

Road Map for Developing an Online Platform to Trade Nonperforming Loans in Asia and the Pacific

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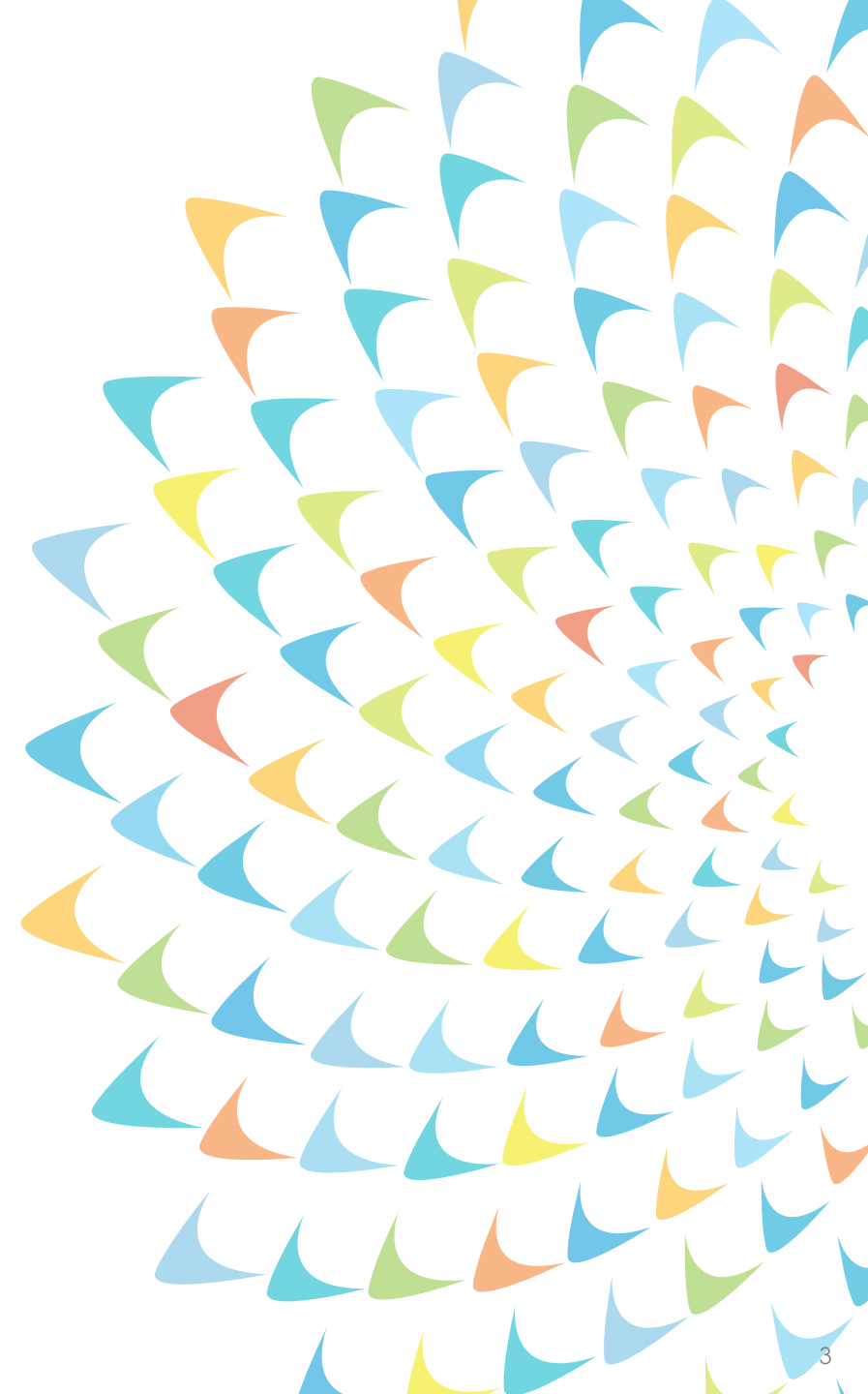
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Outline

1. Background: *Road Map for Developing an Online Platform to Trade Nonperforming Loans in Asia and the Pacific*
2. Practical Considerations in Developing an NPL Platform
3. Key Findings of the Report

BACKGROUND: ROAD MAP FOR DEVELOPING AN ONLINE PLATFORM TO TRADE NONPERFORMING LOANS IN ASIA AND THE PACIFIC





Background: Road Map for Developing an Online Platform to Trade Nonperforming Loans in Asia and the Pacific

- Previous crisis experiences have illustrated negative and persistent macrofinancial effects NPLs can have on the real economy, underlining the importance of swift resolution measures
- A sharp increase in NPLs could destabilize regional financial systems and compromise post-pandemic economic recovery
- A developed market for NPL trading can contribute toward a swift and effective NPL resolution
- While the development and deepening of NPL markets was on the policy agenda prior to the COVID-19 pandemic, current economic and financial conditions underscore the relevance of swift resolution of banks' NPLs.
 - Against this backdrop, this report seeks to examine the feasibility of establishing an NPL transaction platform for Asia and the Pacific region



