

Banking Sector Restructuring

Lessons from Global Experience

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Sameer Goyal
The World Bank



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Outline

- Objectives of restructuring banking system
- Where to Start? Diagnostic
- Choosing a restructuring option
- Lessons from global experience
- Vietnam Banking Restructuring Challenges
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Objectives of restructuring banking system

Motivation for restructuring – Typical Problems

- Financial and Economic Crisis – Real sector problems
- Rising NPLs (real sector stress and excessive exposures to real estate, FX, loss making enterprises (including SOEs), connected party lending, etc.)
- Weak capitalization of banks relative to risk profile -- Fear of insolvency
- Inefficient intermediation - insufficient credit flows, excessive risk taking by banks (rapid, unchecked credit growth), interest rate distortions, hot money etc.
- Weak regulatory and supervisory framework
- Lack of confidence in the banking system

Objectives of restructuring banking system

These need to be clear upfront

Short-term/ Immediate

- Maintain stability of banking system; Ensure solvency, liquidity and uninterrupted financial intermediation
- Address problems in a timely manner to prevent contagion or systemic concerns
- Restore confidence in banking system; Safety net in place
- Minimize costs of restructuring to central bank, Deposit Insurer and/or government

Longer-term/ Structural

- New governance framework
- Build competition and resilience,
- Strengthen overall infrastructure of financial system

Build strong legal, regulatory and supervisory framework and related institutional and enforcement capacity

Where to Start?

- Once there is a clear overall objective and direction for the restructuring – “**where you want to go**”, it is important to understand nature, scope and extent of the issues - “**establish where you are starting from**”
- **Diagnostic / Assessment**
 - Review of financial health of the institutions (capital position, NPLs, liquidity, profitability, etc)
 - Understanding of structural and institution specific issues such as limitations in risk management systems, governance and internal controls, IT system architecture, etc.
 - Review of legal, regulatory and supervisory framework
 - Understanding of institutional capacity at institutions and regulatory bodies

→ *Prepare a Restructuring Plan*

Choosing a Restructuring Option

- Multiple options to address specific/systemic problems

Sign/ Indication	Possible Responses
System capital low (fear of insolvency)	Conditional access to recapitalization funds; facilitate investor access (e.g, allow foreign investors higher participation e.g., Thailand during late 1990s crisis), equitization of SOCBs
Systemic rise in NPLs	Higher capital and provisioning requirements; AMCs (centralized or bank specific), Bad bank-Good bank model, corporate restructuring
Banks having difficult raising funds (deposits) and supporting lending	Temporary provision of liquidity windows (lending of last resort function of central bank); Enhanced depositor protection to resort depositor confidence (e.g., 2008 crisis prompted several countries to increase deposit insurance limits)

