

# **Banking sector consolidation in a post-communist economy - the case from the Czech Republic**

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# Why this topic?

- According to the theory, the banking sector provides basic functions (heart and lungs) of the economy

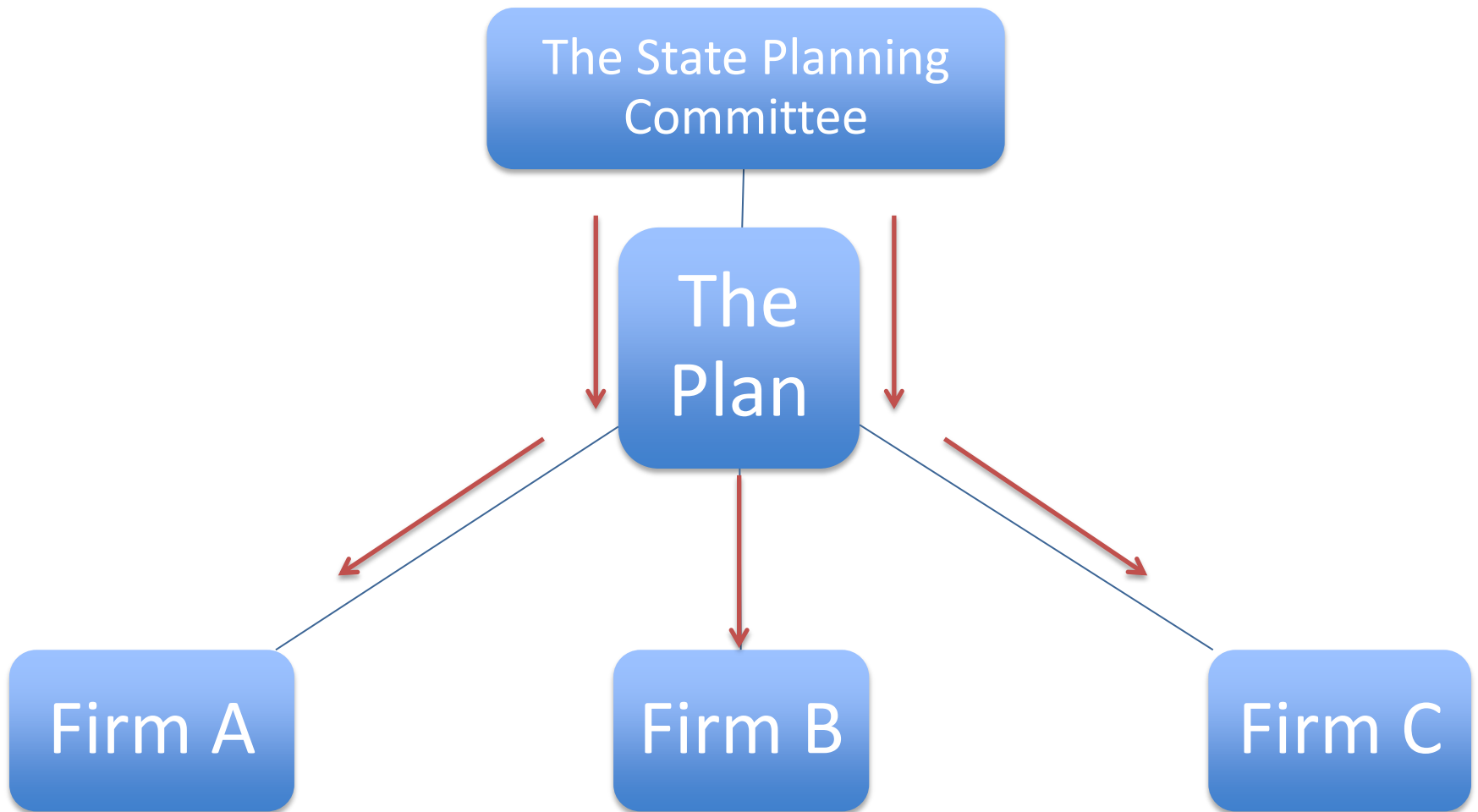
**No market economy can operate without stable, healthy and trustworthy banking sector**

- All post-soviet countries have shared similar conditions after the fall of central-planning systems
- However, not all of them have consolidated their banking sectors in the same (or similar) way
- Looking back, the Czech case brings several important conclusions, that are important, interesting and also applicable on various state interventions nowadays

