

ESRB SECOND ANNUAL CONFERENCE

DEALING WITH NPL IN EUROPE

Aristóbulo de Juan

President of Aristóbulo de Juan y Asociados, S.L.

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SELF INTRODUCTION

- THANK YOU TO THE ORGANIZERS FOR HAVING INVITED ME TO PARTICIPATE IN WHAT I EXPECT TO BE A CANDID DEBATE.
- AS SUGGESTED BY STEFAN INGVESS TO ME, HERE IS A BRIEF SELFINTRODUCTION.

AFTER 12 YEARS HOLDING SENIOR POSITIONS IN COMMERCIAL BANKING, I HAVE DEVOTED 40 YEARS TO WORK HANDS-ON IN PROBLEM BANKS IN 4 CONTINENTS.

THIS INCLUDES 4 YEARS AS THE FOUNDER AND CEO OF THE "SPANISH FDIC" (BOTH AN INSURANCE MECHANISM AND A "BAD BANK"), 5 YEARS WITH THE BANK OF SPAIN (AS HEAD OF BANKING SUPERVISION), DEALING WITH OVER CASUALTIES DURING THE CRISIS OF THE 80'S.

LATER ON, I SPENT 3 YEARS AS AN ADVISOR TO THE WORLD BANK ON BANKING REFORM AND 28 YEARS IN MY CONSULTING PRACTICE IN MADRID, WHERE I MEAN TO DIE WITH MY BOOTS ON.

THE TOPIC OF NPLS, 10 YEARS LATER

1. THE TOPIC IS GOOD NEWS. THE CRUCIAL PROBLEM OF NPL WILL NOW BE ADDRESSED AGAIN

BUT IT IS ALSO BAD NEWS. IN FACT, THE LEGACY OF NPL IS STILL A SERIOUS PROBLEM IN A LARGE NUMBER OF SIGNIFICANT BANKS. PARADOXICALLY, AFTER 10 YEARS OF CRISIS AND REMEDIAL REGULATION, MANY BANKS HAVE A HEAVY BURDEN OF NPLS BUT THEY SHOW A SATISFACTORY LEVEL OF REGULATORY CAPITAL IN THEIR BOOKS. I WOULD DARE SAY THAT SOMETHING LEAVES TO BE DESIRED

2. OF COURSE, MANY REGULATORY EFFORTS HAVE BEEN DONE DURING THESE YEARS AND ARE PRAISEWORTHY. BUT, WHEN ADDRESSING THE FUTURE WITH A FORWARD LOOKING APPROACH, WE MUST TRY TO LEARN LESSONS FROM EXPERIENCE

AN UNQUESTIONABLE FACT AND QUESTIONABLE IMPRESSIONS, THE BACKBONE OF THIS PAPER

3. LET ME STRESS A MOST RELEVANT BUT OFTEN DISREGARDED FACT: THE UNPROVISIONED PART OF NP ASSETS DOES NOT PROVIDE ANY YIELD. IT DOES NOT PERFORM. IT IS AS TRUISM. BUT, MIND YOU, THE LIABILITIES THAT SUPPORT THOSE ASSETS

INVOLVE BOTH A COST AND A CASH OUTFLOW. IN OTHER WORDS, THE NET CONSEQUENCE INVOLVES A CURRENT LOSS AND A WORSENING OF LIQUIDITY. THE BANK SUFFERS AN IMPACT, DAY AFTER DAY.

4. SIMULTANEOUSLY WITH THIS PROCESS, IT CAN BE OBSERVED THAT INTERNATIONAL REGULATORS HAVE THUS FAR FOCUSED STRONGLY ON CAPITAL, WHICH IS GOOD. ON THE OTHER HAND, PREVENTIVE MEDICINE TO REDUCE THE NUMBER OR SIZE OF CRISES, HAS NOT BEEN PAID THE SAME ATTENTION AND IS PENDING EFFECTIVE SOLUTIONS. STRONG FOCUS HAS BEEN PUT ON HOW TO PAY THE BURIAL, BUT NOT TO PREVENT BURIALS.