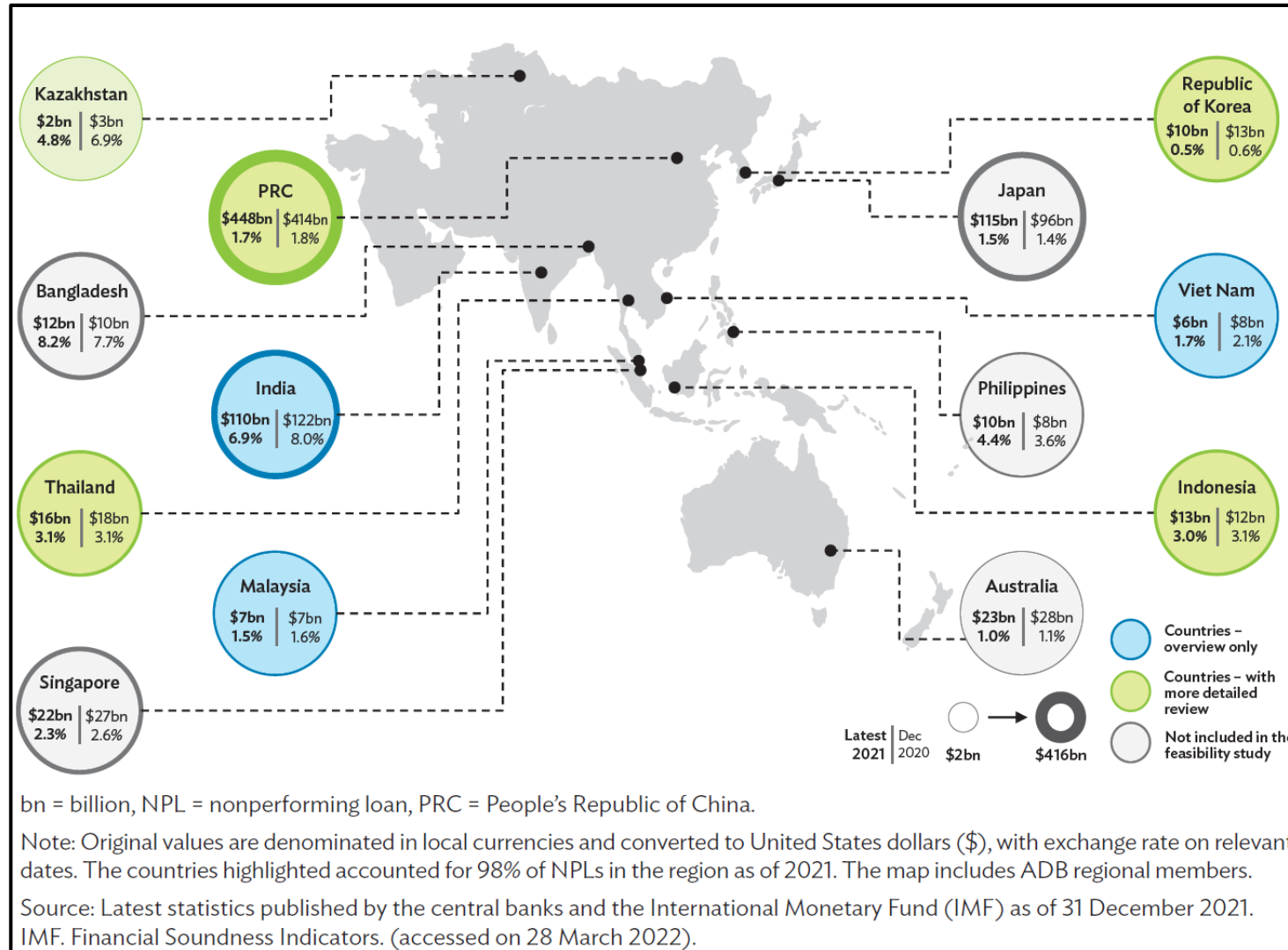
Background: Road Map for Developing an Online Platform to Trade Nonperforming Loans in Asia and the Pacific

- IPAF CCM suggested an assessment of the readiness and feasibility of establishing an NPL trading platform in Asia
- ADB prepared this feasibility study with assistance from a number of different parties
- The study benefitted considerably from IPAF members' support. Interviews and surveys with numerous IPAF members were conducted and insights incorporated into report
- Additional insightful consultations with JVI and EBA, including on EU's Action Plan to reduce NPLs and NPL data templates



Overview: NPL Levels and Ratios in Asia

NPL stocks held by banks totalled to over \$790bn in below economies in 2021 (up from \$758bn in 2020) according to official figures. Amid phasing out of regulatory forbearance, global monetary tightening, and challenging economic and financial conditions there is a risk of increasing NPLs in 2022 and beyond.





Time and Cost of Resolving Insolvency in Asian Economies

Item	Time (years)	Recovery Rate (cents on the US dollar)	Cost of Recovery (% of estate)
Afghanistan	2.0	26.7	25.0
Armenia	1.9	39.2	11.0
Azerbaijan	1.5	39.7	12.0
Bangladesh	4.0	29.1	8.0
Brunei Darussalam	2.5	47.2	3.5
Cambodia	6.0	14.6	18.0
PRC	1.7	36.9	22.0
Hong Kong, China	0.8	87.2	5.0
India	1.6	71.6	9.0
Indonesia	1.1	65.5	21.6
Japan	0.6	92.1	4.2
Kazakhstan	1.5	39.8	15.0
Korea, Rep. of	1.5	84.3	3.5

