

# NPL PORTFOLIO SOLUTIONS

## BUILDING BLOCKS FOR MARKET SALES

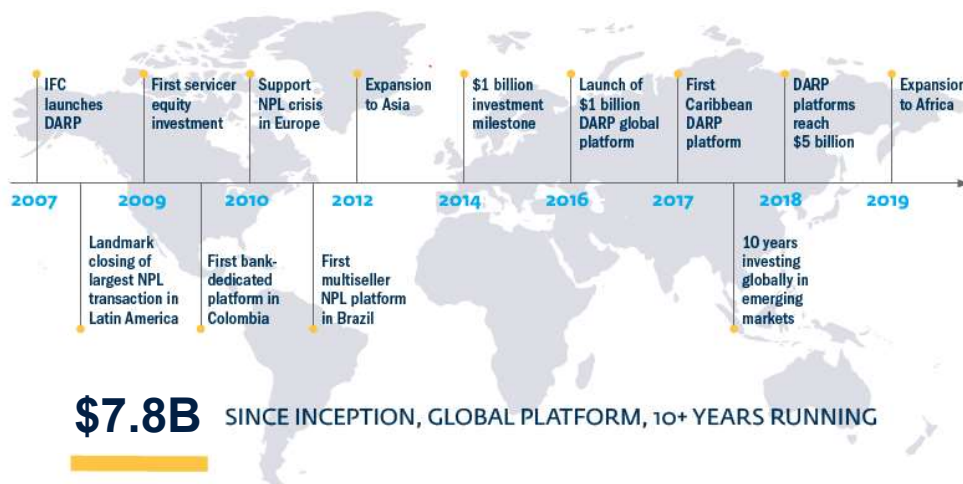


*Creating Markets, Creating Opportunities*

November 4, 2021

# IFC and Non-Performing Loans

## DARP Key Milestones 2007-20



Source: IFC

## Selected DARP Results

# Portfolios Acquired	UPB	# Borrowers	Mobilized Capital
150+	\$33 Billion	19+ Million	\$4.6 Billion
» Acquisitions of NPL portfolios across asset classes in Latin America, Eastern Europe and Asia	» NPLs offloaded from multiple lenders, increasing liquidity and origination of new loans	» Individuals and SMEs able to avoid losing their assets and remain active in the financial system	» Mobilized from third party investors, deepening secondary markets with improved liquidity

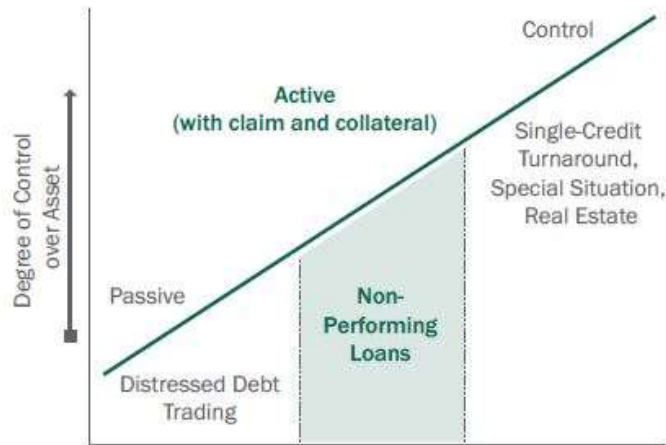
Source: IFC

The Debt and Asset Recovery Program's (DARP) global expansion has been facilitated by its strong financial performance and outstanding developmental impact.

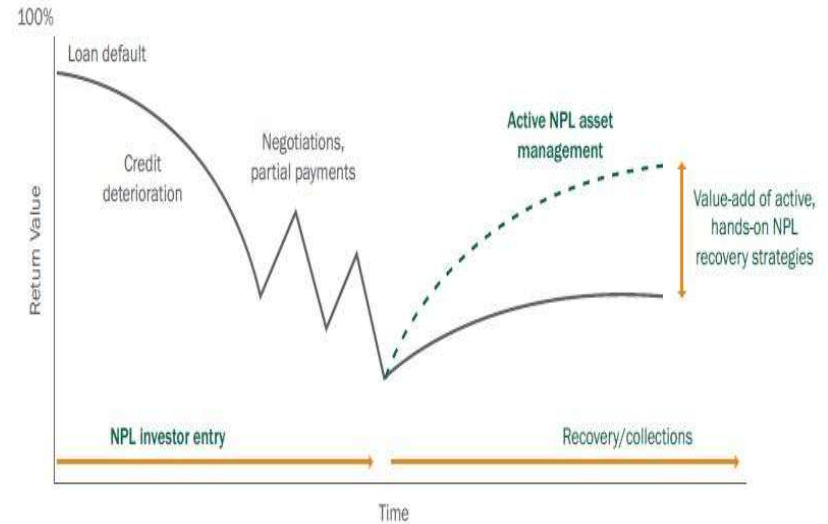
Since inception, DARP has acquired **more than 150 NPL portfolios**, ranging from retail unsecured to corporate secured NPLs, as well as mortgages and commercial real estate-backed NPLs.

