PRICEWATERHOUSECOOPERS

NPL Asia

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A review of what is happening in the Asian non-performing loan (NPL) market

In our last issue of NPL Asia (May 2006) we predicted market activity would be robust in 2006 and the market has proven us correct. Activity levels were strong in most regions, particularly China, Thailand, Korea, Taiwan, Malaysia and the Philippines. Will the pace of sales continue into 2007? To find out, read on.

In this issue we start off with Malaysia, Asia's newest hot NPL market. PwC advised Maybank in the country's first NPL disposal since the issuance of guidelines for the disposal of NPLs by the Malaysian central bank last year. Activity levels are expected to pick up substantially with other banks contemplating sales in coming months, many as a result of tightened loan provisioning guidelines for NPLs aged more than 5 years.

The information contained in NPL Asia has been obtained from numerous sources in the market and is believed to be accurate at the time of going to print. We trust you will continue to find this publication useful, and we welcome any comments you may have.

NPL Sellers in 2006

China: CCB, China Orient, Cinda, Great Wall, Huarong, ICBC

India: Dena Bank, IFCI Ltd, Punjab & Sind Bank, State Bank of Hyderabad, State Bank of India

Korea: Citigroup, Hana, KEB, Kookmin, Solomon Mutual, Samsung

Malaysia: Maybank

Philippines: Metrobank, Philippine National Bank

Taiwan: Land Bank of Taiwan, Taishin Int'l Bank, Taiwan Cooperative Bank,

Thailand: Financial Institutions Department, Siam Commercial Bank

Malaysia

Maybank leads the way in opening up a new Asian NPL market

One year on from the issuance of guidelines for the disposal of NPLs by the Malaysian central bank, the country has just witnessed its first major NPL portfolio transaction. Acting as the sell side advisor, PwC assisted Maybank (Malaysia's largest bank) to sell a portfolio of corporate NPLs, consisting of almost 100 borrowers with a face value of RM 2.2 billion (US$630m). The sale is currently undergoing Ministry of Finance approval and is expected to close within the next 2-3 months. Early assessments indicate that the Maybank sale has created the benchmark for future sales in the Malaysian market.

An interesting dynamic of the sale was the two stage bidding process, with investors submitting indicative offers for the portfolio based on limited data, from which four groups were selected to proceed to full scale due diligence and a binding bid process. This bidding model follows more recent sale trends in Europe and particularly Germany where participants in the auction process have been limited by the selling banks.

One feature of the Malaysian NPL market is the requirement for buyers to be at least 51% domestically owned, meaning that any SPV established for a transaction is limited to 49% foreign ownership. Unlike many other Asian markets, this has led to early involvement of domestic investor groups, rather than 1-2 years into the sale cycle, which seems to be more the norm.

Unlike many other Asian markets, the Malaysian central bank guidelines do not contain tax, stamp duty or in fact any financial incentives to distressed debt buyers; however this has not dampened enthusiasm nor interest from investors. The Maybank transaction had in excess of 25 potential investors expressing a strong interest to participate.

It is widely felt that the Maybank transaction represents the tip of the iceberg, with many other institutions likely to bring NPL portfolios to the market during the course of this year and into next. Maybank itself is currently planning further portfolio sales in the second quarter, with the intention of bringing both retail and SME portfolios to the market.

The timing for Malaysian banks to enter the global distressed debt market could not be better. NPL activity in several other Asian markets appears to be tailing off with much of the NPL stock in those countries having already been sold. Investors, hungry for new opportunities, now have a new market to engage in with significant deal flow anticipated, with reported NPL levels in the Malaysian banking system close to RM 44 billion (US$12-13 billion).

An appealing investment destination

Malaysia enjoys a number of advantages for NPL investment. The legal system is seen as both developed and robust, and the political climate has proven to be historically stable. The real estate sector has also shown considerable growth over recent years across most sectors. Add to this a greater number of recovery options for holders of debt (receivership being one), and the perceived risk profile of the Malaysian market appears lower than many of its Asian neighbours.

Busy year ahead

Regulatory actions are seen as a prime catalyst to force a significant proportion of the existing NPL stock off the balance sheets of the Malaysian banks. Since two years ago, the Central Bank had imposed tightened loan provisioning guidelines for NPLs aged more than 5 years. This has incentivised banks to either resolve or dispose of these loans in order to avoid having to create additional provisions and clean up their books. This dovetails well with the impending Basel II compliance in 2008 and on-going liberalisation of the financial sector in Malaysia.

