructuring Measures in the Financial Sector in the Current Crisis Under the State Aid Rules, 2009 O.J. (C 195) 9.

78 Galand, Dutillieux, Vallyon, 2017.

79 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01) recitals 85, 101.

80 Commission Decision on State Aid C 17/09 by Germany for the Restructuring of Landesbank Baden-Württemberg, 2010 O.J. (L 188) 1.

related to the transfer of assets between the government and the banks' shareholders and creditors, and by the rules on remuneration.[81] while the NPLs' acquisition value determined in line with Part 5 of the NAMA Act and the Valuation Regulations was set as the loans' long-term economic value, taking into account the current market value of the collateral securing the loans and discounts to account for, e.g., difficulties in enforcement or title. The valuation process was long (almost eighteen months, from March 2010 to October 2011) and protracted (the transfer occurred in nine tranches for a gross value of 74 billion euro) and resulted in a discount of 57% on NPLs net book value, leading to a loss of more than 28 billion euro.[82] In the case of **Spain** SAREB also respected State aid criteria:[83] the Commission closely monitored the valuation methodology for the impaired assets transferred between 2012 and 2013 under the EU financial assistance program, and found the asset transfer in line with State aid rules, due to its being based on the estimated long-term REV of the assets and the application of a discount (transfer price was 5-10% below projected REV), to account for AMC expenses and a negative short-term outlook for divestment of the assets. Still, SAREB wound down assets at a slow pace,[84] it has suffered further losses, which have required a write-down and conversion of capital and subordinated debt instruments.[85] As the composition of its portfolio has become less based on loans, and more by real estate, it has transferred assets to municipalities and regions for purposes of social housing or moved into development.[86] This shows that even an objective valuation depends on assumptions whose accuracy may also depend on the timeframe, economic situation, and the nature of the assets themselves. If we compare NAMA and SAREB, NAMA's assets were located 54% in Ireland and 33% in the UK, and at least the latter appreciated as macroeconomic conditions improved, while Spain took longer to turn the corner of the crisis. Second, unlike NAMA, SAREB had many more small loans, which are more difficult and time-consuming to manage, and their value hard and time-consuming to estimate. In light of this, SAREB's valuation process was quite quick, and could thus be less accurate, but time is often not in great supply when it comes to setting up AMCs. Third, unlike NAMA, SAREB had much real estate and loans to developers, where the value depends very much on the development plans of regions and municipalities, which were put on hold or scrapped altogether; even if reactivated, the realization of value requires developing the land, which explains SAREB's move into these activities. With the benefit of hindsight, it might have been desirable to have more time for the valuation, allocate more human resources to manage the NPLs, and have a closer liaison with the local authorities responsible for development plans. In **Slovenia**, DUTB was established with the idea of avoiding fire sales under distressed conditions, to bide for time, and let prices stabilize; nonetheless, it developed a valuation methodology for claims (based on restructuring or recovery), real estate (based on the methodology of the Slovenian Surveying and Mapping Authority) and equity holdings (discounted cash flow), accompanied by an exit process that tried to ensure a good exit price (including the

[81] The Commission also considered the measures involving State guarantees and asset transfers compatible, as "the remuneration of the State [was] embedded in the purchase price," with a 170 bp margin being "added to the . . . Irish government bond yield for the relevant maturity used to discount the assets' expected long-term cash flows." Commission Decision on the Establishment of a National Asset Management Agency (NAMA), in Case N725/2009 (Ireland), C (2010) 1155 final (Feb. 26, 2010).

[82] See, e.g., NAMA Annual report and Financial Statements for 2012, p. 21. See also Commission Decisions on State aid N 331/2010 - Ireland Transfer of the first tranche of assets to NAMA, 3.8.2010 C(2010) 5425 final; or SA.38562 (2014/N) - Ireland Transfer of the last tranches (from tranches 3 to 9) of assets to NAMA, 29.07.2014 C(2014) 5364. The banks also remained exposed to the risk associated to the subordinated notes held in exchange and to the possible introduction of a tax to cover the operating losses of the agency.

[83] See Commission Decision on State Aid SA.35253 (2012/N) – Spain, Restructuring and Recapitalisation of the BFA Group, C (2012) 8764 final (Nov. 28, 2012).

[84] From 2012 to 2016 only 21% of its portfolio had been wound down. In 2020 the figure for the total portfolio was 36,5%, and a 54% of loans (thus, the portfolio is increasingly formed by real estate). See SAREB Informe de actividad. 1er semestre 2020 p. 5.

[85] Ibid p. 8. The write-downs included EUR 259 million in 2014, EUR 719 million in 2015, and additional write-downs in 2016, with provisions of EUR 2,044 million. In May 2016 a conversion of EUR 2,171 million of subordinated debt into capital was approved, to handle write-downs to its portfolio.

[86] SAREB Informe de actividad. 1er semestre 2020, pp. 17-18.

restriction of not selling exposures to the original debtor[87]). The case of **Hungary** was even less debatable, since the MARK, the country's AMC purchased NPLs backed by commercial real estate (CRE) and repossessed CRE at hypothetical market prices.[88] Still, the Hungarian case presented the challenge of calculating such hypothetical market prices in the absence of a market.[89] Thus, the adjusted benchmarking approach was used, and MARK purchased assets at a transfer price not exceeding the market price calculated using an adjusted benchmarking approach, and therefore the measure was deemed aid-free.[90] In the case of **Italy**, the evidence is mixed, as the experience is based not only in the latest crisis, but on the establishment of SGA in 1996. NPLs by Banco di Napoli and its subsidiary Isveimer were transferred to SGA at their net book value for about 6.7 billion euro (a 30% median provisioning over nominal value) with a later downward adjustment of 1.5 billion euro. After 20 years of operation, SGA recovered 90.1% of its NPLs' net value.[91] Thus, around 50% of their gross value can be recovered. In contrast, the REV applied to the NPLs of the four banks resolved in December 2015 was 22% of their gross value, or in the transfer of NPLs from MPS, at a sale price equal to 33% of their gross book value, but eventually at a much lower price.[92]

Thus, in this context it is very detrimental of the public interest being both overly optimistic and overly pessimistic. Contractual ingenuity may help finding the right balance. Indeed, the uncertainty over the accuracy of REV, especially in presence of uncertain recovery ratios, raises the possibility of combining prudent REVs with earnout provisions that let transferring banks benefit from an upside, while also aligning incentives.[93] An alternative to earnout provisions may be using an asymmetric demerger of the NPLs to the AMC, with assignment of AMC's shares to the existing shareholders of the transferring bank, as recently tested in Italy with the MPS demerger of late 2020, or in the Spanish SAREB, through the transfer of equity.

Topic	Question
Transfer prices	Should NPLs strategies try to accompany an assessment of transfer prices with earnout provisions that leave the upside gains to the seller? Should NPLs strategies take into account the complexity of the NPLs portfolio and the human resources needed to manage it?

[87] https://dutb.eu/en/valuation-and-exiting-processes/

[88] Commission Decision. State Aid SA.38843 (2015/N) – Hungary Asset purchase programme by the Magyar Reorganizációs és Követeléskezelő Zrt., a Hungarian Asset Management Company. Brussels, 10.2.2016 C(2016) 820 final (Commission Decision Hungarian AMC).

[89] Galand, Dutillieux, Vallyon, 2017.

[90] For offices outside the Budapest area a benchmark price per square meter was used (the average price of observed transactions was used, given the limited number o observed office transactions). Commission Decision Hungarian AMC

[91] i.e., original gross value less the initial sale discount, after further provisioning adjustments. Mariarosaria Marchesano, Miracolo Bad Bank (2d ed. 2016); the data reported by this book are also discussed by Luigi Zingales, Quel "tesoretto" della bad bank el Banko di Napoli, Il Sole 24 Ore, (Aug. 20, 2016) (hereafter: Zingales).

[92] The difference is a relevant one and should not be overlooked, even if one takes into account recovery costs (0.5 billion euro), the payment of interest on the Bank of Italy liquidity facility (1.7 billion euro), and the two decades spent to fully accomplish the process, a feature common with other Italian experiences of bank distresses, like Sicilcassa, whose liquidation is still ongoing after almost two decades. The two decades also permitted SGA to reach higher recovery ratios by accomplishing realization of real estate guarantees mostly during periods of booming real estate markets (at least until 2008). See Zingales. On top of this, a recent study of Bank of Italy found that in the period 2006–2015, recovery ratios on NPLs were overall in line with their net book value (41% at December 2015) since the median recovery ratio has remained around 43% in the last decade. This was 35% in the years 2014–2015 due to massive sales of NPLs portfolios at a median price of 23%. Secured NPLs outperform unsecured by 55% against 36% and retail borrowers outperform corporate borrowers in their repayment capacity of NPLs (53% against 40%). See Federica Ciocchetta et al., I tassi di recupero delle sofferenze, 7 Banca d'Italia – Note di stabilità finanziaria e vigilanza 1 (2017). A more limited sample was considered by Luisa Carpinelli et al., La gestione dei crediti deteriorati: un'indagine presso le maggiori banche italiane, 311 Banca d'Italia – Questioni di Economia e Finanza, Occasional Papers 1 (2016).

[93] Infra 3.3.4.