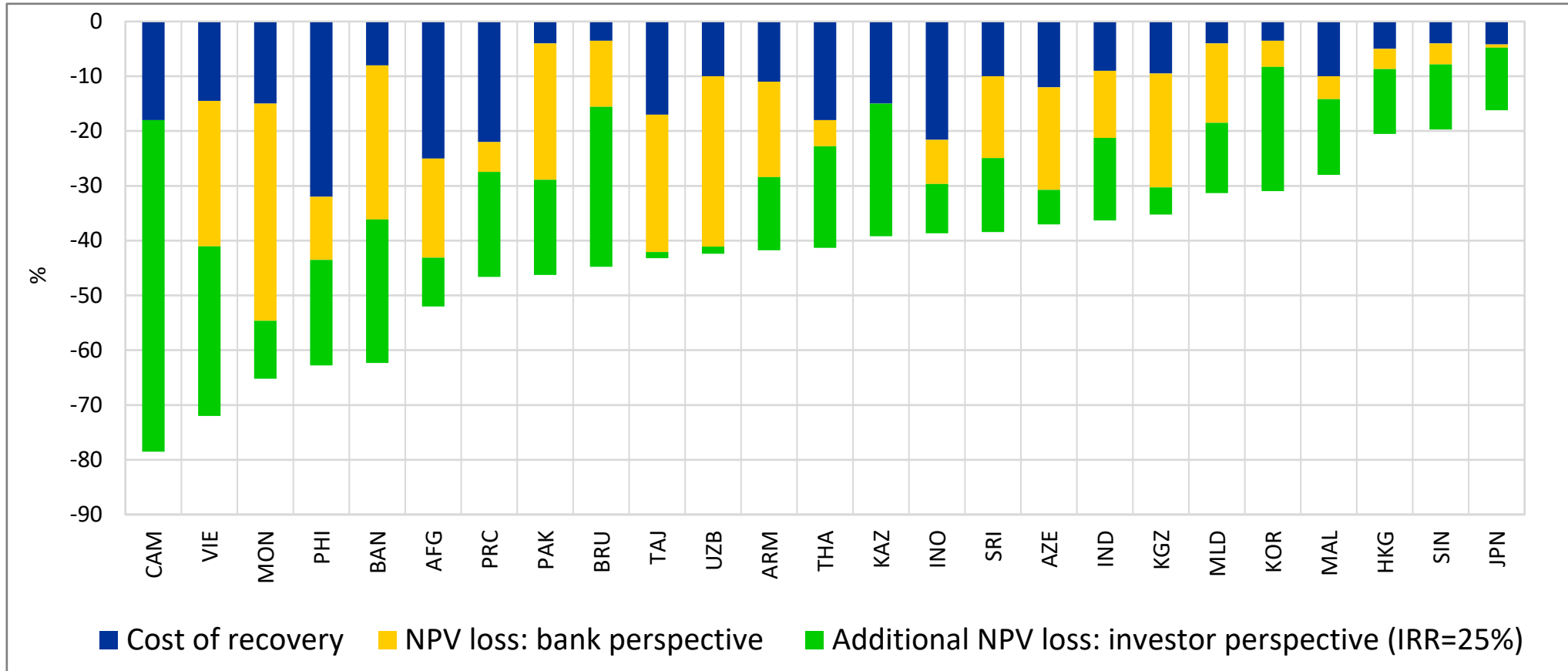
Item	Time (years)	Recovery Rate (cents on the US dollar)	Cost of Recovery (% of estate)
Kyrgyz Republic	1.5	40.6	9.5
Malaysia	1.0	81.0	10.0
Maldives	1.5	50.2	4.0
Mongolia	4.0	18.2	15.0
Pakistan	2.6	42.8	4.0
Philippines	2.7	21.1	32.0
Singapore	0.8	88.7	4.0
Sri Lanka	1.7	43.0	10.0
Tajikistan	1.7	29.6	17.0
Thailand	1.5	70.1	18.0
Uzbekistan	2.0	34.4	10.0
Viet Nam	5.0	21.3	14.5

PRC = People's Republic of China.
Source: World Bank Doing Business Database 2020.



Estimated Bid-ask Spreads in Asia Significant

Difference between net book value and the estimated bid price



AFG = Afghanistan; ARM = Armenia; AZE = Azerbaijan; BAN = Bangladesh; BRU = Brunei Darussalam; CAM = Cambodia; HKG = Hong Kong, China; IND = India; INO = Indonesia; IRR = internal rate of return; JPN = Japan; KAZ = Kazakhstan; KOR = Republic of Korea; KGZ = Kyrgyz Republic; MAL = Malaysia; MLD = Maldives; MON = Mongolia; NPV = net present value; PAK = Pakistan; PHI = Philippines; PRC = People’s Republic of China; SIN = Singapore; SRI = Sri Lanka; TAJ = Tajikistan; THA = Thailand; UZB = Uzbekistan; VIE = Viet Nam.

Notes: For Cambodia and Kazakhstan, only the total NPV loss is reported, without being separated into bank perspective and investor perspective. The bank lending rate data is not available in these countries.

Source: Lee, Park, Park, and Rosenkranz (2021)





Features of Underdeveloped Secondary NPL Markets

A number of factors contribute to low prices and transaction volumes notwithstanding potentially good supply and demand. Common features of underdeveloped NPL markets include:



- **Limited numbers of active investors** – including as a result of high transaction costs which act as a barrier to new entrants (due diligence costs only recoverable for successful bidders – limits investors to those that can afford to absorb them and therefore excludes many small potential investors)



- **High bid ask spreads** – as a result of information asymmetries and poor data quality, and/or unrealistic pricing expectations



