



Brussels, 14.3.2018  
SWD(2018) 72 final

**COMMISSION STAFF WORKING DOCUMENT**

**AMC Blueprint**

*Accompanying the document*

**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN  
PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL AND THE  
EUROPEAN CENTRAL BANK**

**Second Progress Report on the Reduction of Non-Performing Loans in Europe**

{COM(2018) 133 final}

## Table of Contents

<b>SUMMARY .....</b>	<b>3</b>
<b>I. INTRODUCTION .....</b>	<b>20</b>
<b>II. PRECONDITIONS FOR CENTRALISED AMCS.....</b>	<b>22</b>
2.1. Maximising the benefits and efficiency of AMCs .....	22
2.2. Commitment to comprehensive macro and structural reforms, as well as banking sector reforms .....	24
2.3. Considerations of financial stability and public funds at risk .....	25
<b>III. CONDITIONS FOR ASSET TRANSFER TO AMCS .....</b>	<b>26</b>
3.1. Consistency with EU legal framework (bank resolution and State aid) .....	26
3.2. Needed diagnostics and critical mass of impaired assets .....	39
<b>IV. DESIGN AND SET-UP OF AN AMC .....</b>	<b>40</b>
4.1. Legislation, mandate and powers .....	40
4.2. Ownership and governance, institutional independence .....	42
4.3. Asset perimeter and size of the AMC.....	43
4.4. Asset valuation principles and processes .....	48
4.5. Accounting aspects.....	52
4.5.1. Accounting standards .....	52
4.5.2. Specific aspects of accounting .....	53
4.5.3. Accounting related disclosures.....	56
4.6. Data .....	56
4.6.1. Need for harmonisation of data .....	56
4.6.2. Data needs .....	57
4.6.3. Data quality .....	57
4.6.4. Data sharing and transparency .....	58
4.7. Conditions for bank participation.....	59
4.8. Funding.....	59
4.9. Impact on public finances and national accounts .....	61
4.9.1. Main considerations for sector classification of AMC units .....	61
4.9.2. Impact of losses related to impaired assets on government deficit and debt.....	62
4.9.3. Valuation of assets.....	63
4.9.4. Capital injections into banks and apportioned losses .....	63
4.10. Safeguard mechanisms and supervision.....	64
4.10.1. Safeguard mechanisms introduction .....	64
4.10.2. Time-limit safeguards.....	64
4.10.3. Financial safeguards .....	64
4.10.4. Risk management safeguards .....	65
4.10.5. Other safeguard mechanisms.....	66
4.10.6. Supervision.....	66

<b>V. EFFECTIVE OPERATIONS OF AN AMC .....</b>	<b>66</b>
5.1. Organisation and staffing, internal controls and transparency .....	66
5.2. Strategic planning, asset and financial management .....	67
5.2.1. Strategic planning .....	67
5.2.2. Asset and financial management .....	70
5.3. Interaction with transferring banks.....	71
5.4. Options regarding loan servicing .....	72
5.5. Closing the AMC .....	73
<b>ANNEX: OVERVIEW OF AID-FREE IMPAIRED ASSET RELIEF MEASURES ALTERNATIVE TO CENTRALISED AMCS .....</b>	<b>75</b>
NPL securitisation enabled by a market-conform State guarantee.....	75
Aid-free transfer of NPLs to a bank-specific AMC .....	77

## **SUMMARY**

### **Policy context**

The Council's "Action Plan To Tackle Non-Performing Loans In Europe" of 11 July 2017 recognises the complementarity of necessary actions by banks, Member States and the EU. The Action Plan invites the Commission and other actors to take steps on several fronts to tackle both the legacy stock of non-performing loans (NPLs) and the risk of build-up in the future. In order to achieve this, the Action Plan identifies four main areas where further action is needed to tackle NPLs:

- supervisory policies;
- structural reforms (enforcement and insolvency);
- the development of secondary markets for NPLs;
- aiding the restructuring of banking systems.

The Action Plan also invited the Commission to develop a Blueprint for national Asset Management Companies (AMCs) by in close cooperation with other European institutions (i.e. the ECB, EBA and SRB).

This Blueprint, drafted by Commission services, is to be seen in the context of the comprehensive package that the Commission services is putting forward in order to address the four areas identified in the Action Plan and thereby fostering financial stability in the EU. The purpose of the Blueprint is to set out how an AMC can be set up on the basis of these principles; however other ways of designing and operating an AMC may be possible.

This package will enable banks and Member States to better address existing NPLs and avoid excessive build-up of NPLs in the future. The package is an essential part of the Council's Action Plan. In combining several necessary initiatives, it creates the appropriate environment for dealing with NPLs on banks' balance sheets and reducing the risk of future NPL accumulation. Their impact is expected to be different across Member States and affected institutions. Some will have a stronger impact on banks' ex-ante risk assessment at loan origination, some will foster swift recognition and better management of NPLs, and others will enhance the market value of such NPLs. These initiatives mutually reinforce each other and would not be as effective if implemented in isolation.

Historically, AMCs have under the right pre-conditions been an important part of solutions to foster banks' stability. General lessons on how AMCs can be set up and how their operations can be run in an effective and efficient manner can be learned from historical examples, while keeping in mind that the legal framework has changed due the introduction of the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR). The main aim of AMCs has been to remove troubled assets from banks' balance sheets and thereby reduce the high uncertainty about the quality of banks' assets, which made access to finance very difficult. AMCs thereby accelerated the restructuring of banks with high levels of distressed assets, stabilised the national banking sectors at large and eliminated a significant impediment to the flow of new credit to the economy.

The possible use of AMCs is also closely linked to several other key elements of the Action Plan, in particular:

- Further developing secondary markets for NPLs is important in order to enable banks to better manage their NPLs. In addition, AMCs might significantly benefit from better functioning secondary markets as one way by which an AMC maximises the recovery value on its portfolio of NPLs is loan sales to third-party investors. Both the AMC and many potential end-investors would also be dependent on the availability of independent companies to service and manage the loans on their behalf.
- In its review of the Single Supervisory Mechanism (SSM), the Commission further clarified the powers of supervisors, i.e. that they have the power to make prudential adjustments to banks' provisions towards losses on NPLs on a case by case basis.<sup>1</sup> Without such clear supervisory powers, weaker banks could set aside too few funds (i.e. under-provision) to cover the expected losses on their NPLs, and pretend that real losses have not materialised.
- Many banks also have to enhance the management of their NPLs. They have to collect more accurate, undated and standardised data on their NPL holdings, for their own management purposes and provide these to supervisors. As regards data on NPLs, the Commission is working with the EBA towards standardised data templates. The EBA NPL Templates<sup>2</sup> aim to fostering transparency, comparability and proper valuation of NPLs. This should help banks to manage their NPLs better and facilitate the transactions of NPLs between banks and investors, including AMCs. Moreover, banks that have adequately written down the value of their NPLs will be more inclined to sell them as they would not realise an accounting loss at the time of sale.

### **Scope of the Blueprint**

The objective of this document is to provide practical guidance and recommendations for Member States when considering the design and set-up of centralised AMCs at the national level, building, where applicable, upon best practices from past experiences. The Blueprint therefore puts forward a number of non-binding principles, such as the relevant asset perimeter, the participation perimeter, considerations regarding the asset-size threshold, asset valuation rules, the appropriate capital structure, and the governance and operations of the AMC.

AMCs can be private or (partly) publicly funded without State aid, if the State can be considered to act as any other economic agent<sup>3</sup>. Setting up an AMC with State aid should not be seen as the default option and will, in all cases, be subject to all applicable rules including State aid rules, the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation SRMR. The Blueprint clarifies the permissible design for AMCs supported with a State aid element that can be used as an exceptional solution. Such AMCs will remain fully consistent with the EU legal framework, particularly the BRRD), SRMR and State aid rules.

---

<sup>1</sup> Art. 104 CRD and Art. 16 SSMR

<sup>2</sup> <http://www.eba.europa.eu/risk-analysis-and-data/eba-work-on-npls>

<sup>3</sup>This, inter alia, would mean that any transactions take place at Estimated Market Value (EMV).

A Member State's most effective measure to handle impaired assets depends on its specific situation, including the size of the problem, the concerned asset classes and banks' own capacity to manage and work out NPLs. A centralised AMC, as described in this Blueprint, is an effective measure under specific circumstances, namely when impaired assets affect a large part of the domestic banking system and mainly cover loans secured by commercial real estate and large corporate exposures (c.f. section 4.3). For these asset classes, centralised AMCs may enjoy a comparative advantage in working out impaired loans. Under different circumstances, alternative measures may be more suitable, for instance when the impaired assets constitute a very large share of the total assets of the banking system and are heterogeneous in nature. Several Member States have implemented such alternative measures with success in recent years.

Notably, the share of banks with high NPL ratios, the composition of NPLs in a Member State's banking system, and the capacity of the Member State to set up and, in the case of a publicly supported AMC, to operate and (at least partially) fund it, will determine an AMC's capacity to achieve economies of scale. Such considerations will influence the AMC's ability to restructure distressed debt, and allow borrowers a path back to viability and therefore determine whether a centralised AMC will be set up and how wide its mandate will be. Other key choices concern the transfer price of assets and the AMC's funding and ownership structure, which play a critical role in its future success.

Alternative impaired asset measures (IAMs) may include, among others, bank-driven initiatives, securitisation-based approaches, guarantees or asset protection schemes, as well as ad-hoc AMCs common to one or a limited number of banks.

#### **Preconditions for centralised AMCs**

The design of a centralised AMC should follow the identified best practices, as set out in the Blueprint. Otherwise, the AMC may not realise its potential benefits of maximising recovery values and foster financial stability and may even have a negative impact on financial stability and public finances. In the worst case, a loss-making AMC may have to be liquidated under the relevant corporate law, which could trigger the type of fire sale of assets that the AMC is intended to avoid. Similarly, the size of any asset removal scheme, including an AMC, and its riskiness will need to be limited for several reasons.

In general, a number of conditions must be met to achieve sufficient benefits and efficiency the AMC. To mitigate risks related to conflicts of interest and political pressure, sound governance standards are necessary. Managers and administrators must fulfil strictly defined fit-and-proper requirements. Conflicts of interest should be closely monitored and independence from political bodies must be ensured.

Moreover, transferring assets is costly. Good documentation of loans and collaterals and active cooperation of the transferring bank can greatly facilitate the transfer of impaired assets and reduce costs. Therefore, the transactions should be structured in such a way that the incentives of the transferring bank are aligned with maximising recovery values.

A prerequisite for the success of an AMC is its embedding in relevant structural reforms of the economy, the banking sector and relevant legal frameworks, in particular the ability

of the legal systems to enforce contracts and laws. European AMC's have in several cases been created within comprehensive macro-financial recovery programmes that included a set of structural reforms addressing weaknesses that were brought to the surface during the crisis. In this regard, insolvency, bankruptcy and foreclosure laws need to be or become robust in order to ensure that the AMC and prospective asset buyers can access the collateral of insolvent debtors under fair terms and within a reasonable timeframe.<sup>4</sup>

In order to make full use of an AMC, a Member State's banking sector may have to adjust in various ways. Hence, reforms of the banking sector should be initiated, including:

- address the emergence of new NPLs, most notably by sound underwriting practices;
- address the piling up of already existing NPLs, most notably by sound NPL management frameworks, as addressed by the ECB's NPL guidance<sup>5</sup>, and timely provisioning/ write-off practices;
- ensure a high degree of transparency and data availability on NPLs, based on the EBA data templates, to support other NPL workout measures, and to enhance market confidence more generally.<sup>6</sup>

### **Conditions for asset transfer to an AMC**

#### *Consistency with EU legal framework*

The AMC needs to be set up and operate in full compliance with the existing EU legal framework. Practically this entails that, in case the AMC receives public support, compliance with State-aid rules, the BRRD and the SRMR has to be ensured.

Under the EU's bank resolution framework, a bank requiring extraordinary public financial support – for instance to address a regulatory capital shortfall – may be declared "failing or likely to fail" (FOLF) by the competent or resolution authority. This triggers either the bank's resolution (if considered in the public interest by the resolution authority) or, alternatively, its liquidation under national ordinary insolvency law. Where impaired asset aid granted in the context of a transfer of NPLs from a bank to a publicly-supported AMC constitutes extraordinary public financial support,<sup>7</sup> a bank benefitting from such an IAM should thus in principle be resolved or liquidated.

---

<sup>4</sup> For the relevance of insolvency regimes, see for example J.-C. Bricongne (et al.): *Macroeconomic Relevance of Insolvency Frameworks in a High-debt Context: An EU Perspective*, ECFIN Discussion Papers 32, June 2016 ([https://ec.europa.eu/info/publications/economy-finance/macroeconomic-relevance-insolvency-frameworks-high-debt-context-eu-perspective\\_en](https://ec.europa.eu/info/publications/economy-finance/macroeconomic-relevance-insolvency-frameworks-high-debt-context-eu-perspective_en)). Moreover, in the context of financial assistance programmes in EU Member States, structural reforms related to the banking sector, such as enhancing the judiciary capacity or out-of-court settlements, have been inherent features of the programme design. References in this regard can be found in the respective programme documentation ([https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance_en)). Aspects related to data transparency, alignment and granularity have recently gained more prominence within such structural reform elements, as reflected in the ECOFIN Action Plan on NPLs from July 2017.

<sup>5</sup> [https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance\\_on\\_npl.en.pdf](https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf)

<sup>6</sup> <http://www.eba.europa.eu/risk-analysis-and-data/eba-work-on-npls>

<sup>7</sup> In accordance with Article 3(1)(29) SRMR and Article 2(1)(28) BRRD, 'extraordinary public financial support' means State aid within the meaning of Article 107(1) TFEU or any other public financial support at supra-national level, which, if provided at national level, would constitute State aid, that is provided in order to

However, the bank resolution framework provides for an exception to this general principle that is relevant in context of NPL transfers to a publicly supported AMC, namely when extraordinary public financial support is needed inter alia "to remedy a serious disturbance in the economy of a Member State and to preserve financial stability". In case a "precautionary recapitalisation" is granted, a bank will not be considered FOLF. Neither resolution nor liquidation under national ordinary insolvency proceedings will thus be triggered.

In the case of a publicly supported AMC, compliance with the applicable legal framework (i.e. State-aid rules, BRRD and SRMR) has to be ensured regardless whether resolution, insolvency proceedings under national law or, in exceptional cases, precautionary recapitalisation is employed. If the AMC buys assets at a price exceeding the estimated market value (EMV), the transaction involves State aid, in the amount of the difference between the actual transfer price (TP) and the EMV. The transaction has then to be approved by Commission before it can be implemented. A first condition for authorising such aid is that the assets' TP cannot exceed their real economic value (REV). Losses resulting from the write-down of NPLs from their net book value to the transfer price cannot be covered by the impaired asset aid. The valuation of impaired assets should be conducted by independent experts and validated by the competent authority based on the valuation provisions in the Communication.

Any impaired asset aid to a going-concern bank must comply with the general requirements applicable to restructuring aid. In particular, the following general requirements must be met before the aid is granted:

- restoring the bank's long-term viability;
- limiting State aid to the minimum necessary through burden-sharing and own contribution;
- limiting distortions of competition.

Irrespective of whether extraordinary public financial support is granted to a bank in a context of precautionary recapitalisation, resolution or liquidation under national insolvency proceedings, these general principles of the EU's State aid framework continue to be fully applicable, alongside the applicable bank resolution framework provisions.

Considering these general principles of the EU's State aid and the bank resolution framework, there are several scenarios of transfers of NPLs from a bank to a publicly-supported AMC, depending on the TP of the NPLs and the regulatory capital position of the bank. Each scenario implies different regulatory conditions and consequences and involves different relevant authorities:

**Scenario 1 - No State aid:** When a publicly supported AMC buys NPLs from a bank at market value, it acts as a market economy operator and, thus, provides no economic advantage to the ailing bank. Hence, neither State aid nor extraordinary public financial

---

preserve or restore the viability, liquidity or solvency of an entity or of a group of which such an entity forms part.

support is granted to the bank, and the measure is not subject to the EU's State aid and bank resolution framework.

Scenario 2 - Resolution: In the context of resolution of a bank, the use of the asset separation tool (AST) requires the creation of an AMC. The purpose of such AMC is to separate selected assets from a bank's balance sheet.

Scenario 3 - Insolvency proceedings under national law: NPLs are transferred in the context of insolvency proceedings under national law. In this case, the standard practice would be to split the failed bank and perform an asset separation so that the "good" part can be sold, provided that this is possible under the national insolvency framework. Centralising the management of impaired assets in an AMC may increase efficiency in the recovery of impaired assets sharing common characteristics. State-aid rules allow Member States to facilitate the liquidation of an ailing bank under ordinary insolvency proceedings through State measures. Such liquidation aid can be considered compatible with the internal market to facilitate the exit of non-viable players in an orderly manner without endangering financial stability.

Scenario 4 - Precautionary recapitalisation: Precautionary recapitalisation is a form of State aid that can be given under exceptional circumstances, which, provided that the conditions set out in Art. 32(4)(d)(iii) of the BRRD<sup>8</sup> are complied with, does not trigger a "failing or likely to fail" (FOLF) determination for the bank. This tool is usually not used to support the transfer of NPLs to a publicly supported AMC but targeted at providing an extra capital buffer to a bank that is likely to become distressed if economic conditions were to worsen materially. The conditions for its application are therefore more general in nature. Nonetheless, precautionary recapitalisation can also be used in the specific case of a transfer of impaired assets to a publicly supported AMC, provided that it is ensured that such transactions pursue the same objectives as capital injections and that the specific State aid conditions for impaired asset measures (IAMs) are also respected.

### *Diagnostic exercise*

The general purpose of a diagnostic exercise is to help determine the scope of banks transferring NPLs to an AMC, the assets to be transferred, and the terms and conditions under the applicable EU legal frameworks under which a bank can transfer assets to an AMC. Authorities should also use the diagnostic exercise to demonstrate that AMCs have an advantage over other NPL reduction measures for the entire banking system.

If a transfer of a bank's NPLs to an AMC is to be (partially) financed with a precautionary recapitalisation under the BRRD, that bank should first participate in a national or EU-wide asset quality review (AQR), stress testing or similar exercise. EBA guidelines provide further details on such exercise<sup>9</sup>, which needs to have the following features:

- a precise timeline;

---

<sup>8</sup> An analogous provision is contained in Article 18(4)(d)(iii) of the SRMR. Any reference to the BRRD provision in the remainder of the text should be interpreted also as a reference to the SRMR provision.

<sup>9</sup> Guidelines on the types of tests, reviews or exercises that may lead to support measures under Article 32(4)(d)(iii) of the Bank Recovery and Resolution Directive, EBA/GL/2014/09.

- a predefined scope, including a sample of banks justified by economic or prudential reasons;
- a common reference date (i.e. the "cut-off" date for the balance sheet data used for the AQR/stress test);
- a common methodology, including a range of hurdle rates and a common macroeconomic scenario;
- a quality assurance process, carried out by the relevant authorities.

In the case of establishing an AMC supported by State aid<sup>10</sup>, the purpose of the diagnostic exercise would be two-fold. First, it should help the authorities to determine an appropriate transfer price, which typically lies between the (estimated) market value (EMV) and the real economic value (REV) of the concerned assets.<sup>11</sup> Second, it should also inform the calibration of the potential related capital needs of the banks transferring assets to the AMC and the maximum amount of State aid that can be granted. Therefore, and in order to achieve clarity on the health of bank balance sheets, the diagnostic exercise should consist of an AQR and a stress test.

The AQR does not have to cover the entire balance sheet of the banks subject to the diagnostic exercise. Rather, to maximise efficiency of the exercise, it could target a well-identified part of assets that are likely to be separated and deconsolidated from the bank balance sheets through the transfer to an AMC. To do so, the type(s) of assets that constitute the main source(s) of a bank's vulnerability must be well-known and captured within the scope of the AQR. The entire asset perimeter should then be reviewed, to identify a potential misclassification of NPLs and remedy the related provisioning shortfalls. Ideally, this should be carried out at the level of individual debtors, in order to maximise the usefulness of the AQR results for the AMC.<sup>12</sup> The AQR methodology should facilitate the Commission's estimation of the EMV and the REV of the concerned assets, so that the results can feed into the related valuation process. The result of the AQR should serve as the departure point for the macroeconomic scenarios employed in the stress test.

The stress test exercise could be aligned with the well-established EU-wide or national stress testing exercises. However, the regular EU-wide stress test exercise is only performed periodically. Alternatively, and to address the potential need for methodological adjustment that would adapt the methodology better to the context of an AMC, authorities should consider running a parallel stress test review of credit risk and NPL valuations under adverse economic conditions. This review could use the adverse

---

<sup>10</sup> I.e. an AMC that is partially or fully publicly-owned (or even privately-owned but with actions that are imputable to the State, or benefiting from a State guarantee), buying assets at a transfer price higher than the EMV.

<sup>11</sup> The AQR should hence detect misclassifications and provisioning gaps so that the bank's balance sheet can be restated in a 'clean' manner before application of the stress scenarios and authorities obtain more transparency on appropriate transfer prices. Losses which the bank has to book as a result of the AQR are to be considered as incurred losses.

<sup>12</sup> There are synergies between the AQR and future due diligence and strategic review by the AMC management, for example related to filling data gaps, understanding the past and current performance of the asset, updating the valuation of collateral, and analysing the legal position of the creditor.

scenario of the EU-wide stress test, as long as it remains relevant, and the valuation models already established for the AQR.

The diagnostic exercise should cover either the entire banking system of the Member State, or, where not practically possible due to the large number of banks, all banks above a predefined exposure to NPLs, expressed in absolute and relative terms. In case of a large number of smaller banks with a collectively significant NPL stock, the authorities should carry out the diagnostic exercise on a representative sample of loans, covering a critical mass of relevant NPL portfolios. Hence, the stress test exercise should in this case be a top-down exercise run by the authorities, taking into account resource constraints of these authorities, rather than applying a bottom-up approach, which is the case of the EU-wide stress testing exercises.

The duration of this diagnostic exercise should be kept as short as possible. Nonetheless, based on past experience, the usual duration of an EU-wide stress test, from its launch to conclusion, stands at about 5 months. An AQR preceding the stress test will add at least two months to the process. Hence, a diagnostic exercise covering both an AQR and a stress test is likely to require 6 and 12 months to execute.

#### **Design and set-up of a centralised AMC**

The objectives, oversight, roles, functions and main design features of a centralised AMC must be based in legislation. To the extent that the AMC is set up in a resolution context, several elements in the existing framework on resolution (BRRD and SRMR) need to be complied with. If specific legislation is needed for the set-up of the AMC, it must take the specific AMC design into consideration and subsequently communicate this clearly.

The AMC's mandate must be clear and unambiguous. Any secondary objectives should be avoided unless clearly subordinated to its primary objectives. Legislation should also contain strong oversight elements, which will ensure that the objectives of the AMC are disrupted and that the AMC's operations are free of influence or lobbying.

Following from design and financial stability considerations, legislation should ensure that the AMC is established as a one-off vehicle: the asset transfers should be completed in a single round, and there should be no further opportunities for asset transfers to the AMC thereafter, outside of exceptional circumstances. Without these provisions, risks to the objective of the AMC and to financial stability more broadly may emerge.

Banks deemed by the diagnostic exercise to be in scope of transfer to the AMC may hence need to be obliged to transfer NPLs falling within the identified asset perimeter to the AMC. Obliging banks via national legislation to transfer NPLs to the AMC would encroach on their fundamental rights and would therefore need to be justified in the public interest (e.g. for financial stability purposes) and be proportional in nature.

The AMC should be designed with the objective to maximise the recovery value of its assets. The AMC should therefore aim to cover its costs. If it would be able to make significant profits, this would imply that transfer prices of assets were too low, penalising banks and, potentially, having imposed costs on tax payers associated with bank recapitalisations. Equally, an entity set up to make losses is not credible, not least from a

public finance perspective, which will demand that future loss expectations for the public sector, be minimised. The risk-taking of the AMC should be limited to the areas that are strictly related to the work-out of its assets.

Furthermore, the AMC's legal toolkit must not be unduly restricted. In particular, it should be able to enforce collateral and take collateral on its own balance sheet, also with a view of developing its assets to maximise their value. The AMC should be free to liquidate assets that it had once considered viable, if that is justified by changed circumstances.

The AMC should not be granted a banking license or an asset management license. Granting a banking licence would subject the AMC to bank regulation and supervision as well as stricter disclosure requirements, which may obstruct the discharge of its responsibilities.

Regardless whether the AMC has public support or not, it should operate as an independent legal entity, and not as a governmental agency. It should have full budgetary independence<sup>13</sup> and be protected from political interference. Managerial appointments at the AMC should be merit-based and stay outside of political control, as the AMC requires highly specialised expertise in order to fulfil its mandate. Being run as a private sector entity, the AMC can demonstrate its distance from governmental and political influence. Greater flexibility in staffing, etc., can also be attained in this way.

