

Distressed Asset Management and Divestment Practices by Deposit Guarantee Funds in Serbia and Ukraine

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ABBREVIATIONS

AMC	Asset Management Company
BAMC	Bank Assets Management Company (Slovenia)
CESEE	Central, Eastern, and South-Eastern European countries
DIA	Deposit Insurance Agency of Serbia
DGF	Deposit Guarantee Fund
EU	European Union
EUR	Euro
FinSAC	Financial Sector Advisory Center, the World Bank Group
FROB	Spanish Fund for Orderly Bank Restructuring
GFC	Global Financial Crisis
IMF	International Monetary Fund
NAMA	National Asset Management Agency of Ireland
NPL	Non-Performing Loan
RSD	Serbian dinar
Sareb	Spanish Asset Management Company
SDZ	Strategic Development Zone
UAH	Ukrainian Hryvnia
USD	USA dollar



ABSTRACT

Effective and efficient management and sale of distressed assets helps minimize risks to financial stability and support economic growth. This paper summarizes the asset management and divestment experience of deposit guarantee funds in Serbia and Ukraine. It also provides some examples of practices from selected asset management companies in Western Europe. These could help inform policy decisions on the design of bank liquidation frameworks aimed at improving operational

capacity. The examples suggest the following are key factors that contribute to successful distressed asset management and divestment: (i) sound governance practices and clear legal frameworks, (ii) comprehensive asset management and divestment strategies, (iii) active asset management and improvement of assets with safeguards in place to maximize return, (iv) transparent and prudent asset valuation, and (v) transparent and competitive asset sale.



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EXECUTIVE SUMMARY

i. Effective and efficient management and sale of distressed assets has an important role in minimizing risks to financial stability and supporting economic growth.

High levels of distressed assets freeze capital from supporting new lending in the economy and create a negative macro-financial feedback loop. Debt overhang reduces borrowers' investments and influences consumption decisions, accumulating risks to financial stability and jeopardizing growth prospects. The timely disposal of distressed assets is essential to return the assets back to productive use and free-up resources that can be used for fresh lending or repayment to bank creditors, thereby fueling rather than depressing economic development.

ii. Countries have used different approaches to address the stock of distressed assets at a national level.

Experience from Serbia and Ukraine illustrates that deposit guarantee funds (DGFs) with bank liquidation functions can play a crucial role in managing distressed assets. In other jurisdictions in Central, Eastern, and South-Eastern European (CESEE) countries, central banks have a bank resolution and liquidation mandate and manage performing and distressed asset resolution in administrative or court-based processes. Asset management and divestment practices by asset management companies (AMCs) from selected Western European countries also provide valuable insights for bank liquidators to inform their policy decisions regarding the asset management and divestment function.

iii. Agencies responsible for bank liquidation can play an important role in distressed asset resolution and the development of distressed asset markets. Supervisory and regulatory frameworks aim to address distressed asset resolution in viable banks.

For banks in liquidation, this task is often the responsibility of either the central bank or DGF depending on the bank resolution/liquidation mandates in respective countries. In CESEE, the

bank liquidation function is most often entrusted to the central bank, with a few exceptions – Bosnia & Herzegovina, Poland, Ukraine, and Serbia. Well-functioning bank liquidation frameworks can play an important role in increasing the expected recoveries of failed banks, thereby reducing the losses associated with bank failures. A liquid market for distressed assets, where it exists, can further enhance the recovery value of assets and agencies responsible for bank liquidation can play an important role in developing this market in countries where it is lacking.

iv. Insights from different country experiences can help bank liquidators to formulate or update their strategy and approach.

The paper reviews the experience of DGFs in Serbia and Ukraine regarding asset resolution of failed banks following systemic crises in the years after the global financial crisis (GFC). Serbia and Ukraine have accumulated considerable experience in dealing with liquidated bank assets which can inform strategies of other authorities with bank liquidation mandates. In both countries, the DGFs played an important role in the development and deepening of distressed asset markets. Their experiences could be beneficial to other authorities with a bank liquidation mandate as they show pros and cons of different approaches that are often constrained by local legal and other specificities.

v. The DGF bank liquidation mandate has much in common with the functioning of AMCs regarding asset management and divestment and both are useful to learn from.

The paper considers the experience of several European countries that created AMCs to clean their banking systems of distressed assets following the GFC. Consideration of both approaches helps identify important aspects of asset management and divestment functions, especially: (i) in the preparation of the legal frameworks governing bank liquidation; (ii) when drafting asset management and divestment strategies; and (iii) during the process of selling assets.

vi. The successful sale of the distressed assets of banks requires a clear strategy and effective legal framework. Experience of AMCs managing the distressed assets of viable and unviable banks shows a need for a structured approach to the preparation and actual sale of distressed assets that is based on clear legal grounds. Major components of this approach include: (i) sound governance practices and clear legal frameworks, (ii) comprehensive asset management and divestment strategies, (iii) active asset management and improvement of assets with safeguards in place to maximize return, (iv) transparent and prudent asset valuation, and (v) transparent and competitive asset sale. Each of these components are discussed in detail in the paper. The case of Ukraine showed, for instance, that transparent asset sales through an online asset sales platform ensures adequate and equal information to all investors and high transparency in asset management and divestment allows the bank liquidator to explain and justify low recovery rates.

vii. Distressed asset management and disposal must be handled professionally and transparently. Legal mandates should: (i) list actions allowed for improvement of assets under management, (ii) establish the time frame for asset improvement and disposal, (iii) set out general rules for asset valuation, (iv) allow the potential option of new financing if this is value accretive, and (v) offer balanced protection to staff against legal claims, including cases of asset sale at low price (below acquisition price). Professional and independent staff, including management, are essential to discharge the tasks provided in the legal mandate. Staff decisions shall be made purely on a commercial basis without external interference or lobbying. At the same time, management shall be accountable to the stakeholders.

viii. Bank liquidators need to strategically plan their activities, targets to be achieved, and resources needed, based on the operational framework laid out in founding laws. Strategies should aim to optimize asset management and disposal with a goal to maximize recoveries within the specified time horizon and with safeguards in place. The following principles for bank liquidation can help remove ambiguity and increase transparency: (i) dispose of assets in a phased and orderly manner, (ii) use both individual and portfolio sales approaches if feasible, (iii) provide additional financing to certain assets if

legally allowed, it is commercially justified, and does not unduly increase risks, and (iv) use different cash flow enhancement methods (i.e., rental, lease) if appropriate. A balance should be sought between the proper improvement of assets and their sale within envisaged deadlines. In certain cases, distressed assets of “strategic defaulters”, borrowers that have means to pay but choose not to pay using weaknesses in judicial systems or loopholes in legislation, should be specifically addressed. The case of Serbia showed, for instance, that packaging assets into large pools can maximize recovery values of very seasoned distressed assets and that a pilot asset sales project is a good starting point in countries with limited experience in the sales of distressed assets.

ix. The founding law should provide guidance on active or passive asset management and the divestment approach to be used. Active asset management (i.e., renting, leasing, and new financing to develop assets), with safeguards in place, can deliver results and increase the final asset sales price. But it requires resources and is a source of risk. Passive asset management might be warranted if the bank liquidators lack the necessary expertise, experience, or resources for active asset management. However, this strategy should include a minimum level of activity to preserve the asset and prepare it for sale.

x. Prudent and timely valuation of distressed assets is critical. The founding law should provide the basis for the valuation framework to be used by bank liquidators. The following aspects should be clearly set out in the law or internal documents: (i) prudent asset valuation during acquisition and sale, (ii) valuation service providers (i.e., internal or external), (iii) valuation methods to be used, and (iv) sales price determination.

xi. A well prepared and conducted asset sale process is essential to maximize recovery values. The paper provides examples of how asset sales have been organized in different jurisdictions. Key general principles include: (i) appropriate portfolio structuring of assets for sale, (ii) proper marketing to broaden the investor base, (iii) detailed information of assets sold to minimize “price gap”, and (iv) transparent and efficient sales platforms. Transparent valuation processes and disclosure of maximum information to investors regarding assets facilitates price discovery.

INTRODUCTION

1. A high level of non-performing loans (NPLs) poses risks to financial stability and economic growth.

Elevated levels of NPLs in a financial system are a source of systemic risk and can threaten the long-term stability of national financial systems. Financial stability and soundness of banking systems are two important preconditions for sustainable economic growth. As bank financing remains the main source of funding for economies in the CESEE region, banks must remain financially healthy to provide new loans.¹ Non-viable banks with asset quality problems should be liquidated and stranded assets returned to productive sectors as soon as possible to not undermine credit growth.

2. Countries have applied different approaches to address the stock of distressed assets at a national level. In many jurisdictions, central banks have the bank resolution and liquidation mandate and manage distressed asset resolution in administrative or court-based processes. In some CESEE and Western European countries the DGF or an AMC has played a crucial role in managing distressed assets. The primary function of an AMC is to manage and dissolve

entrusted assets according to founding laws. While the primary function of a DGF is to protect depositors, in some countries the DGF also has a bank resolution and liquidation mandate.

3. This paper summarizes the asset management and divestment experience of two DGFs from the CESEE region and three AMCs from Western Europe.

It focuses on two recent country examples where DGFs played a crucial role in managing assets of liquidated banks (Serbia and Ukraine) and provides insights on the asset management and divestment function from national AMCs created in Western Europe (Ireland, Spain, and Slovenia) to deal with the consequences of the GFC. These examples are the most relevant for the study due to the asset size and depth of experience. The focus of the paper is on asset management and divestment functions. It does not aim to review bank resolution or liquidation strategies, NPL management strategies, or other aspects of AMC creation and operation, including mandates, governance, funding structure, and legal frameworks. The paper does not discuss the allocation of bank resolution and liquidation mandates among national

¹ Ivan Huljak, Reiner Martin, Diego Moccero and Cosimo Pancaro. Do non-performing loans matter for bank lending and the business cycle in euro area countries? <https://www.tandfonline.com/doi/full/10.1080/15140326.2022.2094668?src=recsys> and Nir Klein, Non-Performing Loans in CESEE: Determinants and Impact on Macroeconomic Performance. <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Non-Performing-Loans-in-CESEE-Determinants-and-Impact-on-Macroeconomic-Performance-40413>

authorities but provides a summary of national frameworks in **Annex 1**.

4. Agencies responsible for bank liquidation can play an important role in the management and sale of NPLs, as evidenced by the experience of Serbia and Ukraine. The role of bank liquidators in rehabilitating the assets of non-viable banks is important, especially in countries where a significant proportion of banks were closed, as experienced in Serbia and Ukraine. In cases of systemic financial stability problems in such countries, bank liquidators often act as AMCs that, according to national legal frameworks, (i) take over assets from liquidated banks, (ii) manage and improve these assets, and (iii) divest them in allowed timeframes set by the legislator. Bank failures in other CESEE countries in the region (e.g., Montenegro and North-Macedonia)² are not analyzed in this paper due to the small size of assets.

5. The asset management and divestment practices of DGFs in the region can be a source of good practice information for other countries. A timely return of distressed assets to productive economic sectors can facilitate economic growth and develop the NPL market. Assets of liquidated banks are managed by the liquidators for value optimization and subsequent divestment. While some assets can be perfected and sold in a short period of time, other assets are not as liquid and might be difficult to sell. Hence, additional improvements in assets might improve the chances of selling them and/or maximizing their sales value. This review of asset management and divestment practices can provide policy input to support liquidators' efforts to maximize asset returns, with safeguards in place, within the legal and operational frameworks defined by respective laws.

6. Agencies mandated to manage and divest assets of failed banks can learn from the experiences of large European AMCs. National authorities in Europe took different approaches to resolve the stock of distressed assets and deal with failed banks following the GFC. Ireland, Spain, and Slovenia established asset management companies – the National Asset Management Agency (NAMA), the Spanish Asset

Management Company (Sareb), and the Bank Assets Management Company (BAMC) respectively - to deal with turbulence in their financial sectors. All these companies were mandated to manage entrusted assets and divest them to return initial investments to respective authorities (most often national governments) and are therefore informative for this study.

7. The following four chapters focus on asset management and divestment practices in select CESEE countries. While the agencies responsible for bank liquidation can have a wide range of functions, this paper focuses on distressed asset management and divestment practices of these institutions, including: (i) a case study of the Deposit Insurance Agency of Serbia's experience with asset management and disposal (**Chapter II**), (ii) a case study of the Deposit Guarantee Fund of Ukraine's asset management and disposal practices (**Chapter III**), (iii) an overview of good practice and main aspects of the asset management and disposal processes distilled from Serbia and Ukraine and other examples to provide guidance to bank liquidators on how to set up these frameworks (**Chapter IV**), and (iv) key recommendations for agencies mandated to conduct bank liquidations (**Chapter V**). The Annexes include an overview of bank resolution and liquidation frameworks in CESEE countries to show different frameworks for bank, and consequently NPL, resolution (**Annex 1**), and summarize asset management and sales practices by NAMA, Sareb, and BAMC (**Annex 2**).

