AN AMC STRUCTURE TO TACKLE EUROZONE LEGACY BANK DEBTS

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AMC obstacles in general

- Valuation and distribution of losses –
  - if net book value the AMC loses disproportionately
  - if market value the bank will need massive equity injections or otherwise resolution and bail-in (even as an open bank process under the BRRD)
- Transparency and market for lemons situations
- Moral hazard – unless burden sharing
- Governance:
  - warehousing of bad credits of connected parties
  - providing a lifeline to “zombie companies negating the virtuous impact of resolving debt overhang
    - E.g., the PRC scheme

AMC advantages for Corporate NPLs (in general)

- A sound track record of earlier use in the Scandinavian and Asian banking crises – also Ireland
- Clean cut solution – a ceiling is placed on bank losses
  - It provides certainty to equity and bond market investors about the state of bank balance sheets
- Lending resumes as the debt overhang recedes
  - Debt overhang is eating percentage points from GDP growth as opportunity fo new investment is passed up
  - A liquidity draught serious impediment to the recovery of the EZ periphery
- It aids turnarounds
  - Economies of scale in hiring PE workout skills
  - Single point of decision-making
- An radical solution frees up very considerable management time as most of it right now in the high NPL ratio countries is dedicated to NPL management and resolution
- Economies of scale in debt marketing and issuance – aids the creation of a liquid market for NPLs

AMC advantages (for Corporate NPLs) in the EZ (i)

- NPLs act as a drag to EZ recovery
- Bail-ins on a systemic (as opposed to idiosyncratic) basis are the nuclear option as they can induce creditor flight and funding problems post-resolution (Avgouleas, Goodhart 2015)
- The threat of bail-ins can have a behavioural impact inducing regulatory and management forbearance
- A sensible AMC structure would add credibility to the BRRD draconian bail-in provisions
- The Italian bank rescues showed that the exemption can easily become the rule

AMC advantages (for Corporate NPLs) in the EZ (ii)

- **Can lower the cost of funding for banks**
  - In countries like Greece it aids the repatriation of deposits (in conjunction with elimination of currency risk) making banks less dependent on ELA and lowering their cost of funding
  - **Investor confidence in bank solvency**
  - **Ease the burden on the ECB vis-à-vis purchase of banking assets**
- **Better co-ordination of restructuring of multiple claims**
  - Big corporate creditors will invariably hold loans from several domestic banks
  - Banks face asymmetrical incentives and a series of prisoner dilemmas in co-ordinating joint action on corporate debt restructurings,
  - In such an environment of multiple equilibria/disequilibria is highly unlikely that a speedy NPLs resolution can be reached save an optimal one
  - Whereas the AMC being a focal point of entry faces none of those dilemmas and conflicting incentives

AMC obstacles in the Eurozone

- Asymmetrical legal regimes impacting in recovery rates and timeline
- Asymmetrical governance and transparency standards
- Severe market for lemons situation in some of the worst hit jurisdictions
- Inherent/existential (rather than Treaty prohibited) fear of fiscal burden sharing and debt mutualisation
- State aid ”rules” (Commission 2013 Banking Communication and the *Kotnik 2016* case) mandate burden sharing, foremostly for shareholders but also subordinated creditors (though how strong is the requirements for the latter is a matter of debate)
- The BRRD bail-in requirement

SO IS THERE A SOLUTION THAT CAN RESOLVE THE IMPASSE?

Avgouleas, Goodhart 2017 (i)

- Holding company structure/quasi-ring-fenced country-based AMCs
- Centralisation of decision-making, transparency and marketing (EZ holding company/agency)
- Aids comparability of recovery and effectiveness of country recovery regimes
- Debt platforms can be established at the centralised level
- Centralisation and objectivisation of valuations
    - EIB acts as the valuer
    - Price calculated by reference to net book value, market value, Long-Term Economic Value (weighted equally **unless proven unsound**)
    - Real life auctions held, where possible, to identify market value
    - Clear-cut and transparent distribution of losses

Avgouleas, Goodhart 2017 (ii)

- Decentralisation of losses/no permanent transfers/no mutualisation
- Predominantly private scheme at the member state level – bank owned scheme funded by shareholders' equity and asset backed debt
- But the ultimate guarantor of residual losses the state via the ESM precautionary recapitalisation facility in the form of a guarantee- (contingent loan/contingent credit that may or may not have to be disbursed) rather then an outright loan (instant disbursement) –
  - ESM statute change?
  - Or just an opinion issued by its board as to the legal meaning of the term loans?
- Temporary transfers via the ESM to aid financial stability legal under ECJ's ruling in *Pringle*

Avgouleas, Goodhart 2017 (iii)

- Clawback (only) for the worst offenders to battle moral hazard
- Structural conditionality a possibility
- Burden sharing ingrained in the scheme:
  - bank shareholders' lose money through the bank's participation in the scheme
  - raising new equity may be mandated
- Is it legal state aid if subordinated creditors are not hit?
  - Could CoCos be converted –
  - would require change in CoCo documentation via CACs
- It presents no fundamental discrepancies with Enria 2017 and other plans