



NPL Transaction Platforms: Pre-requisites, Benefits, and Feasibility
Strengthening Asia's NPL Markets Through Transaction Platforms

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Background

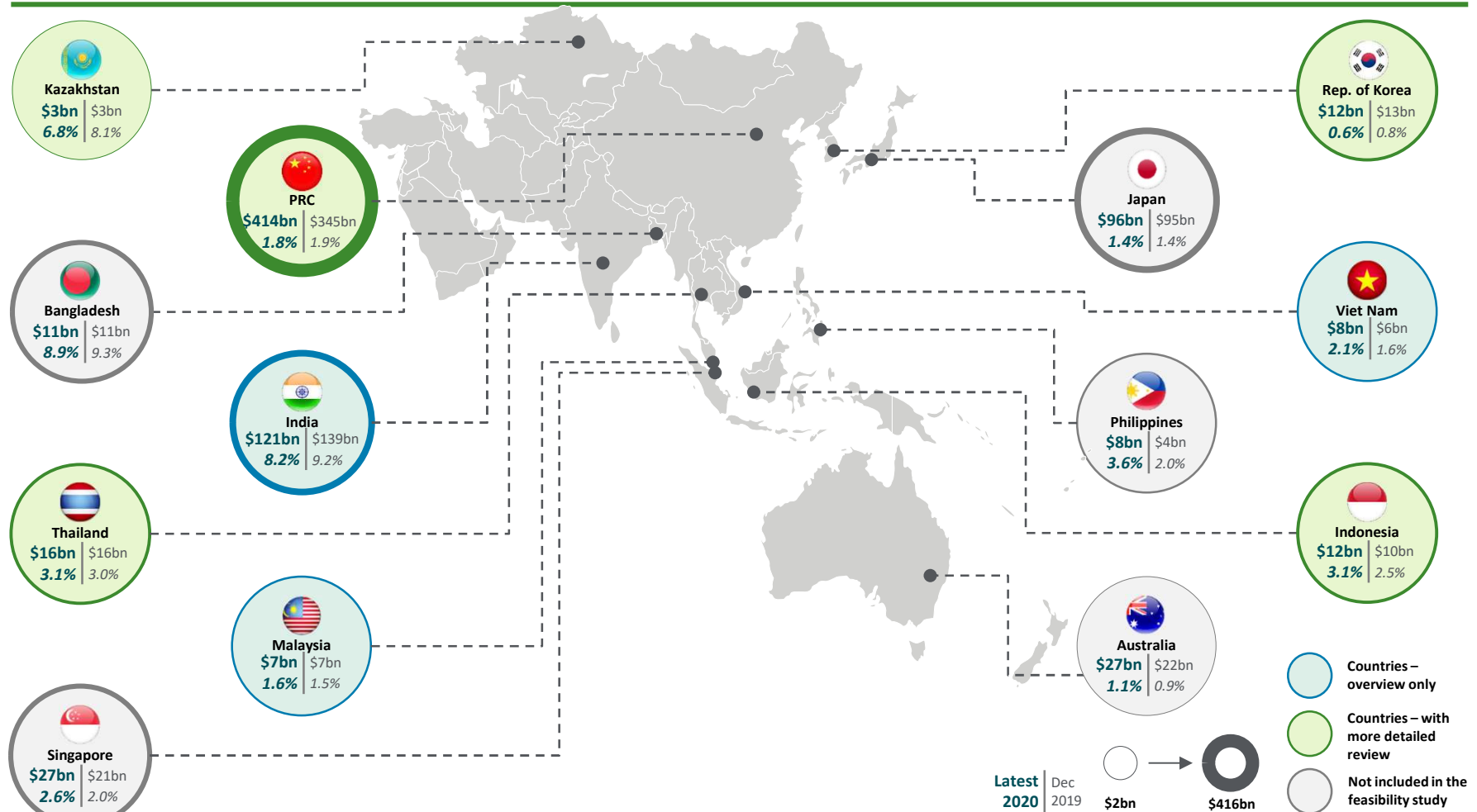
Structure of the study

Against the backdrop of increasing NPL levels as a result of the COVID pandemic, this knowledge project which has been commissioned by ADB seeks to examine the feasibility of establishing an NPL transaction platform for the Asia and the Pacific region as an additional tool for NPL resolution.

