

**3<sup>RD</sup> DICJ ROUND TABLE**  
**February 27 – 28, 2008, Tokyo**

**“SOME THOUGHTS ON ASSET MANAGEMENT APPROACHES”**

Presented by  
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**Session 1: Comparative Study of the Asset Management Companies' Mandate,  
Organizational Structures and Strategy**

A very good morning to Governor Nagata, Deputy Governors Hatano, Hirose, Nagashima and Tanabe, Ladies and gentlemen.

It gives me great pleasure to be here in this session to discuss my thoughts on asset management approaches. Allow me to share some thoughts on asset management approaches based on my experience as the CEO of the Canada Deposit Insurance Corporation (CDIC). The CDIC established an asset management corporation in Canada to deal with one of our largest failure in 1992.

**Goals of AMC**

What are the goals of an AMC? There are generally two basic goals for AMCs. One is to liquidify impaired assets quickly while the other is to maximize value by reducing resolution costs and optimizing recoveries. However there are sometimes other goals in setting up an AMC. Those may include market stabilization, assets warehousing, developing a market or developing a well rounded overall asset management disposition strategy for different asset classes. The goals need to be well defined and well understood by all stakeholders.

One issue I would like to point out here is the importance of determining the timing and objectives for establishing an asset management corporation or AMC. There are generally two objectives. The first is to deal with systemic financial crises where a large number of assets, both non-performing or performing, are being restructured as part of a restructuring of a financial system. The second objective is to resolve a single failure or a wave of bank failures without systemic implications. It is important to note that different goals and objectives require different approaches and strategies.

## **Asset Disposition Techniques**

There are several different types of asset disposition techniques. Some of these techniques include: -

- Bulk sales to 3<sup>rd</sup> party which are usually made up of other banks;
- Sale to vulture funds. Vulture funds specialize in asset acquisition at deep discounted rates and their approach is to liquidify the assets purchased within a short time frame. The seller gets quick cash but in return accepts deep discounted values for the assets;
- Manage and recover assets either through piece meal sale, auctions or sale of pool of assets;
- Warehousing for future sale. This approach is often used when there is no market or there is downturn in the economy. During weak economic conditions, there may be little appetite for specific assets or there may be no market. There may be also concerns about the effect on the market when a large number of competing assets are put up for sale;
- Securitization, partnerships or vendor take-back financing.
- Sale via an agency, whereby assets are administered by a third party but the owner retains ownership and controls the executive decision on the disposition strategy of assets at all time.

Regardless of which technique is used, it should provide the AMCs with the flexibility to deal with the type of assets for disposal.

## **Asset Management Approaches**

There are a number of asset management approaches. Should it be a centralized or decentralized approach? Should the AMC be set up as an in-house entity within a deposit insurer or another public agency or should it be a private independent entity? There are pros and cons to each approach. My view is that the approaches to be adopted are highly dependent on the assets on hand.

This morning we talked about the FDIC's approaches to disposition of assets. In this context, we should remember that the FDIC deals mostly with performing assets of liquidated banks and only a small portion of assets are non-performing or problematic. I must add that there was one big exception during the Savings and Loans debacle where the Resolution Trust was formed to handle a huge number of troubled assets. But the S&L crisis was large but restricted to that industry. The extent of problems faced by countries like Mexico, Japan, Korea, Indonesia and Thailand were of a higher magnitude. Indeed some of these countries are still grappling with the disposition of residual assets from that event.

## **Asset Management Strategies**

Again, there are various asset management strategies and the choice of strategies to be undertaken is dependent on the nature of the assets. For instance, the AMCs can either choose to hold or sell the assets. Selling assets immediately has the advantage of returning the assets quickly to the market. However, one will also have to consider the prevailing market condition at the time of disposal. For example, are the assets being sold in an up-market or down-market? The disposition strategy and approach will be different under different market conditions. There should also be a private sector approach to disposition. The asset disposition process and criteria has to be fair and transparent to all potential purchasers to enable them to appropriately assess the offers.

Secondly, when to litigate or compromise? This morning we talked about the issue of fraudulent transactions. Some bank failures are a result from frauds, mismanagement, and in others due to the political or economic environment. Therefore the decision on whether to litigate or to compromise debts will depend on whether there were fraudulent transactions or a result of weak management, political or economic circumstances or situations.

One should also consider strategies to optimize recoveries. Should one be prepared to enhance the value of the asset or to sell the assets as it is? Refurbishment of assets may increase their value and a detailed cost and benefit analysis should be performed prior to making those decisions. Other strategies may include providing vendor take back financing, mortgages, warranties or guarantees. These were touched upon this morning.

There are also certain strategies that are imposed upon us, such as the built-in sunset clauses which limit the operating life of the AMCs to a specified number of years. Examples of AMCs with such sunset clauses include the Resolution Trust Corporation (“RTC”) in the United States and Danaharta in Malaysia. Danaharta acquired more than RM18 billion of non-performing loans and was required to dispose of them before its sunset date of December 2005. Danaharta was successful in meeting its goals having achieved an overall recovery rate of almost 57%. Therefore, sunset clauses will also drive your disposition strategy and timelines.

## **Influencing Factors**

We must also note that the effectiveness of the strategies or approaches adopted will depend on various influencing factors. These factors include: -

- ***Type of asset:*** Non-performing versus performing assets; different asset types be it by industry (eg real estate, commercial loans, car loans, credit card debts), debtor size or whether the assets are collateralized or not. These are all the factors that need to be considered. Different type of assets will require different expertise and strategies to optimize their recovery values.

