PRICEWATERHOUSECOOPERS

NPL Asia

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

The Asian non-performing loan ("NPL") market continues to flourish. Taiwan's clean-up continues and the Philippines is beginning to show signs of life. China, as always, remains a hot spot with India still waiting for the action to kick-in. Throughout all of these individual markets (and more), PricewaterhouseCoopers ("PwC") continues to be at the forefront of the deals being done. In this fourth issue of ***NPL Asia****, a newsletter aimed at NPL sellers and investors, and the advisors that serve them, we again do our best to report on recent trends, transactions and market developments.*

In this issue we focus once again on China and Taiwan, the most active markets, and also on the issues facing India, Indonesia, Korea and the Philippines.

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* ***NPL Asia*** *useful, and we welcome any comments you may have.*

NPL sellers in 2004

China:	Huarong, China Construction Bank, Great Wall
Taiwan:	Chung Hsing Comm'l Bank, Chinfon Comm'l Bank, Taiwan Cooperative Bank
Korea:	Daegu, Suhyup, IBK, CHB, KDIC, Daewhan Life
Philippines:	National Home Mortgage Finance, Bank of Philippines Islands

China

Understanding the market

The Chinese NPL market should no longer be baffling to market watchers. It is what it is – slow and unpredictable, but at the same time active and forward moving. Nearly every day there are press reports on China's banking reform and the efforts being made to resolve problem loans. China's banking sector is clearly taking steps to modernise their operations and reduce the number of NPLs on their books. NPL disposals from the Asset Management Company's ("AMC") continue, albeit at a slow pace and through a variety of means. Most interested investors and market participants have stopped complaining about the dearth of opportunities in the market and have instead focused their efforts on making their own opportunities, often out of the limelight.

While we are aware of many deals in the works, since the end of last year only a few significant transaction initiatives were publicly offered to the investment community with winning bidders identified. Major deals offered in the market during the past several months include:

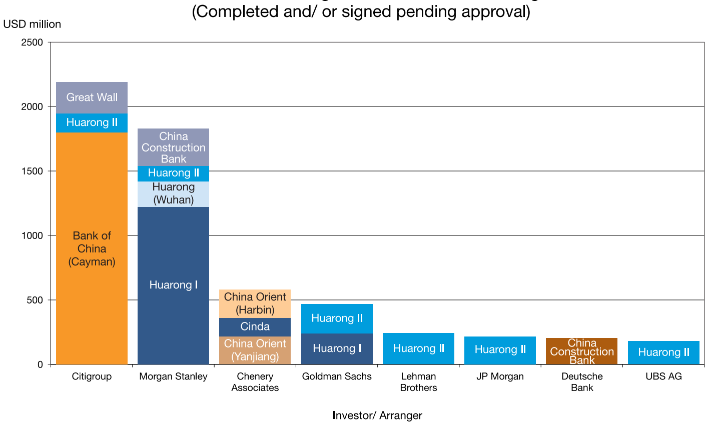
- Huarong AMC's second NPL auction ("Huarong II")
- China Construction Bank's ("CCB") settled asset auction
- Citigroup's bilateral NPL deal with Great Wall AMC
- Industrial and Commercial Bank of China ("ICBC") Ningbo branch's NPL securitisation, and
- Great Wall's closed auction of two small NPL portfolios in Guangdong Province

Notwithstanding these transactions, and a steady stream of sales to domestic investors that are not well publicised, sales to foreign investors remain few. As the tables on the following pages indicate, to date, NPL disposals to foreigners amount to only US$6.0 billion (face value), a scant fraction of China's total, and that's including US$1.8 billion relating to NPLs in Hong Kong.

But new opportunity awaits: the recent bulk sale of RMB279 billion (US$34 billion) of NPLs from Bank of China ("BoC") and CCB to

Cinda AMC in late June 2004 as well as Cinda's acquisition of an additional RMB41.4 billion (US$5 billion) of NPLs from Shanghai-based Bank of Communications has certainly aroused the interest of investors – more on that follows.

China NPL sales to foreign investors: Dec 2001 – Aug 2004
(Completed and/ or signed pending approval)



Huarong II

In December 2003, Huarong held an auction for 22 separate NPL portfolios of over 1,000 borrowers from Huarong branches in 17 provinces across China. The outstanding principle balance totalled approximately RMB22.5 billion (US$2.7 billion) and the winning bidders included Citigroup, JP Morgan, Goldman Sachs, UBS, Morgan Stanley, Lehman Brothers and at least one domestic Chinese company, Ao Yi Er Investment.