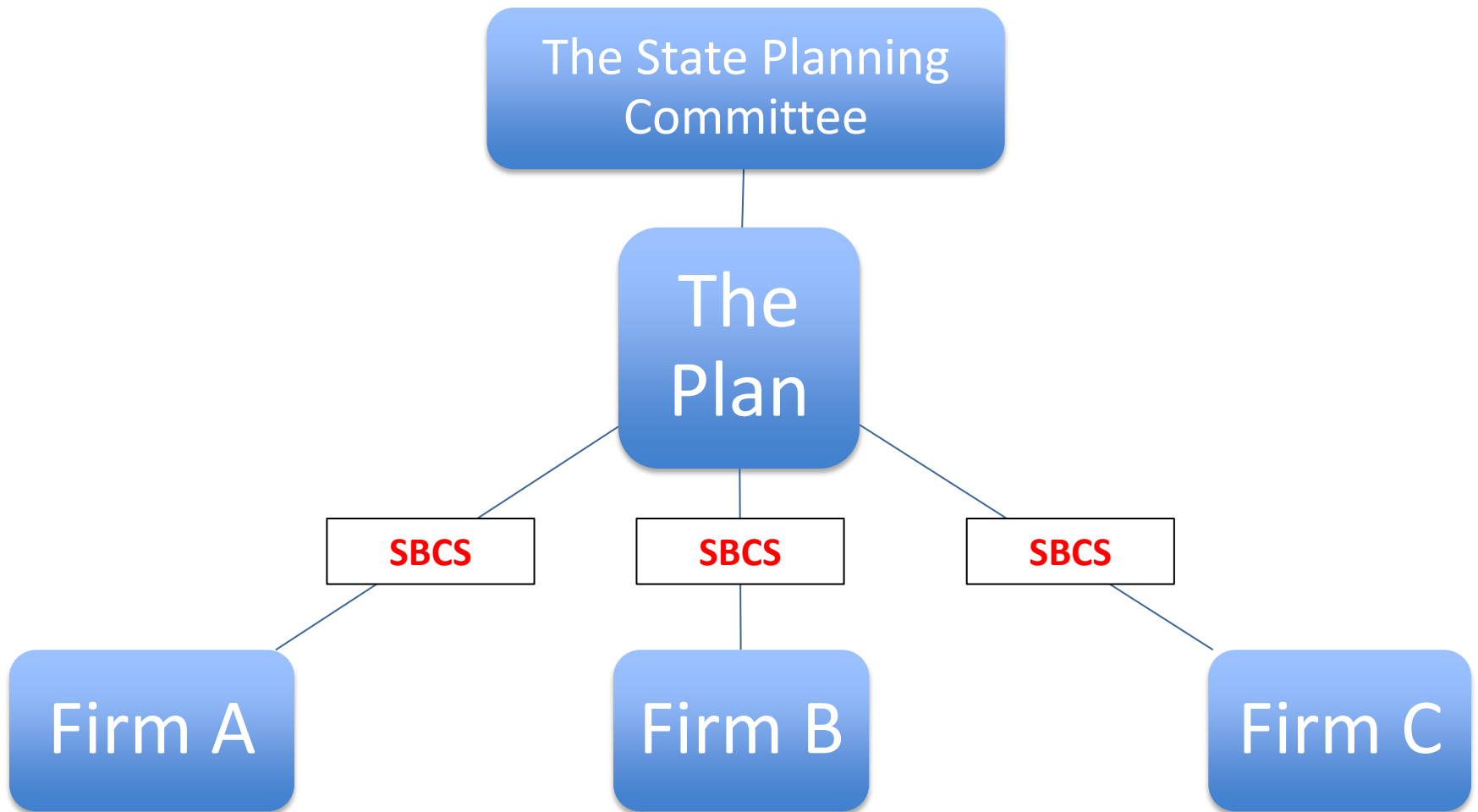
# Capital funding before 1989

- Operation of banking sector in the Czechoslovakia was completely different before 1989
- Since 1967, a system of operational funding of enterprises through credits for constantly revolving working capital had been applied by legislation
- **The key role = THE PLAN**
  - The outcome of enterprises was given by the Plan
  - According to the planned outcome, enterprises' financial needs were covered by special credits provided by the State Bank of Czechoslovakia (SOCIALIST MONOBANK)
  - After assigned finances were spent on production in the given year, the Plan created the reality for the next year