8. The paper aims to complement existing international standards and good practices. The paper builds on international good practices described in the following documents: (i) Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions,³ (ii) European Commission, Asset Management Company Blueprint,⁴ (iii) ECB, Guidance to Banks on Non-Performing Loans,⁵ (iv) World Bank, Public Asset Management Companies - A Toolkit,⁶ and (v) International Monetary Fund, Issues in the Establishment of Asset Management Companies.⁷

² Eurostandard Bank's license was revoked by the National Bank of the Republic of Macedonia and the bank was placed under insolvency proceedings in August 2020. Invest Banka Montenegro AD Podgorica was placed under insolvency proceedings in January 2019 and Atlas Banka AD Podgorica in April 2019. In the case of Montenegro, liquidation administrators were appointed to liquidate the banks.

³ https://www.fsb.org/wp-content/uploads/r_111104cc.pdf

⁴ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018SC0072>

⁵ https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf

⁶ <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/293361467996695247/public-asset-management-companies-a-toolkit>

⁷ <https://www.imf.org/external/pubs/ft/pdp/2004/pdp03.pdf>

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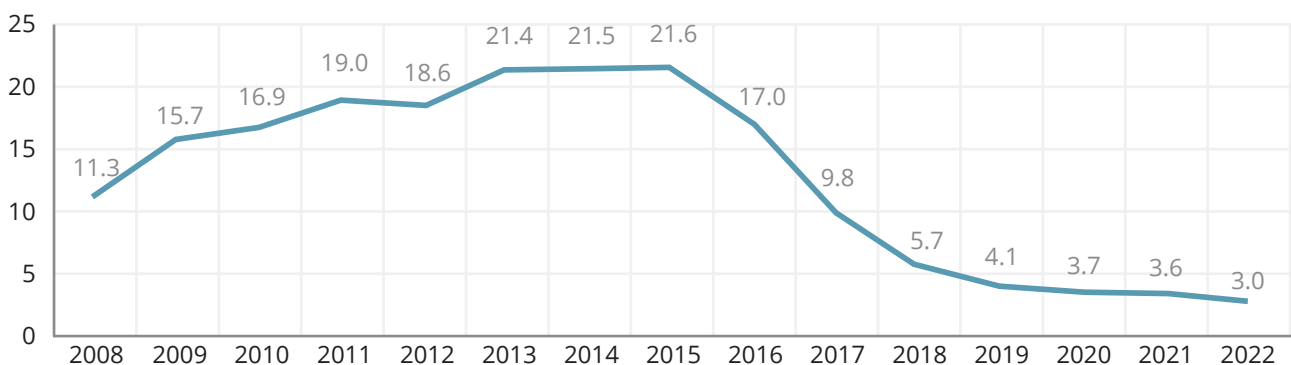
ASSET SALES:
SERBIA'S EXPERIENCE

A. BACKGROUND INFORMATION

9. Serbia needed a national NPL resolution strategy given high levels after the GFC. The level of NPLs in Serbia peaked in 2015 at 21.6 percent (see **Figure 1**). To address the stock and flow of distressed assets Serbia formed the NPL Working Group in 2015. The

Working Group comprised the Ministry of Finance, the National Bank of Serbia, the Ministry of Justice, and Deposit Insurance Agency (DIA) with the World Bank, International Monetary Fund (IMF), and European Bank for Reconstruction and Development as observers. It prepared a study on impediments for resolving distressed assets that informed a national time-bound strategy for NPL resolution (the Strategy),⁸ approved by the government in 2015.

Figure 1. NPLs against gross loans (in % over years)



Source: National Bank of Serbia

10. The Strategy introduced a holistic, system-wide approach to NPL resolution. The Strategy recognized that NPLs had become a source of systemic risk and that they would prevent economic growth unless addressed systematically. The overall goal of the Strategy was to provide incentives, remove identified impediments, decrease the level of NPLs, and prevent the buildup of future NPLs. The strategy encompassed (i) regulatory reforms, (ii) activities related to enhancing banks' capacity to deal with high NPLs, (iii) reforms aimed at enabling the development of an NPL market, and (iv) reforms related to out-of-court debt restructuring, in-court debt resolution, and the mortgage framework. After about three years of implementation there had been a substantial improvement in the level of NPLs to below five percent. The Strategy was then extended to focus on distressed claims of government-controlled financial creditors and prevention of NPL build-up, among other aspects.

11. The DIA had an enhanced role in the implementation of the Strategy. The Strategy included two Action Plans, one prepared by the government and the other by the National Bank. The Action Plan prepared by the government envisaged: (i) boosting the operational and professional capacity of the DIA to deal with distressed assets, (ii) developing internal procedures for asset management and asset appraisal, and (iii) implementing a time-bound asset divestment plan.

12. In 2017, the DIA oversaw asset management of 20⁹ banks¹⁰ and seven insurance companies which were under bankruptcy procedures. The gross book value of these assets was around RSD 580.9 billion (approx. EUR 4.7 billion based on end-2016 exchange rates). In addition, RSD 433.7 billion (approx. EUR 3.5 billion) of assets were managed as part of a government claims collection, bringing the total DIA portfolio to RSD 929.47 billion (approx. EUR 8.2 billion) as of December 31, 2016. Since then, many assets have been disposed of. The value of the total portfolio remained at EUR 2.65 billion in December 2022.

B. GOVERNANCE AND LEGAL FRAMEWORK

13. The DIA has a broad mandate, based on a clear legal framework. The legal framework of DIA operations is guided by the Law on the Deposit Insurance Agency of 2015 (DIA Law),¹¹ and the Law on Bankruptcy and Liquidation of Banks and Insurance Companies of 2015 and 2018.¹² The DIA Law clearly stipulates that the DIA is an autonomous legal entity, functionally independent from any state institution. The DIA performs activities pertaining to statutory deposit insurance and payout of insured amounts in accordance with the law governing deposit insurance. In addition, the DIA (i) acts as the bankruptcy or liquidation administrator for bankruptcy cases of banks, insurance companies, and leasing companies, (ii) manages the assets transferred in the process of bank resolution and performs other activities related to bank resolution pursuant to the law governing banks, and (iii) serves as collector of government claims based on distressed assets carved out of banks undergoing sale, restructuring, or transfer.¹³

14. The DIA Law stipulates clear governance arrangements with proper legal protections. The Managing Board of the DIA consists of five members, three of which are required to be independent (c.f., DIA Law, Section IV). The Law also establishes minimum requirements for Managing Board members, the scope of the Board's work, provisions for managing conflict of interest, and acceptable reasons for dismissal. Similar requirements are set for the DIA's Director. The DIA Law also establishes legal protections for its employees, members of the Managing Board, as well as the persons who, by order of the DIA, perform duties determined by the Law (c.f., Article 20).

15. To effectively implement the NPL resolution strategy, the DIA introduced several organizational and operational changes. Those included a change in

⁹ Four large banks went bankrupt in 2002, seven smaller banks went bankrupt between 2004 and 2012, and 5 larger banks went bankrupt in 2012-14.

¹⁰ In late 2016, 30 banks were operating in the Republic of Serbia with net value of assets at EUR 25.3 billion. Source: DIA. NPL and Asset Management Strategic Plan. April 2017.

¹¹ https://nbs.rs/export/sites/NBS_site/documents-eng/propisi/zakoni/deposit_insurance_agency_2015.pdf

¹² https://nbs.rs/export/sites/NBS_site/documents-eng/propisi/zakoni/bankruptcy_liquidation_banks_insurance.pdf

¹³ Legal framework for bank resolution. Source: DIA website.

the operational structure of the DIA related to NPL and asset management to increase efficiency, and several changes to NPL and asset management procedures.

C. ASSET SALE STRATEGY

16. The DIA's Non-Performing Loan and Asset Management Strategic Plan (Strategic Plan), developed based on the NPL resolution strategy, was the backbone of asset management and disposal. The DIA prepared the Strategic Plan in 2017 in cooperation with the Ministry of Finance and based on the 2015 national Strategy. It was supplemented with annual Asset Management Operational Plans in which short-term targets were spelled out. The DIA's strategic objectives were to: (i) manage distressed assets in an efficient and effective way, (ii) ensure maximum recovery, and (iii) frequently distribute proceeds from asset disposal to creditors. As the DIA was one of the largest sellers of distressed assets in Serbia, it was envisaged in the national Strategy that more active work of the DIA would stimulate and deepen the hitherto underdeveloped NPL market.

17. The Strategic Plan set out the main challenges for smooth asset management and disposal. Asset seasonality (vintage) was one of most important parameters used to describe the DIA's asset portfolio at that time. Some banks, and consequently assets, had been under bankruptcy procedures for over 15 years. Delays in closing these proceedings were attributed to the complexity of selling the banks' outstanding loans. In addition, long court procedures, costly bankruptcy procedures, inability to collect claims from debtors in restructuring, lengthy and complex insolvency and liquidation procedures (including foreign jurisdictions), the under-developed NPL market, loss of value due to the vintage of loans and collaterals, and decline in collateral quality over the long period of time were, among others, issues that implied low recovery values of these assets.

18. The structure of the DIA's asset portfolio was complex.¹⁴ In December 2016, the structure of the DIA's distressed asset portfolio was slightly tilted towards collection of assets for bankrupt banks – 54 percent – while 44 percent of assets represented collections on behalf of the state. Four major banks alone accounted for 28 percent of total assets. Assets in bankruptcy procedures made up 62 percent of the total. The asset portfolio of bankrupt banks included the following asset types: accounts receivable from debtors (91 percent),¹⁵ real estate (4 percent), time deposits (4 percent), and shares and stocks (1 percent). In total, 4,501 debtors made up the portfolio of bankrupt banks' accounts receivable. The asset portfolio of collecting accounts receivable for or on behalf of the state included 329 debtors. These were mostly uncollectable or low recovery rate receivables.¹⁶ Of these, bankruptcy procedures were initiated with 129 debtors.

19. Real estate enforcement was problematic. The DIA's real estate portfolio included 366 properties in total. Of these, 224 properties were not ready for sale due to the following issues: (i) unregistered title, (ii) missing documentation, (iii) property located in Kosovo and Metohija or former Yugoslav republics, (iv) debtor's title in dispute, (v) restitution claims advanced, and (vi) property not registered. A lot of work was needed to perfect these assets and in many cases it was very difficult or impossible to do so.

20. Management of the DIA's equity portfolio required specific skills. Financial institutions in bankruptcy administered by the DIA owned equity in a total of 96 businesses (86 in Serbia and 10 abroad). Of the 86 Serbian entities, 38 were either deleted from the register or in bankruptcy and 48 were active (36 joint stock companies and 12 limited liability companies). Specific skills were required to manage active companies.

21. The DIA optimized information systems to improve collection efficiency and obtain a comprehensive overview of all debtors. While initially, the portfolios were treated separately, it

¹⁴ DIA. NPL and Asset Management Strategic Plan. April 2017.

¹⁵ Most accounts receivable from debtors were held by the four major banks in bankruptcy. These were primarily receivables from other financial institutions and subsidiaries abroad.

¹⁶ Most often these were fully provisioned when they were transferred to DIA from banks' balance sheet.

was identified that consolidation of information about a debtor or debtor group provided a more comprehensive overview of exposures and allowed for a more analytical approach to restructuring where it was feasible. For this reason, a new database was created to allow better-informed strategic decisions to be made about how to recover receivables.

D. MANAGEMENT AND IMPROVEMENT OF ASSETS

22. The DIA's founding laws are not explicit about the principles to be applied for asset management; however, the DIA's Strategic Plan emphasizes maximizing recovery value. In its Strategic Plan, the DIA established its objectives as (i) managing assets efficiently and effectively, (ii) ensuring maximum recovery for creditors including the state, and (iii) distributing proceeds more frequently. The Bankruptcy Law allows the DIA to cover the costs of managing its assets and the bankruptcy proceedings from its own resources, while maintaining the right to recover these costs from the bankruptcy estate.

23. Asset management and improvement follow the principles of maximizing recovery within an optimal period of time. The DIA's Strategic Plan describes that collection activities depend on (i) the form of incorporation of the debtor (trading businesses, sole proprietorship, legal entities in reorganization, bankruptcies, private individuals), (ii) the amount of the outstanding receivables, and (iii) the quality of collateral posted.

24. To accelerate payments to creditors and maximize recoveries, the DIA and Ministry of Finance decided to package certain distressed assets in portfolios for sale. Work began on packaging a so-called "pilot portfolio" in 2018. This aimed to package a small portion of the total NPL portfolio for sale to gain experience on how best to market NPLs. After the successful sale of this portfolio in 2019, a so-called "large portfolio" was offered for sale in 2020, embedding the lessons learned from the first sale (see paras 27-30). The portfolios tied

together certain groups of debtors and loans to make them more attractive to prospective investors and increase competition. This approach was facilitated by investment in information systems (see para 21) that allowed for a consolidated view of debtors across bankruptcy estates. The packaging approach also lowered expenses compared to a loan-by-loan approach.

E. ASSET VALUATION

25. A new valuation framework applied consistently across assets led to considerable downward adjustments. The Law on Bankruptcy and Liquidation of Banks and Insurance Companies stipulated clear requirements regarding the valuation of assets. As the bankruptcy administrator for financial institutions in bankruptcy, the DIA was required to provide an inventory of assets and compile an initial bankruptcy balance sheet within 60 days of taking possession of the assets in accordance with International Financial Reporting Standards (c.f., Article 16). The DIA was also required to publish quarterly updates on the state of each bankruptcy estate. However, the Law only came into effect after many bankruptcies had already been opened. Hence, a re-valuation of assets was required, for which the DIA established a new methodological framework to be applied consistently across assets. This led to a considerable downward adjustment to the valuation of accounts.

