



LOAN PORTFOLIO ADVISORY

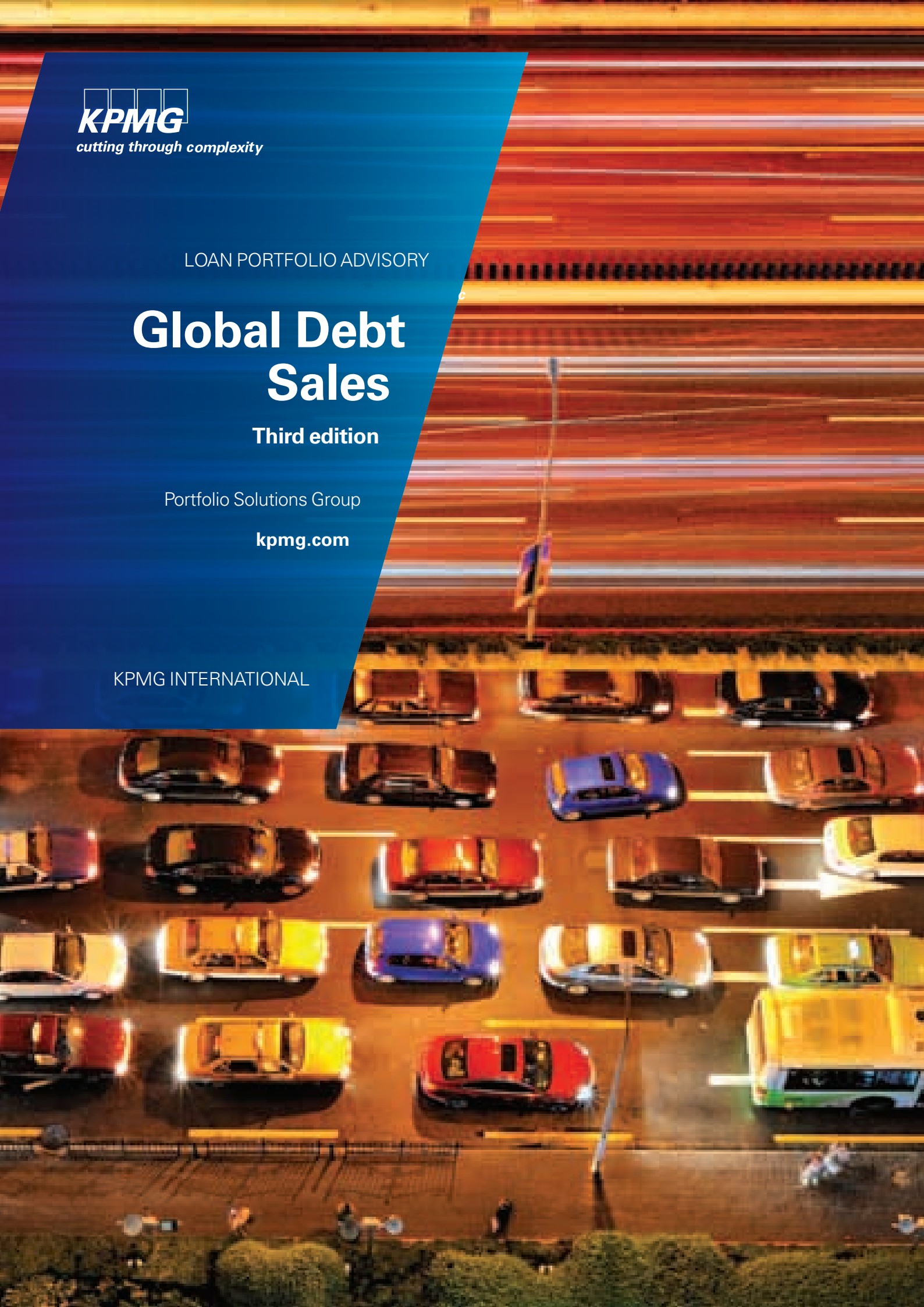
Global Debt Sales

Third edition

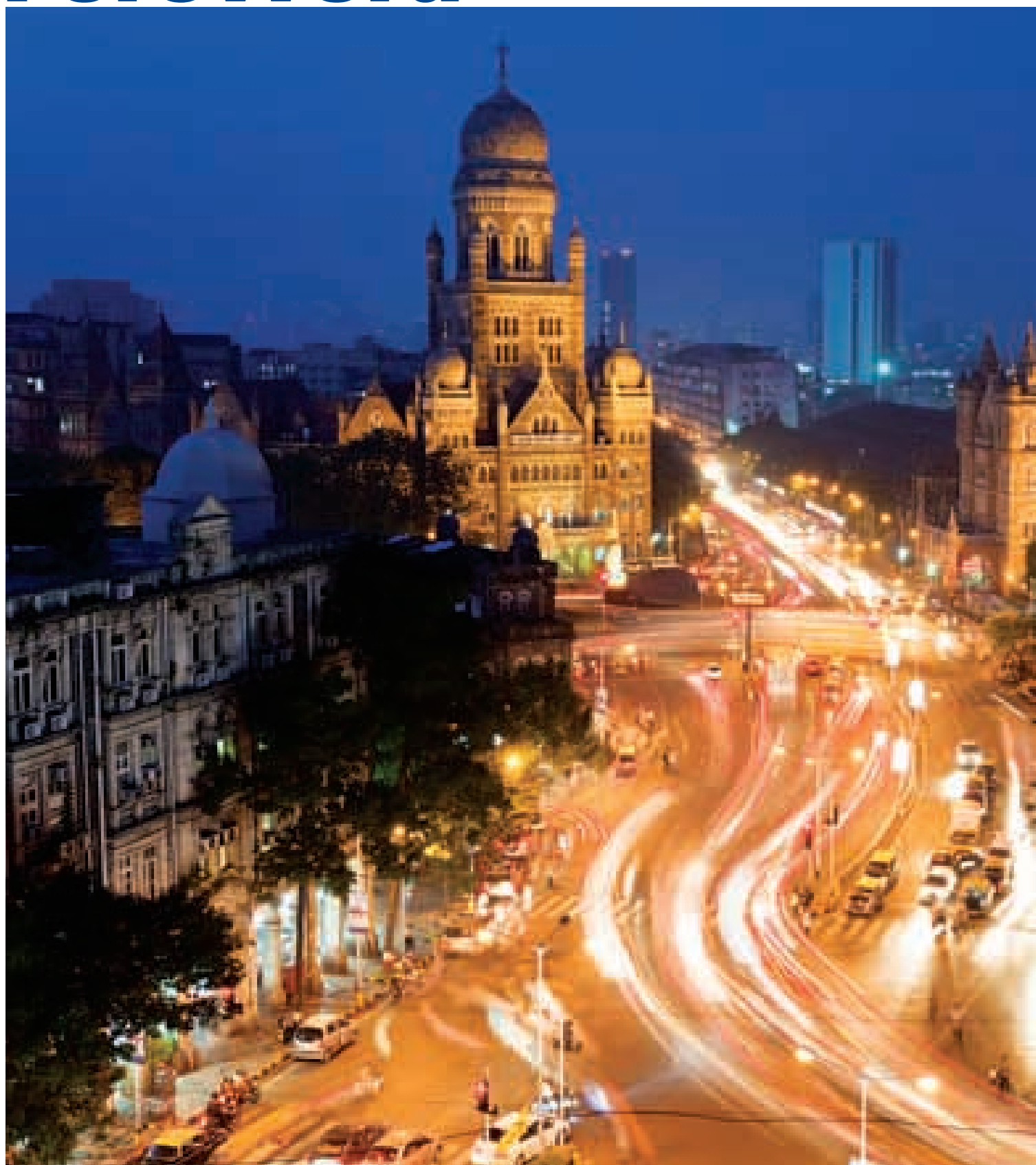
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Foreword





It seems that just about everybody is talking about debt sales. Indeed, as Europe's sovereign debt crisis wears on and economic growth sputters in both the developed and developing markets, debt sales (and the levels of debt held by banks and governments) have become one of the most scrutinized and carefully watched sectors. From media and public advocacy groups through to governments and regulators, all eyes are now firmly trained onto the debt sales markets.

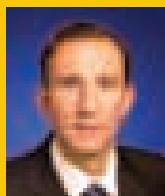
However, increased scrutiny does not always equate into increased activity. In fact, in many parts of the world, banks and debt issuers seem to be continuing to hold onto their portfolios in the hope that both funding and strategic acquirers will return to the market and that the gap between sellers and buyers will narrow. Yet when combined with anticipated increases in the levels of non-performing and past-due debt – wrought by weakened business and household balance sheets – in many markets, there are new strong signals that debt sales markets are now on the verge of a resounding renaissance.

In the midst of all of this, KPMG debt sales and portfolio services experts from around the world have come together to create the third edition of *Global Debt Sales*. As part of this ongoing publication series, KPMG's global Portfolio Solutions Group (PSG) will continue to examine recent debt portfolio activity in a number of key banking markets across Europe, the Americas, Africa and Asia-Pacific. We'll look at a wide array of 'non-core' debt sales, including performing and non-performing loans from around the globe, and will strive to provide high-level insights into trends and new opportunities on the horizon.