Accordingly, activity levels are expected to pick up substantially with other Malaysian banks joining in the foray now that a portfolio sale has been completed. On the investor side, already a number of groups have indicated their desire to acquire portfolios and or large single credits.

China

The China NPL market saw considerable sales activity in 2006 with 28 transactions involving foreign investors being reported—more transactions than in any of the previous 5 years. While 2006 was clearly a good year for investors, how 2007 shapes up remains to be seen.

China NPL sales to foreign investors

Year	No of Deals	OPB RMB Bn	OPB US$ Mn
2001/2002	7	19	2,366
2003	-	-	-
2004	13	75	9,400
2005	16	82	10,193
2006	28	36	4,489
Total	64	212	26,448

So, who was buying in 2006? As the table below indicates, with the exception of investment banks *Citigroup* and *UBS*, last year's buyers were primarily specialist funds such as *CarVal*, *Mellon*, *Avenue Capital*, *DAC* and *Corstone*, all of whom made multiple investments in the China NPL market. Perhaps they have found the key to success in the China NPL market that has eluded others, including some initial entrants who appear to have abandoned the NPL market to pursue other opportunities such as those in real estate or private equity. Why were there so many transactions? We think there are several reasons. First, the AMCs have plenty of loans they needed to get rid of to meet government targets, and most branches were actively trying to sell portfolios. Second, while there was definitely a push by the AMCs to dispose of their Category 5 or "loss" loans, we also saw increased disposals of the better quality Category IV or 'doubtful' loans—so investors were interested. Finally, we think some investors are actually finding ways to actually make money—and they are hoping to make more!

Buyer	Seller	Location	OPB (RMB billion)	OPB (US$ million)	Total (US$ million)	Date
CarVal	China Orient	Harbin	1.9	240		Feb-06
	Cinda	Hunan	2.0	245		May-06
	Cinda	Shenzhen	0.9	110		Jun-06
	Cinda	Wuhan	1.2	144		Nov-06
	Huarong	Xiamen	0.8	95	834	Feb-06
Citigroup	Greatwall	Tianjin	4.5	561		Feb-06
	Greatwall	Shanghai	2.0	250	811	Dec-06
Mellon	China Orient	Shaanxi	4.2	524		Jan-06
	Huarong	Wenzhou	1.0	125	649	Jan-06
DAC	Cinda	Shangdong	0.2	29		Aug-06
	Cinda	Jiangsu	0.1	16		Dec-06
	Cinda	Liaoning	0.2	28		Jan-06
	Huarong	Guangzhou	0.2	26		Mar-06
	Huarong	Heilongjiang	0.7	81		Nov-06
	ICBC*	Liaoning	0.9	113		Jan-06
Caylon/ DAC	CCB*	Guangzhou	0.9	116	409	Nov-06
Corstone	Greatwall	Jiangxi	2.1	268		Feb-06
	Huarong	Beijing	1.0	120	388	Dec-06
PPF	China Orient	Qingdao	3.1		388	Jan-06
UBS	China Orient	Jinan	0.6	81		Dec-06
	Cinda	Chongqing	1.9	239	320	Dec-06
Avenue Capital	China Orient	Yunnan	1.3	163		Aug-06
	Cinda	Hubei	0.5	60		Jun-06
	Cinda	Shijiazhuang	0.3	41		Aug-06
	Cinda	Yunnan	0.4	44	308	Aug-06
Clearwater Capital	China Orient	Jilin	1.4		175	Jan-06
Bank of America	Huarong	Xiamen	0.9		115	Jan-06
Orix Group	China Orient	Shandong	0.7		93	Aug-06
Total			**35.8**		**4,489**	

*settled asset portfolio

Flat year in 2007?

While many believe the increased level of NPL disposals to foreign investors will carry on into 2007, we do not completely share this view. It's not that there isn't an adequate supply. It is difficult to estimate the amount of unresolved NPLs within the AMCs—the only authorised sellers of China's NPLs—as they generally only report the amount disposed from their initial 1999 transfer loans of RMB1,400 billion (US$170 billion), and not amounts disposed from the various subsequent transfers made in 2004/2005 which, based on press reports, we estimate total approximately RMB1,225 billion (US$153 billion). Recent press reports indicate that as of the end of 2006 the AMCs have resolved RMB1,210 billion (US$150 billion) of the 1999 transfer loans. How much of the RMB1,225 billion of subsequent transfer loans are still on the books of the AMCs remains a mystery, but whatever way you look at it, it appears that the AMCs still have a large number of NPLs that they need to resolve.