#### *Asset perimeter and size*

The success of a centralised AMC critically hinges on its scope. A few principles are key for identifying, within a given market, the appropriate size and scope of such AMC:

- Economies of scale and scope:
  - As the main holder of a specific set of impaired assets in a banking system, AMCs can achieve specific expertise and economies of scale in recovering value from specific assets. These, however, will be diminishing, as the number of assets and debtors increases. Historical experience also shows that significant economies of scope for various asset classes are rarely achievable for AMCs.
  - Under the right circumstances, the centralised AMC could aim at taking over a large share of impaired assets of a certain asset class to achieve greater economies of scale. Financial constraints related to the size of the AMCs and/or the impact of the asset transfers on banks may justify choosing a narrower scope for the AMC. The AMC will nevertheless need to be sufficiently large to achieve the objectives of minimizing financial stability risks.
- Maintaining critical size:
  - Economies of scale might diminish for an AMC beyond a certain size and complexity. This would suggest that the centralised AMCs should have a critical minimum size while not being too large relative to the market in which it operates. Furthermore, the transferred assets should not be overly diverse in their

---

<sup>13</sup> Budgetary independence is necessary to reduce the risk of political interference with the AMC's operation via the threat of reductions in the AMC's budget.

nature. The centralised AMC should assume assets for which it has a comparative advantage in working out.

- The wider the asset scope, the larger the AMC may become. Controlling the size and perimeter of the AMC will mitigate a range of serious consequences, e.g. for fiscal budgets, as well as funding and capitalisation challenges for the AMC. A larger or more complex entity that relies on government guarantees will also create a larger and/or riskier potential contingent liability to the Member State. Equally, an entity with a wider scope will be more difficult to manage and hence will have more difficulties realising efficient recovery values. Moreover the larger the vehicle, the more capital it will require at set-up, which may lead to issues, including from a public finance perspective.<sup>14</sup>

Collateral attached to the assets transferred to the AMC are important, as they can help increase the recovery value from NPLs over time. In a crisis the value of collateral is usually depressed, but it can recover with improving macroeconomic conditions. Without sufficient collateral, the AMC may achieve insufficient recoveries. Commercial real estate (CRE) assets offer relatively easier value recovery in this regard than residential real estate (RRE). This has an impact on the suitability of these assets for inclusion in AMCs. Realising collateral for RRE will be highly problematic due to legal, social and political realities. Therefore, the AMC should only in exceptional cases be considered as the instrument to do so.

In principal, any type of loan can be transferred to an AMC. However, past experience suggests the following principles regarding asset transfer to the AMC:

- **Loans secured by commercial real estate (CRE)** can be transferred to the AMC - including those to small or medium-sized enterprises (SME), since they tend to have relatively large unit sizes, which allows the AMC to maintain a relatively light operation. Moreover, these assets have a strong connection with real assets (often property).
- **Loans to large companies that are not secured by CRE** can also be considered for transfer to the AMC since they exhibit some important suitable characteristics. The exposures are often relatively large and are therefore relatively cost-efficient to manage and service for the AMC. Corporate exposures will typically be large and complex. Their complexity will require a high degree of work-out intensity; but these inherent costs can be outweighed by the return on working out large exposures.
- **Beyond these two primary categories, there is scope to consider other, residual, portfolios for transfer.** Banks' own holdings of commercial or residential real estate have been successfully transferred to centralised AMCs in the past. In taking a debtor approach, the AMC should be willing to accept residual portfolios beyond the perimeter outlined above, to ensure that all of a given's debtors loans are captured. In this context, the AMC may also consider acquiring portfolios of non-performing buy-to-let mortgages. Although in such cases, this should only take place where the

---

<sup>14</sup> If the AMC is classified as a defeasance structure and reflected as such in the national accounts, private equity will have to be raised; a large private equity portion will be more difficult to raise than a smaller one.

legislation underpinning the AMC endows it with sufficient legal powers to effectively manage these loans.

- **Exceptions to these principles could be considered in highly specific contexts.** It may be the case that a Member State identifies highly specific cases where it is desirable to transfer other asset classes to the AMC, including, for example, residential real estate mortgages and SME loans. In general, these are unsuitable for AMC workout, but highly limited transfers could be considered in cases where, for example, the transfer would allow a bank to eliminate its exposure to a given business line or region, thereby aiding in its restructuring; where transfer would allow internal bank workout to be more concentrated on other exposures; or where other, highly evident synergies with the AMC could be identified.

In order to reduce the risk that such exceptions are misused and threaten the viability of the AMC, strict criteria and limits must apply to such circumstances. In such cases, the value and the number of assets should not exceed 15% of total AMC assets. This exception may not be binding where the debtor-level approach leads to a higher proportion of other assets being transferred. The rationale for this limit is to prevent too many unsuitable assets being transferred to the AMC, rendering it unduly burdened. On the other hand, this 15% envelope allows a “debtor-level” approach, i.e. the complete transfer of a given debtor's exposures. In this case, however, a significant majority of the transferred assets must be CRE-related and/or corporate loans, and exceed the minimum size thresholds, while not excluding residual transfers of other asset class exposures of the debtor.

Other asset classes, mainly unsecured retail loans, are more suitable for other types of impaired asset measures and should not be considered for transfer to the centralised AMC. The duration of these loans are often shorter, offering less time for the AMC to recover any sufficient value. Furthermore, they have the dual downside of potential political interference and very small individual loan sizes that lead to high complexity and costs related to servicing.

A minimum size threshold for loans to be transferred to the AMC would usefully exclude small and granular exposures and retain only the more complex large-ticket exposures for the centralised AMC, for which the AMC has comparative advantages. These thresholds should be differentiated according to asset type, while taking into consideration the impact of the threshold on the total portion of assets affected. There should also be a minimum threshold at debtor level in order to avoid saddling the AMC with too many small debtors, which would strain its work-out capacity. The Blueprint proposes indicative levels of such thresholds in section 4.3:

#### *Asset valuation*

In the interest of sound management, it is crucial that transfer prices are set in a way that provides an optimal level of relief for the troubled bank while ensuring the AMC is able to recover in an adequate manner all costs implied by its operations. In a stressed environment, it is likely that market values of impaired assets are significantly depressed.

If the AMC receives State aid, these considerations are especially important considering its potential impact on public finances.

A transfer at market value would provide no capital relief to the troubled bank because it would crystallise high losses and erode its capital buffers, but could lead to the potential gains from the recovery of assets by the AMC later on. Instead, publicly-supported AMCs can intervene by purchasing troubled assets at a higher price than their market price (but not higher than the assets' real economic value (REV) and thus provide aid equalling the amount by which the transfer price exceeds the current market price. In this case, all future cash flows and costs generated by the management of the impaired assets should be taken into account in an adequate manner in the determination of the transfer price.

#### *Accounting aspects*

In case the AMC is a non-listed limited liability company without a banking license, it has to prepare and publish financial statements in accordance with national Generally Accepted Accounting Principles [GAAP]. The national GAAP must be aligned with the EU accounting Directive. However, Member States have the option under the IAS Regulation to allow or require the use of EU-endorsed IFRS for companies or public interest entities (including banks). If the AMC issues shares or debt securities on an EU regulated market it must use IFRS for its consolidated accounts. So, the applicable accounting framework for the preparation of financial statements by the AMC is either EU endorsed IFRS or national GAAP.<sup>15</sup>

Within the limits outlined above, and depending on how Member States have exercised their options, the applicable accounting framework can be chosen when setting-up the AMC. When exercising that choice, the objective of the AMC should be considered, i.e. to recover the long-term economic value of the assets over the specified term and to foster financial stability. In particular, the choice of the accounting framework should take into account the risks related to the funding structure and the associated knock-on effects on the willingness of private investors to participate in the ownership structure. A higher relative use of fair value in the accounting framework could lead to more volatility of the P&L or capital than the use of historic cost combined with credit loss provisions.

Even though there might be no legal requirement to prepare financial statements according to IFRS, AMCs may apply EU endorsed IFRS if Member States have allowed that for non-listed companies. The application of IFRS may increase transparency for the stakeholders involved in the AMC, being beneficial especially in the case where AMC bonds are placed with third-party investors without the protection of government guarantees. The current common use of IFRS in the financial sector in a Member State may be another argument for considering the use of IFRS.

---

<sup>15</sup> See the [Commission's homepage on financial reporting](#). For EU rules that limited liability companies have to follow when preparing financial statements see [directive 2013/34/EU](#) ("Accounting Directive").

## *Data*

Transferring banks should be required to run rigorous internal controls and quality checks to ensure that data provided to the AMC are as complete, accurate, reliable, consistent and timely as possible. Banks should be required to use the EBA NPL data templates at an early stage and to comply with their validation rules before submitting data to the AMC.

The AMC should perform a thorough data quality assurance before taking on new assets, based on the EBA data templates that banks should use prior to the transfer. Immediate necessary actions upon establishment of the AMC include data collection and clearing, categorisation and prioritisation of assets and the setting up of specialised work-out teams. Furthermore, data cleansing processes are very important for correct asset pricing and for the sale process. In addition, a regular (i.e. bi-annual) quality assurance process is deemed necessary in order to secure minimum acceptable standards of data quality and ensure data relevance.

After transferring the assets, AMCs need to maintain their database up-to-date. When organising loan servicing, they need to ensure access to all necessary information to maintain the database up-to-date.

In addition to loan data, also collateral related valuation data should be updated on an ongoing basis. If there are no liquid markets for loans or collateral values available, valuation updates need to be performed at least annually. This will enable AMCs to perform accurate and timely valuations.

The AMC is expected to share its data with potential buyers / investors. For this purpose, it should use the relevant EBA NPL templates for portfolio screening to ensure consistency across market participants. A clear market standard based on the EBA NPL templates will help to widen the investor pool. Clear rules for data sharing must be in place. Data storage will have to be done in a way that at no point in time any confidential data can be accessed by third parties.

## *Funding*

The AMC, if publically supported, would ideally acquire assets by issuing senior unsecured bonds to transferring banks. The senior bonds would carry a full and irrevocable guarantee of the national Treasury and would be eligible for use as collateral in Eurosystem credit operations by their holders. The bonds will be bullet securities with a call option available to the issuer.

Market funding without a guarantee should be explored as part of the national AMC design process and, if feasible, may be preferred over the government-guaranteed funding. However, historical experience indicates that such market-based solutions prove difficult to implement and may require a significantly larger equity contribution.

The senior bonds should be structured against the background of cash flow uncertainty and liquidity risk. The AMC is expected to improve cash flow generation over time, as its recoveries tend to come late in its life cycle. However, the maturity of the bonds may need

to be shorter than the expected lifetime of the AMC, in order to minimise the total funding cost paid by the AMC.<sup>16</sup>

While the large majority of the funding should consist of senior guaranteed bonds, subordinated bonds could be issued and placed with participating banks or with equity providers. The latter is preferable as it would fully remove exposure to the transferred assets from the transferring banks as any remaining exposure means a continued dependence of the banks on NPL performance. The equity part should be sufficient to cover the expected Day 1 loss related to the initial recognition of assets at fair value and to provide a buffer that would allow the AMC to work out assets and carry out the necessary hedging strategy without being at risk of falling into negative equity. Part of that buffer could be structured as subordinated debt, for example calibrated to cover the unexpected loss on the assets. In the start-up period, the AMC may require a bridge loan to cover its initial outlays and working capital needs. This could be provided by participating banks against state guarantee, and repaid once the AMC generates income. The government guarantee would need to be remunerated in line with the EU State aid rules.

Appropriate controls must be put in place to ensure that AMC redeems senior debt, rather than building cash reserves or diverting resources to other interests. To ensure that an AMC's overarching goal – the timely wind down of its portfolio – is achieved and not diverted, strict guidelines should be laid down to ensure that an AMC reduces its outstanding liabilities at every reasonable opportunity.

#### *Impact on public finances and national accounts*

One of the key determinants of the fiscal impact of AMCs is their sector classification in national accounts. The choice is between S.12 (financial corporations) and S.13 (general government). AMCs would be classified as part of general government when they do not place themselves at risk and instead the government is carrying risks and rewards associated with asset management and the incurrence of liabilities by the AMC. The government puts itself in this position for public policy purposes, and direct or indirect financial support received by such AMCs implies a redistribution of income and wealth through their operations, which justifies their classification inside general government. If such risks and rewards are instead predominantly with the banking sector, the AMC would be classified in the financial corporations sector.

If an AMC is classified inside general government, its operations will be relevant for the 'Maastricht deficit'. The largest impact on deficit usually relates to the set-up of the structure and/or the transfer of the assets, if the value of cash provided by the government or the liabilities assumed by the government exceeds the market or fair value of the assets.

If the AMC is classified outside general government, government guarantees on the (realisation of the) assets could have an effect on public finances at inception. Government deficit and debt might also be affected in cases when an AMC is classified as a financial

---

<sup>16</sup> In the cases of SAREB and NAMA, the bonds have a contractual maturity of one year, and are rolled over on a periodic basis.

corporation, but some transactions and associated liabilities are considered as done or incurred on behalf of the government.

Conversely, if the AMC is classified inside general government, the impact on debt is more straightforward, due to the gross nature of the 'Maastricht debt': any obligation of an AMC towards units outside general government (e.g. to originating banks) that has a nature of deposit, debt security or loan will add to the government's 'Maastricht debt'.

Units holding predominantly impaired assets (usually referred to as 'defeasance structures' in statistical methodology) show considerable heterogeneity as regards their legal and administrative features, forms of government support, size and origin/background. It is also clear that the national context and framework in which these entities are created differ considerably from one MS to another. It is therefore important that the statistical impact of each case is always separately analysed by the Commission (Eurostat).

#### *Safeguard mechanisms and supervision*

Safeguard mechanisms aim to protect the taxpayers against future liabilities created by an AMC. Historically such mechanisms have been more important in countries with weak legal and institutional environments, especially when the financial sector cannot thoroughly assess the performance of an AMC or weak governance is predominant. An AMC should consider implementing the following safeguard mechanisms:

- (1) Time limits: in order to ensure that the AMC acts expeditiously;
- (2) Financial: to avoid that an AMC becomes a fiscal burden;
- (3) Risk management: to ensure that prudent risk management practices;
- (4) Other safeguard mechanisms: to ensure best market practices are followed.

There may be a trade-off between a fully-fledged implementation of safeguard mechanisms and the effectiveness of an AMC. Therefore, a thorough cost-benefit assessment should be performed before deciding on such safeguard mechanisms

#### *Supervision*

An AMC does not need to attract any deposits or issue new loans. Therefore, it does not require a banking license and thereby adhere to banking supervisory regulations. The AMC would hence be considered neither as a credit institution, nor as an investment firm. It would subsequently not be subject to CRR/CRD supervision.

However, even without a banking license, the AMC will need proper oversight. The appropriate oversight institution would need to be identified by the government under whose jurisdiction the AMC would be set up. Entities which might be designated for this purpose (in the following: supervisor) are the Competent Authority for prudential supervision/resolution, the central bank, comptroller's office / court of auditors or a joint oversight committee of these authorities. In addition, if public funding is at stake, an observer function for the European authorities could be considered.

## **Effective operations in an AMC**

### *Organisation and staffing, internal controls and transparency*

An AMC should be able to hire and adjust staffing as needed during its lifetime. It should also be able to pay market price for specialised skills needed in the work-out process. Moreover, it should not aim to develop its own heavy servicing platforms, with a possible exception for single large, bespoke exposures. Rigorous, best-practice, internal controls must be in place to secure the financial soundness of the AMC and to maintain the entities credibility. These controls should cover all relevant aspects of the AMCs governance and operations.

AMCs should have well-defined disclosure requirements and be, more broadly, transparent to the public. Transparency will be critical in the implementation phase, where it must be demonstrated that asset perimeters, participation perimeters and transfer pricing are rules-based and not subject to possible corruption or cronyism.

### *Strategic planning, asset and financial management*

A general strategic plan should be designed for an AMC's entire life. The three most important parts of a strategic plan are:

- Setting an objective with the consideration of the mandate;
- Selecting an approach for reaching the objectives and;
- Assessing performance and reviewing the whole process (strategic plan review).

The strategic plan should be set in multiple stages, preferably by defining the timespan of each stage. A clear performance measurement should be established, also in order to avoid the interference of external parties, especially as mechanisms against political interference. Performance could be measured by considering the speed of disposal and the profit/recovery percentage, while appropriately considering the operating environment and social benefits. For each stage, a milestone should be set, ideally in form of a threshold of disposed assets. The performance of the AMC should be assessed regularly in order to evaluate the adequacy of the strategic plan and effectiveness of its execution.

## **Disposal strategies**

AMCs have a mix of disposal strategies available to them. The first step in defining the possible spectre of solutions is identifying the viability of the borrower (either going or gone concern). Depending on the nature of the assets managed, the urgency of cash generation, and their life span, AMCs can choose between five main disposal strategies:

- Foreclosure and sale of collateral;
- Insolvency proceeding and liquidation;
- Sale of the loan;
- Restructuring (traditional, debt-to equity swap);
- Out-of-court arrangements (and quick recovery programmes).

### *Interaction with transferring banks*

To address moral hazard, banks need to share the potential losses of an AMC (at least in part). This should be achieved through banks being obliged to hold shares in the AMC.

There should however be no interaction or clawbacks after the transfer in order to ensure an effective risk transfer. Solutions that include clawbacks or requesting participating banks to provide collateral would create several problems and should be avoided. Most notably either the clawback is inefficient, meaning the public funds remain exposed to a failure of the transferring bank, or the very purpose of the transfer of NPLs into the AMC is defeated. The bank would then remain exposed to further losses on the AMC portfolio, and the NPL transfer would not definitively eliminate the risk from the bank's balance sheet but merely shift it from the asset side to the liability side of the balance sheet.<sup>17</sup>

Furthermore, requesting banks to provide collateral against future losses would raise issues in the context of the valuation of these assets and the market volatility at which the bank would expose itself or the assets (if listed). Another key issue with clawback solutions is the governance and timing regarding the valuation decision (with clawbacks legal risks would be increased). Hence, it should be a direct transfer taking the bank out of the decisions / activities post-transfer.

Lastly, if possible, originating banks should not be involved in the servicing of the loans beyond a certain interim period, as they are faced with an inherent conflict of interest, to the degree that they are holding similar assets themselves.

### *Closing the AMC*

The lifespan of the AMC should be finite, and defined in its business plan. It should be realistic, but challenging, to reduce room for complacency and intransigence, and to maintain pressure on management to reduce assets. At the same time, an AMC should have some flexibility in its lifespan<sup>18</sup>, to react to emerging developments, to allow it fulfil its primary mandate (maximisation of asset values) and based on the fundamental rationale of an AMC: to bridge intertemporal pricing gaps. Criteria for flexibly deviating from the planned lifespan should be set down out the outset of operations.

Executive incentives should be provided to strengthen the determination of the AMC's management to meet the deadlines, however, without creating an excessive pressure for asset resolution ahead of the target. A not-for-profit enterprise may aide in these incentives.

The legislation should not provide any opportunities to refocus the AMC towards a different business model, to prolong its lifespan beyond what is strictly necessary to resolve the assets, or to reopen the AMC to later asset transfers. A pre-determined

---

<sup>17</sup> See Martin Hellwig – March 2017 [Carving out legacy assets: a successful tool for bank restructuring?](#) (Scrutiny paper on the SRM provided at the request of the ECON)

<sup>18</sup> Subject to certain restrictions, i.e. no new business model and no prolongation beyond what is strictly necessary (see later on in this section).

lifespan<sup>19</sup> would need to be set at the outset, with a clear and measurable path towards wind-down, specified in the business plan, contingent upon reasonable assumptions about key parameters of baseline macroeconomic and asset recovery scenarios.

---

<sup>19</sup> The appropriate lifespan may differ depending on the type of assets and Member State specific context. Nevertheless, the pre-set, reasonable timespan also underlines that the value of the NPLs and the underlying collateral will only decrease over time. A macroeconomic recovery could deliver an uplift. However, waiting longer than, e.g., 10 years for such a recovery to take place is not sensible either, since by that time it is unlikely that the AMC would be able to retrieve the loss in recovery value.

## I. INTRODUCTION

Historically, and especially in the wake of the financial crisis, asset management companies (AMCs) have been an important part of solutions to clean up banks' balance sheets in some Member States. For instance, in the case of Ireland and Spain, NAMA and SAREB were policy choices in the face of acute financial sector distress and were partly carried out in the context of resolution. General lessons on how AMCs can be set up and how their operations can be run in an effective and efficient manner can be learned from such historical instances, while keeping in mind that they were set up before the introduction of the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR). The main aim of AMCs has been to remove troubled assets from banks' balance sheets and reduce related uncertainty premia, to accelerate the restructuring of banks with high levels of distressed assets and thereby stabilise the national banking sectors at large. AMCs have contributed to addressing financial stability concerns in countries with high levels of non-performing loans (NPLs) and to eliminating a significant impediment to the flow of new credit to the economy. Thanks to the fact that national banking sectors today are in far better condition (with decreasing yet still large NPL stocks), potential positive effects from a systemic NPL removal are likely to materialise in the area of credit extension rather than financial stability.

AMCs can also act as a catalyst to develop secondary markets for distressed debt. However, if poorly designed and/or managed, AMCs may also contribute to financial stability risks, including, in the case of publicly supported or guaranteed vehicles, potentially reinforcing the so-called sovereign feedback loop. It is important to recognise that such undesired and adverse consequences would bear the risk of undermining a fundamental principle of the BRRD<sup>20</sup> and of the SRMR<sup>21</sup> that is breaking the link between private losses and public finances. Overall, past experience has demonstrated that AMCs attain their objectives only when they are part of a wider and comprehensive strategy. Hence, AMCs should not and cannot be considered as a panacea.

More specifically, AMCs can offer a variety of potential benefits to the financial system. They procure expertise, can benefit from economies of scale, creditor coordination and they provide relief to affected banks that are struggling to manage their NPLs and aid them to re-focus on lending to viable firms and households. They also help to bridge the intertemporal valuation gap which is necessary to adopt structural reforms that take hold and hence improve the price of NPLs in secondary markets. However, there are also limitations and costs associated with setting up AMCs. For instance, the transfer of loans

---

<sup>20</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173, 12.6.2014, p. 190.

<sup>21</sup> Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L225, 30.7.2014, p.1.

to AMCs can involve a loss of information on the debtor, which can hinder restructuring and delay recoveries. In addition, protracted discussions on the potential set-up of an AMC could discourage the banks to take swift and necessary actions themselves. Furthermore, other issues that should be kept in mind and carefully considered include: set-up costs, the potential need for new capital to be raised by transferring banks, the capital requirements for the AMC itself, etc.

The objective of this blueprint is to provide practical guidelines for the design and set-up of AMCs at a national level, building upon best practices from past experiences. AMCs can be private or (partly) publicly funded with no need of State aid if the State can be considered to act in a similar way as a market economy operator would. The option of an AMC involving State aid should not be seen as the default solution since AMCs can take multiple forms and can be structured and financed in several ways. Considering the setting up of state-supported AMCs with a State aid element as an exceptional solution, this blueprint clarifies key success factors and the permissible design for such state-sponsored AMCs, consistent with the EU legislative framework, particularly the BRRD and SRMR, which are fully in force and aim at limiting government interventions, and State aid rules.

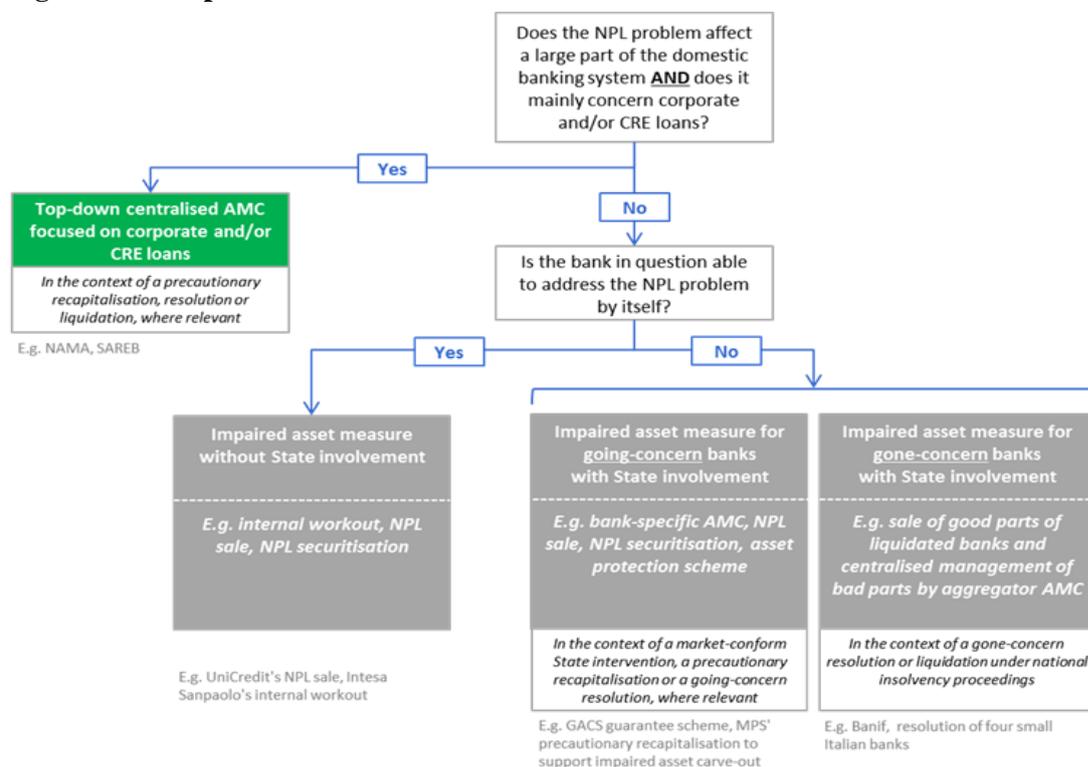
The context in which impaired asset problems emerge can vary significantly. Impaired assets can be the result of a specific macro-financial stress concerning a limited number of asset types (e.g. real estate bubble driven by excessive lending growth), or gradually build up during generalised long and/or deep recessions undermining the capacity to repay of a wide span of borrowers and thereby affecting the quality of a broad range of assets. Impaired assets can also result from deficiencies in loan origination practices or risk management. The presence of substantial stocks of impaired assets on banks' balance sheets can raise uncertainty regarding their valuation, which could undermine confidence in the concerned banks, threaten financial stability and hamper bank lending to the real economy. In such circumstances, reducing the NPL stock in the banking system becomes a public policy objective to put distressed banks once again on a stronger and healthier footing.