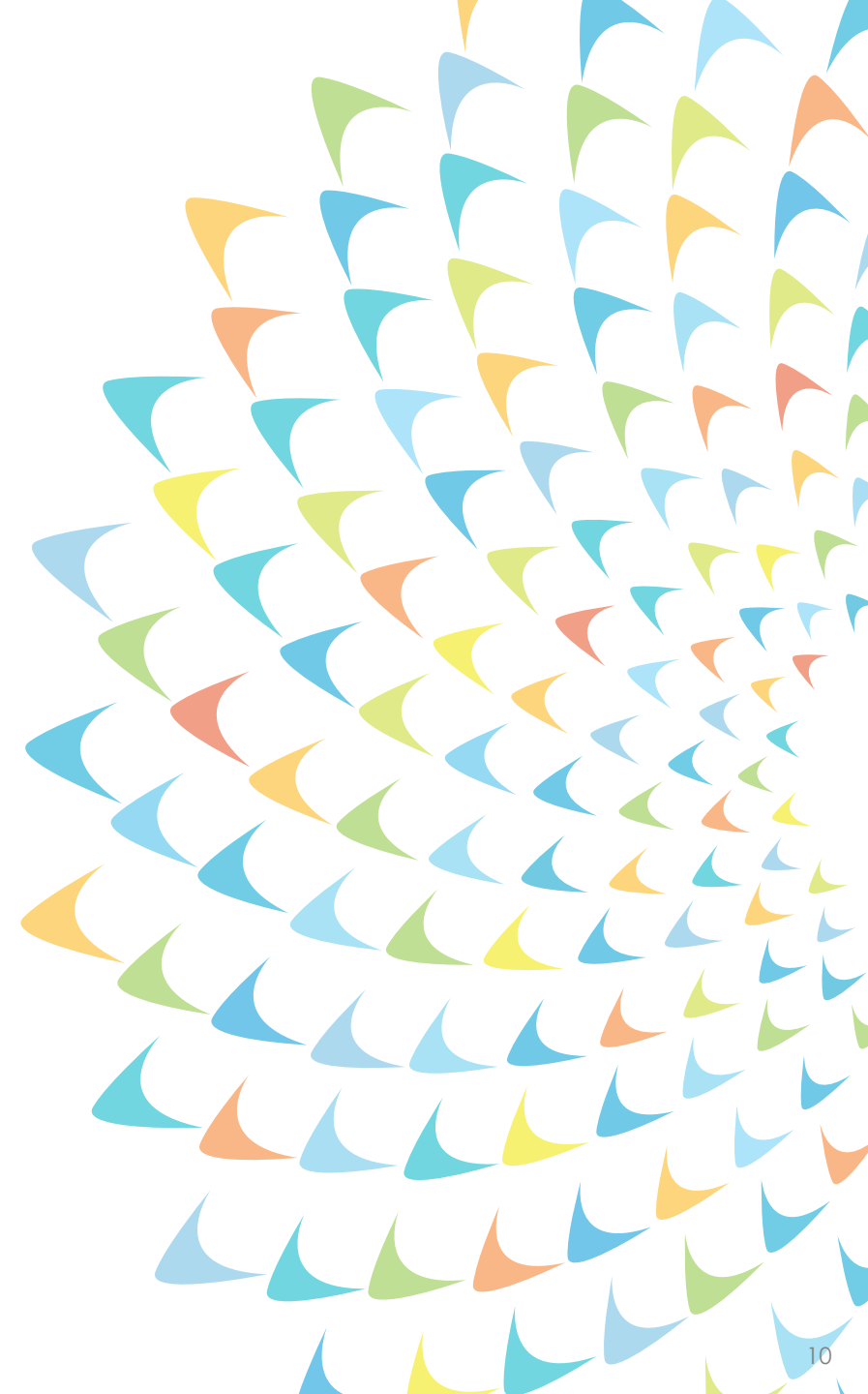
- **Limited information around market prices and volumes**



- **Predominantly domestic market** – restrictions on repatriation of profits/ownership of assets, etc. will limit foreign investors' appetite as will any regulatory or legal uncertainties e.g., around enforcement. Investors will require access to a range of different, independent service providers (e.g., servicers, valuers, legal advisers, appraisers, etc.) – the absence of an appropriate independent loan servicing infrastructure could be a further constraint

As a result of the above, such markets typically see low transaction volumes and low prices, notwithstanding strong levels of supply and good investor appetite

PRACTICAL CONSIDERATIONS IN DEVELOPING AN NPL PLATFORM





Key Elements for a Functioning Market for NPL Sales

Several factors need to be present to allow an active NPL market to develop. And no single global solution. Rather, countries have developed their own bespoke frameworks for dealing with rising NPL stock.



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 and 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 and 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/restrictions on 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 increased levels of bad debts.
- However, **restrictions on buyers, especially foreign buyers**, (e.g., limited ownership, restricted deal structure) create barriers to new entrants.



Advisor

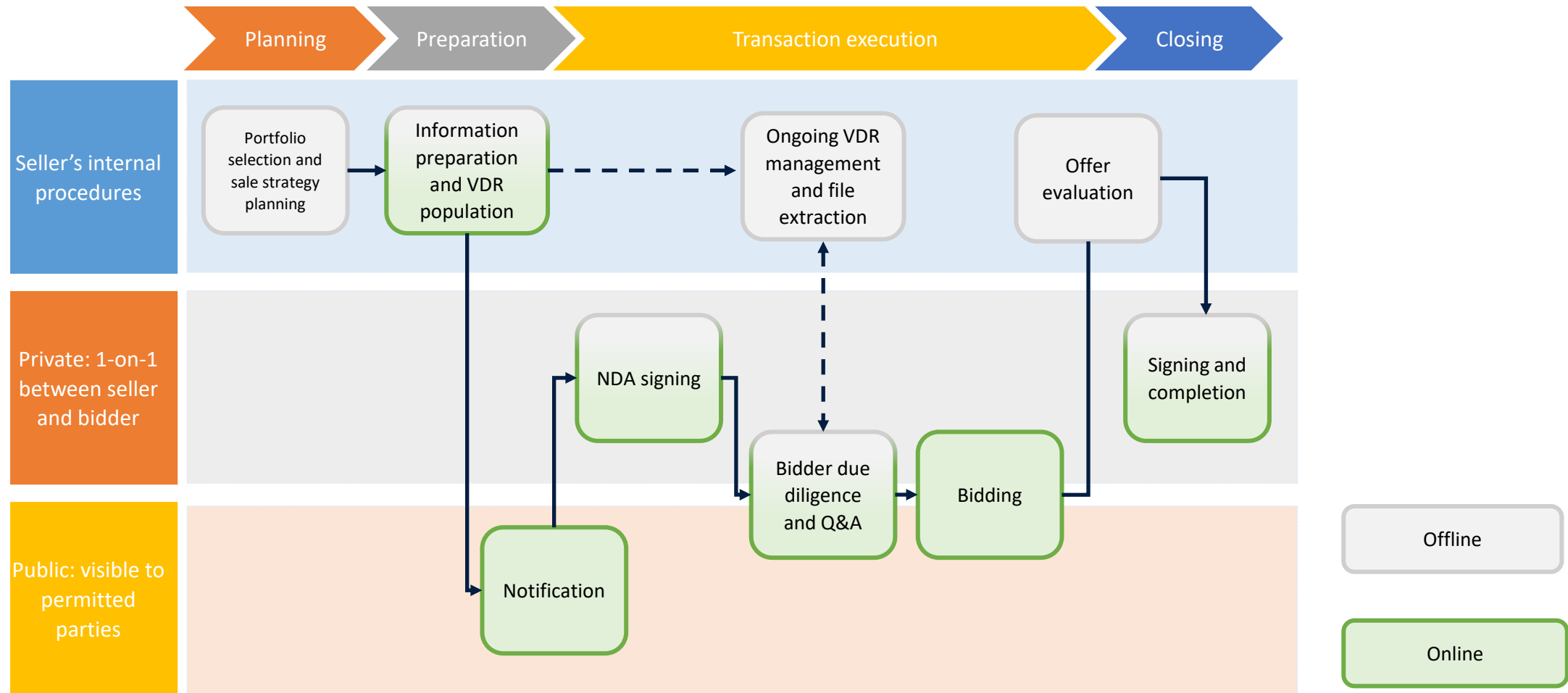
- An advisory community with sufficient skills and resources to support transaction activity (e.g., valuations, due diligence, legal, etc.)





