Journal of Financial Crises

Volume 3 | Issue 2

2021

Uruguayan Non-Performing Portfolio Purchase Scheme

Sean Fulmer
Yale School of Management

Follow this and additional works at: https://elischolar.library.yale.edu/journal-of-financial-crises

Part of the Economic History Commons, Economic Policy Commons, Finance and Financial Management Commons, Macroeconomics Commons, Policy Design, Analysis, and Evaluation Commons, Policy History, Theory, and Methods Commons, Public Administration Commons, and the Public Economics Commons

Recommended Citation

Fulmer, Sean (2021) "Uruguayan Non-Performing Portfolio Purchase Scheme," *Journal of Financial Crises*: Vol. 3 : Iss. 2, 104-115.
Available at: https://elischolar.library.yale.edu/journal-of-financial-crises/vol3/iss2/4

This Case Study is brought to you for free and open access by the Journal of Financial Crises and EliScholar – A Digital Platform for Scholarly Publishing at Yale. For more information, please contact journalfinancialcrises@yale.edu.

Uruguayan Non-Performing Portfolio Purchase Scheme[1]

Sean Fulmer[2]

Yale Program on Financial Stability Case Study
June 23, 2021

Abstract

As the Latin American sovereign debt crisis spread through the continent during the early 1980s, foreign investors began to abandon Uruguay out of fear that it would devalue its currency like Argentina did in March 1981. Five small- to medium-sized commercial banks in Uruguay faced solvency crises as a result. Although the Central Bank of Uruguay (CBU) decided that a full, direct intervention into the failed banks was not necessary due to their size, the CBU arranged for the sale of the banks to foreign financial institutions, while assuming the non-performing portfolios of the failed banks to facilitate the transaction. The CBU purchased about $416 million in non-performing loans, which were denominated in both local and foreign currency. The CBU funded the purchases by issuing $311 million in bonds and promissory notes (denominated in U.S. dollars) to the banks and writing off $105 million in previous financial assistance to the banks. Instead of creating an asset management company to handle these non-performing assets, the CBU simply assumed the portfolios onto its balance sheet. This move resulted in a lack of transparency on loan recovery and discharge data, as well as several parliamentary and judicial investigations. Despite forming a National Office of Asset Recovery in 1984 to facilitate loan recovery, the CBU likely wrote off a sizeable portion of the non-performing portfolios every year as operating losses after loan recovery results proved disappointing.

Keywords: Uruguay, asset purchase programs, Central Bank of Uruguay, broad-based asset management

---

[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering broad-based asset management company programs.

Cases are available from the *Journal of Financial Crises* at https://elischolar.library.yale.edu/journal-of-financial-crises/.

[2] Research Assistant, YPFS, Yale School of Management.

Uruguayan Non-Performing Portfolio Purchase Scheme

At a Glance

Summary of Key Terms	
Purpose: The CBU arranged the sale of local failed banks to foreign institutions, purchasing the non-performing portfolios in the process, in order to avoid "a banking panic and [ensure] the maintenance of the stability of the financial system" (Pérez-Campanero and Leone 1998).	
Launch Dates	1982
Wind-down Dates	Unknown
Size and Type of NPL Problem	30.4% in 1982 (Caprio and Klingebiel 1996) Concentrated in the livestock and industrial sector
Program Size	Not specified at outset
Eligible Institutions	Five failed privately owned commercial banks Closed-bank only
Usage	US$416 million acquired by the Central Bank of Uruguay
Outcomes	Recovered 6.4% of the peso debt and 1.8% of the dollar debt as of end-1983
Ownership Structure	The CBU assumed the portfolio onto its balance sheet
Notable Features	Did not involve the creation of an asset management company and paid for a portfolio partly denominated in local currency with long-term dollar debt

The beginning of the 1980s in Uruguay featured increasing interest rates, an overvaluing of the peso and steadily rising amounts of debt denominated in foreign currency, which led to substantial risk profiles inside the Uruguayan banking sector. When the devaluation of the Argentine peso occurred in March 1981, investors abandoned Uruguay, assuming that a similar devaluation could follow in the neighboring country. This led to a decline in asset prices, which meant that the value of collateral on foreign currency-denominated bank loans dropped significantly (Pérez-Campanero and Leone 1998).