3.2.2. Competitive conditions or hidden subsidies

Table 3: Summary of findings on potential anti-competitive conditions or subsidies

Issue	Distortion of competition
Evidence	Criticism of NAMA's financing of developers. However, the Commission found no evidence of illegal state aid. Isolated (and not strongly substantiated) mentions of "unfair" advantages of FABs in Spain.
Deeper issues	Problems: (i) change in perceptions about the benefits of competition in a crisis and post-crisis environment; (ii) open argument about whether it is correct for AMCs to engage in real estate development (even to maximize returns). Key: open procedures for AMC selection of third-party providers (services, developers), and interactions with authorities.

The second aspect we were asked to address was whether state-sponsored AMCs directly or indirectly command of other tools to increase the recovery value of the NPL portfolio, e.g., by support for planning and building permissions, public lease contracts etc. (potentially to the detriment of competitors in the market). In relation to this question, there have been instances where the actions of some national AMCs have come under scrutiny for allegedly granting, or being granted, conditions that somehow hindered competition. In **Ireland** five property developers filed a complaint in 2015 alleging that NAMA distorted competition in the Irish property development market by granting loans to property developers that were NAMA's creditors at conditions more favourable than those available in the market, and that NAMA itself benefitted from illegal State aid measures, including a State guarantee on its funding. The European Commission looked into the issue without finding any evidence of subsidies.[94] In large part, the case entailed a re-examination of aspects that have already been cleared by the Commission when the NAMA scheme was approved: the transfer of assets at above market price (but not above their REV) and the government guarantee of bonds benefitted the transferring banks, which received a price higher than what they would have obtained in the market, and paid in safe and liquid assets (which could be used for ECB operations[95]). The key (alleged) difference was, in this case, the involvement of NAMA in funding property developers. Yet, the Commission noted that such activities were within NAMA's mandate, and that it had behaved like a market economy operator in the pricing of new loans, restructuring of other loans, and performing viability assessments, for which the Commission relied on ample evidence suggesting that NAMA had, indeed, behaved in such a way, trying to maximise its commercial return, and thus the return for the State.[96]In **Spain** some similar concerns have been echoed in the press,[97] as SAREB has responded to the gradual shift in its portfolio from loans towards real estate by entering the activity of real estate development through *Fondos de Activos Bancarios* (FAB), a kind of SPV subject to a 1% tax rate. In this case, however, the adjudication of FABs followed a competitive process, no complaint was filed before the Commission, and we cannot but note that SAREB keeps struggling, both financially, and in its efforts to unwind its portfolio, due to the fact that an increasingly large part of the real estate in its portfolio needs to be developed to yield any returns.

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[94] European Commission State Aid SA.43791 – Ireland Alleged aid to and through the National Asset Management Agency Brussels, 25.01.2018 C(2018) 464 final (NAMA State Aid Decision SA.43791 2017).

[95] NAMA State Aid Decision SA.43791 2017 recitals (76) – (86).

[96] NAMA State Aid Decision SA.43791 2017 RECITALS (89) – (91).

[97] "SAREB prepara el landamiento de varios FAB para colocar ladrillo libre de impuestos" El Confidencial5 July 2019. https://www.elconfidencial.com/empresas/2019-07-05/sareb-varios-fab-especializados-libre-impuestos_2106963/

The broader point, however, has to do with the role that an AMC is supposed to perform, especially in a post-crisis environment. Here it is important not to confuse four different kinds of arguments.

One is a "time inconsistency" argument. At the peak of the crisis a widespread perception of market failure may strongly justify public intervention, and the willingness to minimize taxpayer losses may justify an AMC mandate to maximize returns. Once the crisis recedes, public perceptions may be more market-friendly but the AMC's design may reflect the priorities of the moment when it was established. Changing the mandate, or operational conditions (thus limiting the AMC's returns) just because perceptions have changed would not send a positive signal to subsequent crises, and banks may abstain from participating in the NPL/AMC scheme.

A second argument is an "efficiency" or "specialisation" argument. Some studies suggest that AMCs characteristics make them better suited for disposing of NPLs than for more complex tasks, such as "restructuring".[98] This could suggest that even more complex tasks, like developing real estate, are unsuited for AMCs. Yet, whether an AMC ends up with a large portfolio of undeveloped real estate in its portfolio is only partly a matter of design: if the nature of the crisis is such that bank portfolios are burdened with loans to developers backed by such real estate, like it happened in Ireland, and even more acutely in Spain, an AMC that does not take on those loans may operate more neatly but will not solve the systemic problem. Once those loans are transferred, managing the real estate may not be a matter of choice for the AMC. If the borrowers default the options are limited to restructuring, foreclosure or forbearance. In the last two cases, developing the land (by the AMC or the original borrower with a vendor financing from the AMC) may be the only option to maximize returns. In fact, liaising with local authorities responsible for development may be a necessity, and something a private developer would be forced to do. If the AMC mission is not just passive collection but active management and this is done efficiently and with strategic vision (as it may well be, if the assets under management are really sizeable), this may even turn a concern into an opportunity. This is more a matter of "how" to ensure the proper conditions, hence the next argument.

A third argument is a "procedural" argument. This accepts all the above premises, i.e., an AMC has to develop the functions stipulated in its mandate, and this may entail performing tasks more complex than the mere disposal of NPLs if this maximizes the return of the portfolio. However, that does not mean that the AMC itself has to perform all those functions; in fact, third parties will most likely be needed: servicers for recovery and/or restructuring, and property developers for development. Then, the key question is how those third parties are selected. In the NAMA case, even if the arguments examined by the Commission suggested no wrongdoing, there were less details concerning the selection of the developers, some of which appeared to be the original borrowers, and no details about why financing the original developers was more efficient than, e.g., foreclosing on the real estate and auctioning the development rights. To strengthen this aspect, AMCs could use an intermediated model, where third parties are selected following an open, transparent procedure, which resembles as closely as possible competitive market conditions.[99] In addition to this, AMCs should ensure that they have a clear exit strategy.

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[98] This is related to the distinction between the "warehouse model" and "factory model" of AMCs. The former relies merely on time for assets to recover their value. The latter is necessary when there is no near-term growth. See Medina Cas; Peresa, 2016.

[99] For examples of this, see, e.g., article 38(5) of regulation 1303/2013, of 17 December 2013, laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund. See also article 21 of Commission Regulation 651/2014, of of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

In this regard, a first finding is that a (entirely or partially) state-owned AMCO can play a useful market role even in the context of a market populated also by private actors. This is shown by the Italian example, which shows for instance that, even when, like in 2017, an active private market for NPLs was still flourishing (also thanks to the state guarantee (GACS) on SPV senior securities), many important but less popular NPLs transactions could be performed only because there was a state-owned AMC ready to act as final backstop.[100]

Thus, by way of preliminary inference, it seems that existing approaches to AMCs tend to focus on simple models of NPLs liquidation. Given that certain asset classes create complications for that model, they tend to sidestep those assets, and to pay less attention to more active roles for the AMC. The problem is that NPLs crises do not necessarily fit the designs of policymakers, by concentrating on the more easily manageable assets, nor ask the authorities permission. If an NPLs crisis leaves a complex portfolio of legacy assets, an AMC strategy that focuses on "simpler" asset types (corporate and CRE) may work well with those assets, but may not fix the systemic problem; an AMC that focuses on a speedy recovery strategy may spread contagion (although so far, none of the AMCs have followed this approach), and an AMC that follows a passive, or hands-off approach, may fail to identify the cases where maximizing value may require active strategies, like restructuring or additional investment (e.g., through land development).

Even if it may make sense to adopt a broader perspective on AMCs that helps tailor them to different kinds of NPLs crises, a final question is whether supervision or resolution authorities should be concerned about this. A strict reading of the relevant provisions on bank supervision and resolution could suggest that the authorities should only focus on the steps until the transfer is completed (after that, the assets are the property of the AMC, which is unlikely to have a banking license, and ceases to be under the purview of resolution (or supervision authorities). Yet, in our view, the provisions should be read more broadly, and supervisory and resolution authorities should be concerned with the design features that determine how the NPLs will be managed. In the case of resolution, avoiding adverse effects on financial stability, including contagion, or protecting public funds are resolution objectives,[101] which do not (or should not) cease to be relevant when NPLs are transferred. Thus, an AMC strategy that addresses "messier" NPLs classes not only seems pertinent, but also a concern for resolution authorities. The answer may be in devising procedures to ensure that the AMCs can liaise with public authorities (e.g., for land development permits) under conditions of openness and integrity, and that they can interact with market operators under, e.g., an intermediated model, where servicers and similar service providers are selected under open market and competition conditions. In light of this, the following question could be asked:

Topic	Question
AMCs relationship with authorities and market operators	Should AMC-NPLs strategies be better prepared for assets that may require active management, and an interaction with between AMC third-party providers, on one side and authorities on another side? Should we learn from successful experiences (e.g., intermediated models) to select third parties?

[100] Compare the data available at KPMG Non-Performing Loans in Italia. Trend in atto e prospettive future, 2018, p. 25

[101] Article 14 (1) and (2) (b) of Regulation 806/2014, of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (SRM Regulation).

There is, of course, an argument of a different kind, one that would question that whether a government-backed AMC only seeks (or should only seek) to maximize financial returns, even at the expense of social goals. This is discussed in the next point.