As recent history shows, for the banks that fail to restore their financial health through market mechanisms, the public policy response can be translated into a wide variety of impaired asset measures, which themselves need to be embedded in a broad and comprehensive strategy (see section 2.2 for more details). A Member State's choice of the most effective impaired asset measure depends on its specific situation and primarily hinges on the pervasiveness of the problem within the domestic banking sector, the asset classes that are concerned, and banks' own capacity to manage and work out NPLs.

A centralised AMC, which is the focus of the present blueprint, is a very effective measure in specific circumstances, namely when impaired assets affect a large part of the domestic banking system and mainly cover loans secured by commercial real estate and large corporate exposures (section 4.3). These asset classes AMCs enjoy a comparative advantage in working out impaired loans. If these circumstances are not present (for instance when the banking system's impaired assets are very heterogeneous), alternative impaired asset measures may be more appropriate and have been implemented with success in recent years by various Member States.

Alternative impaired asset measures may include, among others, bank-driven initiatives, securitisation-based approaches, guarantees or asset protection schemes as well as ad-hoc AMC common to one or a limited number of banks. Furthermore, various types of interventions can complement each other, thereby allowing for tailored approaches to the specific impaired asset situation, which a Member State is confronted with.

**Figure 1: Example decision tree for authorities in the face of a NPL crisis**



Source: Commission Services (DG COMP)

The Blueprint has been developed by the Commission in close cooperation with all relevant institutions, i.e. the ECB/SSM, EBA and SRB. It puts forward a number of common principles, such as the relevant asset perimeter, the participation perimeter, considerations regarding the asset-size threshold, asset valuation rules, the appropriate capital structure, and the governance and operations of the AMC.

## II. PRECONDITIONS FOR CENTRALISED AMCS

### 2.1. Maximising the benefits and efficiency of AMCs

There are a number of conditions that, if fulfilled, can maximise the usefulness and the efficiency of AMCs. AMCs are most useful when banks due to internal or external constraints lack the capacity to deal with impaired assets on their own. An AMC has the potential to pool exposures from distressed debtors and therefore make management more effective and efficient. It could also centralize scarce human resources and expertise and can therefore often handle and work out NPLs better than embattled banks that may suffer from weak management and poor credit policies. This should not prevent banks that are

failing or likely to fail (FOLF) from being liquidated or resolved under the BRRD, which provides for an efficient framework enabling market exit of troubled banks while minimising costs to the taxpayer and negative repercussions to the economy.

A careful design of the AMC and of its mandate is crucial to ensure its success. The choice of one centralised AMC vs. numerous decentralised AMCs in a Member State, with a wide vs. narrow mandate, is closely linked to the number of banks with high NPL ratios and the composition of the NPLs in the system, the capacity to achieve economies of scale and the possibility to restructure distressed borrowers back to viability. Other fundamental choices regarding the transfer price and the AMC's funding and ownership also play a critical role in its future success and need to be carefully reflected upon.

Under a decentralized approach, NPLs are left with the individual bank to deal with, whereas the centralized approach sees NPLs transferred to a centrally managed AMC. Each choice has its distinct advantages and disadvantages, with several trade-offs to be carefully considered. For instance, having one very large, centralised AMC may obtain economies of scale but could also become unwieldy.<sup>22</sup> This could potentially hinder the ability to react swiftly, e.g. in sales transactions. Conversely, the decentralised AMC allows for a more customised approach. This would be more appropriate when the NPLs are not systemic but rather isolated and bank-specific, and when the causes are not markedly shared by other banks in the system.

The decision regarding the mandate of the AMC, be it either wide or narrow, depends on: (1) the size of the NPL problem in a given Member State; and (2) the state of the market. Especially when the amount of NPLs in the system is large and the market for loans is distressed, fire sales should be avoided. In such a case, the AMC should be endowed with a wide mandate, enabling the AMC to collect, restructure and dispose of participating banks' impaired assets over the long term, hence restoring viability of these banks (e.g. SAREB, NAMA). Conversely, a narrow mandate is more appropriate when the amount of NPLs in the financial system is more limited, and when banks can be resolved and assets liquidated, taking away the need for a wide mandate (e.g. UKAR, Finansiell Stabilitet).

In a centralised AMC, management practices and expertise may be weaker than in private structures, and conflicts of interest and political pressure can be more frequent, reducing the efficiency and effectiveness of its operations. To mitigate these risks, sound governance is absolutely necessary: managers and administrators must fulfil strictly defined fit-and-proper requirements, conflicts of interest should be closely monitored and independence from political bodies must be ensured. Managers' remuneration (including all kinds of advantages) need to be transparent and well-defined. Ideally, they should be performance based.

Strong political will and a supportive legal framework are also instrumental in the success of an AMC. The design of the AMC and the transfer of impaired assets must strictly abide

---

<sup>22</sup> See section 4.3.

by EU regulation, in particular the bank resolution framework (BRRD/SRMR) and State aid rules.<sup>23</sup>

Finally, transferring assets is costly and harms business continuity. Good documentation of loans and collaterals as well as active collaboration of the staff handling the impaired assets in the banks can greatly facilitate the transfer and reduce the costs. Therefore, the transactions should be structured in such a way so as to keep the transferring bank's incentives aligned with maximising recovery values.

## **2.2. Commitment to comprehensive macro and structural reforms, as well as banking sector reforms**

A vital prerequisite for the success of an AMC is its alignment with relevant structural reforms. This is because the investors' pricing of the assets includes risk premia linked to enforcement prospects, which can be addressed by policymakers. European AMCs were often created within comprehensive macro-financial recovery programmes that included a set of structural reforms with a view to address weaknesses that were brought to the surface in the course of the crisis. In this regard, insolvency, bankruptcy and foreclosure laws need to be robust in order to ensure that the AMC as well as prospective asset buyers can access insolvent debtors' collateral under fair terms and within a reasonable timeframe.<sup>24</sup> Moreover, a variety of restructuring models should be readily available for cases where further active engagement with the debtor would ultimately increase the asset value more than a collateral sale. This is especially important in the context of safeguarding viable but indebted businesses. Experience shows that the success of an adjustment programme – and hence also the price recovery of the distressed financial assets – can rarely be expected unless investors are sufficiently convinced by the authorities' ability to adopt and implement appropriate measures.

In the context of the use of an AMC there might be a need for important changes in the banking sector regarding many dimensions, such as banks' loan origination practices, monitoring, cost efficiency, disclosure and internal governance. In this respect, different types of banking sector reform initiatives that should be undertaken include:

- preventive measures addressing the emergence of NPLs, most notably sound underwriting practices;

---

<sup>23</sup> See section 3.1.

<sup>24</sup> For the relevance of structural elements such as insolvency regimes see for example J.-C. Bricongne (et al.): *Macroeconomic Relevance of Insolvency Frameworks in a High-debt Context: An EU Perspective*, ECFIN Discussion Papers 32, June 2016 ([https://ec.europa.eu/info/publications/economy-finance/macroeconomic-relevance-insolvency-frameworks-high-debt-context-eu-perspective\\_en](https://ec.europa.eu/info/publications/economy-finance/macroeconomic-relevance-insolvency-frameworks-high-debt-context-eu-perspective_en)). Moreover, in the context of financial assistance programmes in EU Member States, structural reforms related to the banking sector, such as enhancing the judiciary capacity or out-of-court settlements, have been an inherent feature of the programme design. References in this regard can be found in the respective programme documentation ([https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance_en)). Aspects related to data transparency, alignment and granularity have recently gained more prominence within such structural reform elements, as reflected in the ECOFIN Action Plan on NPLs from July 2017.

- measures addressing the piling up of already existing NPLs, most notably sound NPL management frameworks, as addressed by ECB's NPL guidance<sup>25</sup>, and timely provisioning/ write-off practices;
- high degree of transparency and NPL data availability to support other NPL workout measures and to enhance market confidence more generally.

Finally, it is important that banks have adequate credit risk management practices in place. NPLs may be a by-product to bank lending and cannot be fully avoided. Nevertheless, one of the most important lessons learnt from past crises is the need for banks to implement sound underwriting standards and practices. Some banks' lending and monitoring practices and strategies before the financial crisis were one of the key drivers of the ex-ante build-up of the high stock of NPLs in a number of Member States. National Authorities will therefore need to make sure that loan origination standards are set to prevent the build-up of high levels of new NPLs in the future.<sup>26</sup>

### **2.3. Considerations of financial stability and public funds at risk**

The case for any AMC rests on the ability of the AMC to achieve higher recovery rates over its lifetime than the participating banks would do on their own and on remedying a significant threat to financial stability. The former justification informs the choice of the eligible assets to be transferred to the AMC and the participation perimeter. The latter, however, goes beyond operational and managerial considerations. Traditionally, centralised AMCs have been a part of a comprehensive policy response to an acute solvency and liquidity distress affecting entire national banking sectors. That context, arguably, is less relevant currently.

The design of the AMC should follow the identified best practices, as set out throughout this Blueprint. Otherwise, the AMC may have a negative impact on financial stability and public finances. As an example of pitfalls, an undercapitalised AMC may have an incentive to extend short-term forbearance to non-viable debtors, which in the longer run would be destructive to sound borrowers and may also lead to losses within the AMC itself. In the worst case, a loss-making AMC may have to be liquidated under the relevant corporate law, which would trigger the fire sale that the AMC is precisely intended to avoid. Similarly, the size of any asset removal scheme, including an AMC, and its riskiness will need to be limited for several reasons.

In the case of a publicly supported AMC, compliance with the current legal framework (i.e. the BRRD and the SRMR) has to be ensured. In particular, capital shortfalls that may arise in banks whose assets have been transferred to an AMC as a result of this transfer at a price not exceeding the assets' real economic value (REV), i.e. in most cases below the current carrying value, will qualify as extraordinary public financial support and, will in principle, trigger the determination that the bank is FOLF.<sup>27</sup> Furthermore, the scale of a

---

<sup>25</sup> [https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance\\_on\\_npl.en.pdf](https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf)

<sup>26</sup> Banks (and national authorities) should adhere to the upcoming EBA Guidelines on Loan Origination.

<sup>27</sup> See section 3.1.

publicly supported AMC must be limited to mitigate liabilities of the State. From a public finance perspective, if the AMC was to be state-controlled and classified in the general government sector, the capacity of the state to absorb the increase in public debt would have to be assessed, along with the need to provide adequate capital for the vehicle to operate. In addition, second-round effects may need to be considered, including the potential for later recapitalisation needs for the AMC or even the banking sector in adverse conditions, although appropriate design<sup>28</sup> and implementation principles should help mitigate this risk. The impact of contingent liabilities not just on public finances, but also on perceptions of sovereign creditworthiness should also be assessed, in light of the potential for negative sovereign-bank feedback loops to emerge.

A majority or fully privately-controlled AMC may be classified outside the government sector, and would therefore not result in an increase in government debt, provided that a number of conditions are met.<sup>29</sup> A privately-controlled AMC may limit the upfront costs of the AMC to the state, particularly when combined with an appropriate funding scheme.<sup>30</sup> However, a number of challenges arise in achieving such status, stemming from the size of the entity. The vehicle will have to be adequately capitalised in order to ensure that any losses incurred by the AMC will not ultimately have to be borne by the state. When public funding or guarantees are involved, the ESA 2010 provisions need to be borne in mind.<sup>31</sup> Finally, while a privately-controlled AMC may have desirable features, insofar as its liabilities are guaranteed, a publicly supported AMC may remain a contingent liability of the state and adverse developments could under certain circumstances have an impact on its status. This again raises the discussion on size, as a very large entity relative to the state may pose risks, perceived or otherwise.

### **III. CONDITIONS FOR ASSET TRANSFER TO AMCS**

#### **3.1. Consistency with EU legal framework (bank resolution and State aid)**

##### **Applicable regulatory frameworks**

AMCs need to be fully compliant with the existing EU legal framework. Practically this entails that, in the case the AMC receives public support, compliance with State-aid rules, the BRRD and the SRMR has to be ensured. A transfer of NPLs by a bank to a publicly-supported AMC is, as noted above, subject to two EU regulatory frameworks:

- the bank resolution framework, consisting of the BRRD and the SRMR.
- the State aid framework, under which at present aid to banks can be considered compatible with the internal market<sup>32</sup>, if the aid complies with the provisions of a number of successively developed Crisis Communications.

---

<sup>28</sup> See sections 3.2. and 4.3.

<sup>29</sup> See section 4.9.

<sup>30</sup> See section 4.8.

<sup>31</sup> See section 4.9

<sup>32</sup> Based on Art. 107(3)(b) TFEU

## **General principles of the bank resolution framework**

Under the EU's bank resolution framework, a bank requiring extraordinary public financial support – for instance to address a regulatory capital shortfall – may be declared "failing or likely to fail" (FOLF) by the competent or resolution authority. This triggers either the bank's resolution (if considered in the public interest by the resolution authority) or, alternatively, its liquidation under national ordinary insolvency proceedings. Where impaired asset aid granted in the context of a transfer of NPLs from a bank to a publicly-supported AMC qualifies as extraordinary public financial support<sup>33</sup>, a bank benefitting from such an IAM should thus in principle be resolved or liquidated.

However, the bank resolution framework provides for an exception to this general principle which is relevant in context of NPL transfers to a publicly-supported AMC, namely when extraordinary public financial support is needed inter alia "to remedy a serious disturbance in the economy of a Member State and to preserve financial stability", whereby the support takes the form of "an injection of own funds or purchase of capital instruments" and a number of further specific conditions (further discussed below) are met.<sup>34</sup> If all conditions for a "precautionary recapitalisation" are met, a bank will not be considered FOLF. Neither resolution nor liquidation under national ordinary insolvency proceedings is thus triggered.

Irrespective of whether extraordinary public financial support is granted to a bank in a context of precautionary recapitalisation, resolution or liquidation under national insolvency proceedings, the general principles of the EU's State aid framework, as outlined above, continue to be fully applicable, alongside the applicable bank resolution framework provisions.

## **General principles of the State aid framework**

Under the EU Treaty on the Functioning of the EU (TFEU), State aid can be granted only after it has been authorised by the Commission. The first question when confronted with a transfer of impaired assets to a publicly-supported AMC is therefore to verify whether it contains State aid or not.

If the impaired assets are bought by the publicly-supported AMC at the assets' market price – i.e. the price which private investors would pay at the same moment for the same assets – the transaction (impaired asset measure or IAM) does not involve State aid, and State aid rules are hence not applicable. As often the assets at stake are not traded and their price can therefore not be directly observed, the market price has to be estimated based on observable transactions for similar types of assets, yielding the Estimated Market Value (EMV).

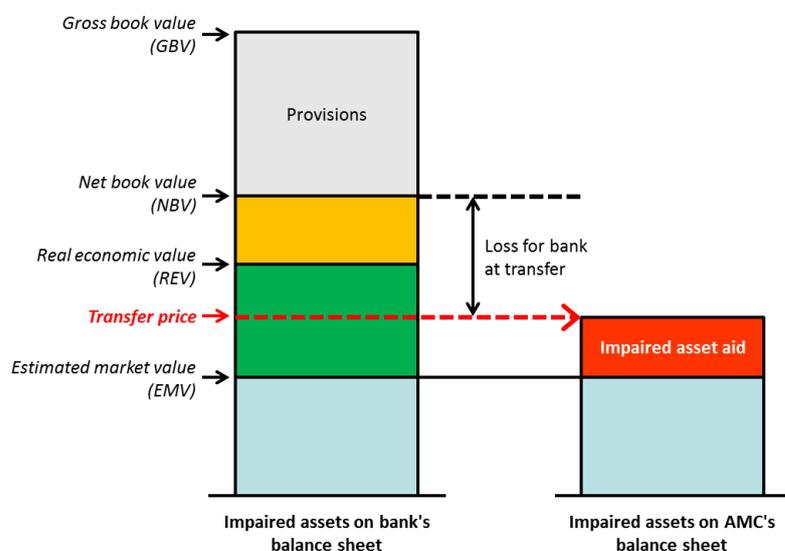
---

<sup>33</sup> In accordance with Article 3(1)(29) SRMR and Article 2(1)(28) BRRD, '*extraordinary public financial support*' means State aid within the meaning of Article 107(1) TFEU or any other public financial support at supra-national level, which, if provided at national level, would constitute State aid, that is provided in order to preserve or restore the viability, liquidity or solvency of an entity or of a group of which such an entity forms part.

<sup>34</sup> See Article 32 (4)(d)(iii) BRRD and Article 18 (4)(d)(iii) SRMR.

If the assets are bought by the AMC at a price exceeding the EMV, then the transaction involves State aid, which amounts to the difference between the actual transfer price (TP) and the EMV. The transaction has then to be approved by Commission before it can be implemented. A first condition for authorising such aid, which is laid down in the Impaired Asset Communication of 2009, is that the assets' TP cannot exceed the said NPLs' REV<sup>35</sup>. Losses resulting from the write-down of NPLs from their net book value (NBV) (in the books of the transferring bank) up to the TP are to be borne by the bank (i.e. by private means) and are not covered by the impaired asset aid. The valuation of impaired assets should be conducted by independent experts and validated by the competent authority based on the valuation provisions in the Communication.

**Figure 2: Calculation of impaired asset aid under EU State aid rules**



Second, any impaired asset aid to a going-concern bank must comply with the general requirements applicable to restructuring aid, laid down in the Commission's Banking Communication of 2013 and the Restructuring Communication of 2009.

In particular, the following general requirements must be met, and this before the aid is granted:

- *Restoration of the bank's long-term viability*: The Member State and the bank have to submit and implement a restructuring plan that demonstrates how the beneficiary bank's long-term viability will be restored and how the IAM in question is both necessary and sufficient to achieve this goal.<sup>36</sup>
- *Limiting State aid to the minimum necessary through burden-sharing and own contribution*: First, the bank must try to finance the restructuring costs with its own

<sup>35</sup> Cf. section 4.4. for further details.

<sup>36</sup> In a situation where over a short period of time a relatively large number of small banks in the same Member State would need to receive State aid, the Commission services could exceptionally consider determining and using a set of ex ante criteria to assess the banks' viability (e.g. certain efficiency ratios, cost of funding, etc.). Furthermore, the Commission services could in such a situation ensure a structured and proportionate approach in assessing the restructuring plans, in line with the Commission's case practice and guidelines. Finally, in view of the greater potential distortion of competition the use of ex ante criteria for larger banks cannot be accepted.

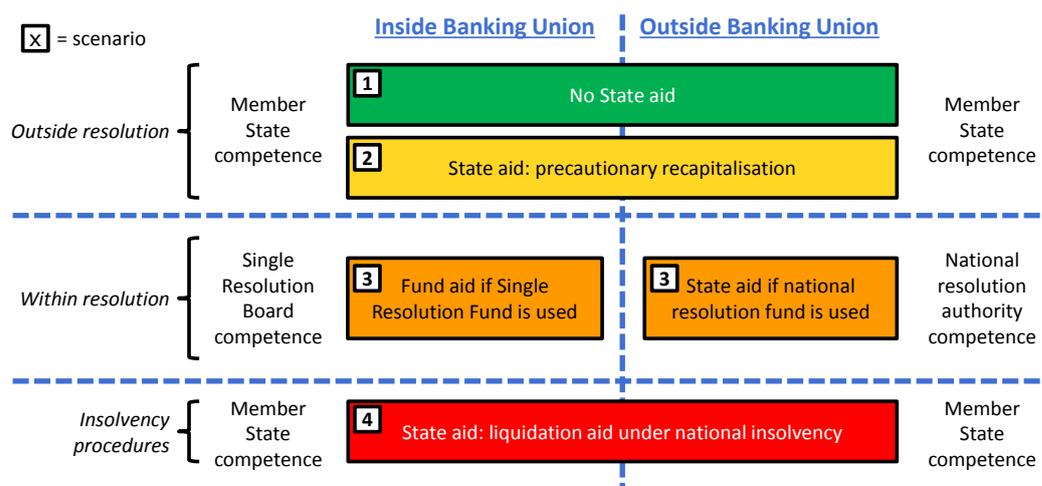
resources as much as possible. Therefore, the bank's restructuring plan should contain cost-cutting measures and propose the sale of non-core activities. In addition, the aid can only be authorised if shareholders and junior debtholders have contributed to the bank's losses first. In practice, this means that shareholders are written down or diluted while junior debtholders are converted (to equity) and/or written down.

- *Limiting distortions of competition:* Measures must be taken to mitigate competition distortions arising as a result of the IAM. The nature and form of such measures is dependent on the aid amount, the circumstances under which the aid was granted and the characteristics of the market(s) where the beneficiary bank operates. The measures typically include structural measures, behavioural measures and market-opening measures.

### Possible scenarios

Considering both the general principles of the EU's State aid and bank resolution framework, a number of scenarios in which a bank transfers NPLs to a publicly-supported AMC can be conceived in function of the TP of the NPLs and the regulatory capital position of the bank. Each scenario implies different regulatory conditions and consequences and involves different relevant authorities.

**Figure 3: Regulatory scenarios for NPL transfers to a State-owned AMC<sup>37</sup>**



#### Scenario 1: No State aid

When a publicly-supported AMC buys NPLs from a bank at market value, it acts as a market economy operator, thus providing no economic advantage to the ailing bank. Hence, neither State aid nor extraordinary public financial support is granted to the bank, and the measure is consequently not subject to the EU's State aid and bank resolution framework.

<sup>37</sup> For Sis, all relevant stakeholders are denoted. ECB is also a stakeholder for SIs in all three stages (outside resolution due to need for involvement in PR, in resolution/insolvency because of involvement in FOLF). For cross-border LSIs, there is SRB competence, combined with NCA on the supervisory side. Concerning insolvency procedures, SRB is responsible for public interest test.

## Scenario 2: Resolution

In the context of resolution of a bank, including State aid or Fund aid, the use of the asset separation tool (AST)<sup>38</sup> requires the creation of an AMC. The purpose of such AMC is to separate selected assets from a bank's balance sheet.

The AST constitutes one of the four resolution tools conferred to resolution authorities under the new EU resolution framework, the others being the sale of business tool, the bridge bank tool and the bail-in tool. It should be noted that the AST may be applied only in combination with another resolution tool to prevent the creation of an undue competitive advantage for the failing entity.

### *Preconditions*

In order to transfer assets, rights and liabilities to an AMC one of the following conditions must be satisfied:

- the situation of the particular market for those assets is of such a nature that their liquidation under normal insolvency proceedings could have an adverse effect on one or more financial markets;
- the transfer is necessary to ensure the proper functioning of the entity under resolution or of a bridge institution; or
- the transfer is necessary to maximise liquidation proceeds.

Concerning the first condition, the relevant EBA Guidelines<sup>39</sup> apply. As such, resolution authorities would need to assess the situation of the market for these assets, and the impact of a disposal of these assets on the markets where they are traded and on financial stability.

### *Characteristics and requirements*

The AMC set up by the resolution authority will need to meet the following requirements:

- The AMC will have to be created in accordance with the applicable national law.
- The AMC is wholly or partially owned by one or more public authorities, which may include the resolution authority.
- The AMC is controlled by the resolution authority (in particular the resolution authority approves the strategy and risk profile of the AMC and approves the remuneration of the members of the management body and determines their responsibilities).
- The AMC has been created for the purpose of receiving some or all of the assets, rights and liabilities of one or more institutions under resolution or bridge institution.
- The AMC's existence is not required to be restricted in time.
- The rights, assets and liabilities may be transferred on one or several occasions.