5. ONE MUST RECOGNIZE THAT BUILDING UP A COMMON REGULATORY FRAMEWORK AND COMMON SUPERVISORY PRACTICES IS VERY DIFFICULT AND TIME CONSUMING. BUT YOU SOMETIMES HAVE THE IMPRESSION THAT STRICT REGULATION AND SUPERVISION IS SOFTENED BY THE EUROPEAN AUTHORITIES FOR THE SAKE OF A HYPOTHETICAL STABILITY OF THE FINANCIAL SYSTEM OR THE ECONOMY.

PERHAPS DREAMING OF A HYPOTHETICAL “BEAUTIFUL NORMALITY”. IN THIS RESPECT, THE IDEA MAY ALSO BE THAT MONETARY EXPANSION WOULD HELP. BUT THE FUTURE MAY PROVE NOT BE “BEAUTIFUL” OR “NORMAL”. THE POLICY I HAVE DESCRIBED WOULD BE TANTAMOUNT TO THINKING: “WE DO MEAN TO IMPROVE THINGS, BUT... NOT YET”.

6. IN FACT, CURRENT STABILITY IS VERY VULNERABLE. LET US SEE WE NOW HAVE EXCESS LIQUIDITY, WHICH MAKES BANKERS LOOSE THE SENSE OF RISK AND LEADS TO BUBBLES (AS DEBT, YIELD...). ADDITIONALLY WE HAVE MR. TRUMP AND THE AMERICAN THREAT OF DEREGULATION THAT MAY PROVE CONTAGIOUS IN EUROPE AND OTHER AREAS. DOES THIS RING A BELL? PERHAPS 2007? ADDITIONALLY WE HAVE THE PENDING PROBLEM OF SYSTEMIC NPL AND SERIOUS GEOPOLITICAL INSTABILITY IN A NUMBER OF STRATEGIC FRONTS.

THEREFORE, I FIRMLY BELIEVE THAT PROBLEMS IN THE FINANCIAL SYSTEM SHOULD BE ADDRESSED HEAD-ON AND THOROUGHLY AS THEY APPEAR, WITHOUT BEING AFRAID OF POTENTIAL CONSEQUENCES. OTHERWISE, SITTING ON THE FENCE MAY LEAD TO A MORE SERIOUS CRISIS. SOONER RATHER THAN LATER.

A SUPPORTING BACKGROUND FOR MY SUGGESTIONS ON NPLS

I WILL NOW LIST A SERIES OF RULES OF THUMB OR PRACTICAL REMINDERS, WHICH ARE OFTEN DISREGARDED BY A NUMBER OF SUPERVISORS.

ON ASSETS

7. PROBLEM BANKS SISTEMATICALLY HIDE THEIR PROBLEMS, THUS LEADING TO UNRELIABLE INFORMATION ON THE BOOKS.

THIS MAY ALSO HAPPEN WITH SYSTEMIC BANKS, WHOSE COMPLEXITY AND POWER MAY MAKE STRONG SUPERVISION DIFFICULT.

THEREFORE, ANY REGULATION ON CAPITAL OR ASSET QUALITY, WHEN BASED ON “UNVERIFIED” INFORMATION PROVIDED BY BANKS IS MOST LIKELY TO PROVE INEFFECTIVE OR MISLEADING. IF BASED ON UNVERIFIED INFORMATION, OFF-SITE ANALYSIS, AUDIT, REPORTS, MODELS, STRESS TESTS, RWA EVALUATION AND EVEN COMPLIANCE WITH CAPITAL REQUIREMENTS MAY ALSO PROVE UNRELIABLE.

