

European Commission gives tentative support for "network" of public asset management companies

By Alexander Nye

Original post [here](#).

On December 16, the European Commission (EC) [announced](#) its support for the creation of a network of national asset management companies (AMCs) (also known as “bad banks”) and encouraged Member States to create AMCs. Such institutions would acquire and manage non-performing assets (NPAs) from the balance sheets of lenders in their home countries. Assuming participating lenders can withstand the losses associated with selling these NPAs, this could free up space for new loans and ultimately bolster profitability. European banks have [had profitability problems](#) since the Global Financial Crisis. The [Wall Street Journal recently wrote](#) that the proposal shows that “Officials are publicly acknowledging a key lesson from the 2008 crisis: Fast balance-sheet cleanup helped U.S. banks recover quickly, while European lenders struggled under a lingering hangover of bad loans.”

This comes as part of the EC’s [action plan](#) for “Tackling non-performing loans (NPLs) in the aftermath of the COVID-19 pandemic.” The action plan is made up of four goals:

1. Developing secondary markets for distressed assets
2. Harmonizing and benchmarking corporate insolvency and debt recovery law within the EU
3. Promoting the establishment of national AMCs
4. Facilitating precautionary public support measures under the EU’s state aid framework and Bank Recovery and Resolution Directive (BRRD)

The first two goals are in line with the EC’s agenda of the past few years. The EC has seen some progress on the first goal; it appears to have found a successful strategy in the [securitization of NPLs](#). Commentators are less optimistic about the second goal. A [recent article](#) from Brugel, a European think tank, describes progress on the insolvency and debt recovery measures as either “very uneven” or “stuck in the inter-institutional process.” The policies related to this goal [buck the trend](#) that we have seen with COVID-19-era bankruptcy reforms, as their [main focus](#) is not on improving the lot of debtors.

The third part of the action plan [describes](#) how national AMCs are likely to benefit from their understanding of their domestic financial sectors, while sharing data via a European data hub and best practices as part of a network could create valuable synergies for AMCs across the EU. However, this would be contingent on whether enough countries actually establish national AMCs and on the extent to which those AMCs are similar to each other.

The action plan reflects the ongoing skepticism within the EC on the issue of an EU bad bank. Since March, European institutions have jostled over the issue of how to handle a surge of non-performing loans coming from the COVID-19 crisis. From [spring](#) through [autumn](#) 2020, various European policymakers argued over proposals for a pan-European asset management company or for various national asset management companies. A Q&A [document accompanying the action plan](#) remains skeptical of a pan-European AMC. It argues that the establishment costs would be large while the heterogeneous NPA portfolios and creditor-debtor laws among Member States would dampen the gains from scale that would come from an EU AMC.

The action plan's theoretical support for a network of national AMCs (incorporating the ECB and the EBA) thus strikes a delicate compromise. The [Governor of the Bank of Greece](#) and the [Chair of the ECB's Supervisory Board](#) pushed for an EU-wide AMC as the proper response to what might be a \$1.7 trillion deluge of NPAs. These proposals [come on the heels](#) of an EU bad bank plan from the Chair of the ECB's Supervisory Board drafted when he was an European Banking Authority (EBA) official, which was soundly rejected by eurocrats in 2017. However, the 2017 efforts did result in the publication of a detailed AMC blueprint. The new action plan refers to that blueprint; the network it proposes bears a [striking resemblance](#) to a section in the blueprint on "synergies and cooperation between AMCs."

The action plan, as well as proposals for more national AMCs, have received criticism. [Consumer advocates](#) fear the sale of portfolios to "vulture funds" (a term for typically foreign hedge funds) that will aggressively enforce borrowers' obligations. An [EU banking lobby](#) does not think that national bad banks would recover funds as efficiently as internal AMCs, that is, bad banks that are built out within existing financial institutions. Their criticism rests on the idea that the banks already owning these NPAs are more likely to understand their context and therefore are better able to maximize returns on them. Ireland, the home of one of the more notable European AMCs, the National Asset Management Agency (NAMA), also may be skeptical of more AMCs. An article in Ireland's [Independent.ie](#), notes that "the prospect of a new bad bank taking on small business or mortgage debt just as Nama is set to close is likely to be politically fraught."

Alexander Lehmann and Reiner Martin of Bruegel [described](#) several issues these AMCs will have to grapple with. First, the COVID-19 portfolio of NPAs is likely to be dominated by corporate loans rather than retail mortgages, unlike NPAs in the vast majority of EU Member States after the financial crisis. These loans are also more likely to be to companies that are ultimately viable, so restructuring rather than liquidation will probably be the best solution for them. Second, questions about loan valuation bogged down GFC-era AMCs' efforts to acquire and restructure assets; this could prove deadly to the many businesses that are hanging on to viability by a thread in the case of COVID-19. The authors recommend that the EC "adopt and publish transparent and predictable valuation methodologies that reflect plausible scenarios for different sectors and asset types in the post-COVID-19 recovery."

Finally, the EU's state aid restrictions and banking directives put a limit on the amount of state support banks can receive by way of NPA purchases at above-market prices that more than

“make up for future likely losses in an adverse scenario” or by way of capital injections. This means that AMC operations may create large holes in bank balance sheets. Lehmann and Martin surmise that the uncertain economic conditions mean that the EC will likely have to clarify their state aid restrictions. This is where measures related to the fourth goal will be relevant.

Under the BRRD, banks that receive extraordinary public financial support must be declared failing or likely-to-fail, which triggers processes like bail-in, resolution, etc. The [fourth goal](#) articulates the EC’s position that governments should be able to circumvent these triggers during the COVID-19 crisis, so long as the bank being assisted is solvent. The exception comes under Article 32(4)(d) of the BRRD, which allows the “injection of own funds in or a purchase of capital instruments from a solvent institution to address a capital shortfall resulting from stress tests, asset quality reviews or equivalent exercises” without a failing or likely-to-fail declaration in cases where the measure “remedies, on a temporary basis, a serious disturbance in the economy of a Member State and preserves financial stability.” The action plan explicitly describes the COVID-19 crisis as one of those serious disturbances and states that the amount of support is to be determined using stress tests.