International Association of Deposit Insurers
Research Letter
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How to Build Efficient and Effective Asset-Disposition Strategies?

Introduction

After a problem bank has been closed, the responsible entity effectively inherits the bank's assets and many of its liabilities. When liquidation and reimbursement of depositors' claims is adopted as a resolution method, the assets and liabilities of the failed institution are transferred to a receiver/liquidator. In a Purchase & Assumption transaction, however, an acquiring bank assumes some or all of the assets and liabilities of the failed bank. Practically, performing assets may be sold as part of the resolution transaction, but investors are often reluctant to assume non-performing loans (NPLs). Hence, those assets not sold to the acquirer at resolution are transferred to the receiver/liquidator for disposition or assumed by government-owned asset management companies (AMC) in some countries, like Japan and Korea.

This Research Letter aims at offering practical methods on how to efficiently manage and dispose of a failed bank's assets in a resolution process. It is designed to help deposit insurance practitioners undertake efficient and effective asset-disposition strategies. The topics addressed in this issue are very much related to the guidance points for conducting the recovery process addressed in the Guidance Discussion Paper on Claims and Recoveries (Discussion Paper), which was presented during the IADI's Fifth Annual Conference from 15 to 17 November 2006.

The Discussion Paper pointed out that once a bank has failed, liquidation of its assets should be pursued on the basis of the economic merits of the available choices with the goal of recovering maximum value possible. In this regard, the Discussion Paper suggested some important guidance points on the recovery process. They include:

- ✓ Effective and efficient asset-disposition strategies should reflect the type and quality of assets that must be sold and should include tools to validate valuation assumptions employed in the appraisal process.
    - The receiver must identify, quantify, and manage or hedge risks related to interest rates, market fluctuations, disposition strategies and asset-specific and legal issues.
- ✓ Two goals – disposing of assets quickly and achieving maximum value – must be balanced by the receiver (or responsible entity) in its decisions regarding asset sales.
    - Asset-disposition strategies should maximize recoveries on a net present value basis.
    - If other considerations (such as a concern for system-wide stability, or those required by the laws of the country) are mandated to take precedence over these goals, they should be identified and addressed explicitly by the receiver.

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Asset Pooling – What is that all about?

In order to prepare efficient and effective asset-disposition strategies, practitioners should first carry out due-diligence on the assets and classify the type and quality of assets concerned.

The types of a failed bank's assets can be roughly classified as 1) loan and lease contracts, 2) securities, 3) real estates and other valuable items such as artistic goods.

The assets can be further classified depending on the quality and other distinctive nature of the assets. (Please see table below)

Table 1: Asset Pooling: An Example

Asset Types	Quality	Other Distinctive Characteristics
Loan and Lease Contracts	• Performing or Non-Performing	• Whether the maturity is long or short? • Whether the contract is foreign currency denominated? • Whether the legal jurisdiction of the contract is outside of the country? • Whether the debtor is a legal entity? • Whether there are collaterals or guarantors with regard to the contract? • Whether the debtor is subject to a special legal management or work-out? • Whether there are pending legal issues regarding the contract?
Securities	• Marketable or Non-Marketable	• Whether the maturity is long or short? • Whether the securities are foreign currency denominated? • Whether the legal jurisdiction of the issuer is outside of the country?
Real Estate And Others		• Whether the real estate is located outside of the country? • Whether there are pending legal issues regarding the real estate? • Whether the real estate is owned by several owners?

Building asset-disposition strategies

If well-classified information on the failed bank's assets is accessible, the receiver (or responsible entity) will then be able to verify which is the most efficient and effective method for each pool of assets. A "Retaining" strategy may also be a potential alternative for the receiver (or responsible entity) to choose. In alternative cases, however, the receiver (or responsible entity) should choose the strategy that maximizes recoveries on a net present value basis.

The discount rate works as a crucial factor to determine the net present value of each disposition strategy and it also heavily depends on the non-performing loan (NPL) market condition and forward looking debt-servicing capability of the debtors. When calculating the net present value of a "Retaining" strategy, the receiver should consider the credit default risks of the debtors and the maintaining costs for the professional asset management. In the case of "Bulk Sales", however, investors may require and apply a considerably higher discount rate at the cost of the transfer of the credit default risks of the debtors.

As a conclusion, various asset-disposition strategies for different types of assets are introduced in table 2.

Table 2: Asset-Disposition Strategies on each Asset Pool: An Example

Disposition Strategies	Asset Pool
Retaining (under the management either by its own skilled staff or through delegation to a professional AMC)	• Performing loan and lease contracts with relatively short-term maturities • Assets with special condition of forbidding disposition or with pending legal issues • Assets that need socio-political considerations such as loans with guarantee from foreign government.
Bulk sale (Outright Sale, Equity Partnership, Block Sale of Stocks, etc.)	• Assets that need to dispose of quickly • Assets that may not be disposed of in other ways • Secured or non-secured NPLs or securities • Asset that need high maintaining costs despite of relatively low recoveries
Individual sale (Bidding, Private Negotiation, etc.)	• Assets with the specific nature that may make private negotiation with the debtor or a certain investor a better alternative to market sales • Marketable securities that can be traded in the securities market • Real estate and other valuable items
Asset-Backed Securities	• Assets that have former collection records and relatively stable cash flows until the maturities • Assets that have no problem in transferring the title and ownership to others • Assets whose legal rights can be separated from the bankruptcy trustee when the originator goes bankrupt • Assets with relatively good credit ratings

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