Press reports and other sources indicated that of the 22 portfolios, only three were won outright by bidders that offered prices that sufficiently exceeded Huarong's minimum reserve prices, with 14 portfolios requiring further negotiation between the "winning" bidders and Huarong under a joint venture format. The remaining five portfolios (amounting to approximately RMB4.9 billion (US$592 million)) were withdrawn because the bid prices were lower than Huarong's minimum reserve prices. With respect to the 14 portfolios kept open for negotiation, our sources indicate that agreements with bidders have been reached for all, and while transaction documents have been executed, none have formally closed as they are still awaiting various government approvals.

No public announcement of the successful bidding prices was noted, but it is generally believed that the prices were substantially lower than those in the first auction held by Huarong in 2001, owing to the poorer quality and aging of the portfolios offered in the second auction.

Notwithstanding the slow results in Huarong II (how long will it take to get the various deals closed!), Huarong II must nevertheless be considered a success, with Huarong maintaining its position as the only AMC to date that has demonstrated its capability and competency in running large-scale auctions in accordance with international terms and best practices.

CCB Settled Asset Auction

Eager to take steps to lower its NPL ratio to meet a targeted 2005 listing, CCB in May 2004 held an outright auction sale of three portfolios of settled assets with book value totalling approximately RMB4.2 billion (US$507 million). The three portfolios consisted of about 160 settled assets including offices, hotels, retail shopping centres, residential and industrial buildings, as well as various land-use rights, located over 18 provinces. These settled assets were grouped into portfolios according to their locations: Northern China (Inner Mongolia & Heilong Jiang), Mid-China and Southern China.

Market intelligence suggests approximately 15 domestic and overseas investors registered as bidders and conducted due diligence on the portfolios, with eight investors submitting bids on some or all of the portfolios. Ultimately, Morgan Stanley won the bid for portfolios in Mid-China and Southern China and Deutsche Bank won the Northern China portfolio. Although the actual individual bidding prices were not disclosed, the overall cash recovery from the auction was reported as RMB1.4 billion (US$169 million), around 34.75% of the book value.

Some aspects of this auction are worth mentioning. If CCB's reported cash recovery rate is true, it would be the highest rate achieved to date by the PRC banks or the four AMCs when disposing of NPL portfolios. The average cash recovery rate in the past five years is approximately 20%, cumulative, as reported by PRC official government websites. Also, unlike other previous auctions, in CCB's there was no reserve price, though for the sake of risk management, the seller maintained a right not to sell. Last but not least, this was the first large-scale auction conducted by a state-owned bank in China in accordance with international best practices, especially the market-clearing practice. Previously, it was very difficult for the banks to adopt the market-clearing practice in an auction because the banks were prohibited by regulatory policies from disposing their loans below their book values. As settled assets are not explicitly governed by such policies, the regulatory authorities' silent consent made it possible for CCB to play the game in this grey area.

What's next for CCB? It is reported that CCB is planning to hold another outright sale auction of its equity interests derived from debt-equity swaps from its borrowers. While market participants await official information on the proposed transaction, market intelligence suggests the rumoured book value of the equity positions to be offered will approximate RMB46 billion (US$5.6 billion). CCB is also actively studying the feasibility of securitisation for its distressed assets. In addition, as reported below, in June 2004, CCB transferred another big portfolio of NPLs, together with a portfolio from BoC, to Cinda.

Great Wall – Citigroup bilateral transaction

To avoid charges that the best price was not obtained, China's AMCs are encouraged to conduct their NPL dispositions through auctions rather than through bilateral discussions. It is thus difficult for investors to conclude bilateral deals with AMCs, even though, as the investors claim, they may actually offer a higher price through this method (they'll pay a bit extra for the "certainty" of closing a deal). To the surprise of many market observers, Great Wall and Citigroup announced the signing of a bilateral transaction (still subject to government approval) in April 2004 regarding an NPL portfolio with a face value of RMB2 billion (US$242 million) consisting of more than 600 borrowers in Huizhou City, Guangdong Province. The transaction price was not disclosed and we understand that the deal had been negotiated for over two years.

Great Wall – Unsecured Loan Auctions – Guangdong Province

Great Wall also recently offered for sale to investors two small NPL pools of unsecured loans in Guangdong Province.
The Huadu portfolio approximated US$40 million while the Guangzhou portfolio, comprised of unsecured loans from Panyu and Baiyun, is rumoured to have been in the US$100 million category. Both portfolios were offered for sale to both domestic and at least one international investor. Discussions with various parties and market intelligence indicate an unofficial or "rumoured" sales price in the range of 10% – 11% of Outstanding Principal Balance. Winning bidder group for both portfolios is a domestic private investor group based in Dongguan, Guangdong Province.

