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Are bad banks good?

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The European Commission recently issued a guide for countries wishing to be able to create bad banks for the purpose of managing their banks' impaired assets, whether loans or repossessed assets. A bad bank is a public or private sector entity that acquires these assets, at a significant discount, and has an extended period in which to liquidate them by means of recoveries or sales. Impaired assets are like a snowball that grows as it rolls down a snowy mountain. The bad banks take that snowball, remove it from the slope and put it in the sun to thaw.

Bad banks have significant advantages, for example management improves if it is centralised and specialised, investors interested in the assets have a single point of contact, and time is gained in liquidating them. This last point makes it possible for assets to be sold at better points in the economic cycle, at better prices. From the point of view of the banks, the bad bank is one of the fastest means of cleaning up their balance sheets and being able to focus on their real function, which is lending. However, the steep discounts at which the assets are acquired mean that the impact on their financials is highly negative.

It might seem that nearly six years after Spain's bad bank SAREB was established is rather late to be creating new bad banks. However, the situation of European countries is very uneven. NPL rates in countries such as Greece (47%), Portugal (17%) and Italy (12%) are way above the European average (4%) or even that of Spain (4.8%).

The new bad banks must comply with the European regulations now in force. These include rules on state aid, if any, but also the Bank Recovery and Resolution Directive in the event that solvency or liquidity problems arise in the banks as a result of the transfer of the assets.

The fact that the proposed creation of a mandatory single bad bank for the whole of Europe has been ruled out for now is a positive development. There are countries such as Spain that have already made significant efforts to reduce NPLs (including a bad bank), so different realities cannot be treated in the same way. But this does not alter the fact that in parallel with this reduction of risks inherited from the crisis we must move forward towards a system for sharing future risks in Europe, in particular by means of a common deposit guarantee fund. To abandon that objective would be to abandon what the Banking Union has already achieved.

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