3.2.3. The social impact of NPLs: the first big gap in the EU's NPLs strategy

Table 4: Summary of findings on AMCs and social or gender issues

Issue	Social impact
Evidence	No clear evidence of comparably more aggressive enforcement strategies. Counterintuitive given an AMC has greater public visibility than banks. Both AMCs and banks more reluctant to enforce. The case may be different with distressed debt funds.
Deeper issues	Main problem: the social (also including gender) dimension of NPLs, and the interplay between social stability and financial stability are absent from the EU NPL strategy. AMCs could be considered within a broader NPLs strategy that uses a data-driven, technically sound approach to maximize economic value while being conscious of the social impact.

In third place, we were asked to consider whether AMCs pursue more efficient/more aggressive strategies than the originating banks to increase the recovery value of the NPL portfolio (potentially to the detriment of the debtors in default or in distress). Here we will also address the broader point of the socio-economic and gender perspective of NPLs strategies.

Studies point out that AMCs are not more efficient at restructuring assets, and enforcement and foreclosure seem to depend more on the efficiency of a country's legal system (positive side of efficiency).[102] This correlation was neatly exposed in the case of Italy. As discussed above, part of the mistrust by investors and depositors between 2015-2016 was based on the perceived unreliability of recovery procedures, and recovery data for NPLs. Therefore, in May 2016 a new Law Decree[103] (which also addressed the problem of mis-selling the subordinated debt of four banks for which the resolution scheme had been adopted in 2015 to retail investors)[104] reformed certain aspects of the inefficiency of the judicial system's recovery processes.[105] The new law was based on the reform of previous expropriation proceedings and on two major pillars:[106]one, a reform of secured transactions law that authorized the pledge without dispossession, and the direct transfer to the mortgagee bank of mortgaged real estate

[102] Brei; Gambacorta; Lucchetta; Parigi, 2020.

[103] Decreto Legge 3 maggio 2016, n.59, G.U. May 3, 2016, n.102 (It.) then converted into Legge 30 giugno 2016, n.119, G.U. Jul. 2, 2016, n.153 (It.). See Elisa Brodi, Il sistema delle garanzie in Italia: una lettura economica delle disposizioni in materia di privilegio, pegno e ipoteca, 356 Banca d'Italia – Questioni di Economia e Finanza, Occasional Papers 1 (2016); Elisa Brodi, Brevi note sull'utilizzabilità dell'art. 48–bis TUB per la gestione delle sofferenze bancarie', Rivista trimestrale di diritto delle procedure di risanamento dell'impresa e del fallimento 1–17 (2017).

[104] Article 1, ¶ 855, of Legge 28 dicembre 2015, n.208, G.U. Dec. 30, 2015, n.302 (70/L) (It.) had already established a scheme for their reimbursement, but the new Law improved and streamlined it under several respects. See Articles 8–10 L. n. 119/2016 (It.).

[105] As already noted, as of December 2016, NPEs totaled 173 Billion in net value, 9.4% of the banks' assets; NPLs equaled 81 Billion, 4.4% of the banks' assets. Panetta, statement supra note **Error! Bookmark not defined.**, at 2–3. The problem was the duration of the proceedings and the weakness of credit security in a macroeconomic scenario. A median of 4.2 years to enforce a guarantee on a real estate in an execution proceeding, with very uneven territorial distribution: from a median of 2.8 years in Bologna to a median of almost 8 years in many southern courts. Bankruptcy proceedings showed, in turn, an even longer median duration: 7.6 years. Ministero della Giustizia, Dipartimento dell'Organizzazione Giudiziaria del personale dei Servizi, Direzione Generale di Statistica e Analisi Operativa, Durata media effettiva dei procedimenti definiti in materia di esecuzioni immobiliari per distretto e circondario 1 (2015).

[106] Decreto Legge 27 giugno 2015, n.83, G.U. Jun. 27, 2015, n.147 (It.) (converted into Legge 6 agosto 2015, n.132, G.U. Aug. 20, 2015, n.192 (50) (It.)). The legal measures focused on speeding up of procedural terms setting up a digital single marketplace for assets sold in insolvency and expropriation proceedings.

("patto marciano") after a nine-months delinquency, with a priority equivalent to a mortgage[107] (in both cases, allowing out-of-court enforcement), and, two, a public register with all relevant judicial data concerning recovery proceedings, to improve NPLs level of transparency.[108]

On the negative side (aggressiveness) there seems to be no evidence of AMCs' aggressive recovery or enforcement strategies. This seems in line with the fact that they are more visible than individual banks, and thus likelier to be in the spotlight. Furthermore, aggressive enforcement strategies may be controversial when involving retail loans (e.g., if they involve foreclosures or evictions). Yet, a large part of AMCs' portfolio has been formed by corporate assets (including corporate loans, loans to developers, or project finance loans). In the case of mixed portfolios, like that of Spain's SAREB, the foreclosures over the real estate backing loans to developers has proceeded without much consequence (other than gradually transforming an AMC into a real estate or development company). In the case of retail loans and residential properties, SAREB promoted evictions in foreclosed properties that had been occupied, i.e., the people evicted were not the original borrowers, and had no legal right or claim over the properties, and yet the SAREB engaged with social services to seek solutions, and still faced some criticism in the press. Eventually, it sold some of the occupied properties to distressed debt funds, and these may have engaged in aggressive strategies. Yet, had SAREB not been present, this might have occurred earlier, and without engagement with social services. Thus, evidence suggests that AMCs are not characterized by aggressive recovery strategies that pursue efficiency at the expense of social impact: their portfolio is not primarily integrated with the kind of assets susceptible of such trade-offs, and even when it is, AMCs are more likely to suffer backlash than private operators. Not surprisingly, the Italian AMCO developed bespoke strategies for the fair treatment of retail borrowers to prevent social unrest due to aggressive foreclosures.

The answer to this specific question, however, should not obscure the more important fact: there is a shortage of comprehensive studies of the rapport between the relational and social dimension of NPLs, and the financial stability dimension of the issue. This may be explained by the tendency of policy initiatives to sidestep the social dimension. The AMC Blueprint clearly indicates that AMCs should primarily be used for CRE but not for residential real estate (RRE) because of the difficulties of realizing collateral, nor for unsecured retail loans.[109] The salient feature of this approach is its exclusive focus on the (in)efficiency of recovery (with no reference to its side effects) and the fact that it puts together the "social" dimension with political interference.[110] The message seems to be clear: NPLs to people are messy, and thus AMCs should not get involved with them. The EBA follows the same approach: loans over residential property are problematic because banks are reluctant to enforce the loans over collateral, and that causes the volume of loans to remain high.[111] This is placed in a context that

[107] Article 2(13–bis) L. n. 119/2016 (It.). Perpetual liability is, thus, now derogated in Italy in several cases: see Articles 120–quinquiesdecies Decreto Legislativo 1 settembre 1993, n.385, G.U. Sep. 30, 1993, n.230 (It.); Article 142 Regio Decreto 16 marzo 1942, n.247, G.U. Apr. 6, 1942, n.81 (It.); Article 14–terdecies Legge 27 gennaio 2012, n.3, G.U. Jan. 30, 2012, n.24 (It.); Article 11–quaaterdecies Decreto Legge 30 settembre 2005, n.203, G.U. Oct. 3, 2005, n. 203 (It.). Article 2 extended the measure, in this case on a non-recourse basis and after 18 months of delinquency, also to new mortgages to retail borrowers by Decreto Legislativo 21 aprile 2016, n.72, G.U. Jun. 20, 2016, n.117 (It.).

[108] Article 3 of L. n. 119/2016 (It.).

[109] Commission AMC Blueprint pp. 12-13.

[110] Commercial real estate (CRE) assets offer relatively easier value recovery in this regard than residential real estate (RRE). This has an impact on the suitability of these assets for inclusion in AMCs. Realising collateral for RRE will be highly problematic due to legal, social and political realities. Therefore, the AMC should only in exceptional cases be considered as the instrument to do so […] Other asset classes, mainly unsecured retail loans, are more suitable for other types of impaired asset measures and should not be considered for transfer to the centralised AMC. The duration of these loans are often shorter, offering less time for the AMC to recover any sufficient value. Furthermore, they have the dual downside of potential political interference and very small individual loan sizes that lead to high complexity and costs related to servicing". Commission AMC Blueprint pp. 12-13.

[111] "the share of household loans that are past due for more than 1 year has increased over the same period […] For social and political reasons, banks might be more reluctant to tackle aggressively household NPLs (e.g. to foreclose residential property, especially primary residences). In addition, the legal framework and impediments to foreclose collateral vary significantly across countries". And in the conclusion: "recent

highlights the (in)efficiency of the judiciary process as the main problem by banks in countries with above-average NPL ratios.[112]

This view, i.e., to stay on the technical level of efficiency in recovery and try (if possible) to leave retail and small-business loans out, seems the prevailing view in policymaking. Yet, it has obvious limitations. Reluctance towards enforcement (even among judges) or political interference may be flawed responses to a perceived absence of informed, technically competent solutions to serious social issues. It may also be a way to not tackle directly complex issues like the compatibility between (too) efficient enforcement procedures and social rights (of constitutional relevance) calling for instance for a more pronounced homestead exemption for defaulted borrowers in home mortgages, with very little revenues and no other living alternatives.