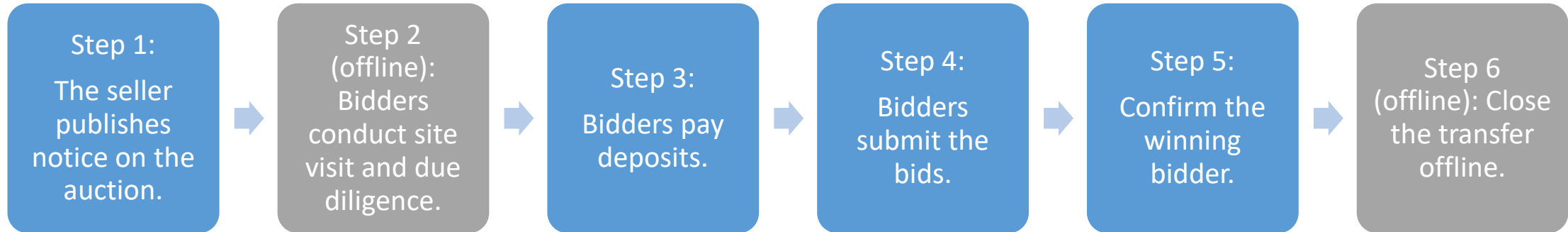
Illustrative NPL Transaction – Simplified Process

The diagram below shows the typical NPL transaction process, from portfolio selection and process design, to information preparation, notification, due diligence, the auction process and completion. Some aspects of the process lend themselves more readily to being managed through an online platform (e.g., notification and bidding).





Typical Online Trading Platform Process



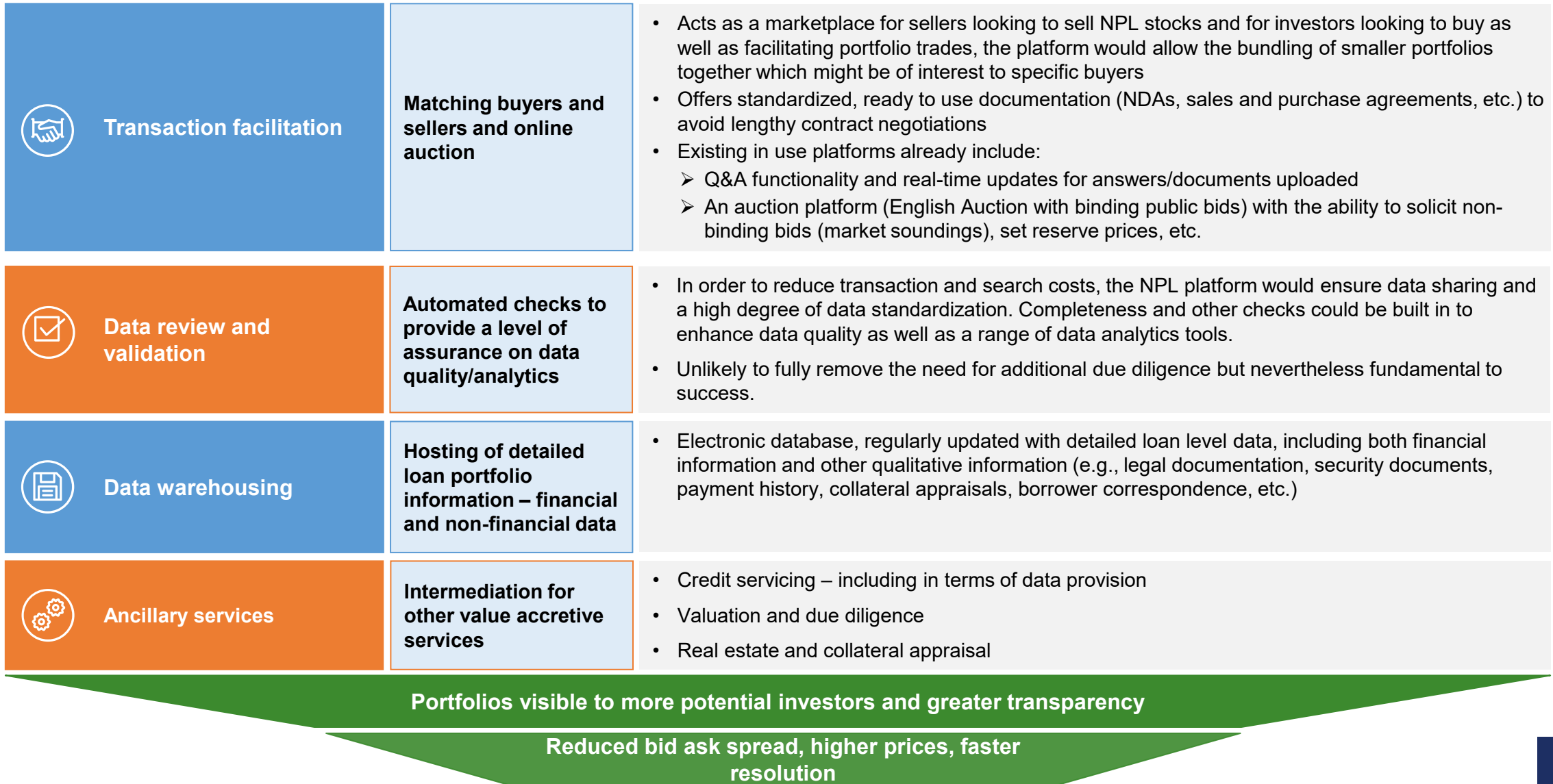
Source: Based on Taobao process.

