13

Asset Management Companies

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In recent decades, many countries have experienced financial crises requiring major overhauls of their banking systems. By one count, 112 episodes of systemic banking crises have occurred in 93 countries since the late 1970s (Caprio and Klingebiel 1999). Bank restructuring often has to be accompanied by corporate debt restructuring as most of the nonperforming loans in the banking system are loans to nonfinancial enterprises. Countries can adopt either flow or stock approaches to resolving distress.

Cross-country evidence indicates that stock solutions are necessary when financial distress is systemic. This type of solution includes the liquidation of banks that are not viable, the disposal and management of impaired assets, and the restructuring of viable banks. For the management and disposal of bad debt, governments have made extensive use of publicly-owned asset management companies (AMCs) that either dispose of assets hived off bank balance sheets or restructure corporate debt. While establishing AMCs is now a resolution strategy that is frequently recommended, little is known about their effectiveness. This chapter analyzes the advantages and disadvantages of AMCs in managing and disposing of impaired assets and

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This paper draws on Klingebiel (2000). The reader is referred to that paper for a detailed description of data sources. Joumana Cobein provided valuable input for the U.S. case study; Marinela Dado for the case studies of Ghana, Mexico, the Philippines, and Spain; and Gabriela M. Gonzalez for the Finnish and Swedish case studies. The author thanks Gerard Caprio, Stijn Claessens, Stephan Haggard, James Hanson, Patrick Honohan, Jose de Luna Martinez, Richard Roulier, and Esen Ulgenerk for comments.

measures the effectiveness of such institutions. It does not discuss the advantages and disadvantages of different bank recapitalization strategies, including the use of AMCs as part of these strategies.

Two main types of AMCs can be distinguished: AMCs set up to help and expedite corporate restructuring, and AMCs established to dispose of assets acquired or transferred to the government during the crisis, such as rapid asset disposition vehicles. According to a survey of 26 banking crises (Caprio and Klingebiel 1996), centralized AMC structures were set up in nine countries. In this paper we study seven cases, where data were publicly available. In three countries, Finland, Ghana, and Sweden, governments set up restructuring vehicles. In the four cases in Mexico, the Philippines, Spain, and the United States governments set up rapid asset disposition agencies.

The results of these cases can be summarized as follows. Two of the three corporate restructuring AMCs did not achieve their narrow goals of expediting corporate restructuring, which suggests that AMCs are not necessarily effective tools for accelerating corporate restructuring. Only the Swedish AMC successfully managed its portfolio, acting in some instances as lead agent in the restructuring process. Special circumstances helped the Swedish AMC; the assets acquired were a small fraction of the banking system and were mostly in real estate.

Rapid asset disposition vehicles fared somewhat better with two, the Spanish and U.S. agencies, out of the four agencies achieving their objectives. These successful experiences suggest that AMCs can be effectively used, but only for asset disposition, including resolving insolvent and nonviable financial institutions. Achieving these objectives requires many ingredients, including a type of asset that is easily liquifiable (for example real estate), political independence, a skilled resource base, appropriate funding, adequate bankruptcy and foreclosure laws, good information and management systems, and transparency in operations and processes. In Mexico and the Philippines, the AMCs were doomed to fail from the start because governments transferred a large amount of loans or fraudulent assets to the AMCs creating a situation that is difficult to resolve. Neither of these agencies succeeded at rapid asset disposition, thus the realignment of asset prices was delayed.

The Centralized Versus the Decentralized Approach

While a growing literature details the do's and don'ts of banking crisis management literature (for example, Delargy and Goodhard 1999; Dziobeck and Pazarbasioglu 1997; Sheng 1996; and chapters 7 and 10 in this volume), empirical studies in this area remain sparse. Bank restructuring seeks to achieve many—often conflicting—goals that include preventing bank runs, avoiding a credit crunch, improving the efficiency of the financial intermediation process, and attracting new equity to the banking industry to economize on claims on public finances. As Dziobeck (1998) notes, the style of response has also changed over time. The lack of a unique or optimal blueprint on how to manage systemic financial distress is therefore not surprising.

Countries can use either flow or stock approaches to resolving banking distress and the overhang of bad debt in the financial system. Whether a country should adopt a flow or a stock solution depends, among other things, on the degree of distress in the system and the extent of the official safety net. Flow solutions usually allow banks to strengthen their capital base over time through increased profits, thus recapitalizing on a flow basis.[1] Cross-country evidence suggests that flow solutions are only successful when banking distress is nonsystemic, and either the official safety net is limited or the supervisory authority is willing to intervene in those institutions whose capital base has further deteriorated. For example, in the early 1990s, U.S. money center banks enjoyed substantial forbearance and successfully recapitalized on a flow basis.[2] Stock solutions are aimed at restoring viable but insolvent institutions to solvency and liquidating nonviable institutions. Stock solutions are necessary in cases where financial distress is systemic.

The proper management and disposition of impaired assets is one of the most critical and complex tasks of successful and speedy bank restructuring. Successful asset management policies can facilitate bank restructuring by accelerating the resolution of nonperforming assets and can promote corporate restructuring by providing the right incentives for voluntary debt restructuring. Debate continues over what the best model for asset management and recovery is. Should banks restructure debt and accomplish workout themselves —as in the decentralized model—or should bad debt be transferred to a centralized, publicly-owned asset management company charged with resolving the overhang of impaired assets (Claessens 1998; Garcia 1997; Lindgren and others 2000; see also box 13.1)? Empirical

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1. Flow solutions also end up taxing either depositors or performing borrowers as banks try to recapitalize from earnings, thus interest rate spreads have to rise. Flow solutions are inherently risky because decapitalized banks have incentives to gamble.

2. Forbearance proved to be less successful in the cases of the U.S. savings and loan crisis and Japan's banking problems, which have continued for nearly 10 years.

Box 13.1. *Advantages and Disadvantages of a Centralized, Public AMC*

Advantages

- Provides economies of scale, that is, consolidation of scarce workout skills and resources within one agency.
- Helps with the securitization as the centralized public AMC has a larger pool of assets.
- Centralizes ownership of collateral, providing more leverage over debtors and better management.
- Breaks links between banks and corporations and improves the collectibility of loans.
- Allows banks to focus on core business.
- Improves prospects for orderly sectoral restructuring of the economy.
- Allows the application of uniform workout practices.
- Expedites loan recovery and bank restructuring when given special powers.