"Relationship banking" has long been a subject of economic analysis. Early studies (theoretical and empirical) emphasized the informational advantage of banks with closer bank-customer relationships,[113] and argued that relationship banking generates a surplus,[114] at least for small borrowers (which may reverse as firms grow[115]). Other studies highlight that relationship banking explains a higher probability of default (because banks are readier to grant riskier loans to long-term customers) but supports the presence of informational rents.[116] Some have suggested that cutting the bank-borrower relationship is important to predict the bank's investment of time and effort in borrower screening, i.e., banks relaxed borrower screening under an originate-to-distribute model based on securitisation.[117]

The studies mentioned above tend to focus on the influence of different relational aspects in the probability of default (PD). Other studies have focused on the loss-given default of loans, i.e., the amount of money a bank loses *once* a borrower defaults, measured as a percentage of the total exposure (roughly, the money owed) at the moment of default; [118] some focusing on factors like collateral, or the efficiency of the legal system;[119] but some also suggesting that relational aspects such as amicable settlements between bank and borrower have a significant positive influence on the

quarters' data suggest that the pace of reduction in the NPLs has been slowing down in the past few quarters. […]a number of reasons […] the most important being the fact that older legacy assets may be more difficult to resolve, also given the inefficiency of the legal framework and judicial processes of some European countries. In addition to this, a large part of the legacy assets are mortgage loans that banks tackle with caution due to social aspects. Therefore, additional effort is still needed to further reduce the NPLs in line with pre-crisis levels". EBA NPLs Report 2019, pp.22, 60.

112 EBA Report on NPLs 2019, p. 55.

113 Steven A. Sharpe "Asymmetric Information, Bank Lending and Implicit Contracts: A Stylized Model of Customer Relationships" Journal of Finance Vol. 45, No. 4 (Sep., 1990), pp. 1069-1087; Mitchell A Petersen; Raghuram G. Rajan "The Benefits of Lending Relationships: Evidence from Small Business Data" The Journal of Finance Vol. 49 No. 1 (1994) pp. 3-37.

114 T. Hoshi; A. Kashyap; D. Scharfstein "The role of banks in reducing the costs of financial distress in Japan", Journal of Financial Economics vol. 27 (1990) pp. 67-68; M.B. Slovin; M.E. Sushka; J.A. Polonchek "The value of bank durability: Borrowers as bank stakeholders", Journal of Finance vol. 48 (1993) pp. 289-302.

115 As firms grow, those with narrower firm-bank relationships are more credit-constrained. Houston, J. F. and C. M. James (2001): "Do relationships have limits? Banking relationships, financial constraints and investment", Journal of Business 74, pp. 347-374.

116 Gabriel Jiménez; Jesús Saurina "Collateral, type of lender and relationship banking as determinants of credit risk" Journal of Banking and Finance vol. 28 (2004) pp. 2191–2212.

117 Uday Rajan Amit Seru; Vikran Vig "The failure of models that predict failure: Distance, incentives, and defaults" Journal of Financial Economics vol. 115 (2015) pp. 237–260.

118 Technically, it is "the ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default;" Article 4 (55) of Regulation 575/2013.

119 Stefano Caselli; Stefano Gatti; Francesca Querci "The Sensitivity of the Loss Given Default Rate to Systematic Risk: New Empirical Evidence on Bank Loans" Journal of Financial Services Research vol. 34 (2008) pp. 1–34; Hong Wang; Catherine S. Forbes; Jean-Pierre Fenech; John Vaz "The determinants of bank loan recovery rates in good times and bad – New evidence" Journal of Economic Behavior and Organization vol. 177 (2020) pp. 875–897.

recovery rate.[120] The relational aspect is not only present in the individual bank-client relationship, but also in a social dimension. Social capital is fundamental in financial development,[121] and seems to have effects in loan spreads and access to finance.[122] In an *ex post*, enforcement scenario, heightened foreclosures have negative implications for house prices in a locality and can thus affect performance of other borrowers in the community.[123]

On gender the picture is similar. There is no shortage of studies on the influence of gender on risk behaviour, including experiments suggesting that all-male markets are more prone to asset price bubbles,[124] men tend more towards overconfidence (and thus lower their returns[125]). As borrowers, women are likelier to pay back loans,[126] less likely to enter bankruptcy,[127] and yet they may receive higher interest rates and worse terms.[128] Observable evidence may, however, be explained by the differences in the nature and size of the businesses owner respectively by men and women,[129] or the fact that, due to the expectation of being turned down, women apply for funding less often,[130] or offer higher interest rates.[131] Acting as lenders, women seem less likely to grant NPLs than men,[132] or to deviate from the system's credit risk score, i.e., to grant a loan when the system does not support it.[133] As directors, more gender-balanced boards seem to make a bank less prone to take on risk.[134] At the policymaking level, EU authorities like the ECB are taking some steps to promote diversity in bank

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[120] Peter-Hendrik Ingermann; Frederik Hesse; Christian Bélorgey; Andreas Pfingsten "The recovery rate for retail and commercial customers in Germany: a look at collateral and its adjusted market values" Business Research vol. 9 (2016) pp. 179-228 (based on data from German NPLs held by Bankaktiengesellschaft Hamm (BAG), founded to resolve the troubled Hammer Bank Spadaka eG.

[121] Luigi Guiso; Paola Sapienza; Luigi Zingales "The role of social capital in financial development". American Economic Review, vol. 94 (2004), pp. 526–556.

[122] Paolo Emilio Mistrulli; Valerio Vacca "Social capital and the cost of credit: evidence from a crisis" Banca d'Italia. Working Papers. No. 1009 (2015) (rise in loan spreads for firms headquartered in localities with lower social capital was more pronounced than for firms headquartered in localities with higher social capital).

[123] Vicki Been; Mary Weselcouch; Ioan Voicu; Scott Murff "Determinants of the incidence of U.S. Mortgage Loan Modifications" Journal of Banking & Finance vol. 37 (2013) pp. 3951–3973.

[124] C.C. Eckel; S.C. Fülbrunn Thar she blows? "Gender, competition, and bubbles in experimental asset markets" American Economic Review, vol. 105 (2015) pp. 906-920.

[125] B. B. Barber; T. Odean "Boys will be boys: Gender, overconfidence and common stock investment Quarterly Journal of Economics, vol. 116 (2001), pp. 261-292.

[126] A. F. Alesina; F. Lotti; P.E. Mistrulli "Do women pay more for credit? Evidence from Italy" Journal of the European Economic Association vol. 11 (2013), pp. 45-66 (hereafter: Alesina; Lotti; Mistrulli, 2013).

[127] S. Khandker Microfinance and poverty: Evidence using panel data from Bangladesh. The World Bank Economic Review vol. 19 (2005) pp. 263-286.

[128] Alesina, Lotti, Mistrulli; D.V. Mascia; S.P.S. Rossi "Is there a gender effect on the cost of bank financing?" Journal of Financial Stability, vol. 31 (2017), pp. 136-153 (finding evidence of discrimination across 11 European countries). However, see also D.G. Blanchower, P.B. Levine; D.J. Zimmerman "Discrimination in the small-business credit market. Review of Economics and Statistics, vol. 85 (4) (2003) pp. 930-943.

[129] M.L. Stefani; V.P. Vacca "Credit access for female firms: Evidence from a survey on European SMEs. Questioni di Economia e Finanza (Occasional Papers), 176 (2013).

[130] Alesina, Lotti, Mistrulli 2013

[131] N. Barasinska; D. Schäfer "Are women more credit-constrained than men? Evidence from a rising credit market" FINESS Working Paper No.D.6.3. (2010).

[132] T. Beck; P. Behr; A. Guettler "Gender and banking: Are women better loan officers?" Review of Finance vol. 17 (2013) pp. 1279-1321.

[133] José G. Moltalvo Marta Reynal-Querol "Gender and Credit Risk: A View From the Loan Officer's Desk". Barcelona GSE Working Paper Series Working Paper nº 1076. March 2019.

[134] Giovanni Cardillo; Enrico Onali; Giuseppe Torluccio "Does gender diversity on banks' boards matter? Evidence from public bailouts" Journal of Corporate Finance (2021 in press).

boards.[135] However, the approach on NPLs policies seems to be gender-neutral (to an advocate) or gender-blind (to a critic).[136]

NPLs strategies in general, and AMCs in particular are supported by sensible arguments, which justify a partial severance of the link between the original lender and borrower, when informational and relational advantages cannot outweigh the costs of managing a large volume of NPLs, or the information asymmetry between bank and third parties. *Yet, that does not mean that the relational, and social, dimensions should be overlooked. "Efficiency" and "socially-conscious" dimensions are not at odds.* Inefficient legal procedures, or absence of pre-packaged bankruptcy arrangements increase the economic cost *and* social cost.[137] However, there can be frictions too. Lack of protection of borrowers can disincentivize information production by financial institutions, which means that one of their key social functions (credit intermediation) would not be present.[138] A disposal strategy that places in the hands of different funds loans that affect different parties in a single area or community can create a coordination problem, where each creditor has an incentive to enforce and foreclose, but this is not socially optimal if it depresses prices in that area or community.