8. IF UNVERIFIED, THE WORST LOANS (BY SIZE AND RISK) ARE OFTEN DISGUISED AS GOOD ONES, MOST OF THE TIMES THROUGH LOAN RESTRUCTURING. SO, THE WORST LOANS WILL NOT BE RECORDED AS BAD. AS A RESULT, THE HIDDEN LOSSES WILL NOT HAVE A SPECIFIC COVERAGE. RESULTS AND CAPITAL ON THE BOOKS WILL BE FICTITIOUS

9. THAT IS WHY THE KEY TO PRUDENTIAL SUPERVISION IS RELIABLE ASSET EVALUATION.

10. IN MY EXPERIENCE, FOR ASSETS EVALUATION TO PROVE REALISTIC, IT SHOULD BE PERFORMED BY MEANS OF ON-SITE CASE-BY-CASE INSPECTION, AIMED AT RECORDING THE MARKET VALUE OF FORECLOSURES AND THE ESTIMATED VALUE OF LOANS BASED ON THE REPAYMENT CAPACITY OF THE BORROWERS. THIS SHOULD BE DONE BEYOND THE FORMAL SITUATION OF THE LOANS “ARREARS” OR “INCURRED”, WHICH CAN BE EASILY MANIPULATED.

11. THE SPECIFIC LEVEL OF PROVISIONS AS WELL AS SUSPENSION OF UNPAID INTEREST AS INCOME SHOULD BE IMPOSED PROMPTLY, IN SPITE OF MANAGEMENT RESISTANCE. THIS IS TO BE EMPHASIZED, BECAUSE IT SO HAPPENS THAT PROVISIONS AND ACCRUAL SUSPENSION ARE THE ENEMY OF DIVIDENDS, EMOLUMENTS AND BONUSES FOR TOP MANAGEMENT, EXTRAVAGANT EXPENDITURE AND MANAGEMENT POWER, BOTH FINANCIAL AND SOCIAL, AN IMPORTANT REASON WHY PROVISIONS ARE AVOIDED BY BAD BANKERS

12. THEREFORE, PROPER PROVISIONS AND SUSPENSION OF UNPAID ACCRUALS AS INCOME, WHEN TIMELY IMPOSED BY SUPERVISORS, ON A CASE-BY-CASE BASIS, PROVES THE MOST EFFECTIVE PREVENTIVE MEDICINE. THE SNOW BALL OF HIDDEN LOSSES WILL STOP ACCUMULATING. GRADUAL REMEDIAL ACTION BY MANAGEMENT AND SUPERVISORS WHEN PROBLEMS ARE IDENTIFIED (RATHER THAN ACCUMULATING HIDDEN LOSSES) WILL PROVE VERY EFFECTIVE AND WILL REDUCE THE NUMBER AND DEPTH OF CRISES.

13. THE BLAME OF UNADDRESSED NPASSETS OR NPLS IS OF COURSE TO BE PUT ON MANAGEMENT, WHO ARE PRIMARILY RESPONSIBLE TO THEIR STOKHOLDERS AND TO THE MARKET. BUT ALSO ON REGULATORS AND SUPERVISORS. IT IS A MATTER OF POLITICAL WILL.

ON CAPITAL

14. AS REGARDS CAPITAL, I WILL STATE UPFRONT THAT REAL CAPITAL IS NOT CAPITAL AS PER BOOKS. REAL CAPITAL IS CAPITAL AS PER BOOKS MINUS INSUFFICIENT PENDING PROVISIONS AND MINUS RESERVES THAT WERE RECORDED BUT RETAINED FROM FICTITIOUS INCOME

15. THE REALITY OF CAPITAL IS ALSO AFFECTED BY THE POOR QUALITY OF SOME OF THE COMPONENTS OF REGULATORY CAPITAL THAT LACK RED BLOOD CELLS. LET US THINK OF COCOS, A LIABILITY, AS LONG AS THE ISSUER DOES NOT FAIL. IT IS ALSO A VERY EXPENSIVE LIABILITY, WHICH CONSTITUTES AN INCENTIVE FOR HIGH RISK LENDING IN TIMES WHEN ROA IS GENERALLY STAGNATED. ALSO GOOD WILL AND DTA ARE MORE THAN QUESTIONABLE AS CAPITAL WITH LOSS ABSORTION CAPACITY