# Capital funding before 1989



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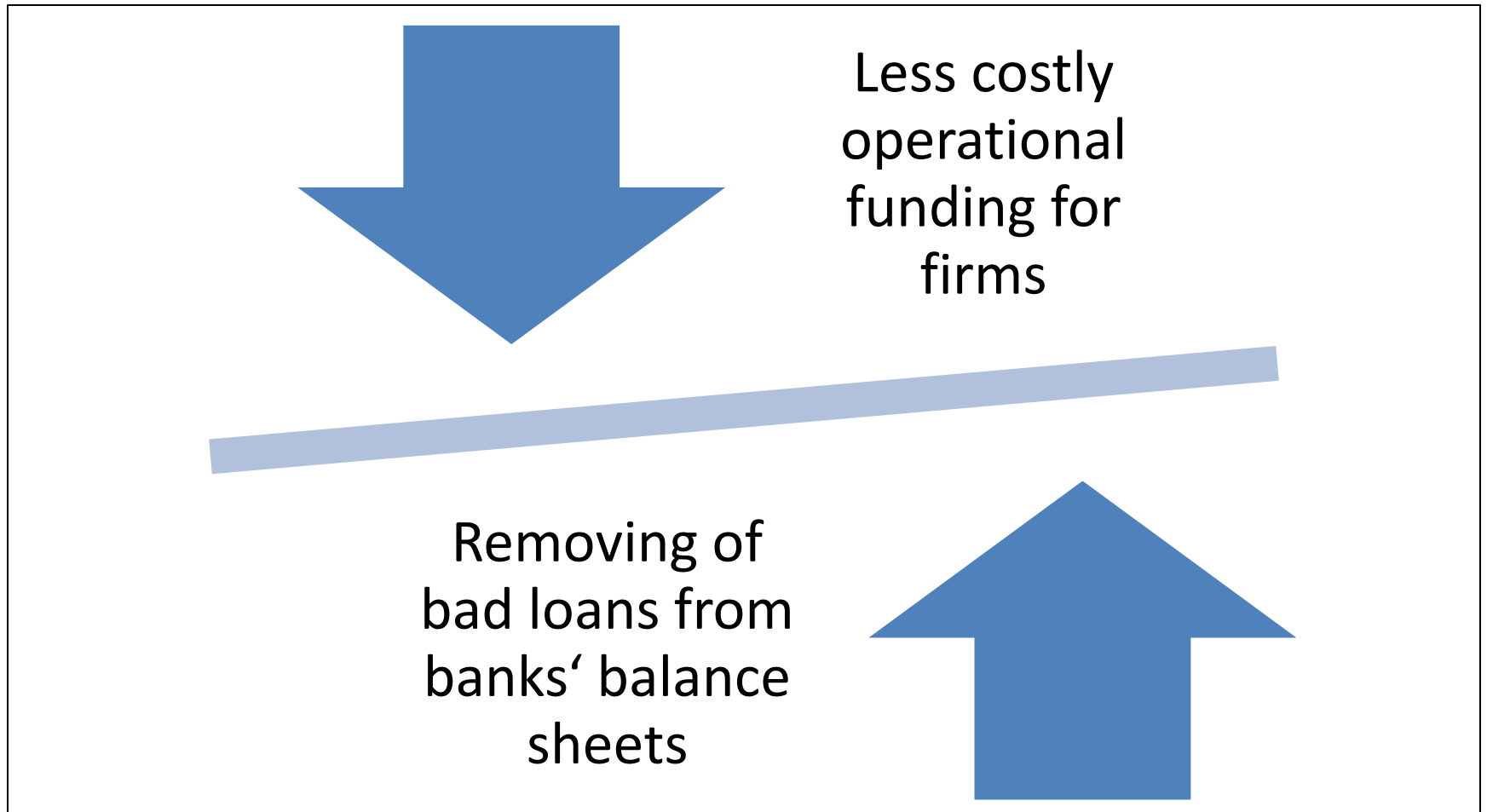
# The Revolution

- After 1989, the ongoing liberalization (market principles) has brought serious problems
- All enterprises had commitments to the SBCS
- These assets were transferred to brand new banks, but most of credits were *classified*
- Banks administered more than 110 billions CSK of financial assets (loans) with no expectation to be repaid by new debtors

# The process of consolidation

- This heritage of post-socialist assets with a low probability to be repaid was called “*a block of bad loans*” or “*old bad loans*”
- Therefore, the Czechoslovak government decided to establish a brand new institution