Continuing with the focus on disposing of assets in the Greater Guangzhou area, Great Wall is expected to offer for auction an unsecured portfolio approximating US$370 million. The auction is targeted for sometime in late September or early October. Market intelligence indicates the assets are primarily from the Foshan area.

Summary of China NPL sales to foreign investors: Dec 2001 – Aug 2004

Seller	Investor / Arranger	Transaction Type	Deal Size (OPB) (US$'m)	Completion date / Status
BOC (Cayman)	Citigroup	Open Auction	1,800	December 2003
China Const.	Morgan Stanley	Open Auction	310	May 2004
Bank	Deutsche Bank	Open Auction	203	May 2004
Cinda	Chenery Associates	Negotiated	145	December 2001
China Orient	Chenery Associates*	Negotiated – Harbin	210	December 2002
	Chenery Associates	Negotiated – Yanjiang	217	December 2001
Great Wall	Citigroup	Negotiated	242	Signed – pending approval
Huarong	Goldman Sachs	Open Auction – Huarong I	240	December 2002
	Morgan Stanley**	Open Auction – Huarong I	1,304	December 2002
	Morgan Stanley / GE Comm'l Fin	Closed Auction – Wuhan	215	Signed – pending approval
	Morgan Stanley	Open Auction – Huarong II	125	Signed – pending approval
	Citigroup	Open Auction – Huarong II	145	Signed – pending approval
	Lehman Brothers	Open Auction – Huarong II	240	Signed – pending approval
	JP Morgan	Open Auction – Huarong II	220	Signed – pending approval
	UBS AG	Open Auction – Huarong II	185	Signed – pending approval
	Goldman Sachs	Open Auction – Huarong II	229	Signed – pending approval
		Total:	**6,030**	

Note: The data contained herein has been obtained from various sources in the market and may not be all-inclusive. Final deal sizes may vary from those shown.

* *Arranged by Chenery Associates. Loans purchased by investors organized by Distressed Assets Consulting.*

** *Morgan Stanley is the leader of an investor consortium that includes Lehman Brothers, Salomon Smith Barney (now Citigroup), KTH Capital Management Ltd, Zhongjin Fengde and International Finance Corporation.*

Recent transfer of NPLs from BoC & CCB to Cinda

In June 2004, in a major effort to ensure that there is no increase in their NPL ratios relating to pools of specific loans, CCB and BoC transferred certain Category IV (doubtful) NPLs with a face value of RMB128.9 billion (US$15.6 billion) and RMB149.8 billion (US$18.1 billion) respectively to Cinda AMC, the winning bidder over its AMC rivals in an auction organised by the Ministry of Finance ("MoF") and the People's Bank of China ("PBoC"). Market reports indicated that while the official winning price of the NPLs was 50% of their face value, Cinda won the auction by, among other things, offering a promised cash recovery rate of 30.5% on the face value of the loans transferred, and demonstrating its competency and capability for NPL resolution (its cumulative recovery rate to date is in the range of 32%, well beyond that of its competitors).

As usual with government orchestrated clean-up measures, figuring out the financial implications of the transfer is complicated. While there are many steps in the process, from what we can piece together, the net effect of this exercise is that the banks will transfer loans with a face value of RMB128.9 billion (US$15.6 billion) and RMB149.8 billion (US$18.1 billion) respectively to Cinda and in exchange will receive a note (guaranteed by the PBoC) for 50% of those amounts. Cinda will collect on the loans acquired to cover the note, with the PBoC effectively underwriting any shortfall. The end result looks like big "win" for BoC and CCB as almost certainly the loans they are transferring are worth less than the 50% they are being guaranteed by the PBoC.

Cinda is expected to repackage the NPL portfolios and resell them in subsequent auctions to international and domestic investors, including the three other AMCs. As part of its commitment to the various government agencies and ministries, we understand Cinda is obligated to offer the assets for sale by the end of 2005, and this will clearly be a boon for the market.

Little has been known about the quality of the NPL portfolios acquired by Cinda except, as mentioned above, that they have been classified as Category IV or "doubtful" in the new five-category classification system that is being applied across all of China's mainstream banks. It is believed that there will be a flurry of interest from overseas investors when Cinda sells these NPLs as they are likely to be of better quality than those offered in previous auctions held by the AMCs as they are newer.