Disadvantages

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

studies on the usefulness and success of the decentralized versus the centralized approach in asset management have yet to be performed. In this paper, we will analyze the actual performance of AMCs given their stated goals, thus providing insight into whether or not AMCs may be a useful tool in the management of distressed assets.

In general, banks should be better positioned to resolve nonperforming loans than centralized AMCs are because banks have the loan files and institutional knowledge of the borrower. Leaving the problem assets on banks' balance sheets may also provide better incentives for banks to maximize the recovery value of bad debt and avoid future losses by improving loan approval and monitoring procedures. This approach also has the advantage that banks can provide new loans within the context of debt restructuring. Successful decentralized debt workouts require, however, limited or no ownership links between banks and corporations, adequately capitalized banks, and proper incentives for banks and borrowers. For example, the slow speed of restructuring in Japan is in part due to the extensive ownership links among banks, other financial intermediaries, and corporations (IMF 1999). Moreover, for debt workout by banks to be successful financial institutions must have sufficient skills and resources to deal with problem loans.

A decentralized bad debt workout can be accomplished by establishing an internal workout unit that is separately capitalized and is often a bank subsidiary. The sole objective of these units or bad banks is to focus attention on the workout of assets and maximize the recovery rate through active restructuring. A clean break can also help rebuild confidence in troubled banks. However, considerable risks are also associated with private AMCs that are spun off from individual banks. They can be used for window dressing if assets are transferred at book value or above market value, or in other words, when not all losses are taken at the bank level.[3] Even if regulations that require financial institutions to transfer their assets at market value are in place, the supervisory authority needs to have the powers and the incentives to enforce such rules. Banks that establish separately capitalized workout units, or bad banks, need to be supported by a well-functioning regulatory framework, appropriate disclosure and accounting regulations, and strong monitoring and enforcement by the supervisory agency.

The centralized asset recovery approach permits a consolidation of skills and resources in debt restructuring within one agency, thus centralizing workout skills and information technology, which may be a more efficient way to recover maximum possible value. Centralization can help with the securitization of assets because it concentrates a larger pool of assets. In addition, it focuses the ownership of collateral, thus providing potentially more leverage over debtors and more effective management. Moreover, distressed loans are removed clearly, quickly, and completely from banks, which allows them to focus on their day-to-day activities.[4]

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3. For example, if the bank is not subject to consolidated supervision, it can transfer problem assets at book value and hide the losses because the ACM's balance sheet is not reconciled with that of the bank. Even if the accounts are consolidated, they may be obscured if the bank takes a minority position (to avoid consolidation at the bank level) and asks connected companies to put up the rest of the equity.

4. Nevertheless, some economists argue that a reasonable amount of small-sized problem loans should remain within the bank's ordinary organization, even if the bulk of bad assets are transferred to a separate AMC. Apart from maintaining a level playing field among the remaining banks, leaving some nonperforming assets in the banks will preserve their capability to work out loans that do not require special expertise. In addition, the transaction cost incurred by transferring small assets may outweigh any potential gains. For more detail, see Ingves and Lind (1997).

Centralized agencies may also have the advantage of being able to break links between banks and corporations and thus being better able to collect on connected loans. Other elements that favor single entities include improved prospects for orderly sectoral restructuring in the real economy, application of uniform workout practices, and easier government monitoring and supervision of workout practices. Finally, another benefit of a centralized agency is that it can be given special legal powers to expedite loan recovery and bank restructuring. Special powers, however, may not compensate for a weak judicial system and may prove less useful if they must be enforced by the judicial system.

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

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

The Different Types of Asset Management Companies

Two main types of centralized asset management companies exist. These are asset disposition vehicles, which also cover liquidation, and longer-term restructuring vehicles. Whereas the typical objective of asset disposition and liquidation agencies is to sell the assets promptly through bulk sales, securitizations, or purchase and assumption transactions, restructuring agencies have other objectives.

Centralized asset sale agencies are set up to dispose of particular classes of assets that by nature tend to be more easily liquifiable—real estate assets, commercial real estate loans, secured loans that can be either easily sold off or securitized in case of a deep capital market—that were transferred to the AMC during a bank restructuring or recapitalization exercise. To maintain value, assets need to be managed. Even good loans tend to lose value when they are taken from the originating bank unless the AMC monitors them actively. Either the AMC or the originating bank, if it is still in operation, can manage the assets, or management can be outsourced to the private sector. In the case of the bank managing the assets, a loss-sharing arrangement with the AMC could provide incentives for the bank to monitor or manage the assets properly.[5] Liquidation agencies are set up to resolve failed financial institutions by selling assets through purchases and acquisitions, insured deposit transfers, and deposit payoff and sale of the performing or nonperforming assets.

Restructuring agencies are usually set up to operate on a longer-term basis and are aimed at restructuring and liquidating nonperforming loans of nonviable borrowers prior to their sale. Typically, as a first step in the restructuring process, the assets transferred to the AMC are grouped either into viable claims that need to be restructured or into nonviable claims the borrowers of which will be forced into bankruptcy.[6] The overall objective of the AMC, if pursuing a commercial objective, is to make the assets attractive to buyers. The restructuring of viable assets can include—in the case of an industrial company—selling off noncore assets and improving the overall efficiency of operations by reorganizing and reducing staff, cutting other costs, restructuring product lines, and so on. In the case of commercial real estate and residential homes, measures to increase the attractiveness of the properties can include renovation of the properties to adapt

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5. In Mexico, the management of the assets was left to the originating banks. Despite loss-sharing agreements aimed at providing incentives for the originating bank to continue to manage the assets properly, assets transferred to the AMCs were managed inadequately, which resulted in further deterioration of asset values. This suggests that developing incentive-compatible contracts to prevent asset value deterioration from happening may not be an easy undertaking.

6. To increase transparency and depoliticize the process, third parties should assess the viability of the assets being transferred to the AMC.

them to current market demand or reducing the vacancy ratio, which is a crucial factor in improving cash flow. Because restructuring often requires new lending, the AMC needs to have the capacity to lend.

Private, centralized AMCs are rare. If a substantial amount of bad loans and assets is transferred to an AMC, finding private investors willing to assume ownership without requiring far-reaching state guarantees covering the future value of the asset portfolio is usually difficult. In that case, the government may be in a more favorable position if it owns the AMC rather than provides such guarantees because it might then benefit from any upward price movement of AMC assets. Moreover, in such a scenario, structuring a guarantee in a way that preserves the private owners' incentives to sell the assets at best prices may be difficult. Public ownership is also warranted if the value of impaired assets could be destroyed through fire sale liquidations. In that instance, the gradual sale by a specialized public agency is preferable.