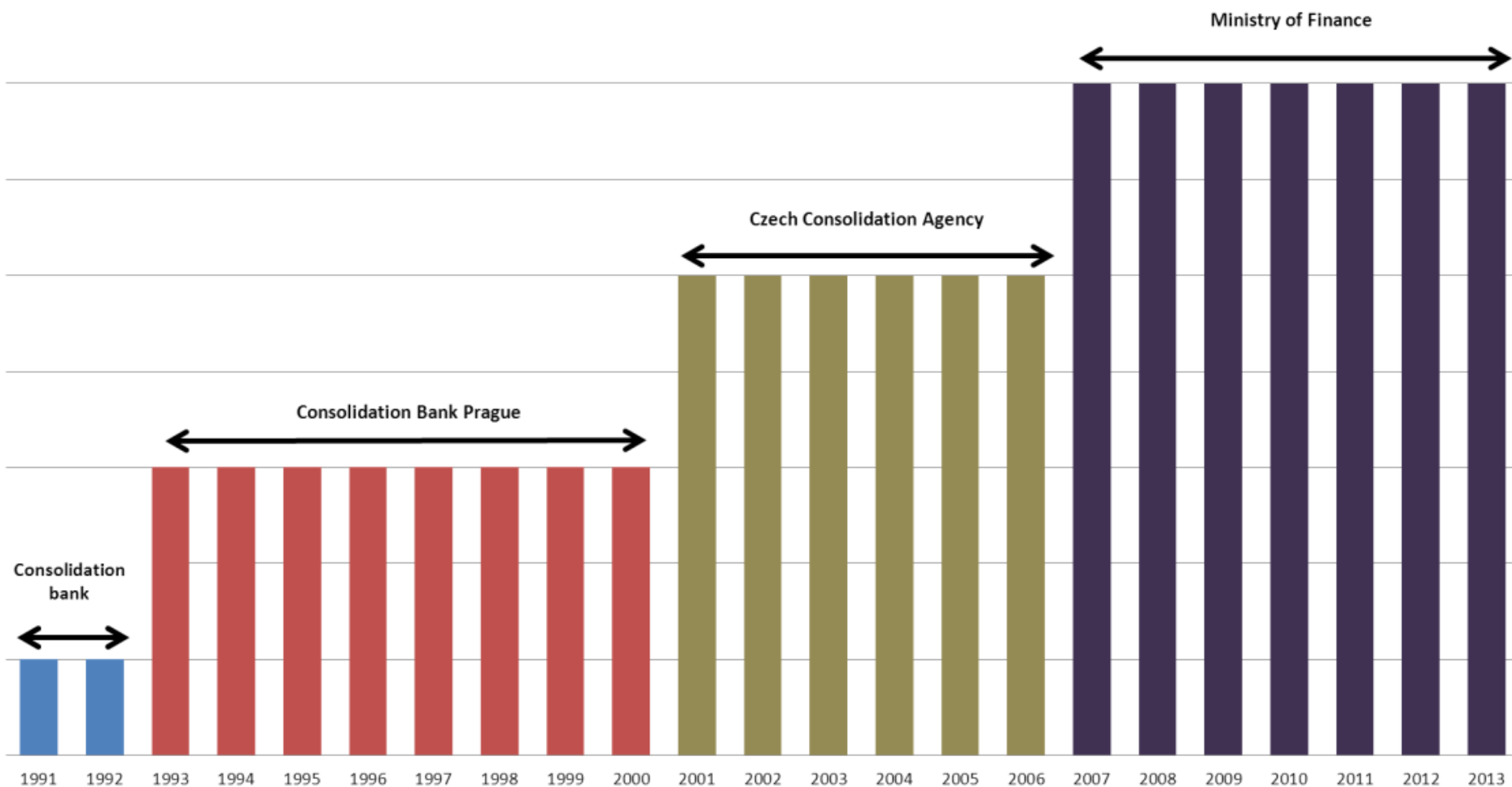
# The Consolidation Bank



# The process of consolidation

- In 1993, the Czechoslovakia has been split into two sovereign states (The Czech Republic and Slovakia), so was the Consolidation Bank (into the Consolidation Bank Prague and the Consolidation Bank Bratislava)
- In 2001, political circumstances (e.g. CBP couldn't get majorities in subsidiaries and managed firms) led to a need of establishing of the Czech Consolidation Agency by special Law
- In 2004, "The Project 2007" was passed, which factually meant to finish all goals of the CCA till 2007