So why are we bearish on foreign investors' prospects in the China NPL market? As we allude to in our recent *"China NPL Investor Survey 2006"*, we believe that despite ample supply and demand, many NPL auctions targeted at the foreign investment community will fail due to price expectation gaps between the AMCs and investors. The AMCs' acquisition costs for the NPLs remaining on their books are high—likely around the value of the loans. And as the AMCs generally can't sell these loans for less than they bought them for, it doesn't leave much room for investors to make a profit. As a result, we expect to see in 2007 more of what we saw in 2006: failed auctions due to high selling prices that few foreign investors will be brave enough to meet.

Should it happen that auctions at the AMC's fail, this will not necessarily put the AMCs' in a predicament as they have other avenues for disposal. So who will they sell to? Investors that have broader interests than profit alone: municipal and provincial governments eager to protect and rescue the debtors in their regions. This isn't a new phenomenon—most of the portfolios sold by the AMCs to date have been to domestic parties including local governments—we simply expect it will continue in earnest going forward. Indeed only last September the Liaoning Provincial Government announced it would acquire RMB33.6 billion (US$4.2 billion) of NPLs from Greatwall AMC—nearly as much at the total sold to foreign investors during 2006. You can't blame the AMCs for this. "Keeping it in the family" is a concept practiced the world over and in any event, local governments may be best placed to sort out solutions and therefore are logically going to be willing buyers.

Another reason we believe NPL sales to foreigners may not be particularly robust in 2007 is the potential for foreign investors to be discouraged from participating in NPL auctions due to new regulations governing the sale of NPLs to foreigners that were issued in February. In many respects the new regulations don't cover much new ground. And while initial press reports focused on the regulation requiring portfolio purchases by foreign investors to be settled up front via a single payment, in practice we have not seen a significant number of portfolios being sold via instalments. So it's not the new regulations themselves that may keep foreigners away from NPL sales; rather, it's the feeling many foreign investors have that the only reason the new regulations were promulgated in the first place was to limit possible unfounded criticisms that NPLs are being sold to foreigners on the cheap. What many foreign investors are afraid of is that the new rules can only lead to one thing: higher asking prices and more difficulty in getting deals approved.

So while there is plenty of supply, we expect the above factors will have a significant negative impact on the number NPL transactions involving foreign investors going forward, ultimately reducing demand to only a core group of committed players.

Is bigger better?

But just because the bulk of NPL sales will be to domestic parties it does not mean the market will dry up for foreigners. And as the chart above indicates, there are many investors committed to acquiring portfolios. How they will actually go about it remains to be seen but what is beginning to become clear is that experienced investors—those that have actually bought Chinese NPL portfolios—appear to be falling into one of two camps, those with large teams on the ground pursuing multiple deals and those with smaller teams, happy to pursue smaller transactions with local partners. This begs the question, who's got the right strategy?

Some investors argue that it is difficult to make China NPL acquisitions without disastrous results for all but the biggest market players—those with large teams of people to sift through the multitudes of potential opportunities. For investors following this strategy, size evidently matters, and it's not the size of their wallet.

The 'big team' argument may have some merit. As any experienced investor will tell you, to find out if a portfolio of NPLs is worth buying, you've got to spend a lot of time analyzing it. And therein lies the problem for investors from small shops: In their quest to find a good investment—a portfolio of loans with good prospects for collection that can be had for a reasonable price—they can really only look at opportunities serially, one at a time. Their bigger team competitors, on the other hand, can look at several opportunities simultaneously, and because of this they believe they are far better placed to find better investment opportunities.

Not so say those from small shops. Looking at as many portfolios as possible in the hopes of finding a good deal is a fool's errand, and a costly one at that. Maintaining big teams can be a huge expense, as can be the cost of conducting due diligence on large numbers of NPL portfolios. And while there is no certainty that the portfolios ultimately identified by these teams will be high yielding, there is certainty that the associated costs of finding them will take a huge bite out of returns.

The key to finding the high yielding portfolios, they argue, is not by looking at great numbers of portfolios, but by looking for and partnering up with good domestic investors (domestic parties with actual money to invest in deals—even if the amount is only a small proportion of the deal—as opposed to domestic parties with nothing at stake and only offer to service the portfolio). Domestic investors, they believe, not only get the best portfolios steered their way but they are also, through their connections, best placed to underwrite the portfolio on offer. But finding a good local partner can be tricky, as can be repatriating your money if your deal is not blessed by the authorities. And the key to this strategy is finding multiple local partners for different regions as most investors have found that 'connections' in China can only travel so far. Going local certainly has its risks, but many believe it may be the best way to make superior returns in today's market.