With extensive experience advising both sellers and buyers on hundreds of mandates globally, our senior team of loan portfolio professionals work alongside government and financial institutions, private companies, strategic and financial investors, debt collection agencies, industry financiers and other professionals to understand the specific issues facing each market. More and more, our clients look to us to provide a combination of strategic options analyses of portfolios and platforms, along with robust market sounding exercises with our extensive investor network to deliver quality solutions from both a country and global perspective.

We hope to once again share some insight with our readers in order to help market participants cut through the complexity of global debt sales and maximize the value of their loan portfolio positions.

We encourage you to contact the authors of this publication, or your local KPMG member firm to discuss any of these issues or insights in more detail.



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Trend Watch

Regulation

The turmoil in the markets caused by the Eurozone debt crisis is the latest manifestation of the banking crisis that almost brought the global economy to its knees in 2008. Unlike then, however, it's now the interconnection between government debt and the banking sector making the markets nervous. Breaking this link is key.

Since the crisis the focus has been on strengthening regulation of the banking sector. Banking Union is the key policy priority at present, but high capital, more liquidity and de-risking the derivatives market remain key policy targets. On October 26, 2011, the European Banking Authority (EBA) announced that a number of key banks across Europe needed to increase the size of their capital base and therefore had to raise in excess of EUR110 billion by June 2012. To achieve this, the EBA believed banks would take a number of actions including the issuing of new equity, the retention of earnings (rather than paying them out as dividends), the reduction of staff costs (thereby boosting Core Tier 1 capital) and the conversion of hybrid capital instruments into Core Tier 1 equity.

The banks were required to submit their plans, via their national authorities, to the EBA in January 2012. On July 11, 2012, the EBA reported back announcing that the majority of the banks meet the required ratio of 9 percent Core Tier 1 (CT1). For the few banks not able to meet the capital level using private sources, backstop measures are being agreed with national governments. The higher requirements were met mainly via measures directly impacting capital – retained earnings, new equity, and liability management. The EBA also reported that the exercise did not lead to reduced lending – deleveraging measures led to an overall reduction of risk weighted assets (RWAs) by only 0.62 percent.

What was clear from the exercise is that – on the equity/liability side of the balance sheet – little new capital has been raised. Indeed, profits are (at best) volatile and the debate about bail-outs has resulted in banks keeping their options open when it comes to transforming hybrid capital into Core Tier 1 equity. That being said, there are strong indications that significant action has been taken on the asset side

of the balance sheet, with de-leveraging being observed.

But it is widely known that this was not the EBA's policy intention. In fact, according to the EBA, the declared objective of these measures was to avoid an aggressive and potentially disorganised deleveraging process focused exclusively on the assets side. The potentially serious implications of the restriction in new credit was widely recognized and the authorities were clearly not looking for this response from the banks.

So while they likely accepted that some assets would be sold as banks returned to their business models, they probably wanted (and expected) lower quality, high risk assets to be sold as a way of reducing balance sheet risk and mitigating the danger of future profit volatility. But, in reality, most of the sales have been of good quality, performing assets.

Why did the banks have this response, and what are the wider implications? In our view, there were actually a number of factors at work here; some complimentary and some conflicting.



The political dynamic

Politicians find themselves in a difficult bind. On the one hand, there is palpable nervousness about domestic economies and growth (or the lack of it) across the European Union. But it is also clear that the overhang of government debt will likely lead to the continuation of austerity measures across Europe.

There is clear tension here between the need for economic stimulation (which governments cannot afford to fund) and new credit coming available for the wider economy, versus the disinclination to contemplate another bail out of the banks and another round of regulatory policy which is effectively driving more risk averse business models. Indeed, governments are sending out a very risk averse message, and following this up with policy interventions that are seeking to both manage the “too big to fail risk” while also pushing for the flow of credit to continue.

But this leads to a very serious debate about whether the lack of new credit is

actually supply-led or demand-driven. The banks argue that demand for credit is weak, and that large corporations are instead tapping the bond markets directly. They also (somewhat justifiably) point out that the regulatory burdens now placed on them are restricting their ability to lend profitably, particularly given the wider change in the credit risk profile of the economy. Of course, it must be noted that some of the stronger corporates (and some households) are paying down debt in the normal course of business and this is also depressing the net lending numbers.