---

<sup>38</sup> Article 42 BRRD

<sup>39</sup> See the adopted text of the EBA Guidelines concerning Article 42(14) of Directive 2014/59/EU, available [here](#).

- The rights, assets and liabilities may be re-transferred from the AMC to the entity under resolution under certain conditions.<sup>40</sup>

#### *Valuations and transfer of assets, rights and liabilities*

To inform and carry out the resolution action, the valuation of all assets, rights and liabilities will be performed, in principle, by an independent third party appointed by the resolution authority. This valuation will determine the disposal value of the transferred assets, rights and liabilities. This valuation will then inform the decision of the resolution authority on the value of any consideration to be paid to the institution under resolution.<sup>41</sup> All losses in relation to the transfer will, in principle, be borne by the resolved bank's existing shareholders and creditors.

#### *Aid provided through the resolution fund*

The AMC created under the AST will likely incur significant costs (e.g. establishment costs or ongoing operational costs). In addition, an adequate level of capitalisation and liquidity must be ensured. The Single Resolution Fund (SRF) and the resolution financing arrangements in non-participating Member States may be used under certain circumstances to ensure the efficient application of resolution tools and the exercise of the resolution powers.

Any use of the SRF is subject to the Union State aid rules and requires authorisation from the European Commission. Support by the SRF requires a minimum contribution to loss absorption and recapitalisation of 8% of total liabilities including own funds by shareholders and creditors of the entity in resolution (bail-in), if losses are indirectly passed on to the SRF. In that case, the upper ceiling for contributions by the SRF is capped at 5% of the total liabilities including own funds of the entity under resolution. Alternative funding sources may be activated in extraordinary circumstances and only in the event that the 5% limit has been exhausted and after a full bail-in<sup>42</sup> has been implemented.

#### Scenario 3: Insolvency proceedings under national law

Where resolution under the BRRD/SRMR is not considered to be in the public interest NPLs can be transferred, in combination with State aid, within the context of insolvency proceedings under national law. In this case, the standard practice would be to split the failed bank and perform an asset separation so that the "good" part can be sold, provided that this is possible under the national insolvency framework. Regarding the impaired assets, centralizing their management by means of an AMC may help to reap the

---

<sup>40</sup> The resolution authority may transfer rights, assets and liabilities back from the AMC to the institution under resolution in one following circumstances: the possibility that the, rights, assets and liabilities might be transferred back is stated in the instrument by which the transfer was made or in the case of the rights, assets and liabilities do not in fact within the classes of, or meet the conditions for transfer of assets and liabilities specified in the instrument by which the transfer was made.

<sup>41</sup> Article 36(4)(e) BRRD and Article 20(5)(e) SRMR

<sup>42</sup> I.e. a bail-in of all unsecured, non-preferred liabilities, other than eligible deposits. See Art. 27(9)(b) SRMR.

efficiency benefits of AMCs in the recovery of impaired assets sharing common characteristics.<sup>43</sup>

The Commission's Banking Communication of 2013 allows Member States to facilitate the liquidation of an ailing bank under ordinary insolvency proceedings through State measures. The latter may involve the mobilisation of public resources through the national deposit guarantee scheme (DGS)<sup>44</sup> or other resources imputable to the State to set up an AMC to which the impaired assets are transferred. Such liquidation aid can be considered compatible with the internal market to facilitate the exit of non-viable players in an orderly manner without endangering financial stability. Notwithstanding the latter objective, the overarching principle of limiting the amount of aid should remain a key priority. In that sense, Member States could favour a pure exit of non-viable banks rather than their (partial) sale to competitors, which is subject to additional State aid requirements.

State aid in the form of an asset transfer to an AMC in the context of ordinary insolvency proceedings, irrespective of whether it is provided through the national DGS or other resources imputable to the State, must still comply with the general principles of the State aid framework, set out above. Specifically for aid in the context of the orderly winding down of an ailing bank, the 2013 Banking Communication states that its compatibility will be assessed on the same lines *mutatis mutandis* as set out in sections 2, 3 and 4 of the Restructuring Communication (2009). Aid measures in this context must therefore comply with the above-mentioned general principles of the State aid framework, further tailored to a bank liquidation context:

- Limitation of liquidation costs: The aid should enable the ailing bank to be effectively wound up in an orderly fashion, while limiting its amount to the minimum necessary.
- Limitation of competition distortions: To avoid undue distortions of competition, the winding-up phase should be limited in time while the beneficiary ailing bank must neither actively compete on the market nor pursue any new activities as long as it continues to operate.
- Burden sharing: To minimize moral hazard and to ensure appropriate own contribution to the costs of winding down by the aid beneficiary, the claims of the shareholders and subordinated debtholders must not be transferred to any continuing economic activity.

In addition to the criteria mentioned above, the compatibility of a transfer of impaired assets from an ailing bank to a publicly-supported AMC is also to be assessed under the Commission's Impaired Assets Communication of 2009. It is crucial to note however that

---

<sup>43</sup> See section 3.3.

<sup>44</sup> While a DGS's main objective is to repay covered depositors, in the transposition of the Deposit Guarantee Scheme Directive (DGSD) into national legislation, Member States are allowed to extend the mandate of the national DGS: Article 11(6) of the DGSD allows a DGS to use of its available means "to preserve the access of depositors to covered deposits, including transfer of assets and liabilities and deposit book transfer, in the context of national insolvency proceedings". However, the DGS has to ensure that the cost of such interventions "do not exceed the net amount compensating covered depositors" at the insolvent bank.

the complete liquidation of the institution under ordinary insolvency proceedings does not require the transfer price of the NPLs to be below the loans' REV, as the residual entity will be facing constraints which limit distortions of competition and will totally exit from the market.

Finally, an IAM during an orderly liquidation procedure can be part of a wider State measure that also includes the sale of (part of) the ailing bank. The latter may entail State aid to the buyer, unless the sale is organized via an open and unconditional competitive tender and the assets are sold to the highest bidder. The compatibility of the sale would also imply a verification that the sale can contribute to the restoration to long-term viability of the transferred economic activity. The buyer would need to be viable and capable of absorbing the transfer of the troubled bank.

#### Scenario 4: Precautionary recapitalisation

Precautionary recapitalisation is a form of State aid that can be given under exceptional circumstances, which – provided that the conditions set out in Art. 32(4)(d)(iii) of the BRRD<sup>45</sup> are complied with – does not trigger a "failing or likely to fail" (FOLF) determination for the bank.

This tool is usually used for providing an extra capital buffer to a bank which is likely to become distressed if economic conditions were to worsen materially. Nonetheless, precautionary recapitalisation can also be used in the specific case of a transfer of impaired assets to a publicly supported AMC, where the objectives pursued by such a transfer are the same as in case of a direct capital injection; and provided that the specific State aid conditions for impaired asset measures (IAMs) are also respected.<sup>46</sup>

The general conditions for the use of the precautionary recapitalisation tool and the concrete steps for its practical application are presented below.

#### A. General principles established in the BRRD and requirements in the State aid guidelines

##### *Objectives of the aid*

The precautionary recapitalisation is required "to remedy a serious disturbance in the economy of a Member State and preserve financial stability". In addition, the aid "shall be proportionate to remedy the consequences of the serious disturbance".

##### *Form and temporary nature of the aid*

Article 32(4) BRRD aims to ensure that in the presence of an unlikely loss a solvent bank is provided with temporary support to ensure it can preserve its capital position.

Article 32(4)(d)(iii) of the BRRD indicates that precautionary recapitalisation takes the form of "an injection of own funds or purchase of capital instruments". The notion of

---

<sup>45</sup> An analogous provision is contained in Article 18(4)(d)(iii) of the SRMR. Any reference to the BRRD provision in the remainder of the text should be interpreted also as a reference to the SRMR provision.

<sup>46</sup> See Council (FSC Subgroup) report on NPLs, Annex 4 (p. 100-101).

"own funds" refers to all CET1, AT1 and T2 capital instruments, as identified in the Capital Requirements Regulation (CRR). The aid "*shall be of a precautionary and temporary nature*". Also, Article 32 BRRD requires that the measure must be "*proportionate to remedy the consequences of the serious disturbance*".

Subject to a case-by-case assessment, precautionary recapitalisation may be used to enable a removal of impaired assets from the beneficiary bank's balance sheet. Such a transaction, if properly structured, may achieve exactly the same recapitalisation objective for the beneficiary bank as a straight-forward injection of own funds or purchase of capital instruments. In case of a direct injection of own funds, the assets are sold at market price and the State contributes with capital (or other forms of own funds/capital instruments) to ensure that the bank maintains its capital position following the loss from the sale of the assets. In case of an impaired asset relief measure, the bank is allowed to sell the NPLs at a price higher than market price (but not exceeding the assets' real economic value (REV)). Therefore the capital position of the bank is preserved by reducing the upfront loss.

For the transfer of impaired assets to a publicly supported AMC to be proportionate and of a temporary nature, as required by the second subparagraph of Article 32(4) BRRD, the extraordinary public financial support must be limited in terms of amount and time. To this effect, certain safeguards, in order to ensure compliance with the above-mentioned legal requirements, can be considered such as:

- a conservative assessment of the assets' estimated market value and real economic value to ensure that unlikely losses are correctly identified;
- the AMC liability side which is structured in a manner that reduces the overall risk for the State (e.g. a preference for guarantees over direct financing to the AMC, attracting private capital and funding to the maximum extent possible);
- a clear exit strategy for the State from the extraordinary public financial support;
- where appropriate, in particular where the estimated market price cannot sufficiently reflect the risk of a [further] deterioration of the market situation, a mechanism ensuring that the State will not bear losses higher than the difference between the transfer price and the market value.

In the case of using an IAM, the exit strategy should be foreseen to make the State's intervention (through the publicly supported AMC) temporary. This strategy may consist of different elements:

- Prior to its set-up, the AMC's lifespan should be clearly limited in time. The lifespan should also be proportionate to its objective of working out / selling the purchased impaired assets.
- Furthermore, assets that the AMC would acquire will in general have a fixed duration (i.e. a set maturity date) and are thus not perpetual in nature.

When the AMC is backed by public guarantees, this support should also be available only for a certain period of time. Remuneration clauses featuring a step-up fee on these

guarantees could be added to incentivise the AMC to end its reliance on State support as soon as possible, hence further limiting the State's involvement.

#### *Financial health of the beneficiary bank*

The beneficiary bank must be solvent. The assessment of a bank's solvency pursuant to the BRRD/SRMR is the responsibility of the competent supervisory authority. In past cases, the ECB has determined a bank as solvent based on the fact that it meets the own funds requirements (Pillar 1) set out in Art. 92 of the Capital Requirements Regulation (CRR).<sup>47</sup> In the context of a stress test and/or AQR, this implies that the bank should not have any shortfall of regulatory capital following the AQR and under the baseline scenario of the stress test (or the relevant shortfalls are covered by private means). As follow-up of the lessons learned from crisis cases, the ECB is currently reviewing its methodology for the assessment of a bank's solvency in the context of precautionary recapitalisation.

Furthermore, the beneficiary bank must not be deemed FOLF based on the criteria set out in Art. 32(4)(a/b/c) of the BRRD. This implies respectively that (i) the bank does not (and is not expected in the near future to) infringe its authorisation requirements in a way that would justify the withdrawal of its license, (ii) which also entails that the bank's assets are not (and are not expected to be in the near future) less than its liabilities, and (iii) that the bank is (and is expected to be in the near future) able to pay its debts or other liabilities as they fall due. The assessment of these FOLF criteria is the responsibility of the competent supervisory authority and, under certain conditions, the resolution authority.<sup>48</sup>

#### *Compliance with EU State aid framework*

A precautionary recapitalisation is required to respect the general principles of the EU State aid framework. More specifically, the BRRD requires it to "*be conditional on final approval under the Union State aid framework*", in particular the Commission's Banking Communication (2013) and Restructuring Communication (2009), and that it is granted "*at prices and on terms that do not confer an advantage upon the institution*".

Moreover, in the specific case where this tool is used to enable a transfer of NPLs to a publicly-supported AMC, compliance with the specific conditions provided for in the Commission's Impaired Asset Communication (2009) is also required. This implies that impaired assets can be purchased by the AMC at a transfer price (TP) that exceeds the estimated market price (EMV) of the assets but which does not exceed their real economic value (REV). In other words, if a State-controlled AMC buys the impaired assets at market value, there would be no State aid in the IAM. In such cases, the public intervention (i.e. IAM) would not qualify as extraordinary public financial support and therefore, the measure would not trigger FOLF-status for the entity and the assessment of the conditions for precautionary recapitalization would not be relevant.

In operational terms, as explained in more detail below, a precautionary recapitalisation budget must be determined to identify the total maximum aid that can be granted. The

---

<sup>47</sup> Consisting of a minimum 4.5% CET1 ratio requirement and a minimum 8% total capital ratio requirement

<sup>48</sup> The BRRD however does not require the competent supervisory or resolution authority and/or resolution authority to explicitly declare that the bank does not meet the FOLF criteria.

budget is quantified on the basis of the capital shortfall which emerged from the stress test.

The precautionary recapitalisation budget can be used for any combination of recapitalisation aid (injected into the bank to recapitalise it) and impaired asset aid (as a contribution to a higher price<sup>49</sup> at which the bank transfers impaired assets to the AMC to help the bank avoid bearing the full extent of losses that would stem from the sale of the impaired assets in the market). The sum of the recapitalisation aid and the impaired asset aid cannot exceed the precautionary recapitalisation budget.

*B. Precautionary recapitalisation budget in the presence of a transfer of NPLs to a publicly-supported AMC: practical application*

*Step 1: Separating incurred, likely and unlikely losses and determining the precautionary recapitalisation budget*

The precautionary recapitalisation budget must be set in accordance with Art. 32(4)(d)(iii) of the BRRD, which requires it to be "*limited to injections necessary to address capital shortfall established in the national, Union or SSM-wide stress tests, asset quality reviews or equivalent exercises by the European Central Bank, EBA or national authorities*". These exercises should comply with the applicable EBA guidelines.<sup>50</sup> Furthermore, a precautionary recapitalisation "*shall not be used to offset losses that the institution has incurred or is likely to incur in the near future*". In the context of a stress test and/or AQR, this implies that the bank should not have any shortfall of regulatory capital following the AQR and under the baseline scenario of the stress test (or the relevant shortfalls are covered by private means).

In order to comply with the latter requirement, a methodology is needed to make a distinction between incurred, likely and unlikely losses. Ideally, such a methodology should be developed along the lines of the following practice.

An asset quality review (AQR) conducted would identify incurred losses that cannot be covered by the precautionary recapitalisation. The baseline scenario of a stress test carried out following the AQR would identify likely losses which also cannot be covered by the precautionary recapitalisation. Only the losses emerging from the *adverse* scenario of a stress test conducted together with an AQR (cleared from overlaps, if any, with those of the baseline scenario) could in principle be eligible to be covered by the precautionary recapitalisation as they correspond to unlikely losses.

A stress test and an AQR should be carried out as early as possible to ensure that data used to calculate the precautionary budget is up to date. If the most recent available stress test is deemed partially outdated by the competent authority, the application of the procedure described above becomes more complicated. In this case, other specific *ad-hoc* solutions might need to be applied. For instance, losses booked in published accounts after the date

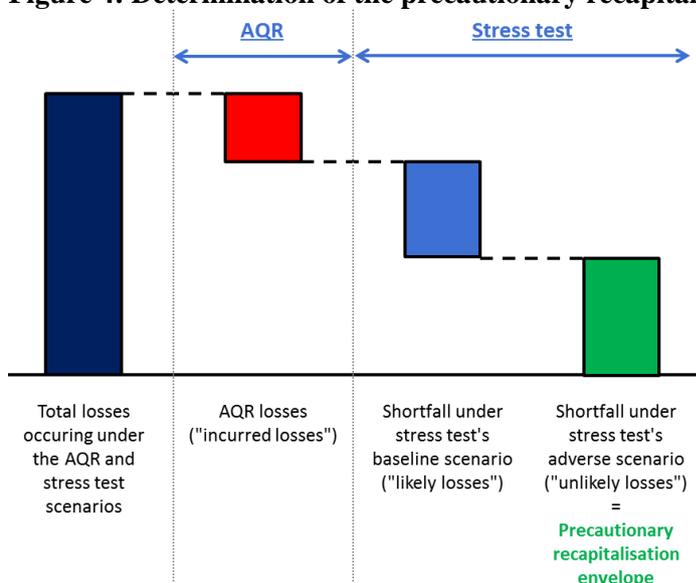
---

<sup>49</sup> See Council (FSC Subgroup) report on NPLs, Annex 4 (p. 100-101).

<sup>50</sup> EBA, *Guidelines on the types of tests, reviews or exercises that may lead to support measures under Article 32(4)(d)(iii) of the Bank Recovery and Resolution Directive*, EBA/GL/2014/09, 22 September 2014.

of the stress test could constitute the basis for estimating incurred losses, and losses due in the near term on the basis of a prudent valuation of assets could give indications on likely losses which may be used to complement and refine the information contained in the stress test.

**Figure 4: Determination of the precautionary recapitalisation budget<sup>51</sup>**



As for likely losses, while these may include losses necessary to comply with the requests of the supervisor, they should not include losses stemming from competition measures necessary to authorize the State aid. Likely losses might therefore include, for instance, losses determined by the sale of impaired assets as requested by the supervisor, but should not encompass losses necessary to deleverage the bank's balance sheet (to avoid distortions of competition) which are a necessary condition to receive State aid.

*Step 2: Covering incurred and likely losses with private means*

As the precautionary recapitalisation can only cover unlikely losses, any losses stemming from the baseline scenario of the stress test and from the AQR (respectively considered likely losses and incurred losses) must be covered with private means.

Items that are certainly to be counted as private means include CET1 capital in excess of Pillar 1 minimum requirements, cash deriving from asset sale proceeds, CET1 new issuances and capital generated by burden-sharing through the write-down or conversion of AT1 and T2 capital.

In case private means are insufficient to cover incurred and likely losses, precautionary recapitalisation cannot be granted.

<sup>51</sup> The figure refers to a case where there is no overlap between losses in the baseline and in the adverse scenarios.

### *Step 3: Addressing unlikely losses with State aid*

Once incurred and likely losses are fully covered by the bank's private means, State aid can be granted to cover in principle all the remaining losses (i.e. unlikely losses as identified by the shortfall in the stress test).

The ultimate purpose of providing a precautionary recapitalisation is to remedy a serious disturbance in the market on a precautionary and temporary basis by covering the shortfall identified through the precautionary budget. To this end, the bank must be in a position, after receiving the aid, to meet its prudential requirements set by the supervisor. In general, a precautionary recapitalisation that does not allow the bank – also taking into account available private means – to meet its prudential capital requirements (set by the supervisor), after the recapitalisation has been implemented, cannot be authorized by the Commission.

On the other hand, when the amount identified with the precautionary budget exceeds the amount of aid that would be needed to meet the SREP requirement set by the supervisor, an assessment should be made of whether aid up to the precautionary budget is needed and adequate to address the serious disturbance. As indicated above, the precautionary recapitalisation budget can be used fully or partially to grant impaired asset aid by supporting a transfer of NPLs to a publicly-supported AMC above the estimated market value (and up to the assets' real economic value). In practical terms, if the precautionary recapitalisation budget has not been fully depleted by the impaired asset aid, the difference may be injected in the bank as direct recapitalisation aid, provided that also in this case the direct recapitalisation aid remaining available after the IAM is sufficient to allow the beneficiary bank to meet its SREP requirements.

### **Final considerations**

Given the tight intertwining of the State aid and bank resolution framework, efficient sequencing and coordination between the various stakeholders (EU and Member-State level) is paramount:

- In scenario 1, sequencing and coordination issues do not arise as there is no State aid.
- In scenario 2, once the competent supervisory or resolution authority declares a bank FOLF, the resolution authority (the SRB or the resolution authority of the non-participating Member State) is the key stakeholder in the chain, as it has to propose and implement a resolution scheme, after authorisation by the Commission of any Fund aid involved.
- In scenario 3, the Member State is in charge, following the resolution authority's declaration that there is no public interest in resolution and the Commission's authorisation of any State aid involved.
- In scenario 4, this refers to the competent supervisory authority (SSM or national banking supervisor which has to confirm that the beneficiary bank is solvent), the Commission (in charge of authorising the State aid involved) and the Member State in question.

### 3.2. Needed diagnostics and critical mass of impaired assets

The general purpose of a diagnostic exercise is to help determine the sample of banks transferring NPLs to AMC, the assets to be transferred, and the terms and conditions under the applicable EU legal frameworks at which a bank can transfer assets to an AMC. Authorities should also use the diagnostic exercise to demonstrate that the AMC has an advantage over other NPL reduction measures from the perspective of the entire banking system. This could be based, for example, on the magnitude of the NPL issue or on its composition (e.g. whether the NPLs are concentrated in asset classes that lend themselves to an efficient resolution in an AMC), or the presence of adverse market conditions that render the value of NPLs uncertain or depressed.

If a bank's transfer of NPLs to an AMC (considered as an impaired asset measure) is to be (partially) financed with a precautionary recapitalisation under the BRRD, that bank should first participate in a national or EU-wide AQR and stress testing exercise. An EBA guideline provides further details on the nature of that exercise<sup>52</sup>, which needs to have the following features:

- a precise timeline;
- a predefined scope, including a sample of banks justified by economic or prudential reasons;
- a common reference date (i.e. the "cut-off" date for the balance sheet data used for the AQR/stress test);
- a common methodology, including a range of hurdle rates and a common macroeconomic scenario;
- a quality assurance process, carried out by the relevant authorities.

In the case of establishing an AMC supported by State aid<sup>53</sup>, the purpose of the diagnostic exercise would be two-fold. First, it should help the authorities to determine an appropriate transfer price, which typically lies between the (estimated) market value (EMV) and the real economic value (REV) of the concerned assets.<sup>54</sup> Second, it should also inform the calibration of the potential related capital needs of the banks transferring assets to the AMC and the maximum amount of State aid which can be granted (i.e. the State aid envelope). Therefore and in order to achieve clarity on the health of bank balance sheets, the diagnostic exercise should consist of an AQR and a stress test.

The AQR could focus particularly on a well-identified pool of assets, where potential risks are deemed to be particularly present and which are likely to be deconsolidated from the bank balance sheets through transfer to an AMC, if the type(s) of assets that constitute the

---

<sup>52</sup> Guidelines on the types of tests, reviews or exercises that may lead to support measures under Article 32(4)(d)(iii) of the Bank Recovery and Resolution Directive, EBA/GL/2014/09.

<sup>53</sup> I.e. an AMC that is partially/fully publicly-owned (or even privately-owned but with actions which are imputable to the State, or benefiting from a State guarantee), buying assets at a transfer price higher than the EMV.

<sup>54</sup> The AQR should hence detect misclassification issues and provisioning gaps so that the bank's balance sheet can be restated in a 'clean' manner before application of the stress scenarios and authorities obtain more transparency on appropriate transfer prices. Losses which the bank has to book as a result of the AQR are to be considered as incurred losses.

main source(s) of a bank's vulnerability are well-known and are captured within the scope of the AQR. In all cases, the entire asset perimeter should then be reviewed, to identify potential misclassification of NPLs and remedy the related provisioning shortfalls. Ideally, this should be carried out at the level of individual debtors to maximise the usefulness of the results for the AMC.<sup>55</sup> The AQR methodology should facilitate the Commission's estimation of the EMV and REV of the concerned assets, so that the results can feed into the related valuation process. The result of the AQR should serve as the reference and departure point for the macroeconomic scenarios employed in the stress test.

The diagnostic exercise could be aligned with the well-established EU-wide or national stress testing exercises. A time constraint, however, may complicate this alignment, as the regular EU-wide stress test exercises is only performed periodically. As an alternative, and to address the potential need for methodological adjustment that would adapt the methodology better to the context of an AMC, authorities should consider running a parallel stress test review of credit risk and NPL valuations under the adverse economic conditions. This review could use the adverse scenario of the EU-wide stress test, as long as it remains relevant, and the valuation models already established for the AQR.

The diagnostic exercise should cover either the entire banking system of the Member State, or – where not practically possible due to the large number of banks – all banks above a predefined exposure to NPLs, expressed in absolute and relative terms. In case of a large number of smaller banks with a collectively significant NPL stock, the authorities should carry out the diagnostic exercise on a representative sample of loans, covering a critical mass of relevant NPL portfolios. The diagnostic exercise should hence in this case be a top-down exercise run by the authorities rather than a bottom-up one (which is the case of the EU-wide stress testing exercises) while taking into account resource constraints of the authorities.

The duration of this diagnostic exercise should be kept to the absolute minimum. Nonetheless, based on past experience, the usual duration of an EU-wide stress test, from its launch to conclusion, stands at about 5 months. This is however the case of a stress testing exercise which is not preceded by an AQR, which is going to add at least two months to the process. In practical terms, a diagnostic exercise covering both an AQR and stress test is therefore likely to require a significant time to execute, possible between 6 and 12 months.