So who's right, David or Goliath? It is hard to argue against going local. By operating under the radar screen and seeking deals meant for domestic investors, foreign investors with small teams — and large wallets enabling them to make multiple investments — may have found the right formula for success in the China NPL market. But the big players have the capacity to (hopefully) find the best deals, including some with domestic local partners if they want to. Clearly the jury is still out on this one.

India

Ongoing momentum in NPL portfolio auctions and single credit transactions…slow movement in regulatory reforms

The increased NPL sales activity amidst slow liberalisation in the financial services sector we described in the last issue of NPL Asia continued over the last nine months as we saw a number of NPL auctions by banks, particularly public sector banks and single credit transactions. It would be appropriate to mention that over the years, there has been substantial improvement in the NPL situation in India and there is little systemic pressure at present on banks. However, in view of regulatory pressures such as the impending implementation of Basle II norms, in order to free up capital and human resources — including senior management time — to take advantage of a myriad of opportunities, and to improve the quality of financial statements, the NPL auction route is becoming increasingly acceptable with the public sector banks.

While some NPL auctions saw good investor interest and adequate response, several issues emerged which affected some of the sell-off attempts:

- Smaller size cases and allowing investors to bid for single assets
- Inadequate time for investor due diligence
- High value expectations and a lack of clarity in the sales process
- Unpalatable contractual conditions

In most the cases, the public sector banks approached the markets on their own, without advisors. In the first advisor led auction of an NPL portfolio by a public sector bank in India, PwC advised Dena Bank in carrying out its NPL auction. Nine investors participated in the auction process (the highest we know of to date in a portfolio sale) for the NPL portfolio comprising 37 accounts with an OPB of US$110 million. The portfolio was successfully auctioned in December 2006 and Asset Reconstruction Company (India) Limited ("ARCIL") was the successful bidder. This was the largest NPL portfolio sale in the past six months.

The existing guidelines regulating foreign investment in share capital of asset reconstruction companies (ARCs) and in security receipts (SRs) issued by trusts set up by the ARCs for acquisition of NPLs have limited foreign participation in NPL acquisition and resolution, particularly in portfolio sales by the banks. Existing guidelines on foreign investments allow foreign investors to:

- Acquire up to 49% equity stake in an ARC under foreign direct investment route
- Invest in each tranche of SRs issued under a scheme (set up by an ARC), collectively up to 49% and individually up to 10% under the foreign institutional investor (FII) route

The resulting requirement for NPL investors through the ARC route, whether directly or through schemes or trusts set up by the ARCs, to find matching domestic funding and to collaborate with like minded NPL investors, has limited participation by foreign investors. While these regulatory requirements on the one hand have limited competition, on the other hand presence of limited number of eligible investors have made the auction process effectively "closed", giving comfort to the existing bidders.

Currently, foreign players with a banking presence in India such as *Deutsche Bank*, *Standard Chartered Bank*, *Barclays Bank*, *Bank of America* and *JP Morgan Chase* are the main eligible foreign investors. Kotak Mahindra Bank, a private sector Indian Bank, ARCIL and ASREC, the two operating ARCs are the main domestic investors. The past six months also saw ARCIL strengthening its capital base (increasing to US$0.5bn from US$0.2bn) for funding NPL acquisitions, primarily due to:

- Reserve Bank of India's (RBI) notification in September 2006 mandating that ARCs invest in security receipts, a cash amount not less than 5% of SRs issued under each scheme
- Competition from other NPL investors (largely banks), who were making upfront cash payments when acquiring NPLs

Though ASREC has begun NPL acquisitions, other licensed ARCs have yet to commence their operations. In order to help form a broad based NPL market, RBI has notified a window of six months to force licensed ARCs to commence their operations. We understand CarVal's acquisition of a 49% stake in ACE is at an advanced stage.

The period also saw some significant legislative clarity, allowing lenders to enforce their security interest without withdrawing or suspending their ongoing recovery suits. Earlier banks which had filed cases in Debt Recovery Tribunals (DRT) had to withdraw their cases from DRT, in order to enforce their security interest under Securitisation Act.