In addition to the NPL acquisitions from BoC and CCB, in July 2004, Cinda reportedly purchased a further RMB41.4 billion (US$5 billion) (face value) of NPLs from the Bank of Communications (which is targeting to list in Hong Kong and Shanghai at the end of this year). We understand that the structure is quite similar to the BoC/CCB deals with a selling price discount of 50%, a promised cash recovery rate in the 30%-40% range and with funding support from the PBoC. The NPL sale, part of the bank's overall restructuring plan, was passed at a Bank of Communications' shareholders' meeting held in late June. The restructuring plan also includes bringing in foreign strategic investors – now known to be HSBC – and issuing more shares and bonds to increase its capital base.

Finally, Cinda recently announced that it will auction non-performing assets with a book value of RMB15.7 billion (US$1.9 billion) to foreign and domestic investors. The auction is expected to attract international investors and includes 185 assets from various sectors including real estate, coal and electricity, all located in northeast China.

Securitisation: a new hot topic

In recent years, China's AMCs and banks have expressed their strong intention of seeking breakthroughs in alternative NPL disposal methodologies. They are especially interested in securitisation, hoping to solve the deficiencies in the existing NPL disposal mechanism. Before 2001, securitisation was almost impossible due to the lack of related legislative guidelines. The introduction of the PRC Trust Law (effective from October 1, 2001) made it possible to execute securitisation transactions by using a trust certificate structure.

China NPL securitisations are currently the hot topic in NPL circles. From the view of AMCs and banks, securitisation may be much better than outright sale transactions, for which "proper pricing" has long been a headache. There is no standard formula for pricing an NPL portfolio in China, which has an inherent high level of uncertainty. Securitisation can allow sellers to retain residual upside benefits and hence enables them to avoid the theoretical argument and criticism of selling state assets at too low a price. To date, only two AMCs have completed domestic securitisations (sales of trust certificates to domestic parties only). Cinda is thought to have completed the first, in mid-2003, when it teamed-up with Deutsche Bank in a securitisation involving NPLs totalling RMB1.6 billion (US$193 million). Huarong completed the second, which closed in August 2003, teaming-up with China International Trust and Investment Corporation ("CITIC") in relation to a portfolio of NPLs totalling RMB13.3 billion (US$1.6 billion).

ICBC's First Securitization

In April 2004, ICBC's Ningbo Branch joined hands with Credit Suisse First Boston ("CSFB"), a Chinese security company and a Chinese trust company to securitise an NPL portfolio with a face value RMB2.6 billion (US$314 million). The press revealed that following an independent rating by two Chinese rating agencies on the estimated cash flow, a specific purpose trust of approximately RMB800 million (US$97 million) was established. Backed up by cash flow streams generated by underlying assets/ loans, three classes of trust certificates were issued, namely the Class A Senior Trust Certificates, the Class B Junior Trust Certificates, (both targeted at domestic institution investors) and a residual equity position to be retained by ICBC. The Senior Certificates had senior priority on the cash flow streams and enjoyed a domestic credit rating "AAA"; Class B certificates had junior priority on the cash flow streams but were guaranteed by ICBC, thereby still enjoying a "AAA" credit rating. Information on the size and the respective yield rates of the two non-residual classes was not disclosed.

Coming Securitizations

News from the market indicates that one of the Big-4 commercial banks is going to conduct 1 – 2 securitisations totalling RMB5.0 – 9.0 billion (US$600 million – 1.1 billion) of its NPLs in the coming few months. Similar transaction structures will be adopted to target domestic institutional investors and the same domestic rating agencies will be employed.

Taiwan

The clean-up continues

Transactions in the second half of 2003 saw Taiwan as the most active NPL market in Asia. Public auctions remained the most popular method of disposal of NPLs for Taiwan banks, with total auctions in 2003 of around NT$186 billion (US$5.6 billion), an approximate 10% increase from 2002.

Investor appetite appears to have remained robust in 2004 (see table opposite), with completed/proposed auctions totaling approximately NT$72 billion (US$2.1 billion).

NPL Auctions: 2004

Seller	Approximate Size (NT$ billion)	Winning Bidder
Chung Hsing Commercial Bank	51.3	TAMCO Lone Star GE Capital
Chinfon Commercial Bank	7.2	Orix
Taiwan Cooperative Bank	13.0	Not yet announced
Total	**71.5**	

Chung Hsing Commercial Bank and Chinfon Commercial Bank, have successfully disposed of several NPL portfolios amounting to approximately NT$59 billion (US$1.8 billion), via auction to Lone Star, GE Capital, Orix and Taiwan Assets Management Company ("TAMCO"). Taiwan Cooperative Bank has also announced an auction of NT$13 billion (US$0.4 billion), the result of which is unknown at press time. Shin Kong Life Insurance Co., a major life insurance provider, is also planning to announce an auction, which would be the first time an insurance company in Taiwan has disposed of NPLs via an auction process.