- **Step 1** – The online notice typically includes: a basic description of the asset, any defects, key documentation, seller’s reserve price, eligibility of the bidders, auction process, timeline, contact details of the seller, etc.
- **Step 2** – Based on the (non-confidential) information provided in the public notice, interested buyers proceed with due diligence which may be managed offline. All the information provided on the main auction page will be fully public and will not require a non-disclosure agreement (“NDA”).
- **Step 3** – To participate in the auction, bidders may need to pay a deposit through the platform’s online payment system which will be frozen until the end of the bidding process.
- **Step 4** – Once the deposit is paid, a bidder can submit their bid on the auction page. All bids submitted are live, anonymized and visible to other participants.
- **Step 5** – The bidder with the highest bid wins the auction, and the system automatically generates a confirmation letter stating the winning bidder. Where the sale is by way of judicial auction (e.g., in PRC), the confirmation letter is published on the auction page, stating the name of the vendor, the buyer, and the transacted price thus, providing full transparency. For other (non-judicial) auctions, including NPL sales by banks or AMCs, details will not be made fully public.
- **Step 6** – The buyer contacts the seller offline to execute the transaction documentation and complete the transfer.



Fully Suite Online Trading Platform Functionalities

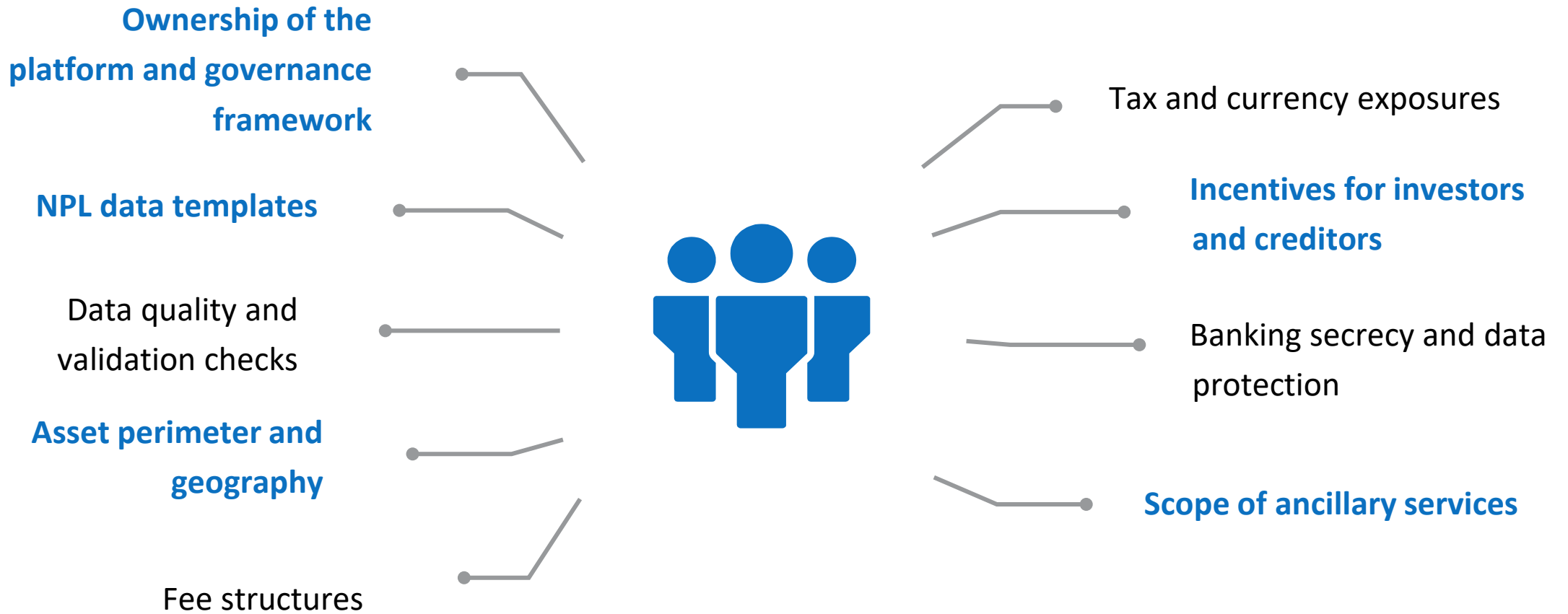
Below diagram is an example of what may be offered through an online trading platform.





NPL Transaction Platforms: Practical Issues

The report identifies nine practical issues that require consideration when rolling out an online NPL transaction platform.





Ownership of the Platform and Governance Framework

Who should own the platform and what governance model should apply? How would that differ for a regional model? How would the differing stages of development of NPL trading ecosystems affect the choice?



State ownership

The platform is **jointly owned** by the governments of participating nations either in **equal shares** to minimize potential conflicts around the leadership or undue influence, or according to the **respective NPL market size** in each country, or the **level of investment**. State involvement brings with it a risk of political interference.



Private ownership

A single or a group of independent private operators, **experienced** in running similar platforms (e.g., Alibaba and JD in PRC, DEBITOS in Europe) and without any state involvement.

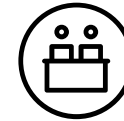
Guidelines could be introduced to cover best practice execution.



Public-private partnership

A **balanced cooperation** between the private sector and government in each participating country.

An option to consider may be an evolution of PPP, where the state plays a **greater role during the initial stages** of the platform development and exits the project once it is fully functioning.