With actual total commitments to date of more than **\$7.8 billion**, including **\$2.7 billion from IFC's own account** and **\$4.6 billion from third-party investors**, DARP has secured its global leadership role as a distressed assets investor in emerging markets.

# NPL Investment Concepts



Dedicated NPL investors focus on and specialize in actively managed debt recovery/resolution of NPL portfolios and single assets



NPL investors create value via active, hands-on recovery strategies, including potential new funding to resuscitate Borrower back to profitability

## An active NPL market attracts global/regional investors

- Investing in “distress” implies buying at discount
- NPL portfolios offer diversification, self-liquidation, security/collateral, cash flow, risk-adjusted returns

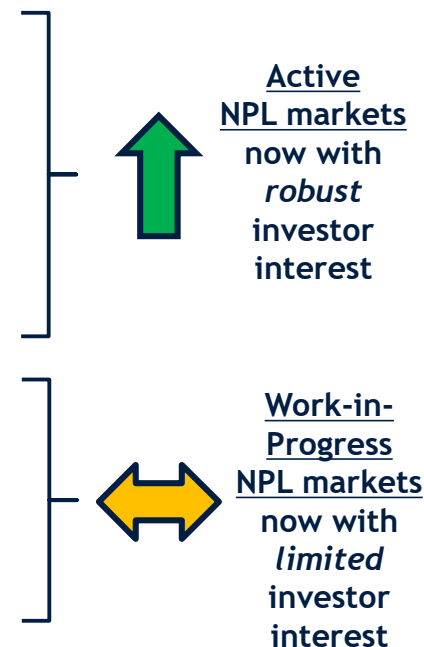
# NPL Solution Concepts

- NPLs are costly to manage . . . \$ and human resources
- Time is the enemy of NPLs . . . NPLs are perishable
- NPLs not self-healing . . . NPLs don't fix themselves
- NPL resolutions embed moral hazards . . . Including contagion risk
- NPL market truisms:
  - Attractive risk-weighted investments . . . Portfolios create greatest win-win
  - Market-based conditions . . . Will fetch highest pricing
  - Optimizing NPL investment . . . For hands-on investors/servicers
- NPL portfolios enable bulk sale *and* clean start . . . Win-Win for the market
- Open-market and rule of law concepts attract global/regional/local NPL investors
  - Investors accept NPL return risk . . . There is never a “bad” asset, only “bad” pricing
  - If you build it (an enabling NPL market) . . . They (investors) will come

# Opening NPL Markets

## □ NPL markets opened with varied development experiences:

- ✓ **USA** - RTC kickstarted NPL sales with massive securitizations; *Big-bang institutional*
- ✓ **Korea** - KAMCO ran market-clearing NPL auctions monthly; *Process-driven success*
- ✓ **Thailand** - FRA opened NPL market with 2 huge no-reserve auctions; *Bold action by govt*
- ✓ **Philippines** - Early NPL auctions bolstered by govt incentives; *Win for banks, investors*
- ✓ **Taiwan** - Banks ran market-clearing NPL auctions monthly; *Process-driven success*
- **China** - “By exception” regulations enabled early auctions; Foreign investors retreated
- **India** - NPL market opened with focus on big single-credits; Got stalled on jumbo NPLs
- **Japan** - Early NPL auctions with smaller NPLs; Slow action on big zombie companies
- **Indonesia** - IBRA internalized the NPL market; Limited investor interest to this day



## □ Enabling environment for NPL sales:

- Market-based investment and regulatory framework will attract NPL investors
- Supporting infrastructure will develop (servicers, valuers, legal, accounting, tax, etc.)
- Creates baseline for NPL trading platforms, NPL securitizations, secondary/tertiary sales
- Provides effective NPL clearing mechanism for financial sector

# Opening Vietnam NPL Market

- NPL sales most effective with . . .
  - I. Market-based principles for transacting NPLs: (i) open/transparent data room, (ii) abundance of loan info and access to loan officers, (iii) adequate time for underwriting, (iv) fair P&S agreement with reps/warranties, (v) no cherry-picking, (vi) tranche portfolios with loan types (Corporate, SME, Mortgage, Consumer, etc.), (vii) no reserve prices, etc.
  - II. Commercial regulations for resolving NPLs: (i) NPL servicing (proprietary and 3<sup>rd</sup> party), (ii) clear creditor rights, (iii) ability to realize on security/collateral, (iv) out-of-court restructuring, (v) insolvency framework, etc.



