



When a Higher Recovery Becomes a Worse Financial Decision

The Hidden Economics of Holding Distressed Assets

Why banks can protect nominal recovery targets while sacrificing economic value – and what effective Asset Resolution should measure instead.

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Executive Summary

A bank can achieve a higher recovery and still make a worse financial decision. Although the distinction between nominal proceeds and economic value is well understood in financial theory, it is not always reflected consistently in the way distressed asset strategies are evaluated, approved and monitored.

Consider an institution that rejects an immediate offer for a non-performing loan portfolio because its internal recovery forecast indicates that higher proceeds can be achieved through continued servicing, restructuring or enforcement. The decision may be entirely justified. However, its economic merit depends on more than the difference between the



available purchase price and the anticipated collections. The timing of recoveries, incremental costs, execution uncertainty, capital implications and the institution's ability to manage the underlying exposures must also be considered.

The challenge is not primarily mathematical. Banks possess the expertise and analytical tools required to evaluate discounted cash flows and alternative recovery scenarios. The more difficult question is whether their decision-making processes, performance indicators and institutional incentives consistently encourage management to select the economically superior resolution strategy.

Nominal collection targets, accounting carrying values, regulatory capital considerations and established recovery expectations can influence decisions in different ways. While each serves a legitimate purpose, problems arise when one measure becomes the dominant criterion for evaluating alternatives. A strategy that maximizes gross collections may not maximize present value. A transaction that improves reported asset quality may not necessarily create economic value. Similarly, avoiding the recognition of an accounting loss does not establish that continued ownership is preferable to disposal.

These distinctions become particularly important in the management of complex corporate exposures and legacy portfolios, where recovery processes may extend over several years and depend on uncertain legal, commercial and operational developments.

This briefing examines the economics of holding distressed assets through three interconnected questions: why institutions may pursue higher nominal recoveries despite deteriorating economics; how competing resolution strategies should be evaluated; and when management should reconsider a strategy that no longer delivers the value originally anticipated.

The central argument is that **Asset Resolution performance should be measured by the economic value realized from available alternatives, rather than by the nominal amount ultimately recovered.**



This does not imply a preference for accelerated NPL disposals. In many circumstances, continued restructuring, enforcement or portfolio preparation can create substantial additional value. The objective is to ensure that the decision to retain an exposure remains supported by credible assumptions, realistic execution capabilities and a demonstrable economic advantage.

Ultimately, effective distressed asset management requires more than maximizing collections. It requires the financial discipline to recognize when pursuing a higher recovery has become the less attractive decision.

Key Takeaways

1. **Recovery performance should reflect economic value, not nominal collections alone.** A higher future recovery may be economically inferior to an immediately executable alternative once timing, costs and uncertainty are considered.
2. **Institutional incentives can influence resolution decisions.** Recovery targets, accounting outcomes, organizational responsibilities and established valuation assumptions may encourage continued ownership even when the economic rationale has weakened.
3. **Hold-versus-sell decisions require a consistent financial framework.** Portfolio disposals, negotiated restructurings and enforcement strategies should be compared using realistic, probability-weighted cash flows, appropriate discounting and clearly identified incremental costs.
4. **Accounting, prudential and economic values serve different purposes.** IFRS 9 measurements, regulatory capital implications and management's assessment of alternative recovery strategies should inform one another without being treated as interchangeable.



5. **Recovery strategies require explicit reassessment triggers.** A strategy that was justified when approved may become economically unattractive following delays, changes in borrower performance, collateral deterioration or revised recovery expectations.
6. **Effective governance should distinguish decision quality from realized outcomes.** Management should be assessed on the reasonableness of its assumptions, the quality of its execution and its willingness to revise decisions when material circumstances change.



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The Institutional Preference for a Higher Recovery

In distressed asset management, the objective of maximizing recoveries appears straightforward. A bank seeks to recover as much as reasonably possible from an impaired exposure while protecting its contractual rights, complying with applicable requirements and managing the resources committed to resolution. In practice, however, the meaning of a successful recovery can vary considerably depending on the perspective from which performance is assessed.