Regional NPL overview	Feasibility to first engage in domestic NPL trading, as well as possibly in cross-border transactions of distressed debts	Overall feasibility and key challenges to be considered in developing an NPL platform
<ul style="list-style-type: none"> • Analysis of NPL levels and market trends in the region against the backdrop of COVID-19 • Overview of existing online NPL or public asset disposal system being used by governments and/or public agencies • Breakdown of outstanding NPLs, valuation methodologies, resolution practices, and typical court auction procedures by country • Market appetite (banks to sell, investors to buy, regulators willingness to make the changes necessary) • Role of AMCs in resolving NPL's in the region • Rationale for improving NPL resolution mechanisms & importance of secondary markets • NPL platform as one option 	<ul style="list-style-type: none"> • Policies & mechanisms for repatriation, incentivizing foreign investors, and restrictions, if any, on selling NPLs to foreign investors and or the ownership of NPLs or collateral • An assessment of both existing and possible legal requisites and conditions for (online) NPL trading • Servicing infrastructure • Legal foundation of public AMCs to realize profits from intermediating NPL sales to foreign investors • The possibility of foreign investor participation by appointing an agency or establishing an SPV • The ownership transfer of NPLs between creditors in different countries • A legal framework for NPL securitization, if any • Dynamics between platform founders/operators and platform participants 	<ul style="list-style-type: none"> • Examples of existing NPL platforms • Practical issues • Data consistency and quality/standardised data template (EBA NPL template) • Data privacy (including for cross border) • Where should data be hosted • Governance • Ownership • Any restrictions on public AMCs' involvement in such an online NPL trading platform (as limited by mandates, business scope, regulatory requirements)

APAC NPL landscape – top countries

NPLs held by banking institutions amounted to over c.\$775bn by end 2020 (\$704bn – 2019), which do not include distressed assets held by AMCs and non-deposit-taking institutions – real levels could be higher. Fitch projects NPLs will double on average across 14 APAC economies* by 2022.



Source: Latest statistics published by Central banks and IMF as of 15 February 2021. Original values are denominated in local currencies and converted to US\$ with exchange rate on relevant dates.
 * The 14 economies include Australia, Bangladesh, People’s Republic of China (PRC), Hong Kong, China, India, Indonesia, Japan, Republic of Korea, Malaysia, Philippines, Singapore, Sri Lanka, Thailand and Viet Nam

Pre-requisites for an NPL Transaction Platform

Pre-requisites for an NPL transaction platform

Success of an online NPL trading platform will depend on the existence of a viable and active distressed asset market in the country. The creation of an NPL transaction platform, however, would help facilitate the further development of such markets and help improve their efficiency.



Key elements for a functioning market for NPL sales



Regulator

- **Clear and supportive frameworks for NPL transfer and investment** are crucial to developing an efficient market.
- Some countries in Asia still lack policy guidance around resolution methods and loan sales.



Legal Enforcement Frameworks

- **A creditor-friendly legal regime for restructuring, enforcement & insolvency** would improve recovery from distressed assets from an investor's perspective.
- Lengthy and complex enforcement processes in some markets create uncertainty, increase collection costs and ultimately lead to a wider bid-ask spread for NPL sales.



Servicer

- **Depth of experienced servicing & restructuring skills** is a key driver for recovery. Sufficient servicing capabilities are required to effectively rehabilitate debtors.
- Foreign buyers sometimes team up with trusted local servicers to manage NPLs post-transaction.



Seller

- **A sizeable supply and a visible pipeline** of future deals are critical in attracting investors.
- **Sellers should commit to the transaction with realistic price expectations.** The reluctance of banks to accept losses/ restriction of banks' ability to sell below par will discourage NPL transactions.



Buyer

- **Participation of foreign investors** in domestic NPL markets offers banks access to larger capital pools, which can absorb an increased amount of bad debts.
- However, **restrictions on buyers, especially foreign buyers**, (e.g. limited ownership, restricted deal structure) create barriers to new entrants.