26. As of end-2016, assets of financial institutions in bankruptcy or liquidation administered were valued at RSD 580.9 billion (EUR 4.7 billion). Loans issued to debtors constituted 91 percent of the total (RSD 529 billion or EUR 4.3 billion). Of the remainder, about RSD 22 billion (EUR 0.2 billion) were in cash, RSD 22 billion (EUR 0.2 billion) in movable and immovable property, and RSD 6 billion (EUR 0.05 billion) in units and shares. Property and units and shares appraised by an authorized valuer were carried at their appraised liquidation value, while property that had not been subject to appraisal by an authorized person or was in dispute was carried at book value.

F. ASSET SALES PROCESS

27. The sale of the pilot portfolio and the large portfolio of NPLs consisted of four steps. First, the DIA, supported by international consultants, assessed the collectability of the portfolio, valued the collateral, prepared an indicative valuation of the portfolio, and drafted a Process Letter for the sale and relevant sales documents. The second step included preparatory activities for the sale, including preparing advertisements, agreeing on the data tape, preparing the draft binding offer, and developing data room rules. Third, the tender for sale was issued through public advertisement, requesting potential investors to submit their expressions of interest. Interested investors were, in the fourth step, invited to undertake their due diligence by visiting the data room. This led to the submission of binding offers for review and evaluation by the DIA. Based on the review, the DIA went into negotiations with the successful bidder and closed the sale.

28. The DIA decided to set a minimum reserve price for the portfolios at sale to set expectations, provide transparency, and signal commitment to sell. The reserve price was set at the median valuation of claims assessed as collectible within the portfolio. The reserve price was expected to prevent possible hold-out behavior by one or a minority of sellers at the final stage of binding offers. The DIA was open to disclosing the reserve price to interested investors to signal commitment to sell, understanding however that this could imply lower offers than potentially possible (as investors would target an offer around the reserve price). However, the DIA expected competition to be high, in which case such behavior was less likely.

29. Multiple bids were received for each portfolio, and both were sold to international companies specialized in the recovery of impaired assets. The two portfolios together consisted of EUR 2.04 billion in claims. This equaled 32 percent of the aggregate nominal value of the combined portfolio managed by the DIA as of end-2018. The pilot portfolio of EUR 242.4 million consisted of claims of the state and five bankrupt banks and successfully closed in 2019. The large portfolio of EUR 1.8 billion consisted of

claims of the state and eight bankrupt banks and closed in 2021. Following these sales, the DIA began work on a so-called Remaining Portfolio for sale. This portfolio comprised about EUR 318 million of claims and was publicly tendered in December 2022. At the time of writing this report, the deal has not yet been completed.

30. The asset sales reduced the value of the DIA's portfolio significantly. As of end-2022, the DIA's portfolio stood at EUR 2.65 billion, about 30 percent of its 2016 value. In addition, the DIA collected EUR 273.59 million from debtors between January 2016 and December 2022 and closed 22 bankruptcy/liquidation cases.

G. LESSONS LEARNED

31. Three important lessons can be learned from the Serbian experience:

- i. A systematic analysis of distressed assets from banks in liquidation, identifying similar characteristics and opportunities for packaging assets in portfolios, can increase the probability of a successful sale and the recovery value as larger portfolios attract the interest of more potential investors. To allow for such systematic analysis, IT upgrades and staff upskilling may be needed. A critical assessment of the value of portfolios is necessary for successful sales.
- ii. In countries where experience with NPL portfolio sales may be limited, starting with a pilot portfolio of NPLs for sale can be useful to gain experience before aiming to sell larger portfolios. This can increase recovery value and save time, including through avoiding unsuccessful tenders.
- iii. Resolving NPLs is complex and requires a comprehensive approach, working across institutional boundaries and addressing legal and operational obstacles as they are identified. The national NPL resolution strategy and the DIA's strategic plan were fundamental for the successful asset sales that followed.

CHAPTER

3

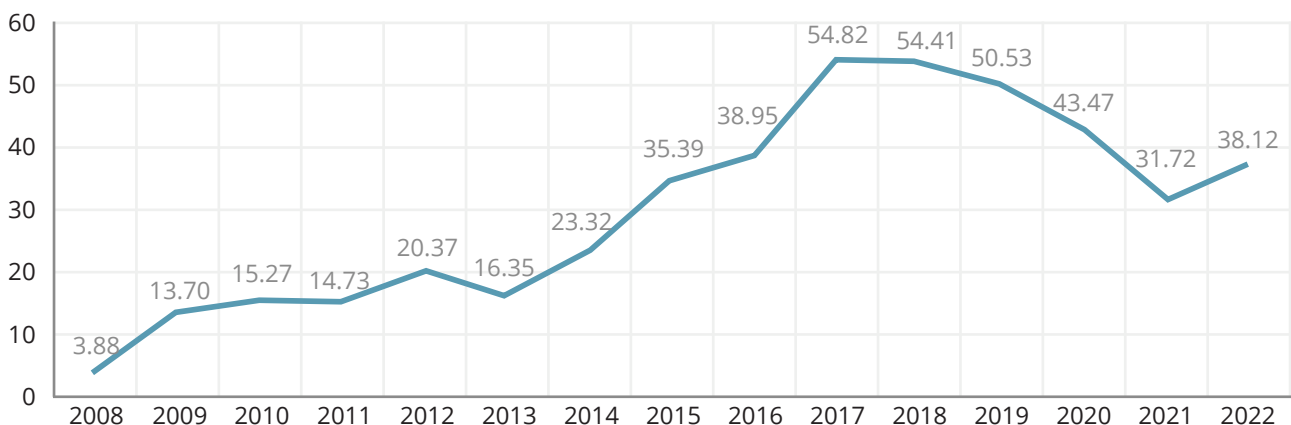
ASSET SALES:
UKRAINE'S
EXPERIENCE

A. BACKGROUND INFORMATION

32. The high level of NPLs were becoming increasingly concerning following the GFC and a substantial currency depreciation from 2014 to 2017. The level of NPLs increased sharply, reaching 55 percent in 2017 (see **Figure 2**). To address the build-

up, the World Bank conducted a study on the NPL resolution framework in Ukraine. This revealed good practice gaps in the framework and recommended bank supervisory and regulatory reforms and judicial and legal reforms to streamline insolvency and collateral enforcement frameworks. After part of these reforms were implemented in 2017 and 2018, the NPL rate started to decrease, mostly due to substantial NPL write downs by banks.

Figure 2. NPL rate (%)



Source: IMF FSI

33. The DGF of Ukraine plays a key role in NPL resolution. Since 2012,¹⁷ the DGF is the legally designated bank resolution and liquidation entity in Ukraine and is mandated to manage and sell its assets under management. During the currency depreciation crisis (2014-2017), the DGF carried out the resolution of 94 insolvent banks. Hence, a large part of bank NPLs were transferred to the DGF for resolution. As of August 2023, the DGF was in the process of liquidating 54 banks with only 15 still having assets.¹⁸ The DGF continues to play a major role in NPL resolution and remains a dominant player in the NPL market in Ukraine.

B. GOVERNANCE AND LEGAL FRAMEWORK

34. The DGF has a broad mandate that is anchored in the Law "On Deposit Guarantee System" (DGF Law) from February 2012. The DGF is an economically independent public law entity. The Law specifically states that it is independent from government agencies and the National Bank of Ukraine (responsible for banks' regulation and supervision). The DGF has a key role in the financial architecture of the Ukrainian financial system and has many functions including: (i) paying agent for the insured depositors of failed banks, (ii) bank resolution authority, and (iii) management of assets of liquidated banks. The DGF is accountable to the Verhovna Rada of Ukraine (Parliament), the Cabinet of Ministers, the Ministry of Finance, and the National Bank of Ukraine.¹⁹

35. The DGF Law sets the framework for governing bodies and operational arrangements. The two-tier administrative system includes two bodies: (i) the Administrative Board and (ii) the Executive Board. The Administrative Board consists of five persons – one from the Cabinet of Ministers, two representatives

from the National Bank of Ukraine, one representative from the Parliament, and one DGF Managing Director. The Executive Board consists of seven members,²⁰ who satisfy the requirements specified in the Law.²¹

36. Organizational and legal changes were made to optimize the DGF's work to deliver on the mandate. Several organization improvements were implemented to reflect the dynamic changes in workload. An asset management strategy was prepared (see Section C below) and the Fund introduced two new governing bodies – (i) the Committee on Consolidation, Management, and Sale of Bank Assets and (ii) the Property Management Committee. These two committees were merged in 2019 after the volume of assets decreased due to aggressive sales. In parallel, the Fund partnered with a domestic electronic trading platform, Prozorro. Sales, to optimize asset sales and to ensure maximum transparency (see para 42).

37. The DGF Law provides legal protection for staff who work in good faith. The Law clearly states that DGF staff and management, including retrospectively, are not liable for any acts or omissions if they acted based on, within the authority of, and in the manner provided for by the Constitution of Ukraine and laws of Ukraine.²² The legal protection of DGF employees and related costs are covered by the DGF.

C. ASSET SALES STRATEGY

38. The asset sales strategy has evolved over time. The main pillars of the DGF asset sales strategy were originally: (i) professional asset management process and (ii) transparency during the sales process. In April 2016, the Department of Consolidated Sales and Management of Assets was created to improve the asset management process.²³ At the same time, a policy of maximum information disclosure during

¹⁷ Between 2008 and 2010, 24 banks were declared insolvent and liquidated by the National Bank of Ukraine. DGF only paid out depositors guaranteed compensation.

¹⁸ As per July 2023, there were 64 banks with valid licenses.

¹⁹ Article 5.1 of the Law "On Deposit Guarantee System".

²⁰ According to the law there are seven Executive Board members. However, the Executive Board has operated with six members.

²¹ Article 11 of the Law "On Deposit Guarantee System".

²² DGF Law. Article 16.3.1.

²³ DGF Annual Report 2016. Page 7.

the asset sales process was initiated. Under this policy all available information regarding assets for sale, including rights to claim on loans, is publicly disseminated and is available to potential investors. Data rooms were created and public asset passports were developed and introduced. This addressed long-standing issues of lack of transparency and corruption risks. In the following years, the strategy was finetuned to address problem areas identified in the work process, including improving the auction process during the sale and optimization of cash flows from assets using leasing and renting tools.

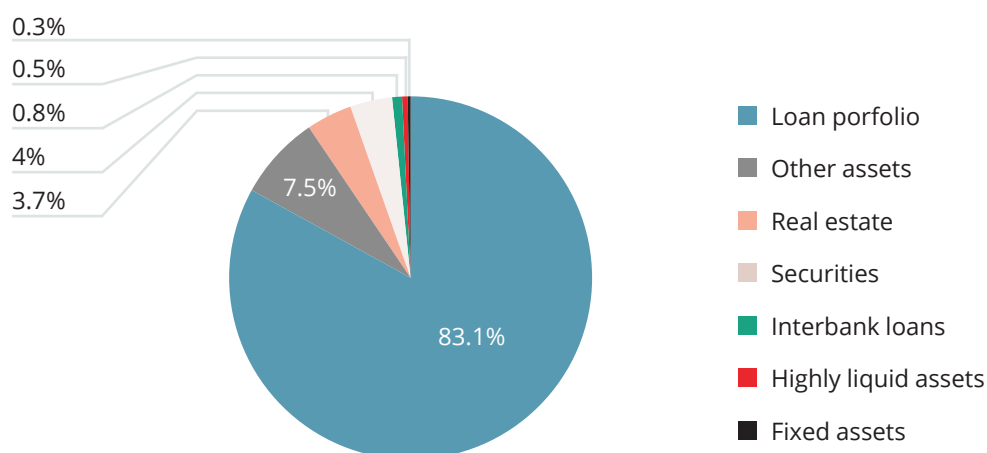
39. The strategy envisages maximization of return on assets. The main goal of the DGF during the bank liquidation process is to maximize proceeds from the management and sale of the insolvent bank's assets towards satisfying the bank's creditors' claims.²⁴

40. The DGF's asset sales strategy is constrained by a time-bound limit on asset sales. The DGF Law requires the DGF to sell assets within a three-year period from the initiation of the bank liquidation procedure.²⁵ This limit is extended to five-years in the case of a systemically important bank liquidation.

This time constraint forces the DGF to come up with innovative approaches to asset management but at the same time it limits the potential to maximize asset returns.²⁶ The DGF Law provides for a possible extension of the time limit in some exceptional cases, such as if there is no access to assets or records or if there is a court decision to overrun the DGF decision on the bank liquidation procedure. The time constraint on asset sales is one of the reasons for low recovery rates of disposed assets, see **Table 1**.

41. The complexity of the asset portfolio under management requires special approaches. While there are some changes in the structure of the assets portfolio from year to year, claim rights against loans remain dominant. For example, in January 2018, 94 banks were under the DGF's management with a total book value of assets of UAH 526.39 billion²⁷ (USD 18.75 billion). 83.1 percent of total assets were claim rights against loans (see **Figure 3**). The diversity of assets requires specialized skills for asset management and divestment. The large share of the loan portfolio requires special approaches to borrowers' depending on their viability, debt servicing capacity, and legal status of the loan (i.e., under legal procedures or not).