With the gradual evolution and improvements of bidding mechanisms and transparency in 2003, the Taiwan NPL market has matured and we have seen increased interest from local investors funded by financial holding companies, such as Mega AMC, Taihsin AMC, and Fuhwa AMC entered the market. Some of these new players have started to participate aggressively in public loan sales, although most have not clearly demonstrated their investment preferences or intentions to date.

There are also a number of other market factors and influences which are likely to impact on NPL sales in the near term:

- Many banks over the past few years have focused strongly on their consumer and credit card loan businesses. Depending on broader economic conditions, we may well see these loans joining the "bad bank" in the coming years.
- Under pressure from the government, banks with 5%+ NPL ratios are likely to speed up their NPL sales, with the possibility that these banks will team up with investors who have the necessary restructuring expertise.
- There is a significant number of non-performing syndicated loans from the mid-1990s waiting to be resolved. Generally, there has been little progress on these loans given the difficulties in getting consensus from diverse and numerous syndicate members. However, recently, we have sensed some enthusiasm from banks to resolve these loans through public auctions.
- Finally, with some investors focusing on other territories (e.g. mainland China), we expect to see more "inter-investor" transactions for investors wishing to close off their Taiwan exposures.

The Bureau of Monetary Affairs has reported that the average overdue loan ratio for all domestic banks has fallen significantly since 2002, from 8.03% in March 2002, to 4.34% at the end of 2003 to 3.80% by April 2004. Notwithstanding this, government statistics indicate that by December 2003, 13 out of 50 domestic banks had still not met the Ministry of Finance's ("MOF") target NPL ratio of 5%. It is also worth noting that in 2003 the MOF announced proposed changes in the loan classification system, which banks are required to follow, including classifying as NPLs all loans with overdue principal or interest of three months and/or loans where legal action for recovery has been commenced. These new classifications are not likely to be implemented until 2005 but, if enacted, would increase the overall level of NPLs (some estimates have NPLs increasing by over NT$200 billion (US$6 billion) under the new rules).

Philippines

Momentum is gathering

Regulations update

It has been a long time coming but the financial community's commitment to NPL resolution appears to be gaining momentum in the Philippines. With incentives granted under the Special Purpose Vehicle ("SPV") Act of 2002, set to expire in April 2005, banks and financial institutions are even more compelled to examine their NPL portfolios for immediate disposals under this scheme. However, to date, little use has been made of SPVs intended to support asset restructuring, with financial institutions seemingly unwilling to recognise significant losses. This appears to have been a reflection of the pricing of the assets by potential investors.

For its part, the government in February 2004 issued a memorandum revising the accounting guidelines on the sale of NPLs. These incentives were rolled out to address the financial system's need for temporary regulatory relief, in addition to the tax relief granted under the SPV law. The central bank now allows financial institutions to write down losses over a period of 10 years, an increase from the previous mandated 7 years. It is hoped that this will encourage the disposal of NPLs, even at substantial discounts.

Industry update

Though not a transaction under the SPV Act, the only reported sale of NPLs in the first semester this year has been a delinquent housing loan portfolio of Php13.4 billion (US$237 million) by the state-run National Home Mortgage Finance Corporation ("NHMFC") to DB Real Estate Global Opportunities IB LP, an affiliate of Deutsche Bank AG. This deal, which traded after a first round of failed bidding, is expected to close in October.

The Bank of Philippines Islands ("BPI") recently sold a portfolio of NPLs amounting to Php8.6 billion (US$153 million) to Morgan Stanley Emerging Markets, Inc. This transaction will be structured under the SPV Act and is expected to be completed within the year, after complying with the regulatory requirements.

Details on the exact structuring surrounding both the BPI and NHMFC sales are not public. In any event, the fact that these transactions have occurred is a positive sign to the market of the potential deal flow that might be available to investors going forward.

Furthermore, United Coconut Planters Bank ("UCPB"), which has the third largest NPL ratio among all commercial banks at 34.13% of its total loan portfolio and NPLs at 39.73% of its total assets, is working to dispose its Real and Other Properties Owned or Acquired assets ("ROPOAs") amounting to Php15-20 billion (US$265-354 million) this year. PwC has been appointed as financial advisor to assist UCPB throughout the sale process.

Several other banks have also expressed their intention to sell assets under the SPV law. The Philippine National Bank ("PNB") aims to sell Php20 billion (US$354 million) in idle assets, which consists of Php10 billion (US$177 million) in ROPOAs. Land Bank of the Philippines is also looking to dispose of Php17.8 billion (US$320 million) of NPLs and foreclosed assets this year, while Rizal Commercial Banking Corp. is in talks with a US investment bank on the sale of Php3.9 billion (US$69 million) of NPLs. Another bank, PBCom, is also planning to sell Php10 billion (US$177 million) of its non-performing assets within the year.