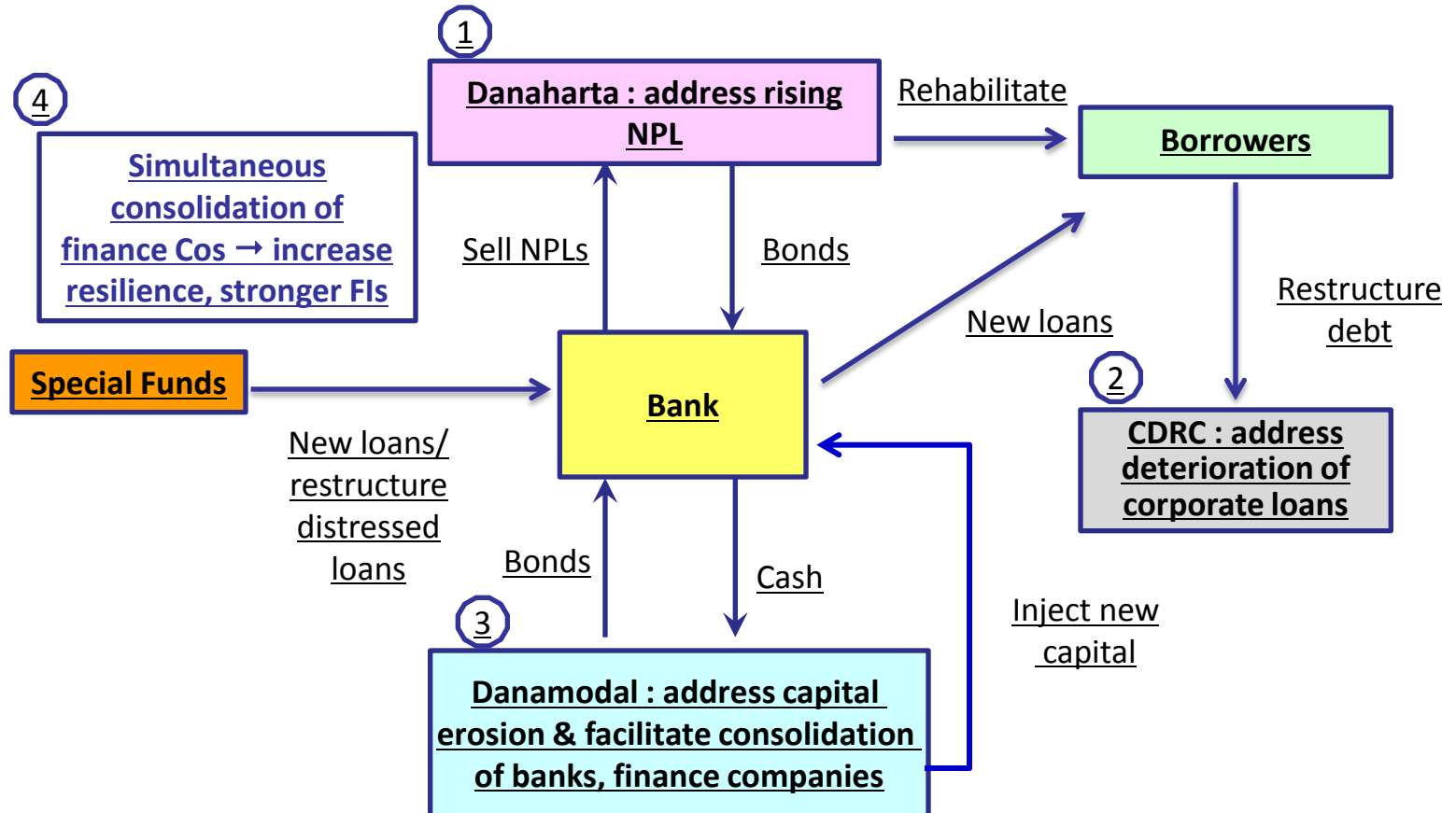
- **The option or response a Government chooses depends on several factors** – political economy, scale and severity of the problem, current economic conditions, financial position of the banks and the Government, limitations of the legal and regulatory framework (including bankruptcy and other related laws), institutional capacity of the involved institutions, etc.

→ ***options should not be looked at in isolation***

Malaysia: Bank Restructuring

Late 1990s & 2000s


The Plan adopted a 4 pronged approach



Undertaken on back of comprehensive measures to restore FS stability & comprehensive pro-recovery measures & initiatives

Resolution on NPLs

Asset Management Companies - *Different Approaches*



<i>Decentralised</i>		<u>Banco Latino</u> <u>Den Norske Bank</u> <u>Foreningsbanken</u> <u>Swedbank</u> <u>Nordbanken, "Securum"</u> <u>Gota-Retriva</u>
<i>Central</i>	<u>Thailand "FRA"</u> <u>Indonesia IBRA "AMU"</u> <u>USA "RTC"</u>	<u>Thailand "AMC"</u> <u>Indonesia IBRA "AMU"</u> <u>Korea "Kamco"</u> <u>Malaysia "Danaharta"</u> <u>Finland "Arsenal"</u>
	<i>Rapid Disposition</i>	<i>Longer-term Asset Management</i>

*Though used widely, AMCs have shown mixed results at best
→ In considering any option, it is critical to look at international experience as well as domestic factors*

Lessons:

Political Economy of Restructuring

- **Commitment and participation** at the highest levels
- Clear and robust **institutional structure to implement the plan** – including clear objectives, powers, assignment of responsibilities, resources, reporting and accountability
- Strong focus on **building capacity of regulatory bodies**
- **Cooperation between stakeholders** – within/between industry, regulatory bodies, Government and the political regime
- **Transparent Communication Strategy** with consistent messages
- **Leveraging global expertise and investors** to speed up reforms
- Clarity on **role of the State** in the banking sector (as owner of banks; equal treatment; level playing field)

Lessons: *Success factors from international experience in Banking Sector Restructuring*

- **Restructuring goal** : Restore stable financial conditions for economic growth ⇒ go beyond “cleaning up” banks’ balance sheet. Restructuring of banks is **not in isolation** ⇒ part of financial sector development and economic transition
- Restructuring of banks **accompanied by development of bond & other capital market for balanced distribution of risks** through diversified sources of financing economic activities
- Establish comprehensive well **sequenced plan with clear targets**, time lines & final outcomes. Mode of restructuring should be based on **reducing fiscal burden**
- Implementing bank restructuring must be **based on technical & economic considerations**, undertaken by teams with strong technical expertise. There must be **adequate preparation for staff** likely to be affected by restructuring
- Restructuring accompanied by **measures to ensure monetary & financial stability** during restructuring period