## **IV. DESIGN AND SET-UP OF AN AMC**

### **4.1. Legislation, mandate and powers**

The objectives, oversight, roles, functions and main design features of a centralised AMC must be based in legislation. To the extent that the AMC is set up in a resolution context,

---

<sup>55</sup> There are synergies between the AQR and future due diligence and strategic review by the AMC management, for example related to filling the data gaps, understanding the past and current performance of the asset, updating the valuation of collateral, and analysing the legal position of the creditor.

several elements are foreseen in the existing framework on resolution (BRRD and SRMR). These provisions are of course to be complied with. If specific legislation is needed for the set-up of an AMC, it must take the specific AMC design considerations into account – legislating for an AMC before the design-related work has been completed can lead to difficulties in the AMC's operations later on. In particular, the primary objectives of the AMC must be provided for in legislation – and subsequently communicated clearly. The mandate of the AMC must also be clear and unambiguous. Any secondary objectives should be avoided unless clearly subordinated to the primary objectives. The AMC should be empowered to implement design-based decisions, with respect to, for example, in scope asset classes, asset perimeter, and bank participation. Legislation should also contain strong oversight elements, which will help insulate the objectives of the AMC from being disrupted and can ensure that the AMC's operations are free of influence or lobbying.

Any legislation needs to be drafted with the expectation that it will be tested and challenged in court. Such processes may be useful in underlining the legitimacy of the AMC, as well as its mandate and powers.

Following from design and financial stability considerations, legislation should ensure that AMCs be established as a one-off vehicles. The asset transfers should be completed in a single round, and there should be no further opportunities for asset transfers to the AMC thereafter, save for exceptional circumstances.<sup>56</sup> Without these provisions, risks to the objective of the AMC and to financial stability more broadly may emerge.

Banks deemed by the diagnostic exercise (cf. above) to be in scope to transfer assets falling within the identified asset perimeter (cf. section 4.4) to a publicly supported AMC may hence need to be obliged via national legislation to transfer these assets to the AMC at the identified transfer price, which cannot exceed the REV (cf. section 4.4). Obliging banks via national legislation to transfer the relevant NPLs to the AMC would impact their fundamental rights and would therefore need to be justified in the public interest (e.g. for financial stability purposes). The encroachment (i.e. the national measure) also needs to be proportional. Most notably, it needs to be necessary and balanced as regards the public interest vs the protection of individual rights.

The AMC should be designed with the objective to maximise the recovery value given certain constraints.<sup>57</sup> Assuming the objective of an AMC is to maximise the value of assets that it is endowed with, and based on an accurate asset valuation process, from the outset, the AMC should therefore aim to cover its costs (captured largely in valuations that led to the TP). If the AMC would be able to make significant profits, once all costs have been covered, it would imply that transfer prices of assets were too low, penalising banks and, potentially having imposed tax-payer costs associated with bank recapitalisations. Equally, an entity set-up to make losses is not credible, not least from public finance perspective. The risk-taking of the AMC should be limited to the areas that are strictly related to the

---

<sup>56</sup> See also sections 4.7. and 4.10.2.

<sup>57</sup> See section 5.2 for further details.

work-out of its assets. The AMC should not assume open foreign exchange positions, or interest rate risk positions.

Furthermore, it is essential that the AMC's legal toolkit is not restricted in any meaningful way, and that it should be treated as any other creditor. In particular, it should be allowed to enforce collateral and take collateral on its own balance sheet, also with a view of developing its assets to maximise their value (e.g., by finishing incomplete real estate projects). At inception, the AMC should carefully assess the assets and determine the right strategy (foreclose/acquire collateral, forbear/restructure, liquidate). However, the strategy for individual assets should be periodically reviewed to adjust to changing market and economic conditions. The AMC should not be held back from liquidating assets it has once considered viable, if that is justified by changed circumstances.

However, in specific cases, exceptions may be considered to facilitate debt restructuring by the AMC. Notable an AMC is first and foremost not a typical investor. For example, this may relate to waiving the required mandatory take-over bids in the event where the AMC acquires a qualified majority stake in a company.

While an AMC may also be able to provide interim financing against strict criteria, it generally should not be granted a banking license or an asset management license. In principle, an AMC could be granted a banking license to facilitate the provision of credit to third parties, although this might not be strictly necessary. However, this would likely subject the AMC to bank regulation and supervision as well as stricter disclosure requirements, which may obstruct the discharge of its responsibilities. Furthermore, a state-supported bank established in times of financial sector stress may not be well-disciplined and sufficiently oriented to achieve the narrow goals set-out above.

#### **4.2. Ownership and governance, institutional independence<sup>58</sup>**

Regardless if the AMC has public support or not it should operate as an independent legal entity, and not as a governmental agency. Therefore, it should not be part of the public sector. It should have full budgetary independence<sup>59</sup> and be protected from lobbying and political review. Managerial appointments at the AMC should be merit-based and stay outside of political control, as the AMC requires highly specialised expertise in order to fulfil its mandate. The same applies to remuneration policies of AMC staff and management. The required expertise is hard to find in the public sector and the AMC is likely to compete against private employers for suitable candidates especially once it gets closer to its wind-down date. The AMC should therefore be able to offer market-consistent remuneration. Being run as a private sector entity can demonstrate a distance from governmental and political influence. Greater flexibility in staffing, etc., can also be attained in this way.

---

<sup>58</sup> For a detailed discussion on the supervision and accountability of the AMC please refer to section 4.10.6.

<sup>59</sup> Budgetary independence is necessary to reduce the risk of political interference with the AMC's operation via the threat of reductions in the AMC's budget.

### 4.3. Asset perimeter and size of the AMC

#### Initial considerations

This section aims at identifying the size and scope of a centralised AMC where this type of vehicle could maximize its comparative advantage in recovering value from impaired assets. In this context, it should be noted that, as a complement or alternative to a centralised AMCs, there are several alternative impaired asset measures (IAM) that should be considered for assets where the benefits of management by a centralised AMC are doubtful, and hence deemed unsuitable for transfer to such a vehicle.

The success of a centralised AMC in remedying a significant stock of impaired assets in a Member State critically hinges on its scope. Several principles are key for identifying, within a given market, the appropriate size and scope of a centralised AMC. These are related to the AMC's relative advantage in addressing specific classes of impaired assets, avoiding problems of creditor coordination by consolidating all debts of a debtor, the asset domicile, the overall capacity of the AMC (particularly the availability of third-party loan servicing), collateral liquidity, and political autonomy.

The guiding principles are as follows:

- Economies of scale and scope:
  - By being the main holder and central counterparty of a specific set of problematic assets in a specific banking system, AMCs can achieve specific expertise and economies of scale in recovering value from specific assets. These, however, will be diminishing, as the number of assets acquired increases. Historical experience also shows that significant economies of scope for various asset classes are rarely achievable for AMCs.
  - Centralised AMCs may only in specific cases achieve operational synergies in managing several asset classes simultaneously. AMCs can potentially realise some such synergies by pooling all outstanding debt of larger debtors even if these debts are split along different asset categories.
  - Under the right circumstances, centralised AMCs could aim at taking over a large share of problematic loans of a certain asset class to achieve greater economies of scale.<sup>60</sup> Financial constraints around the size of AMCs and/or the impact on banks may justify choosing a narrower scope while nevertheless being sufficiently large to achieve the objectives of minimizing financial stability risks and reducing the uncertainty surrounding the concerned banks. This choice should be made taking into account country-specific conditions and on the basis of the findings of the asset valuation exercise.<sup>61</sup>
- Maintaining critical size:
  - The economies of scale are likely to be diminishing as AMCs grow beyond a certain size and complexity, as described above. This suggests that, in general,

---

<sup>60</sup> In this case under financial crisis conditions, i.e. where certain dynamics are in evidence.

<sup>61</sup> See further section 4.4.

centralised AMCs should have a critical size without becoming too large. Consequently, the available capacity for establishing an AMC – which is hence limited – should be utilised for assets upon which an AMC will have comparative advantage, on the basis of historical experience.

- The wider the asset scope, the larger an AMC may become (assuming the participation perimeter is not proportionately diminished). Controlling the size and perimeter of the AMC will mitigate a range of serious impacts such as fiscal, funding and capitalisation challenges. A larger vehicle, assuming it relies on government guarantees, will create also create a contingent liability to the Member State. Please see section 4.9 for a discussion on these aspects. Equally, the larger the vehicle, the more capital it will require, which may lead to issues at the set-up of the AMC.<sup>62</sup>
- Finally, the presence of collateral underlying the AMCs' assets is important since this offers the vehicle a way of realising value over time as depressed collateral values present in a crisis can recover over time when macro-conditions improve. In the absence of this opportunity, the AMC may achieve insufficient recoveries. CRE assets offer relatively easier value recovery in this regard than RRE, which affect the suitability of these assets for inclusion. As realising collateral for RRE will be highly problematic due to cultural, social and political realities, an AMC may not be able to solve the underlying problem. Therefore, AMCs should only in exceptional cases be considered as the instrument to do so.

### **Asset perimeter**

Table 1 below gives an overview of the suitability of all major asset classes present in a bank portfolio for workout by a centralised AMC. In general, experience suggests that commercial real estate (CRE) loans, corporate lending and loans granted for property development have historically been proven to be suitable instruments for transfer to a centralised AMC.

Historically successful centralised AMCs have often been given the mandate to resolve CRE and large corporate exposures (e.g. in Ireland, Spain, Korea, Sweden, United States).

---

<sup>62</sup> If the AMC is classified as a defeasance structure and reflected as such in the national accounts, private equity will have to be raised; a large private equity portion will be proportionately more difficult to raise than a smaller one.

**Table 1: Suitability of asset classes for workout by an AMC based on past experience**

Exposure class	Heterogeneity	Granularity	Collateral quality	Political sensitivity	Typical resolution approach	Suitability for an AMC
Commercial real estate	Low	Low	High	Low	Sell collateral	Yes
Residential property development	Medium	Low	Medium to high	Low	Restructure/ sell collateral	Yes
Large corporate	High	Low	Low to medium	Medium	Restructure/ liquidate	Depending on industry
Small and medium enterprises (SME)	High	High	Low to medium	Medium	Restructure/ liquidate	Depending on size and industry
Residential mortgage	Low	High	High	High	Restructure	In limited cases
Unsecured consumer	Low	High	None	Medium	Liquidate	No
Governments and government agencies	Low	Low	Low	High	Restructure	No

Source: ECB

On the other hand, retail loans, small business (SME) loans, and loans to the public sector have rarely been worked out by AMCs with good results.<sup>63</sup>

- **Loans secured by commercial real estate** (including those where the borrower is an SME) tend to have relatively large unit sizes, which allow the AMC to maintain a relatively light operation. Moreover, these assets have a strong connection with real assets (often property) that have a lasting value over the medium and long term, and have reasonable prospects for improvements in value, linked to more general macro-financial improvements. A further advantage of tackling commercial real-estate related exposures is that external service providers, such as property value appraisers, property managers and other property-related service providers, tend to be readily available in the market, allowing centralised AMCs to function with relatively few internal resources.
- **Loans by large corporates that are not secured on CRE** also exhibit some important characteristics that tend to make them suitable candidates for transfer to centralised AMCs. The exposures are often relatively large in size and are therefore relatively cost efficient to manage and service for the AMC. Corporate exposures will typically be large and complex; being complex, they will require a high degree of work-out intensity; but these inherent costs can be outweighed by the return on working out large exposures. Viable corporates may also be most likely to benefit from debt re-structuring, which can be best achieved with a single counterpart, rather than multiple creditors. This implies that viability assessments will be required. More generally, overcoming coordination challenges will be an important benefit of an AMC, as large corporates are more likely to have exposures to multiple lenders, and so the debtor-level approach is important.
- **Beyond these two primary categories, there is scope to consider other, residual portfolios for transfer.** Banks own holdings of real estate, be it commercial or residential, which may have been acquired by foreclosure procedures, have been successfully transferred to centralised AMCs in the past. However, an AMC will not have a ready sales outlet for such assets and potential buyers may struggle to finance

<sup>63</sup> Performing residential mortgages and other retail loans have been in the scope of decentralized AMCs (e.g. UKAR) but not in centralised ones. Please see Annex 1 for further details.

such assets, unless vendor financing arrangements are put in place. In taking a debtor approach, the AMC should be willing to accept residual portfolios beyond the perimeter outlined above, to ensure that all of a given's debtors exposures are captured, so long as the majority of those exposures are CRE, corporate, etc. AMCs may also consider acquiring portfolios of non-performing buy-to-let mortgages, although in such cases, this should only take place where the legislation underpinning the AMC endows it with sufficient legal powers potentially going beyond those available to the originating bank.<sup>64</sup>

- **Exceptions to these principles could be considered in specific contexts.** It may be the case that a Member State identifies highly specific cases where it is desirable to transfer other asset classes to an AMC, including, for example, residential real estate mortgages and SME loans. These are, in general, unsuitable for AMC workout, but highly limited transfers could be considered in cases where, for example, the transfer would allow a bank to eliminate its exposure to a given business line or region, thereby aiding in its restructuring; where transfer would allow internal bank workout to be more concentrated on other exposures; or where other, highly evident synergies with the AMC could be identified. The work-out of residential mortgages through an AMC carries high risks of political interference, especially for primary residences (owner-occupied units). In these cases foreclosure by a State-owned entity like an AMC might prove difficult. In such circumstances, it cannot be excluded that the AMC would show leniency towards distressed homeowners to such extent that asset recovery is impeded, which would undo any benefits of an AMC. Political independence of the AMC would be a key criterion for considering the possible inclusion of residential mortgages.

In order to reduce the risk that such exceptions can be misused and threaten the viability of the AMC, strict criteria and limits should apply to such circumstances. The proportion of assets, both in terms of value and/or volume, in such cases is not recommended to exceed 15% of total AMC assets. This exception may not be applicable where the debtor-level approach leads to a higher proportion of other assets being transferred. The rationale for this limit is, on the one hand, to prevent too many unsuitable assets being transferred into the AMC, rendering it unduly burdened. On the other hand, this 15% envelope allows a “debtor-level” approach to be taken; that is, the complete transfer of a given debtors exposures, so long as a significant majority of those assets are CRE-related and/or corporate, and exceed the minimum size thresholds, whilst not excluding residual transfers of other asset class exposures of the debtor.

Other asset classes, mainly unsecured retail loans, are more suitable to other types of IAMs and should not be considered for inclusion in a centralised AMC. The duration of these loans are often shorter offering less time for the AMC realising recovery and have

---

<sup>64</sup> A transfer could for example be considered for a well-identified pool of buy-to-let mortgages, in Member States where it is possible to acquire the underlying collateral quickly, the rights of the landlord are well protected, and where the underlying properties produce a predictable stream of income.

the dual downside of potential political interference and very small individual loan sizes that lead to high complexity and costs related to servicing.

### **Asset size**

A minimum size threshold for loan transfers to the AMC may be beneficial as it would exclude the tail of small and granular exposures and retain only the more complex large-ticket exposures for the centralised AMC. It thus avoids the problem of the above-mentioned diminishing returns to scale. Historical examples support using a size-based threshold, the calibration of which should be country- and asset-class specific. The minimum size threshold should be calibrated in terms of the centralised AMC's envisaged critical size, country-specific characteristics, and the particularities of the asset perimeter. This would prevent an exponential increase in the number of exposures that a centralised AMC would have to take on, and furthermore would ensure that banks build and maintain capacity to work out NPLs on their own.

Thresholds should be set at different levels, taking into consideration also the impact of the threshold on the total portion of assets affected. At the highest level, a debtor level threshold should be established, which could be in the order of EUR10 million.<sup>65</sup> At the asset level, corporate exposures could be limited to those above EUR10 million, CRE above EUR 5 million. Foreclosed real estate assets and buy-to-let mortgages would be limited to the top 25% largest exposures, in terms of amount, within its category in the relevant national banking system. Other loans would be limited to the top 25% largest exposures in terms of amount within its category in the relevant national banking system. These thresholds are indicative and require calibration. As a result, a debtor with total exposure to a national banking system of EUR 10 million could have assets transferred to an AMC, while, as noted above, a single Corporate or CRE exposure above EUR 10 million and EUR 5 million, respectively, could be transferred.

### **Debtor-level approach and avoidance of creditor coordination problems**

One of the important advantages of AMCs is that they help solve the multiple-creditor problems by consolidating the total exposure of the banking system to a specific borrower in one entity. For this reason, multi-lender and syndicated exposures should be fully transferred to an AMC (even if the debtor performs well vis-à-vis some of the lenders, which will require robust legislation). If that is not possible, the AMC should receive a sufficient share in the total lending to a debtor to be able to work out the loan efficiently.<sup>66</sup> More generally, AMCs should take over the entire exposure of the banking system towards troubled debtors, regardless of the actual performance of individual loans. This also allows for the complete break of the close personal links that sometimes exist between bank staff and some debtors, in the case of substandard loan origination practices.

---

<sup>65</sup> NAMA, for example, set the threshold at EUR 20 million.

<sup>66</sup> For example, if insolvency legislation allows the majority of creditors to bind minority creditors (e.g. cram-down or collective action clauses), the AMC's share should provide it with that majority.

## **Asset domicile**

AMCs may in principle receive both domestic and foreign assets. This choice should depend only on the nature of the assets and the prospects of recovery by the AMCs. The AMC should assess the jurisdiction in which the asset is located and whether it has or may acquire comparative advantage in the management of such assets compared to the bank. For example, if a foreign asset is located in a developed jurisdiction where the bank has little expertise, transferring this asset to an AMC may be a good option. Conversely, if an asset is located in a jurisdiction where the bank has a local presence (e.g. through a subsidiary) and where the rule of law is less developed, this asset may benefit from continued management by the bank.<sup>67</sup>

### **4.4. Asset valuation principles and processes**

#### **General considerations on asset valuation**

In the case of a AMC that receives State aid, in the interest of sound management of private and public finances, it is crucial that transfer prices are set in a way that provides an optimal level of relief for the troubled bank while ensuring the AMC is able to recover in an adequate manner all costs implied by its operations. In a stressed environment, it is likely that market values of impaired assets are significantly depressed.

A transfer at market value may not provide relief to the troubled bank because it would crystallise high losses and erode its capital buffers, but could lead to the potential gains from the recovery of assets by the AMC later on. Instead, publicly-supported AMCs can intervene by purchasing troubled assets at a price which is higher than their market price (but not higher than the assets' real economic value (REV) – see below and section 2.5.) and thus provide aid equalling the amount by which the transfer price exceeds the current market price. In this case, all future cash flows and costs generated by the management of the impaired assets should be taken into account in an adequate manner in the determination of the transfer price.<sup>68</sup>

The determination of the exact transfer price of the impaired assets needs to rest upon an asset valuation that complies with the principle of prudence in order to maximize the chances of the AMC to at least break even (and in best-case scenarios, to earn a small profit) and maximize the taxpayers return. In this regard, it may not be possible to value every asset within a reasonable period of time prior to the transfer due to the sheer number of assets subject to the transaction. An ex-post due diligence performed by an independent valuator with a full granularity will be needed in such case. To minimise the impact of this due diligence on the transferring banks, it is therefore recommendable to set prudent transfer prices.

---

<sup>67</sup> In general, very complex financial assets are best left with the bank, since there is no obvious comparative advantage to the AMC managing this type of assets.

<sup>68</sup> See below for the definition of the REV.

On the cost side, realistic assumptions should be made regarding the costs that an AMC will face over the course of its activity: funding costs, loan workout costs, operational costs, legal costs, servicing costs as well as fiscal charges. Flanking structural reforms/legislative amendments that have a positive impact on the development of secondary market for impaired assets and on cash flows (e.g. insolvency or collateral enforcement reforms which shorten or simplify the loan workout process) need to be taken into account in an adequate manner as they can substantially affect asset valuations and therefore the conditions for economic soundness of an AMC. Closely intertwined is the prudent estimation of the cash flows that are projected to be generated by the recovery of the loans over the course of their lifetime.

It is the responsibility of the Member State / AMC to perform a valuation of the impaired assets to determine their possible transfer price. Since this process is often very complex, Member States / AMCs often hire third-party experts to provide assistance in assessing market-specific risk premia, the credit restructuring potential and the collateral recovery process.

On the basis of that work by the Member State / AMC, the Commission – in its responsibility of enforcing State aid rules, and often with the help of external experts – will estimate the transferred assets' market value (estimated market value or EMV) to assess the presence of aid, as well as their REV in order to determine – in case aid is present – whether this aid is compatible.<sup>69</sup> As this process may require significant time and resources, Member States may put in place tools to facilitate the Commission's valuation assessment. Databases set up in the context of in-depth (regular or irregular) valuations such as AQRs can be of great help and yield substantial synergies that will save time and resources.

### **Estimated market value (EMV)**

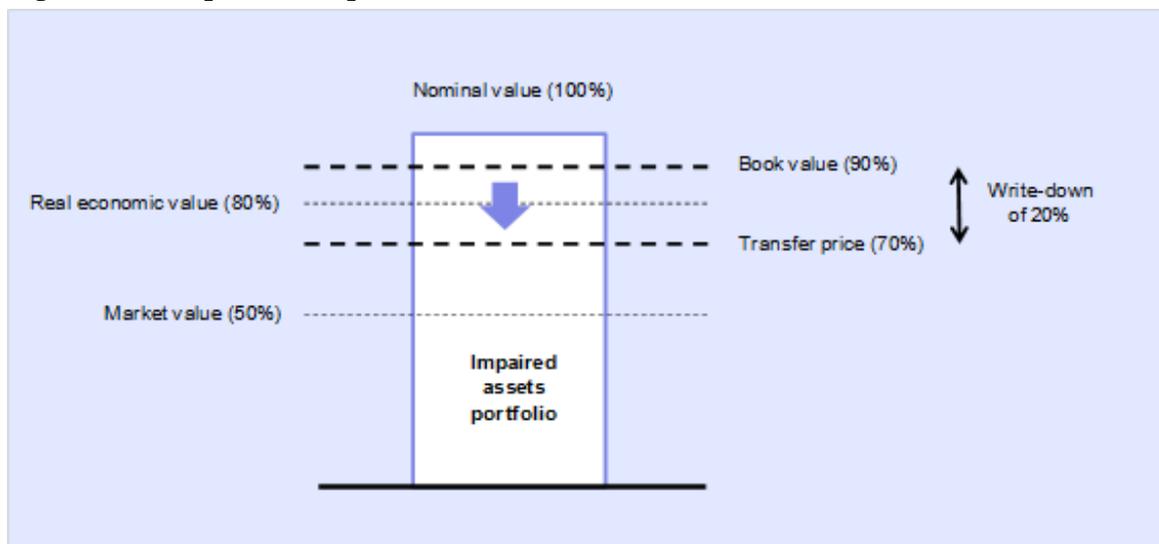
In circumstances where there is no liquid market and no directly comparable transaction taking place at the same moment, the Commission may, in order to establish the market value, use adjusted benchmarking to correct the price observed for the sale of assets that have some similarities with the assets in question. The adjustment is based on the difference of the characteristics and quality of the two sets of assets.

### **Real economic value**

The concept of REV was introduced by the Commission's Impaired Asset Communication of 2009, and is defined as the "underlying long-term economic value of the assets, on the basis of underlying cash flows and broader time horizon". It is an estimation of the asset value by disregarding the additional haircuts which private investors require because of the lack of information and because of the temporary illiquidity of those assets. If markets are efficient and liquid, the REV of assets equals the assets' market price. However, if markets are seized up by lack of information and illiquidity, the REV usually exceeds the market price (or EMV) (see Figure 5).

In the context of NPLs, REV will typically be lower than the assets' net book value (NBV) in banks' books as banks either do not have an incentive or are even prohibited by accounting rules to reduce the book value of asset without objective evidence of impairment<sup>70</sup>. This implies that the transfer leads to losses for the banks in many cases.

**Figure 5: Example<sup>71</sup> of the potential articulation of the different value indicators**



Source: Commission Services (DG COMP)

The Impaired Asset Communication<sup>72</sup> caps impaired assets' actual transfer price at their REV so that the transfer to the publicly-supported AMC does not relieve a bank from losses that are foreseeable (likely). This also helps to minimize possible losses for the AMC (and thus indirectly taxpayers) and fosters adequate *ex-ante* recognition of losses. Any transfer price exceeding the REV is incompatible aid and ought to be repaid by the beneficiary bank.

### *REV calculation methodologies*

The calculation of REV is done on a case-by-case basis and takes into account several elements: the type of the assets and the underlying collateral (and the location of the latter in the case of real estate), the expected cash flows (and their expected timing), various costs (including servicing costs, funding costs, taxes and maintenance costs), the long-term macroeconomic outlook as well as the application of a discount factor that correctly reflects the risks and provides an adequate remuneration for the buyer (here a state-supported AMC).