**Vietnam NPL market now developing. Create enabling environment for NPL sales and resolutions to attract foreign investors.**

# Vietnam NPL Market Obstacles for Investors

Many upfront challenges for foreign NPL investors to enter Vietnam market:

- ❑ Ambiguous regulations on NPL acquisition, trading, enforcement and collection of debt
  - Clarify laws on NPL purchases and on-selling, NPL creditor rights, NPL servicing, and NPL debt collection
- ❑ Foreclosing on collateral for NPL resolution requires debtor's consent
  - Change to debtor public notification only (China did this)
- ❑ Foreign investors restricted from land ownership
  - Consider special law to allow foreign NPL investors to foreclosure (to at least sell onward to a local buyer)
- ❑ Convoluted and unpredictable judicial proceedings to enforce creditor rights
  - Consider introducing a simplified fast-track process for NPL judicial proceedings (India did this)
- ❑ No official guidelines/schemes for out-of-court corporate restructurings
  - Consider issuing standards or principles to encourage and guide constructive NPL workouts
- ❑ Lack of specialized bankruptcy court
  - Longer-term reforms for insolvency adjudication will benefit overall market
- ❑ No government incentives for encouraging NPL sales
  - Consider tax incentives on transfer taxes, extended time to recognize losses, etc. (Philippines did this)

# Structured NPL Sales Can Open Market

**Challenges to NPL Sales**

- Difficult execution in nascent markets
- Divergent investment horizons, return profiles, risk tolerances
- Buyer/Seller cost of capital different
- Transaction can trigger write-downs



**Optimized NPL Sales**

- Private negotiation; custom solution
- Portfolio theory smooths out lumpy NPLs with more homogeneous NPLs
- Bank retains recovery upside, gains knowledge transfer, debtor relations
- Partner-centric; alignment of interests

**Outright transaction**

- Sale or auction
- Best in *active, robust NPL markets*
- Issues include:
  - Value/Price gap inevitable
  - Advisor(s), Data scrub, War room
  - Airing dirty laundry
  - Regulatory/Auditor attention

In early NPL markets with limited NPL activity, outright sales pose many difficult challenges



**Structured transaction**

- Bilateral, negotiated transaction
- Best in *inactive and early NPL markets*
- Benefits include:
  - Price gap bridging strategies
  - Recovery/Up-side sharing
  - Servicing arrangement
  - Knowledge transfer

Early NPL market conditions can be mitigated via a structured transactions





# Structured Sales Approach to Open NPL Market

Structured deals can support NPL sales in the following situations:

- ✓ NPL pricing gaps
- ✓ Challenges to sell for regulatory reasons
- ✓ Challenges to sell for capital/liquidity reasons
- ✓ Buyers' market for NPLs
- ✓ Meaningful long(er)-term recovery value in holding asset or funding new \$
- ✓ Seeking to maintain amicable relationship with NPL debtor
- ✓ High level of legacy institutional knowledge of asset
- ✓ Can customized structure for bank-specific requirements
- ✓ Partner-centric and interests aligned

**Structure examples (for nascent and difficult NPL markets)**

1. Sale of NPLs with B Note . . . True-sale with seller-carry note to capture residual cash flows
2. Sale of NPLs to Purchaser JV . . . Contribution of NPLs to “Investment in JV”
3. Sale of NPL Cash Flows . . . Not a true-sale, complicated structure, but monetizes/manages NPLs

# Conclusion – Foreign Investors for Vietnam NPL Market

Generally, clarify regulations on NPL acquisition, trading, enforcement and debt collection

## Top 3 reforms to attract foreign NPL investors

1. Eliminate debtor's consent requirement to enforce foreclosure
2. Enable foreclosure of land/building collateral for foreign investors
3. Offer government incentives to encourage NPL sales

Suggested structure approach to kick-start Vietnam NPL market (until reforms)

## Sale of NPL Cash Flows

- Investor purchases NPL cash flows only; Bank retains ownership of NPLs
- Investor pays Bank \$ upfront for right to manage the NPLs for X years
- Investor establishes local Servicer (and can second some of Bank asset managers)
- Investor/Servicer instructs Bank to take specific NPL resolution actions on each NPL
- Collections from NPL resolutions, cash flows distributed per waterfall:
  - i. To Servicer to cover servicing agreement costs
  - ii. To Investor to recover its \$ investment, plus agreed-upon IRR
  - iii. To Bank and Investor in agreed-upon % split of residual cash flows