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## ► 'HOLD & HOPE' IS NOT A STRATEGY FOR DISTRESSED LOANS

Across Europe, with the most extreme cases being in the UK and Spain, banks are confronted by the same fundamental dynamics: increasing arrears on their loan books, the inability to gear up the workout function at the necessary speed to address these problem loans, and inadequate information to realistically assess the likely resulting losses. This situation is only going to get worse for the rest of this decade. Those institutions that are going to survive the current turmoil are those that take decisive action regarding distressed loans and their resolution. The two most critical actions required are a strategic approach to the construction of the workout function and a realistic assessment of likely loan losses by a combination of internal resolution and external loan sales.

Common mistakes regarding the workout

process are the myth that vanilla internal and third party servicers can transform themselves easily into special servicers (or add 'bolt-on' units to address these needs.) This is far more difficult than it would appear: traditional, performing loan servicing is a scale business driven by high volume processes using low cost people. This approach to special servicing is a recipe for disaster. Given the volume of problem loans that banks are going to face, a completely separate platform is required, staffed with professionally recruited workout personnel. The banks that are going to survive are those that are hiring and training into their workout areas, not those that are transferring under-utilised loan originators, with minimal screening, to the work-out area. It is easy to build a bloated workout function; it is far more challenging to create an effective one.

Until banks have tested the value of their distressed loans, they are not in a position to grade their existing workout department, frame what the appropriate investment in that workout function should be, or set aside prudent loan loss reserves. The means to bracket the value of troubled loans is through the

combination of internal resolution and external distressed loan sales. Which strategy will yield the highest proceeds adjusted for time and expense is dependent on market liquidity, workout department skill sets and asset types. All banks are familiar with the internal workout process. The market leaders are using external loan sales as a means of benchmarking their internal processes and addressing loans falling outside of the workout function's competence. With these two data points, likely immediate sale value versus projected workout proceeds, banks can make intelligent decisions.

Unless bank management use this approach, aggressive construction of a professional workout function benchmarked against what they would receive from an immediate sale in the secondary market, they will mislead themselves, their regulators, and their shareholders as to their true health. ■

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