The warehousing of assets in the hopes of obtaining higher prices later may not prevent prices from tumbling because the future supply of assets will be discounted in current prices (Lang, Poulsen, and Stulz 1995; Shleifer and Vishny 1992). This is especially the case for real estate assets, where fire sale losses need not imply an economic loss of value. At the same time, selling assets rapidly establishes floor prices that promote speedier recovery from the economic crisis. This may especially be true for public AMCs, which typically have limited market insights.

The success of centralized AMCs can be assessed on the basis of two dimensions: whether the AMCs achieved their narrow objectives, and whether the banking system returned to sustained solvency.[7] The speed of asset disposition measures the success of rapid asset disposition and liquidation agencies. In this case, an AMC is judged to be successful if assets, including banks, are disposed of within five years. In the case of restructuring agencies gauging whether they have achieved their narrow objectives of accelerating corporate restructuring is more difficult because of little data and the lack of the counterfactual. Thus, they will be considered successful if they sold off 50 percent of their assets within five years, indicating that the existence of a public AMC did not delay corporate restructuring. To assess whether AMCs accomplished their broader objectives of

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7. Some facilities also pursued the explicit objective of minimizing fiscal costs. However, as we do not have information concerning the counterfactual, we cannot evaluate whether AMCs have achieved that objective.

restoring the banking system to health, two criteria are used. First, we must ask if the banking system experienced repeated financial distress, and second, has real credit to the private sector resumed and aggregate credit growth been positive in real terms.

Evidence

Centralized asset management companies have only recently become a popular component of banking distress resolution strategies; Indonesia, Korea, and Malaysia all set up centralized AMC structures in the late 1990s. According to a survey of 26 banking crises (Caprio and Klingebiel 1996), centralized AMC structures were only set up in nine cases and were particularly popular in Africa.[8] Out of these nine, seven cases with sufficient, publicly available data were selected for more detailed analysis. In four out of the seven cases, the governments of Mexico in 1994, the Philippines in 1981–86, Spain in 1977–85, and the United States in 1984–91 set up rapid asset disposition vehicles. In Finland in 1991–94, Ghana in 1982–89, and Sweden in 1991–94, restructuring agencies were established. The bibliography and reference list provides country sources of the data used in the analysis.

In the analysis, we first lay out the objectives and main characteristics of the AMCs, including the amount of assets transferred relative to banking system assets, the sectoral breakdown of assets, the criteria authorities used for the transfer of assets, and the transfer price. We then study the success of those entities and analyze factors that are key to the success of or are impediments to the success of the AMC structure. Except in the U.S. example, all banking systems in the sample suffered from systemic crises, that is, the aggregate banking system's capital had been exhausted. In all country cases, the authorities adopted financial sector restructuring mechanisms that included the setting up of a centralized AMC structure.

Figure 13.1 provides an overview of the share of banking system assets transferred to AMCs. The figure illustrates that the share of financial system assets managed by AMCs as a result of asset transfers varied widely among the countries. Both as a share of total system assets and as a percentage of gross domestic product (GDP), the Philippine AMC had to deal with the largest share of nonperforming loans as assets transferred amounted to almost 22

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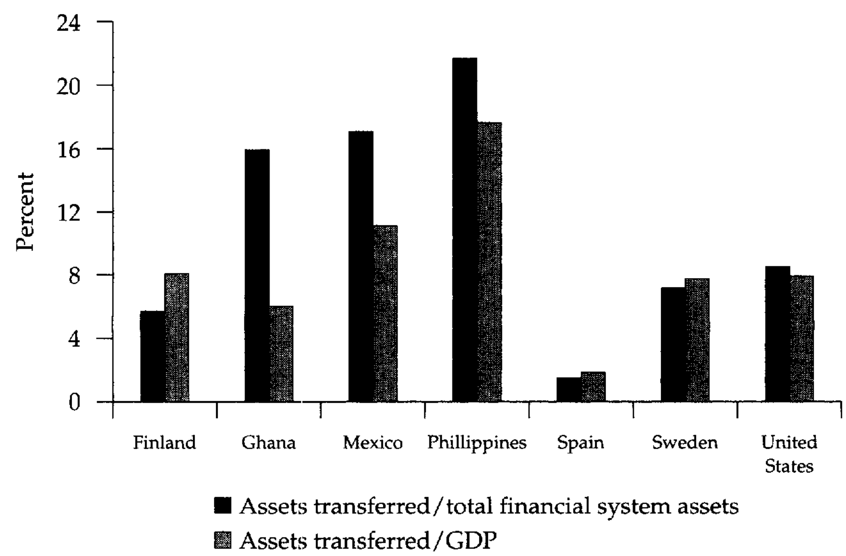
8. Benin, Côte d'Ivoire, Ghana, and Senegal set up centralized AMCs as part of their bank restructuring mechanisms. Other countries where centralized AMCs were established were Finland, the Philippines, Spain, the United States, and Uruguay.

Figure 13.1. Assets Transferred to AMCs



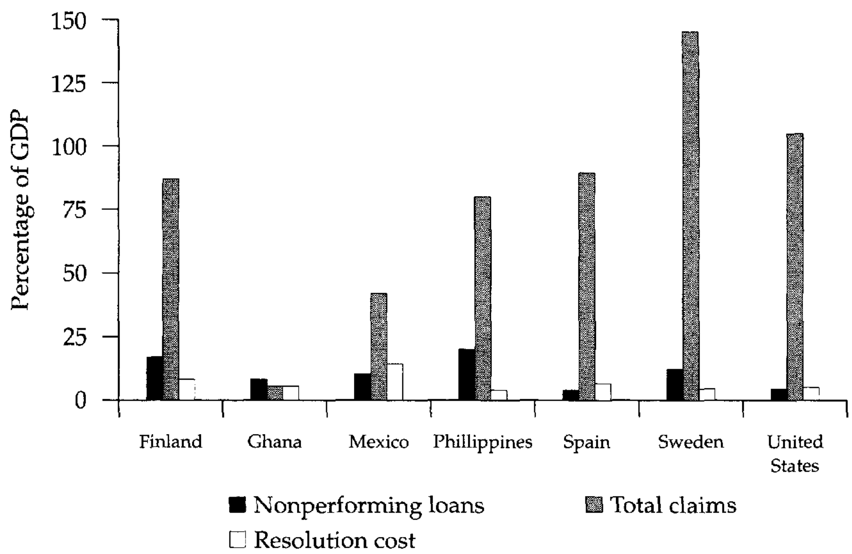
Source: Klingebiel (2000).

percent of financial system assets and 18 percent of GDP. At the other end of the spectrum, Spain's AMCs dealt with only 1.0 percent of financial system assets, or 1.3 percent of GDP. With the exception of the U.S. case, all assets transferred to the AMCs had been previously classified as nonperforming.