## The agenda of the old loans' consolidation in Czech Republic (1991-2013)



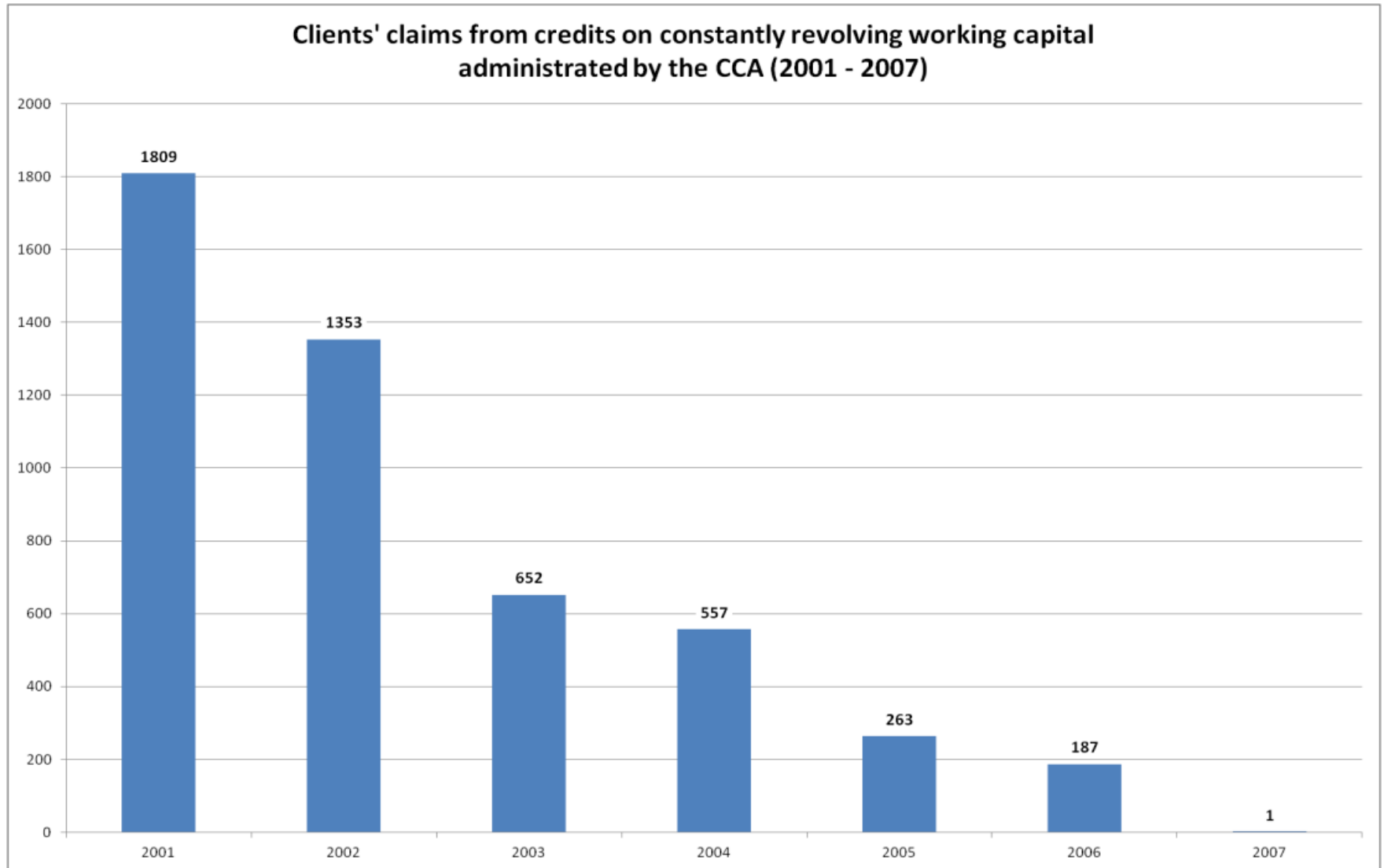
# The Consolidation Bank

<b>The CB (data in billions CSK)</b>	<b>1991</b>	<b>1992</b>
Total assets	111.9	107.2
- <i>the Czech share</i>	83.5	79.9
Old block of loans	110.8	107.2
- <i>the Czech share</i>	80.1	81.2
Credits on constantly revolving working capital	110.8	92.7
- <i>the Czech share</i>	80.1	66.1

# The Consolidation Bank Prague

<b>Receivables of the CBP</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
The old block of loans (bln. CZK)	74,6	67,9	63,8	60,8	59,4	58,0	53,3	39,5
- credits on constantly revolving working capital (bln. CZK)	62,3	55,7	49,7	42,3	39,4	37,7	33,0	29,5
- credits on constantly revolving working capital (%)	83,5 %	82,0 %	77,9 %	69,6 %	66,3 %	65,0 %	61,9 %	74,7 %
Clients of the CBP in total (number)	3816	3790	3996	4044	3950	4045	4748	3808
- clients of credits for constantly revolving working capital (number)	3711	3715	3839	3752	3625	3655	3246	2146
- clients of credits for constantly revolving working capital (% of total)	97,2 %	98,0 %	96,1 %	92,8 %	91,8 %	90,4 %	68,4 %	56,4 %