16. CAPITAL SHOULD BE ADSCRIBED TO COVER "UNKNOWN UNKNOWNNS" IF THEY APPEAR IN THE FUTURE. IF NEW CAPITAL IS USED TO COVER CURRENT LOSSES, IT IS NOT REGULATORY CAPITAL. CAPITAL SHOULD BE CLEAN

17. ALSO, ISSUING NEW CAPITAL WHEN A BANK HAS A NEGATIVE NETWORKH, WITHOUT MAKING THE SITUATION TRANSPARENT TO POTENTIAL SUBSCRIBERS, IS A DECEITFUL MALPRACTICE. REMEMBER THE FAMOUS PRINCIPLE: "DO NOT PUT GOOD MONEY ON BAD MONEY"

OTHER SUPERVISORY TOOLS

18. A "FORWARD LOOKING" APPROACH, AS IS NOW THE PREVAILING MOTTO, IS WELCOME. BUT IT SHOULD NEVER REPLACE ON SITE SUPERVISION OF QUALITY. SUPERVISORS SHOULD ALWAYS GIVE PRIORITY TO THE PRESENT.

19. STRENGTHENING GOVERNANCE AS A SUPERVISORY TOOL, SHOULD ALSO BE WELCOME, BUT SHOULD NOT REPLACE INSPECTION. BECAUSE GOVERNANCE IS A FLUID CONCEPT, VERY DIFFICULT TO CONTROL AND WILL NEED A GRADUAL CHANGE OF CULTURE OVERALL. SO, IT WILL ONLY BE ACHIEVED IN THE LONG TERM.

PARADOXICALLY, SUPERVISORS' FORBEARANCE OR TOLERATING LAX PRACTICES, PARTICULARLY IN ASSET EVALUATION, AS OFTEN HAPPENS, WOULD INVOLVE COSMETICS AND PROVE A CONTRADICTION IN TERMS WITH GOOD GOVERNANCE. EFFECTIVE SHORT TERM TOOLS ARE INDISPENSABLE

LIQUIDITY SUPPORT AS A TOOL

20. DEPOSIT RUNS MAY APPEAR SUDDENLY, WHEN LACK OF MARKET CONFIDENCE OR A SPECIAL EVENT TRIGGERS PANIC. IT THUS ADDING TO THE IMPACT OF DECAPITALIZATION.

UNFORTUNATELY, IT OFTEN HAPPENS THAT IT IS ONLY THEN THAT SUPERVISORS STEP IN. TOO LATE AND TOO EXPENSIVE.

21. TREATING DECAPITALIZATION OR INSOLVENCY JUST WITH BORROWING OR LIQUIDITY SUPPORT, IN WHATEVER MODALITY, WILL NOT “REFILL THE HOLE”. BORROWED LIQUIDITY HAS TO BE REPAYED. AS SIMPLE AS THAT. WE SHOULD REMEMBER THAT LENDING OF LAST RESORT HAS TRADITIONALLY BEEN SHORT TERM AND COSTLY, AS AN INCENTIVE FOR CORRECTIVE ACTION BY BOTH MANAGERS AND SUPERVISORS.

22. ON THE CONTRARY, MASSIVE LIQUIDITY SUPPLIED BY CENTRAL BANKS AT ENDLESS TERMS AND AT LOW OR NO INTEREST RATES, IN AN ATTEMPT TO ENHANCE INFLATION, ECONOMIC RECOVERY AND TO IMPROVE NON RECURRENT BANK RESULTS, MAY PROVE EFFECTIVE FOR A WHILE. BUT, IF PERPETUATED, THE SIDE EFFECTS OF SUCH MONETARY EXPANSION INVOLVE SERIOUS RISKS. FOR EXAMPLE: CHANGES IN THE BANKING BUSINESS MODELS, STAGNATION OF RETURN ON ASSETS (ROA), BUBBLES AND MORAL HAZARD LEADING BANKS TO OVEREXTENSION AND HIGH RISK. THIS POLICY WOULD THEN PROVE TO BE A “FALSE FRIEND”.

