HOW ASSET MANAGEMENT COMPANY WILL ENHANCE BANK LENDING IN NIGERIA

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INTRODUCTION

Since 2007, banks and other financial services institutions in most parts of the world have witnessed the worst of times. The global financial crisis that reared its ugly head and culminated in global economic meltdown could be attributed to the subprime mortgages issues in America. Due to the impact of globalization and the effect of interconnectivity in financial and economic affairs, the crisis spread like wild fire to the most economically active parts of the world. Today, almost 50 per cent of over 8,000 banks/financial institutions in the US have failed. Governments of the US, Britain and most of Europe resorted to the utilization of tax payers' money to bail out some banks and other companies that were considered very strategic so as to avoid the collapse of their economies because, "they are too big to fail". Consequently, stimulus packages, under various terms and conditions, were structured to bail out the ailing institutions, most of them banks and manufacturing companies. This is to sustain the commanding heights of their economies and avoid their collapse with the possible accompanying pains in unemployment and socio-political upheaval..

Generally, the basic challenge for the banking industry is the management of risk assets, its major "stock in trade". Once a bank's risk asset is impaired, it has significant implications for its going concern status. First, it erodes the bank's capital base and put its capital adequacy in jeopardy. Much more significant is that it curtails its operational capability because it would not be able to lend and thereby constraints its revenue generation. This may lead to illiquidity, which if not properly managed, may end up in insolvency and liquidation.

A major vehicle that has been designed to assist banks to ease the burden of nonperforming loans is the establishment of Asset Management Company (AMC).

ASSET MANAGEMENT COMPANY AND HOW IT WORKS

An AMC is a special vehicle usually created to acquire, manage and dispose impaired banks' risk assets. An AMC is normally established as one of the major outcomes of the policy frameworks to achieve financial restructuring needed for long term soundness and sustainability of the banking system. It is meant to deal with banks asset quality problems by purchasing the bad loans (assets) of the banks and provide them with cash to enable them promptly resume their roles of lending and general financial intermediation. It is therefore usually a fallout of a country's banking crisis occasioned by high level of nonperforming loans. In view of its peculiarity, and AMC is always a creation of the law, with special enablement. AMC is thus an interventionist strategy and it can be publicly or privately owned or a centralized or a bank – based model.

In the wake of the Asian economic crises of the late 1990s, most of the Asian countries resorted to the establishment of AMC to assist in taking off the burden of nonperforming loans from the banks so that they can have needed liquidity and resume on their traditional role of lending and intermediation. It is interesting to note that the level of nonperforming loans were then at their zenith. For example, the level of nonperforming loans to total loans was 43 per cent in Thailand in 1998; In South Korea, several banks closed while India nationalized a huge proportion of its financial system within a spate of 3 to 4 years to save them from total collapse with its attendant agony and complications. Korea, Malaysia, Thailand and Indonesia are some Asian countries that established AMC during the Asian financial market crises. China and America had also had the need to do so at various times.

Creating or establishing an AMC has numerous benefits. These benefits are plausible justifications for their emergence in an economy whose banking system is bedeviled or almost bedeviled with systemic distress. It is interesting to note that, perhaps the most significant of all these is the fact that, a bank is able to have access to liquidity made available through the purchase of the loans and the assets. The most significant is the opportunity it gives to banks to remove bad loans from their books and make a clean, fresh start in their core calling of financial intermediation. It also assists in freeing up tied capital by the mere fact that it removes much of the bad debts from the books of the banks thereby putting a stop or bringing a reprieve to the debt overhang in the banking system. Another very important benefit is the fact that with the establishment of an AMC, it helps preserve the economic value of the assets in question. In an atmosphere of distress and illiquidity, the tendency is always high for the affected banks to dispose precious or valuable assets at their forced sales value to enhance cash inflows to abate illiquidity. However, once these assets have been purchased by the AMC, they can be sold when their due or economic value will be realized. This further assists to prevent price distortions on those assets or market. Good examples are the real estate or mortgaged assets and stocks (shares).

There are various models of AMCs; some are publicly owned and are therefore government funded while in some countries, privately funded AMCs are encouraged. For effect, the centralized model is always supported for emerging markets. In an atmosphere of systemic or near – systemic distress, the centralized model is more acceptable. It is also reasonable to adopt the centralized model in an environment of weak legal structure so that special legislation can be enacted to establish, empower and override certain inhibitive existing legislations. The law gives special powers that enables an AMC to resolve the non performing loan in an effective and timely manner and allows it to carry out its duties outside the normal legal tangle or cobweb especially issues relating to bankruptcy, contract, property laws. As such, AMC will accelerate the disposal of certain loans and assets which would ordinarily be problematic if there were to be no centralized AMC or a special legislation.