As this financial crisis rapidly intensified, eventually culminating in the devaluation of the Uruguayan peso in November 1982, five small- to medium-sized banks faced serious solvency issues in the beginning of 1982, as banks lacked sufficient liquidity to meet depositor withdrawals and previous government financial assistance failed to return the firms to solvency (Vaz 1988, 119). The Central Bank of Uruguay (CBU) determined that these banks did not require a direct intervention and liquidation, as they were smaller and not necessarily a systemic risk. Instead, the CBU arranged for the sale of the banks to foreign financial institutions, while purchasing the non-performing portfolios of the failed banks in the process (Banda 1990). These portfolios were denominated in both Uruguayan pesos and U.S. dollars. 65.1% of the acquired portfolios were denominated in foreign currency. In order to finance the US$416 million portfolio purchase scheme, the CBU issued US$311 million in bonds and promissory notes, denominated in U.S. dollars, to the failed banks and wrote off US$105 million in previous financial assistance (Pérez-Campanero and Leone 1998).

Instead of creating a separate asset management company to take on the non-performing assets, the CBU assumed the purchased portfolios directly onto its balance sheet (Pérez-Campanero and Leone 1998). These operations did not occur simultaneously but occurred

on a case-by-case basis from April 1982 through early 1983 (Banda 1990). The CBU claimed that this approach allowed the central bank to spread the losses out over many years and recoup the financial assistance provided to the banks, as well as limit the possibility of a banking panic since the failed banks were sold rather than liquidated (Pérez-Campanero and Leone 1998).

The CBU also acquired some non-performing assets from other commercial banks who agreed to lend the central bank foreign currencies to cover its foreign reserve shortage. Two foreign banks, Bank of America and Citibank, sold 58 percent of the loans that the CBU purchased under this program. These banks made significant capital gains since their portfolio purchase occurred a month before the devaluation of the Uruguayan peso while they simultaneously negotiated the Uruguayan external debt (Pérez-Campanero and Leone 1998). However, this second operation is not the focus of this case study.

The CBU did not indicate a designated timeframe within which they wanted to recover the loans. The administration of the portfolios shifted several times after the CBU purchased them, from the CBU, to the foreign banks that purchased the local banks, back to the CBU, to a state-owned bank, and finally to a recently nationalized commercial bank (Pérez-Campanero and Leone 1998).

Summary Evaluation

Since the CBU assumed the non-performing portfolios onto its balance sheet, there is a lack of transparency in data regarding loan recovery and restructuring, with the last publicly released data on loan recovery coming at the end of 1984. For this reason, Pérez-Campanero and Lopez (1998, 329) state that "the long-term impact of this purchased portfolio on the accounts of the Central Bank of Uruguay is hard to assess."

Of the data available at the end of 1983, the CBU had recovered just NUr$409.9 million (6.4%) of the debt denominated in pesos and US$8.7 million (1.8%) of the debt in dollars. Loan recovery increased to NUr$724.5 million for the peso debt and US$13.7 million for the dollar debt by August 31, 1984, which is the final release of public data. Beyond 1984, Pérez-Campanero and Leone (1998) claim that the CBU likely wrote off a portion of the portfolio every year, but the CBU did not confirm this.

Pérez-Campanero and Leone (1998) cite four major reasons for poor loan recovery results: 1) continued debtor insolvency; 2) a refusal to pay by debtors favoring loan amnesty; 3) a weak judicial system that favored borrowers; 4) a hope that better future economic conditions which would increase the value of collateral.

In the wake of poor recovery of non-performing portfolios in Uruguay, additional domestic banks became insolvent and were taken over by a government-owned bank, leading to government-owned banks holding 75% of deposits by 1987. In response, Uruguay passed the Domestic Debt Refinancing Law in November 1985, which attempted to create a legal framework for alleviating the debt burden of viable firms. This law created the Financial Analysis Commission, which facilitated the rescheduling of debt and had the ability to liquidate firms and halt dividends (Pérez-Campanero and Leone 1998).

Some in Parliament and the judiciary found irregularities in the portfolio purchasing scheme and questioned the unique structure of the intervention. In particular, the usage of long-term dollar debt to purchase portfolios partly denominated in pesos drew criticism (Pérez-Campanero and Leone 1998).

Uruguayan Non-Performing Portfolio Purchase Scheme: Uruguay Context	
GDP (SAAR, Nominal GDP in LCU converted to USD)	$9.179 billion in 1982 $5.102 billion in 1983
GDP per capita (SAAR, Nominal GDP in LCU converted to USD)	$3,107 in 1982 $1,716 in 1983
Sovereign credit rating (5-year senior debt)	Data not available for 1982 Data not available for 1983
Size of banking system	Data not available for 1982 Data not available for 1983
Size of banking system as a percentage of GDP	Data not available for 1982 Data not available for 1983
Size of banking system as a percentage of financial system	Data not available for 1982 Data not available for 1983
5-bank concentration of banking system	Data not available for 1982 Data not available for 1983
Foreign involvement in banking system	Data not available for 1982 Data not available for 1983
Government ownership of banking system	Data not available for 1982 Data not available for 1983
Existence of deposit insurance	Data not available for 1982 Data not available for 1983
Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.	