23. ANY FINANCIAL ENGINEERING MECHANISM, INCLUDING “BAD BANKS”, SHOULD BE AVOIDED IF:

IT FAVOURS THE BANKERS WHO CAUSED OR PRESIDED OVER THE PROBLEMS.

IT INVOLVES COSMETICS TO OVERVALUE THE ASSETS IN THE BOOKS (IN ORDER TO SHOW A HEALTHY PICTURE TO THE MARKET), BETS ON PROMPT OR UNREALISTIC RECOVERY OF THE PRICE OF BAD ASSETS. SUCH EXPECTATION MAY NEVER MATERIALIZE AND LACK OF PERFORMANCE OF NPASSETS, AS WELL AS MAINTENACE AND MARKETING OR SERVICING COSTS MAY MAKE IT A RISKY AND COSTLY OPTION.

ALSO, FOR “BAD BANKS” TO BE EFFECTIVE, THEY SHOULD BUY BAD ASSETS AT MARKET PRICE. OF COURSE, THE UNPROVISIONED LOSS WILL THEN MATERIALIZE IN THE “CLEANED UP” BANK AND SHOULD BE AUTOMATICALLY CHARGED ON RESERVES. IF PRICE IS SET ABOVE MARKET, THE LOSS OR PART THEREOF WILL BE INCURRED BY THE BAD BANK AND WILL ALSO HAVE TO BE PROMPTLY COVERED.

SUGGESTED MECHANISM

24. OF COURSE I WOULD NOT EXCLUDE OTHER MECHANISMS TO SOLVE THE NPASSETS OR NPLS PROBLEM, BUT IT SO HAPPENS THAT A NUMBER OF MECHANISMS NOW IN PLACE PROVED ARTIFICIAL AND INEFFECTIVE.

25. WHY NPLS AND NPASSETS ARE NOT LIQUIDATED AND REMAIN AS A BURDEN IN QUITE A NUMBER OF EUROPEAN BANKS AND COUNTRIES? MOST OF THE TIMES BECAUSE THEY ARE NOT PROPERLY PROVISIONED AND THEIR SALE WOULD MATERIALIZE

LOSSES. ALSO, EXCESS LIQUIDITY ON THE MARKET DISCOURAGES LIQUIDATION. BUT THERE IS ALWAYS A MARKET. AT A PRICE.

26. THEREFORE, THE BEST WAY TO FACILITATE THE PROMPT LIQUIDATION OF NPLS AND NPASSETS, IS TO HAVE THEM VALUED IN THE BOOKS AT RECOVERY VALUE OR MARKET PRICE, RESPECTIVELY, SO THAT THEIR SALE WILL NOT MATERIALIZE ANY NEW LOSS.

27. HOW TO PROCEED? A SPECIAL TURN OF THE SCREW MAY BE NEEDED. IN THE AREAS OF BOTH REGULATION AND SUPERVISION. FOR MANY, IFRS-9 IS GREAT PROGRESS AND THERE IS NO NEED FOR MORE TIGHTENING UP. BUT I DO NOT SHARE THAT VIEW, BECAUSE THE NEW PANACEA, THE CONCEPT OF “EXPECTED LOSSES” (AFTER THE INERTIA OF MORE THAN A DECADE OF ENPHASIS ON “INCURRED” LOSSES), IS QUALIFIED WITH NUMEROUS CAVEATS, THAT MAY BE SUBJECT TO RESTRICTIVE INTERPRETATION. ALSO, IT WRONGLY MAINTAINS INCOME RECOGNITION OF UNPAID INTEREST. ONE OF THE WORSE ENEMIES OF FINANCIAL SUPERVISION. AS CALIBRATED BY SOME REPUTED SPECIALISTS, PROGRESS COULD PROBABLY BE REDUCED TO MINIMAL PROPORTIONS, IF ANY. THE TURN OF THE SCREW SHOULD THEN APPLY TO A STRICTER TREATMENT OF EXPECTED LOSSES AND TO SUPERVISORY PRACTICES. IN MY PERCEPTION NEW STANDARDS FOR FINANCIAL REPORTING SHOULD BE ISSUED SHORTLY.