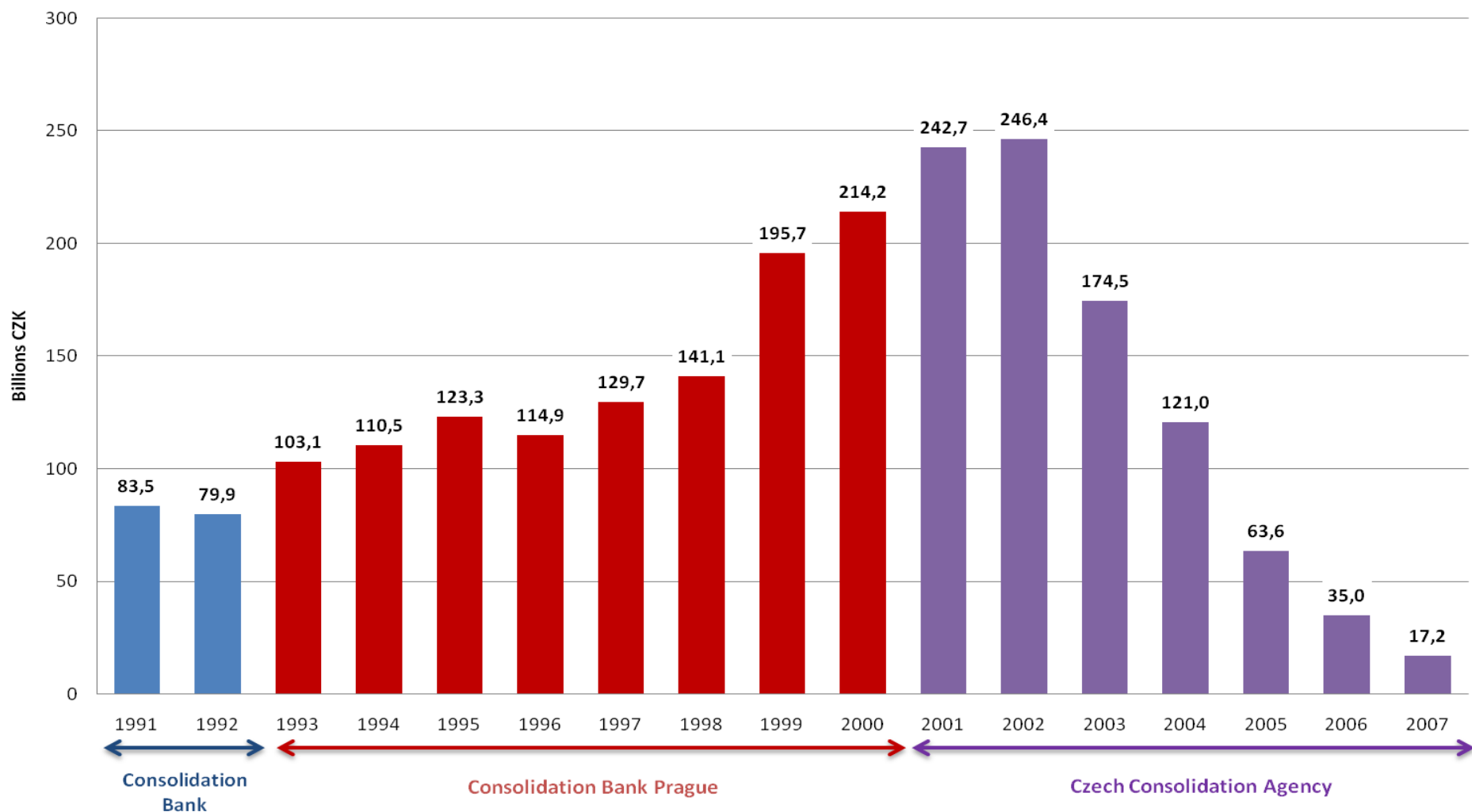
# The Czech Consolidation Agency



# Goals of consolidation agencies

- **Main goals:**
  - To clean up the Czech banking sector from bad assets and to facilitate privatization of new banks
  - To manage these assets under the special regime and help them to develop in the market economy
- **Additional goals:**
  - To provide special transactions during the the process of privatization for the government
  - To bail out other institutions (not just banks)
  - To organize block sales of assets to the public