Figure 3. Structure of assets under management (2018)



²⁴ DGF Annual Report 2018. Page 55.

²⁵ Article 44.5 of the Law "On Deposit Guarantee System".

²⁶ International experience shows that distressed asset investors might benefit from forced asset sales at a discount when public asset managers are forced to liquidate assets in a certain time period. This was a serious concern for the NAMA and for this reason the legislation did not envisage the time cap on asset sales but instead required an overall asset management and liquidation plan that provided steady loan repayments to the lender (the state in the case of Ireland). Otherwise, investors might wait till the end of the asset disposal period and buy assets at a discount when the seller is compelled to sell them.

²⁷ Annual Report 2017. Page 63. Exchange rate UAH/USD=28.07.

42. An online asset sales platform is used to widen the potential investor pool and ensure transparency for asset sales. Given the large volume of assets of failed banks, the DGF, in partnership with Transparency International Ukraine, created the electronic trade system Prozorro. Sales in 2016 to sell the assets of the banks being liquidated. Since 2017, almost all DGF auctions have used this trade platform, ensuring openness and transparency of the process. In 2018, as part of a pilot project, a small number of large asset pools were sold on the First Financial Network (USA) and DebtX (USA) platforms. However, these volumes were not large and Prozorro. Sales remains the dominant sales platform for the DGF.²⁸ All funds received from the sale and management of banks' assets are used to satisfy the claims of the creditors of the banks being liquidated.

43. The sale of some valuable assets achieved reasonably high recovery rates but generally proceeds from asset sales have been low. Table 1

provides a summary of recovery rates during the period 2016-2022. In 2016 and 2017, average recovery rates were relatively high – 43 and 24 percent respectively. However, in consecutive years these rates were below 5 percent (2019-2021). This can be explained by the sale of more valuable assets in the initial years and the sale of more difficult assets at later stages, including the sale of portfolios. Other factors that contributed to the low recovery rates during asset sales include: (i) poor underwriting standards of loans in banks under insolvency, (ii) limited time for improvement and sale of assets (see para 40), and (iii) the long and costly collateral enforcement and insolvency process in Ukraine that is reflected in low offer prices by investors. The volume of sales decreased substantially after Russia's full-scale war and the introduction of martial law in Ukraine in February 2022. The high recovery rate in 2022 was mostly due to the sale of the good and liquid assets of two closed subsidiaries of Russian banks.²⁹

Table 1. Asset sales by DGF (UAH thousand, %)³⁰

Year	Book value of assets (property) sold		Sales price of assets in auctions and direct sales		Ratio of sales price of assets to the book value of assets, %
	UAH thousand	USD thousand	UAH thousand	USD thousand	
2016	6,964,386	258,036	3,013,321	111,646	43.3%
2017	24,186,555	855,970	5,797,598	207,576	24.0%
2018	62,793,498	2,289,227	6,278,121	228,878	10.0%
2019	237,726,370	10,238,000	7,977,141	343,546	3.4%
2020	283,210,975	10,014,532	3,693,155	130,592	1.3% ³¹
2021	73,636,168	2,692,364	2,415,250	88,309	3.3%
2022	2,001,174	54,188	1,535,200	41,571	77.0%

²⁸ Annual Report 2018. Page 9.

²⁹ After the invasion in February 2022, the National Bank of Ukraine decided to liquidate two subsidiaries of Russian banks. The balance sheets of these banks included a lot of liquid assets since licenses for these banks were withdrawn for non-insolvency reasons. Source: https://www.epravda.com.ua/cdn/cd1/2023/yak_prodaie_fond_harantuvannia_vkladiv/

³⁰ UAH/USD exchange rates used: 2016 - 26.99; 2017 - 27.93; 2018 - 27.43; 2019 - 23.22; 2020 - 28.28; 2021 - 27.35; 2022 - 36.93.

³¹ In 2020, the ratio was particularly low since it coincided with the final "clean up stage" for the banks liquidated in 2014-2015 under a 5-year sunset clause. During this year many assets were sold in the so called "one bank - one pool" auctions. In particular, assets of two systemic banks – Delta and Nadra – consisting of FX mortgage loans that suffered four-fold UAH devaluation and had 10 years of accruing interest were sold contributing to the low recovery rate.

D. MANAGEMENT AND IMPROVEMENT OF ASSETS

44. The DGF founding laws allow for active asset management. The main goal of the DGF bank liquidation function, as defined in the DGF Law, is to maximize proceeds from insolvent banks to meet bank creditors' claims. This legal basis allows the DGF to optimize cash flows of assets under management and minimize operating costs. This includes active asset management by (i) leasing or renting tangible assets, (ii) offering loan restructuring options to borrowers, and (iii) actively enforcing collaterals.

45. Operational reforms have optimized the asset management function. With the growth of assets under management, a new Asset Management Department was established in 2017. The main aim of this reform was to improve the asset management process and make the decision-making process more transparent. Internal procedures were streamlined and operational manuals prepared.

46. Leasing of property generated additional cash flows for the DGF. In 2018, the DGF approved a new Regulation on the lease of insolvent banks' property. This provided a transparent way to lease much of the tangible asset portfolio and improve revenues. The DGF operated a specialized rental site to allow interested parties to find and rent property. This site operated as part of the DGF website. It provided information, including presentations and photos, about all tangible assets that the DGF offered for rent and collected indicative offers from interested parties. The biggest interest in this segment was related to property complexes and office space in central city areas. In December 2018, the DGF had leased non-residential premises with a book value of UAH 0.29 billion, that generated UAH 0.10 billion revenue.³² In January 2019, 346 properties were leased by the DGF. Since 2019, all rental and lease properties have been auctioned on the Prozorro.Sales platform to attract more investors.

E. ASSET VALUATION

47. The DGF Law provides for basic asset valuation principles. The Law requires the DGF to prepare an inventory of a bank under liquidation's assets, including property, within six months from the date of the decision to liquidate the bank.³³ The valuation of these assets should be done in accordance with the procedure established by the DGF. The DGF has a right to involve external appraisers and expense these services to the liquidation asset pool of the bank.

48. The DGF conducts appraisal according to internal methodology. The Law requires the DGF to prepare and use internal methodology for the appraisal of assets at different stages of the process (i.e., at asset acquisition and disposal). Internal regulation for asset valuation builds on the local valuation standards that are adjusted for the DGF's needs. The DGF may decide on re-evaluation of assets for sale in cases of significant changes in asset characteristics.

49. The DGF uses both internal and external valuation services. Internal valuation is often used only for advisory purposes. External appraisal services are used for all actions related to bank resolution and asset liquidation. The DGF aims for high transparency and hence publishes a list of valuers with whom they work on their website. This list is reviewed every two-years, but the DGF has the right to arrange an ad-hoc procedure if needed. Specific qualification criteria for valuers are published on the DGF website.

50. Quick sales discounts are applied to certain transactions. Due to legal constraints on the asset liquidation period, the DGF uses quick sales discounts on assets that are not sold at the first attempt. These discounts are applied to regular market price as assets near the deadline for asset liquidation. Advanced market players are aware of this nuance and seek to use it in their favor.

³² Annual Report 2028. Page 9.

³³ Article 50.4. The DGF Law.

51. Different valuation approaches are allowed for asset valuation. In line with international valuation standards, local valuation standards allow the use of three main valuation methods: (i) comparative – market approach, (ii) capitalization or discounting – income approach, and (iii) depreciated replacement cost – cost approach. The DGF allows use any of the three approaches when external valuers prepare their appraisal reports. Often, a mixture of approaches is used.

52. The DGF conducted a study on historical asset sales that will inform future asset valuations. The study on pricing factors and price prediction models for sales of failed bank assets was conducted with the support of the World Bank in 2023.³⁴ It analyzed asset sales data from 2017 to February 2022, and identified specific factors that influence the sales price. Based on these findings, the DGF will improve its internal valuation models.

F. ASSET SALES PROCESS³⁵

53. The asset sales process is organized to achieve high transparency and maximum return on assets. Since 2017, almost all asset sales auctions organized by the DGF are conducted on the Prozorro.Sales electronic trading platform to access the widest range of investors and maximize sales prices. Each asset class traded on the platform has its own information template (called “passports”) that is available to any interested party prior to the auction. The platform is a well-recognized distressed asset trading platform in Ukraine because the DGF, the biggest distressed asset seller in the country, exclusively uses this platform for its operations.

54. The DGF has detailed procedures regarding information that is available on assets for sale. Key information about assets is usually disclosed to all interested parties including: (i) basic loan information,

including days-past-due, (ii) borrower's indebtedness, and (iii) basic information on collateral. The DGF uses a standardized assets for sale passport for each asset class to ensure consistent and comparable information. When investors have particular interest in a specific asset or pool of assets, they sign a non-disclosure agreement with the DGF and then receive access to an on-line data room where more granular information is available.

55. The DGF sets the initial sales price for each asset using publicly available manuals. Asset sales auctions begin from the higher of either nominal book value or appraisal value. As the largest share of assets sold are loans, of which most are NPLs, nominal book value is usually the highest and therefore the starting point for the auction. For the first auctions, the DGF used a market price determined internally based on external appraisal reports but uncertainty regarding some inputs (e.g., discount rate, valuation method) led to the change to the highest of two values approach.

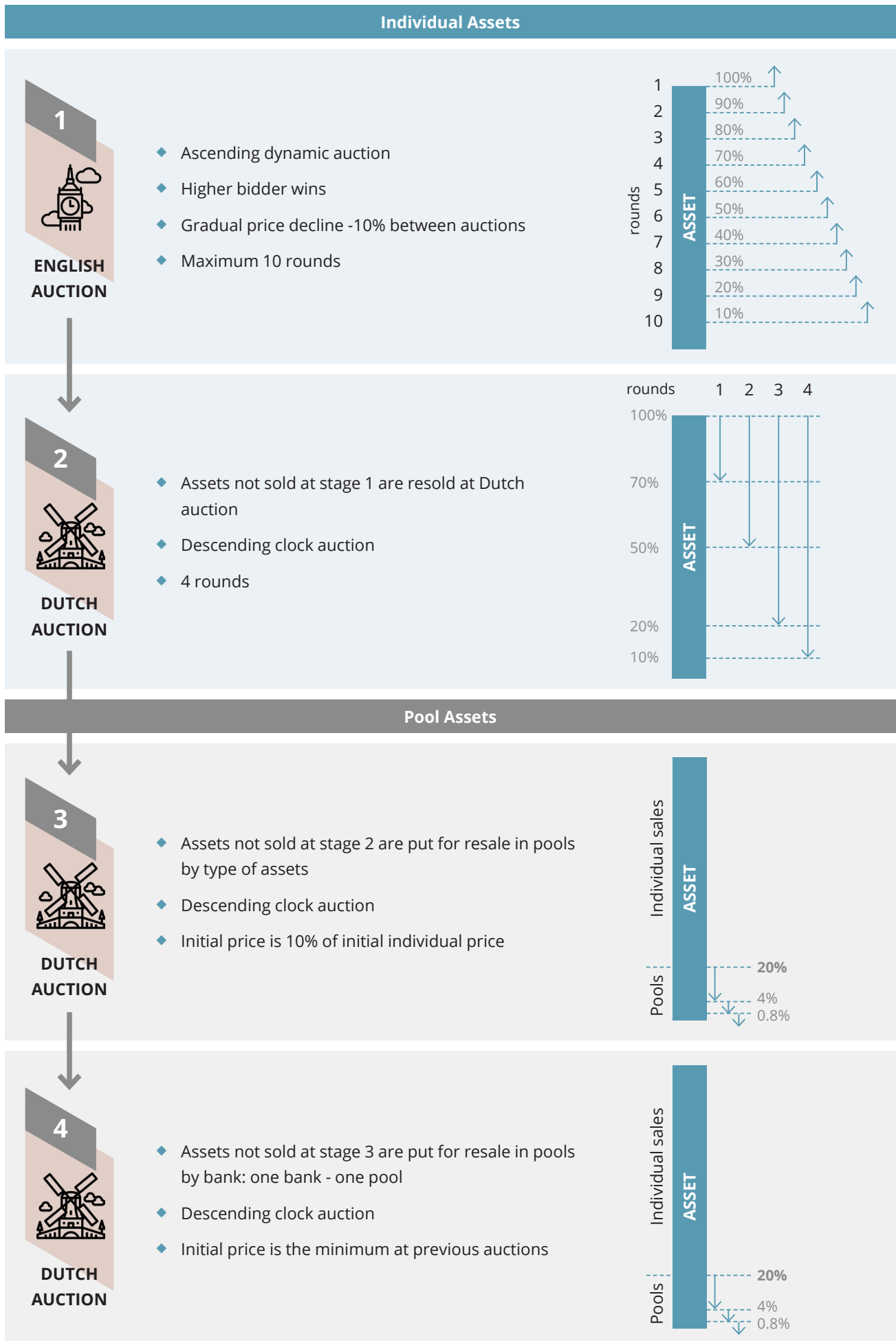
56. Assets are advertised via multiple channels to maximize investor awareness. The DGF uses multiple marketing channels to inform potential investors about assets for sale. These channels include: (i) Prozorro.Sales website, (ii) social networks (for retail assets), (iii) press releases and media announcements, (iv) direct contacts with investors (usually for pools of assets to inform institutional investors), and (v) information posts in specialized media (e.g., real estate portals, journals).