Overall, the Philippine NPL market is expected to evolve considerably over the next 12 months, with numerous NPL sales set to emerge on the horizon. With the deadline for SPV transactions looming (investors only have until September 2004 to establish an SPV), the Bankers Association of the Philippines (BAP) has started its campaign for the extension of the SPV Act.

Korea

Slow start to 2004

Credit cards

With major bank growth in the last few years driven principally by credit card growth, it is perhaps no surprise that the major NPL sellers in 2003 were credit card companies, who have been forced to sell delinquent loans in order to meet the Korean government's mandated non-performing loan percentage requirement of 10%. Approximately US$4.9 billion of credit card loans and receivables were sold in 2003, with Lone Star again the largest buyer with approximately US$2.7 billion.

However, after a particularly active last quarter in 2003, there have been very few transactions in 2004. NPL prices have fallen along with increasing delinquency rates, with Q4 2003 credit card receivable prices being half Q1 2003 prices. Subsequently, sale prices have been well below expectations resulting in significant losses for the selling banks. As a result, it is expected that the 10% delinquency rate threshold will be relaxed, or abolished entirely, with the resulting effect that sales in 2004 and beyond are likely to decline.

Corporate loans

In the corporate loan sector, there was a fairly active end to 2003, although there have been fewer reported deals so far in 2004. In particular, investors have shown a preference for the loans in companies likely to be subject to mergers or restructurings, such as Jinro, Hynix Semiconductor and SsangYong Motor Corporation.

Korean NPL auctions completed between Q3 2003 and Q1 2004

Seller	Approximate size (US$ million)	Winning Bidder	Asset type
Daegu led consortium	66	Domestic/ Foreign	Corporate loans
Suhyup	16	Foreign	Corporate loans
IBK	11	Foreign	Corporate loans
CHB led consortium	53	Foreign	Corporate loans
IBK	21	Foreign	Corporate loans
KDIC	44	Foreign	Corporate loans
Daehan Life Insurance	21	Foreign	Corporate loans
CHB	175	Foreign	Corporate loans
Total	**407**		

India

The winds of change blow through

Historically, debt recovery in India has been hugely problematic, mainly due to a legal system that fosters years of litigation rather than swift conclusions. This has had the effect of dissuading creditors from taking legal action in pursuing debt recoveries. Thus, the inability to recover Indian debts in a timely manner – or even to estimate the timing of recovery – has been a major impediment to investors charging into the Indian NPL market.

However, there have been several developments on the Indian NPL front since our last issue which indicate that the Indian NPL market may finally start to heat up, thanks primarily to the much awaited judgement in the Mardia Chemicals case which was handed down by the Supreme Court in April 2004. In Mardia, the Court upheld the constitutional validity of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (“SRFAESI Act”), which allows for the exercise of security enforcement without the need to seek court intervention.

The settlement of the uncertainty regarding the SRFAESI Act and the repeal of the Sick Industrial Companies Act in early 2004 (under which borrowers got protection from actions by secured lenders) are positive developments for secured lenders. However the Court has struck down the SRFAESI requirement for borrowers to make a deposit (previously 75% of the debt amount) before making an appeal to the Debt Recovery Tribunal against a lender action. At the same time, the Court has held that this appeal can be made only after the secured lenders have taken possession of the charged assets, thus maintaining the threat of dispossession of the assets on defaulting borrowers.

In the meantime, a number of important issues still need to be addressed to ensure the success of the Asset Reconstruction Companies (“ARCs”). Recognising this, the Indian government (under an Asian Development Bank Technical Assistance initiative) appointed a team led by PwC to assist in the formulation of a workable framework for the ARCs, aimed at the early resolution of NPLs. The study looked at the existing legal, regulatory, tax and foreign investment environment, as well as experiences of other Asian AMCs, with a view to recommending changes to generate vibrancy within the Indian NPL market.

PwC submitted its recommendations to the Ministry of Finance and the ADB in February 2004 and the same are available at http://finmin.nic.in. The Government of India has now constituted a Steering Group with senior level representation from the Ministry of Finance, Ministry of Law, Reserve Bank of India and PwC to review and implement the report. Examination and implementation of the recommendations is currently underway hopefully leading to the creation of a conducive environment for NPL transactions functioning ARCs.