Key Design Decisions

1. Part of a Package: The CBU purchased portfolios of non-performing assets from insolvent institutions in order to facilitate their sale to healthy institutions.

The CBU purchased non-performing loans from five small- to medium-sized banks that had failed, with the issuance of bonds and write-off of previous financial assistance, and then assisted in the sale of the banks to foreign financial institutions (Pérez-Campanero and Leone 1998). This operation is the focus of this case study, as it was intended to remove problematic loans from the banking sector to prevent financial instability.

A second type of operation, which is not the focus of this case study, functioned instead as a solution to the CBU's shortage of foreign reserves. Under this operation, the CBU used promissory notes to purchase portfolios with at least two-thirds of the loans classified as good quality and, in return, banks lent foreign reserves to the CBU.[3] Although the CBU bought portfolios with some non-performing loans, that was not the sole purpose of this operation, but rather a bargaining chip. Foreign banks, specifically Citibank and Bank of America, were the primary sellers of these portfolios, at a disproportionate rate to their involvement in the Uruguayan banking sector (Pérez-Campanero and Leone 1998).

2. Legal Authority: Decreto-Ley No. 15322 provided ex post facto justification for the portfolio purchase scheme.

Vaz (1988) states that the CBU utilized Decreto-Ley No. 15322, passed in September 1982, as ex post facto justification for the portfolio purchase scheme, since the first bank intervention occurred in April 1982. In this new law on financial regulation, the CBU is allowed to sell bonds as well as promissory notes to financial institutions under its lender-of-last-resort authority (Asamblea General de Uruguay 1982).

The Parliament, comptroller, and the courts all initiated investigations into the legality of the portfolio purchase scheme. The CBU's lawyers claimed that the pre-existing law was vague on purpose, which encouraged the CBU to enjoy widespread powers (Vaz 1988). It is unclear if the investigations resulted in any tangible results or punishments.

[3] The CBU could have potentially raised foreign reserves through a sale of its gold, but it appears that foreign banks, specifically Citibank and Bank of America, pushed for the implemented operation. Citibank and Bank of America were also negotiating Uruguay's external debt at the same time, which Pérez-Campanero and Leone point out as suspicious and possibly the reason for the structure of this operation (Pérez-Campanero and Leone 1998).

3. Special Powers: The CBU does not appear to have had any special powers, but as loan recovery stagnated and debt burdens increased, Uruguay ultimately adopted debt-refinancing legislation

Since the CBU assumed the non-performing loan portfolios onto its balance sheet rather than create a separate asset management company, there do not appear to be any special powers involved in this scheme.

The CBU struggled to recover a significant portion of the non-performing assets likely as a result of this lack of special powers to address delinquency. However, as loan recovery stagnated and debt burdens increased, the Uruguayan government responded with the Domestic Debt Refinancing Law in November 1985, which sought to alleviate the debt burdens of viable firms and allow for the rescheduling of debt to allow for more borrowing. The law created the Financial Analysis Commission, which served as the authority in classifying and evaluating debtors under the new law. The commission had the power to liquidate assets if the debtor became delinquent for over six months, as well as the ability to halt dividends until the debt was reduced by two-thirds. The commission also determined if a debtor qualified as a viable firm and was thus eligible for the automatic refinancing provisions included in the Domestic Debt Refinancing Law (Pérez-Campanero and Leone 1998).

4. Mandate: The CBU portfolio purchase scheme allowed five failed local banks to avoid bankruptcy and sought to recover outstanding debts from the acquired portfolios.

The CBU intended the non-performing portfolio purchase scheme as a method to avoid a direct intervention into the failed banks (Pérez-Campanero and Leone 1998).

5. Communication: Information about the scheme appeared in several Uruguayan newspapers, but the final mention of loan recovery data occurred in 1984, before the full recovery or discharge of the assets.

Many of the newspapers and magazines reporting on the portfolio purchase scheme are no longer in publication and do not have available digitized archives. However, Pérez-Campanero and Leone (1998) cite heavily from local newspapers, which seemed to report detailed information on the announcement of the scheme and its progress. Pérez-Campanero and Leone note that the CBU stopped releasing data on loan recovery efforts on November 11, 1984. Since the CBU simply took the non-performing portfolios onto its balance sheet, there is a lack of transparency into the accounting for individual loans and recovery process.