57. A four-stage sales scheme begins by offering individual assets and then moves on to package pools of assets that have not sold initially. Over time, the DGF has developed an advanced asset sales scheme to maximize returns given the time constraints. This scheme has four stages: the first two stages allow assets to be sold on an individual basis and the next two stages are envisaged for packaging assets to be sold in pools. Each stage has different auctioning parameters and price move intervals:

³⁴ <https://www.fg.gov.ua/en/about-dgf/study-on-pricing-factors-and-price-prediction-modelling-for-sales-of-the-failed-banks-assets-was-conducted-with-the-support-of-the-world-bank>

³⁵ Information collected from: (i) annual reports, (ii) DGF presentation “DGF Sales Process”, and (iii) the World Bank. “Asset Sale Practices and Use of Electronic Debt Trading Platforms by Public Asset Management Companies and Deposit Insurance Funds”. 2022.

Figure 4. Four stages of asset sales auctions



- i. Stage one.** The first stage of the asset sales process (for assets such as real estate, cars, and loans less than two-years overdue) uses an English auction³⁶ with four to ten consecutive rounds. The starting price is set on the first round at the higher of gross book value (aggregated amount of principal and accrued interest) or independent appraisal value. It is an ascending dynamic auction where the highest bidder wins. At this stage the price can decline by 10 percent between rounds.
- ii. Stage two.** The second stage is used if sale attempts in stage one were not successful and also immediately for loans that are more than two-years overdue (which are not included in stage one auctions). Stage two uses a hybrid Dutch/English auction³⁷ where the price decreases by 1 percent every 5 minutes. There are four rounds usually each once a week: (i) in the first round the price can decrease from 100 percent to 70 percent of the initial value, (ii) in the second round from 100 percent to 50 percent, (iii) in the third round from 100 percent to 20 percent, and (iv) in the final round from 100 percent to 10 percent.
- iii. Stage three.** If the sale of individual assets is not successful, they are packaged together by asset

types (i.e., loans to individuals, loans to legal entities, real estate, land plots, and fixed assets). This is done to attract the interest of institutional investors that focus on specific asset classes. Packages are auctioned under hybrid Dutch/English auction rules using a descending clock. The initial price is set at 10 percent³⁸ of the initial individual asset price. Often these pools include some good assets and mostly assets that are difficult to sell on an individual basis.

- iv. Stage four.** The same principles as in stage three are applied here except that assets are pooled by a principle: one bank - one pool. All remaining assets on the balance sheet of a liquidated bank not sold in the previous stages are included to clean up the balance sheet of the bank.

Figure 4 provides a summary of the four auction stages.

58. Auctions results are publicly available. To ensure highest transparency, all auction results, including the "live" auction process, are publicly available through different media outlets: (i) DGF website www.fg.gov.ua, (ii) Prozorro.Sales website, and (iii) other media and social networks.

Table 2. Assets sold by type

Loans*			Tangible assets		
Year	Number of assets, in thousands	Amounts, in UAH thousands	Year	Number of assets, in thousands	Amounts, in UAH thousands
2016	more than 1	1,693,115	2016	more than 18	1,320,206
2017	more than 129	3,703,063	2017	more than 65	2,094,535
2018	more than 790	4,236,331	2018	more than 114	2,041,790
2019	more than 395	4,806,841	2019	more than 153	3,170,300

³⁶ Bidders are not identified to each other during the auction, they see only "Bidder 1," "Bidder 2" (no names).

³⁷ Hybrid Dutch/English auction. The starting price is the higher of gross book value (aggregated amount of principal and accrued interest) or independent appraisal value (usually it is gross book value for loans). After the auction has been stopped by one of the bidders, other bidders can place higher bids only once and the bidder who stopped the auction has the final say. Bidders do not see each other's bids, only the bidder who stopped the auction sees the maximum bid before their final say. The final say is optional, in this case the maximum bid of the English part wins. In practice, most often only the descending Dutch auction part is used.

³⁸ Until mid-2022, when the DGF renewed asset sales after a short suspension immediately after the full-scale invasion), the minimal price was set at 20 percent. Changes aimed to reflect on (i) further UAH depreciation, (ii) increased amount of interest that continues to accrue, and (iii) shortage of investment appetite for pools of loans.

Loans*			Tangible assets		
Year	Number of assets, in thousands	Amounts, in UAH thousands	Year	Number of assets, in thousands	Amounts, in UAH thousands
2020	more than 808	2,469,825	2020	more than 42	1,223,330
2021	more than 23	748,607	2021	more than 17	1,666,643
2022	More than 30	118,446	2022	more than 13	1,417,394

* Securities (shares) and receivables from customers.

59. Loan sales dominate in terms of number of assets and volumes sold during auctions. Due to the structure of asset portfolios (see para 41), loan sales have dominated DGF conducted auctions.

Table 2 provides an overview of amounts and numbers of assets sold from 2016-2022. During this period, more than 2.2 million loans and 0.4 million tangible assets were sold through auctions. In absolute amounts, UAH 17.7 billion of loans and UAH 9.8 billion of tangible assets were sold, with the highest intensity in 2018-2020.

G. LESSONS LEARNED

60. Four important lessons can be learned from the Ukrainian experience:

- i. A transparent asset sales process that ensures adequate and equal information to all interested investors builds trust between the DGF and buyers. The use of a dedicated online sales

platform improved transparency and facilitated the opening of the NPL market in Ukraine.

- ii. High transparency in the asset management and divestment process allows the DGF to explain and justify the low recovery rate on assets under management.
- iii. The flexibility provided in the DGF Law to improve assets while under the DGF's management has provided additional cash flows during the asset management process and maximized the return to insolvent banks and other stakeholders.
- iv. While the three year period set by the DGF Law to divest assets under management in a standard case is understandable, it limits the DGF's ability to maximize recovery rates on assets for two reasons: (i) it may not allow enough time to improve assets and maximize cash flows from the asset and (ii) it may encourage professional investors to run down the clock before offering low prices knowing the DGF has to sell by a certain deadline.

4

IMPORTANT ASPECTS OF ASSET MANAGEMENT AND DIVESTMENT

61. The sale of distressed assets of banks requires a structured approach to preparation and a process based on clear legal grounds. The experience of the DGFs in Serbia and Ukraine in managing distressed assets of banks demonstrate the importance of: (i) sound governance and a clear legal framework, (ii) an asset sales strategy, (iii) management and improvement of assets, (iv) independent and prudent asset valuation, and (v) a transparent and competitive asset sales process. Each of these components play an important role in the successful sale of distressed assets.

62. Beyond the cases discussed above, valuable lessons learned in terms of asset management and sale can be drawn from European AMCs. Asset transfer to an AMC is one option available to help resolve a systemic financial crisis. National authorities in Europe took different approaches to resolve stocks of distressed assets and deal with failed banks as a consequence of the GFC. Ireland, Spain, and Slovenia established asset management companies – NAMA, Sareb, and BAMC respectively – to deal with turbulence in their financial sectors. All these

companies were mandated to manage entrusted assets and divest them to return initial investments to respective authorities (most often national governments) and are therefore informative for this study. **Annex 2** provides background information on the establishment and operation of these three AMCs.

63. The creation of an AMC is not a silver bullet to resolve a financial crisis and there are many differences with DGFs. Authorities may consider the creation of an AMC as part of NPL resolution options in a systemic financial crisis, but international experience of this approach is mixed.³⁹ The establishment of an AMC requires many conditions to be met, such as systemic financial crisis, a large pool of distressed assets, adequate funding, analysis of potential impact on public finances, and good governance practices in the country, among others. An AMC is created in response to a systemic crisis as a tool to alleviate the banking system from distressed assets, this is different to the mandate of bank liquidation which is focused on higher asset recovery for the benefit of the failed bank's creditors. The purpose of this paper is not to analyze these aspects but to focus purely on the asset

³⁹ International experience shows that the risks and costs associated with establishing and operating an AMC are often underestimated, resulting in high fiscal costs. The key risks are: (i) high uncertainty around transfer pricing, (ii) high vulnerability to downside risks, (iii) high set-up costs, and (iv) operational risks (including the lack of skilled professionals, efficient NPL servicing industry, among others).

management and divestment function, that has many common characteristics for both types of entities.

64. A balanced approach may yield the best results.

To generate returns on transferred distressed assets, the bank liquidators need to ensure that all five (see para 61) of the above-mentioned components are addressed in a timely and professional manner. The failure to address any one of these components can bring suboptimal results during the asset divestment process. For example, failure to value assets prudently prior to the sale can lead to multiple failed auctions which may discourage investors from participation in the sale process as a waste of time and money (see the case of Ukraine – paras 47-52). This section builds on analysis of the experience of the DGFs in Serbia and Ukraine and AMCs in Ireland, Spain, and Slovenia to highlight key aspects relevant to agencies with bank liquidation mandates.

A. GOVERNANCE AND LEGAL FRAMEWORK

65. **Clear mandates play an important role in bank liquidation operations.** To discharge their duties, agencies responsible for bank liquidations need a clear legal framework to use optimal instruments (see more in para 72) to manage, improve, and prepare the sale of assets under management. The founding laws governing the process of asset management of failed banks need to provide a clear and unambiguous legal framework for them to operate including: (i) list of actions allowed for improvement of assets under management, (ii) time frame for asset improvement and disposal, (iii) general rules for asset valuation, (iv) potential option of new financing if this is value accretive, and (v) balanced protection against legal claims against staff, including cases of asset sale at low price (below acquisition price).

- i. **Improvement of assets and collateral perfection often bring additional value to the portfolio.** Assets transferred to bank liquidators often do not have proper information in credit files or are missing certain pieces of documentation regarding collateral. Perfection of collateral and gathering information for a complete credit file can maximize the recovery value of the asset.⁴⁰ In addition, transferred assets might be leased or rented to generate additional cash flows. For example, if assets include a commercial real estate property, the liquidator could rent it out (or hire a professional company to do this on its behalf). The legal framework needs a clear provision establishing which actions are allowed to maximize recovery value.
- ii. **A balance between maximizing additional cash flows and the ultimate sale of the asset needs to be achieved.** This will depend on the asset sale strategy and “sunset clause” of asset management operations. While it is good practice that asset management companies have a “sunset clause” for their operations to avoid “mission creep”,⁴¹ this should not result in fire sales of assets at low prices. Experience in Ukraine (see para 43) was that investors offered low prices during auctions, knowing that the DGF had to sell assets within a three-year period of acquisition. In Ireland, NAMA found that optimizing the time horizon of the asset sale⁴² provided a higher recovery value than a forced asset sale.
- iii. **Asset valuation plays a crucial role in measuring the success of asset management.** Clear rules related to asset acquisition (in the case of a “bad bank”) and prudent asset valuation are needed to measure the initial and sale values of assets. Good practice requires that asset values are reviewed after the initial transfer and real market values are recorded (even if the initial transfer was done at above market prices).⁴³ Often the agencies responsible for bank liquidation have internal

⁴⁰ The remedy of legal errors in existing loan documentation could be done in the following ways: (i) by obtaining missing documentation and permits or (ii) by ensuring access to the property.

⁴¹ Sunset clause is a termination date of asset management and divestment operations. Source: The World Bank. Public Asset Management Companies - A Toolkit. 2016. A special paragraph on page 49 discusses aspects related to sunset clauses.

⁴² Article 10 c) of the NAMA Act sets out the duty to protect, or otherwise enhance the value of entrusted assets, in the interests of the State. This meant NAMA could avoid forced sales of assets during a shallow property market. Instead, assets were managed to enhance their future disposal value, most notably by (i) working with debtors and receivers to complete unfinished projects, (ii) funding viable commercial and residential developments, and (iii) obtaining planning permissions and removing other obstacles to development. Source: The World Bank. Asset Sale Practices and Use of Electronic Debt Trading Platforms by Public Asset Management Companies and Deposit Insurance Funds. 2022.

⁴³ IMF. Managing Systemic Banking Crisis. New Lessons and Lessons Learned. No. 20/05. February 2020. (Box 10).

valuation guidelines or regulations that build on or complement international or national valuation standards.

- iv. An ability to provide additional financing to complete projects can be value accretive, with safeguards in place.** Legislators may consider allowing agencies with bank liquidation mandates, as part of their asset management function, to provide new financing to existing borrowers or projects under condition that this is value accretive on net present value terms. Additional financing to complete projects needs to be carefully assessed, with all operational and financial costs weighed against the risk appetite of the asset manager, and in full congruence with the long-term liquidation strategy. It might entail significant risks, both operational (in the absence of qualified professionals), financial (additional funding costs), and credit (increased exposure to borrowers). For example, if the DGF acquired a loan with an unfinished shopping mall as collateral, there are at least two options: (i) to keep the collateral as it is and sell the loan after some time or (ii) hire a developer, provide financing (from internal resources) to complete the shopping mall, find renters, and sell the property as a solid cash flow generating asset. Sales prices for these two options will be substantially different. However, the availability of both the financial resources and necessary professional expertise would need to be considered and the decision should favor returning financial resources to investors as soon as warranted.
- v. Protection against legal claims.** A core principle of an effective deposit insurance system is legal protection for DGF staff in the discharge of their work duties,⁴⁴ however this may not be the same for other agencies responsible for bank liquidation. The liquidator's staff should be protected from any liability arising from their decisions, actions, or omissions in good faith in the normal course of their duties.⁴⁵ This protection should be enshrined in legislation to avoid ambiguity. Without this protection, staff might be afraid of maximizing the recovery value of assets under management.