Politicians, however, take an alternate view. They believe that the banks are not willing to take their share of the responsibility and that, to do so, they need to lend and help manage the slowing levels of economic activity.

The shortage of capital on the supply side, when combined with the pressure for new lending, will likely mean that some of the lower yielding but high risk-weighted assets may need to be sold (such as mortgages that have high loan-

to-value (LTV) ratios but no discernible signs of distress).

But the practicality of selling impaired assets is also becoming more and more complex, largely because those buyers that are prepared to take the risk are also calling for larger ‘haircuts’ on the valuation. In turn, this creates an impasse with banks unwilling to take an accounting loss on loans that are still performing, albeit with signs of future distress.

The liquidity environment

Ever since the announcement of the Basel III accords, it has been clear that liquidity would be critical to new regulatory arrangements. Many had been hoping that the delay in announcing some of the details of the arrangement (and, keep in mind, that we are still waiting for the longer-term Net Stable Funding Ratio) meant that the stance taken on the Liquidity Coverage Ratio (the short term one) would be relaxed. But this has not proven to be the case.

It has also become clear that the willingness of retail depositors to lock



up their deposits for longer terms has also not materialized, either because short-dated rates remain attractive or due to on-going nervousness about deposit protection. At the same time, the corporate market has also proven to be a non-starter, largely because of an unwillingness to lock up funds for any period of time.

As a result, there has been increased demand for High Quality Liquid Assets (HQLAs) which, in practice, can only be funded by selling other assets, namely loans. Indeed, it is now easier to sell lower-risk assets quickly without taking a haircut (which would impact overall Core Tier 1 capital), than enter into long negotiations on the poorer quality assets.

2011 also saw the onset of significant shortages of US dollar funding and, as a result, significant books of good quality, dollar denominated assets have been sold simply because the dollar funding costs have made this business unprofitable. In large part, these have involved US banks rather than hedge funds or other private equity type players.

But since these loans are generally well performing, they have been sold either at, or above, book value due largely to the fact that it is easier for US banks to source in this form rather than going out and originating new credit. This has led to the release of some capital capacity which could be used to lend in the domestic currency (subject to the other liquidity requirements to hold HQLAs).

Capital management

The capital management position is also far from straightforward, with many banks holding long-dated loans that were originated at narrow margins in the competitive pre-crisis world. But with the change in both capital and funding costs, these loans are no longer profitable.

The reality is that solvent borrowers are not likely to refinance by choice, while those that would consider refinancing are largely unable to find alternative finance due to the value of their collateral (notably domestic property). Given Basel III, one might assume that it would

be reasonably easy to determine the amount of capital required by using a formulaic table, but this overlooks the vagaries of the various models now in use, and thus makes a significant difference to the risk weighted asset (RWA) value and, therefore, the profitability of the loan. As a result, lower margin loans with higher risk weighting are more likely to be sold than others.

Non-performing loans (NPLs) are somewhat trickier. For instance, even though credit is normally priced to include (on a portfolio basis) a certain level of future impairment, the actual valuation of such portfolios on a 'for sale' basis becomes much more difficult once the default rate starts to diverge from the norm. So, while future losses (whether they are booked now or in some future accounting period) will likely be a straight Core Tier 1 write off, the buyers of such books will need to have a higher risk appetite and therefore will expect higher rewards. In turn, this will drive down prices which will also impact Tier 1.

Collateral management

Collateral management is an issue that is often overlooked when assessing capital and liquidity drivers in preparation for the sale of assets from the balance sheet. True, the European Central Bank (ECB) has provided significant medium-term liquidity with large tranches injected in December 2011 and February 2012. But this lending must be supported by good quality collateral which necessitates the removal of more good quality assets from the mix. At the same time, some banks have issued new covered bonds aimed at raising longer-term liquidity from the market, but these are also secured with higher quality assets.

The impact of this has been to remove significant blocks of assets that would otherwise have typically been sold to meet the EBA requirements. And while the impact of the ECB intervention on stability was both pronounced and welcome, the downside is that it has

also caused an even larger proportion of quality assets to essentially be taken out of the system.

What does this tell us?

Logic would dictate that if a board had taken the decision to deleverage and derisk, we would have seen significant books of lower quality assets being sold on the market. Clearly, this has not happened.

In part, this is because potential buyers of these assets are looking for significant returns which would force the banks to take large haircuts that they are unwilling to accept. But facing the need to maintain capital levels (namely by avoiding significant haircuts), meet liquidity requirements (by achieving a quick sale of good quality assets without discounts); and tie up their assets as central bank collateral, we are therefore left in the current situation where managers are selling assets that they should intuitively be keeping, rather than the higher risk, higher capital absorbing and higher margin loans (those that still carry a long-term impairment risk) that remain on their books.