For a workout manager, success may be expressed through collections achieved against an annual target. For a finance function, the relevant outcome may include the difference between realized proceeds and the accounting carrying amount. For a Chief Risk Officer, the reduction of non-performing exposures, the reliability of recovery forecasts and the resulting risk profile may be equally important. At board level, the decision may also be influenced by capital efficiency, liquidity, strategic balance-sheet objectives and the institution's capacity to absorb further uncertainty.

These perspectives are legitimate, but they do not necessarily produce identical conclusions. A transaction that improves one performance indicator may weaken another, while a strategy that appears attractive from an accounting perspective may be less compelling when assessed through discounted expected cash flows. The difficulty arises when institutions evaluate recovery decisions primarily against established targets or carrying values rather than the economic merits of the alternatives available.

Consider a distressed portfolio with an internal expected recovery of €115 million and an executable investor offer of €92 million. Management may reasonably question whether accepting the offer would transfer too much value to the purchaser. The internal estimate may reflect detailed knowledge of individual borrowers, collateral and ongoing negotiations



that external investors cannot fully incorporate into their pricing. However, the difference between the two figures does not establish that continued ownership is preferable. The expected €115 million must still be translated into cash flows, adjusted for uncertainty and assessed against the additional resources required to realize it.

This distinction can become particularly difficult when the institution has already incorporated the higher recovery estimate into its business plan or portfolio valuation. Reducing expectations may require management to acknowledge that earlier assumptions were overly optimistic, that enforcement is progressing more slowly than anticipated or that the available market price is more attractive than previously believed. Such revisions are a normal consequence of managing distressed exposures under uncertainty, but they can become institutionally uncomfortable when performance discussions focus disproportionately on deviations from established targets.

The resulting risk is not necessarily that management deliberately disregards economic considerations. More often, several individually reasonable objectives begin to influence the same decision without a sufficiently clear hierarchy. The desire to protect recovery performance, avoid unnecessary accounting losses, maintain strategic consistency and demonstrate confidence in existing workout plans may collectively reinforce the preference to retain an exposure.

Yet continued ownership is itself a financial decision. By rejecting an executable disposal, the institution chooses to retain the risks and potential benefits associated with future recovery. The relevant question is therefore not whether the internal recovery estimate exceeds the available offer, but whether the expected incremental value justifies the additional time, costs and uncertainty.

A disciplined Asset Resolution framework should make that distinction explicit before the decision is approved. Rather than treating the difference between internal recovery estimates and external offers as evidence of value preservation, management should establish whether the expected incremental proceeds justify the additional financial commitment. This requires a forward-looking assessment of realistic alternatives,



supported by credible recovery assumptions, appropriate risk adjustments and a clear understanding of the institution's capacity to execute the selected strategy.

Comparing Resolution Strategies: The Economics Behind the Recovery Forecast

The appropriate comparison between alternative resolution strategies begins with a simple principle: decisions should be based on expected future economic outcomes rather than historical contractual balances or previously established recovery targets.

For a distressed corporate portfolio, the available alternatives may include an immediate sale, continued restructuring and internal workout, or collateral enforcement. Each strategy produces a different combination of expected proceeds, timing, costs and execution risks. Their relative attractiveness cannot be determined reliably by comparing gross recovery estimates alone.

Consider a hypothetical portfolio for which management is evaluating three alternative resolution strategies: an immediate sale, continued internal workout and collateral enforcement. For comparative purposes, the sale is assumed to be executable, unconditional and settled immediately, with €92 million representing the net cash proceeds available to the institution. The projected workout and enforcement recoveries represent illustrative probability-weighted expected amounts, reflecting both favorable and adverse outcomes. The analysis focuses on future incremental cash flows from the decision date and excludes historical costs already incurred.

Financial assumption	Immediate portfolio sale	Internal workout	Collateral enforcement
Probability-weighted expected gross proceeds	€92.0m	€115.0m	€135.0m
Expected resolution period	Immediate	18 months	36 months
Incremental resolution costs	Included in net sale proceeds	€4.0m	€9.0m
Expected net proceeds	€92.0m	€111.0m	€126.0m
Present value of expected net proceeds at 12%	€92.0m	€93.6m	€89.7m



Methodological note: All figures are hypothetical and intended solely to illustrate the economic comparison of alternative resolution strategies. Future recoveries represent probability-weighted expected cash flows, with proceeds and incremental costs assumed, for simplicity, to occur at the end of the respective resolution periods. The 12% annual effective discount rate is illustrative and applied consistently across the alternatives, on the assumption that it does not duplicate risks already reflected in the projected cash flows. The analysis excludes transaction-specific tax effects, institution-specific capital constraints and other considerations that may influence an actual decision. It is a simplified management decision-support illustration, not a complete portfolio valuation or an IFRS 9 measurement.