66. A conducive enabling environment, including balanced creditor rights and efficient legal enforcement systems, is essential for bank liquidation agencies to discharge their duties. Clear and effective frameworks for the transferability of claims and tax regimes play an important role.

67. The management of assets must be professional and transparent. To maximize returns, agencies with a bank liquidation mandate need professional staff capable of managing different asset classes. The operational independence of institutions, including independence of staff (management and supervisory board members and experts), is important to ensure decisions are made purely on a commercial basis without political interference or lobbying interests of certain groups. Proper governance arrangements are crucial. Professional and independent asset managers need a proper remuneration scheme in place (this is often a problem due to the status of those agencies as public entities with respective caps on compensation packages). Outsourcing of certain functions may be considered in the event of a shortage of specific skills or a better return on investment. The employees and managers of the bank liquidation agencies should be held accountable for their actions through internal and external audit reviews and appropriate reporting and disclosure.

68. The skill set of asset managers should be aligned with the structure of the asset portfolio. Legal skills dominate in the management of (i) loan and asset enforcement and (ii) borrowers in insolvency procedures. Financial skills are needed to restructure liabilities of semi-viable borrowers or prepare a financial and/or operational restructuring plan for an exposure. Real estate management skills are needed in cases of a large share of assets under management in land, commercial, and retail real estate projects. The structure of assets under management differs in each individual case depending on whether the balance sheets under liquidation are treated as "bad banks" or liquidators are mandated to manage all performing and non-performing loans of failing banks. The need for legal skills will dominate in the former case as these assets most probably consist of

⁴⁴ The DGFs reviewed in the paper had to deal with legal cases. However, specific information is confidential.

⁴⁵ International Association of Deposit Insurers (IADI). IADI Core Principles for Effective Deposit Insurance Systems. November 2014. Principle 11 – Legal protection.

loans to borrowers in financial difficulties where legal intervention is needed. Experts with these skills can be retained from the liquidated banks, hired or trained internally, or the functions outsourced.

69. An optimal caseload leads to better results. It is important to ensure a balanced workload per expert to avoid unrealistic expectations and insufficient time to properly prepare, manage, and liquidate an asset. International experience shows⁴⁶ that the optimal caseload in terms of size and complexity per expert is as follows: 5-7 large/complex cases, 10-15 medium cases, and 20-30 small cases. It is appropriate for these cases to be handled by experienced, intermediate, and junior experts accordingly.

B. ASSET SALE STRATEGY

70. A well thought through and timebound strategy of asset improvement and disposal is the backbone of successful operations of bank liquidation agencies. Based on the operational framework laid out in the founding law and thorough portfolio analysis (that often takes a lot of time) the agencies responsible for bank liquidations should prepare a strategic operational plan including targets to be achieved and resources needed to achieve them. It should aim to optimize asset management and disposal with a goal to maximize recovery of acquired assets (loans and tangible assets) with safeguards in place. Strategic plans need to include:

- i. a mix of sale, investment, or holding strategies that best fit the agency's risk appetite and its operational constraints (mandate, financial costs, lifespan, type of assets),
- ii. transparent rules of engagement with all stakeholders (including debtors and interested third parties such as NPL investors),
- iii. tools to be used in managing different segments of the asset portfolio,

- iv. principles used in asset management and disposal, and
- v. timebound milestones for asset divestment.

Plans should be updated from time to time to adjust for changes in internal (e.g., unexpected inflow or outflow of assets, use of new approaches to asset management and disposal) and external (e.g., changes in the real estate market, economic cycle, changes in legal frameworks) aspects.

71. Clear and transparent rules of engagement with relevant stakeholders contribute to successful asset management and disposal. Depending on the structure of asset portfolios, bank liquidation agencies are advised to identify key stakeholders and define principles of engagement with them. A policy related to dealing with debtors, potentially disclosed to the public, should provide clear rules of engagement which will create a level playing field. For example, the strategy could envisage working only with co-operative and viable or semi-viable debtors. To define the debt servicing capacity of retail borrowers, regulators might issue guidance on what is considered "reasonable lifestyle".⁴⁷ In addition, it could elaborate on the following aspects: (i) enforcement of personal guaranties if in place, (ii) rules for injection of new financing (i.e., creditor hierarchy), (iii) consolidation and restructuring of loans of an individual borrower or borrower's group, and (iv) use of standardized legal documents in dealing with debtors. This would be used as an input in estimating the distressed borrower's repayment capacity for the purposes of loan restructuring. Active, strategic, and transparent communication with distressed asset investors is of paramount importance to mobilize purchasing power during the asset disposal phase.

72. Bank liquidators need a wide range of available tools to use as appropriate in dealing with debtors. International experience in distressed asset resolution identifies the following tools:⁴⁸ (i) debt recovery (continued collection of loans), (ii) restructuring of loans,⁴⁹ including potential debt forgiveness (e.g., accrued interest rate or principal), (iii) debt

⁴⁶ World Bank and Bank of Slovenia. Handbook for Effective Management and Workout of MSME NPLs. March 2017. Box 1 on page 28.

⁴⁷ After the GFC, Ireland and Greece issued national regulations regarding "reasonable lifestyle", used as input in defining and calibrating debt restructuring plans for retail borrowers.

⁴⁸ The World Bank, FinSAC. COVID-19 and Non-Performing Loan Resolution in the Europe and Central Asia region. December 2020.

⁴⁹ Restructuring of loans usually includes financial restructuring of the loan. Sometimes this can be complimented with operational restructuring of the debtor's business (in cases of corporates or small & medium enterprises).

enforcement through legal procedures, (iv) insolvency of debtor, and (v) sale of assets. As a rule of thumb, (i) and (ii) could be used for viable or semi-viable cooperative debtors, and (iii) and (iv) for non-viable or non-cooperative debtors. The sale option - (v) - could be used in both cases. Depending on the structure of assets under management, the liquidators should apply the most appropriate tools. A mixture of tools can be utilized.

73. In many jurisdictions, a special group of borrowers — “strategic defaulters”⁵⁰ — warrant special attention. Often these borrowers default on payments in the hope of debt discharge or the possibility to buy back debt at a discount when the loan is auctioned during the asset sale process. In some countries this group of borrowers is relatively large. The two approaches that could be used to tackle this problem are: (i) strengthened judicial and legal systems that could be used as a credible threat⁵¹ against them and/or (ii) a new and enforced rule that a borrower or their representatives (e.g., lawyers, related parties) are prohibited from participation in the auction of that borrower’s loan(s) or assets.⁵²

74. Pre-determined principles of asset management and disposal remove ambiguity and increase transparency. Bank liquidation agencies are advised to prepare and publish the main principles of their operations. For example, the following principles could be considered:

- i. Dispose of assets in a phased and orderly manner.** In case assets under management represent a large share in real estate or distressed asset market total volume in a country, sales decisions should be carefully planned to avoid market disruptions or market price distortions due to oversupply and/or limited capacity for the market to absorb it.
- ii. Conduct sale of assets under management on a case-by-case or portfolio basis.** Depending

on demand, or for price maximization purposes, the liquidators could use two strategies in their disposal operations – individual sales or sale of asset pools. Often there is retail client demand for smaller tangible assets (e.g., vehicles, garages, land plots) and there is institutional (i.e., asset managers, funds, investors) demand for portfolios of assets with similar parameters (e.g., cash flow generating commercial or retail real estate property, mortgage loans, land for development). The liquidators can mix these approaches if they fail to sell assets under one strategy (see the case of Ukraine, para 57).

- iii. Provide additional financing to certain assets if this is commercially justified, with safeguards in place.** For example, in the case of large commercial real estate concentration in a portfolio, agencies responsible for bank liquidation can apply individual solutions to unfinished real estate projects subject to robust cost benefit analysis. Often, this could lead to a more appealing final product for investors and could generate higher recovery value on a net basis. If agencies do not have internal expertise to manage such projects, a joint venture project with a reputable real estate developer might be considered. In cases where large corporate loans are acquired and restructured with new financing, the liquidator might assign “monitoring trustees” to the corporate supervisory board to ensure the agency’s interests are represented.⁵³

- iv. Adopt an individual policy to deal with assets in other jurisdictions.** In case loans are issued or pledged collaterals are registered in other jurisdictions, the liquidator could pool these assets together and resolve them separately.

Publication of the main principles is beneficial from a transparency and accountability perspective, but the detailed procedures should be prepared and kept for internal use.

⁵⁰ Borrowers that have means to pay but choose not to pay using weaknesses in judicial systems or loopholes in legislation.

⁵¹ The portfolio manager can argue that the liquidator will initiate insolvency procedure for corporate borrowers if they do not cooperate and service their debt properly. Experience shows that this is effective only in countries with strong legal and judicial systems (Ireland).

⁵² BAMC (Slovenia) obliged all bidders in auctions to disclose their beneficial owners. Failure to do this would eliminate them from auction participation. NAMA Act, Chapter 6, para 172 stated that auction participants should sign a declaration that they are not acting on behalf of former debtors. Legal sanctions were envisaged for auction participants if this relationship was established.

⁵³ As practiced by BAMC in Slovenia, usually as part of a loan restructuring package. It took over large corporate loans and nominated “monitoring trustees” or “procurators”. They served as a link between BAMC and the debtor.

75. Consider timebound milestones for divestment of assets to allow for better internal planning and clear guidance to investors. Often, legal frameworks of AMCs include “sunset clauses” for the termination of their asset management and divestment activities. In some cases, legal frameworks prescribe timelines for asset divestment (see the case of Ukraine). Both the liquidating agency and investors benefit from short- and medium-term plans for asset sales during an institution’s life span. The aim should be for granularity in terms of time and asset classes. However, terms should be kept under review, there are examples of legal extensions (see **Annex 2**) to optimize asset disposal or due to a new inflow.

C. MANAGEMENT AND IMPROVEMENT OF ASSETS

76. The founding law should establish the main principles for asset management. There are different mandates for the bank liquidators in terms of asset management: for example, preserving value of assets (passive management); maximizing recovery value⁵⁴ (active management); or achieving at least break-even price (sales price not less than acquisition price). Founding laws should clearly set out the mandate and the liquidating agencies should build their strategies and operational plans based on this. In cases where active asset management is mandated or allowed, the agencies should ensure that they have the internal capacity to deliver. The agencies should be allowed, if warranted, to use external expertise to achieve their mandate.

77. Active asset management requires resources, delivers returns, and is a source of risk. Depending on the complexity of assets under management, active asset management might require additional resources and expertise.

- i. Servicing retail unsecured loans requires the least resources** – a call center infrastructure that nowadays could be almost fully automated.⁵⁵ Often, these services are provided by third parties, where competition is usually fierce.
- ii. Leasing and renting of property can provide additional cash flows.** In cases of repossession of movable assets (i.e., cars, equipment) the liquidators can lease these assets to the same borrower or a third party. In cases of large properties, the liquidators can rent out these assets to generate additional revenues. For example, a liquidator manages the ownership of a hotel or an office building. Renting out this property can be considered if this brings net revenue (after deducting all internal and external expenses related to these activities). The timing of these activities needs to be aligned with the asset sales strategy and any “sunset clause” in place.
- iii. While more sophisticated expertise is required to successfully provide additional financing to develop assets it can maximize the recovery value,** with safeguards in place. This might include to: (i) prepare and get permission for a new building plan to develop a land plot, (ii) develop infrastructure for existing real estate assets (e.g., roads, water, electricity), (iii) undertake renovation work (e.g., repaint, refurnish, install a fire-extinguishing system) if needed, or (iv) complete unfinished phases of building or furnishing processes. Improvements to assets, including the completion of buildings, may be financed from internal resources (e.g., proceeds from assets sold and not yet returned to beneficiaries). A cost-benefit analysis should be performed and the additional investment weighed against the company’s risk tolerance. In addition, in case DGFs are responsible for bank liquidation, they should be mindful of potential conflict of interest between DGF’s primary mandate to protect depositors and a mandate to maximize returns on assets under management.⁵⁶

⁵⁴ The maximization of recovery value should be analyzed on a net present value basis. While active asset management may add value to the final sale price of the asset, this must be considered together with the time value of money and the administrative costs associated with these activities.

⁵⁵ The main function of a call center is to reach out to retail borrowers and remind them about their existing obligations.

⁵⁶ DGF’s broader mandates, such as depositor protection, bank resolution, or development of other public policies (social protection for weak borrowers or housing, for example) may generate serious conflicts of interest and jeopardize the objective of maximizing value within the time frame.

Box 1. Development of the Dublin Docklands Strategic Development Zone by NAMA.

The Irish asset management company – NAMA – was mandated to maximize recovery of acquired loans from banks after the GFC. NAMA's focus was to protect and enhance, where possible, existing assets by working with competent and cooperative debtors to complete unfinished projects, if commercially justified. NAMA provided new financing for viable commercial and residential developments where needed. A substantial value improvement could be achieved by enhancing planning permissions and removing other impediments to real estate in development. One example of value added from planning permission management was the Dublin Docklands Strategic Development Zone (SDZ).