28. AS A PART OF THE TURN OF THE SCREW, REGULATIONS ON NPASSETS SHOULD MAKE IT MANDATORY FOR THEM TO BE

BOOOKED AT MARKET VALUE. THAT IS, THEY SHOULD BE PROPERLY PROVISIONED AS SOON AS POTENTIAL LOSS IS IDENTIFIED. IF THINGS ARE GETTING BETTER, A PHASE-IN PERIOD COULD BE ESTABLISHED TO CUSHION THE IMPACT. LET US REMEMBER THAT IFRS 5 ESTABLISHED A LIMIT OF 1 YEAR (WHICH WAS UNEVENLY OR POORLY APPLIED) TO LIQUIDATE BAD FIXED ASSETS. IN NO CASE SHOULD THE DEADLINE EXCEED A MAXIMUM OF 2 YEARS

29. ALSO, UNPAID AND UNPAYABLE ACCRUALS WILL HAVE TO BE MANDATORILY SUSPENDED, RATHER THAN UNDULY RECOGNIZED AS INCOME IN THE P & L. THIS SUSPENSION SHOULD BE APPLIED TO THE TOTAL PRINCIPAL AND NOT ONLY TO THE NONPROVISIONED PART OF THE LOANS. HOW COME? WHEN A LOAN IS BAD, THE BORROWER IS NOT REALLY PAYING INTEREST, WHICH INSTEAD IS OFTEN REFINANCED BY THE VERY LENDER.

30. MODELS GROUPING LOANS OR ASSETS BY ECONOMIC SECTORS OR PRODUCTS SHOULD NOT BE TRUSTED. PRECISELY IF DESIGNED BY THE BAD BORROWER AND NOT VERIFIED AND PROPERLY QUANTIFIED, THEY ARE NOT RELIABLE. ALL THE MORE SO WHEN THOSE MODELS ARE THE BASIS OF THEORETICAL STRESS TESTS

31. THE REQUIRED PERCENTAGE OF PROVISIONS SHOULD BE APPLIED OVER THE WHOLE DURATION OF THE LOAN, NOT OVER A CONVENTIONAL SHORT PERIOD OR TO THE DISCOUNTED PRESENT VALUE OF THE ASSET. IN OTHER WORDS, THE BOOKS

SHOULD RECORD THE WHOLE LOSS TO BE INCURRED IF THE ASSET WAS LIQUIDATED RIGHT AT THE TIME THE INSPECTION TOOK PLACE

BRIEF DEBATE ON INSPECTION, PROVISIONS AND CAPITAL

32. PROPER PROVISIONING AND SUSPENSION OF ACCRUALS WOULD POSSIBLY REQUIRE RESUSCITATING ON-SITE CASE BY CASE INSPECTION, THAT SHOULD AIM AT QUANTIFICATION OF INCURRED OR EXPECTED LOSSES, LAST AS LONG AS NECESSARY AND SHOULD NOT LIMIT THEMSELVES TO MATTERS OF PROCEDURE.

