IFC and Non-Performing Loans

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.

DARP Key Milestones 2007-20

$7.8B SINCE INCEPTION, GLOBAL PLATFORM, 10+ YEARS RUNNING

Source: IFC

Selected DARP Results

<table>
<thead>
<tr>
<th># Portfolios Acquired</th>
<th>UPB</th>
<th># Borrowers</th>
<th>Mobilized Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>150+</td>
<td>$33 Billion</td>
<td>19+ Million</td>
<td>$4.6 Billion</td>
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» 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
NPL Investment Concepts

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

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*Active NPL markets now with robust investor interest*

*Work-in-Progress NPL markets now with limited investor interest*
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 3rd 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

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

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

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

In 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:
  - To Servicer to cover servicing agreement costs
  - To Investor to recover its $ investment, plus agreed-upon IRR
  - To Bank and Investor in agreed-upon % split of residual cash flows