Whilst the Impaired Asset Communication gives some guidance on the methodology to be followed to arrive at the REV, a formula which would be directly applicable to all types of

<sup>70</sup> However, the introduction of IFRS9 will change this paradigm with the use of provision based on 1-year or lifetime expected credit losses. Being based on a forward-looking perspective, this new methodology will favour by construction early recognition of impairments.

<sup>71</sup> In this example, the transfer price is below the REV but it could be higher and at most equal to REV (for the aid to be found compatible by the Commission).

<sup>72</sup> Please see section 2.5 for further details on the Communication.

assets is difficult to design given the heterogeneity of the assets potential concerned. In any case, the valuation method should be consistent at Community level and based on observable market inputs and realistic as well as prudent assumptions about future cash flows.

In practice, the Commission has relied on external valuation experts who have consistently applied the following methodology for assets in dysfunctional markets.

Two simplified examples of formulas applied in the past are presented:

(a) Cash flow-based method

After an accurate and prudent estimation of the future cash flows related to the assets (including their collateral where relevant), the REV is obtained through a discounting of all future cash flows (net of workout costs) using a sufficiently prudent credit spread ("a risk premium") over and above the risk-free rate:

$$REV = \sum_i E(CF_i) / (1 + R_{risk-free,i} + Credit\ Spread_i)$$

The applicable credit spread premia depend on the default probability of the asset and its maturity whereas the sum of E(CF) is estimated in a manner that avoids double-counting of risk in the numerator and denominator of the formula.

(b) Direct expected loss-based method

If the bank has default probabilities (PD) and loss given default (LGD) figures available at individual asset level, experts can calculate "stressed expected losses".

The resulting  $EL_{stressed} = PD_{stressed} * LGD_{stressed}$  is then plugged into the formula  $REV(in\ %) = 100\ \% - EL_{stressed}$ .

In the case of non-performing exposures, if the "stressed expected loss base" method is used, default probabilities are assumed to be 100% and the focus lies on prudently estimating recoveries (net of all workout costs and reflecting the time to carry out the workout). It therefore converges with the result of the cash flow based method.

Country-specific characteristics that may influence the calculation of REV are to be taken into account as much as possible. Structural reforms undertaken by a Member State, for instance regarding insolvency and collateral repossession frameworks, may significantly influence recovery values over a given horizon. When it is generally accepted by observers that these reforms will be efficient and fully implemented, they should be duly taken into account in the valuation.<sup>73</sup>

---

<sup>73</sup> While information at the macroeconomic level provides an important basis for the valuation, some cases require to delve deeper and to incorporate as much as possible microeconomic features and developments that may significantly affect the REV. This would typically be the case for CRE assets which intrinsic features may vary substantially from one place to another. For instance, an office building with substantial annual maintenance costs would put downward pressure the net cash flows which it can be expected to generate, despite a positive overall trend in the market as a whole.

## 4.5. Accounting aspects

### 4.5.1. Accounting standards

In case the AMC is a non-listed limited liability company without a banking license, it has to prepare and publish financial statements in accordance with national Generally Accepted Accounting Principles (GAAP). The national GAAP must be aligned with the EU accounting Directive. The EU accounting Directive aims at providing a true and fair view of the financial position and financial performance of the reporting company. It includes specific requirements on valuation, presentation, disclosure, publication and statutory audit. However, Member States have the option under the IAS Regulation to allow or require the use of EU endorsed IFRS for companies or public interest entities (including banks)<sup>74</sup>. If the IFRS option is used requirements on management reports, disclosures and statutory audit in the Accounting Directive continue to apply. If the AMC issues securities (shares or debt securities) on an EU regulated market, it must use IFRS for its consolidated accounts.<sup>75</sup> Hence, the applicable accounting framework for the preparation of financial statements by the AMC is either EU-endorsed IFRS or national GAAP.<sup>76</sup>

**Within the limits outlined above and depending on how Member States have exercised options, the AMC can choose its applicable accounting framework.** When exercising that choice, the authorities should consider the objective of the AMC, which is to recover the long-term economic value of the assets over the specified term and to foster financial stability.<sup>77</sup> In particular, the choice of the accounting framework should take into account the risks related to the funding structure (e.g. the likelihood of government guarantees, if applicable, being triggered)<sup>78</sup>, and the associated knock-on effects on the willingness of private investors to participate in the ownership structure. A higher relative use of fair value in the accounting framework could lead to more volatility of the P&L or capital than the use of historic cost combined with credit loss provisions. In the worst-case scenario, that volatility may lead to the AMC unravelling which could be detrimental to financial stability and public finances.

**Even though there might be no legal requirement to prepare financial statements according to IFRS, AMCs may apply EU-endorsed IFRS if Member States have allowed that for non-listed companies.** The application of IFRS may increase transparency for the stakeholders involved in the AMC, being beneficial especially in the case where AMC bonds are placed with third-party investors without the protection of

---

<sup>74</sup> Several Member States (including EE, IT, GR, HR, CY, LV, LT, MT, SI, SK) have used the IFRS option to require banks to prepare IFRS financial statements. Some other Member States (such as LU, NL, FI or UK) allow banks to use IFRS for the preparation of financial statements.

<sup>75</sup> See section 4.5.2.iii on the potential need to prepare consolidated accounts and the idea that the AMC might be considered as an investment entity in the meaning of IFRS 10.27.

<sup>76</sup> See the EU [Commission's homepage on financial reporting](#). For EU rules that limited liability companies have to follow when preparing financial statements see [directive 2013/34/EU](#) ("Accounting Directive").

<sup>77</sup> See section 2.1 on the mandate and objectives, and 2.3 on financial stability considerations.

<sup>78</sup> See section 3.8 on the funding strategy.

government guarantees. The current common use of IFRS in the financial sector in a Member State may be another argument for considering the use of IFRS.

#### **4.5.2. Specific aspects of accounting**

From the AMC perspective, there are essentially two relevant accounting issues:

1. "Initial recognition" incl. the accounting value of the transferred NPL asset that the AMC uses when including the transferred asset on its balance sheet for the first time;
2. "classification and subsequent measurement";
3. also the accounting for investments from an AMC's perspective needs to be considered.

From the transferring bank perspective, the following accounting issues are important to consider during the set-up of an AMC:

1. "de-recognition" of transferred NPLs;
2. consolidation or accounting for investments in the AMC.

To illustrate the possible accounting issues faced by an AMC, it is assumed that the AMC uses IFRS. The same accounting issues will occur when the AMC uses national GAAP but the outcome may be (slightly) different. Note that several Member States have provisions in their national accounting laws requiring the use of IFRS in case an issue is not covered in their national GAAP.

##### **i. Initial recognition: Accounting specifics at transfer**

The main aspect to be considered at the transfer of the NPL financial assets from banks to the AMC is the initial value of the transferred NPL transferred asset on the AMC's balance sheet.

**First time recognition of the NPL asset on the AMC's balance sheet shall be at its fair value.** In the IFRS context, IFRS 9 and IFRS 13 assume that the transaction price is normally the financial instrument's fair value at initial recognition. However, there can be exceptions. Assuming that the transfer takes place at the REV or at a price between the EMV and REV, it needs to be proven that the TP is the fair value. As the TP differs from the EMV – with the EMV estimated “based on observable transactions for similar types of assets” – such proof might be difficult.

The difference between the TP and fair value (potentially the EMV) needs to be considered according to IFRS 9.B5.1.2A which may lead to recognising this difference at initial recognition of the asset or deferring the difference over time. The recognition of such differences might have a significant impact on the AMC's equity.

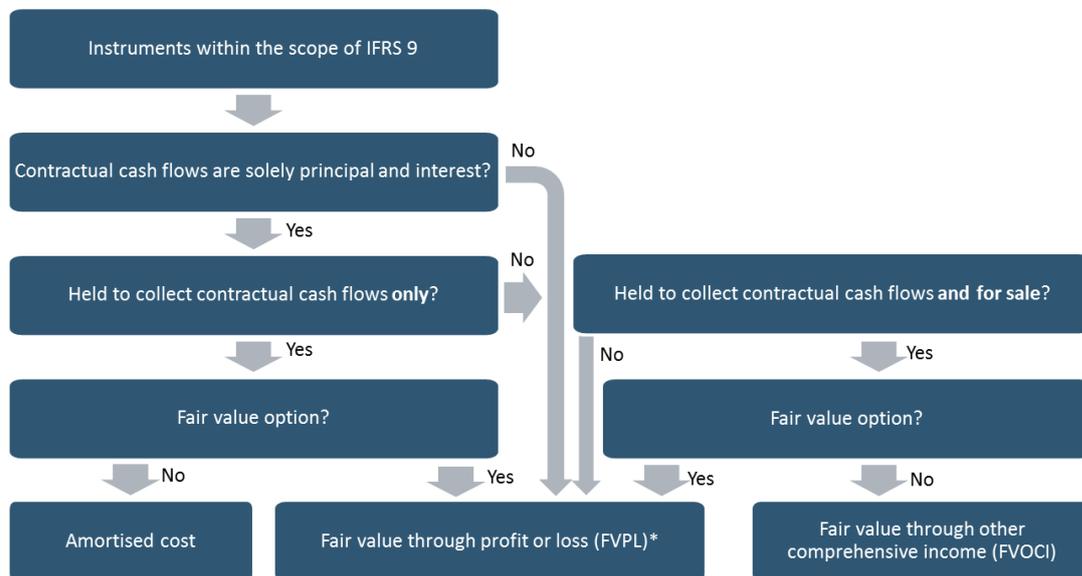
##### **ii. Classification and subsequent measurement**

Although the amount of initial recognition of financial instruments is the same irrespective of their classification, the accounting classification creates differences in how financial instruments will be subsequently "measured" (valued) over their remaining life.

IFRS has three main classifications with specific subsequent measurement approaches: 1) "amortised cost", 2) "fair value" with fair value changes through Profit or Loss (FVPL) or 3) fair value with changes directly in equity (FVOCI) (see classification scheme in Figure 6).<sup>79</sup> The fall back classification in IFRS is fair value at profit or loss<sup>80</sup>.

IFRS provides rules and principles for the classification of financial instruments based on a combination of the contractual cash-flow features of the transferred NPLs and the AMC's business model. The business model could for example be to run-off the NPLs or to manage the sale of NPLs<sup>81</sup>. In addition to these mandatory classification criteria, IFRS allows to apply fair value optionally for example to prevent accounting mismatches between financial assets and liabilities or hedging instruments. Respective decisions on the valuation approach are always based on an individual evaluation by the management of the AMC.

**Figure 6: Classification assessment under IFRS 9: process to apply requirements**



\* Presentation option for equity investments to present fair value changes in OCI

Source: EBA, IFRS 9.B3.2.1

Most financial assets transferred to the AMC are likely to meet the test of having “solely payments of principal and interest” (SPPI). In that case, if the AMC’s business model is to pro-actively manage (i.e. sell) these assets then the financial assets would be measured at fair value. In case the AMC business model would be to run off the NPL loan portfolio then it is collecting contractual cash flows only and can measure the financial instrument

<sup>79</sup> It is assumed in the following that IFRS 9 will be applicable when an AMC starts its operations. The classification of a financial instrument needs to be done at its recognition (IFRS 9.3.1.1). However, as this has significant impact on the ongoing accounting, it is described in this and not the following section. Potential reclassification is not covered in this Blueprint. See also for more details IFRS 9.4.1, 4.2 and IFRS 9.4.15.

<sup>80</sup> Looking beyond IFRS accounting, also the Accounting Directive, which national GAAPs have to comply with, requires that Member States either require or permit the application of fair value accounting for certain financial instruments as well as other assets.

<sup>81</sup> See section 5.2.

at amortised cost<sup>82</sup>. The measurement of financial instruments at amortised cost creates generally less volatility than measurement at fair value. However, measurement at amortised cost implies possible "impairment" charges<sup>83</sup> and does not allow showing profits if the fair value of the NPL portfolio would go up before actually selling the NPL portfolio.

### **iii. Accounting for investments from an AMC's perspective**

Avoiding the need to prepare consolidated accounts is of crucial importance. As such, in respect of the accounting of subsidiaries it is assumed that the AMC is considered as an investment entity according to IFRS 10, which means that its subsidiaries are measured at fair value.

### **iv. De-recognition from a bank's perspective**

The set-up structure of the AMC should be such that the transferred assets qualify for **de-recognition** and that the **AMC is not consolidated from the banks' perspective** (see section 1.1.2.4).<sup>84</sup> If these aspects are not carefully considered, then the whole exercise of setting up an AMC will be undermined because the NPLs will remain on the balance sheet of the transferring bank.

The transferring bank will need to examine whether the transferred assets qualify for de-recognition from its financial statements. IFRS provides rules<sup>85</sup> for deciding whether a financial asset can be de-recognised. Important conditions for de-recognition are: the transfer of the rights to receive contractual cash flows to the AMC and the bank not substantially retaining risks and rewards.

### **v. Consolidation or accounting for investments in the AMC**

The set-up of a national AMC should avoid the need for any of the transferring banks to consolidate the AMC as otherwise the transferred NPLs would be included in the consolidated accounts of the transferring bank.

According to IFRS, consolidation is needed, in case an investor controls another entity. As it is assumed that the AMC has got its pre-set mandate to manage its assets itself and run them down with the primary objective to maximise the recovered value on a commercial basis from the sales, such control can most probably not be assumed. However, an individual judgement will be needed in each separate case. In case the AMC includes assets from several banks, the examination of a need for consolidation at each bank will need to consider if it holds interests in a "silo", i.e. a deemed separate entity within the

---

<sup>82</sup> IFRS 9.B.4.1.6. However, in case the AMC's aim is solely to recover the money from the customers or try to recover values from collaterals, then the amortised cost would be the appropriate valuation approach (assessment additionally depending of the instruments' cash flows). A third option would be the recognition of the financial assets at fair value through other comprehensive income. However, this option will not further be elaborated here (see IFRS 9.4.1.2A).

<sup>83</sup> Given the nature of the assets, it is probable that the bulk of the assets would already be impaired prior to the transfer and be acquired at a significant discount with respect to the gross book value. The likelihood of future impairments would therefore be limited by the transfer price mechanism.

<sup>84</sup> See section 5.3 on AMC interaction with transferring banks.

<sup>85</sup> See IFRS 9.3.2.

AMC that includes its former assets. I.e. the examination will not consider the whole AMC, but the respective “silo” of assets originally transferred by the bank.

The ownership and control structure should be such that the AMC is de-consolidated and considered either as an investment entity according to IFRS 10 "consolidated financial statements" or an investment in an associates and joint ventures IAS 28 applies.

**Potential issue:** Going beyond accounting aspects, the AMC’s set-up structure shall also be designed in a way to prevent that the AMC would be under the prudential scope of consolidation from the banks’ perspective.

#### **4.5.3. Accounting related disclosures**

The AMC should aim to make its financial condition and operations transparent, as required under the relevant accounting framework. The AMC shall apply **accounting related disclosure requirements** as applicable according to national law.<sup>86</sup> In case it provides financial statements according to IFRS on a voluntary basis, respective disclosure requirements – provided in its “notes” to the financial statements – shall be applied accordingly.

### **4.6. Data**

#### **4.6.1. Need for harmonisation of data**

The need for harmonised data on NPLs is highlighted by all stakeholders for a number of reasons. Detailed and binding data requirements will reduce information asymmetry, which is identified as one of the major factors for wider bid-ask spreads in NPL markets, and is partly caused by incomparable and poor data on NPLs. The EBA has therefore developed standardised NPL data templates<sup>87</sup>, “EBA NPL Templates”, which consist of templates for (1) financial due diligence and valuation purposes, and (2) portfolio screening. The templates are focused on collateral related data, differentiating real estate collaterals (including e.g. tenant related data) and other collaterals (incl. guarantees). They also cover data on historical cash collections, the status of legal enforcement (e.g. status in the insolvency process), forbearance related information etc.. The templates also take asset class, country specific as well as confidentiality aspects into consideration. These templates envisage laying the foundation of secondary NPL market activity providing increased transparency and comparability of respective data and therefore to be used by banks and investors in NPL related transactions. For that reason, fully completed data templates are a condition for a transfer of loans from banks to AMCs. Furthermore, AMCs will need to keep this data updated in their systems and readily available, so that the data can be easily provided to prospective investors, either for financial due diligence / valuation purposes or for the initial portfolio screening.

---

<sup>86</sup> See also the EU Commission’s publications on transparency requirements for listed companies and non-financial reporting.

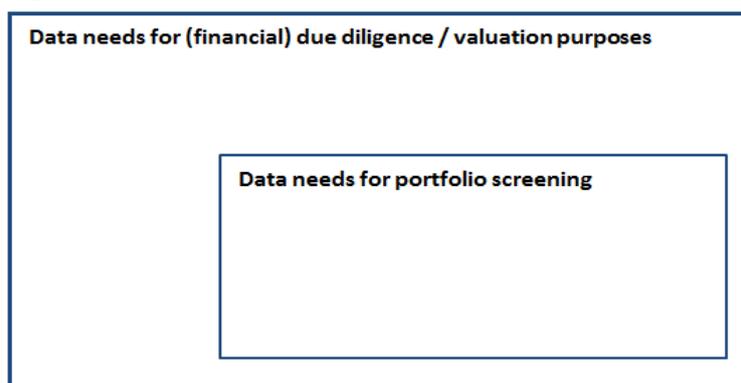
<sup>87</sup> <http://www.eba.europa.eu/risk-analysis-and-data/eba-work-on-npls>

### 4.6.2. Data needs

Financial due diligence / valuation and portfolio screening require different data with different level of granularity. These different data needs are assumed to build up on each other so that their usage by banks and AMCs is as simple as possible. The data needs for financial due diligence and valuation purposes are the most detailed, and these include loan by loan data along with identified data needs for all asset classes and potential differentiation between them, whereas the level of detail decreases for screening purposes:

The data for the portfolio screening enable potential bidders to analyse a portfolio at a high level so that they are able to identify if the portfolio acquisition is of general interest or not. The data for the financial due diligence and valuation enable potential bidders to perform proper and detailed financial analysis of a portfolio and to conclude a bid price.

**Figure 7: Data needs**



Data needs vary between asset classes (e.g. mortgage loans, commercial real estate loans, auto loans etc.). Therefore, asset class specific templates have been developed. These templates include not only data on individual loans and collateral (e.g. information about the loan type, maturity, client, information about the collateral), but also general market data (e.g. bankruptcy proceeding periods or cash outflows related to legal or servicer costs).

### 4.6.3. Data quality

High quality asset data is of prime importance as they form the basis for financial due diligence and objective valuations for all parties involved. Data quality consists of several aspects:

- **Completeness:** all required data are reported;
- **Accuracy:** data reflect reality;
- **Validity:** data values are reported as specified;
- **Consistency:** data are consistent across fields, templates, external sources, over time without duplications;
- **Integrity:** consistent relations between entities and attributes;
- **Timeliness:** data are updated and available when needed.

Banks should therefore be required to run rigorous internal controls and quality checks to ensure that data provided to the AMC are as complete, accurate, reliable, consistent and timely as possible. Banks should also be required to comply with validation rules before submitting data to the AMC.

AMCs should be expected to perform a thorough data quality assurance before taking on new assets. Immediate actions upon establishment of the AMC include data collection and clearing, categorization and prioritization of assets and the setting-up of specialised work-out teams. Furthermore, data cleansing processes are very important for correct asset pricing and for the sale process. The files inherited from banks, including collateral documentation, need to be reviewed and completed in case of missing information. The process should engage with numerous specialised experts (surveyors, engineers, attorneys etc.) and should not be paid for by the AMC.

In addition, a bi-annual quality assurance process, which might involve data updating, cleansing, re-categorization and / or re-prioritisation of assets, is deemed necessary in order to secure minimum acceptable standards of data quality and ensure data relevance.

After transferring the assets, AMCs are expected to maintain their database up-to-date. When organising loan servicing, AMCs need to ensure that they will have access to all necessary information to maintain the database up-to-date.

In addition to loan data, also collateral related valuation data should be updated on an ongoing basis. If there are no liquid markets for loan or collateral values available, valuation updates need to be performed at least annually. This will enable AMCs to perform accurate and timely valuations.

#### **4.6.4. Data sharing and transparency**

An AMC is expected to share its data with potential buyers / investors. For this purpose, the relevant data templates developed by the EBA for portfolio screening should be used to ensure consistency across market participants, therefore setting the market standard and widening the investor pool. Clear rules for data sharing must be in place. Data storage will have to be done in a way that at no point in time any confidential data can be accessed by third parties. Processes for data anonymization shall be in place, so that in general protected data might still be shared with third parties, e.g. for valuation purposes or when sharing data with the EU wide transaction platform.

AMCs should be subject to an approved Code of Practice<sup>88</sup>, which would set out their obligations in respect of disclosure of interests and confidentiality. The Code of Practice should be ratified by the Ministry of Finance and should be adhered to strictly. When Member States set up the AMC in national legislation, the provisions of Regulation (EU) 2016/679 will apply to the processing of personal data. This includes in particular, where personal data is processed for the purposes of the Member State legislation setting up the AMC, the precise purpose should be specified and the relevant legal basis referenced.<sup>89</sup> In addition, personal data protection by design and data protection by default should be

---

<sup>88</sup> I.e. a code or general legal obligation could be sufficient, as for any other seller or investor. AMCs need to be bound by these obligations.

<sup>89</sup> The relevant security requirements laid down in Regulation (EU) 2016/679 should be complied with, and the principles of necessity, proportionality, purpose limitation and proportionate data retention period respected. Equally, administrative cooperation and mutual assistance between the competent authorities of the Member States should be compatible with the rules on the protection of personal data laid down in this Regulation, as well as in accordance with national data protection rules implementing Union legislation

embedded in all data processing systems developed and used within the framework of the national legislation setting up the AMC.

The AMCs are also expected, when prompted, to make available the standardised data so that it could be stored on a centralised platform at European level. The centralised platform, in case is developed in the future, could combine exposures from multiple AMCs and banks and vouch for quality of the data. Similarly, AMCs should provide the data for the development of a European NPL-information platform that would aim to enhance transparency and facilitate transactions of NPL.

#### **4.7. Conditions for bank participation**

One condition to restore a stable and healthy banking sector is that banks are freed from NPL portfolios (at least to a large extent) to allow bank management to focus on new business and long term growth strategies. In order to achieve this, it needs to be ensured that all NPLs are properly identified and valued, and bank solvency position is tested against plausible scenarios from a forward-looking perspective. Where appropriate, banks' participation can be organised based on a qualified mandatory basis. In those cases banks deemed by the diagnostic exercise to be in scope of transfer to the AMC may, if deemed appropriate, be obliged via national legislation to transfer NPLs falling within the identified asset perimeter to the AMC.

Banks in scope would subsequently need to address any shortfalls vis-à-vis their respective capital requirements resulting from the NPL disposal losses. When banks are unable to address such shortfalls in private ways (e.g. by raising new equity in the market, selling assets, etc.), they need State aid. This raises the need for either, resolution, liquidation, or precautionary recapitalisation (if all applicable conditions – notably regarding the bank's solvency – are met)<sup>90</sup> Although AQRs and stress tests are time and resource consuming exercises which take between 6 to 12 months to conclude, they are a precondition for any type of public support for an AMC, as follows from the BRRD and the SRMR. This also contributes to avoiding that banks, after having received public support, are still struggling with the clean-up of residual NPLs due to the lack of buffers and are thus not able to focus on lending to the economy.

#### **4.8. Funding**

The funding of the AMC could be structured following the examples of SAREB and NAMA.<sup>91</sup> The AMC would acquire assets by issuing senior unsecured bonds to originating banks. The senior bonds would carry a full and irrevocable guarantee of the national Treasury, and would be eligible for use as collateral in Eurosystem credit operations by their holders. The bonds will be bullet securities with a call option available to the issuer.

---

<sup>90</sup> See section 3.1.

<sup>91</sup> This does not imply that funding approaches should be limited to those implemented in the cases of NAMA and SAREB. Similar, yet alternative, models could be applied, optimally adapted to Member States' specific characteristics. This type of funding solution could be structured in compliance with the BRRD and SRMR.

Market funding solutions without a guarantee should be explored as part of the national AMC design process and, if feasible, they may be preferred to the government-guaranteed funding. However, historical experience indicates that such market-based solutions prove difficult to implement and may require a significantly larger equity contribution, thus being uneconomical.

The repayment schedule of the senior bonds would be part of the AMC's business plan and aligned with the intended asset disposal schedule. A waterfall of repayments would be agreed in advance. The subordinated bonds should only be repaid after all senior bonds will have been amortised. Similarly, the equity should be last to be repaid, after redemption of all debt instruments.

The senior bonds should be structured with cash flow uncertainty and liquidity risk in mind. The AMC is expected to improve cash flow generation over time, as its recoveries would come late in its life cycle. However, the contractual maturity of the bonds may need to be shorter than the expected lifetime of the AMC to minimise the total funding cost paid by the AMC.<sup>92</sup> In this case, then transferability of the AMC senior bonds would be, at least initially, restricted, to avoid the risk of the AMC being faced with large redemption needs. Together with the repayment schedule, the redemption needs would impose market discipline from the bondholders' side.