Figure 13.2 provides data on the scope of the financial sector crisis, using peak levels of nonperforming loans in the financial system. Because the level of nonperforming loans is a reflection of the real sector's performance, this number can also be used as a rough proxy for the extent of corporate distress. Spain and the United States were the only countries in the sample where the extent of nonperforming loans in the system remained limited, that is lower than ten percent of gross loans. In Finland and the Philippines, official numbers on nonperforming loans reached substantial proportions that account for near or more than 20 percent of financial system assets.[9] In Ghana, more than half of banking system loans were nonperforming. In Mexico,

9. Because accounting conventions differ among the countries in the sample, these figures should be treated with caution. Among these countries, Finland, Spain, Sweden, and the United States have stricter classification regulations compared with Ghana, Mexico, and the Philippines.

Figure 13.2. *Magnitude of Crisis and Resolution Costs*



Source: Klingebiel (2000).

nonperforming assets transferred to Fondo Bancario de Protección al Ahorro (FOBAPROA) amounted to 23 percent of financial system loans or 17 percent of financial system assets at the end of 1996.

Rapid Asset Disposition Agencies[10]

Appendix table A.13.1 provides an overview of the main characteristics of the four country examples with rapid asset disposition vehicles. Two of the agencies—the Mexican and the Spanish AMCs—were housed within an existing public agency, the Deposit Guarantee Agency. The Philippine and the U.S. agencies were set up as stand-alone agencies with a limited life span. All four agencies pursued similar objectives. The main goal of Mexico's FOBAPROA, the Philippine's Asset Privatization Trust (APT), the Spanish Deposit Guarantee Fund, and the U.S. Resolution Trust Corporation (RTC) was to dispose of the assets that were transferred to them as fast

10. The analysis of the Mexican rapid asset disposition agency, FOBAPROA, reflects information available before the end of 1998.

as possible while maximizing the recovery value of the assets. In contrast, FOBAPROA was also involved in the cleanup and recapitalization of the banks that were still in operation. By the end of 1997, the assets to be disposed of by FOBAPROA amounted to 17 percent of banking system assets compared with the 22 percent on APT's books. APT solely focused on the disposition of nonperforming assets that had been transferred in a one-off transaction. The Spanish Deposit Guarantee Fund and the RTC operated as centralized liquidation agencies, and as such were responsible for resolving financial institutions and the liabilities of which that had been previously taken over or been intervened in. Moreover, the amount of bad debt that was effectively managed and sold by these entities was small relative to financial system assets, 1 percent in the case of the Spanish agency and 8.0 percent in the U.S. case.

FOBAPROA and APT did not achieve their narrow objective of rapid asset disposal. By early 1999, four years after it had been established, FOBAPROA sold only 0.5 percent of its assets, and twelve years after starting its operations APT still has 50 percent of the original assets on its books. In both cases, a variety of reasons hampered the disposal efforts of these agencies (see table A.13.1). The most important of these reasons was the type of assets transferred, that is, whether the assets were politically motivated or fraudulent loans. Having limited independence and great susceptibility to political pressure, neither of the two government agencies was equipped to resolve assets whose initial extension was based more on political connections than on the merits of the projects to be financed. A weak legal framework also hampered asset disposal.

For example, at the time of asset transfer in Mexico, the government had restricted financial institutions, including FOBAPROA, from foreclosing on assets. Moreover, the rapid sale of assets was further hindered by the fact that the agency was insufficiently funded. As assets were transferred from banks at higher than market values, the disposition of these assets would have revealed the true losses of the banking system. Finally, the considerable amount of impaired assets under FOBAPROA impeded effective corporate restructuring in at least three ways. First, the large amount of impaired assets depressed the market values of bank assets generally. Second, continued government control of this large share of total indebtedness encouraged continued politicization of the asset restructuring process. Third, repeated nonperforming asset sales limited banks' incentives to engage in corporate restructuring.

Neither FOBAPROA nor APT was successful in helping to build a more robust banking system. The Mexican banking system remains weak, and one of the two banks that were cleaned up in the Philippine case appears to be in financial distress again. In addition, FOBAPROA's repeated loan purchases at Mexican banks coupled with debt relief for borrowers led to general deterioration of the payment discipline and asset prices. Moreover, loan growth did not recover and remained strongly negative in Mexico.

In contrast, banking sector solvency problems did not reoccur in Spain or the United States. The Spanish and the U.S. agencies met their narrow objectives by disposing of 50 percent of assets within five years. The Spanish Guarantee Fund and the RTC, after some initial problems, were successful in developing fair, credible, and transparent processes and mechanisms for the resolution and sale of financial institutions. These agencies managed to sell those institutions in a relatively short period of time, thus minimizing disruptions for depositors and borrowers (Sheng 1996).

One key factor in the success of the Spanish Deposit Guarantee Fund was that the banks to be resolved were relatively small, which made dealing with them politically easier. Moreover, the largest commercial banks in the system were sound enough to assist substantially in the resolution of the small banks. However, despite success in selling the 26 banks, the Spanish Deposit Guarantee Fund proved less successful at disposing the assets that had been carved out before the sale of the institutions, and a portion of those assets remain with the fund even today.

The RTC's success was helped by the fact that most of the assets to be disposed of were real estate loans or assets or mortgage loans that could relatively easily be bundled and securitized or sold via bulk sales. Moreover, a deep and sophisticated capital market and a recovery in the real estate market also proved advantageous for the RTC, as did an effective organizational and governance structure and skilled personnel.

Restructuring Agencies

In Finland and Sweden, restructuring agencies were tasked with cleaning up banks before their sale to new investors. In Ghana, the government set up a restructuring agency to deal with recapitalized banks. In all three cases, the narrow objective of the restructuring agency was to manage and liquidate nonperforming assets and accelerate corporate restructuring (see appendix table A.13.2).