Asset management companies

Considering their **vast experience** and that they may already have their own platforms, AMCs could also be an option for 3rd party disposals; as owners of NPLs, this could be perceived as creating a conflict of interest if transacting assets other than their own.



International development organizations

The platform is established and owned by an international or regional development organization. This ownership type could help **minimize** both political and commercial **conflicts of interests**.

How heavily should the platform be regulated? Contrast where the platform does not represent financial market infrastructure (and hence, may not need to be regulated) with the situation whereby the platform becomes a quasi monopoly. Also depends what services are offered.



Asset Focus and Key Considerations

Key considerations

Secured /
Unsecured

- Secured loans are relatively easier to roll out on the online platform as:
 - The documentation and data availability/requirements are relatively well understood by both buyers and sellers.
 - There is enough supply held by the banks to sustain the pipeline.
 - It would also be easier to price a collateralized NPL than an unsecured one in secondary markets as the value of the collateral sets the minimum value of an NPL..

Retail /
Corporate

- Retail portfolios would benefit from the homogeneity of underlying loan products and borrowers. The loan files are usually standardized with limited customized terms for each individual loan.
- 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 little 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.
- Banking secrecy/GDPR challenges around consumer loans.

Narrow / Broad

- NPL platforms look to benefit from realizing economies of scale and scope, 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. It may be appropriate to start with a narrower focus and then gradually open up as the platform develops.

Regional /
National

Investors can enjoy the benefits of diversification on a cross-border regional trading platform which pool assets from several jurisdictions. However, specific national data needs, regulations, and different legal enforcement frameworks across countries would need to be taken into account.



Incentives for Investors and Creditors

Should users be offered incentives to use the platform?

Key questions:



Should use of the platform be **voluntary** or made **mandatory**?



Would incentives work in markets where the NPL trading is in an **early stage of development** or **simply inactive**?



How to build **trust and credibility** in the newly created NPL trading platform?

Options to consider:



Commercial incentives – e.g., fee structures at less than cost. How would this be funded?



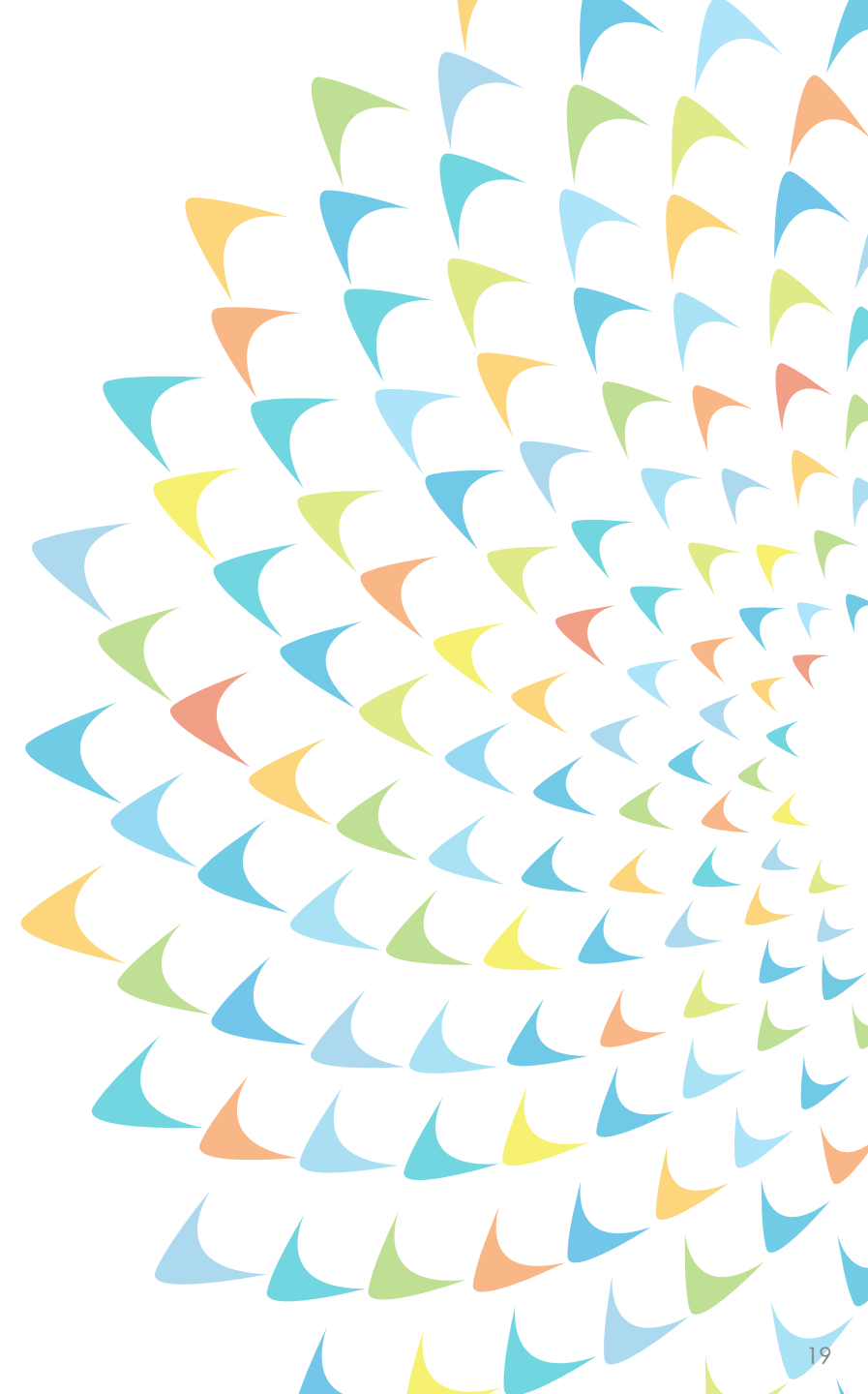
Regulatory incentives – Tax incentives.