A portion of bonds could be subordinated, the amount to be calibrated, with the bonds being placed with participating banks or with equity providers, with the latter being preferable to fully remove exposure to NPL from the banks. If subordinated bonds are placed with transferring banks this would come with the drawback that the banks would have a continued dependence of the banks on NPL performance – exactly the dependence we try to break with the AMC in the first place. On the other hand, this residual dependence, limited to a small part of the AMC capital structure, can serve as an incentive for banks to cooperate with the AMC after the asset transfers are completed, for example in the field of loan documentation.<sup>93</sup>

The large majority of the funding should consist of senior guaranteed bonds. The equity part should be sufficient to cover the expected Day 1 loss related to the initial recognition of assets at fair value<sup>94</sup> with a buffer that would allow the AMC to work out assets and carry out the necessary hedging strategy without being at risk of falling into negative equity. Part of that buffer could be structured as subordinated debt, for example calibrated to cover the unexpected loss on the assets.<sup>95</sup>

---

<sup>92</sup> In the case of SAREB and NAMA, the bonds have a contractual maturity of one year and are rolled over on a periodic basis.

<sup>93</sup> Ex post interaction between banks and the AMC is often a necessity, as quality of loan documentation and data often turns out to be poor. Without a financial incentive to do so, banks may not be willing to resolve the data issues. A profit-based servicing fee structure would likely be a weak incentive as the banks are going to be only a bridge servicer, until an independent servicer can be found (see section 5.3), over the period when the AMC is unlikely to generate profits.

<sup>94</sup> See section 4.5.

<sup>95</sup> In that case, it would be natural to place the subordinated bonds with the banks as payment-in-kind. However, the subordinated tranche would be subject to a high capital requirement, and may have to be marked down from

The benefit of the payment-in-kind would be that the liquidity needs of the AMC would be minimised, as the AMC would not need to raise cash to acquire the assets and could lock up the funding from originating banks. Additionally, banks would benefit from swapping a high-risk non-performing asset for a low-risk, quasi-sovereign asset that would improve their funding position without tying up large quantities of regulatory capital, although their balance sheets would not shrink substantially.

In the start-up period, the AMC may require a bridge loan to cover its initial outlays and working capital needs.<sup>96</sup> This could be provided by participating banks against state guarantee, and repaid once the AMC generates income.

The government guarantee would be remunerated in line with the State aid rules.

The guarantees, being a contingent liability of the government with a remote probability of being ever called due to the pricing of asset transfers and a capital cushion of the AMC, would not increase the stock of public debt.<sup>97</sup>

Appropriate controls must be put in place to ensure that AMC redeems senior debt, rather than building cash reserves or diverting resources to other interests. To ensure that an AMC's overarching goal – the timely wind down of its portfolio – is achieved and not diverted, strict guidelines should be laid down to ensure that an AMC reduces its outstanding liabilities at every reasonable opportunity, bearing in mind the natural priority of the capital structure, and does not run up large cash buffers.

## **4.9. Impact on public finances and national accounts**

### **4.9.1. Main considerations for sector classification of AMC units**

One of the key questions determining fiscal impact of AMCs is their **sector classification** in national accounts. The choice is between S.12 (financial corporations) and S.13 (general government). In national accounts, any given unit can belong to only one sector<sup>98</sup> and, as a general rule, units are not split.

AMCs would be classified as part of general government when they **do not place themselves at risk** and instead the government is carrying risks and rewards associated with asset management and the incurrence of liabilities by the AMC.<sup>99</sup> The government puts itself in this position for public policy purposes, and direct or indirect financial support received by such AMCs implies a redistribution of income and wealth through their operations, which justifies their classification inside general government.<sup>100</sup> If such risks and rewards are instead predominantly with the banking sector, the AMC would be

---

face value upon recognition, causing an additional Day 1 loss. Overall, this speaks in favour of limiting the size of the subordinated tranche.

<sup>96</sup> It should not be forgotten that an AMC should run a positive cash balance to cover its projected operating expenses and smooth the volatility of cash inflows and outflows.

<sup>97</sup> See more detailed discussion on the impact of guarantees on public finances in section 4.9.

<sup>98</sup> ESA 2010: 2.41

<sup>99</sup> ESA 2010: 20.32-20.34, 20.46, 20.243-20.248.

<sup>100</sup> ESA 2010: 20.02.b.

classified in the financial corporations sector. The balance of risks and rewards takes predominance over formal characteristics of the AMC: for example, an AMC can be classified as part of general government regardless of the fact that it maintains its banking licence and is included in the MFI list.<sup>101</sup>

#### 4.9.2. Impact of losses related to impaired assets on government deficit and debt

The key public finance impact concerns **losses** from impaired assets: the price that is paid by the government upon acquiring the assets (or value of liabilities assumed by government in relation to such assets) is to be compared to the market or fair value of the assets. Any consideration provided in excess of market or fair value of the assets is recorded as a deficit-increasing capital transfer.<sup>102</sup> However, determining the value of the asset is often difficult in practice, particularly when there is no representative or functioning market.

If an AMC is classified inside general government, its operations will be relevant for the '**Maastricht deficit**'<sup>103</sup>. The largest impact on deficit usually relates to the set-up of the structure and/or the transfer of the assets, when the value of cash provided by the government or the liabilities assumed by the government exceeds the market or fair value of the assets.<sup>104</sup> If the AMC is classified outside general government, **government guarantees** on the (realisation of the) assets could have an effect on public finances at inception: when the government guarantee is on any given value (e.g. nominal value) higher than the estimated fair value, then a deficit-increasing capital transfer shall be recorded for the difference.<sup>105</sup> Deficit and debt impact are possible also in cases when an AMC is classified as a financial corporation but some transactions and associated liabilities are considered as done or incurred **on behalf of the government**.<sup>106</sup>

The impact of losses does not exclusively occur in the beginning of the process but may also crystallise at later stages. In cases when AMCs are classified outside government, it can occur for example when government **guarantees** are called, when government makes additional **capital injections** in the company (see also discussion below), or when a government **cancels some of the claims** related to the impaired assets, beyond what was already recorded as having a deficit-increasing impact in the beginning of the process. When AMCs are classified inside government, this can occur when further losses on the assets are recognized, either due to new estimates or to the resale (or other transformation) of those assets.

---

<sup>101</sup> ESA 2010: 20.32-20.34.

<sup>102</sup> ESA 2010: 20.246-20.247

<sup>103</sup> "Maastricht deficit" or "Excessive Deficit Procedure (EDP) deficit" is defined in Protocol No 12 on the Excessive Deficit Procedure attached to the TFEU and in the subsequent legal acts and corresponds to net borrowing (net lending) of the general government sector, as defined in the European System of Accounts ESA 2010. It is used when assessing Member States' compliance with the requirements of the Stability and Growth Pact.

<sup>104</sup> See section 4.10.

<sup>105</sup> ESA 2010: 20.245, 20.256

<sup>106</sup> ESA 2010: 1.78

The impact on debt of classifying an AMC as part of government is more straightforward, due to the gross nature of the '**Maastricht debt**'<sup>107</sup>: any obligation of such an AMC towards units outside general government (e.g. to originating banks) which has a nature of deposit, debt security or loan, will add to the government's 'Maastricht debt'.

Units holding predominantly impaired assets (which are usually referred to as 'defeasance structures' in statistical methodology) show considerable heterogeneity in what concerns their legal and administrative features, the forms of government support, their size and their origin/background. It is clear also that the national context and framework in which these entities are created differs considerably from one MS to another. It is therefore important to clarify that the **statistical impacts of each case is always separately analysed by the Commission (Eurostat)**.

#### 4.9.3. Valuation of assets

As a general rule, valuation in national accounts is based on **market value**<sup>108</sup>, although recording of loans has its specificities. Under normal market conditions it can be assumed that market values could be easily established for securities, quoted shares and, to a lesser extent, also for real estate, whereas loans will be recorded in the balance sheet at their **nominal value**<sup>109</sup>. In situations of market distress, it is possible that meaningful market value could be difficult to establish. Fair value or expected redemption value of the assets has thus to result from **estimates carried out by an independent body** on the basis of usual pricing methods<sup>110</sup>.

#### 4.9.4. Capital injections into banks and apportioned losses

Government support to financial institutions often takes the form of acquisition of equity or other forms of (regulatory) capital. When determining the impact on public finances, the main criterion is that payments to cover accumulated, exceptional or future losses, or provided for public policy purposes, are recorded as **capital transfers** (with deficit impact). As a secondary criterion, when a government is acting as a normal shareholder (in the sense that it has a valid expectation of earning a sufficient rate of return), payments are recorded as **acquisition of equity** (without deficit impact).<sup>111</sup> Sometimes capital injections are combinations of the two above-mentioned forms of transactions.

The application of these principles, however, poses practical difficulties when capital injections are made into corporations under restructuring or recapitalisation, i.e. when **forward-looking considerations** of future rate of return coincide with **past losses**. To

---

<sup>107</sup> "Maastricht debt" or "Excessive Deficit Procedure (EDP) debt" is defined in Protocol No 12 on the Excessive Deficit Procedure attached to the TFEU and in the subsequent legal acts and corresponds to total general government's consolidated gross debt at nominal value outstanding at the end of the year, constituted by the liabilities of general government in the following categories: currency and deposits, debt securities and loans, as defined in the European System of Accounts ESA 2010. It is used when assessing Member States' compliance with the requirements of the Stability and Growth Pact.

<sup>108</sup> ESA 2010: 1.94

<sup>109</sup> ESA 2010: 7.70

<sup>110</sup> Manual on Government Deficit and Debt: IV.5.2.3-IV.5.2.5

<sup>111</sup> ESA 2010: 20.198-20.199

address this, Eurostat proposed an implementation rule of '**apportioned losses**': part of the capital injection which corresponds to government's share in accumulated past losses is in any case to be recorded as a capital transfer (with deficit impact), while for the remaining amount usual considerations of sufficient rate of return and other arguments (e.g. participation of private investors) apply when determining the nature of the transaction.

## **4.10. Safeguard mechanisms and supervision**

### **4.10.1. Safeguard mechanisms introduction**

Safeguard mechanisms aim to protect the taxpayers against future liabilities created by an AMC if it does not perform financially or drifts from its mandate. Historically the importance of these mechanisms has been more evident in countries with weak legal and institutional environments, especially when financial community cannot thoroughly assess the performance of an AMC or weak governance is predominant. An AMC should consider implementing the following safeguard mechanisms:

- (1) Time limits: in order to ensure that the AMC acts expeditiously;
- (2) Financial: to avoid that an AMC becomes a fiscal burden;
- (3) Risk management: to ensure prudent risk management practices;
- (4) Other Safeguard Mechanisms: to ensure that best market practices are followed.

There may be a trade-off between a fully-fledged implementation of safeguard mechanisms and the effectiveness of an AMC. Therefore a thorough cost-benefit assessment should be performed before deciding the implementation of such mechanisms.

### **4.10.2. Time-limit safeguards**

Time-limit safeguard mechanisms secure that an AMC's management remains focused on its goal and that the AMC does not drift from its mandate. The temporary character of the AMC, according to State aid rules, requires the AMC to have a predefined lifespan. However, past experience has proven that flexibility to extend the lifespan, under certain conditions, is an important success factor for AMCs. A sunset clause, as clearly defined in the AMC's business plan, is necessary to ensure the temporary character of the AMC. However, it should be possible to differentiate the foreseen lifespan of the AMC (to a shortened or lengthened period), in order to enable tailoring to varying specifics across countries and/or asset classes. This would allow the AMC's management to accommodate, if necessary, relevant market development and would also ensure that the AMC does not act under pressure to sell its assets (subsequently leading to fire sales). Nevertheless, the decision to alternate from the suggested lifespan should be duly justified by the AMC management.

More importantly, the time to purchase assets should be limited and the AMC should be strictly constrained to perform periodic acquisitions. The time-limit to purchase assets reinforces the focus of the AMC on the core work of its operations. It simultaneously sends a strong message to banking institutions to immediately offload the relevant assets.

Furthermore, it ensures that sound loan origination and risk management will not be impaired by the expectations of subsequent asset transfers to the AMC.

#### **4.10.3. Financial safeguards**

Financial safeguards can be considered in order to avoid an AMC becoming a fiscal burden and they are mostly relevant when external controls are weak. Where the local financial community and external controllers can assess appropriately the role of the AMC, then financial safeguards may not be necessary.

However, when the financial community and external controllers do not have the necessary capacity and therefore cannot assess appropriately, the following financial safeguards could be put in place. The size of the AMC could be capped at inception with an overall limit on the total issued debt or total borrowing, securing the focus remains on the AMC's mandate. Yet, the AMC's size should stay consistent with the targeted critical mass of NPL. However, such limits entail risks in case they are violated, potentially leading the AMC to lose credibility. In order to protect the credibility of the AMC, the imposed limits should be strictly respected and adhered to. Other ways of financial safeguards for an AMC would be to restrict the use of cash through sinking funds for the issued bonds, and/or set up repayment clauses and to promote financial transparency.

#### **4.10.4. Risk management safeguards**

As a result of its operations, an AMC is exposed to credit, interest rate, liquidity and possibly currency rate risks. The AMC needs to carry out an in-depth analysis to identify the most relevant risk factors in order to support its decision-making. A separate and independent risk management unit that should be reporting directly to the board of directors is required to perform this task. Risk management safeguards aim to limit risk tolerance and set lower levels on accepted market (e.g. interest rate and foreign currency risks (i.e. open positions)), credit and liquidity risks.

Changes in interest rates and exchange rates or other market prices result in market risk, which is the potential loss in the income or net worth of the AMC. Market risks arise from open positions in interest rates and currency products. Currency risks arise when the AMC acquires foreign currency loans, which create asset/liability mismatches. The AMC also faces ongoing currency risks after loan acquisition as non-domestic currency facilities are drawn, repaid or rescheduled and assets are disposed. An AMC should utilise currency-hedging practices using derivative contracts to mitigate or manage the currency risk. The AMC is also exposed to interest rate risks due to issued bonds, acquired loans and booked derivatives. The assessment and management of the interest rate risk is related to current and expected performance of the loan or derivative book. The AMC should therefore manage interest rate risk by utilising hedging practices through derivative contracts.

As the AMC's financial asset portfolio represents the majority of its assets under management, the assessment and management of credit risk is crucial for the AMC to meet its mandate.

Further to this, liquidity risk needs to be actively managed, which may incorporate ongoing liquidity stress-testing and the maintenance of a minimum liquidity buffer or cash reserves. The buffer should be kept in line with the overall asset and liability management strategy.

#### **4.10.5. Other safeguard mechanisms**

Mechanisms are required to safeguard that the staffing of the AMC is done purely on the basis of merit and that the staff's remuneration remains at market prices. It should be possible to provide incentive based remuneration schemes but these should follow best market practices. Safeguard Mechanisms for the asset valuation should ensure fair and appropriate respective processes are carried out.

#### **4.10.6. Supervision**

An AMC would not need to attract any deposits or issue new loans. It is therefore deemed unnecessary for it to obtain a banking license and adhering to banking supervisory regulations. The AMC would hence be considered neither as a credit institution, nor as an investment firm. It would subsequently not be subject to CRR/CRD supervision.

However, even though the AMC will not be under national banking supervision (competent authority), it still needs proper oversight. The institution that is to provide this oversight function would need to be identified by the government under whose jurisdiction the AMC would be set up. Entities which might be nominated for this purpose (in the following: supervisor) are the Competent Authority for prudential supervision/resolution, the Central Bank, Comptroller's office / court of auditors or a joint oversight committee of these authorities. In addition, if public funding is at stake, an observer function for the European authorities could be considered.

The supervisor should be well equipped and should possess sufficient expertise to adequately and efficiently supervise an AMC. An AMC needs to be subject to independent oversight in order to further strengthen its governance. However, oversight should be strictly limited to compliance with regulation and the AMC's mandate and should not imply powers to change or challenge business decisions. The scope of supervision by the designated competent authority should include, for instance, the review of the business plan of the AMC as well as the compliance of the AMC with accounting rules and governance requirements.

## **V. EFFECTIVE OPERATIONS OF AN AMC**

### **5.1. Organisation and staffing, internal controls and transparency**

The mandate of the AMC should account for the fact that AMCs should not operate as a for-profit enterprise.<sup>112</sup> AMCs should remain a light operation, with limited numbers of staff. Within the constraints mentioned above, AMCs should be able to adjust staffing as needed during its lifetime. It should also be able to pay market price for specialised skills needed in the work-out process. In particular, it should not aim to develop its own heavy servicing platforms, with a possible exception for single large, bespoke exposures that merit special senior management attention and demand complex expertise.

Rigorous, best practice internal controls must be in place to secure the financial soundness of the AMC and to maintain the entities credibility. These controls should be established to cover all commercial aspects of the AMCs governance and operations. A strong legislative mandate can only be harnessed through effective operational control, to mitigate operational risks arising. Audits of control functions should be conducted by external auditors with shortcomings immediately addressed. Control functions should be tailored to the specific nature of the AMC enterprise and some aspects should even be entered into the relevant legislation. These aspects are related to, for example, prevention of external interference with the operations of the AMC. In the case of NAMA, lobbying was considered an offence, and staff were under an obligation to report any attempts to lobby NAMA to the proper authorities.

AMCs should be transparent to the public with well-defined disclosure requirements. Transparency will be critical in the implementation phase, where it must be demonstrated that asset perimeters, participation perimeters and transfer pricing are rules-based on not subject to possible corruption or cronyism. Later, public interest will shift to operations, focusing the disposal of assets and the consistent treatment of debtors, and to the financial performance of the AMC.

### **5.2. Strategic planning, asset and financial management**

#### **5.2.1. Strategic planning**

The strategic plan is the most important part of defining operations of an AMC. A general strategic plan should be designed for an AMC's entire life with the possibility of reviewing and fine-tuning it rather than completely revising it. This part of the plan should be finished to a large extent before the establishment of an AMC. An AMC should have a mechanism in place to decide on the strategy of the AMC. All strategic planning decisions need to be communicated throughout the organisation with clarity. A more detailed strategic plan is defined by the management at a later stage.

---

<sup>112</sup> The AMC's main objective should be to maximise the value of assets that it is endowed with. For more details, see section 4.1.

The three most important parts of a strategic plan are:

- Setting an objective with the consideration of the mandate;
- Selecting an approach for reaching the objectives and;
- Assessing performance and reviewing the whole process (strategic plan review).

Effective governance is one of the key parameters for the successful implementation of the strategic planning. Therefore, it is of the highest importance to communicate the adopted plan within the AMC with the purpose of educating the staff about the goals of the organisation. In addition, transparency with the general public and other stakeholders about the strategic plan is also very important in order to gain public support.<sup>113</sup>

### **i. Objective of an AMC**

The main objective of an AMC is to maximise recovery value deriving from the disposal and management of the assets transferred to the AMC, while considering a number of constraints. First, the recoveries have to be maximised given the country-specific operating environment. Second, the performance of the AMC has to be measured in the context of the appropriate timeframe. Finally, during the sale and work-out of NPLs for AMCs dealing mainly with household and small enterprise loans, the social aspect should be appropriately considered. Above all, borrowers should be treated fairly.

### **ii. Approach for meeting the objectives**

Selecting an approach for reaching the objectives depends on a number of factors. The two most important ones are mentioned above: operating environment and timeframe. The macro-economic outlook plays an important role in both factors and hence in selecting the approach. The best way to forecast the macroeconomic developments is to look at the position in the economic cycle. Depending on this position, the most suitable approach is chosen for a specific asset class and a specific country/region.

#### ***Factory vs warehouse approach***

There are two main general approaches in dealing with assets: the warehouse approach (“wait and sell”) and the factory approach (“repair and sell”). The first approach relies mostly on time in order for assets to recover in value.<sup>114</sup> It is therefore the best option when the economy is in its initial upswing (i.e. early boom cycle). If there is no visible near-term growth, which is often the case, the factory approach is more suitable.

#### ***Fast disposal vs slow disposal***

Another dimension in the disposal process is the speed of disposal of assets. Highly capital-intensive assets should be fixed (restructured or hedged) and sold as soon as possible.<sup>115</sup> Alternatively, for medium-term performing assets that are not very capital-consuming (illiquid long-dated assets or assets for which fixing and/or sale costs would be

---

<sup>113</sup> Cerruti and Neyens, 2016

<sup>114</sup> Medina and Peresa, 2016

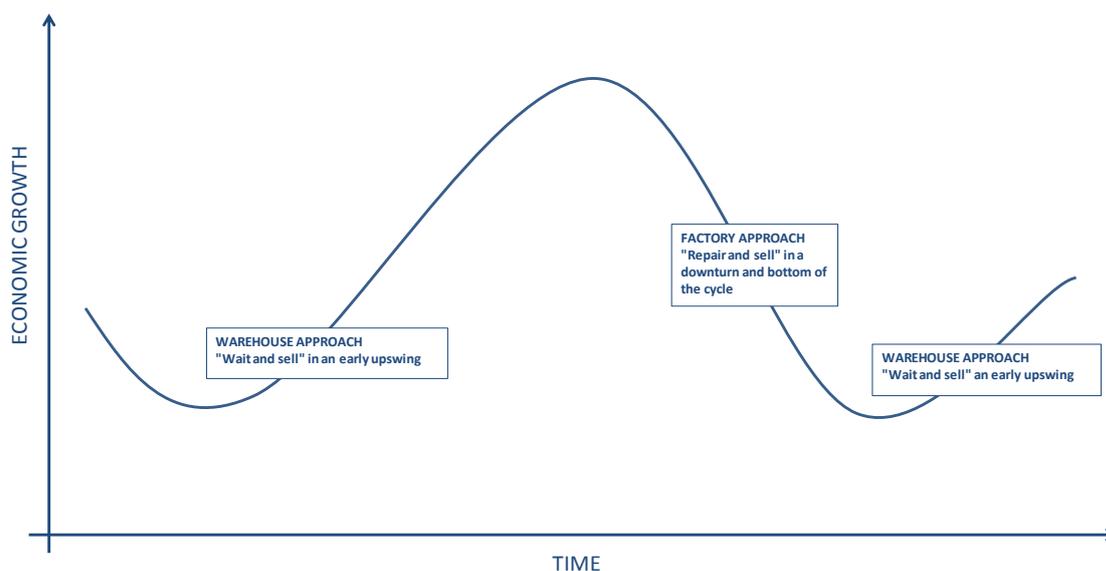
<sup>115</sup> Medina and Peresa, 2016

prohibitively high), it is better to wait with the sale. In addition, quick disposal of large volumes of assets might trigger a fire sale and destabilise the secondary market for NPLs and banks dependent on sales therein.

For this reason, before deciding on the speed of disposal AMC, the following characteristics across asset classes should be carefully considered:

- capital intensity;
- liquidity of the market for specific assets;
- cost of repair/restructuring/sale;
- volume compared to the market.

**Figure 8: Economic cycle and disposal approach**



### ***Sale channels and marketing***

AMCs should be perceived as easily approachable, flexible and transparent sellers of NPLs. AMCs should therefore develop platforms to enable window-shopping and initial screening by potential investors. These platforms should share initial screening data for raising interest with investors, who would then engage bilaterally with the AMC for receiving information in order to perform a full due-diligence. Such platforms would enable the build-up of portfolios, sale of assets in packages, securitisation or disposal of single loans.

### **iii. Performance assessment and review of the strategic plan**

The performance of the AMC should be assessed regularly in order to evaluate the adequacy of the strategic plan and effectiveness of its execution. The strategic plan should be set in multiple stages, preferably by defining the number of years for each stage. For each stage, a milestone should be set, ideally by setting a threshold of disposed assets. Together with profit generation (also measured in recovery percentage), disposal speed will be the main performance measure.

Key performance indicators for assessing the success of the strategy should consider the operational environment and the deadline objectives. As such, performance could be measured by considering the speed of disposal and the profit/recovery percentage given the operating environment and social benefits. A clear performance measurement should be established in order to avoid the interference of external parties, especially as mechanisms against political interference.

Strategic plans should be reviewed annually in conjunction with annual business plans and revised only if the underlying fundamentals of the business or the macroeconomic scenario change.<sup>116</sup>

## **5.2.2. Asset and financial management**

### **i. Asset management**

The main part of the asset management process is choosing the adequate disposal strategy for NPLs. Servicing of assets represents an important part therein.