Arsenal, the Finnish agency, disposed of more than 50 percent of assets after five years in operation and seems to have enhanced corporate restructuring. The following factors worked in Arsenal's favor. First, Arsenal only had to resolve a relatively small amount of banking system assets as assets transferred amounted to 5.2 percent of banking system assets. Second, a large amount of the assets transferred were loans to real estate companies or loans secured by real estate. Third, Arsenal was provided with appropriate funding and had professional management and a skilled human resource base. Finally, a strong economic recovery in which the economy expanded at 4 percent and 5.1 percent in 1994 and 1995 may have helped asset resolution and disposition. However, because Arsenal received nonperforming loans regardless of type and size of asset, using wholesale divestiture techniques may have been more difficult for the agency.

Securum, the Swedish asset management agency, was successful in achieving its narrow objective of restructuring or selling off assets in a relatively brief period of time. In addition, the agency expedited restructuring in the broad real estate sector by acting in some cases as a lead agent enhancing creditor coordination (Bergren 1998). It closed its doors in 1997 five years after being established and having sold off 98 percent of its assets. Several factors contributed to the success of Securum. First, the government transferred mostly commercial real estate assets, which may have been easier to restructure because they did not involve politically sensitive issues, for example, factory worker layoffs. Second, the assets that were transferred to Securum were mostly large, complicated assets that Securum may have had a comparative advantage in resolving. Third, the government only transferred a limited amount of assets, equal to 8 percent of banking system assets. In addition, Securum enjoyed political independence and had appropriate funding. Finally, the economy and the real estate market recovered over that period.

In contrast with the examples of Arsenal and Securum, Ghana's Nonperforming Asset Recovery Trust (NPART) did not achieve its narrow objective of performing a substantial role in the restructuring of the corporate sector and expediting the restructuring process. In the end, the agency engaged mostly in cosmetic financial restructuring by extending maturity, lowering interest rates, and functioning as a collection agency. Factors that contributed to that outcome were the agency's lack of political independence and lack of professional management at the highest level of the institution. In addition, NPART not only had to resolve a large share of outstanding banking system assets, but also more than 50 percent of assets transferred were loans to state-owned enterprises, assets that are typically difficult for government agencies to restructure. Importantly, a weak legal framework hampered the work of NPART. The government attempted to mitigate the implications of a weak legal framework for NPART by granting it special legal powers. Yet this strategy proved largely ineffective because the courts were debtor friendly, and NPART needed the approval of the borrower before it could proceed with the liquidation process.

All three institutions' track records with respect to their broader goals are mixed at best. Sweden and Finland did not record any renewed banking system distress, but real credit to the private sector contracted significantly in both countries in the year following the establishment of the AMCs, indicating that the restructuring of banks was not yet complete (table 13.1). While bank loans to the private sector increased significantly in Ghana, state-owned commercial banks that had been cleaned up through the loan purchase program again appeared to experience problems in the mid-1990s.

Lessons from Cross-Country Experience

Table 13.2 summarizes the main characteristics of the country cases including the size of the banking system, the depth of the capital market, and the quality of the legal framework as measured by the enforcement of creditor rights and the amount of assets transferred to the respective AMCs. As table 13.2 indicates, initial conditions for AMCs were significantly weaker in the developing economies. For example, the legal framework was considerably weaker in developing countries, and capital markets were less developed as the low bond market capitalization indicates. At the same time, AMCs in these countries had to deal with notably larger problems given that the assets transferred to these agencies accounted for a large proportion of banking system assets overall. Governments in Ghana and the Philippines tried to compensate for the weak legal framework by granting superpowers to their respective AMCs. In both cases this strategy proved ineffective. In Ghana, the courts remained debtor friendly, and in the Philippines the overall efficiency of the court system did not improve.

Table 13.3 presents an overview of the main characteristics of the AMCs that were established including the type of assets transferred—real estate assets or politically motivated assets—the independence of the agency, legal superpowers, and funding resources. The table highlights the fact that mainly the following factors hindered the success of the AMCs in developing countries. First, AMCs in developing countries mostly received nonreal estate, state-owned assets, or assets reflecting political connections. Second, many AMCs in developing countries had to resolve large amounts of banking system assets and received assets of all sizes. Third, AMCs in developing countries were not set up as independent institutions and thus were susceptible to political pressure. Finally, they often lacked appropriate funding to dispose of assets quickly. The RTC in the United States was the only agency that outsourced management of the assets to the private sector, which included

Table 13.1. *GDP and Real Credit Growth*

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

a. Year when the Deposit Guarantee Fund was granted legal powers for bank restructuring.
Source: IMF data.

Table 13.2. Characterization of Country Cases

	Initial conditions				
Country	*Enforcement of creditor rights*[a]	*Private sector claims (percentage of GDP)*[b]	*Bond market capitalization (percentage of GDP)*[b]	*Peak level of nonperforming loans (percentage of financial system assets)*	*Amount of assets transferred (percentage of financial system assets)*[d]
Finland	18.0	87	39.7	18.7	5.2
Ghana	1.0	6	n.a.	60.0	50.8
Mexico	6.0	41	1.1	18.9	17.0
Philippines	7.7	79	16.6[c]	23.1	21.7
Spain	8.0	88	43.2[d]	5.7	1.4
Sweden	24.0	145	58.5	10.8	7.4
United States	18.0	103	50.5	4.1	8.0

n.a. Not available.

a. The product of an index of how well the legal framework protects secured creditors and a law and order index. The index ranges from 0 to 24 with 0 as the lowest and 24 as the highest score.

b. Private sector claims and bond market capitalization are shown at the onset of the financial crises in these countries.

c. 1983.

d. 1990.

Source: Author calculations; IMF data; University of Maryland (various editions); La Porta, Lopez-de-Silanes, and Shleifer (1999).

Table 13.3. *Characteristics of Established AMCs*

Country	*Real estate assets (percentage of transferred assets)*	*Transfer of politically motivated assets*	*Agency is independent*	*Agency has legal super-powers*	*Agency has appropriate funding*
Finland	34	No	Yes	No	Yes
Ghana	Negligible	Yes	No	Yes	No
Mexico	n.a.	Yes	No	No	No
Philippines	Negligible	Yes	No	Yes	No
Spain	8.2	No	Yes	No	Yes
Sweden	80	No	Yes	No	Yes
United States	49	No	Yes	Yes	Yes, after initial problems

n.a. Not available.

