

THE CREDIBILITY OF BANKS: BALANCE SHEETS, GOVERNANCE AND LAW

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WHAT HAPPENED SINCE THE CRISIS TEN YEARS AGO?

- Bank regulation has improved – but has become extraordinary cumbersome
- Bank supervision has improved – at least where the SSM is involved
- Bank balance sheets have improved – but not everywhere and not at all as quickly as desired
- Bank governance – boards and management – shows a split picture
- Bank law and (in particular) bankruptcy law is still lagging behind

WHY IS A BALANCE SHEET FULL WITH NPLS SO BAD?

- It keeps the bank management and board busy with the past
- It prevents the bank from new lending
- Most important; it prevents necessary restructuring of corporates. These corporates need financial and sometimes operational restructuring before they can develop their business.
- The NPL issue must be fixed. Not for the shareholders to be happy, but for the economy to prosper

Clean balance sheets in banks are required to make the economy recover

WHY ARE THE BALANCE SHEETS NOT CLEAN EVERYWHERE AFTER 10 YEARS?

- Selling NPLs creates a hole in the balance sheet (because they are not correctly valued)
- Showing the hole correctly will make the bank insolvent (or at least unable to fill the legal capital requirements)
- There is not enough equity available to fill the hole. The state has (so far) not been allowed to provide support due to state aid regulations – even if it had the money

So the banks muddle through, solving the NPL issue slowly as they can afford it. And domestic economic recovery is correspondingly delayed

WHAT SHOULD IDEALLY BE DONE?

- Best is to create an independent Asset Management Company (AMC) and transfer the NPLs there. But this will show the hole and require capital. And bank management seldom likes it
- Second best is to create an independent AMC department within the bank and employ necessary restructuring expertise
- Worst is to let the ordinary bank staff handle the bad assets which they once participated in creating. And this is the way it is usually done.

The most efficient way to handle the NPLs is seldom used.

WHAT SHOULD BE DONE TO IMPROVE BANK GOVERNANCE?

- All systemic banks need boards with recognized financial competence
- There must be international board participation to create credibility
- There must be an established selection process to guarantee independence of board members
- Conflicts of interest must be clearly recognized in the selection process
- Boards must provide necessary ethical rules (a policy) and supervise that it penetrates the bank.

THE LEGAL STRUCTURE IS OFTEN LAGGING

- Can banks sell NPLs to non-banks domestically and to foreign buyers?
- How long time does it take for a bank to get final access to collateral?
- Are there working out-of-court procedures?
- Are there established proceedings for auctions?
- Etc...

A QUESTION FOR EACH SEE COUNTRY

- Have bank balance sheets, bank governance and the relevant legal structure improved sufficiently to make banks credible institutions during the next recession – which is not necessarily a crisis?