



Asian Asset Management Companies in Retrospect

In the decade since the Asian financial crisis, the vast majority of problem loans and other distressed assets have reached a point of resolution. Publicly sponsored asset management companies (AMCs) were an important agent in the resolution of non-performing loans (NPLs), particularly in the crisis-affected countries of Malaysia, Thailand, Indonesia and South Korea. Each country chose a different path, based on the philosophical positions of government sponsors regarding the relative power they chose to grant their respective AMCs, the merits of temporary versus permanent operating charters, and the desired speed of resolving problem assets. This *Asia Focus* provides a brief history of these AMCs, describes their asset purchase methods, and compares their resolution results and future prospects.

HISTORICAL OVERVIEW

The Asian financial crisis had a particularly severe impact on the real economies of the crisis-affected countries given the heavily bank-centric nature of their economies. As NPLs reached excessively high levels, it became very difficult for these banks to remain solvent, let alone act as effective financial intermediaries. This in turn led to immediate and severe financial dislocations, which had commensurate impact on the real economy. In response to this state of crisis, one of the actions taken by many countries, including South Korea, Indonesia, Malaysia, and Thailand, was the establishment of AMCs to assume control of these NPLs. This was generally done to provide a two-fold benefit of reducing the banks' burden of managing these problem loans, and improving the balance sheet of the distressed banks. Once NPLs were reduced to more reasonable levels, the sponsoring countries hoped that banks would be able to resume their role as financial intermediaries, and service the needs of new and existing customers.

The four AMCs discussed in this paper are Danaharta in Malaysia, Thai Asset Management Company (TAMCO) in Thailand, Indonesia Bank Restructuring Agency (IBRA) in Indonesia, and Korea Asset Management Company (KAMCO) in South Korea. Most of these AMCs were formed near the beginning of the Asian financial cri-

sis. A notable exception was KAMCO. While KAMCO was formally established in 1997, it was in fact a reorganization of an agency that was formed in 1962 to manage the distressed assets of a state-owned policy bank, Korea Development Bank.

TABLE 1 (next page) compares aspects of the four AMCs, focusing on inception dates and directives given to them by their respective governments regarding assumption of NPLs. More detailed descriptions are provided in the text that follows.

PURCHASE OF ASSETS

NPL Pricing

All four AMCs were given specific directions on how to price assets purchased from financial institutions, and all strived for a balance between losses to the bank transferring the asset and potential future losses to the AMC from paying too high a price. This balance was generally struck with a purchase price at fair value or some variant, with a profit sharing agreement as the compensation for the reduction in value. According to a BIS study, the average acquisition price of credits purchased by the AMCs in Malaysia, Thailand and South Korea was between one third and one half of book value.¹

Except for IBRA, profit participation was not only a sweetener given to the banks in lieu of selling for less than book value, but also an incentive for the AMC to achieve optimal price in debt resolution. For Danaharta and TAMCO, the AMC kept a relatively small portion of the gain and gave a majority to the selling bank. KAMCO allowed profit and loss participation through put and call options on assets sold.

NPL Transfer Requirements

All four AMCs were established with either formal government requirements for the transfer of NPLs or government incentives to do so. These were enforced by mechanical requirements, or more informally through either regulatory influence or as a requirement for government support. For

¹BIS Occasional Paper No. 3: *Public Asset Management Companies in East Asia*, February 2004, page 26

instance, if a Malaysian bank refused to sell, Danaharta would enforce a write-down of NPLs to 80% of its initial offer price, which was clearly a powerful incentive to transfer. KAMCO's influence came from governmental suasion of the banks as part of any government recapitalization discussions. Most governments strived for transfer of all NPLs. The notable exception was TAMCO, which required transfer of larger NPLs from public banks, allowing optional transfers of smaller NPLs from the private banks.

Financing of NPL Purchases

While direct government financing would have been immediate, and likely lower cost, it also would have required overt recognition as a budgetary drain. Consequently, financing was usually a combination of direct government support, through purchase of NPLs, and government-backed AMC bonds. For Danaharta, TAMCO, and KAMCO, funding was a mixture of direct government support to effectively capitalize the AMCs, and then government sponsored debt to fund the bulk of NPL purchases. IBRA is the notable exception, where the government directly funded purchase of NPLs, and did not resort to government sponsored bonds.