At the same time, substantial returns on first round of distressed investments made in 2004-2005 in sectors such as cement, engineering and paper have encouraged new distressed debt players to look for NPL investment opportunities. Various investors have already set up or are in the process of setting up Non Banking Finance Companies (NBFCs) to explore entry into the Indian financial services sector, including investments in single credit cases, even in absence of security enforcement rights. Foreign investors like *Citigroup*, *Clearwater*, *ADM Capital*, *JP Morgan Chase* and *Spinnaker* have pumped in around US$1 billion into various stressed corporates through a combination of debt and equity instruments. Other investors like *WL Ross*, *Lehman Brothers*, *CarVal*, *Avenue Capital* and *JC Flower* have also entered the market. Recently, *Lehman Brothers* has reportedly acquired the debt held by ARCIL in Spectrum, an independent power producer. This is one of the largest single credit transactions completed recently. While on the one hand, distinction between private equity funds, special situation funds and venture capital funds is getting blurred as different investors want to have a piece of the cake, the market is becoming slightly more challenging due to rising value expectations and the fact that much of the "low hanging fruit" has already been lapped up.

Outlook

Transaction activity in the portfolio space is building up and public sector banks are likely to sell part of their NPL portfolios soon. More single credit transactions are also in the offing and large cases acquired by ARCs are in a stage of re-rating and may be offered to investors.

Market estimates suggest that the US$2.0 billion OPB sold threshold has been crossed in the Indian NPL market in 2006 and given recent market developments this is expected to cross the US$3.0 billion barrier in 2007. With several regulatory hurdles in the process of being removed, evolving pricing benchmarks and increased investor interest, we expect India to continue to offer significant NPL investment opportunities in 2007.

Korea

NPL ratios at Korean banks and credit card companies decreased significantly between September 2005 and September 2006, falling from 1.46% to 0.98% and 12.35% to 7.18% respectively. The decreases were due to a combination of factors including the continued efforts of financial institutions to reduce their NPL ratios through NPL disposals and improvements in the financial condition of corporations and individual consumers.

NPL disposals actually decreased in 2006 as many companies either reorganized or were taken over by other companies. Unlike in 2005, the consumer loan market was active in 2006, mostly involving household loans. There was only one sale of credit card receivables. As the chart below indicates, there were three disposals in both May and August, primarily to local investors as foreign investors seem to have lost interest in the Korean NPL market, likely due to unsatisfying returns on prior investments in the consumer loan sector and their preference generally for investing in secured loan portfolios.

Korean NPL sales completed during 2006

Seller	Date	Deal Size (Unit : USD million)	Buyer	Asset type	PwC's role
Korea Exchange Bank (KEB)	Nov 2006	344	Confidential	Corporate & Household	Financial Advisor
Solomon Mutual Savings Bank	Nov 2006	344	Confidential	Corporate & Household	
KEB	Sep 2006	661	Confidential	Credit card	Financial Advisor
Citigroup	Aug 2006	129	Solomon mutual savings bank	Household	
Industrial Bank of Korea	Aug 2006	69	Hansin mutual savings bank	Household	
Kookmin Bank	Aug 2006	271	Failed	Corporate & Household	
Hana Bank	May 2006	203	Citi/Nara credit information	Household	
Citigroup	May 2006	23	Tong yang investment bank	Household	
Samsung Card	May 2006	923	Solomon	Credit Card	Financial Advisor

Outlook

As a result of the significant decrease in NPL ratios in 2006, it is expected that there will be fewer Korean NPL transactions in 2007 compared to 2006. This said, we believe it is possible that NPL ratios could increase in 2007 if regulations proposed by the government to curb house prices are fully implemented (such as regulations relating to the disclosure housing costs and restrictions on the number of mortgage loans).

Philippines

Amendatory SPV law enacted in 2006

On 24 April 2006, Republic Act 9343 (RA 9343) was signed into law, amending the Special Purpose Vehicle Act (SPVA) of 2002. Based on the information provided by the Securities and Exchange Commission, RA 9343 was published on 29 April 2006 and became effective on 14 May 2006.

Looking back, the Philippine Congress passed the SPV Law in 2002 to encourage banks to dispose of an estimated Php500 billion (US$10 billion) of the industry's soured loans and foreclosed assets. The law exempts the selling banks or financial institutions and buyers of nonperforming assets (NPAs) from paying certain taxes on these transactions, specifically the documentary stamp tax, capital gains tax and the expanded value added tax. NPAs are composed of nonperforming loans (NPLs) and foreclosed assets or real and other properties acquired (ROPA). According to Bangko Sentral ng Pilipinas (BSP), banks were able to dispose of Php96.7 billion (US$1.9 billion) worth of NPAs through the SPVA by the end of 2005.