The point is not that social goals should trump over efficient recovery; only that there are trade-offs and complementarities, which are currently not being considered (at least, not openly). There are possible reasons for this, which invite caution, but do not look entirely convincing. First, limiting the arguments to corporate NPLs and sidestepping retail loans does not mean that these and other more socially controversial categories of NPLs will be unscathed. If the (in)efficiency of the legal system is a major determinant of loss-given default (LGD), the answer will be widespread reform of creditor enforcement and bankruptcy. Reformed legal provisions regulating enforcement and bankruptcy should, and most likely will, be consistent at their core.[139] This means that they will affect retail borrowers as well. Thus, any such reform should consider the impact beyond the category of loans that forms part of the NPLs strategy, because retail borrowers will be affected as well. Second, the fact that relational (bilateral and social) aspects are harder to measure than variables like the time or value of recovery does not mean that they should be entirely overlooked. So far, the views of EU institutions and authorities seem to be shaped by the perspective of government and judiciary civil servants,[140] and banks.[141] Even if gathering the perspective of borrowers is more difficult, it would be important to have it as well; in fact, it looks odd to pursue a line of reforms without a comprehensive viewpoint. Third, EU authorities may wish to avoid giving ammunition to populist movements, which may advocate greater

[135] See, e.g. response by Andrea Enria on 14 February 2019 to a letter by MEP Sven Giegold, regarding the appointment of temporary administrators at Banca Carige(https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.mepletter190218_Giegold~bd06c67112.en.pdf). See also a mention in a recent Speech by Elizabeth McCaul "Bank boards and supervisory expectations". 3 December (2020.https://www.bankingsupervision.europa.eu/press/speeches/date/2020/html/ssm.sp201203~4c2c39db9d.en.html)

[136] EBA Report on NPLs 2019; Felix Steffelk Analysis of Individual and Collective Loan Enforcement Laws in the EU Member States. Report commissioned by the European Commission. 2019 (Steffelk Commission Report 2019); EBA Report on the Benchmarking of National Loan Enforcement Frameworks EBA/Rep/2020/29. No mention is made of any gender dimension.

[137] Caselli; Gatti Querci; Hinh D. Khieu; Donald J. Mullineaux; Ha-Chin Yi "The determinants of bank loan recovery rates" Journal of Banking & Finance vol. 36 (2012) pp. 923–933 (pre-packaged bankruptcy plans are relevant for loan recovery rates).

[138] Louise Gullifer; Ignacio Tirado "A Global Tug of War: A Topography of Micro-Business Financing" Law and Contemporary Problems vol. 81 (2018) pp. 109-134.

[139] For example, one of the frictions in the Hungarian legal system identified in 2014-2015 was a Civil code provision that considered a pledge/mortgage to be novated or "newly established" where the contractual position to which the security was accessory was transferred. See EBRD, Ernst & Young, White & Case Analysis of Corporate restructuring and Insolvency in Hungary, 23 February 2015. A reform that introduced a new "independent lien" was passed in 2016. See, e.g., Balász Bodzasi "Reregulated Non-accessory Lien in the New Hungarian Civil Code" Hungarian Journal of Legal Studies vol. 58 (2017) pp. 206-223. The reform, although prompted by the above considerations, was obviously not limited to the subset of loans that were subject to Hungary's NPL strategy, but encompassed all loans.

[140] See, e.g., Felix Steffelk Analysis of Individual and Collective Loan Enforcement Laws in the EU Member States. Report commissioned by the European Commission. 2019.

[141] EBA Report on NPLs 2019, p. 55.

political interference with NPLs strategies. In this, they seem to follow the practice of multilateral institutions, like the IMF, which try to keep the assessment of AMCs and similar strategies objective by focusing exclusively on measurable outcomes, like disposal and recovery rates, leaving out other considerations.[142] Yet, even accepting this argument in its own terms, the IMF experience is mixed, and trying to avoid controversy may be the surest path to being placed on the wrong side of it. Furthermore, rigor and transparency in the measurement of social costs may be a step towards their minimization, and, in turn, an antidote to the wrong kind of political interference. Anecdotal evidence suggests that a model that involves AMCs can better safeguard social interests (by, e.g., facilitating liaison with social services) than a model where banks sell their NPLs directly to distressed debt funds. However, this cannot be stated with certainty in the absence of hard data.

Even if the interplay between social and financial stability is relevant, one may ask whether it is relevant for supervisory or resolution authorities. We believe it is. Ensuring the "continuity of critical functions" of banks is a relevant resolution objective.[143] Critical functions are defined as *"activities, services or operations the discontinuance of which is likely in one or more Member States, to lead to the disruption of services that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations".*[144] Thus, unlike "critical services", which are important for the institution itself, "critical functions" are important for the real economy. The applicable rules,[145] and the SRB[146] follow an organized, structured approach where both banks and resolution authorities work to identify the critical functions, and then assess their "separability", the idea being that, since resolution should ensure the continuity of critical functions, those functions should be susceptible of economic separation from other functions upon the entity's failure.[147] One could read these provisions narrowly, meaning that the authorities must ensure a clean break between NPLs and bank that leaves the bank's subsequent lending capacity in good shape. Yet, in our view the provisions should be read as meaning that the authorities must also try to ensure that the NPLs transferred to the AMC (or third party) are properly managed to avoid feedback loops between social impact, social unrest, and financial instability. In fact, the Commission Delegated Regulation states[148] that:

"A function shall be considered critical, where it fulfils both of the following:

(a) the function is provided by an institution to third parties not affiliated to the institution or group; and

"(b) the sudden disruption of that function would likely have a material negative impact on the third parties, give rise to contagion or undermine the general confidence of market participants due to the systemic relevance of the function for the third parties and the systemic relevance of the institution or group in providing the function".

Thus, there are arguments to suggest that the resolution objective does not stop at the water's edge of the transfer of the NPLs, but it encompasses the strategies to manage NPLs afterwards to minimize

[142] IMF 2015.

[143] Article 14 (2) (a) SRM Regulation.

[144] Article 2 (1) (35) of Directive 2014/59/EU on Bank Recovery and Resolution (BRRD).

[145] Commission Delegated Regulation 2016/778 of 2 February 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the circumstances and conditions under which the payment of extraordinary ex post contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines (hereafter: Commission Regulation 2016/778).

[146] Critical functions: SRB approach, available at: https://srb.europa.eu/sites/srbsite/files/critical_functions_final.pdf (hereafter: SRB Critical Functions).

[147] Commission Regulation 2016/778 recitals (5), (12), SRB Critical Functions paras. 3, 23.

[148] Article 6 (1) Commission Regulation 2016/778.

social impact, avoid contagion, or avoid undermining market confidence. This makes the gathering of reliable data on the social impact of NPLs and their management.

Topic	Question
Social/ economic impact of NPLs strategies	Should authorities try to gather more data on the interplay between financial impact and social impact (including gender) of NPLs strategies, and pursue AMCs designs that minimize social impact to prevent feedback loops between social unrest and financial instability?

3.2.4. Summary of findings

Table 5: Summary of findings on the questions asked, deeper issues and possible questions

Issue	Punitive transfer prices	Distortion of competition	Social impact
Evidence	No clear evidence of excessively steep discounts. Criticism in Ireland for average discounts of 58% (above market price). In Spain, despite discounts of 52%, subsequent write-offs. Problem: short valuation process, complex portfolio, uncertainty of some assumptions (e.g., development plans). Slovenia: 71% discounts, objective valuation process. Hungary: market prices.	Criticism of NAMA's financing of developers. However, the Commission found no evidence of illegal state aid. Isolated (and not strongly substantiated) mentions of "unfair" advantages of FABs in Spain.	No clear evidence of comparably more aggressive enforcement strategies. Counterintuitive given an AMC has greater public visibility than banks. Both AMCs and banks more reluctant to enforce. Different case with distressed debt (vulture) funds.
Deeper issues	Problems: (i) anchoring effect of loans' accounting value; (ii) sale under distressed conditions; (iii) emphasis on market values in presence of market failure. The issue seems to be the focus on market values or short-to-medium term REV in a context where markets have failed, and recovery may be long-term.	Problems: (i) change in perceptions about the benefits of competition in a crisis and post-crisis environment; (ii) open argument about whether it is correct for AMCs to engage in real estate development (even to maximize returns). Key: open procedures for AMC selection of third-party providers (services, developers), and interactions with authorities.	Main problem: the social (also including gender) dimension of NPLs, and the interplay between social stability and financial stability are absent from the EU NPL strategy. AMCs could be considered within a broader NPLs strategy that uses a data-driven, technically sound approach to maximize economic value while being conscious of the social impact.
Possible Questions	Should NPLs strategies try to accompany an assessment of transfer prices with earnout provisions that leave the upside gains to the seller? Should NPLs strategies take into account the complexity of the NPLs portfolio and the human resources needed to manage it?	Should AMC-NPLs strategies be better prepared for assets that may require active management, and an interaction with between AMC third-party providers (on one side) and authorities on another side? Should we learn from successful experiences (e.g., intermediated models) to select third parties?	Should authorities try to gather more data on the interplay between financial impact and social impact (including gender) of NPLs strategies, and pursue AMCs designs that minimize social impact to prevent feedback loops between social unrest and financial instability?

Source: Authors' own elaboration.

3.3. Underpinning factors for success or failure: an analysis of AMCs' defining features

The previous sub-section discusses some potential risks associated to AMC-based strategies. Yet, such risks and others are themselves a consequence of the design features of the AMC. This Section analyses those features. First, we restrict our analysis to centralized AMCs (3.3.1.) Second, we focus on the influence of the public/private/social dimension in the AMC's ownership, governance and mandate (3.3.1.) Then, we analyse the procedure for selecting the entities participating in the AMC scheme, and the assets (3.3.3.) Finally, we focus on the liabilities, and the mechanism to limit moral hazard (3.3.4.).

