

# Are bad banks good?

El País (Spain)

Ana Rubio

26 Mar 2018

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.

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance. This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.