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## ***Selected Observations Regarding the Resolution of Troubled Loans In Japan***

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## ***The exact level of distressed loans and the resulting economic impact are issues of debate but:***

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- The level of loans identified by banks as requiring “special attention” is very large with some borrowers near or in bankruptcy
  - Experience has shown that bankers (and sometimes regulators) tend to take an overly optimistic view of such loans
- Efforts should focus on resolving the problem, not measuring exact size
  - Weak loans deteriorate when the financial sector is under stress
  - The burden of weak loans distract bank funds and management from promoting business development and economic growth
- The issue to debate is not the size of loan problems but how best to solve them

## ***Some argue that taking action now will be unnecessarily painful while others argue that doing nothing will only make matters worse and cause more pain***

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- Inaction will not improve matters and action may result in some painful restructuring in some quarters:
  - Some bank creditors may need to absorb more losses
  - Some owners may have to sell their business to new capital
  - Some companies may fail or downsize business operations
  - Some employees may lose their jobs
  
- On the other hand there can be some positives:
  - Restructured companies will be more healthy
  - New companies will have better access to funding
  - Restructuring process will bring many new employment opportunities

## ***Resolving Japan's Distressed Loans will require the joint efforts of Government and Private Sector Experts***

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- Government can serve as the catalyst to encourage the resolution of troubled loans but the process is very labor intensive
  - The effort requires a lot of private sector and government expertise
  - For every one RTC employee, another 10 were hired as contractors
- Government must provide the incentives to attract and develop the expertise needed in both the public and private sector
- RCC needs in-house experts but should rely heavily on outsourcing and joint venturing with private sector firms to resolve distressed loans
  - Using the private sector will create many new careers and job opportunities
  - The government can work with private sector experts to develop standards and procedures manuals to guide employees and contractors
  - Relying on private sector will allow for a more rapid and efficient mobilization of human resources in both the ramp-up and wind-down phase

## ***The Government has proposed giving banks several years to reduce loan problems to acceptable levels***

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- Bank actions over the next several years can have a major impact on the eventual budget cost, economic impact and the overall probability of success
- The government should be involved in bank efforts and progress
  - Encourage banks to develop a more rapid timetable for phasing down troubled loan exposure
  - Encourage banks to adopt a systematic approach for prioritizing loans for resolution
  - Require banks to develop specific resolution plans for high priority loans
  - Monitor bank progress in meeting plan objectives
  - Act quickly if bank's efforts are not achieving plan objectives
    - Adjust plans or replace management as appropriate
- The Government should provide performance based incentives to resolve loans or release them to RCC
  - Incentives might include regulatory forbearance for achieving targets and prompt corrective enforcement action
  - Time-based pricing incentives might be provided to encourage prompt sale of problem assets to RCC to minimize asset deterioration
    - Provided incentives do not increase RCC carrying value above market value

## ***Banks must act promptly to allocate their limited resources to high priority loans***

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- Prioritization factors to consider include:
  - The size of the loans and commitments
  - The status of business operations
  - The volume of business sales
  - The importance of customers served
  - The number of employees
- Banks must determine whether loans are to a good business with too much debt or a bad business with too few prospects.
  - The former might be saved with loan compromises and debt equity swaps
- Banks should develop detailed action plans for each high priority loan as well as groups of loans

## ***Some Recommendations For RCC Operations and Oversight***

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- Ensure independent governance and operations with:
  - Executives of recognized expertise, Integrity and Independence
  - Procedures to prohibit undue political interference in specific transactions
  - Attractive compensation packages to attract qualified staff
  - Provisions for adequate operational and asset acquisition funding
  - A published and enforced code of ethics for employees and contractors
- Establish clear policies to govern RCC operations including:
  - Pricing and Valuation of loans acquired from banks
    - RCC values must be market based, regardless of price paid banks
  - Objectives and priorities for acquired loans
    - Time limits for disposing of asset inventory
    - Strict limits on any RCC funding intended to enhance value
- Strongly encourage outsourcing and partnering with private sector to provide:
  - Increased market expertise and staffing flexibility as assets change

***RCC and banks will need to sell many assets, including restructured loans, but such efforts are constrained by high transactions costs that limit competition, lower prices, and increase criticism.***

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**SELLERS encounter obstacles when trying:**

- To attract broad investor interest and funding
- To develop standardized and transparent sales procedures
- To optimize the size and characteristics of sales transactions

**Potential BUYERS lack understanding or confidence about:**

- Availability of global opportunities
- Consistency and reliability of asset information
- Customs, laws, and practices of a selling country
- Fairness and transparency of the sales process
- Magnitude of potential due diligence cost burden

**A better solution is available for selling many assets  
that will increase market depth and efficiency!**



## ***When a decision is made to sell an asset, the Internet can significantly improve the traditional sales process***

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### ■ **By increasing market depth and efficiency:**

Greater market reach and enhanced due diligence capabilities will attract the critical mass of foreign and domestic buyers needed to achieve fair value prices as well as lower effective transaction costs

### ■ **By strengthening public confidence and support:**

Increased transparency and greater capacity for buyer participation will strengthen public acceptance of the fairness of the sales process and the prices received

## ***The Internet can dramatically improve the traditional process for offering certain loans and other assets for sale by:***

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### **Increasing the number of investors:**

- through direct marketing and one stop shopping
- through providing for more transaction options and smaller asset pools

### **Reducing transaction and other costs:**

- through advanced technology for due diligence
- through electronic bidding and transaction closing capability

### **Increasing the scope of information available to buyers:**

- through expanded due diligence access that minimizes disruption
- through increased awareness of a broad range of key service providers

## ***The Internet using a high technology platform can provide:***

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- A secure environment that provides the level of confidentiality desired by sellers
- An advanced information database that allows sellers to more effectively manage their asset inventory and sales process
- An improved and less costly way for sellers to reach strategic investors about sales opportunities
- An improved and less costly tool for investors to evaluate and price investment opportunities

## ***The United States Government has endorsed using the Internet to sell illiquid assets but Japan can set the global standards.***

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During the financial crisis in the United States during the 1980s and early 1990s, the Resolution Trust Corporation set the standards for securitizing and selling illiquid assets.

Many US based consultants have exported this process that continues to grow in popularity. Securitization has grown in popularity worldwide – including Japan.

The FDIC and several other US government agencies have begun using the Internet to sell distressed and illiquid loans with favorable results. The number of investors and prices have increased. However, the approach is fragmented and lacks standards. The process is even less developed in Japan and elsewhere.

Japan, the World's second largest economy, is in first place when it comes to troubled loans. Japan can be the catalyst and set the global standards for listing and selling illiquid assets over the Internet.

More uniform processes and standards will allow other nations to sell assets in a platform that further increase market efficiency.

Japan can become to Internet sales of illiquid assets what the RTC was to securitized sales of illiquid assets.