6. Ownership structure: The purchase of loan portfolios by the CBU did not include the creation of a stand-alone asset management company, but rather, the CBU took the portfolios onto its own balance sheet.

The CBU preferred the structure of the portfolio purchase paired with the sale of the failed banks to direct interventions by the central bank. The chosen approach allowed the CBU to

maintain some level of control and prevent further panic because the sales happened on a case-by-case basis, rather than having to schedule the direct intervention of the banks at the same time. Additionally, this strategy allowed the CBU to spread out the losses of the intervention across several years on its balance sheet, as well as recoup the financial assistance provided to the insolvent banks prior to the intervention (Pérez-Campanero and Leone 1998).

7. Governance/Administration: The administration of these portfolios often changed, from delegation to the BROU (a state-owned bank), to assumption by the CBU, back to BROU, and, finally, to a nationalized commercial bank.

The portfolios involved in this operation routinely changed hands within the government, since the CBU did not have the manpower or technical ability to deal with such large and complex portfolios. The CBU transferred the administration of its private sector loan portfolio, including the purchased non-performing assets, to the BROU, a state-owned bank, in 1988. Parliamentary and judicial investigations into the takeover deals occurred due to "irregularities" and the unique structure of the program; however, the outcome of such investigations was unclear (Pérez-Campanero and Leone 1998).

8. Size: There did not appear to be a cap on the amount of non-performing assets that the CBU could purchase, which ended up totaling $416 million.

The portfolio purchase scheme did not limit the amount of assets that the CBU could assume, since the CBU assumed the entire non-performing portfolios of the banks on a case-by-case basis. In total, the CBU assumed $416 million in loan portfolios from the five failed banks (Pérez-Campanero and Leone 1998).

9. Funding Source: The portfolio purchase scheme was government funded.

The CBU funded the portfolio purchase scheme through the issuance of bonds and promissory notes. Additionally, the CBU wrote off previous financial assistance provided to the failed banks in the form of loans (Pérez-Campanero and Leone 1998).

10. Eligible Institutions: The portfolio purchase scheme involved several failed commercial banks in the process of their sale to foreign financial institutions.

The five failed commercial banks did not comprise a significant share of the banking sector, which explains why the CBU did not believe the situation warranted a direct intervention (Banda 1990). See Appendix A for information on each bank intervention.

11. Eligible Assets: The CBU operation did not appear to have any limitations on eligible assets, as long as the assets were non-performing and owned by the five failed local banks.

The CBU purchased the non-performing portfolios from the five failed local banks prior to their sale and did not appear to define what they considered eligible to be included in the non-performing portfolios (Pérez-Campanero and Leone 1998). There does not appear to

be further information on the makeup and composition of the loan portfolios bought by the CBU.

12. Acquisition – Mechanics: The CBU purchased loan portfolios through the issuance of $311 million in bonds and promissory notes, as well as the write-off of $105 million in previous financial assistance.

The CBU issued bonds and promissory notes, denominated in U.S. dollars, to pay for the acquired portfolios. The bonds issued by the CBU had a seven-year maturity, two-year grace period, and an interest rate of one and a half points above LIBOR. Additionally, the CBU wrote off $105 million in outstanding loans it had previously provided the failed local banks in an attempt to resolve their insolvency (Pérez-Campanero and Leone 1998).

The CBU used long-term dollar debt to purchase portfolios of non-performing loans partially denominated in pesos, which the CBU defended this decision by claiming that allowed the CBU to spread the monetary effects over several years and that banks refused to hold long-term peso debt. The president of the CBU said that offering a cash payment instead of long-term dollar debt would have just led to widespread purchase of dollars (Pérez-Campanero and Leone 1998).

13. Acquisition – Pricing: There is no available information on how the CBU priced the non-performing loan portfolios.

It is unclear how the CBU determined the pricing of the portfolios purchased from the failed banks (Pérez-Campanero and Leone 1998).

14. Disposal: The CBU underestimated the level of unrecoverable loans and implemented several loan restructurings to encourage payment within the acquired portfolios.