RA 9343 extended the following deadlines:

1. Establishment of an SPV from 19 September 2004 to 18 months from May 2006
2. Availment of tax benefits from April 2005 to two years from May 2006

The BSP articulated that the medium-term objective of the SPVA is to bring the NPL ratio of Philippine banks back to the pre-1997 financial crisis level of 4%. Furthermore, the industry regulator is making sure that banks comply with proper accounting procedures in booking asset sales, especially those under SPV transactions. Among other measures, the adoption of internationally accepted accounting standards would promote greater transparency in the way asset sales are booked.

According to the latest BSP data as at the end of October 2006, the bad loan ratio of universal and commercial banks is now down to 7.16%. NPLs declined by Php12.9 billion (US$258 million) from Php155.12 billion (US$3.1 billion) in end-2005 to Php142.2 billion (US$2.8 billion) as of end-October of 2006. Meanwhile, local banks successfully unloaded Php9.11 billion (US$182 million) worth of ROPAs, from Php186.11 billion (US$3.72 billion) in end-2005 to Php177 billion (US$3.54 billion) as of 3rd quarter 2006.

2Q to 4Q 2006 performance of the SPVA

The BSP estimated early last year that at least Php50 billion (US$1 billion) worth of bad assets could be unloaded in 2006 especially after the enactment of the amendatory SPV Law. The 2006 estimate was half of the total target of Php100 billion (US$2 billion) worth of NPAs the BSP said would be unloaded under the SPVA. The BSP also authorised banks to enter into joint ventures with real estate firms to develop foreclosed assets or real and other properties acquired, the sale of which had tended to lag other NPAs.

After the banking sector got its two-year extension on the sale of bad assets, data from the BSP showed that banks were still slow to rid themselves of NPAs.

According to BSP and contrary to its expectations, only about Php21.85 billion (US$437 million) worth of bad assets were actually applied for incentives under the SPVA in 2006. Banks intended to sell bad assets amounting to Php62.7 billion (US$1.25 billion). If these assets were actually brought out for sale, total SPVA transactions could amount to Php85 billion (US$1.7 billion). Further disclosures revealed that the BSP approved various incentives for the sale of about Php48.2 billion (US$964 million) worth of individual NPAs with five pending applications for incentives covering assets worth Php21.8 billion (US$436 million).

We tend to agree with the regulator's opinion that banks are slow in ridding themselves of NPAs because local banks took longer to recover from the 1997 Asian crisis especially since, unlike some other countries, the government did not take a direct hand in rescuing the banking industry.

Moreover, banks had to contend with the capital impact of cleaning up the soured accounts from their loan portfolio while building up capital to deal with the impact of complying with the provisions of the Basel II Convention.

Known transactions in 2006

The majority of the deals in 2006 were via auction sales and were dealt under the SPVA, with the exceptions of Metrobank, which opted to dispose of its portfolio outside of the SPVA, and Philippine National Bank, which went for a structured sale, i.e., limited auction with sharing on the upside.

Selling Bank	Approximate Size		Buyer	Asset Type	Transaction Type
	Php	US$ Equivalent			
Asia Recovery Corp.	Php13.2 billion	US$264 million	HvB	NPL and ROPA	Within the SPVA
Security Bank and Trust Co.	Php1.2 billion	US$24 million	ADM	NPL	Not available
Development Bank of the Philippines	Php9.55 billion	US$191 million	Lehman Brothers	NPL and ROPA	Within the SPVA
Metrobank	Php8.7 billion	US$174 million	Barclays	NPL	Outside of the SPVA
Rizal Commercial Banking Corp.	Php4.8 billion	US$96 million	Standard Merchant Bank	NPL and ROPA	Within the SPVA
Philippine National Bank	Php19.3 billion	US$386 million	ING	NPL and ROPA	Within the SPVA

Expectations for 2007

Local banks are planning to unload at least Php84.55 billion (US$1.69 billion) worth of bad assets following the extension of the SPVA. The amount is lower than the BSP's target to strike off Php100 billion (US$2 billion) worth of banks' bad assets by April 2008. BSP data also showed that 16 banks have already informed the BSP of plans to unload Php62.7 billion (US$1.25 billion) worth of bad assets under the extended SPVA. Banks also intend to sell their bad assets worth Php50 million (US$1 million) to individual buyers.