Meanwhile, in March 2004, the Reserve Bank of India directed all ARCs to have a minimum Owned Fund of not less than the lower of 15% of the total financial assets on an aggregate basis or Rs1 billion (US$ 22.5 million). The minimum Owned Fund has to be maintained irrespective of whether the assets are transferred to a trust set up for the purpose of resolution or retained in the ARCs. The existing ARCs have been given three months to attain the level of revised requirements.

The Reserve Bank of India reported aggregate NPLs amounting to Rs900 billion (US$20 billion) as at March 2003. This figure is widely expected to have increased when figures for March 2004 are released. However, the impact of this could be mitigated somewhat by speedier NPL resolutions through greater focus and improvements in creditor rights and restructuring mechanisms. Some transfers of NPLs to ARCs have also taken place, though largely against “pass through instruments” which continue to be held by the originating lenders. Most banks have voiced their commitment to a further reduction of NPLs over the next 2-3 years.

During the financial year 2003-04, Asset Reconstruction Company (India) Limited (“ARCIL”) – the first and currently the only operating ARC in India) – acquired NPLs aggregating around Rs30 billion (US$700 million), largely from the State Bank of India and ICICI Bank. Review and indicative value analysis of a majority of these NPLs has been conducted by PwC. ARCIL is now seeking investor participation to resolve these loans, thus providing interesting opportunities for NPL investors.

A number of other players have submitted their applications to the Reserve Bank of India for registration as ARCs, one of the larger being ASREC Limited, which is being set up by Unit Trust of India and certain other lenders. Also assisted by PwC, ASREC is currently preparing its business plan and formulating guidelines and procedures for its functioning.

We believe that these recent developments will help to energise international investor interest in Indian NPLs, resulting in increased activity for distressed debt investors.

Indonesia

IBRA finally closes its doors

After more than five years of operations, the Indonesian Bank Restructuring Agency (“IBRA”) officially closed its doors in February 2004. Following its closure, a new company, PT Perusahaan Pengelola Aset (“PPA”) was established to sell those remaining NPLs and equity stakes that IBRA had been unable to resolve during its tenure.

During 2003, in a final attempt to wrap-up its affairs, IBRA sold approximately IDR208 trillion (US$22 billion) of NPLs. In total, IBRA recovered IDR77 trillion (US$8.3 billion) from a total nominal amount of approximately IDR270 trillion (US$29 billion) of bad loans transferred to it. This represented a recovery rate of around 29%. A mixture of recovery techniques were deployed by IBRA, ranging from loan disposal and sale (representing over 70% of nominal loan values), to loan settlement and litigation and sale of foreclosed assets. As would be expected, there was considerable variance on recovery rates achieved by IBRA, although, generally, the more recent sales achieved significantly lower returns than the earlier sales. Whilst the full range of foreign and local investors have, at any one point in time, been involved in the acquisition of loans from IBRA, the last two years have been very much dominated by local investors.

There has been a steady improvement in bank NPL ratios over the past five years, with Bank Indonesia, the Indonesian Central Bank, estimating that the total level of NPLs as at 31 December 2003 amounted to IDR39 trillion (US$4.2 billion), and an overall NPL ratio of some 8.2%. This compares to a NPL ratio of some 32.8% in 1999. Bank Indonesia has said that the total NPL ratio has fallen further to 7.8% by the end of March 2004.

Shown in the table below are the NPL ratios for each of the 10 largest banks in Indonesia as at 31 March 2004:

No.	Banks	NPL (Gross)(%)	NPL (IDR bio)
1	Bank Mandiri	7.7%	6,341
2	Bank Negara Indonesia	4.3%	2,146
3	Bank Central Asia	1.3%	397
4	Bank Rakyat Indonesia	5.8%	3,147
5	Bank Danamon Indonesia	7.1%	1,665
6	Bank Internasional Indonesia	6.7%	773
7	Permata Bank	7.7%	887
8	Bank Tabungan Negara	4.6%	537
9	Lippo Bank	7.5%	415
10	Bank Niaga	3.6%	533
	Total		**16,841**
	Sub total State Owned Banks		12,171
	Subtotal Private Indonesian Banks		4,670
	Total		**16,841**

Source: Banks Quarterly Report, taken from Bank Indonesia's Official Website

The table opposite clearly shows the predominance of state-owned banks, which account for over 70% of all NPLs in the country's largest banks. As state-owned banks lack clear guidelines relating to NPL dispositions, most such banks sit on their NPLs rather than dispose of them. Until such time that clear guidelines are issued, we believe the level of NPLs at Indonesia's state-owned banks will continue to languish.