The nominal results suggest that collateral enforcement offers the strongest recovery, followed by internal workout and immediate disposal. Enforcement is expected to generate €43 million more than the available sale price, while the workout strategy offers an additional €23 million in gross proceeds.

The economic comparison produces a different conclusion. After allowing for the assumed resolution periods, incremental costs and discounting, internal workout provides the highest present value, although its advantage over immediate disposal is relatively modest. Collateral enforcement, despite producing the highest expected nominal recovery, offers the lowest present value under the stated assumptions.

The important observation is not that internal workout should automatically be selected. The difference between its estimated present value and the immediate sale is approximately €1.6 million, a relatively narrow margin for a portfolio whose resolution depends on eighteen months of further execution. A modest deterioration in collections, an extension of the timetable or additional costs could reverse the ranking.

The narrow economic advantage of the workout strategy also illustrates why sensitivity analysis should form an integral part of material hold-versus-sell decisions. Under the stated assumptions, a relatively small reduction in expected workout proceeds or a moderate extension of the resolution period would be sufficient to make the immediate sale economically preferable. Management should therefore assess not only the strategy with the highest expected present value, but also the robustness of that conclusion under plausible adverse scenarios. Where competing alternatives produce similar economic values, execution certainty, liquidity requirements and the institution's operational capabilities may become decisive considerations.



This is where a more sophisticated assessment becomes necessary. The gross recovery forecasts should themselves reflect probability-weighted outcomes rather than a single optimistic scenario. A restructuring may succeed and generate strong collections, but it may also fail, requiring subsequent enforcement or disposal at a lower value. Similarly, an enforcement strategy may benefit from favorable collateral realization while remaining exposed to litigation delays, legal challenges and market liquidity.

For example, an expected workout recovery of €115 million could arise from a 70% probability of collecting €125 million and a 30% probability of collecting approximately €91.7 million. The resulting probability-weighted expectation is approximately €115 million, but the distribution reveals a material downside scenario that would be invisible in a single headline figure. A decision-maker should understand both the expected value and the consequences of outcomes materially below that expectation.

The timing of cash flows is equally important. Actual corporate workouts rarely produce one payment at a precisely defined future date. Collections may occur through staged settlements, asset disposals, operating cash-flow sweeps and refinancing proceeds. Enforcement may involve several assets with different legal positions and realization periods. A credible financial model should therefore project cash flows at the level of detail justified by the underlying exposures, rather than relying exclusively on a single portfolio-level recovery date.

Discounting also requires consistency. If expected cash flows already incorporate probabilities of default, restructuring failure and recovery shortfalls, the selected discount rate should not mechanically reproduce the same risks. Conversely, using a relatively low discount rate with optimistic cash-flow assumptions can materially overstate the attractiveness of continued ownership. The appropriate framework depends on the institution's decision objective, risk appetite and economic assumptions, with particular attention to avoiding double-counting.



The comparison should also distinguish economic decision analysis from accounting measurement. IFRS 9 expected credit loss calculations follow specific recognition, measurement and discounting requirements. A management assessment of alternative resolution strategies may use different assumptions because it seeks to answer a different question: which available course of action is expected to produce the strongest economic outcome for the institution?

The value of this analysis lies less in the apparent precision of the final figures than in the discipline it imposes on the decision. It requires management to explain why additional recovery proceeds are achievable, what they will cost, when they are expected and how the preferred strategy performs under less favorable conditions.

Without that discipline, the highest recovery estimate can become the most persuasive number in the discussion, even when it is not the most economically relevant one.

Accounting Values, Capital Considerations and the Economics of Disposal

The distinction between accounting performance and economic value becomes particularly important when a bank considers selling a distressed portfolio. The accounting carrying amount provides an essential reference point for recognizing the financial consequences of disposal, but it does not independently determine whether selling or retaining the exposures is economically preferable.