33. THIS KIND OF SUPERVISION SOUNDS TO MANY AS A STONE AGE TOOL. IN FACT, IT COULD BE ARGUED THAT THIS KIND OF INSPECTION IS MORE CUMBERSOME. HOWEVER, TRADITIONAL SAMPLING MECHANISMS SHOULD BE USED FOR THE LESS THAN MAJOR ASSETS, IN ORDER TO MAKE THE TASK LESS CUMBERSOME. ALSO, RECORDS OF MANY CRISES AND THE AMERICAN EXPERIENCE PROVE THAT THIS KIND OF SUPERVISION IS MORE EFFECTIVE THAN THE ALTERNATIVE MECHANISMS THAT HAVE BEEN RECENTLY PUT IN PLACE.

34. IT COULD ALSO BE ARGUED THAT THIS KIND OF INSPECTION REQUIRES A HIGH NUMBER OF STAFF AND IS VERY COSTLY. BUT HISTORY SAYS THAT NO SUPERVISION OR LIGHT INSPECTION PROVES MUCH MORE COSTLY, AT THE END OF THE DAY.

35. IT COULD ALSO BE SAID THAT LOSSES COULD BE OVERESTIMATED BY SUPERVISORS. BUT EVEN IF THAT HAPPENED, THEY COULD ALSO BE RECOVERED LATER AND WILL THEN BE CREDITED ON THE P&L, AS MISCELLANEOUS INCOME. ANYHOW, IT IS LESS RISKY TO OVERESTIMATE LOSSES THAN TO UNDERESTIMATE THEM
36. IT IS ALSO CLAIMED THAT COVERING POTENTIAL LOSSES WITH CAPITAL, RATHER THAN WITH PROVISIONS, IS SAFER, BECAUSE PROVISIONS CAN BE LATER MANIPULATED BY BAD BANKERS. BUT THIS IS NOT NECESSARILY TRUE: MANIPULATION CAN BE PREVENTED BY AD-HOC SUPERVISION, ADDITIONALLY, CAPITAL CAN BE MANIPULATED AS WELL. THINK OF THE PART OF CAPITAL THAT IS BASED ON RWA, WHICH IS OFTEN MANIPULATED. BEAR ALSO IN MIND THAT SOME CAPITAL SUSCRIPTIONS ARE PARTLY FINANCED BY THE ISSUING INSTITUTION.
37. ANOTHER ARGUMENT IN FAVOUR OF SPECIFIC PROVISIONS IS THE FACT THAT THEY ARE MORE TRANSPARENT AND LEAD TO A PROPER AND TIMELY SUSPENSION OF FICTITIOUS ACCRUALS. CAPITAL DOES NOT. IN FACT, CAPITAL CAN NOT BE INCREASED EVERY YEAR OR GRADUALLY. IT MAY THUS PROVE UNTIMELY OR LATE. ALSO THE MARKET WILL FIND IT QUEER.
38. A KEY ASPECT TO BE UNDERLINED. IF YOU COVER CURRENT LOSSES WITH CAPITAL, RATHER THAN REDUCING PROFITS THROUGH PROPER PROVISIONING, YOU ARE FOSTERING THE BAD BANKERS' MORAL HAZARD. THEY MAY CONTINUE TO PAY

UNDUE TAXES AND DIVIDENDS, CONTINUE TO MAKE BAD LOANS OR RESTRUCTURING THEM TO HIDE LOSSES. ALSO MANAGEMENT SALARIES AND BONUSES, WILL NOT BE ADJUSTED AND EXTRAVAGANT EXPENDITURES AND FINANCIAL AND SOCIAL INFLUENCE WILL CONTINUE TO REMAIN IN PLACE.

39. NOW, A CRUCIAL FEATURE OF THE MECHANISM I PROPOSE: WHEN THOSE LOSSES ARE CURRENT THE PROVISION ESTABLISHED FOR ASSET LOSSES SHOULD BE CHARGED AGAINST P&L. THIS ALLOWS FOR AN INSTANT AWARENESS THAT THE BANK IS DETERIORATING WHEN IT IS TIME. THIS WILL FAVOUR A POSITIVE REACTION: MANAGEMENT- AND SUPERVISORS - WOULD BE LEAD TO GEAR REVERSE IN PLACEMENTS AND TRANSPARENCY AND/OR APPLY CORRECTIVE ACTION.