Special Powers

These AMCs were given a broad range of powers to obtain NPLs and to collect on assets acquired. Such powers were generally granted in response to what was often perceived as relatively slow legal proceedings to effect debt collection. Examples of such powers included the ability to seize debtor assets without prior court approval (IBRA) and the ability to force debtors to the bargaining table (TAMCO). Of course, many governments also moved swiftly to alleviate legal difficulties in areas such as forcing corporate reorganization, or repossession of collateral for sale. In this respect, KAMCO is notable, as it was not granted any specific new powers. But given KAMCO's long-standing experience in debt collection and South Korea's better functioning legal processes, the agency often forced reorganization and pursued collection strategies on recalcitrant borrowers using existing legal processes.

TABLE 2 compares certain performance measures, relative approaches to resolution, and sunset dates of the AMCs.

TABLE 1	Danaharta (Malaysia)	Thai Asset Management Company (TAMCO)	Indonesia Bank Restructuring Agency (IBRA)	Korea Asset Management Company (KAMCO)
Inception Date	1998	2001	1999	1997 (1962)
Pricing	Fair value, with profit sharing	Net book value, with gain / loss sharing	Effectively 100% of book value, no gain or loss sharing	Fair value, with gain or loss sharing
Government Transfer Requirement	Not required; if refusal to sell to AMC, write-down to 80% of offer price	Required, but only syndicated loans at public banks.	Not required, regulatory influence to transfer NPLs, pricing incentive	Required as part of government recapitalization
Means of Financing	Government support / backed AMC bonds	Government support / backed AMC bonds	Government support	Government support / backed AMC bonds
Share of Gain / Loss %	<u>Gain</u> : 80% to bank, 20% to Danaharta. <u>Loss</u> : No sharing	<u>Gain</u> : Even split of first 20%, then 100% of gain to bank up to book value <u>Loss</u> : First 20% to bank, next 20% split, remainder to	Not Applicable	<u>Gain / Loss</u> : Call and put options retained by bank and KAMCO respectively.

Sources: Danaharta and Malaysian government websites, TAMCO website, annual financial statements, Indonesian government website, KAMCO website

RESOLUTION AND FUTURE PROSPECTS

Recovery Rates and Disposition Strategies

As shown in the table below, Danaharta and KAMCO achieved the highest overall recovery rates, at 58% and 55%, respectively. TAMCO is not too far behind at 49%, though the bulk of its recoveries came after the other three, as it was formed a few years later than the other AMCs.

There are two general means for an AMC to achieve resolution of NPLs. The first is rapid disposition, which involves quick sale of the loan or collateral “as is” to a third party. The second is restructure, which involves a wide array of strategies to either allow the borrower to repay at least a portion of the loan in a reasonable span of time, or concentrate on improving the borrower’s viability. The two AMCs with the highest collection percentages (KAMCO and Danaharta) split their collections about evenly between the two methods. TAMCO predominately relied on restructures, and is third in recovery rates.

There are numerous difficulties in comparing AMC performance. Among many differences, AMCs were formed at different dates and operated in different

macro-economic and political environments. But while overall comparison of performance is difficult, it’s notable that countries with the highest recovery percentages used a variety of disposition strategies. For example, KAMCO regularly formed joint ventures with foreign and domestic investors to aid in managing collection of NPLs, and used securitization to dispose of assets to various investor groups. In fact, KAMCO sold a very high percentage of its loans to foreign partners, and securitizations accounted for approximately 20% of overall recoveries. Danaharta made use of a several different collection and loan restructure techniques, such as appointing special administrators and using foreign expertise if needed.

Employing a broad array of strategies, as KAMCO and Danaharta did, appears to be a significant factor in the performance of Asian AMCs. More generally, it’s reasonable to expect higher recovery rates by tailoring disposition strategies to the particular characteristics of each loan or borrower. For example, for borrowers lacking cash flow, or with loans secured by marketable collateral, prompt liquidation may be a more effective approach. On the other hand, borrowers with some level of consistent cash flow or unsecured loans would be more likely candidates for restructure.

TABLE 2	Danaharta (Malaysia)	Thai Asset Management Company (TAMCO)	Indonesia Bank Restructuring Agency (IBRA)	Korea Asset Management Company (KAMCO)
Assets Transferred to AMC (US\$ million)	\$14,691	\$23,991	\$64,288	\$111,200
NPLs transfers as a % of National loans	7.4%	18.7%	76.4%	29.8%
Estimated Recovery Rate of Book Value	58%	49%	28%	55%
Rapid Disposal / Restructure	46% / 54%	36% / 64%	75% / 25%	52% / 48%
Remaining Assets (US\$ millions)	0	Nominal amount	\$1,600 (now held by government)	\$33,000
Sunset Date	2005	2013	2004	None. Going Concern.