3.3.1. Focus on centralised AMCs

We will restrict our analysis to centralised AMCs. Although decentralized bad banks are a legitimate option for dealing with NPLs problems in specific banks and have been used in NPLs strategies in Germany or Austria (*supra* 2.1.) or Italy. Yet, they are not the tool to deal with a systemic problem. Since the premise for this study is to explore the viability of AMC strategies to deal with NPLs at the level of the EU or Member States, not of individual banks, we will not focus on decentralised AMCs. The Italian case seems to show that a centralised AMC can be the suitable tool of choice to address a systemic problem, without undermining at the same time the need for flexibility in tailor making the structure of the individual NPLs portfolio disposals to the specific needs of each different case (thus adopting, at the centralised AMC level, different strategies like securitisation, portfolio acquisition, asset segregation, demergers).

3.3.2. Ownership, governance and mandate

We have previously discussed the issue of the social impact of AMCs (*supra* 3.2.3.) Yet, the deeper determinants of this are the ownership, governance and mandate of the AMC itself. If we first consider its **ownership,** private ownership shows the market's trust in the project and enables efficient management but means that losses will be fully borne by the banks, which may lack the resources to do so if the problem is truly systemic. Public ownership enlists the State's larger resources and may restore confidence more quickly, although not necessarily if the State's resources are perceived as insufficient or not fully committed and paves the way for political interference and mismanagement.[149] *Thus, a hybrid, private/public ownership may offer a good combination.* This was the approach chosen in Ireland (51/49%) and Spain (55/45%),[150] although NAMA had a veto right over certain decisions.[151] The Slovenian and Hungarian models were, on the other hand, based on 100% public ownership, in line with the (decentralized) models in Germany and Austria. The Italian case presents a state-owned AMC, initially fully participated by the state and, after the MPS NPLs' demerger in 2020, also participated by private investors (MPS shareholders) holding non-voting B shares.

More importantly, a public, or public/private ownership should facilitate the adoption by the AMC of a long term objective of value creation, meant to ensure profitability but with expected rate of returns on capital (IRR) less aggressive than those usually applied by private actors. As already noted, in this way, if the NPLs market is liquid enough, an AMC can help in fostering competitive market prices to the benefit of the transferring bank (with micro and macro prudential advantages), to the extent that such a state-sponsored AMCO, if efficiently managed, can expect for its shareholder(s) return on capital which,

[149] Medina Cas & Peresa, 2016 at 7–8.

[150] The private holdings were held by 14 national banks, two foreign banks, several insurers, and one energy company (Iberdrola), while the public holding was in the hands of the resolution authority (the Fondo de Restructuración Ordenada Bancaria, or FROB).

[151] Medina Cas & Peresa 2016, at 7-8.

albeit still fair and competitive, are nonetheless less aggressive than the usual IRR expected by hedge funds or other similar private actors. *Due to the overall amount of NPLs to be managed, also small but significant variations in the IRR expected by the portfolio's acquirer may change quite dramatically the outcome.* If the NPLs market dries up, as it is often the case when liquidity shrinks in the market or when the size and quality of the portfolios do not meet the expectations of market players, then a state sponsored AMC may prove the only viable solution to preserve an active NPLs market. Finally, a partial state-backed ownership may also contribute to diminish the cost of funding (in particular if this can be done via a European mechanism).

Still, ownership is not everything, and **governance** and incentives are also crucial. The AMC needs to work smoothly and professionally and avoid political interference. A "pure" private governance model, with executive and non-executive directors, and pay-for-performance for employees may promote professionalism. Thus, the Commission Blueprint favours independence, private remuneration and incentives.[152] Nonetheless, an AMC set up by the government, especially one with public funding, also needs to be perceived as accountable, and private incentives may have caused the NPLs crisis in the first place, which is why public accountability is also needed, and private incentives must be accompanied by adequate staff policies.

A third important factor is the AMC's **mandate**. The Commission Blueprint emphatically favours a narrow mandate to maximize asset value without any nuances.[153] This is fine in the abstract. Yet, if the NPLs crisis has undermined public trust, rebuilding that trust may need a not only to enhance the AMC's accountability, but to also focus on social goals. Still, this should be done with caution, because combining a maximisation mandate, with other goals, such as social housing, may make the AMC's management more difficult, and open the door to political interference.[154,] Thus, the key may be in securing independence and accountability, while finding ways to make the AMC more socially-responsible and socially sustainable. This may depend on the ability to use reliable metrics of social goals other than maximizing return value, and/or facilitate liaison with local governments for those purposes. **NAMA's** mixed mandate of maximizing asset value and promoting residential housing has not prevented it from a relatively steady winding down, whereas **SAREB'**s mandate, more focused on contributing to financial stability, minimising public financial support, paying back debts, minimizing market distortions and maximizing realization value,[155] could also incorporate social housing into its mission. In practice, the relatively slow winding down, or the sale of real estate for social housing purposes has been more a consequence of the assets transferred to SAREB than of its mandate. The mission of the **Slovenian** DUTB is broader than that, but it only encompasses corporate restructuring,[156] not social goals like housing, something motivated by the fact that the majority of its assets were corporate in nature as well. On this the AMC's independence from political interference can be accompanied with strong reporting measures to enhance accountability.[157] The **Italian** AMCO, in turn, once confronted not only with NPLs but also with corporate Past Dues (PD) and Unlikely To Pay

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[152] Commission AMC Blueprint.

[153] "The mandate of the AMC must also be clear and unambiguous. Any secondary objectives should be avoided unless clearly subordinated to the primary objectives. Any secondary objectives should be avoided unless clearly subordinated to the primary objectives. […] The main objective of an AMC is to maximise recovery value deriving from the disposal and management of the assets transferred to the AMC, while considering a number of constraints". Commission AMC Blueprint pp. 42, 69.

[154] Medina, Peresa, 2016 at 14.

[155] SAREB bylaws, article 2.

[156] DUTB's mission is: i) to stabilise the Slovenian financial sector by implementing the bank stability act (ZUKSB-A) through taking over non-performing assets from systemically important banks; ii) to promote confidence in the financial system and to operate in accordance with the highest international standards of governance; iii) to maximise the recovery value of assets acquired; and iv) to facilitate and encourage sustainable corporate restructuring in Slovenia.

[157] European Commission AMC Blueprint sections 4.5. and 4.10.6. Nonetheless, this is placed more in the framework of accounting and supervision. See Caroline Cerruti Public Asset Management Companies: International Experience Policy Brief, 2019, who emphasizes reporting as a mechanism to also achieve political accountability.

(UTP) and secured NPLs, *soon realized that an AMC of significant size may turn into a quite important node of economic intervention, if the AMC actively and strategically manages its portfolio.* In this vein, the Italian AMCO developed, as already noted, bespoke strategies for the fair treatment of retail borrowers (to prevent social unrest due to aggressive foreclosures) and also (i) a strategic active management, via financial restructuring, for corporate PDs and UTPs (including new lines of financing) and (ii) a specialised management for real estates and their further development.

Yet, admittedly, when it comes to financial vs. social goals, the problem is the gap on data. Studies and metrics have primarily focused on AMCs efficiency in dealing with NPLs (by disposing of them or restructuring them). If this is the only yardstick, anything that deviates from a steady disposal is, by definition, inefficient. It also opens the door to political interference because, by definition, financial metrics are considered a-political. *The point is that these conclusions partly rely on the absence of clear, reliable evidence about the social impact of NPLs crises, and the interplay between social instability and financial instability. In this sense, what is not measured is not relevant, and thus can only be a source of distraction.* Even if there were reliable metrics that does not mean that AMCs would be an effective tool to deal with social goals. The fact that their structure is good to exploit economies of scale, and stabilize market supply does, in principle, not look as suitable for those tasks that involve more granular interventions. Nonetheless, there is no clear evidence yet supporting or denying a role for AMCs in tasks like "restructuring" or "development", and, in the case of NAMA and SAREB this has been seen not as their "core" mandate, but as an inevitable side effect of (i) the nature of the crisis and the NPLs themselves; and (ii) the need to maximize their value (*supra* 3.2.2.) By the same token, it would be useful to understand the dynamics of the interplay between the relational (bilateral and social) dimension and the financial dimension of debt with the goal of maximizing the value of the assets, and preventing political interference by providing a sound, professional strategy to minimize the social impact. *In fact, AMCs like NAMA or SAREB have liaised with local governments to supply real estate for social housing, or, in the case of SAREB, with social services to facilitate the housing of families. Yet, all this has been done informally, as it could not be explicitly deduced from the entities' mandate or governance structure.* It would be useful to reflect on possible (and slight) adjustments that, by accommodating social needs, could minimize the impact, and help maximize the value of the assets, and help AMCs' tasks to unfold more smoothly, by preventing political interference.