40. ADDITIONALLY, GRADUAL COVERAGE OF LOSSES WILL PREVENT BIG LOSSES FROM APPEARING SUDDENLY. THEY ARE NEVER INCURRED SUDDENLY. RATHER, THEY GROW GRADUALLY OVER TIME. SO, THEY SHOULD BE CAPTURED AND TREATED AS SOON AS IDENTIFIED. I.E.: WHEN IT IS TIME FOR PROPER REACTION AND PREVENTIVE MEDICINE.

41. IF LOSSES HAVE BEEN MADE IN THE PAST BUT ARE BELATEDLY UNVEILED SUDDENLY, THEY SHOULD BE CHARGED ON RESERVES AND CAPITAL. BUT IF REGULATORY CAPITAL THEN FALLS BELOW THE PRESCRIBED LEVELS, RECAPITALIZATION SHOULD BE PROMPTLY DEMANDED BY THE SUPERVISOR.

42. TO SUM UP, I BELIEVE THE IDEAS I HAVE AIRED HERE WILL MAKE THE LIQUIDATION OF NPLS AND NPASSETS IN GENERAL, EASIER AND SPEDITIOUS AT ANY TIME IF BOOKED AT MARKET -OR CLOSE TO MARKET- VALUE. AS STATED BEFORE, THERE IS OFTEN A MARKET AT A PRICE. THEN, LIQUIDATION WILL NOT TRIGGER ANY NEW LOSS IN THE BOOKS. OR PRACTICALL SO. INSTEAD, THE PROBLEM BANK WILL FINALLY BE CLEANED UP,

QUESTION MARKS

43.GIVING PRIORITY TO TIME OVER ILLUSORY EXPECTATIONS OF SOLID AND QUICK RECOVERY IS ESSENTIAL. EVEN IF THIS LEAD TO MATERIALIZE THE LOSS, THE BANK WOULD BECOME MORE LIQUID AND WOULD MORE EASILY RETURN TO A NORMAL LIFE.

44.IT IS TRUE THAT MY OPTION MAY UNVEIL THE FAILURE OF SOME INSTITUTIONS. THE QUESTION WILL THEN BE RAISED: WHO SHOULD PAY THE BILL AND IN WHAT PROPORTIONS: SHAREHOLDERS?, CREDITORS?, THE INDUSTRY? GOVERNMENTS?

45.UNFORTUNATELY, OTHER OPTIONS MAY FACE THE SAME PROBLEM WHEN BASED ON IMAGINATIVE ACCOUNTING AND ON UNREALISTIC EXPECTATIONS OF QUICK PRICE RECOVERY. AT THE END OF THE DAY, THE HIDDEN "HOLE" WILL COME TO SURFACE AND WILL ALSO HAVE TO BE REFILLED. "A HOLE IS A HOLE" WORSE: THE HOLE WILL PROVE TO BE DEEPER AND EVEN

WORSE: THE BANK IN QUESTION MAY HAVE BECOME A VIABLE BUT VULNERABLE ONE.

46. NOW COMES THE DEVIL'S ADVOCATE: WHO WERE THE MOST SUCCESSFUL SUPERVISORS IN GETTING THEIR SYSTEMS BACK TO NORMAL AND IN RECOVERING THE FUNDS THEY PUT IN THE RESCUE OPERATIONS? THOSE WHO ACTED UPFRONT AND INJECTED GOVERNMENT AND INDUSTRY MONEY. PERHAPS RECAPITALIZATION & RESOLUTION RULES, -PROBABLY STILL INMATURE- MAY HAVE TO BE REVISITED.

47. **A CONCLUDING QUOTE:** AS GENERAL MC ARTHUR USED TO SAY, "THE CAUSE OF ALL DEFEATS CAN BE SUMMARIZED IN TWO WORDS: TOO LATE"