Advisor

- Engaging a **credible and experienced advisor with in-depth knowledge** to manage the transactions will significantly increase buyer confidence and therefore the success rate.
- An advisor should be able to support banks in assessing risks across capital, funding, execution, regulatory, and other key considerations.



Functionalities and Benefits of an Online NPL Platform

Typical Functionalities of an NPL Platform

	Data warehousing	Hosting of detailed loan portfolio information – financial and non-financial data	<ul style="list-style-type: none"> • Electronic database, regularly updated with detailed loan level data, including both financial information and other qualitative information (e.g. legal documentation, security documents, payment history, collateral appraisals, borrower correspondence, etc.)
	Data review and validation	Automated checks to provide a level of assurance on data quality/ analytics	<ul style="list-style-type: none"> • In order to reduce transaction and search costs, the NPL platform would ensure data sharing and a high degree of data standardisation. Completeness and other checks could be built in to enhance data quality as well as a range of data analytics tools. • Unlikely to fully remove the need for additional DD but nevertheless fundamental to success.
	Transaction facilitation	Matching buyers and sellers and online auction	<ul style="list-style-type: none"> • Acts as a marketplace for sellers looking to sell NPL stocks and for investors looking to buy as well as facilitating portfolio trades, the platform would allow the bundling of smaller portfolios together which might be of interest to specific buyers • Offers standardised, ready to use documentation (NDAs, SPAs, etc.) to avoid lengthy contract negotiations • Existing in use platforms already include: <ul style="list-style-type: none"> ➢ Q&A functionality and real time updates for answers/ documents uploaded ➢ An auction platform (English Auction with binding public bids) with the ability to solicit non-binding bids (market soundings), set reserve prices, etc.
	Ancillary services	Intermediation for other value accretive services	<ul style="list-style-type: none"> • Credit servicing – including in terms of data provision • Valuation and due diligence • Real estate and collateral appraisal

Portfolios visible to more potential investors and greater transparency

Reduced bid ask spread, higher prices, faster process for disposals

Benefits of an online NPL platform

Transactions through accredited online NPL platforms can bring substantial benefits to all constituents, including buyers, sellers and other service providers.

Providing access to larger pools of investors/ opportunities/ other resources

- NPL platforms provide sellers with **access to a pool of investors** based on preferred assets type, which they can tap in one go instead of directly approaching investors. This is particularly beneficial for smaller sellers.
- Similarly, buyers will be able to screen multiple opportunities and target assets suitable for their investment criteria, which **facilitates deal origination**, especially for new entrants.
- Platforms could act as **intermediaries for selected servicers/law firms/appraisers/financiers** with detailed local knowledge thereby breaking down one of the barriers to entry for potential buyers.

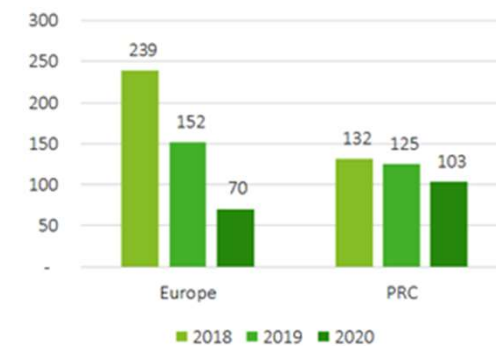
Improving information provision and data quality

- Validated and harmonised data would improve data quality and ensure the **provision of necessary and appropriate data** required by investors.
- Using standardised data and information during the underwriting process allows investors to **improve the consistency of valuation models and the pricing accuracy**. It enables the sellers to run more precise valuation models and set **realistic asking prices**.
- Adoption of standardised, appropriate data templates may also encourage banks who expect to conduct multiple sales on the platforms to adjust their internal system such that the required data fields are available in-house for future transactions. It would reduce the amount of preparation work required for future transactions.