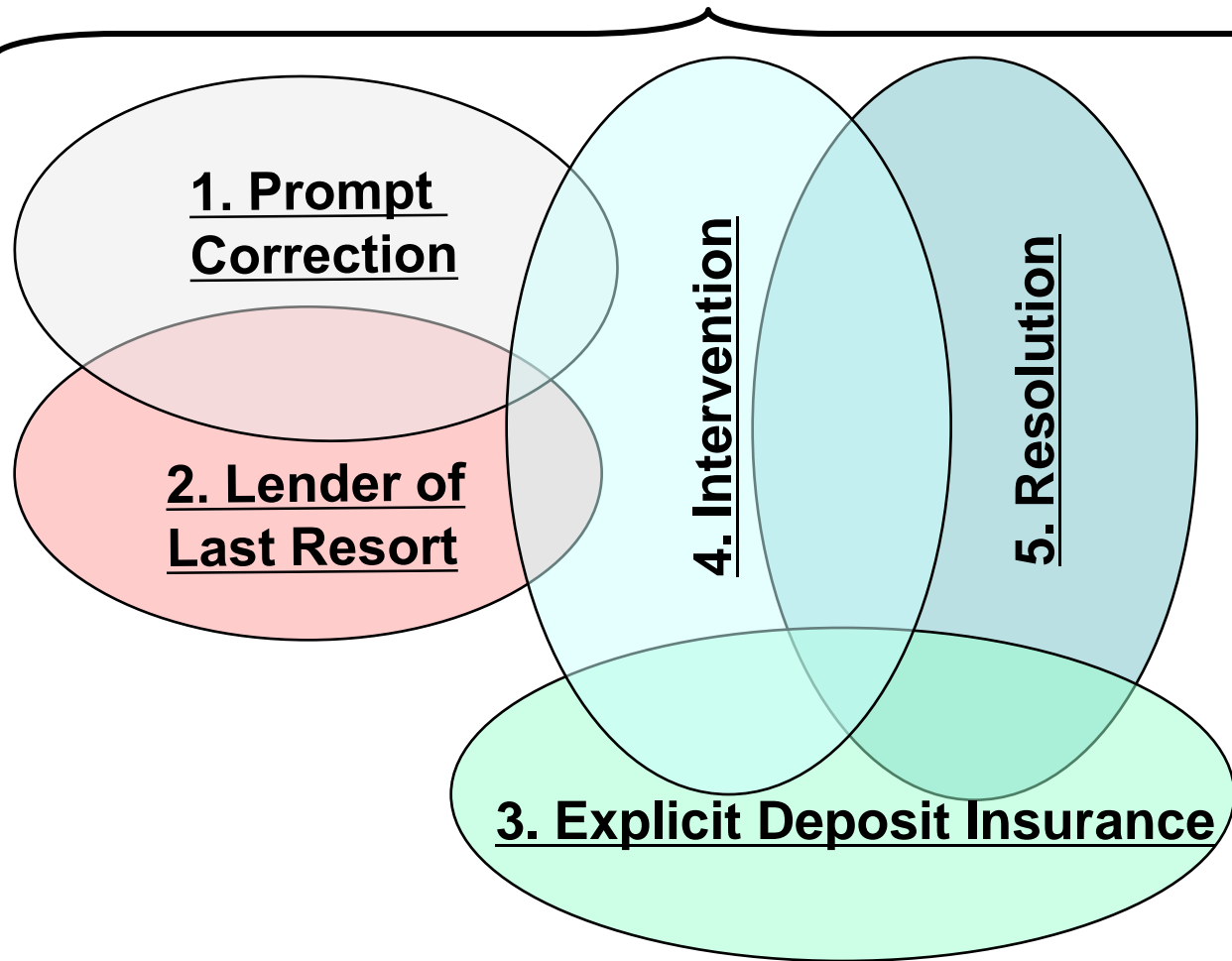


Lessons:

Preparedness and Banking Safety Net

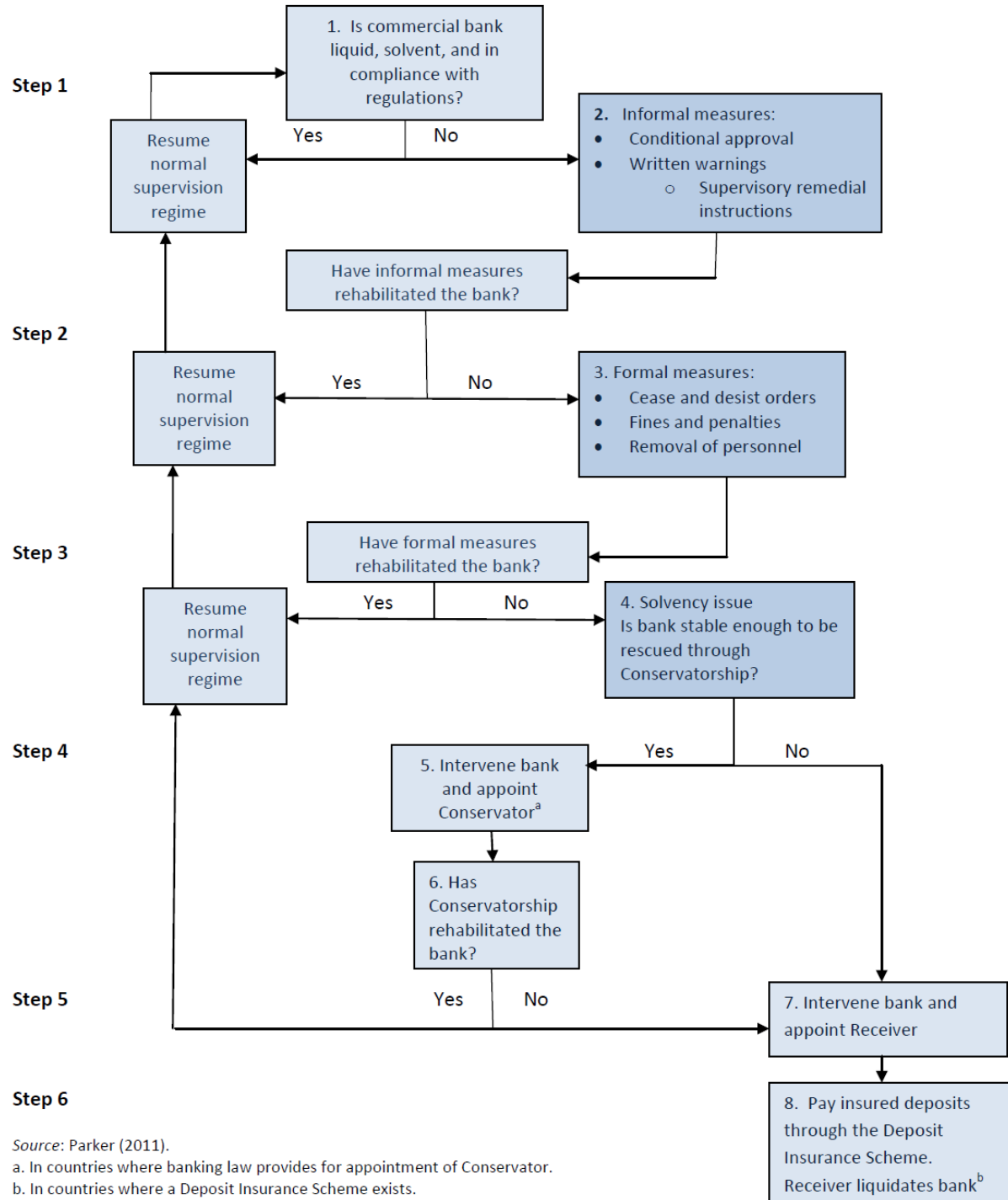
Normal Monitoring

Early Warnings





Decision Tree for Problem Bank Resolution



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Bank Resolution Toolkit

Source: Parker (2011).

a. In countries where banking law provides for appointment of Conservator.

b. In countries where a Deposit Insurance Scheme exists.

Vietnam Banking Sector Restructuring Challenges

- Banking sector assets are nearly 2 times GDP → major restructuring **may require large resources** (different from past)
- Following rapid credit growth , portfolio quality of banks under **stress** → adequacy of capital under question. **Diagnostic capacity and tools** to understand scope of problems.
- **Banking legal and regulatory framework** still not at par with international standards .Adequacy of bankruptcy and corporate restructuring framework, may need to be revisited. Link to economic/ SOE restructuring. Related **institutional capacity** at may need to be upgraded quickly.
- **Contingency planning framework** (preparedness) may need to be developed in detail.
- Importance of **multi-agency coordination** framework can not be understated- MOF, SBV, SSC, DIV, MOJ etc.
- **Transparency and Disclosure** critical but currently limited
- Consultation and Cooperation between **multiple stakeholders** important - ultimate responsibility for implementation of any plans lies with the banks

World Bank Tools

Analytical

- FSAP
- Financial Projection Model
- Simulation exercises to identify gaps (legal, coordination, capacity, etc) in preparedness to address financial stress / crisis situation
- Contingency Planning - Bank Resolution Toolkit
- Bank Governance Assessment

Operational

- Banking and Corporate Restructuring Loans
- Development Policy Loans to support banking system reforms



Thank you!

Sameer Goyal
sgoyal@worldbank.org

Finance and Private Sector Coordinator
The World Bank, Vietnam