However, this might be seen as a bail out of private commercial banks, AMCs, or other sellers. There is also a risk of moral hazard: lending institutions may underwrite loans without sufficient credit checks or collateral assessment, knowing that they can subsequently sell NPLs via the platform and receive certain tax benefits.



Legal requirement – State bodies may legally oblige NPL sellers to use online NPL platforms to offload bad loans and assets. However, this may reduce incentives on the platform to innovate or to drive efficiencies. Equally, what if the platform does not deliver the promised benefits?

KEY FINDINGS OF THE REPORT





Countries' Readiness for an Online NPL Transaction Platform

- **Methodology:** We used a scoring system to evaluate readiness for and or benefit from the development of an online NPL transaction platform, considering:
 - Absolute and relative NPL levels
 - Experience of NPL trading (incl. if already use of online platforms)
 - Strength of legal frameworks
- **Findings:** The PRC, Thailand, Republic of Korea and Indonesia may have a greater readiness for and/or benefit most from such an initiative.

Country	DMC	Active Public AMC	World Bank Classification	Region	NPL Stock	NPL Stock Score	NPL Ratio	NPL Ratio Score	Historical NPL Trade	Online Platform Already	"Strength of Legal Framework" World Bank Score	Legal Framework Score	Total
Australia	Advanced Economy	N	High Income	Pacific	23.1	1.0	1.0%	-	1.0	-	78.9	1.0	3.0
Azerbaijan	DMC	N	Upper Middle	Central and West Asia	0.5	-	4.6%	1.0	-	-	63.5	1.0	2.0
Bangladesh	DMC	N	Lower Middle	South Asia	11.8	-	8.2%	2.0	-	-	28.1	-	2.0
Cambodia	DMC	N	Lower Middle	Southeast Asia	0.9	-	2.1%	1.0	-	-	48.5	0.5	1.5
People's Republic of China	DMC	Y	Upper Middle	East Asia	447.9	3.0	1.7%	-	1.0	1.0	62.1	1.0	6.0
India	DMC	N	Lower Middle	South Asia	109.6	2.0	6.9%	1.0	1.0	-	62.0	1.0	5.0
Indonesia	DMC	Y	Upper Middle	Southeast Asia	12.7	-	3.0%	1.0	1.0	-	68.1	1.0	3.0
Japan	Advanced Economy	N	High Income	East Asia	114.6	2.0	1.5%	-	1.0	-	90.2	1.0	4.0
Kazakhstan	DMC	Y	Upper Middle	Central and West Asia	1.7	-	4.8%	1.0	-	1.0	66.7	1.0	3.0
Republic of Korea	Graduated DMC	Y	High Income	East Asia	9.8	-	0.5%	-	1.0	1.0	82.9	1.0	3.0
Malaysia	DMC	Y	Upper Middle	Southeast Asia	6.6	-	1.5%	-	1.0	-	67.0	1.0	2.0
Mongolia	DMC	N	Lower Middle	East Asia	0.7	-	10.0%	2.0	-	-	30.1	-	2.0
Nepal	DMC	N	Lower Middle	South Asia	0.5	-	1.4%	-	-	-	47.2	0.5	0.5
New Zealand	Advanced Economy	N	High Income	Pacific	0.9	-	0.3%	-	-	-	69.5	1.0	1.0
Pakistan	DMC	N	Lower Middle	Central and West Asia	5.1	-	8.3%	2.0	-	-	59.0	0.5	2.5
Philippines	DMC	N	Lower Middle	Southeast Asia	9.5	-	4.4%	1.0	1.0	-	55.1	0.5	2.5
Singapore	Graduated DMC	N	High Income	Southeast Asia	22.3	1.0	2.3%	1.0	-	-	74.3	1.0	3.0
Sri Lanka	DMC	N	Lower Middle	South Asia	2.5	-	5.0%	1.0	-	-	45.0	0.5	1.5
Thailand	DMC	Y	Upper Middle	Southeast Asia	16.2	1.0	3.1%	1.0	1.0	-	76.8	1.0	4.0
Uzbekistan	DMC	N	Lower Middle	Central and West Asia	1.7	-	5.7%	1.0	-	-	43.5	0.5	1.5
Viet Nam	DMC	Y	Lower Middle	Southeast Asia	6.3	-	1.7%	-	1.0	-	38.0	-	1.0

- = zero score, AMC = asset management company, DMC = developing member country, N = No, NPL = nonperforming loan, Y = Yes.

Note: Using the scoring system above, countries in green were selected for further study. Both Kazakhstan and Viet Nam governments have announced their intentions to investigate the steps necessary to develop NPL markets, including the prospect of cross-border trading and the development of an online NPL trading platform.

Sources: Asian Development Bank, World Bank, International Monetary Fund, central banks, and prudential authorities.

- Kazakhstan and Viet Nam governments are actively exploring development of an online NPL platform



Key Principles for the Development of NPL Markets and an Online Trading Platform

- **Harmonization**— adoption of agreed international standards for NPL recognition and valuation methodologies.
- **Level playing field**— NPL markets and platforms should be regulated on a non-discriminatory basis, with the same standards and regulatory requirements applying to both foreign and domestic NPL investors.
- A level of **minimum standards** should be developed both in terms of NPL markets generally and online NPL platforms.
- **Balanced protections for consumers**— sustainable collection practices which protect consumers and borrowers and industry standards that do not restrict lenders' ability to efficiently work out NPLs.
- NPL markets and ecosystems are at different stages of readiness. As such, **development of a regional platform may best be attempted by way of a phased approach.**
- **A network of platforms** could be an option, with common standards in terms of best practice operation and information disclosure, cooperating with each other to maximize reach and the number of transactions.



Thank you for your attention!

ADB Report

Road Map for Developing an Online Platform to Trade Nonperforming Loans in Asia and the Pacific



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Nonperforming Loans in Asia and Europe— Causes, Impacts, and Resolution Strategies



ADB Economics Working Paper

Nonperforming Loans in Asia: Determinants and Macrofinancial Linkages



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