Improving infrastructure and streamlining transaction processes

- Clear rules and procedures and standardised data infrastructure offered by platforms would **increase market transparency**.
- Bringing elements online and **automating the transaction process** will help the market perform fairly and efficiently.
- Investors may be incentivised further if regulators agree to provide a **“seal of approval”** to those platforms.
- As a response to COVID-19, many sectors are actively adopting digital technologies. The digital elements of online platforms will **reinforce market resilience** and support the level of transaction activities even under extreme conditions.

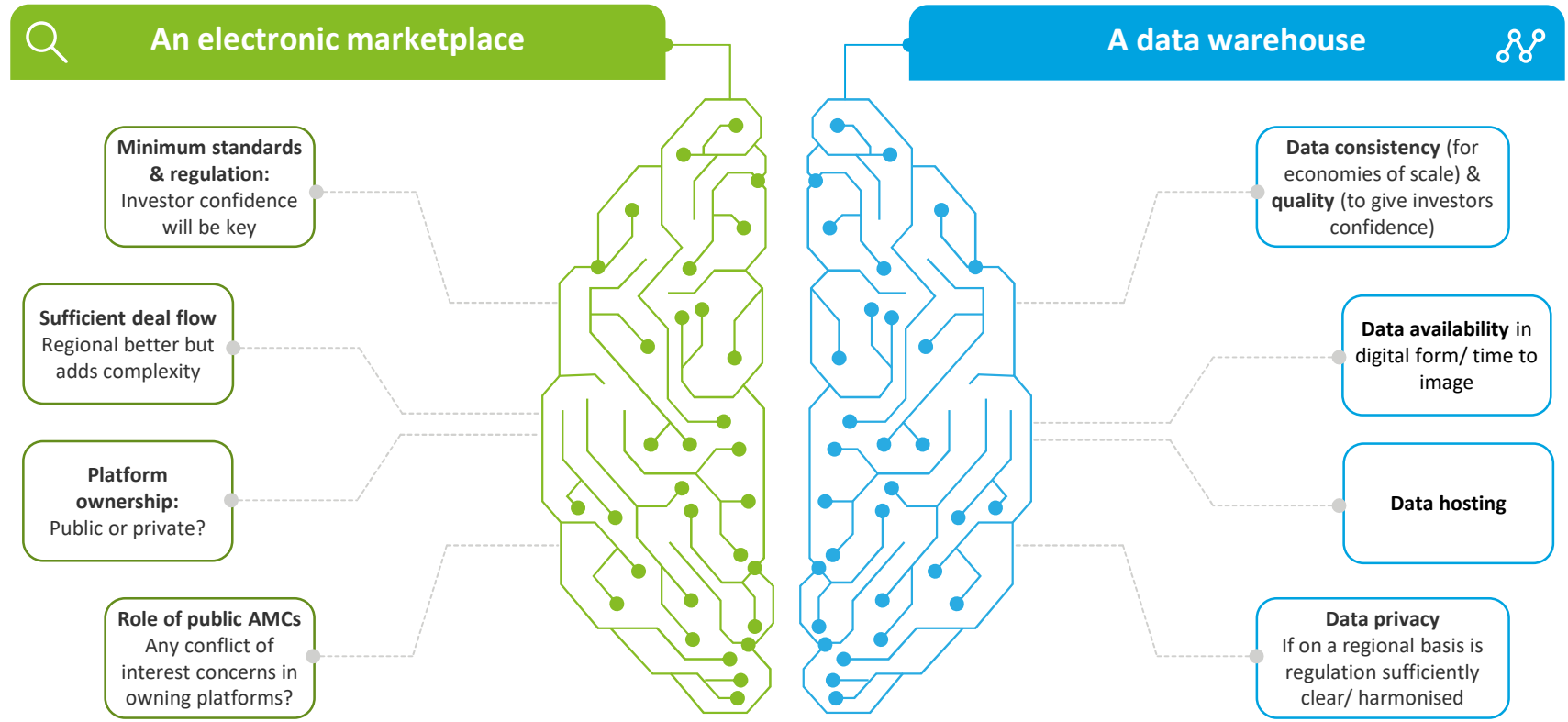
Completed loan deals (balance in USD*bn)



Source: Deloitte research, Zheshang Asset Management Company

Key Considerations in Developing an NPL Platform

Practical considerations



Asset focus and key considerations

NPL platforms look to benefit from realising economies of scale, and as such may best be achieved by considering a broad range of asset classes to the extent practical. The scope may also be extended to include performing loans to attract different types of investors.