A portfolio may have a carrying amount above the price currently available in the market. Selling it could therefore crystallize an accounting loss, while continued ownership may preserve the possibility of recovering a higher amount. However, the existence of an accounting loss on disposal does not establish that retention is the superior decision. The carrying amount reflects applicable accounting measurement requirements and estimates; it is not necessarily equivalent to the present economic value of the institution's available resolution alternatives.

The reverse is also true. A sale above carrying value may generate an accounting gain without demonstrating that the transaction maximized economic value. If the institution had



a credible and economically superior recovery strategy, disposing of the portfolio could still represent an unattractive decision despite its favorable accounting presentation.

Capital considerations introduce additional complexity. Depending on the characteristics of the exposures, applicable prudential treatment and transaction structure, disposal may reduce risk-weighted assets, eliminate certain future credit risks and improve selected balance-sheet indicators. It may also affect regulatory capital through the accounting profit or loss recognized on the transaction. These effects should be evaluated explicitly, but not treated as automatic or independent sources of value.

A common analytical weakness arises when discounted recovery proceeds, capital release benefits and funding advantages are combined without establishing whether the underlying economic effects have already been reflected elsewhere in the valuation. If the discount rate incorporates the institution's relevant cost of capital, introducing an additional capital charge may result in double-counting. Equally, a reduction in regulatory capital requirements should not automatically be treated as an immediately realizable economic benefit. Its value depends on whether the released capacity can be deployed productively, whether capital constraints are genuinely binding and how the transaction affects the institution's overall financial position. A credible hold-versus-sell assessment must therefore distinguish between accounting consequences, prudential effects and incremental economic value, while ensuring that each relevant cost or benefit is recognized only once.

The economic value of capital flexibility depends on the institution's actual constraints and opportunities. A bank with substantial capital headroom and limited profitable lending opportunities may attach a different value to capital release than an institution whose growth is constrained by regulatory capital requirements. The same distressed portfolio can therefore have different strategic implications for different owners, even where the underlying recovery cash flows are comparable.

These distinctions become especially relevant in large-scale NPL reduction programmes and institutional wind-downs. A bank seeking to simplify its balance sheet may rationally accept



a lower nominal recovery in exchange for certainty, reduced operational complexity and the release of resources. Another institution with established workout capabilities and a longer investment horizon may be better positioned to retain the exposures and capture additional value.

Neither strategy is inherently superior. The important requirement is that management identifies the actual economic objectives of the decision and evaluates the available alternatives consistently.

The danger lies in allowing accounting outcomes, regulatory indicators or nominal collection targets to substitute for that analysis.

The Economic Cost of Maintaining a Distressed Portfolio

Financial models generally capture identifiable external costs associated with continued recovery activity. Legal fees, enforcement expenses, collateral valuations, property maintenance and third-party servicing charges can be estimated and allocated to the relevant exposures. In complex corporate workouts, however, the resources consumed by continued ownership extend beyond these direct expenditures.

Distressed exposures often require sustained involvement from restructuring specialists, credit risk professionals, legal teams, collateral managers, finance departments and senior decision-makers. The resolution of a single complex corporate case may involve repeated financial reviews, negotiations with creditors, restructuring proposals, legal proceedings and committee approvals over several years.

Not all associated internal expenses are economically avoidable. A bank may continue employing certain professionals and operating its systems regardless of whether an individual portfolio is retained or sold. Consequently, allocating the entire cost of these functions to a disposal decision could overstate the benefits of exiting the exposure. A more appropriate assessment distinguishes between genuinely incremental costs, expenses that could be eliminated and specialist capacity that could realistically be redeployed. For decision-making purposes, the relevant costs are those that differ



between the available alternatives. Existing overhead that would remain unchanged following a disposal should not be treated as an avoidable holding cost, while future expenditure required exclusively to pursue a particular recovery strategy should be included. The same principle applies to internal resources: their economic relevance depends on whether continued portfolio management prevents their productive redeployment or requires additional expenditure that could otherwise be avoided.

The latter consideration can become particularly important during portfolio run-off. As straightforward exposures are resolved, the remaining portfolio may become increasingly concentrated in difficult restructurings, contested collateral, prolonged litigation and borrowers with limited repayment capacity. Although the nominal outstanding balance declines, the complexity of the remaining cases may increase relative to their economic value.