3.3.3. Scheme's (voluntary/mandatory) membership, and assets

A second range of issues relates to the way the assets for the scheme are selected, i.e., which entities should participate, whether **participation** should be mandatory or voluntary, and what kind of assets should be transferred to the AMC. All things being equal, voluntary participation is preferable. However, as outlined above, this is a "market for lemons," prone to adverse selection issues.[158] Thus, authorities will need to ensure that those banks affected by NPLs issues participate in the program through legal mandate or through the exercise of supervisory competences by, e.g., linking participation in the scheme to asset quality review or stress tests. Nonetheless, measures intended to make banks participate in an AMC scheme must respect the banks' individual rights.[159] In **Ireland** the scheme was open to all Irish banks but was limited in the asset classes and timing. Also, the seller made

[158] Voluntary participation may give rise to inaction, given the first-mover disadvantage, or to cherry picking of NPLs. John Fell, Maciej Grodzicki, Reiner Martin and Edward O'Brien "A Role for Systemic Asset Management Companies in Solving Europe's Non-Performing Loan Problems" European Economy 2017.1 (hereafter: Fell et al.) at 80

[159] "Obliging banks via national legislation to transfer the relevant NPLs to the AMC would impact their fundamental rights and would therefore need to be justified in the public interest (e.g. for financial stability purposes). The encroachment (i.e. the national measure) also needs to be proportional. Most notably, it needs to be necessary and balanced as regards the public interest vs the protection of individual rights." Commission AMC Blueprint p. 42. It would be desirable if borrower's rights also received attention.

an offer of eligible assets, and the NAMA SPV could cherry pick those to be transferred (and potentially ask for different assets[160]). In **Spain** the participating entities were undergoing financial difficulties, and thus participation was under distressed conditions. In **Slovenia** the program involved NPLs from systemically important banks, and the application could be initiated by the bank, the Bank of Slovenia or DUTB, which means that it was at least partly non-voluntary. In **Hungary**, NPLs could be offered by financial institutions on a voluntary basis.

A second relevant question is what kind of **assets** should form part of the program. Studies suggest that AMCs have shown promising results in asset classes like commercial real estate, large corporate exposures and syndicated exposures.[161] Others suggest that AMCs are better at disposing of assets than at restructuring them.[162] Yet, sometimes the choice is not entirely left to the authorities, but it depends on the nature of the NPLs crisis. Sometimes an AMC may be useful for "warehousing".[163] In this sense, in the crisis in **Ireland**, the NPLs were of the kind where AMCs work well. A similar thing can be said of Hungary (where NPLs were corporate NPLs, often backed by commercial real estate). For **Spain**, the nature of the assets did not lend itself to a smooth, steady wind-down, and in fact SAREB has struggled, and is still struggling. Yet, that does not mean that SAREB was not useful, as it allowed cleaning up of banks' balance sheets and the warehousing of assets, allowing the subsequent recapitalization and sector restructuring.

A third issue concerns the size and speed of the **disposals** by the AMC. A speedy disposal rate eliminates the risk of further deterioration. However, in scenarios of high volatility, it may contribute to a flooding of the market and may further depress prices.[164] A more gradual approach allows a better calibration of supply and demand but may be more capital intensive. In practice, this is, again, a case-by-case assessment, which also depends on the nature of the assets themselves (which, in turn, depend on the nature of the NPLs crisis). Thus, NAMA, SAREB, DUTB and MARK were set up with horizons in their divestment plans.[165]

3.3.4. AMC liabilities and mechanisms to avoid moral hazard

The structure of an AMCs' financing and liabilities is also important. Senior debt has the advantage of its relatively easy placement in the market, but it makes it challenging to restore confidence to the market in the absence of capital or subordinated loans or bonds. Capital or subordinated bonds or loans may be the best way to allay the fears of market participants but will be harder to place in the market. Admittedly, this is more relevant if part of the AMC's design includes hybrid ownership (*supra* 3.3.1.) Finally, bank deposits (which means that the AMC will have a bank license) grants access to central bank funding and deposit guarantee but may make the process of setting up the AMC much more cumbersome. In practice, the different AMCs have been set up with significant volumes of debt funding, but also capital financing, and no design has included a banking license (i.e., no centralized bad bank was, in practice, a bank, in the regulatory sense of the term). In those cases where ownership was public (**Slovenia** or **Hungary**) the figure of capital was of less consequence. In those cases of hybrid

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160 Five of them (three credit institutions and two building societies) made use of it. See Medina; Peresa, 2016 at 36. The asset classes were detailed in the NAMA Act, art. 69. The assets had to be on the bank's balance sheet as of December 31, 2008.

161 Fell et al. p. 80.

162 Brei; Gambacorta; Lucchetta; Parigi 2020.

163 Medina; Peresa p. 24.

164 Ibid at 23.

165 NAMA was created in 2009 with debt reduction targets of 25% by end-2013, 80% by end-2017, and 100% by end-2019. SAREB was created with a maximum of 15 years for its divestment plan (maximum lifespan).

ownership (**Ireland**, **Spain**) government support not only came in the form of capital, but also of a guarantee over the entity's senior debt, which made it eligible for central bank operations.

The financing of the AMC is also relevant for avoiding moral hazard, which, despite put in question by some studies,[166] it remains a key issue for policymakers.[167] Since, according to some, the presence of an AMC scheme creates an incentive to overstate prices, or offload the most hopeless assets,[168] one solution would be to impose large haircuts. However, this may mean that the program will not be voluntary (*supra* 3.3.3.) which, in turn, raises serious issues with regard to the banks' fundamental rights. Furthermore, if the problem is the uncertainty of the initial valuation, it provides for no correction mechanism if subsequently it is shown that the initial valuation was too optimistic or pessimistic. Thus, an alternative are **claw-back** provisions, which may impose further losses on the originating banks if the initial valuation provides too optimistic; it is also in line with the ways to recover illegal state aid. In Ireland, NAMA introduced a claw-back in the form of a tax surcharge when the assets transferred suffered losses.[169] However, claw-back provisions pose a problem of enforcement. Thus, a smooth way is to account for the need to prevent moral hazard in the AMC's funding structure, by giving originating banks a stake in the equity or subordinated debt of the AMC, in exchange for their NPLs. Such **skin-in-the-game** approach makes banks share in ulterior losses, but also benefit from possible upsides. It is also more coherent with a private or hybrid ownership structure or shared burdens and profits. In fact, the funding structure of **NAMA's SPV** and **SAREB** allowed for this, and in the case of SAREB, a write-down of capital, and conversion of subordinated instruments was necessary to account for subsequent losses.
An alternative would be to fix a prudent REV but to structure the disposal transaction so as to grant to the disposing bank or its shareholders an earn-out or profit-sharing right where recovery over performs. This was done, for instance, in different ways, with the MPS NPLs securitisation (allocating a junior tranche, backed by flows from lower-quality unsecured assets free of charge to existing MPS shareholders, with the dual purpose of ensuring full de-recognition of NPLs from MPS's balance sheet and of leaving to the shareholders, already affected by capital losses, the hope of a possible mid- to long-term upside if the NPLs' recovery activity proved effective)[170] and with the asymmetric demerger of MPS's NPLs in 2020 to AMCO. Private distressed funds are likely less available to similar profit-sharing strategies, than a state sponsored and yet profitable AMC, whose IRR must be fair to justify a profit but need not to be aggressive.

The above considerations suggest that the current strategy towards NPLs and AMCs is sound, but could perhaps be more nuanced, taking cues from the experiences in dealing with NPLs crises. Thus, the following question could be asked:

Topic	Question
AMC structures	In light of evidence suggesting that there are different kinds of NPLs crises, should NPL strategies be more broadly conceived to account in particular for NPLs that may require more active and intensive management, as well as a more careful look at the interplay between social and financial impact?

[166] Arner et al.

[167] Brei; Gambacorta; Lucchetta; Parigi 2020.

[168] Piers Haben & Mario Quagliariello, Why the EU Needs an Asset Management Company, Central Banking (Feb. 20, 2017), https://www.centralbanking.com/central-banking-journal/opinion/2481794/why-the-eu-needs-an-asset-management-company.

[169] NAMA Act § 221.

[170] See Bruno Inzitari, Crediti deteriorati (NPL), aiuti di stato nella BRRD e nella Comunicazione sul settore bancario del 30.7.2013 della Commissione europea, LXIX Banca, borsa e titoli di credito, 641, 650 n.10 (2016).

3.3.5. A second gap: potential complementarities and synergies between AMCs and securitisation schemes

So far the debate on potential strategies to deal with NPLs has focused on considering the potential advantages and disadvantages of AMCs, on one side,[171] and looking at mechanisms like securitisation as alternative proposals,[172] more characterized by being decentralized, and bank-driven.[173]

The reality is, however, one of complementarity of these two instruments.[174] Securitisation presents advantages that can help address some of the perceived difficulties in AMCs schemes. *Its patrimonial structure[175] is sufficiently flexible to isolate cash flows associated to a specific pool of assets, which helps to address the perceived difficulty of managing heterogeneous assets*. Different SPVs could be set up to render each securitisation issuance sufficiently homogeneous. Furthermore, securitisation's structure in tranches can help to distribute the securities among investors with different risk appetite, while also making possible the existence of a state guarantee (over the more senior tranches of the securitisation offering). The skin-in-the-game goal could be achieved by having the originators retain a sizeable part of the more junior tranche.

At the same time, AMCs also present some advantages that could aid securitisation schemes. Their centralisation could help the initial warehousing of NPLs while they are sorted out and allocated to different securitisation issuances. Their expertise in disposal or restructuring could help facilitate the distribution and management of assets, by liaising with underwriters or servicers. If an intermediated model with competitive bidding is put in place, having common rules and procedures for selecting the third parties could strengthen transparency and accountability.

The complementarities have been illustrated by the Italian experience, which has shown that AMCs need to have very flexible strategies in the way they structure their portfolios transactions. The Italian AMCO adopted e.g.:

(a) in the Banco Popolare di Vicenza and Veneto Banca case approved by the European Commission with decision C(2017)4501 final, an asset segregation tool based on Article 2447, letter a) of the Civil Code (*patrimoni destinati di tipo operativo*) (Article 5, D.L. 99/2017 converted into Law 121/2017): those portfolio were thus segregated within the AMC, which acted as sponsor under IFRS 12 (and this helped segregating profits and losses and offering a more accurate accounting reporting).