## Assets in balance sheets of COB, COBP a CCA (1991 - 2007)



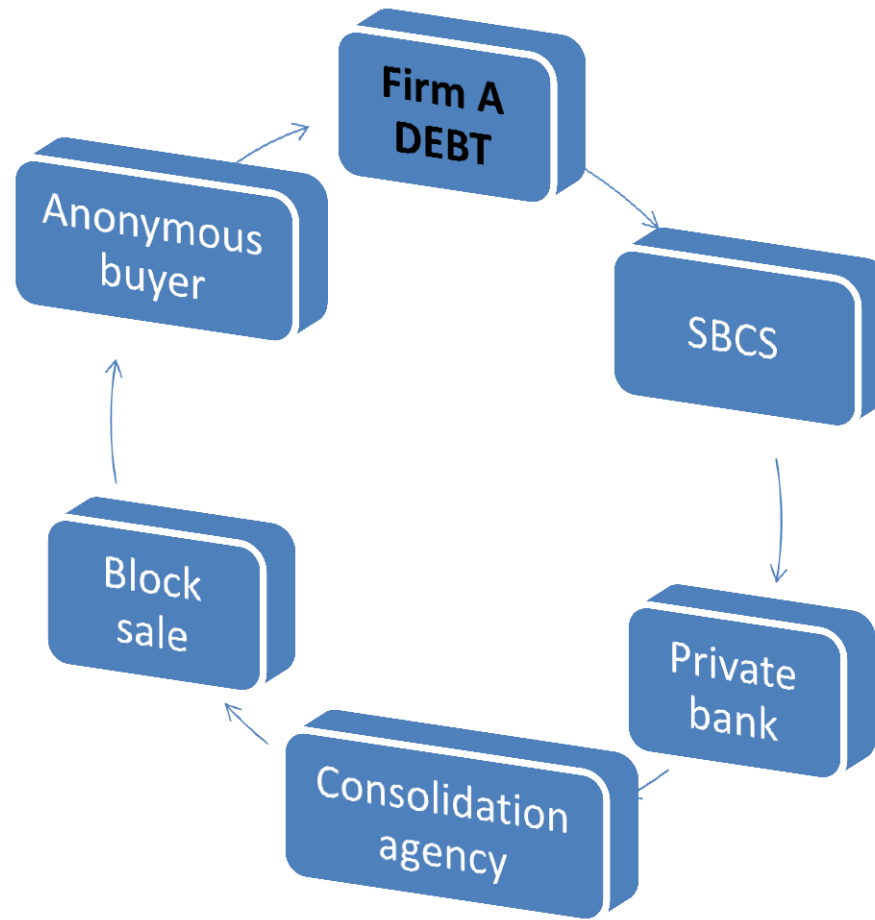
# Problems related to the Czech way

- Management of assets had not been controlled by regulators as it should be
- Czech consolidation agencies were under undesirable influence of politicians
- Institutions were misused by politicians for other goals than originally intended
- Many debtors re-bought their debts in block sales for a small part of the original amount
- The legislation passed during early 1990' was not prepared for attacks of rent-seekers which costs additional tax-payers' money

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# Re-buying of own debts



**Owner of the firm A = anonymous buyer of assets in a public tender**

# Public sales of assets

Period	Transaction	Number		Value		Selling price	Yields to	
		clients	claims	Nominal	Net accounting		Nominal value	Net accounting value
				Million CZK	Million CZK		%	%
2004	Blocks	222	251	47.8	45.5	3	6.20 %	6.50 %
	Individual	136	232	7 187.40	6 091.90	1 472.50	20.50 %	24.20 %
	<b>Total</b>	<b>358</b>	<b>483</b>	<b>7 235.20</b>	<b>6 137.40</b>	<b>1 475.50</b>	<b>20.39 %</b>	<b>24.04 %</b>
2005	Blocks	2 175	2 598	13 913.90	10 236.80	1 002.40	7.20 %	9.80 %
	Individual	190	341	17 630.20	14 007.90	4 709.20	26.70 %	33.60 %
	<b>Total</b>	<b>2 365</b>	<b>2 939</b>	<b>31 544.10</b>	<b>24 244.70</b>	<b>5 711.60</b>	<b>18.10 %</b>	<b>23.60 %</b>
2006	Block CCA 103	2 670	3 880	3 547	3 547	75	2.10 %	2.10 %
	Individual	178	393	13 156	11 435	3 004	22.80 %	26.30 %
	<b>Total</b>	<b>2 848</b>	<b>4 273</b>	<b>16 703</b>	<b>14 982</b>	<b>3 079</b>	<b>18.40 %</b>	<b>20.60 %</b>