Note: Business strategy includes type, size, and amount of assets transferred. Business strategies are judged appropriate if they are in line with agency resources including funding, institutional capacity, and independence from political pressure, and the development of the capital markets.

Source: Author.

foreign investment banks and advisors that may have compensated for the lack of independence and curbed the scope for political interference.

As table 13.4 indicates, two out of three corporate restructuring AMCs did not achieve their narrow goals of expediting corporate restructuring. These experiences suggest that AMCs are not necessarily effective tools for expediting corporate restructuring. Only the Swedish AMC successfully managed its portfolio, acting in some instances as lead agent in the restructuring process. Special circumstances helped in the Swedish case, which made it easier for the AMC to maintain its independence from political pressures and to sell assets back to the private sector. Rapid asset disposition vehicles fared better. Two out of the four agencies that employed this technique, the Spanish and U.S. agencies, achieved their objectives. These successful experiences suggest that AMCs can be effectively used, but only for resolving insolvent and nonviable financial institutions and selling off their assets. Achieving these objectives required many ingredients, including a type of asset that is easily liquifiable, political independence, a skilled resource base, appropriate funding, adequate bankruptcy and foreclosure laws, good information and management systems, and transparency in operations and processes.

Table 13.4. *Evaluating Success*

		Corporate restructuring and asset disposition			*Health of banking system*	
Country	*Objective of AMC*	*Share of assets disposed (percentage of transferred assets)*	*Have AMCs achieved their narrow objective*	*Recurrent problems*	*Growth of real credit*	*Have AMCs achieved their broader objectives*
Finland	Restructuring	>64	Unclear	No	Negative	Unclear
Ghana	Restructuring	n.a.	No	Yes	Positive	Unclear
Mexico	Rapid asset disposition	0.1	No	Yes	Negative	No
Philippines	Rapid asset disposition	<50	No	Yes	Positive	Unclear
Spain	Liquidation	Majority	Yes	No	Positive	Yes
Sweden	Restructuring	86	Yes	No	Negative	Unclear
United States	Liquidation	98	Yes	No	Negative	Unclear

n.a. Not available.
Source: Author.

Appendix 13.A. Main Characteristics of Asset Management Companies

Table A.13.1. Rapid Asset Disposition Agencies

Rapid asset disposition	*Objectives of rapid asset disposition agency*	*Asset transfer*	*Outcome*	*Key factors*
Mexico: FOBAPROA				
• Set up in 1995; no established duration limit • Public ownership • Centralized entity • FOBAPROA set up as a bank restructuring agency	• Clean up and restructure banks • Sell off or recover assets as quickly as possible, through auction, securitization, or other market mechanisms	• Amounts of assets transferred: Mex$ 142 billion (Mex$ 119 billion net of reserves for loan losses) equivalent to 17 percent of banking system assets. • Sectoral breakdown of assets: consumer, mortgage, and corporate loans • Criteria for asset transfer: nontransparent and repeated process (this led to perceptions that some banks received more favorable treatment than others) • Asset price: transfer at book value because assets were not valued prior to transfer	• Transfer of loans did not succeed in restoring the banking system to solvency. Capital deficiency was underestimated, and institutions remained weak after repeated rounds of loan repurchases at greater than market price. Operational restructuring was limited, and bank management was left unchanged. • As weaknesses in the banking sector remained, loan growth did not recover. • By the end of 1998, FOBAPROA had sold only 0.5 percent of transferred assets. The huge overhang of impaired assets impeded effective restructuring in three ways. First, it depressed the market value of bank assets generally. Second, continued government control of such a large share of total indebtedness encouraged politicization of the asset restructuring process. Third, repeated nonperforming asset sales limited banks' incentives to engage in corporate restructuring.	Favorable factors: • Strong economic recovery Unfavorable factors: • Type of asset transferred: politically connected loans assets are difficult for government agencies susceptible to political pressure to handle. • Lack of independence: FOBAPROA was under central bank management, and policy decisions were made by a committee comprised of the minister of finance, the central bank governor, and the president of the financial supervisory body. • Substantial deficiencies in bankruptcy and foreclosure code: when assets were transferred to FOBAPROA, the government restricted financial institutions, including FOBAPROA, from foreclosing on assets. • Insufficient funding of FOBAPROA.

(table continues on following page)

Table A.13.1 continued

Rapid asset disposition	*Objectives of rapid asset disposition agency*	*Asset transfer*	*Outcome*	*Key factors*
Philippines: Asset Privatization Trust (APT) • Set up in 1987; intended to be closed in 1991, but still in operation • Public ownership • Set up as centralized stand-alone entity	• Orderly and fast transfer of nonperforming assets to the private sector • Administration of the assets pending disposal • Divestiture of large government corporations (starting in 1991)	• Amounts of assets transferred: assets of about P 108 billion equivalent to 21.7 percent of banking system assets • Sectoral breakdown of assets: mining ventures, ships, textile plants, and food processing to luxury hotel resorts; 70 percent of value was held in 15 percent of assets; 75 percent of assets constituted financial claims for which foreclosure procedures had not been completed • Criteria for asset transfer: size and nature of accounts (that is, nonperforming); potential for sale; any special expertise required to dispose of the assets • Transfer price: book value	• ATP did not reach its objective of orderly and fast transfer of assets to private sector. Forty to 50 percent of assets remain in APT's portfolio to date, including those of the largest account, National Construction Corporation, despite macroeconomic environment conducive to asset transfer. • One of the recapitalized banks again faced solvency problems in the late 1990s. Nevertheless, credit growth rebounded relatively strongly.	Favorable factors: • Strong economic recovery Unfavorable factors: • Type of asset transferred: politically connected loans or fraudulent assets are difficult for government agencies susceptible to political pressure to handle. • Rapid asset disposition: legal problems severely hampered asset disposition despite the fact that APT had temporary extrajudicial powers • Weak governance and insufficient funding: APT was neither privately managed nor an independent agency, and budgetary pressures, such as avoidance to reveal losses, reduced APT's commitment to rapid sale. • Lack of disclosure of information on its activities and financial situation to the public: while APT had to submit quarterly reports on performance and financial status to the president and congress, and the process of asset sales remained nontransparent.

