"Good bank- bad bank" as a concept for bank restructuring in China

Chuanfang Di

Bachelor Thesis in Banking and Finance

University of Zurich

Department of Banking and Finance

Prof. Dr. Urs W. Birchler

September 15, 2012

Executive Summary

In this paper the concept of good bank- bad bank" and its applications have been discussed. This approach has arisen as a useful instrument to restructure failing banks during severe financial crisis. The fundamental idea is to separate healthy parts of a financial institution from its ailing business.

The application of this approach can be in form of division into two entities or establishment of a subsidiary. China as well as some western countries has put this concept into practice.

In private sector and on a smaller scale the "good bank- bad bank" structure turned out to be a great success.

The state-owned bad bank scheme is appropriate to deal with poorly capitalize or insolvent banks that are too big to fail. Chinese government used this approach to address the banking system's NPL loan problem. Compared to Sweden's application, Chinese bad bank plan is on a larger scale in terms of transferred assets. Thus the costs are much higher and the assets recoveries are much slower. The Swedish bad banks Securum and Nordbanken have proven to be a great success because all the involved parties made profits and the costs to the public were minimized with no expense of taxpayers in the end.

The success of "good bank- bad bank" scheme depends on several critical factors. A proper extent of government intervention is important to overcome specific constraints in each country. The toxic assets which need to be removed from financial institutions should be fairly valued and carefully managed. An effective legal base and a reasonable incentive system should be set up.