An institution can consequently reach a point at which a smaller portfolio requires a disproportionately expensive operating structure. The relevant management question is no longer simply how much remains to be recovered, but whether the existing resolution model continues to represent the most efficient way of achieving those recoveries.

This does not necessarily support immediate disposal. Certain residual exposures may justify intensive specialist management because their expected incremental recoveries remain substantial. Others may be better suited to outsourcing, settlement, portfolio sale or alternative enforcement arrangements.

The appropriate allocation of resources depends on expected economic returns rather than exposure size alone. A relatively small case with strong collateral, limited legal uncertainty and a short expected resolution period may deserve greater attention than a significantly larger exposure whose apparent recovery potential depends on years of uncertain litigation.

For boards and senior management, this raises an important question about the operating economics of Special Assets functions. Performance should not be assessed exclusively



through gross collections or reductions in outstanding exposure. It should also reflect the resources required to generate those outcomes and whether the institution's resolution capabilities remain aligned with the characteristics of the portfolio being managed.

When the Original Recovery Strategy No Longer Makes Economic Sense

One of the most difficult decisions in distressed asset management is determining when an established recovery strategy should be reconsidered. The challenge is not necessarily identifying that circumstances have changed. It is recognizing when those changes are sufficiently material to alter the original economic rationale.

A bank may initially retain an exposure because a restructuring is expected to restore sustainable debt-servicing capacity. The decision may be supported by credible operating forecasts, committed shareholders and an achievable implementation timetable. If the borrower subsequently misses critical milestones, liquidity deteriorates and additional financing becomes necessary, the original strategy cannot simply be extended without reassessing its economic implications.

A similar problem arises in collateral enforcement. Management may reasonably expect a favorable realization following a defined legal milestone. If proceedings become prolonged, collateral maintenance costs increase or market conditions deteriorate, the anticipated nominal recovery may remain unchanged in internal reporting even though its present economic value has declined.

In both situations, continued ownership can gradually become the default position. The institution remains committed to the original strategy because substantial professional effort has already been invested, negotiations are ongoing or the next milestone appears sufficiently close to justify another extension.

Past expenditure, however, cannot by itself justify future commitments. A sound hold-versus-sell assessment must be forward-looking, comparing the incremental cash flows, risks and resources associated with the alternatives available at the current decision date. Historical losses, previously incurred legal expenses and earlier restructuring concessions



may explain the institution's present position, but they should not determine the economic ranking of future strategies unless they affect remaining contractual rights, future cash flows or relevant constraints. The decision to continue a workout or enforcement process should therefore be justified by its prospective economic value, not by the amount of time or resources already invested.

This is particularly relevant when internal recovery forecasts become difficult to challenge. In complex cases, the professionals responsible for developing a strategy often possess the most detailed knowledge of the exposure. Their expertise is indispensable, but close involvement can also make it harder to reassess assumptions that have guided negotiations and decisions over an extended period.

Effective governance should therefore create opportunities for independent challenge without undermining the responsibility of the workout team. The purpose is not to replace professional judgment with procedural escalation, but to ensure that material changes in expected cash flows, execution timelines and recovery risks lead to a genuine reconsideration of available alternatives.

A credible resolution strategy should identify the assumptions on which continued ownership depends, the milestones expected to create additional value and the circumstances that would require management to change course. These conditions may include missed restructuring milestones, material collateral deterioration, unexpected enforcement delays, significant deviations from expected collections or the availability of a disposal offer whose economic value exceeds the revised hold strategy.

The decision to change strategy should not be interpreted automatically as evidence that the original approach was flawed. Distressed asset management operates under uncertainty, and reasonable decisions can produce disappointing outcomes. The more important measure of professional competence is whether management responds appropriately when new information changes the economic balance.



An institution that repeatedly revises its strategy in response to credible evidence may demonstrate stronger risk management than one that preserves its original recovery target despite progressively weaker assumptions.

Why the Highest Market Bid Is Not Always the Best Outcome

The economic case for evaluating continued ownership rigorously should not be confused with a preference for accelerated portfolio disposals. There are circumstances in which retaining distressed exposures can create substantially greater value than accepting an immediate market offer.