(b) in the Banca del Fucino transaction, a securitisation where AMCO acted as corporate servicer and noteholders' representative but also as investor for all junior and mezzanine tranches;

(c) in Banca Carige a (reversible) portfolio acquisition, with a put and call valid 24 months after the closing of the transaction;

(d) in the Progetto Cuvée, AMCO, together with MPS and Prelios, established a multi-originator platform to manage UTPs in the real estate sector; the structure of the transaction was based on a securitisation, through the sale of those UTS to a SPV (AMPRE), whose notes have been subscribed by

[171] See, e.g., Andrea Enria, Piers Haben, and Mario Quagliariello Completing the Repair of the EU Banking Sector- A Critical Review of an EU Asset Management Company European Economy 2017.1, pp. 59-70; in that same number, Fell et al; Emilios Avgouleas; Charles Goodhart "Utilizing AMCs to Tackle Eurozone's Legacy Non-Performing Loans".

[172] In that same number of European Economy, see Brunella Bruno; Giuseppe Lusignanni; Marco Onado "Why We Need to Breach the Taboos on European Banks' Non-Performing Loans". See also European Commission AMC Blueprint p. 76.

[173] The European Commission AMC Blueprint characterizes these as "AID-FREE IMPAIRED ASSET RELIEF MEASURES ALTERNATIVE TO CENTRALISED AMCS".

[174] In the interest of full disclosure, in Lamandini; Lusignani; Ramos Muñoz 2018 we explored this possibility, i.e., of a scheme based on securitization, but coordinated under the umbrella of an AMC.

[175] David Ramos Munoz The Law of Transnational Securitization Oxford University Press, (2010).

a real estate funds; the units of the real estate fund have been acquired by AMCO, MPS and Prelios in exchange for their credits vis-à-vis AMPRE. AMCO acts as master and special servicer.

(e) in the MPS asymmetric demerger the transaction consists of a partial non-proportional demerger of MPS in favour of AMCO, implemented through the assignment to AMCO of a compendium of assets (non-performing and unlikely-to-pay loans, deferred tax assets and other assets), liabilities (including, among others, a bridge loan of Euro 3,179,187,010) and net equity, owned by MPS, with the allocation to the Bank's shareholders of AMCO class B shares in exchange for the cancellation of MPS ordinary shares. The AMCO Class B shares allocated to the MPS shareholders will have the same rights as those of the ordinary shares of AMCO already issued, with the exception of the voting rights at the ordinary and extraordinary shareholders' meeting of AMCO, and are not, and will not be, traded on any regulated market or multilateral trading facility. MPS minority shareholders (including MPS as holder of treasury shares) may elect to not receive any AMCO Class B shares, to not have any of their MPS shares cancelled and, therefore, to remain exclusively MPS shareholders, which would increase their MPS shareholding in percentage terms.

Topic	Question
AMCs and securitisation	Do the current approaches to NPLs and AMCs correctly capture the synergies and complementarities (or at least the interplay) between AMCs on one side, and securitisation and market transactions on the other side?

3.3.6. Summary table

Table 6: A systematic analysis of the defining features of AMCs in Member States

Choice	Public/private/social Ownership, Governance, mandate	Participants, Assets Disposal rate	Funding Avoiding moral hazard
Advantages Disadvantages	Ownership/management Private: efficient management; loss of confidence Public: resources (confidence), accountability & public interest; inefficiencies, political meddling Narrow: focused, measurable; risk of wrong incentives Mandate Broad: can input social considerations; mandate can be unfocused and prone to meddling	Voluntary participation better, but difficult. Coerced participation difficult. Can be prompted through asset reviews or stress test Homogenous assets are better but may not be an option (depends on the NPLs crisis). Disposal: quick, acknowledges losses, may depress prices; gradual: smoother supply-demand management; more capital intensive + risks further deterioration	Equity & subordinated debt: builds confidence – hard to find buyers. Senior debt: easier find buyers; no restore confidence without capital. Deposits: access to DIS and central bank funding; more cumbersome. Moral hazard, state aid Claw back: protects public funds, no initial commitment, but hard to enforce Skin-in-the-game: two-sided (loss but also gain if there is an upside), private investment from the outset. Both comply with state aid rules
Ireland (NAMA)	Hybrid 51 – 49% (with NAMA veto power) Independent board Debt reduction & residential housing	Mostly corporate assets, some development properties 10 years. Quick	Equity + debt (government guarantee) Claw-back + skin-in-the-game
Spain (SAREB)	Hybrid 55 – 45% Independent board Mixed: bylaws	Heterogeneous 15 years. Slow	Equity + debt (government guarantee) Skin-in-the-game.
Slovenia (DUTB)	100% public ownership	Corporate assets 9 years. Quick	Equity, debt (primarily debt), public
Italy	100% public ownership	Different banks in financial distress at different points in time, different assets, including corporate, retail and others (e.g., shares)	Securitisation transactions, guaranteed senior tranches, junior tranches often retained by AMCO.
Hungary (MARK)	100% public ownership (National Bank of Hungary), privatized later	Commercial Real Estate (CRE) including project finance 10 years. Quick	Equity, debt, public (subsequent privatization)

Source: Authors' own elaboration.

3.4. Possible exemplary questions

Table 7: Compiled list of possible exemplary questions

Topic	Question
Transfer prices	Should NPLs strategies try to accompany an assessment of transfer prices with earnout provisions that leave the upside gains to the seller? Should NPLs strategies take into account the complexity of the NPLs portfolio and the human resources needed to manage it?
AMCs relationship with authorities and market operators	Should AMC-NPLs strategies be better prepared for assets that may require active management, and an interaction with between AMC third-party providers (on one side) and authorities on another side? Should we learn from successful experiences (e.g., intermediated models) to select third parties?
Social/ economic impact of NPLs strategies	Should authorities try to gather more data on the interplay between financial impact and social impact (including gender) of NPLs strategies, and pursue AMCs designs that minimize social impact to prevent feedback loops between social unrest and financial instability?
AMC structures	In light of evidence suggesting that there are different kinds of NPLs crises, should NPL strategies be more broadly conceived to account in particular for NPLs that may require more active and intensive management, as well as a more careful look at the interplay between social and financial impact?
AMCs and securitisation	Do the current approaches to NPLs and AMCs correctly capture the synergies and complementarities (or at least the interplay) between AMCs on one side, and securitisation and market transactions on the other side?

4. CONCLUSIONS

The in-depth study offers the following main conclusions:

AMCs are adequate tools to deal with NPLs, but their efficiency varies between simpler tasks (e.g., disposal) and complex ones (e.g., restructuring). Less attention has been given to the need to fit AMCs to the actual NPLs crisis. The perceived advantages and disadvantages of AMCs are partly influenced by an approach that focuses on AMC in isolation, when their performance is largely determined by their combination with other NPLs-management tools.

There is no clear evidence that AMCs' efficiency stems from "unfair" advantages, such as excessively discounted transfer prices, anti-competitive operating conditions or socially aggressive practices. The controversy around AMCs can have several causes: (i) there are different expectations about an AMC's goals and outcomes; (ii) perceptions about the urgency of the situation change; (iii) disagreements about AMCs' funding, especially if a common European funding mechanism were to be adopted.

The deeper problem is twofold. One, the NPLs market is at the moment an opaque market. Two, NPLs strategies sidestep relevant issues to avoid controversy. This results in a relatively narrow approach to AMCs. There are important information gaps about, e.g., (i) the interplay between social and financial performance and stability; or (ii) the interplay and synergies between AMCs and securitisation schemes. An open discussion of AMCs as part of a comprehensive strategy would be preferable, but complex. Several ideas could help: first, the possibility for state-owned or state-sponsored AMCs to negotiate with disposing banks less discounted transfer prices (yet preserving AMC profitability) based on long term v short term value-creation objectives and less aggressive expected returns on capital (IRR). Second, to ensure that AMCs can use open, competitive processes to enlist third-party expertise to aid servicing, recovery or restructuring efforts, or even real estate development when needed, and that contacts with public authorities are fluid, but also open and accountable. Third, to explore the synergies between AMCs (that aid centralisation and learning economies) and mechanisms like securitisation (that use pooling and tranching to facilitate distribution). Fourth, to strengthen information gathering on the NPLs market, recovery rates and trends, with special attention to the social and gender impact, to make AMCs part of a broader, technically sound strategy that maximizes economic value while bolstering social trust.

Certain factors that drive AMCs performance. Some are a matter of choice (e.g., ownership and governance). Others depend on the nature of the crisis (e.g., the nature of the NPLs). Rather than a one-size-fits-all approach, AMCs should fit different types of crises.

It is important to fill the gaps in publicly available data (on a national or European level) to objectively calibrate the mid-to-long term evolution of recovery rates and offer granular information on those recovery rates associated to different clusters of loans within each portfolio. This would help to calibrate the social impact of NPLs strategies, and to adapt some aspects of design to fit different contexts and crises.

Source: Authors.

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In this in-depth analysis we examine the experience of Member States with Asset Management Companies (AMCs) to understand their opportunities and risks, and deeper determinants of performance, to draw some lessons for exploring potential solutions at an EU level.

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