- **Economic environment:** Are we disposing in a strong economy or recession? Both FDIC and DICJ have shared with us this morning their respective strategies in asset disposition. FDIC was facing an inflationary economy which essentially allows them to dispose of their assets rather quickly. On the other hand, DICJ was facing a deflationary economy which resulted in them having to take a relatively much longer time to dispose of their assets. Therefore, economic environment will also dictate the kind of disposition strategies to be adopted.
- **Magnitude of problem:** The size of the NPLs in the system will also influence the approach and strategies to be taken. For instance, when there is a substantial amount of impaired assets in the financial system to be dealt with, it is often very difficult to find a private investor willing to purchase these assets. In this situation, the government may be in a more favorable position to own the AMC.
- **Funding to the AMC:** The availability of funding is always a big issue and is usually the driver and determining factor on strategy selection.
- **Legal infrastructure:** The legal infrastructure are often restrictive because AMCs are usually set up in times of crisis or set up within a deposit insurer with no clear statutory mandate or powers to deal specifically with asset dispositions. They are often deposit insurers which are pay-boxes. Therefore, we often find ourselves operating within a restrictive legal infrastructure that constrains us from optimizing recoveries and minimizing costs.
- **Political will:** Political will to act and political environment are always major issues that need addressing. And this morning we touched upon social issues. Are the AMCs mandated to dispose of assets for the social welfare or common good or are they mandated to optimize recoveries? Are they also required to meet certain government programs, such as maintaining jobs or ensuring availability of affordable housing, in accordance with existing government programmes? From experience, we know that in real life there will always be political issues related to certain debtors and to certain assets. To succeed one needs to be able to identify and manage social implications and put in place structures to deal with them.
- **Incentives structure:** AMCs face an inherent incentive problem. Most commercial operations can assure their continued existence by being successful. However, AMCs are considered successful if they are able to restructure and/or dispose of the assets under their care within a specified period. This means employees have to work themselves out of a job and the more successful they are, the faster they become unemployed. Therefore, there is a need to implement a structure of incentives that are designed to ensure effective and efficient asset management and disposition. These incentives need to address both the issues of the limited life of the AMC and the performance of employees to meet the mandate of the AMC.

## **MDIC's Powers**

Allow me now to brief you on some of MDIC's powers. MDIC was set up in September 2005 and retains all the powers of Danaharta, the past public AMC. These powers are set out in our legislation. MDIC has the power to take control of non-viable banks, dispose of their assets, nationalize or liquidate them. We have the power to establish an AMC as a subsidiary with its own governing body and management team. Thus it can be independent from MDIC. We can also acquire assets before or after a member has been declared non-viable for purposes of minimizing exposure to loss. We also have the power to transfer title of ownership via statutory vesting without having to go through the normal court process. We can also appoint conservator to manage ailing borrowers and for assets involving land, we can take all steps necessary to preserve the value of the assets.

MDIC is currently in the midst of developing our resolution approaches, policies and procedures and systems to, amongst others, deal with the establishment of an AMC when the time comes. And our view is that it is important to do it in good times because in bad times, one is not in control of the agenda.

## **Challenges**

Let me now address some of the common challenges faced by AMCs.

- ***Lack of information*** on specific assets, security and/or borrowers. This is often due to restricted access to information, poor documentation and poor information system management for loans and in many cases deposit liabilities.
- ***Funding issue:*** That is always an issue and a major challenge.
- ***Lack of market for certain assets:*** This could be particularly acute in some Asian countries given that their markets for non-performing loans are relatively new or have yet to be developed. This makes it difficult to value assets accurately.
- ***Lack of skilled personnel in asset management:*** AMCs, especially government AMCs, often face funding problems and rules that restrict it to attract and hire the best people skilled in asset management and disposition. CDIC, for example, outsourced its claims and recoveries activities to private sector organizations with specialized expertise in real estate, legal, insolvency and commercial loan. These experts were given the financial incentives to motivate them to recover and optimize recoveries. In the end both parties were successful in sharing the upside gained.
- ***Setting appropriate key performance expectations:*** In so far as the disposition strategy goes, it has to be transparent to all the stakeholders. A strong accountability and reporting regime and appropriate key performance indicators need to be established. For example, some organizations talk about achieving recovery rates of 60% or 80% but were these rates based on net present value or nominal value? Depending on the valuation, one can get different results. One can take an asset and warehouse it for 20 years and its value will appreciate. But does that mean higher

recoveries were achieved? In order to answer that, one would need a benchmark such as assessing to the net present value of cash that was recovered after 20 years and the carrying cost of the asset including cash flows.

- **Reputation risk:** One of the biggest issues I have had to deal with was managing reputational risk and conflicts of interest. Some of the assets were very difficult to deal with. And certain creditors will do anything to protect their own interests even if it is at the expense of your reputation. So it is critical to have strong ethical and conflict of interest policies in place which are monitored and which protect the employees and the organization.

### **Concluding Remarks**

Final thoughts! There is no one size fits all approach. But I would say that managing stakeholders' expectations is a priority. And I cannot stress enough on the importance of a strong accountability and reporting regime. There need to be full transparency on the criteria used for asset disposition and on the decisions made as you may be called upon one day to account for all your decisions either in the Parliament or in Court.

So what are some of the lessons learnt? In this business, it is too expensive to learn by doing. One needs to develop contingency plans and asset management approaches during good times. You need a clear mandate and roles and responsibilities which need to be well understood. And you need to manage expectations and manage your stakeholders.

Thank you for your attention.

Malaysia Deposit Insurance Corporation  
27 February 2008

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