#### ***Disposal strategies***

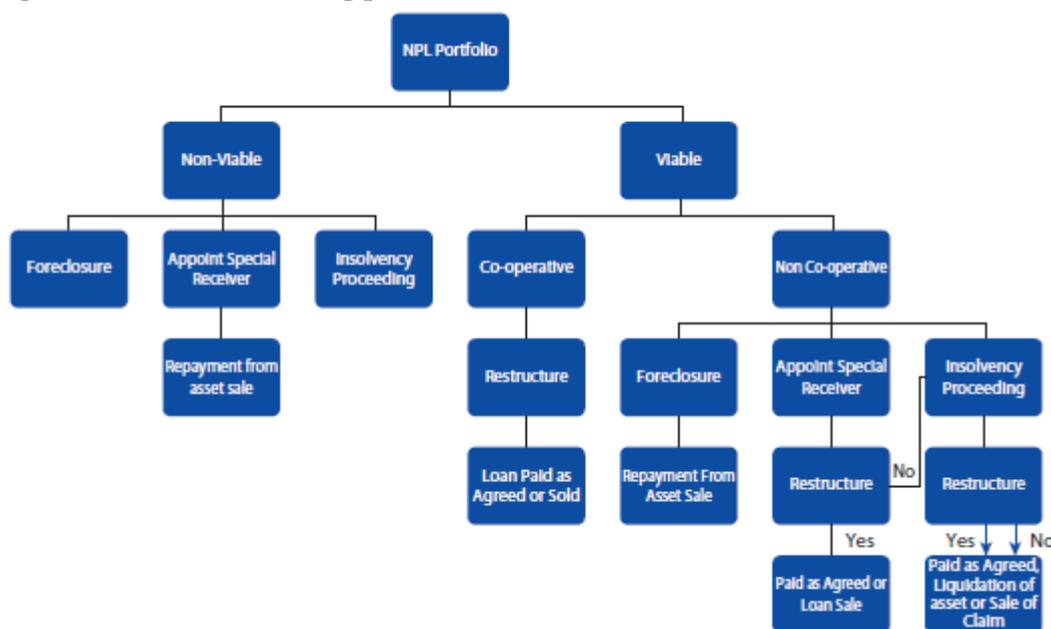
AMCs have a mix of disposal strategies available to them. The first step in defining the possible spectre of solutions is identifying the viability of the borrower (either going or gone concern). Depending on the nature of the assets managed, the urgency of cash generation, and their life span, AMCs can choose between five main disposal strategies:

- Foreclosure and sale of collateral;
- Insolvency proceeding and liquidation;
- Sale of the loan;
- Restructuring (traditional, debt-to equity swap);
- Out-of-court arrangements (and quick recovery programmes).

---

<sup>116</sup> Cerruti and Neyens, 2016

**Figure 9: Loan restructuring process**



Source: World Bank

The adequacy of disposal strategies also depends on the asset class and the geography, where the loan is located.

### ***Synergies and cooperation between AMC's***

In case of multiple AMC's, there is a possibility of synergies, especially in view of the sale and underwriting process. This can be done through a common sale platform or data hub for sharing information. The biggest benefit of such cooperation is to increase the volume of available assets for big investors and to take advantage of economies of scale in dealing with information. Additionally, cross-border investors have facilitated access to data, hence potentially encouraging cross-border disposal of assets.

#### **ii. Financial management of an AMC**

Most of the financial management of an AMC is connected to cost control. Similar to the assessment of profitability, the efficiency has to be monitored and scrutinised through a set of key performance indicators.

In the process of allocating resources for specific operational processes, the AMC should consider outsourcing certain activities, if:

- it is a one-off process;
- the process is capital intensive;
- there is no potential in reaching economy of scale internally;
- there is no internal knowledge in the specific field.

A very important part of financial management of an AMC is public disclosure. In order to build up public support, the AMC should strive to be transparent as to how it spends its resources. Going beyond regular reporting disclosures, the AMC also needs to

communicate clearly externally about efforts to keep cost-management (and the AMC itself) as efficient as possible.

### 5.3. Interaction with transferring banks

To address moral hazard, banks need to share the potential losses that an AMC might face (at least in part). This should be achieved through a possession of AMC shares by banks participating on a qualified mandatory basis.<sup>117</sup> There should be no interaction or clawbacks after the transfer in order to ensure an effective risk transfer. Solutions that envisage a securitisation process should fulfil the prudential conditions under which a significant risk transfer is recognised and the assets transferred to the securitisation vehicle are considered as deconsolidated.<sup>118</sup>

Solutions that include clawbacks or requesting participating banks to provide collateral would create several problems and should be avoided. Most notably either the clawback is inefficient, meaning the public funds remain exposed to a failure of the transferring bank, or the very purpose of the transfer of NPLs into the AMC is defeated. The bank would then remain exposed to further losses on the AMC portfolio. Hence, clawback provisions create a contingent liability. If this liability is put on the bank's balance sheet, the NPL transfer is not definitively eliminating the risk from the bank's balance sheet but is merely shifting it from the asset side to the liability side of the balance sheet.<sup>119</sup>

Furthermore, requesting banks to provide collateral against future losses would raise issues in the context of the valuation of these assets and the market volatility at which the bank would expose itself or the assets (if listed). Another key issue with clawback solutions is the governance and timing regarding the valuation decision (with clawbacks legal risks would be increased). Hence, it should be a direct transfer taking the bank out of the decisions / activities post-transfer.

Lastly, if possible, originating banks should not be involved in the servicing of the loans beyond a certain interim period, as they are faced with an inherent conflict of interest, holding similar assets themselves.<sup>120</sup> However, in case the AMC would need to be set up quickly leaving it without sufficient time for the selection of external asset servicers, the loan servicing agreements with the originating banks should include appropriate provisions to incentivize these banks to ensure a proper management of their assets transferred to the AMC. Moreover, one of the underlying reasons to transfer the loans to the AMC is that those originating banks could concentrate on the lending activity.

---

<sup>117</sup> See section 4.7.

<sup>118</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council sets out the conditions under which a significant risk transfer ('SRT') by an originator institution is recognised. Furthermore, the EBA Guidelines on Significant Credit Risk Transfer (EBA/GL/2014/05) and the ECB Public guidance on the recognition of significant credit risk transfer provide further details on the recognition process.

<sup>119</sup> See Martin Hellwig – March 2017 [Carving out legacy assets: a successful tool for bank restructuring?](#) (Scrutiny paper on the SRM provided at the request of the ECON)

<sup>120</sup> Leaving NPL management with the original credit institutions, the latter would logically tend to prioritise their own NPLs over the distressed assets owned by the AMC.

#### **5.4. Options regarding loan servicing**

AMCs may decide either to service the loans in-house or to outsource to independent external servicers. AMCs should be free to choose the option that adapts better to the maturity of the servicing market and their particular mandate. However, in-house loan servicing encounters some challenges such as the AMC's potential lack of expertise, know-how of the market as a newly incorporated entity or even high upfront costs due to the need to hire specialised staff in asset management and disposal. Moreover, AMCs should keep operational overheads as light as possible. Although it may deliver advantages in terms of economies of scale, in-house servicing also requires more internal resources, capacity and staff. Alternatively, if the AMC outsources to independent servicers pure servicing activities, it would allow them to focus on the analysis of the underlying exposure and decision-making. Therefore, the AMC should be able to outsource services to independent providers at market prices. Wherever independent servicing capacity in the market is deemed insufficient, in particular due to the existence of certain barriers to entry (e.g. for foreign asset servicers), reforms should be enacted in order to enable the build-up of the servicing industry.

Despite the payment of servicing fees, AMCs are in a strong bargaining position to negotiate the terms and conditions of the assets servicing agreements with third party servicers. This should ensure that the third party servicer aligns with the objectives and particular circumstances of the AMC such as the temporal mandate and the eventual transfer of the loans to (foreign) investors.

By requiring external servicers with aligned incentives to manage the NPLs, the AMC would generate strong incentives for the development of the servicing industry.<sup>121</sup> The inherent economies of scale of the AMCs should also attract (additional) third party servicers that are eager to work out the underlying assets to the best interest thereof. This may encourage the specialization of credit institutions that wish to concentrate on lending activities. In addition, it also contributes to the overall development of secondary markets as a whole, as it should attract more foreign investors that can rely on and trust sufficient local servicing capacity and expertise to manage the pool of loans. This growth in demand should also have positive effects on the AMC's mandate to sell the loans within the lifespan of the vehicle.

To the extent possible, the servicing of the loans should be performed without the involvement of the originating banks – as they are faced with an inherent conflict of interest, holding similar assets themselves – at least beyond a certain interim period.<sup>122</sup> Only if no other options exist, and where banks can demonstrate that the conflict of interest is well managed (e.g. through Chinese walls), servicing by banks may be considered as a bridge solution until capacity is established in the market. The cost of servicing should be factored into the transfer prices of the assets, and should not be passed through to banks, as that would weaken the incentive of the AMC management to accelerate recoveries and to discipline the servicers.

---

<sup>121</sup> A clear positive example is the case of Spain after the creation of SAREB.

<sup>122</sup> For more details, see also section 5.3 (Interaction with transferring banks).

Instead of relying on the originating banks, independent servicers may specialize to provide more efficient and targeted services to the AMC. Consequently, servicers could focus on debt collection, distribution of payments or other activities offering a wide range of options to the AMCs (activity segmentation). Likewise, the AMC could look for servicers specialized on consumer credit, SMEs loans or mortgage loans (type of loans segmentation). Lastly, AMCs could outsource loans based on whether the collateralized assets are located in some particular areas (geographical segmentation).

## 5.5. Closing the AMC

The lifespan of the AMC should be finite, and defined in its business plan. It should be realistic, but challenging, to reduce room for complacency and intransigence, and to maintain pressure on management to reduce assets. At the same time, an AMC should have some flexibility in its lifespan<sup>123</sup>, to react to emerging developments, to allow it fulfil its primary mandate (maximisation of asset values) and based on the fundamental rationale of an AMC: to bridge intertemporal pricing gaps. Criteria for flexibly deviating from the planned lifespan should be set down out the outset of operations.

Executive incentives should be provided to strengthen the determination of the AMC's management to meet the deadlines, however, without creating an excessive pressure for asset resolution ahead of the target. A not-for-profit enterprise may aide in these incentives.

The legislation should not provide any opportunities to refocus the AMC towards a different business model, to prolong its lifespan beyond what is strictly necessary to resolve the assets, or to reopen the AMC to later asset transfers. An initial horizon of a pre-determined amount of years<sup>124</sup> would need to be set at the outset, with a clear and measurable path towards wind-down, specified in the business plan, contingent upon reasonable assumptions about key parameters of baseline macroeconomic and asset recovery scenarios.

An AMC will shed staff as it shrinks and approaches expiry. For this reason and others, it may be considered to sell the AMC rump – the remaining portion of its residual assets – for efficiency reasons, so that operations can be wound up, rather than carried on for the purposes of managing a small portfolio.

---

<sup>123</sup> Subject to certain restrictions, i.e. no new business model and no prolongation beyond what is strictly necessary.

<sup>124</sup> The appropriate lifespan may differ, depending on the type of assets and the Member State's specific context. Nevertheless, a pre-set, reasonable timespan also underlines that the value of the NPLs and the underlying collateral will only decrease over time. An economic recovery could deliver an uplift. However, waiting longer than, e.g., 10 years for such a recovery to take place is not sensible either, since by that time it is unlikely that the AMC would be able to retrieve the loss in recovery value.

## **ANNEX: OVERVIEW OF AID-FREE IMPAIRED ASSET RELIEF MEASURES ALTERNATIVE TO CENTRALISED AMCS**

Depending on the specific impaired asset situation faced by a Member State, authorities may consider a range of possible measures, either tailor-made for each bank or addressing the NPL problem of several banks. As explained in section 3.3 of this blueprint, a centralised AMC is the appropriate tool to deal with impaired assets under certain conditions. However, where those conditions are not met or where such an AMC does not have a clear comparative advantage, other impaired assets measures can be considered. Such measures can both be alternatives and complements for centralised AMCs. Furthermore, Member States may also prefer measures that do not qualify as State aid, the latter occurring when the State is charging a market conform price for its intervention. In such cases, the compatibility conditions laid down in the State aid rules and the BRRD are not applicable.

In the remainder of this annex, two types of aid-free impaired assets measures recently implemented by Member States will be discussed. In particular, it concerns respectively an NPL securitisation enabled by a market-conform State guarantee and an aid-free transfer of NPLs to a bank-specific AMC. The Commission has however also authorised social measures in the form of public support to defaulted borrowers to help them repaying their loans and thereby avoid foreclosure. If the indirect advantage to the banks is strictly limited, such support does not qualify as extraordinary public financial support in the meaning of the BRRD as was the case for a Cypriot grant scheme to borrowers and micro-companies.<sup>125</sup>

When comparing the various impaired assets measures, it should be kept in mind that the suitability of a measure for a specific situation depends on the policy objectives that should be achieved and the operational constraints (e.g. timing, budget, available expertise, etc.). Therefore, while this overview attempts to provide a high-level description of the respective measures, outlining their pros and cons, and referring to specific examples (in the boxes) there is no one-size-fits-all approach. It is up to each Member State to decide, in light of the type of impaired assets, the available financial and other resources, and the national and EU legal frameworks, which measure(s) are most suitable for their situation.

### **NPL securitisation enabled by a market-conform State guarantee**

#### *a. Description: high-level explanation of the measure*

In a securitisation, NPL portfolios are transferred to special purpose vehicles (SPVs) which securitise them. This transfer can take place either at market value or above (up to the REV of the assets). The asset side of the SPVs' balance sheets contains the NPLs while their liability side would typically consist of an equity tranche and several debt tranches. These tranches (with different seniority) are then placed with investors. The involvement of the State to facilitate such a measure can consist of the public authorities guaranteeing

---

<sup>125</sup> See Commission decision of 28.06.2016 in case SA.45004 (2016/N), OJ C 302 of 19.08.2016, p. 1.

or funding certain tranches of the SPV. The State can for instance finance the equity tranche of the SPV and/or guarantee the junior debt tranches. This usually helps drawing in private investors for the more senior debt tranches. However, the State may also choose to guarantee only the senior debt tranches leaving the riskier parts for private investors. In general, the State may prefer to provide guarantees rather than funding in order to minimize the direct impact on the State budget. In addition, it will be easier to demonstrate that a State guarantee of senior debt tranches is market-conform and hence free of aid compared to the State guaranteeing junior debt tranches or funding equity tranches.

*b. State aid and BRRD considerations*

The State guarantees for securitisation schemes can be free of State aid provided that a market-conform guarantee fee is paid and that the other conditions laid down in the Commission's Guarantee Notice<sup>126</sup> are complied with. In order to determine a market-conform guarantee fee, the risk taken by the State must be assessed and comparable market transactions or benchmarks should be used. For the risk assessment, the Commission normally requires a credit rating by an independent rating agency.

*c. Pros and cons*

<b>PROs</b>	<b>CONs</b>
The securitisation is transforming illiquid NPL into a type of securities which a wider variety of market investors can purchase	When applied for smaller and older vintage portfolios: less scope for economies of scale & higher funding costs
Range of NPLs that can be securitized is wide and can be done also for smaller NPL portfolios	Requires more due diligence by investors and by rating agency, which could be a challenge for smaller banks with the absence of detailed loan portfolio data and weaker NPL servicing quality.
Direct budgetary impact for State is limited	The bank has to outright recognise the losses implied by the impaired assets sale to the SPV (depends on transfer price)

*d. A practical example*

Box 1 describes how in Italy the securitisation of NPLs is facilitated through the "GACS" State guarantee scheme. This guarantee scheme is set up so as to not involve State aid through the payment by the SPVs of market-conform guarantee fees. Since that measure is free of aid, it also does not trigger the conditionality provided for under the EU's State aid and bank resolution rules. Of course, it does not generate an advantage to the participating banks equivalent to that of a state measure containing State aid.

---

<sup>126</sup> Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (2008/C 155/02)

## Aid-free transfer of NPLs to a bank-specific AMC

### *a. Description: high-level explanation of the measure*

When a bank faces distress due to a sharp deterioration of a specific and limited portfolio (e.g. a specific type of assets or assets related to a particular geographical area), one way to provide relief is to set up an ad-hoc AMC that carves out the impaired assets of the bank's balance sheet and to work them out. This eliminates the uncertainty concerning the real value of those assets and facilitates restoration of access to the funding market by the bank. If the State-supported (or State-owned) AMC acquires the impaired assets at their estimated market value, there is no State aid to the bank selling those assets. As regards the management and servicing of the sold assets, it can be carried out by the AMC itself, by a third party provider or – only when the assets are sold at market price as is the case in an aid-free transaction – outsourced by the AMC back to the selling bank.

### *b. State aid/BRRD considerations and other practical issues*

The State can choose to partially or fully fund this type of AMC or guarantee its funding raised on the market. Since the AMC purchases the impaired assets at market prices, this transaction does not entail any State aid to the bank. As a result, this type of transaction is neither subject to the BRRD nor to the State aid compatibility requirements.

### *c. Pros and cons*

<b>PROs</b>	<b>CONs</b>
Designed to take over any type of asset class and granularity	Depending on the State's involvement in the AMC, there may be an immediate negative impact on the State budget or debt.
Improves asset quality and reduces bank funding cost	Setting up an ad hoc AMC may take time and it may not have the needed expertise to manage the assets.
Enables the institution to resume the normal course of its business and improve its profitability going forward	The bank has to outright recognise the losses implied by the upfront sale of the impaired assets

### *d. A practical example*

Box 2 presents the recent example of the transfer of impaired shipping loans from the German bank HSH Nordbank at market price to a dedicated public vehicle.

Another example is the Hungarian asset management company MARK<sup>127</sup>, to which solvent financial institutions in Hungary can, on a voluntary basis, decide to sell at market price a specific pool of non-performing loans backed by commercial real estate. The Commission's assessment showed that MARK's methodology to determine the transfer price will ensure a market conform valuation and therefore the measure is free of State aid.

---

<sup>127</sup> See Commission decision of 10.02.2016 in case SA.38843 (2015/N), OJ C 104 of 18.03.2016, p. 1.

**Box 1: Impaired asset measure with State involvement for going-concern banks – securitisation of NPLs supported by the "GACS" guarantee scheme (Italy)<sup>128</sup>**

The Italian "GACS" guarantee scheme illustrates how impaired asset relief measures involving State resources can be constructed in an aid-free manner, thereby not triggering the conditionality provided for under the EU's State aid and bank resolution rules.

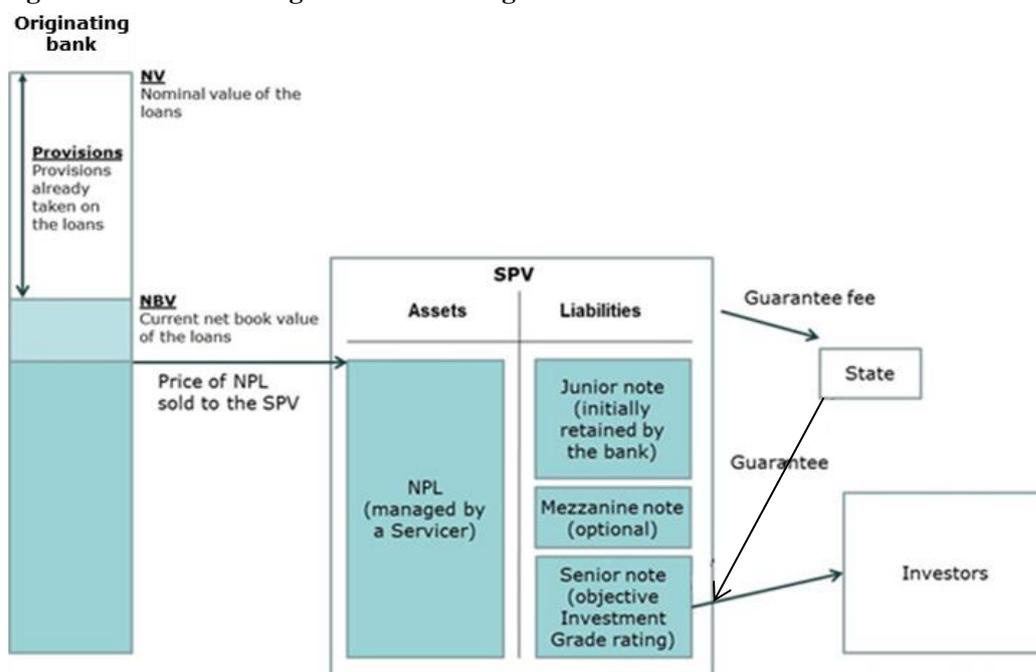
**Background**

In February 2016, the Italian authorities created a guarantee scheme ("GACS") with an initial duration of 18 months to support the securitisation<sup>129</sup> and disposal of non-performing loans (NPLs) by Italian banks. The scheme was subsequently prolonged<sup>130</sup> in August 2017 for another 12 months.

**Key features of the impaired asset measure**

The main characteristics of the GACS scheme are shown in Figure A.1.

**Figure A.1 – Functioning of the "GACS" guarantee scheme**



Source: Commission Services (DG COMP)

The scheme allows the Italian State to give a State guarantee on the senior funding tranche of a special-purpose vehicle (SPV) to which a bank transfers (part of) its NPLs at a price not exceeding the loans' net book value (NBV). The range of NPLs that can be securitised can be wide: in one case, it included secured loans (with a variety of collateral types) and unsecured loans related to corporate, SME or individual borrowers. For the State guarantee to be granted, some conditions need to be fulfilled: (i) an ECB-approved credit rating agency<sup>131</sup> must confirm the investment-grade risk profile of the SPV's senior notes (i.e. rating before

<sup>128</sup> See Commission decision of 10.02.2016 in case SA.43390 (2016/N), OJ C 161 of 04.05.2016, p. 1.

<sup>129</sup> For further securitisation-related concepts, see Fell, et. Al (2017), *Resolving non-performing loans: a role for securitisation and other financial structures?*, ECB Financial Stability Review May 2017

<sup>130</sup> See Commission decision of 06.09.2017 in case SA.48416 (2017/N), OJ C 40 of 02.02.2018, p. 1.

<sup>131</sup> The GACS decision specifies that the rating and the calibration is performed by an External Credit Assessment Institution (ECAI) approved by the ECB as of 1 January 2016 (the "rating agency").

taking into account the granting of the State guarantee); and (ii) at least half of the SPV's more risky junior and mezzanine notes must be sold to private investors. These conditions ensure that the risk that the State runs remains limited and that the securitisation operation is confirmed by the market before the guarantee is granted. The guarantee fee to be paid to the State is based on a market benchmark. This ensures that no advantage is conferred to participating banks and their securitisation vehicles, so that no State aid is involved.

**BRRD and State aid considerations**

As the use of the scheme does not entail extraordinary public support as it is State-aid free, the scheme does fall neither under the BRRD nor under State aid compatibility requirements.

**Box 2 : NPL hive-off from a going concern bank to a bank-specific AMC:  
HSH Nordbank (Germany)<sup>132</sup>**

This case illustrates how impaired assets in the context of a distressed bank that remains going-concern can be hived off to a single ad-hoc AMC. The good parts of the bank continue to carry on their activities.

**Background**

In May 2016, with a view to prepare the sale or wind-down of HSH-Nordbank, the German authorities decided to transfer up to EUR 6.2 billion of assets to a vehicle owned by the Land Schleswig-Holstein and the City of Hamburg (HSH Finanzfonds AöR) at market prices. This allowed the bank to continue carrying out its banking activities pending its sale or wind-down.

**Key features of the impaired asset measure**

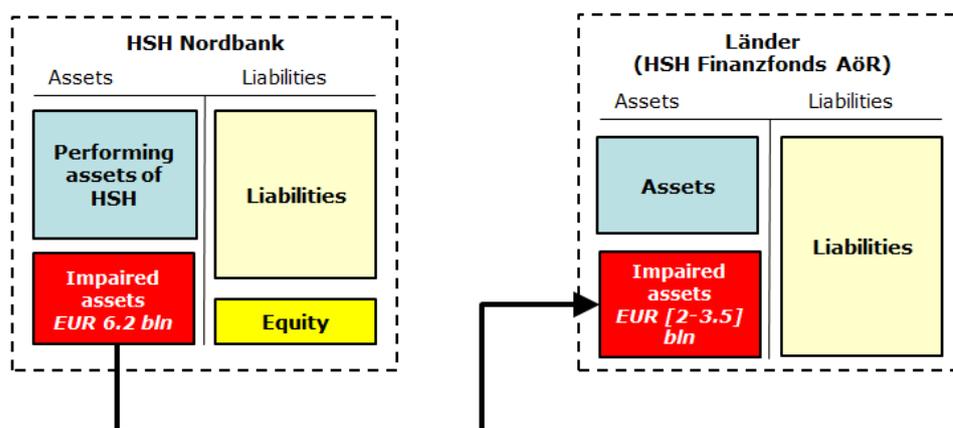
Asset perimeter: The transferred NPLs were all impaired shipping loans.

Aid amount: The impaired assets were transferred at market prices to so that the measure was aid-free.

**BRRD and State-aid considerations**

Since the transfer of the NPLs was made on market terms it was considered as aid-free. Therefore, it does not entail extraordinary public support and does fall neither under the BRRD nor under State aid compatibility requirements.

**Figure A.2.: Transfer of impaired shipping loans from HSH to an ad hoc AMC**



Source: Commission services (DG COMP)

<sup>132</sup> See Commission decision of 02.05.2016 in case SA.44910 (2016-N), OJ L 319 of 25.11.2016, p. 13.