A bank may possess detailed borrower information, established creditor relationships and restructuring capabilities that allow it to realize recoveries unavailable to an external investor. A viable corporate restructuring can preserve operating value, avoid unnecessary enforcement costs and restore sustainable repayment capacity. Similarly, a secured creditor approaching a decisive legal milestone may have a credible basis for expecting materially stronger proceeds than those reflected in an investor's current bid.

Portfolio preparation can also justify a deliberate delay. Investors price uncertainty, particularly where loan documentation, collateral records, enforcement status or historical servicing information are incomplete. Targeted remediation of material information deficiencies may improve pricing and transaction certainty sufficiently to compensate for the additional time and expenditure.

The distinction is whether the institution can identify a credible source of incremental value. Retaining an exposure to complete an advanced restructuring supported by measurable operational improvements is fundamentally different from postponing disposal because management expects market conditions to improve eventually.

External pricing should therefore be treated as important evidence, but not necessarily as a definitive measure of recoverable value. An investor's offer reflects its required return, funding structure, servicing capabilities, information constraints and assessment of



execution risk. A bank with different capabilities and constraints may rationally arrive at another valuation.

Nevertheless, internal estimates deserve the same scrutiny. Familiarity with a portfolio can create genuine informational advantages, but it can also reinforce established expectations and reduce sensitivity to changing market conditions. Independent valuation, competitive market testing and transparent scenario analysis are valuable precisely because they help management distinguish between an informed difference of opinion and an unsupported belief that continued ownership will eventually produce a better outcome.

The decision should ultimately rest on whether the institution has a realistic, executable and economically superior strategy for capturing the value that external investors are unwilling to pay for today.

What Boards Should Expect from Asset Resolution

For boards and senior management, the central governance challenge is to ensure that recovery performance is evaluated through measures that support sound economic decisions. Gross collections, recovery rates, NPL reductions and progress against annual targets remain necessary indicators, but they should not become substitutes for assessing whether the institution is realizing the greatest economically justified value from its distressed exposures.

A recovery team may exceed its collection targets while achieving proceeds materially later than anticipated. Another team may accept lower nominal recoveries through negotiated settlements or portfolio disposals but produce a stronger present value outcome. Without a consistent economic framework, conventional reporting may favour the first result even when the second represents a more effective use of institutional resources.

This does not mean that every recovery decision should be reduced to a single discounted cash-flow figure. Financial models depend on assumptions, and the uncertainty surrounding complex distressed exposures cannot be eliminated through increasingly elaborate calculations. Management must also consider legal enforceability, strategic



constraints, reputational considerations and the institution's ability to execute the proposed strategy.

The value of a structured economic framework is that it makes those considerations explicit. It enables decision-makers to understand which assumptions determine the preferred strategy, how sensitive the outcome is to changes in timing or recoveries and what developments would justify reconsideration.

For material exposures, boards should expect management to demonstrate that the selected resolution strategy has been compared with realistic alternatives, that the expected incremental value is sufficient to justify continued ownership and that changes in the underlying assumptions are being monitored. Where a strategy is retained despite repeated delays or deteriorating expectations, the institution should be able to explain why continued ownership remains economically preferable.

The same discipline should apply to performance assessment. A favorable recovery outcome does not necessarily demonstrate that the original decision was economically optimal, just as an adverse outcome does not automatically establish that management exercised poor judgment. Decision quality should be assessed primarily on an ex-ante basis, considering the information reasonably available at the time, the credibility of the underlying assumptions, the alternatives examined and the risks that could reasonably have been anticipated. Subsequent performance should then be evaluated separately, with particular attention to execution discipline and management's willingness to revise the strategy when material new information becomes available.

This distinction is especially important in Special Assets management, where outcomes are frequently influenced by factors outside the institution's control. Effective governance should encourage informed commercial judgment rather than defensive decision-making designed primarily to avoid criticism for deviations from established targets.

Ultimately, the role of the board is not to determine individual workout strategies. It is to ensure that the institution has the professional expertise, decision-making authority and



analytical discipline necessary to distinguish between value-preserving patience and economically unjustified delay.

Regulatory and Supervisory Context

European supervisory guidance provides an important foundation for the governance and management of non-performing exposures. The European Banking Authority's Guidelines on Management of Non-Performing and Forborne Exposures, EBA/GL/2018/06, establish expectations concerning NPE strategies, governance arrangements, operational capabilities, monitoring and sustainable portfolio reduction.