The Dublin Docklands territory, 22 hectares of developable land acquired as security for NPLs from the banks, received the status of a SDZ in December 2012, after active work by NAMA and other stakeholders. The planning scheme of the area was approved by respective authorities in May 2014 and then underwent major development of commercial and residential properties. The previously undeveloped territory of the North and South Docks, consisting of a kilometer-long waterfront site, was transformed into a large commercial (Grade A office and retail) and residential property space. As of the end of 2022, 99 percent of NAMA's original interests in the SDZ were sold. The remaining 1 percent related to a site in which NAMA had a leasehold interest.

Usually, the above-mentioned active asset management measures positively contribute to the final sales price of assets under management, but they are not immune to asset price cyclicality. **Box 1** provides a value accretive example from Ireland.⁵⁷ This example focuses on maximizing value, as required by law, not a full assessment of NAMA. However, active asset management is also a potential source of risk including but not limited to (i) accepting bribes or other benefits by managers and staff, (ii) granting or receiving advantages, privileges, or position to relatives, and (iii) making non-commercial decisions based on political influence. Hence, the agencies responsible for bank liquidations should ensure that governance frameworks are well established and operate smoothly.

78. Passive asset management can be justified in certain cases. In countries where the bank liquidation agencies have not played an active role in distressed asset resolution, passive asset management could be a more suitable option due

to limitations in experience and expertise. The main aim under this approach is to preserve the value of assets and dispose of them when warranted. However, this strategy should include: property services and preparation for sale in the case of foreclosed assets; and restructuring of viable and cooperative borrowers, legal action (i.e., seizure of collateral or bankruptcy proceedings), and realistic write-offs of bad debts in the case of loans. As bank liquidators often receive overvalued distressed assets (not properly provisioned) from banks, a passive approach often leads to loss recognition after the sale of assets.

D. ASSET VALUATION

79. Prudent valuation of assets is critical. Asset valuation should be done at least two times – on acquisition of assets and prior to disposal – or more

⁵⁷ Information from NAMA website and annual reports 2018-2022.

often according to local valuation frameworks, founding laws, internal guidelines, or when new market information becomes available. This can be done either by internal or external certified valuation experts. International standards provide guidance on valuation methods to be used. The liquidators are encouraged to disclose valuation methods and the value of assets under management at least once a year to improve transparency and accountability. Extensive public disclosure could help build public trust and confidence and improve accountability.

80. Valuation of assets sets a benchmark at acquisition and informs the sale price at disposal.

Prudent valuation of assets during acquisition (to determine the asset transfer price) plays an important role in setting a benchmark for bank liquidator's performance evaluation.⁵⁸ Hence, it is crucial that assets are prudently valued at acquisition and that these values should be confirmed by an independent external valuer.⁵⁹ Prudent valuation before the sale of assets is critical to succeed in the process and to avoid repeated sales attempts (often with lowering prices). Prudent valuation and recording of these values on an individual loan or asset basis will allow the bank liquidating agencies to track individual asset performance. Analysis of this information should inform future policy decisions related to asset management and sale. Local valuation frameworks or founding laws may require more frequent asset valuation – at least annually. A proportionality approach could be introduced for valuation purposes: (i) larger assets need valuation more often than smaller ones or (ii) assets above a certain threshold need valuation by external certified experts. The European Commission introduced a special term “real economic value” for the purposes of asset valuation in public AMCs as part of the state aid concept.⁶⁰

81. Different bank liquidation agencies have different valuation practices but it is important that this task is undertaken by certified professionals.

Some agencies rely on internal valuers, which is often a cheaper option but does not provide for independent views. Some agencies hire external valuation services due to the lack of internal resources and to get independent reviews. Some may use both external and internal valuations, for example the DGF of Ukraine. For a large asset valuation, asset managers may hire two independent valuers to provide valuations, for example NAMA. In addition to the international or national valuation framework applied, the liquidators often also use internal valuation guidelines or methodologies to provide for a more calibrated application of discounts and valuation methods.

82. Income and market approaches are best for valuation of distressed assets.

International valuation standards allow for three approaches in asset valuation – income, market, and cost.⁶¹ Good practice for the valuation of assets in distressed situations recommends using only the first two approaches.^{62,63} International experience shows that using the replacement cost method as a main tool can significantly overestimate collateral value in distressed conditions. Hence, preference should be given to the income approach for assets with cash flows (e.g., commercial and residential real estate, businesses, toll roads) and the market approach for assets where groups of similar assets exist (e.g., standardized apartments, land, cars) and can be used for comparison. For example, BAMC in Slovenia has an internal equity valuation methodology that uses the discounted cash flow method or enterprise value/EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization ratio), depending on enterprise size.^{64,65} A mixture of various valuation methods is supported as well.

⁵⁸ This may be complicated by information asymmetries and the need to rely on assumptions about the future value of the distressed assets. However, if the transfer price is not based on a prudent valuation of assets—which estimates real economic value and incorporates the significant costs and risks entailed—the liquidator will only serve as a mechanism to defer losses to the stakeholders, rather than minimize them.

⁵⁹ IMF. Managing Systemic Banking Crises. New Lessons and Lessons Learned. No 20/05. 2020. Pages 71-74.

⁶⁰ EC AMC Blueprint. Section 4.4. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018SC0072>

⁶¹ The World Bank. FinSAC. Collateral Valuation in the CESEE region. 2018.

⁶² IMF. Managing Systemic Banking Crises. New Lessons and Lessons Learned. No 20/05. 2020. Box 5.

⁶³ European Central Bank. Guidance to banks of NPLs. March 2017. Section 7.4. Valuation methodology.

⁶⁴ BAMC website and BAMC Annual Reports 2016-2019.

⁶⁵ The World Bank. Asset Sale Practices and Use of Electronic Debt Trading Platforms by Public Asset Management Companies and Deposit Insurance Funds. 2022.

E. ASSET SALES PROCESS

83. A well prepared and conducted asset sale process is essential to maximize recovery values.

Extensive preparatory actions should be taken to optimize the sale object and mobilize maximum interest from potential investors. This includes: (i) portfolio structuring of assets for sale, (ii) marketing of assets, and (iii) investors' access to relevant information. An advanced auction platform can play an important role in the success of the sale (see para 53 on Ukraine's experience).

84. Careful portfolio structuring of assets for sale is important. A clear vision of market demand for distressed assets will reduce the risk of the asset sale failing. Bank liquidating agencies should conduct market analysis of the demand for distressed assets and use this to plan the supply flow. This is especially important if the bank liquidating agency is a key player in the market, to avoid supply and demand shocks that may distort price maximization. For example, as it was a large market player in the Irish commercial real estate market, NAMA planned the size and structure of assets to sell in each period and communicated this to the market. Market analysis should also inform whether assets are sold on an individual basis or in pools. The DGF of Ukraine pooled unsold individual assets using two distinct parameters and auctioned them in packages (see para 57).

85. Good marketing of assets is essential. Targeted marketing of specific assets to appropriate audiences will help maximize price tension during the sale. Channels that can be used include:⁶⁶

i. Retail channel. Assets targeted to retail investors (i.e., land, houses, cars, storage places) are usually sold on an individual basis. These assets can be marketed and sold on different information platforms, including agencies' websites, servicer platforms, and interactive media.

ii. Direct channel. Direct marketing is most often used to sell complex and prime assets. The target audience for these assets are usually medium-sized investors, specialized asset managers, or developers.

iii. Institutional channel. This is reserved to service professional investors. Large and specialized portfolio buyers often prefer to buy large portfolios of assets, which needs a different marketing approach. Relationships with these investors may be nurtured over time to gain trust. In addition, marketing can be done at investor conferences or forums.

A separate budget allocated specifically for marketing of assets for sale usually leads to better results during the divestment process.

86. Detailed information about the asset for sale is critical for price maximization. Investors need to know all critical aspects about the asset for sale (e.g., information about the borrower, loan servicing patterns, collateral, and potential guarantees)⁶⁷ to offer the best possible price. Anything that is unknown or undisclosed could result in an investor pricing at maximum risk, meaning a lower offer price. Hence, the bank liquidating agencies should strive to disclose as much information as warranted to mitigate perceived risks from investors' side. During the first years of operations, asset managers often fail to provide adequate and detailed information on assets for sale but it improves over time. Detailed information should be provided to investors only after a non-disclosure agreement between institutions has been signed. After signing this agreement, investors will get access to the data tape, where detailed information about the asset is provided.

87. Electronic auction platforms provide a convenient way to sell assets. While direct sales to one or targeted investors can be done using a sealed-envelope principle or another convenient method, assets are often sold on auction platforms.⁶⁸ These

⁶⁶ A similar marketing strategy was used by Sareb in Spain.

⁶⁷ For example, the European Banking Authority issued updated NPL templates (December 2022) to guide banks on information needed to deepen the NPL market. The templates include 129 data points – out of which 69 data points are mandatory. Different data points are mandatory for retail and corporate loans and depending on whether loans are secured or not.

⁶⁸ Examples of largest auction platforms around the world: Debitos, NPLMarkets, DebtX, First Financial Network, Credantial, Debexpert, Bidx1.

platforms can be internally or externally managed. External platforms often provide services in addition to auctions, such as due diligence, transaction advisory, data extraction and normalization, document imaging, valuation of assets, marketing, virtual data rooms, and reporting. A 2022 World Bank study⁶⁹ on online distressed asset trading platforms showed that only two asset management companies and DGFs

(Korea and Ukraine) out of eight⁷⁰ surveyed used electronic debt trading platforms for asset sales. The Ukraine DGF successfully used a state-owned platform Prozorro.Sale to divest most of its assets (see para 53). In 2017, Sareb launched a new internal online distressed asset sales platform, but it was terminated soon afterwards due to lack of trading volume.

⁶⁹ The World Bank. Asset Sale Practices and Use of Electronic Debt Trading Platforms by Public Asset Management Companies and Deposit Insurance Funds. 2022.

⁷⁰ Countries included in the survey – Korea, Ireland, Thailand, Philippines, Japan, Ukraine, Spain, Slovenia.

5

KEY RECOMMENDATIONS FOR AGENCIES RESPONSIBLE FOR BANK LIQUIDATION

85. The following key recommendations are suggested for regulators and legislators of bank liquidators, as well as the bank liquidating agencies themselves, to optimize the distressed asset management and sales process:

1. Sound governance practices and clear legal frameworks are key to the successful operation of a bank liquidation agency.
2. Comprehensive asset management and sales strategies, updated from time to time, provide a clear roadmap for actions. Synchronization of these strategies with national NPL reduction strategies can bring better results.
3. Active asset management and improvement of assets with proper governance frameworks and safeguards in place help to maximize returns.
4. A clearly defined, prudent, and transparent asset valuation policy helps to optimize the sales process.
5. Transparency and high competition in the sales process maximizes a successful outcome. Online sales platforms have proved to be an efficient channel to sell distressed assets.
6. Good marketing can broaden the investor base.
7. Detailed information on assets for sale can minimize “price gap”.
8. A balance should be sought between the proper improvement of assets and their sale within envisaged deadlines.
9. A pilot sales project is a good starting point for less experienced bank liquidating agencies.
10. Packaging assets into large pools can maximize recovery values of very seasoned or poorly collateralized distressed assets.

ANNEX 1.

OVERVIEW OF BANK RESOLUTION AND LIQUIDATION FRAMEWORKS IN CESEE⁷¹

Many CESEE countries⁷² have introduced or amended their bank resolution frameworks in the period since the GFC. These frameworks are usually centered around two pillars: (i) Financial Stability Board Key Attributes,⁷³ and (ii) European Union (EU) bank resolution rules.⁷⁴ However, each national framework is tailored to local specifics and there are significant differences among them. **Figure 5** provides more detailed information on bank resolution frameworks in certain CESEE countries.

Central banks lead on bank resolution in most CESEE countries. This function is complementary to the financial sector supervision mandate assigned to the central bank. However, there are some exceptions: (i) the Banking Supervision Agencies⁷⁵ are the resolution agencies in Bosnia and Herzegovina, (ii) DGFs are the resolution agencies in Poland and Ukraine, and (iii)

in Serbia, the court appoints the DGF as liquidator/ bankruptcy administrator. A detailed analysis of these frameworks is provided in FinSAC's policy note "A harmonized framework for [Sm]All bank resolution in FinSAC client countries".

Bank liquidation frameworks⁷⁶ differ among countries. Legal proceedings are based on administrative procedures in many countries. Often the central bank, as resolution authority, has control of the liquidation process and leads the appointment of the liquidator (Albania; Moldova; Georgia). Some countries have a mixed court and administrative-based process (Armenia) or have court-based bank liquidation regimes (Bulgaria, Croatia, Romania, North Macedonia). In Ukraine, administrative procedures are used by the DGF as a responsible authority.

Figure 5. Bank resolution and liquidation frameworks in certain CESEE countries (January 2023)

Country	Resolution authority	Liquidation framework
FinSAC EU countries		
Bulgaria	Central bank (CB)	Court-based, free-standing
Croatia	Central bank	Court-based, modified insolvency

⁷¹ FinSAC's policy note "A harmonized framework for [Sm]All bank resolution in FinSAC client countries", on a harmonized resolution framework for big and small banks is used as input for this chapter.