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# Rent-seeking

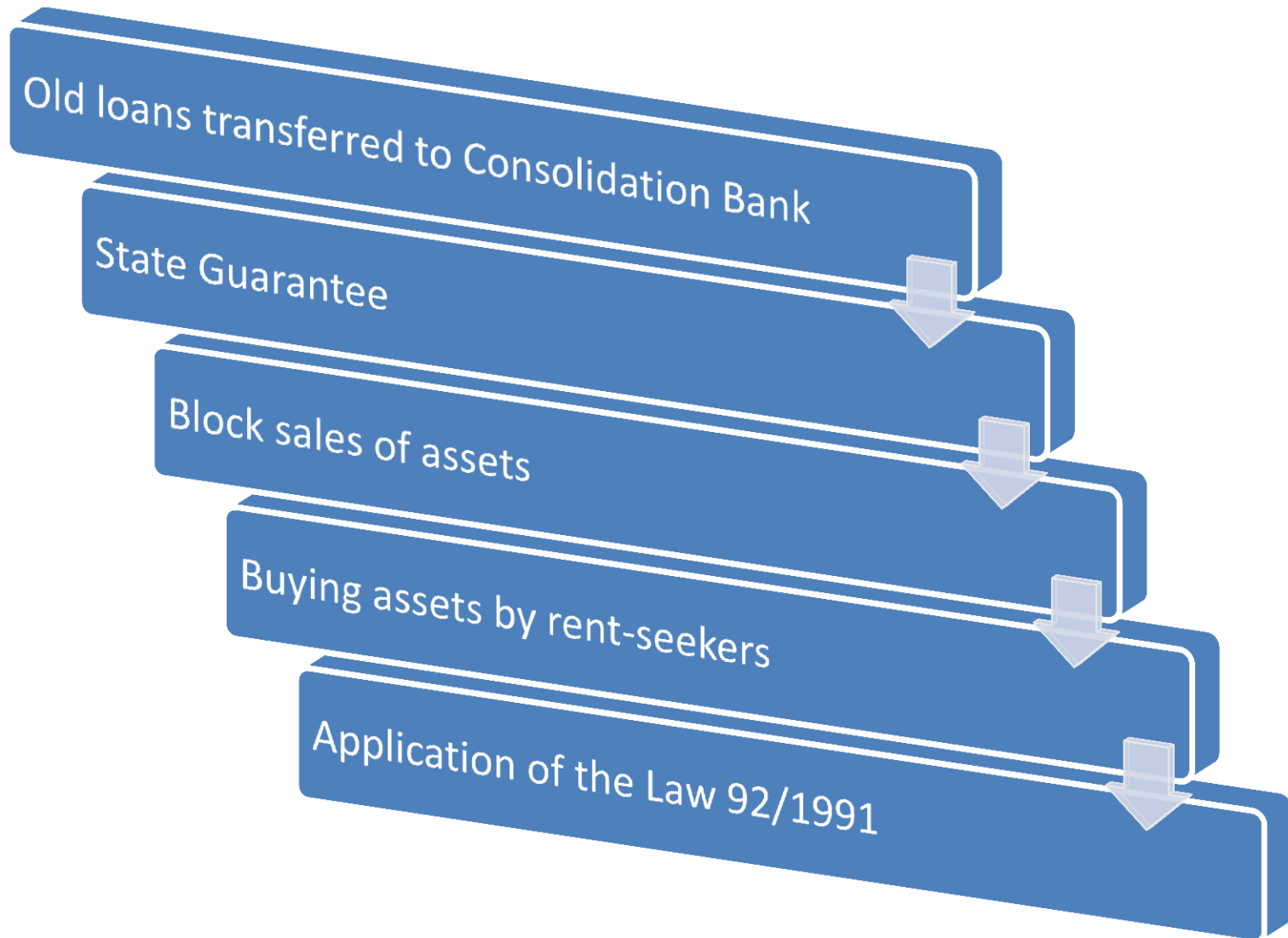
- Base: The law No. 92/1991 Coll., about conditions for transfer of state property to other subjects (passed in February 1991)

*“The state has taken the full guarantee and responsibility for economic costs (damages) made before 1989 which would negatively influence a value of a private property restituted and privatized after 1990.”*

# Rent-seeking

- **Intention of rent-seekers:**
  - Receivables emerged from bad loans were held against companies primarily owned by the state which have been restituted or privatized into private hands.
  - The core of relationship originated before 1989.
  - The fact that they haven't been repaid is economically harmful for a holder.
  - The state has taken the full responsibility for damages originated before 1989.
  - Therefore, the State should compensate actual holder of assets.

# Rent-seeking



# Rent-seeking

## **This legal intention really works!**

- More than 160 legal suits against the state had been initiated (sum: 13 billion CZK)
- Negotiation between new owners of assets and the Ministry of Finance begun
- In 2013, the MF reacted on several lost lawsuits and offered a compensation
- In Oct 2013, the contract providing 1.38 billion CZK off-court reimbursement was agreed

# Conclusion

**The total costs of the Czech way of consolidation are estimated in hundreds of billions CZK.**

# Comparison - the Slovak case

- In 1993, 26.6 billions CSK were transferred into the Consolidation Bank Bratislava
- In 2001, a successor called Slovak Consolidation Limited has been established
- Slovak institutions chose another way of consolidation – without externalization of the problem.
  - The enforcement of receivables continued with all available tools – restructuring, repayment schedules, and available legal instruments
  - Failed claims to be recovered were subsequently managed under bankruptcies and liquidation proceedings and – accounted by depreciation or written-off.
- **The Slovak way of bad loans consolidation was faster, cheaper, equitable, i.e. more efficient than the Czech one!**

# Today's implications

- If the state established a subject for consolidation, than:
  - ... *it should be clear that taxpayers' money are needed.*
  - ... *it should be secured that the legislation dealing with goals, tools and guarantees is impeccable.*
  - ... *all potential short term and long term scenarios should be taken into decision-makers' account.*
  - ... *the deadline of the operation should be set as well as the cap of bailed out costs.*
  - ... *the externalization of the problem shouldn't be approved unless it is really necessary.*
  - ... *no "bianco checques" or guarantees should be made.*

# Thank you for your attention.