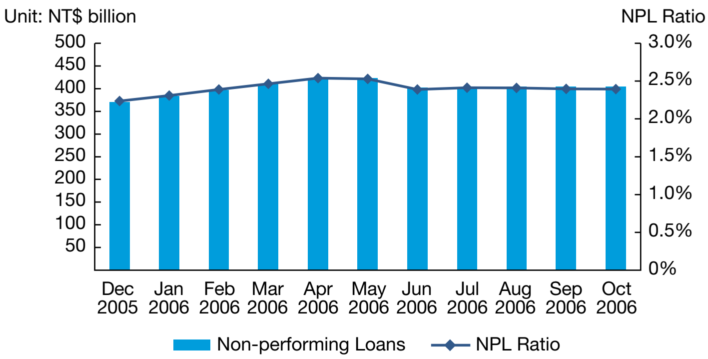
Some of the major deals in the near future include:

- United Coconut Planters Bank (UCPB) announced plans to auction off approximately Php20 billion (US$40 million) worth of its NPAs in the 2nd quarter of 2007
- Bank of the Philippine Islands reportedly intends to dispose of about Php10 billion (US$20 million) worth of NPAs

Taiwan

NPL figures controlled

The overall NPL ratio for Taiwanese banks was relatively flat in 2006. Although the cash card & credit card (double card) non-performing crisis and the transferring restriction of double-card loans to AMCs by government policy resulted in the slight climb of both NPL amounts and ratios in the first half of 2006, the overall NPL ratio for Taiwanese banks decreased and stayed below 2.5% in the second half of 2006. This phenomenon implies that there is greater credit awareness and improvement of risk management among banks in order to control the amount of their NPLs. In addition, during 2006 local banks in Taiwan continued to dispose of their NPLs by either internal write-off or public auctions.



Source: Banking Bureau, Financial Supervisory Commission

2006 roundup

Throughout 2006 public announcements revealed that approximately NT$221.21 billion (US$6.7 billion) of NPLs were put up for auction. While not all auctions announced ended in completed transactions, two transactions that were completed by Taiwan Cooperative Bank (TCB) and Land Bank of Taiwan (LBOT) are worth mentioning.

To improve the asset quality after the merger of TCB and Farmers Bank (TCB was the acquirer) in May 2006, TCB held two NPL sales. The first was held in June with a portfolio of NT$19.3 billion (US$587 million) being purchased by *GE Capital*. The second was held in December with TAMCO purchasing a NT$30 billion (US$912 million) portfolio.

LBOT completed the sale of NPLs totaling NT$25.75 billion (US$783 million) in 2006 with one tranche going to *ORIX* and the other purchased by a consortium (MEGA and HUANAN). According to press reports, the recovery rates of these big public auctions have been satisfactory to the sellers as acquisition prices were strong due to increases in real estate values and the keen competition amongst buyer AMCs. After their successful disposals, both TCB's and LBOT's NPL ratios decreased to approximately 2.5%, which is close to the market average of 2.39%.

Consumer loan disposal continued

Out of the NT$221.21 billion (US$6.73 billion) of announced NPL public auctions, double card loans made up approximately 36% or NT$79 billion (US$2.4 billion). This is a considerable amount given the unsecured nature of cash card and credit card loans. Statistics sourced from the Bankers Association of the Republic of China reveal that at least ten local banks have disposed of various double card loans via public auctions, where the top three banks in order of disposal amount were Cosmos Bank, The Chinese Bank and Taishin International Bank. The purchasers in the double card loan market consist mainly of local AMCs or the banks' own AMCs. As mentioned above, banks also have the option to dispose of their NPLs by simply writing them off. According to the Banking Bureau, NT$108 billion (US$3.28 billion) of NPLs were written off from January to November 2006. The top four were Chinatrust Commercial Bank, Cathay United Bank, Taipei Fubon Bank and Taishin International Bank, where amounts written-off totaled 40% of the abovementioned NT$108 billion (US$3.28 billion).

Resolution of distressed banks might lead to new NPL sales in 2007

Another market event worth keeping an eye during coming months is the resolution of distressed financial institutions. The Financial Supervisory Commission (FSC) took over the management of Taitung Business Bank (Taitung) on December 16, 2006 since Taitung had accumulated huge debts and was unable to increase its capital as promised. Taitung's net worth had fallen to minus NT$0.8 billion (US$24 million) as of September 2006 while its NPLs had jumped to NT$8 billion (US$243 million). Reports indicate that Taitung will be disposed in about six months, and another six financial institutions are under observation as targets for takeover if they cannot improve capitalization as promised in a certain period of time.