Paradoxically, whilst Bank Indonesia's report indicates an overall improvement in the quality of bank loans, one of the Deputy Governors of Bank Indonesia has warned that the banking sector faces the possibility of increased NPLs in the near term. We believe he may have been referring to certain of the un-restructured loans acquired by banks from IBRA, which have deteriorated in quality, but which the banks are now looking to offload.

PwC has, over the last four years, helped IBRA sell restructured NPLs with a face value in excess of US$3.5 billion. Recently, we were retained by Bank Indonesia to act as its lead advisor in the sale of over US$370 million of NPLs.

Our Experience

PricewaterhouseCoopers is a leading adviser to both buyers and sellers of NPLs in Asia.

Some of the more significant transactions in which we have recently been involved in include:

Country	Seller	Portfolio size (US$m)	PwC's role
China	China Orient AMC	225	Financial advisor to the seller; Post-sale loan servicing manager
		3,900	Vendor due diligence and valuation on 10 NPL portfolios
		490	Buy-side advisory and due diligence
	Great Wall AMC	700	Financial advisor to seller
		415	Buy-side advisory and due diligence
		410	Buy-side advisory and due diligence
	Huarong AMC	365	Buy-side advisory and due diligence
		2,800	Buy-side advisory and due diligence for multiple bidders
		215	Buy-side advisory and due diligence
	Cinda AMC	217	Buy-side advisory and due diligence
	Bank of China (Cayman Islands)	1,800	Buy-side advisory and due diligence for multiple bidders
	Big-4 commercial bank	1,000	Financial advisor to seller
		340	Financial advisor to seller
	China Construction Bank	500	Buy-side advisory and due diligence for multiple bidders – Settled asset auction
Taiwan	Chung-Hsing Commercial Bank	1,100	Financial advisor to seller
	Kaoshiung Business Bank	962	Financial advisor to seller
	Taiwan Cooperative Bank	750	Financial advisor to seller
	Land Bank	632	Buy-side due diligence and valuation
	Hwa-Nan Bank	388	Buy-side due diligence and loan sale closing services to multiple bidders
	Grand Commercial Bank	232	Buy-side advisory and due diligence
	Chinfon Commercial Bank	212	Financial advisor to seller
	Taichung Commercial Bank	153	Financial advisor to seller
Korea	Korea Exchange Bank Credit Services & others	4,167	Due diligence and valuation services for seller
	Korea Exchange Bank Credit Services	205	Financial advisor to seller
	Woori Bank	167	Financial advisor to seller
	Daegu Bank and others	66	Financial advisor to seller
	Hyundai Card	44	Financial advisor to seller
	IBK	21	Financial advisor to seller
	IBK	11	Financial advisor to seller
Philippines	United Coconut Planters Bank	265-354	Financial advisor to seller
Indonesia	Bank Indonesia	370	Financial advisor to seller

Our NPL related services

Throughout Asia, PwC has partners and staff experienced in delivering a complete range of NPL related services, including:

Sell-side services

We act as the lead financial adviser in relation to all facets of NPL sales including complete management of the disposal process:

- Preparation for sale: Portfolio review, classification and stratification; Pooling and packaging sub-portfolios to maximise their potential value; Advising on appropriate form of investor review files; Advising on appropriate marketing and disposal strategies; Preparation of confidential information memoranda; Co-ordination and management of third party service providers such as lawyers and Asset Appraisers.
- Investor sourcing: Identifying potential investors for bilateral deals or public tenders; Targeting specialist investors for specific sub-portfolios/tranches.
- Execution/completion of sale: Management of the entire portfolio sales process; Transaction structuring; Designing appropriate bidding/sales procedures; Overseeing investor contact, including investor invitation and investor qualification; Evaluation of investment proposals; Negotiating detailed terms; Co-ordinating the involvement of legal and other advisers.

Buy-side services

We offer complete advisory services tailored to meet investor requirements:

- Due diligence and negotiation support: portfolio review and valuation.
- Advising on appropriate deal structures for proposed negotiated transactions;
- Advising on accounting/tax implications of proposed structures;
- Advising on the nuances of the Government approval process (if applicable);
- Assisting in the deal completion process, including assistance in securing requisite government approvals;
- Identifying potential portfolio investment opportunities;

Post-deal services

- Portfolio Management: Portfolio strategy advice and implementation; Managing the loan collection process; Advising on loan servicing set-up issues; Advising on issues that impact the collection process.

Dedicated Website

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

www.pwcloansalesasia.com

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 regional NPL advisory group that can act as an overall co-ordinator for Asia Pacific NPL mandates and opportunity identification. Through this group, both buyers and sellers of NPLs can receive consistent, seamless, service across the region, integrated with territory specific knowledge and expertise:

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