⁷² For the purposes of this study, countries are assigned to one of three groups – FinSAC EU countries, FinSAC EU aligned countries, and FinSAC other countries.

⁷³ Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions, October 2014.

⁷⁴ EU, Bank Recovery and Resolution Directive (BRRD).

⁷⁵ The Banking Agency of the Federation of Bosnia and Herzegovina (FBA) and the Banking Agency of Republika Srpska (BARS).

⁷⁶ The two main parameters in these frameworks are (i) insolvency regimes and (ii) lead institutions in proceedings procedures. Insolvency regimes can be divided into two categories: (i) free-standing insolvency regimes, where the bank insolvency regime is regulated by a separate act compared to a general insolvency framework and (ii) modified regimes, where the general insolvency framework is applied to banks with specific modifications. Legal proceedings can be done either by (i) an administrative authority, without the court's involvement or (ii) the court, where proceedings are led by a liquidator who is a court officer.

Country	Resolution authority	Liquidation framework
Romania	Central bank	Court-based, modified insolvency
FinSAC EU aligned countries		
Albania	Central bank	Administrative (CB appoints and controls liquidator)
BiH	Banking Supervision Agencies	Administrative (Supervisory Agencies appoints and controls liquidator)
Moldova	Central bank	Administrative (CB appoints liquidator)
Montenegro	Central bank	Administrative (CB appoints liquidator)
Serbia	Central bank	Court based (court appoints DGF as liquidator/ bankruptcy administrator)
FinSAC other countries		
Armenia	Not formally identified	Court-based (upon CB referral)
Georgia	Central bank	Administrative (CB appoints liquidator)
Kosovo	Not formally identified	Not formally identified
North Macedonia	Not formally identified	Court-based (CB proposes to appoint liquidator)
Ukraine	DGF	Administrative (DGF)

ANNEX 2.

ASSET MANAGEMENT AND DIVESTMENT BY NAMA, SAREB, AND BAMC⁷⁷

A. ASSET SALES BY THE IRISH NATIONAL ASSET MANAGEMENT AGENCY

NAMA was established to deal with problem loans in Ireland after the GFC. It was established by the NAMA Act⁷⁸ in 2009, to address a serious threat to the economy and preserve financial stability in the system. The Act provided the legal framework for (i) asset acquisition, management, and sale, and (ii) the enhancement, protection, and valuation of assets. It gave certain powers in respect of land or an interest in acquired land, including powers related to the development of land. The Act allowed NAMA to take necessary steps to protect, enhance, and better realize the value of assets transferred to it.⁷⁹

NAMA acquired assets from five Irish banks at a substantial discount. By the end of 2011, NAMA acquired assets from five participating Irish banks in the amount of EUR 74 billion, consisting of loans to 800 debtors.⁸⁰ In exchange for these asset transfers, it paid EUR 31.8 billion consideration to the participating banks: EUR 30.2 billion in the form of senior bonds guaranteed by the Irish State and EUR 1.6 billion in subordinated bonds. NAMA acquired these assets at a discount of 57 percent at a portfolio level. 61 percent of acquired assets were from Ireland, 32 percent from

the UK and Northern Ireland, and 7 percent from the USA and Europe.

The valuation of acquired assets was based on the long-term economic value of the loan. According to NAMA's 2010 Annual Report, the asset transfer was done at the long-term economic value of the loan, which was determined by the NAMA Act and the Valuation Regulations.⁸¹ This method allowed correction of the current market value using a long-term economic adjustment component.⁸² NAMA's definition is very close to the real economic value definition⁸³ introduced by the European Commission to address the state-aid issue within the EU in the aftermath of the GFC.

The assets transferred and managed by NAMA were mostly commercial real estate. The loans that were transferred to NAMA were mostly secured by assets concentrated in the commercial real estate and land for development sectors. This was unlike the two European AMCs discussed below, whose assets were more diversified and included, among others, a substantial part of smaller residential real estate (Sareb) and SME loans (BAMC). From this perspective, the portfolio of assets acquired gave NAMA an advantage as it could apply a more focused strategy. The structure of the EUR 21.5 billion property value (in 2010) that secured transferred loans⁸⁴ is shown in **Figure 6**.

⁷⁷ Annex 2 builds on the World Bank technical note "Lessons learned from European AMCs for asset sale in Kazakhstan". March 2020.

⁷⁸ <http://www.irishstatutebook.ie/eli/2009/act/34/enacted/en/pdf>

⁷⁹ NAMA Act, Article 1, para 11.

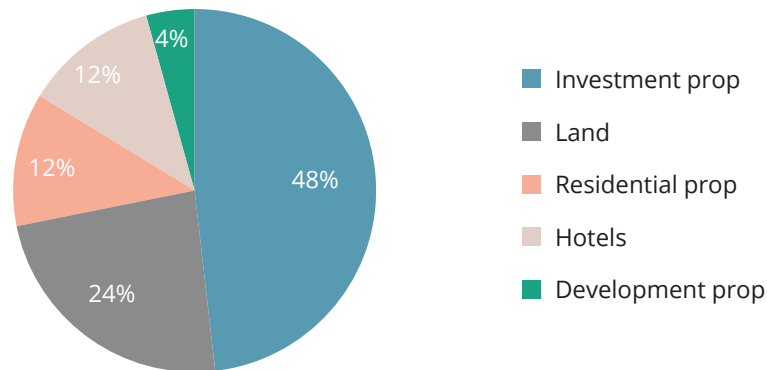
⁸⁰ NAMA 2010 Annual Report and results presentation. <https://www.nama.ie/uploads/documents/NAMA2010AnnualResultsPresentationByCEO.pdf>

⁸¹ NAMA 2010 Annual Report (page 17).

⁸² NAMA Act, Part 5 – Valuation methodology, para 72.

⁸³ Non-Performing Loans and State Aid Rules. July 2017. European Commission, DG COMP. <https://european-economy.eu/2017-1/non-performing-loans-and-state-aid-rules/>

⁸⁴ NAMA 2010 Annual Report.

Figure 6. Property type (in %)

One of NAMA's tasks was to protect and enhance the value of assets. Article 10 c) of the NAMA Act defines its role to protect or otherwise enhance the value of entrusted assets in the interests of the state. This enabled NAMA to avoid forced sales of Irish assets during the shallow property market in Ireland in 2010-2013, after the GFC. Instead, the focus was on asset management to enhance the future disposal value of Irish assets, most notably by (i) working with debtors and receivers to complete unfinished projects, (ii) funding viable commercial and residential developments, and (iii) enhancing planning permissions and removing other obstacles to development.

The NAMA Act allowed for new financing to acquired borrowers. NAMA was able to provide additional funds, typically debt, to cooperative and competent borrowers⁸⁵ whose loans were transferred to NAMA. This capital injection was meant to maximize the ultimate sales value in the future. Most non-enforced NAMA debtors had financial monitors in place, which enabled effective reporting of debtors. NAMA required that this financial monitoring was provided by an adviser,⁸⁶ independent of the debtor. Often, NAMA was a minority shareholder in commercial real estate development projects, playing a passive role.

B. ASSET SALES BY THE SPANISH ASSET MANAGEMENT COMPANY

Sareb was established to deal with problem loans in Spain after the GFC.⁸⁷ Royal Decree-Law 9/2012 of November 14, 2012, provided the legal basis to found Sareb. The Law entrusted the Fund for Orderly Bank Restructuring (FROB) to create an AMC to help clean up the Spanish financial system from excessive exposures to the real estate sector. This was one of the preconditions for the country to receive financial aid from international donors.

Private shareholders owned majority shares of Sareb. Sareb's shareholding structure was different from NAMA and BAMC, which were fully government-owned companies. The majority shareholders of Sareb were private investors, with a 55 percent share of capital, and the state owned 45 percent through the FROB.

Sareb acquired assets worth close to EUR 51 billion. According to the legal framework, Sareb acquired close to 200,000 loans valued at EUR 50,8 billion. These assets were purchased at an average 55 percent discount⁸⁸ (EUR 107 billion nominal). **Figure 7**

⁸⁵ Good developers and strong managers that NAMA trusted to maximize return on its assets.

⁸⁶ Typically audit and property advisory companies. Service fees varied but typically EUR 15,000-20,000 a month for a large debtor (above EUR 50 million asset value), or EUR 1,000-2,000 a month for a small debtor covered by the borrower. This is a similar arrangement to the one the European Commission DG COMP uses to monitor state aid in the banking sector.

⁸⁷ Information from Sareb's website.

⁸⁸ The acquisition price was determined by the Bank of Spain (central bank). Source: Sareb Annual Report 2013.

Figure 7. Discounts for acquired assets by SAREB

Asset	Discount
Developer loans	
Completed housing	32.4%
Projects under construction	40.3%
Urban land	53.6%
Other land	56.6%
Other guarantee	33.8%
No guarantee	67.6%
Real estate assets	
New building housing	54.2%
Projects under construction	63.2%
Land	79.5%

provides more details on the average individual asset discounts. 78 percent of these assets were developer loans and 22 percent were real estate assets (finished and unfinished residential and ancillary properties, e.g., storage units, parking lots). Developer loans were secured by close to 400,000 properties. Assets were transferred from nine distressed Spanish banks to clean their balance sheets from non-viable assets. Most exposures were with companies.

The legal framework envisaged divestment of assets over a period of 15 years. Sareb was tasked to optimize the value of assets under management in order to repay debt guaranteed by the Spanish state. To achieve this goal, Sareb pursued an active asset management strategy to maintain and increase the value of its assets.

C. ASSET SALES BY THE BANK ASSETS MANAGEMENT COMPANY IN SLOVENIA

BAMC was established in March 2013 to deal with financial instability in Slovenia. BAMC was fully owned by the Republic of Slovenia and its main task was to facilitate the restructuring of banks with systemic importance that were facing severe solvency and liquidity problems in the aftermath of GFC. Its statutory framework was established by the December 2012 Law “On the Actions of the Republic of Slovenia for Strengthening Bank Stability”.⁸⁹

BAMC acquired problem loans from six banks in Slovenia. In 2013, BAMC acquired problem loans from two systemically important banks⁹⁰ worth EUR 1,008 million at the price of 27 percent and 37 percent of the gross exposure.⁹¹ Acquired assets were almost exclusively in the form of loans from corporates (including SMEs, micro enterprises, and sole entrepreneurs) with a very small amount of equity. In 2014, additional problem loans from (i) two large banks⁹² worth EUR 550 million (at the price of 48 percent of the gross exposure)⁹³ and (ii) two small banks worth EUR 40 million, were purchased.

Acquired loans were collateralized by various collateral types. The total amount of 1.617 units of real estate pledged as collateral against the transferred loans were scattered among different real estate types, primarily in the industrial and undeveloped land sectors. **Figure 8** provides further information on this distribution. The wide range of real estate collaterals made the asset management process more complicated than in NAMA where assets were more homogeneous.

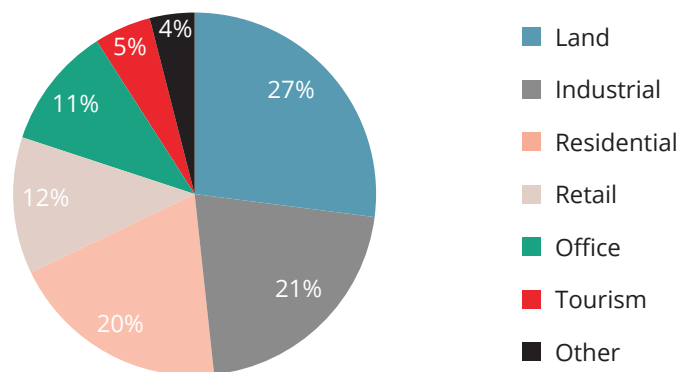
⁸⁹ Published in Official Gazette of the Republic of Slovenia, No. 105/12 of 27 December 2012.

⁹⁰ NLB and NKBM.

⁹¹ BAMC Annual Report 2013.

⁹² Abanka and Banka Celje.

⁹³ BAMC Annual Report 2014.

Figure 8. Number of collateral real estate by type

BAMC was set to operate for only five years but its lifespan was extended. The statutory framework established in 2012 envisaged a five-year period of operations. This “sunset” clause was meant to deal with NPLs quickly and close the fund to avoid “mission creep”.⁹⁴ However, the poor market situation, lengthy asset management process, and the aim to maximize returns to the state led to an extension of the fund’s lifespan till the end of 2022.⁹⁵

BAMC pursued an active asset management strategy. While BAMC’s initial task was to facilitate the restructuring of banks with systemic importance, it was mandated to maximize returns to the State. To pursue this, BAMC (i) implemented a proactive, cooperative, and holistic approach to the restructuring of companies, (ii) actively managed assets, and (iii) handled its assets to maximize the exit price.⁹⁶

⁹⁴ The gradual addition of new tasks or activities to a project so that the original purpose or idea is diluted.

⁹⁵ Amendments and supplements to the Law “On the Actions of the Republic of Slovenia for Strengthening Bank Stability, approved on 18 December 2015.

⁹⁶ BAMC Business Strategy 2019-2022.