Sources: Danaharta closing statement as of September 30, 2005, TAMCO September 30, 2007 Quarterly Report, Indonesia Report to the World Bank, February 2004, KAMCO website, as of March 31, 2008, BIS Occasional Paper

IBRA's relatively low recovery rate (28% of book value) is likely due in part to the sheer volume of assets assumed; the company took control of more than three-quarters of total Indonesian bank loans, which put considerable strain on resources. But strategy appears to be another significant factor in the low recovery rate. IBRA's decision to seek bids for this large volume of loans predominantly in the domestic market probably resulted in substantially lower asking prices than what might have been possible with a broader strategy (like KAMCO's) that included more loan sales to foreign investors.

Sunset Dates and Future Prospects

Three of the four AMC's are either closed or quickly coming to the end of their natural life. Danaharta closed in 2005, and transferred residual assets to the government. IBRA had a higher volume of assets to manage, largely minority equity interests in certain banks. As a result, the government took the compromise approach of dissolving IBRA on schedule, and managing remaining assets under direct government control. TAMCO is scheduled to close in 2013, and currently has nominal assets under management. Until its closure, TAMCO plans to handle relatively minor problem asset transfers from financial institutions.

Malaysia, Thailand and Indonesia established sunset dates for three key reasons. The sunset date would tend to force reasonably prompt resolution of problem assets, minimize the cost of the AMC to the taxpayer, and avoid the potential moral hazard of being a perpetual government sponsored "dumping ground" for future NPLs.

KAMCO and the South Korean government have taken an entirely different view of this issue, as they believe it is crucial for a public institution to maintain core competencies in problem asset management. This philosophy is the primary reason KAMCO has such a long history of operation and no sunset date. In fact, KAMCO has broadened its original mission during the past few years, with steady expansion into overseas activities. This began with advising and training other AMC's during the early part of this decade. In July 2005, the Korean government formalized this change in direction by authorizing KAMCO's investment in overseas non-performing assets. KAMCO's most recent move was announcing the intent to purchase approximately \$1.0 billion of distressed residential mortgage backed securities (RMBS) in the United States. After purchasing the assets, KAMCO will then package and securitize them for sale to private parties. Given that funding for overseas purchases will be from private sources as KAMCO follows an "originate to distribute" model, and the agency's avowed desire to significantly

expand overseas, it is quite possible this will be the first of many more deals to purchase distressed assets in the U.S. and other overseas markets. From this sequence of actions, KAMCO will have transformed itself from a traditional AMC to a government sponsored investor in overseas distressed assets.

CONCLUSION

Most of the public AMC's established in response to the Asian financial crisis have closed or are nearing the end of their life. While their mission has been accomplished, the collective experience of these institutions would be of great value to any jurisdiction facing the extraordinary need to supplement bank and other private debt resolution activities with a public AMC. The AMC's in these four countries had notable similarities in their design. They established pricing for transferred assets that attempted to optimally balance NPL prices seen as reasonable by the transferring bank, yet minimizing AMC losses. Each jurisdiction provided explicit governmental support for its respective AMC, as demonstrated by mandatory requirements or strong incentives for NPL transfer, government-provided financial support, and the granting of special powers. Most of the AMC's were established with sunset dates, because they were seen as temporary measures to augment banks' resolving their own problem loans, and to avoid moral hazard in weakening such private asset resolution efforts. The one exception to this (KAMCO) has effectively expanded its mission beyond that of an AMC.

While it is difficult to compare performance of these AMC's, we can draw some lessons that could be helpful in the future. The two AMC's with the highest recovery rates each used a variety of disposition strategies that were intentionally designed to consider the different characteristics of the assets they had assumed, and to obtain as many purchase bids as possible for the loans they decided to sell. The specific strategies within this approach included securitizing assets, tailoring collection methods to specific loans, and tapping foreign expertise and capital. Any future AMC will surely face a different set of market and political conditions than those seen during the Asian financial crisis. Nevertheless, flexible strategies that allow a range of disposition methods are more likely to result in higher overall success.