An AMC takes over the nonperforming loans at either the book value or at a fair value. The price or value at which the assets are taken is a matter of policy and business models of the company. Each of these has implications and consequences for both the banks and the asset management company. It is sufficient to note that assets purchase pricing can and do have enormous impact on speed of assets transfers, the banks' financial statement, loss allocation and subsequent recapitalization programs.

Since AMCs are typically problem-resolution vehicles, they are in most cases in existence for prescribed time. The life of an AMC must be determined from the outset and it must be realistic to deal with assets under it; not too long to make it sit on assets for considerable lengthy period of time and not too short to enable it do a meaningful exercise.

MAKING THE AMC WORK IN NIGERIA

Following the Central Bank's special and target examination of banks, we have seen that the action assisted in pre-empting what could have resolved into banking crisis, systemic failure and loss of confidence in the banking system. But part of the fallout from that exercise and subsequent events are the huge level of non performing loans that confirmed the erosion of the capital base of quite a number of the banks. The results released so far by the universal banks showed over a trillion naira in classified assets. Clearly, their lending capacity has been impaired and the economy is clearly to suffer from it. The situation had necessitated stimulus package which has been efficiently handled by the Central Bank.

There is no doubt that there is the need to establish a centralized AMC in Nigeria. The quantum of non-performing loans already disclosed by the various banks is material enough to warrant a special vehicle that can take this problem off their neck and redirect them to the path of provisioning of core banking services. Imagine the banks having the opportunity to have over a trillion naira injected into it in form of purchase of the bad assets by an AMC. It will significantly enhance the capacity of the banks to lend again with implication for production, wealth creation and employment generation. Thus as is customary, the AMC will assist the banks to regain the capacity for financial intermediation, help achieve greater economic stability, solve the debt overhang in the financial system and assist in stabilizing the capital and property markets.

Much more, the existing legal framework will not be adequate to enable individual financial institution to record much progress in recovery activities. We are all witnesses to the slow recovery achieved even with the support of the Economic and Financial crime Commission (EFCC), which in itself is a distraction for the anti – graft agency. A central institution like an AMC is better equipped to handle this.

There are a number of issues to address to make this happen. The starting point is to articulate the objectives for which the AMC is being set up. This becomes imperative so that the company does not become a jack of all trades. It should be seen to have clear mandate and focus so that it is not bedeviled with pursuing non core activities and also to make it easy to measure its performance. Furthermore, it is imperative for the enabling legislation to be enacted that will empower the AMC to function effectively without being curtailed and encumbered by litigations and injunctions. Meanwhile, AMC requires special skills and competencies and the Central bank should quickly begin to identify such personnel and provide the necessary training and competencies.

The Central bank will also have to begin to work on the structure and processes that will enable the AMC achieve efficiency. For instance, there must be provisions that will not make the AMC to become a dumping ground for all sorts of non performing loans that do not have potential value or backed up by valuable security e.g. shares or property. The underlying quality of the asset transferred will undoubtedly affect the speed and ease of resolution and the recovery performance of the company. It should not become a "junkyard" for unsecured loans and worthless assets.

Very importantly, the AMC should have a structure that does not encourage banks to perpetuate reckless lending. Moral hazard can come from the behavior of borrowers and banks if non performing loans are adopted by AMC at little or no cost. This is very important as AMC is normally supported by public funds. Hence, the AMC should make it impossible to transfer bad assets to it.

The funding of an AMC can also impact its efficiency, independence and achievement. An AMC can be funded directly by the government through appropriation or indirectly through the Central Bank. Where the government funds, it then implies that public funds is being utilized to solve bank restructuring who are wholly private enterprises. Where it is not, the company may be underfunded and therefore unable to carry out its core mandate. In some cases, AMC are encouraged to raise funds through bonds which may then be guaranteed by the government. The more effective means of funding an AMC should be direct government funding through appropriate budgeting.

The level of independence has a lot to do with the success of an AMC. The company should be insulated from political and other interference especially in determining which assets to take over and at what cost. It should also be able to dispose assets without interference and manipulation.