The European Central Bank's Guidance to Banks on Non-Performing Loans, published in March 2017, addresses NPL strategy, governance, operational arrangements, forbearance, impairment measurement and collateral valuation. It also recognizes the relevance of institutions' internal capabilities, market conditions and strategic objectives when evaluating approaches to reducing non-performing exposures.

These supervisory frameworks reinforce the importance of credible strategies and effective oversight, but they do not prescribe a universally optimal choice between continued workout, enforcement and portfolio disposal. The economic merits of each alternative depend on the characteristics of the exposures, the institution's circumstances and the realistic prospects for execution.

The EBA Guidelines on Loan Origination and Monitoring, EBA/GL/2020/06, provide additional context concerning credit monitoring, governance and collateral valuation throughout the credit lifecycle. IFRS 9 establishes the applicable accounting framework for expected credit losses, including relevant requirements concerning probability-weighted cash shortfalls and discounting.

A distinction must nevertheless be maintained between accounting measurement, prudential treatment and internal economic decision-making. Each serves a different purpose, and a sound resolution framework should recognize their interaction without treating them as interchangeable measures of value.



The regulatory references discussed above provide the supervisory and accounting context for the management of non-performing exposures. They establish relevant expectations concerning governance, monitoring, recovery planning, valuation and financial reporting, but should not be interpreted as prescribing the economic comparison methodology presented in this article. The assessment of alternative resolution strategies through probability-weighted expected cash flows and management-oriented discounting is an analytical decision-support framework, not a valuation approach mandated by the cited authorities. Its application must remain consistent with the institution's circumstances and should be distinguished from the specific measurement requirements applicable under IFRS 9 and relevant prudential regulations.

Conclusion: Recovery Performance Is Ultimately a Question of Economic Judgment

The objective of distressed asset management is often described as maximizing recoveries. While this remains a legitimate ambition, it becomes incomplete when the amount ultimately collected is considered independently of the time, costs and risks required to achieve it.

A bank may recover more through prolonged restructuring or enforcement and nevertheless produce a weaker economic result than an earlier disposal. Equally, an institution may destroy substantial value by selling prematurely when a credible and executable recovery strategy offers materially stronger prospects.

The distinction cannot be resolved through a general preference for holding or selling. It requires disciplined comparison of realistic alternatives, consistent treatment of expected cash flows and a willingness to reconsider decisions when the underlying economics change.

For experienced workout professionals, this is not simply an exercise in financial modelling. It involves understanding borrower behavior, evaluating the credibility of restructuring proposals, assessing legal and collateral risks, negotiating under uncertainty and



recognizing when additional time is likely to improve recoveries rather than merely postpone an unavoidable outcome.

The institutional challenge is to ensure that these professional judgments are supported by governance arrangements and performance measures that reward economic value creation rather than nominal results alone.

A recovery strategy should therefore be evaluated not only by the proceeds ultimately realized, but by the quality of the decision made when alternative courses of action were available. That assessment must consider the information reasonably available at the time, the assumptions supporting the selected strategy and the institution's ability to respond when subsequent developments materially change the expected economic outcome.

For boards, CROs and Special Assets executives, the central challenge is to ensure that recovery decisions remain grounded in economic judgment rather than nominal targets, accounting considerations or institutional attachment to established strategies. The objective is not to eliminate uncertainty from distressed asset management, but to make informed decisions under uncertainty and to reconsider them when the financial rationale changes.

The real measure of Asset Resolution performance is not how much a bank eventually recovers, but whether management selected the economically superior course of action based on the information and alternatives reasonably available at the time.

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Corporate Credit Risk | Restructuring | Special Assets | Distressed Assets

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Regulatory References & External Sources

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4. **IFRS Foundation – IFRS 9 Financial Instruments**, International accounting requirements concerning the classification and measurement of financial assets and the recognition and measurement of expected credit losses.
5. **Basel Committee on Banking Supervision – Basel Framework**, International prudential standards relevant to credit risk, regulatory capital and the treatment of banking exposures.

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The analysis discusses general principles of credit risk management, distressed asset resolution, banking governance and financial valuation. Actual recovery and portfolio management decisions depend on institution-specific circumstances, applicable contractual arrangements, regulatory requirements, accounting standards, market conditions and the availability of reliable information.



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