(table continues on following page)

Table A.13.1 continued

Rapid asset disposition	*Objectives of rapid asset disposition agency*	*Asset transfer*	*Outcome*	*Key factors*
Spain: Deposit Guarantee Fund • Set up in 1977; still in existence; given legal capacity to assume bank ownership to initiate bank restructuring (1980); no pre-established duration limit • Public ownership • No stand-alone entity, but part of entity set up to resolve failed banks	• Restructuring of banks for prompt resale by carving out bad assets that new investors were unwilling to take on • Prompt sale of carved out assets with the aim of maximum recovery value	• Amounts of assets transferred: fund took over 26 banks with assets amounting to 1 percent of financial system assets. These banks were restructured and then sold off to new investors. In some instances, large amounts of assets were taken off bank balance sheets and remained for rapid asset disposition in the Deposit Guarantee Fund. • Sectoral breakdown of assets: 8.2 percent was real estate; 72.5 percent was other assets; 19.4 percent was shareholdings. • Criteria for asset transfer: assets that acquirers of banks were unwilling to take on	• Successful in selling intervened banks in relatively short period of time upon acquisition. Banks were sold off on average within one year, indicating that the Deposit Guarantee Fund managed to accelerate the bank restructuring process. • Banks resumed lending in 1980, and credit to the private sector by banks grew in real terms. • The fund was less successful in achieving its aim of rapid disposal of bad assets that had been carved out from banks' balance sheets. • The fund was not involved in resolution of 20 small and medium size banks of the Rumasa group. Due to the scope of the problems of the Rumasa group, the government decided to nationalize the banks and the 200 industrial firms belonging to the group. The government adopted a two-pronged strategy. First, take over control of companies. Second, resell the companies as soon as possible.	Favorable factors: • Fund operated as an independent public agency under private law and appropriate funding and powers (could change management immediately, purchase assets, offer guarantees or counter-guarantees on behalf of restructured banks, grant long-term loans at subsidized rates, or permit temporary regulatory forbearance) for resolving institutions. • Banks to be resolved were small banks, which made them politically easier to resolve, and the fund was not involved in resolution of the politically sensitive Rumasa group. • The largest commercial banks in the system were sound enough to assist substantially in resolving the small banks, albeit under considerable state pressure. Also, competition in the home market from foreign banks provided incentive for Spain's private banks to acquire recapitalized banks while sometimes even assuming losses.

(table continues on following page)

Table A.13.1 continued

Rapid asset disposition	*Objectives of rapid asset disposition agency*	*Asset transfer*	*Outcome*	*Key factors*
				• In terms of disposal of nonperforming assets, the amount of those assets was small (1 percent of banking system assets). • Overall, the fund operated in a benign macroenvironment. Unfavorable factors: • The framework for foreclosures and seizures of collateral was deficient and impeded rapid sale of assets. • The Deposit Guarantee Fund encountered problems with transfer of titles. • The fund experienced lackluster demand for real estate assets.
United States: Resolution Trust Corporation (RTC) • Set up in 1989, designed to operate until 1996; ended operations in 1995	• Social and commercial: RTC was to maximize the net value proceeds from savings and loan crisis resolution, but	• Amounts of assets transferred: RTC resolved 747 thrifts with total assets of US$465 billion. These assets accounted for roughly 23.2 percent of savings and loans assets or 8 percent of total bank and thrift assets in 1989. Of these, RTC sold US$153 billion through asset disposition that was not connected to the sale of the	• RTC was successful in resolving 747 thrifts and disposing of assets that were carved out prior to bank sale. • RTC recovered 87 cents to the dollar.	Favorable factors: • The amount of assets transferred were relatively small (8 percent of financial system assets), and a large part of those assets were performing. Moreover, also notable is that the savings and loans problem affected only a fraction of the U.S. financial system, leaving sound institutions in

(table continues on following page)

Table A.13.1 continued

Rapid asset disposition	*Objectives of rapid asset disposition agency*	*Asset transfer*	*Outcome*	*Key factors*
• Public ownership • No stand-alone entity; part of entity set up to resolve failed banks	also had a broader mandate of minimizing the impact on local real estate and financial markets. Another part of this mandate involved maximizing available and affordable housing for low to moderate income individuals.	financial institution. • Sectoral breakdown of assets: RTC acquired performing and nonperforming assets. The sectoral breakdown of assets transferred was as follows: 42 percent mortgage loans, 7 percent real estate, 8 percent other loans, 35 percent cash and securities, and 8 percent other assets. • Criteria for asset transfer: insolvency of the financial institution as determined by the Central Bank.		the market as potential buyers of the assets. • The type of assets—mostly performing real estate-related assets and consumer loan assets were transferred—could be sold off through wholesale disposal mechanisms (bulk sales, securitization, and auctions). • The RTC was in an environment marked by deep and sophisticated capital markets. • Adequate governance structures, professional management, and extensive use of private sector contractors were available for asset disposition. The RTC relied on a detailed set of directives and guidelines for its staff and contractors that covered a wide range of operations, including asset management and disposition, contract policies, bidding procedures and marketing. While this reduced RTC's flexibility in handling individual cases, these factors

(table continues on following page)

Table A.13.1 continued

Rapid asset disposition	*Objectives of rapid asset disposition agency*	*Asset transfer*	*Outcome*	*Key factors*
				minimized the possibility of fraud, made policy and cost evaluation more transparent, and expedited resolution process. • An effective organizational structure including information management systems that can handle large amount of information and management of assets allowed RTC to collect 31 percent of the total assets transferred and reduced the amount of assets needed to be sold by one third. Unfavorable factors: • Sporadic funding of RTC (several pieces of legislation were required to approve funding) hampered speedy resolution of failed savings and loans and increased resolution costs. • Rapid asset disposition was hampered by inconsistencies in the agency's objectives. In addition to its cost minimization and expeditious disposition objective, the RTC was also supposed to structure and time its asset sales to minimize any impact on local real estate and financial markets.

Source: Author.