Secured	Residential mortgage, car loans, etc.	Loans secured by commercial real estate, equipment and machinery, inventory, etc.	Security <ul style="list-style-type: none"> • Secured loans are relatively easier to roll out on the online platform as: <ul style="list-style-type: none"> ○ The documentation and data availability/requirements are relatively well understood from the buyers and the sellers. ○ There is enough supply held by the banks to sustain the pipeline. • According to a survey conducted as part of this project, commercial mortgage, residential mortgage and secured corporate/SME lending are the top three asset classes traded in the NPL markets in Asia, as ranked by a number of national AMCs in the region.
	Unsecured	Credit cards, personal loans, etc.	
	Retail	Commercial	Borrower type and homogeneity <ul style="list-style-type: none"> • Retail portfolios would benefit from the homogeneity of underlying loan products and borrowers. The loan files are usually standardised with limited customised terms for each individual loans. • However, in some countries, banks already work with DCAs to dispose of their unsecured retail loans on a regular basis, and an online trading platform may add less value to the process. • Corporate loans (including special lending) could have multiple lender relationships where a single borrower may be indebted to several banks. Lack of coordination between banks may add to the difficulty in the transaction and resolution of such loans. • In addition, documentation requirements are usually more complex for corporate loans and special lending compared to retail loans. Buyers may expect to see evidence on the operation and solvency status of the company and/or the assets/projects.

Discussion & next steps

Questions to consider

1

How do you assess the current state of the NPL market in your country? Are NPLs actively traded? Who are the main sellers and buyers?

2

To the extent that NPL secondary markets are undeveloped, what do you consider the main reasons for that? What actions are necessary to unlock them?

3

How might greater foreign participation be encouraged? Where is this on the political agenda?

4

Considering the NPL market characteristics and regulatory regime – do you consider that the type of NPL platform discussed here would be of benefit?

5

Considering the functionalities of the platform and potential impediments – which countries do you think are ready to adopt such a platform? Which countries would need further improvement in infrastructure and/or state support?

6

What do you consider would be the key operational and design issues to consider? For example: Data quality/ consistency/ privacy, ownership, regulation, etc.

Speakers Today



Alok Gahrotra

Partner, Portfolio Lead Advisory Services, Deloitte

T: +44 7795 970686
E: agahrota@deloitte.co.uk

- Alok has over 18 years corporate finance advisory and investing experience, most recently specialising in the acquisition of loan portfolios. Before joining Deloitte, Alok was part of the Portfolio Investment team at Bank of America Merrill Lynch.
- As part of the team at Bank of America Merrill, Alok spent the last 5 years investing in and managing portfolios across Europe including in Poland, Portugal, Romania and Greece where the Bank invested in multiple portfolios.



Richard Bevan

Director, Portfolio Lead Advisory Services, Deloitte

T: +44 7769 648922
E: rbevan@deloitte.co.uk

- Richard is an experienced insolvency and restructuring professional with over 25 years' experience. Since 2007 he has focused on the financial services sector.
- He is part of the core team working on and advising in relation to the bank recovery and resolution planning. Richard is a resolution specialist, focussing on no creditor worse off analysis and independent valuations and contingency planning. He has worked on a number of RRP assignments for major UK financial institutions as well as resilience simulation exercises to test the effectiveness of organisations' resolution plans.



Lily Hao

Manager, Portfolio Lead Advisory Services, Deloitte

T: +44 7586 283276
E: lhao@deloitte.co.uk

- Lily has experience supporting major financial institutions in executing distressed portfolio transactions in both sell side and buy side capacities across Europe and Asia.
- Prior to Deloitte, she gained experience in credit risk management advisory where she assisted in developing internal credit risk monitoring and early alarm systems for banks and financial leasing companies in China.

Thank you



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