The CBU did not anticipate having as much difficulty recovering the loans in the portfolio as it did, which led to greater costs to the CBU. Several measures were taken in April 1984 to improve the recovery of assets in the loan portfolios. The government established the National Office of Asset Recovery to streamline the recovery process. Additionally, borrowers, regardless of which currency the debts were denominated in, were split into two categorizations: high-standard and low-standard borrowers. In order to be classified as a high-standard borrower, a borrower had to have paid at least 60% of interest accrued in six months of 1983 and would have paid 60% of the interest for the whole year of 1983 by May 15, 1984 (Pérez-Campanero and Leone 1998).

High-standard borrowers received several benefits, with the first being a write-off of 20% (for local currency borrowers) and 40% (for foreign currency borrowers) of interest accrued in 1983. Second, the maturity periods were extended. Third, high-standard borrowers in local currency could convert their outstanding debt into indexed debt at a four percent interest rate, with the adjustment factor being the lower of the change in exchange rate or inflation rate. Finally, high-standard borrowers in foreign currency could similarly

convert their outstanding debts into local-currency indexed debt, under the same conditions as the borrowers in local currency (Pérez-Campanero and Leone 1998).

All borrowers that made a payment 180 days before the due date, if this occurred before September 30, 1984, were eligible to receive a write-off equivalent to the prepayment amount, for up to 25% of the debt outstanding before the prepayment. If the prepayment occurred after September 30, 1984, borrowers were eligible for a similar benefit, except the write-off could only equal 15% of the debt outstanding (Pérez-Campanero and Leone 1998).

Although in-depth public data was not available on individual loan recovery, Pérez-Campanero and Leone (1998) state that it is likely the CBU wrote off a sizeable portion of the loan portfolio every year as an operating loss.

15. Timeframe: There was no announced timeframe for the portfolio purchase scheme and the CBU stopped providing loan recovery data in 1984.

The CBU did not announce an intended end date for the disposal of the portfolios acquired from the five failed local banks.

References and Key Program Documents

Legal/Regulatory Guidance

(Asamblea General de Uruguay 1982) Asamblea General de Uruguay. September 17, 1982. "Decreto Ley No. 15322."
Law passed in1982 which provided ex-post facto justification for the portfolio purchase scheme.
https://ypfs.som.yale.edu/library/decreto-ley-no-15322.

Reports/Assessments

(Banda 1990) Banda, Ariel. 1990. "Regulacion Bancaria, Crisis Financiera y Politicas Consecuentes: El Caso Uruguayo." In *Ahorro y Asignacion Derecursos Financieros*, 321–57.
Book chapter that focuses on the Uruguayan banking crisis of 1982 written in Spanish.
https://ypfs.som.yale.edu/library/regulacion-bancaria-crisis-financiera-y-politicas-consecuentes-el-caso-uruguayo.

(Caprio and Klingebiel 1996) Caprio, Gerard, and Daniela Klingebiel. July 1996. "Bank Insolvencies: Cross-Country Experience."
Report that provides data on bank insolvencies and non-performing loans in Uruguay at the time.
https://ypfs.som.yale.edu/library/bank-insolvencies-cross-country-experience.

(Pérez-Campanero and Leone 1998) Pérez-Campanero, Juan, and Alfredo M. Leone. 1998. "Liberalization and Financial Crisis in Uruguay, 1974-1987." In *Banking Crises: Cases and Issues*, by V. Sundarajan and Tomás J. T. Baliño, 276–375. International Monetary Fund.
Book section that focuses on the BCU operation.
https://ypfs.som.yale.edu/library/liberalization-and-financial-crisis-uruguay-1974-87.

(Vaz 1988) Vaz, Daniel Enrique. 1988. "Four Banking Crises: Their Causes and Consequences."
Uncompleted thesis that focuses on the 1982 Uruguayan banking crisis and the creation of the bank portfolio purchase scheme.
https://ypfs.som.yale.edu/library/four-banking-crises-their-causes-and-consequences.

Copyright 2021 © Yale University. All rights reserved. To order copies of this material or to receive permission to reprint any or all of this document, please contact the Yale Program on Financial Stability at ypfs@yale.edu.

Appendix

Appendix A: Individual Bank Portfolio Purchases

Local Bank	Foreign Purchasing Bank	CBU Purchase in US$ million	Debt in N$/US$/Both	Date
Banco Panamericano	Banco Central de Madrid	15.9	Both	4/22/1982
Banco de Litoral	Banco Santander	173.1	US$	9/1982-3/1983
Banca Federada del Interior	Banco Exterior de Madrid	88	Both	10/1982
BAFISUD	NMB Bank	105	Both	Early 1983
Pemar Sudamericana Casa Bancaria	Banco de Italia	27	US$	n/a

Source: Banda 1990.