Table A.13.2. Restructuring Agencies

Restructuring	*Objectives of restructuring agency*	*Asset transfer*	*Outcome*	*Key factors*
Finland: Arsenal • Began activities in 1993, still in operation; expected to close in the year 2000; set up to absorb nonperforming assets • Public ownership • Stand-alone entity	• Established as a clean-up mechanism for the Savings Bank and Skopbank • Manage, restructure, and liquidate nonperforming loans and other holdings, in an orderly manner and at minimum cost	• Amounts of assets transferred: assets transferred had a book value of Fimr 42.9 billion • Sectoral breakdown of assets: only nonperforming loans transferred; real estate assets amounted to 34 percent; client receivables 41 percent; assets under management and other assets 25.3 percent • Criteria for asset transfer: All nonperforming assets transferred to Arsenal regardless of type and size of loans • Transfer price: book value	• At the end of 1997, Arsenal still managed 46.5 percent of the assets that were transferred to it. • By the end of 1997, Arsenal had disposed of 78 percent of the real estate assets it had taken over. • The extent to which Arsenal accelerated corporate restructuring and how active Arsenal was in corporate restructuring remains unclear. • Real lending to the private sector remained strongly negative in real terms in the years after the establishment of Arsenal.	Favorable factors: • A large amount of real assets were transferred, including client receivables, which made loans easier to restructure or dispose as less politically sensitive issues are involved (real estate is considered to be a more cyclical industry). • Appropriate funding allowed Arsenal to mark assets at market value after transfer. • Arsenal had professional management and adequate skilled resources. • A benign macroenvironment, in which real GDP rebounded strongly, and the economy expanded at 4–5 percent in 1994–95. Unfavorable factors: • Transfer of all types of nonperforming loans regardless of type and size of assets may have made it more difficult to use wholesale divestiture techniques and also required Arsenal to build up expertise in different areas.

(table continues on following page)

Table A.13.2 continued

Restructuring	*Objectives of restructuring agency*	*Asset transfer*	*Outcome*	*Key factors*
Ghana: NPART • Initiated operations in 1990; closed in 1997, 2 years later than stipulated • Wholly owned government agency • Set up as centralized stand-alone agency	• Restructure and recapitalize publicly owned government banks • Restructure companies and expedite corporate restructuring • Maximize recovery value to reduce fiscal burden on the government	• Amounts of assets transferred: about 13,000 accounts were transferred to NPART • Sectoral breakdown of assets: corporate loans from state and private sector companies across industrial and service sectors; most loans collateralized by plant, equipment, and machinery • Criteria for asset transfer: nonperforming assets, otherwise process of asset transfer nontransparent • Transfer price: book value of assets excluding accrued interest	• NPART failed to play a substantial role in expediting or enabling corporate restructuring. • NPART functioned effectively as a collection agency, restructuring its loan portfolio via extension of maturities or modifications to terms and conditions. • While government-owned banks were cleaned up through transfer of assets, and banks were operationally restructured, state-owned commercial banks in Ghana appeared to be in financial difficulties again in the late 1990s. At the end of 1997, state-owned commercial banks had nonperforming loans exceeding 15 percent. • Lending to the private sector did nonetheless recover and turned strongly positive in 1992.	Favorable factors: • While inadequate legal framework hampered the restructuring and sale of assets, an extra-judicial tribunal was set up to mitigate the problem. However, NPART was slow to make use of the tribunal, which often sided with the debtor. • NPART received substantial foreign aid in the form of money and technical support. A team of expatriate experts, out of which two were former U.S. RTC officials, managed the operations of NPART. Unfavorable factors: • A large amount of banking system loans were transferred, amounting to 51 percent of banking system assets, and no clear eligibility criteria for the type of assets to be transferred were established. As a result NPART ended up with disparate set of assets. • More than 50 percent of assets transferred were loans to state-owned enterprises. This type of asset is typically difficult for a government agency that lacks independence to restructure.

(table continues on following page)

Table A.13.2 continued

Restructuring	*Objectives of restructuring agency*	*Asset transfer*	*Outcome*	*Key factors*
				• Initial funding problems slowed down the establishment of NPART and the development of professional expertise. • Senior management consisted of political appointees. • The agency lacked political independence. • Corporate restructuring efforts being undertaken by various government agencies and NPART were not coordinated. • A weak legal framework caused, for example, asset sales to be impeded by the fact that debtors had to agree with sale of assets.
Sweden: Securum • Set up in 1992; expected to operate between 10 and 15 years; closed operations successfully in 1997 • Public ownership	Securum/Retriva: • Function as clean-up agencies or bad banks for Nordbanken (Securum) and Gotha Bank (Retriva), two banks that	• Amounts of assets transferred: gross value: SKr 67 billion, 4.4 percent of total banking assets (Securum); gross value SKr 45 billion or 3 percent of SKr banking assets (Retriva) • Sectoral breakdown of assets: 80 percent of assets were related to the real estate market; Securum: loans 91.1 percent, share portfolio 6.2	• Securum/Retriva succeeded in managing and selling assets in relatively short period of time. • Most of Securum's and Retriva's assets were real estate assets. Shareholdings were mostly concentrated in construction companies. Thus, while Securum may have helped to expedite restructuring	Favorable factors: • The type of assets—mostly commercial real estate—were easier to restructure as the assets were less politically sensitive (layoffs); high concentration of the economy may have made industrial restructuring easier. Also, transferred assets that were of particular type, size, and

(table continues on following page)

Table A.13.2 continued

Restructuring	*Objectives of restructuring agency*	*Asset transfer*	*Outcome*	*Key factors*
• Set up as a stand-alone agency Retriva: • Set up in 1993; absorbed by Securum in 1995; public ownership • Set up as a stand-alone agency	government had taken over • Recover maximum values of nonperforming loans transferred to it • Establish best practice in corporate restructuring for private banks	percent, real estate 2.7 percent; Retriva: Loans 86.2 percent, real share portfolio 1.6 percent, real estate 12.3 percent • Criteria for asset transfer: mainly size and complexity of loan: only loans greater than SKr 15 million were transferred, typically consisting of corporation with operations in different countries or complicated structures in terms of subsidiaries; no takeover of assets that could be securitized • Transfer price: assets transferred at book value	in the real estate and construction industry by enhancing coordination among debtors, its impact on the restructuring efforts in other sectors of the economy appears to have been limited. • In terms of restructuring Nordbanken and Gotha Bank, management was changed, and the banks were operationally restructured and successfully sold to private investors. • Real lending to private sector by banks did not recover. In 1993 and 1994, real credit to the private sector contracted significantly.	structure limited the amount of assets Securum had to deal with, making restructuring a more manageable exercise. • Private management and strong governance mechanisms ensured the agency's independence. • The agencies had prompt structured appraisal of assets and a transparent process of asset management, restructuring, and sale. • The agencies had adequate legal frameworks. • The agencies had adequate funding and adequate skilled resources. • A limited amount of assets were transferred (7.7 percent of banking sector assets). • The real estate market recovered. • Economic growth recovered. In 1994, real GDP growth turned positive. Unfavorable factors: • The agencies experienced sporadic bouts of scandal due to the incentive-compensation scheme for employees.

Source: Author compilation.

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