These resolutions are likely to follow the resolution model pioneered by PwC in Taiwan in the successful resolution of Chung Shing Bank and Kaohsiung Business Bank. In these cases both AMCs and bank investors became involved as the distressed banks were split into a Bad Bank (NPLs) and a Good Bank (non-NPL assets, liabilities, operations and branch licenses).

New sources of NPL sales will likely emerge if a more aggressive policy to resolve distressed financial institutes is applied.

Thailand

Business as usual: Bank of Thailand issues new measures to help accelerate NPL reductions

The Bank of Thailand (BOT) is continuing their push for NPL reductions via two measures which are due to be phased in over the next 12 months. This is in support of their overall objective of reducing total NPLs to 2% by the end of 2007.

The first measure relates to how NPL figures are reported and will allow banks to report net NPL figures, ie after allowance of loan loss reserves, rather that the gross NPL figures which are currently reported. This measure, while effectively "window dressing" in relation to the overall level of NPLs, may help to present a better picture of a bank's asset quality.

The second measure will however likely have more of an effect on banks via the phased implementation of IAS39 which outlines new mandatory provisioning requirements for NPLs. IAS39 requires a 100% provision be taken on the difference between the outstanding balance of a loan and the present value of expected cashflow payments to be received from the borrower. If there is no expected cashflow, or if actual cashflow received by the bank is lower than the forecast expected cashflow for the first 3 months, then the future expected cashflow of the borrower will be based on underlying collateral, usually being real property or plant equipment (to the extent a value for plant and equipment can be determined and justified).

IAS39 will be implemented over three phases as follows:

- The first phase, effective by the end of 2006, will apply to all NPLs which are subject to legal proceedings irrespective of the type of court
- The second phase, effective June 2007, will apply to borrowers that are over 6 months past due (essentially all NPLs classified as "doubtful")
- The third phase, effective December 2007, will apply to borrowers that are over 3 months past due (essentially all NPLs classified as "sub-standard")

The general view is that IAS39 will require a number of banks to greatly increase their current reserve levels. This in turn, should increase the attractiveness of NPL sales as any loss on sale of an NPL is likely to be similar to the reserve that would be required to be affected under IAS39.

Recent NPL activity

There continues to be a steady stream of NPL activity in Thailand, primarily in single credits, however several portfolios have also been offered as follows:

- Siam Commercial Bank offered Thb17.6 billion (US$470 million) via 4 tranches. Buyers were allowed to "cherry pick". While official sale results have not been released, market talk indicates that fewer than 25% of the loans were sold
- Bangkok Commercial Asset Management Company (BAMC) finalised contracts to purchase Thb30 billion (US$800 million) worth of non-performing assets from thirteen banks and three debt-management companies. The purchase prices reportedly ranged from 12% to 33% of the appraised values of the underlying collateral based on a four-step grading scale from A to D (applies to real property BAMC will pay for the assets through zero-coupon bonds with a maturity ranging from two to nine years

- The Financial Institutions Development Fund ("FIDF") sold several stakes in listed and non-listed companies through a series of auctions throughout 2006. These stakes were mostly acquired by FIDF from the now-defunct 56 finance firms that failed in the financial crisis in the late 1990s.

Banks that have indicated that they are likely to go to market with NPLs in 2007 include:

- TMB with a portfolio of approximately Thb20 billion (US$530 million)
- Kasikorn Bank with a mixed portfolio of approximately Thb5-6 billion (US$150 million)
- Government Savings Bank with a large volume retail portfolio

While the main issue facing investors in 2007 will continue to be whether NPLs will be sold at realistic market prices to third parties or whether they will be transferred to private or state owned AMCs, the introduction of IAS39 combined with the BOTs continuing to drive to reduce NPLs by year end should see increased NPL activity in Thailand throughout 2007. The recent political situation in Thailand is not expected to prevent banks from going to market.

According to the BOT, as at October 2006 NPLs represented 8.86% of total loans (Commercial Banks registered in Thailand), or Thb 465 billion (US$12.3 billion).

Dedicated Website

For more regular updates on NPL activity in Asia or Europe, or for past editions of **NPL Asia**, please visit our website:

www.pwc.com/loansales

Our Contacts

Across Asia, we have experienced partners and directors that can assist you with your NPL related needs in any of the following territories. In addition, PwC has a dedicated international NPL advisory group that can act as an overall co-ordinator for worldwide NPL mandates and opportunity identification. Through this group, both buyers and sellers of NPLs can receive consistent, seamless service across the world, integrated with territory specific knowledge and expertise:

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