This has led to a growing debate as to whether Basel III is really the right policy framework and, indeed, whether it will have a significant impact on the economy over the long-term. We believe that the level of debt – both in the wider economy and between the banks – was too high historically, and therefore experience would show that any policy response would have met a difficult transition period. Basel III is not perfect, but there are few – if any – viable alternatives being discussed.

That being said, Basel III has no hope of working in isolation and, therefore, more effort must be placed into developing the role of macro prudential tools in order to help manage the wider direction of the economy and reduce the gross risks now haunting the banking system.

Giles Williams

Financial Services Regulatory Centre of Excellence and Partner, KPMG in the UK

Shipping Loans

Stormy waters for the shipping industry

With the global economic downturn reducing trade levels across the board, shipping companies are facing increasingly challenging circumstances. And with excess capacity on order with shipyards, the existing imbalance between supply and demand has been further exacerbated by increasing downward pressure on both time-charter and spot rates, as well as operating margins.

As a result of the excess order book, the global fleet is expected to break previous records in 2012, with 7 percent growth overall. Dry bulk will see the highest capacity increases at 12 percent, containers will experience a 7 percent rise, and tankers, a more modest 4 percent increase. Most of this growth is being built in yards in China, Korea and Japan. It seems likely that shipbuilding sectors in those territories are also exposed.

“The prolonged depression in charter and freight rates experienced between 2008 and 2012 has eaten away the available facilities and cash reserves built up by owners and operators during the extended shipping boom that ended in 2008. This means that it is not just loan-to-value (LTV) covenants giving their lenders a headache, but also debt service and the prospect of impending refinancing within a sector that many wish to decrease their exposure to.”

John Luke

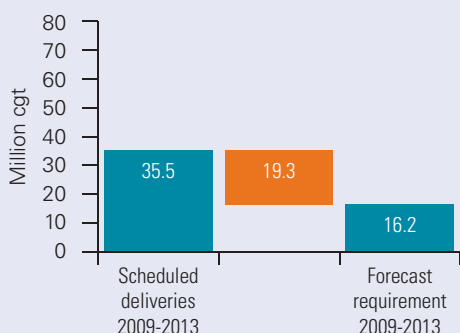
Global Head of Shipping and Partner, KPMG in the UK

Price trends and overcapacity

Oil tankers

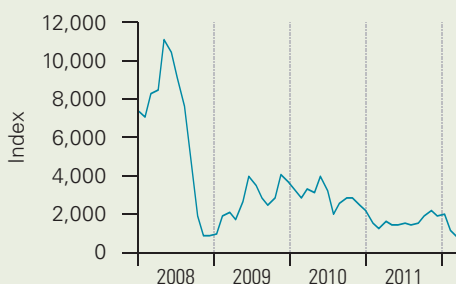


— Baltic dirty tanker index

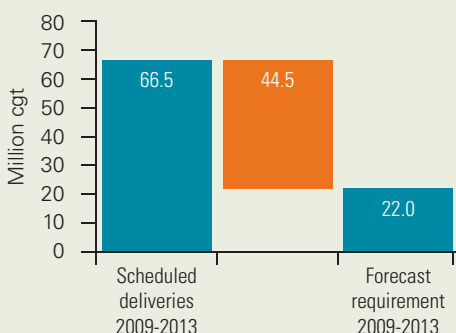


Source: DataStream, 2012.

Bulk carriers

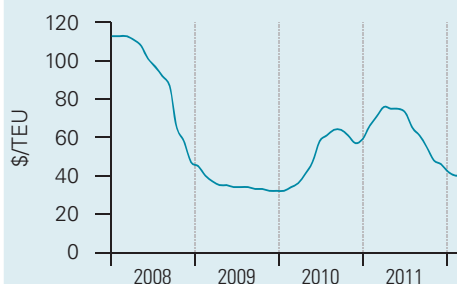


— Baltic dry index

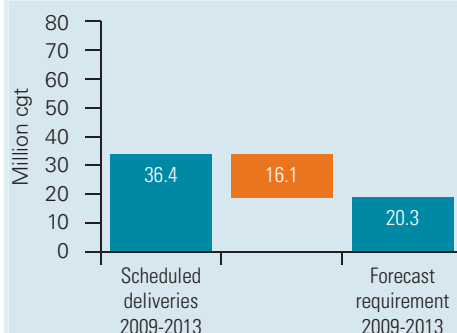


Source: DataStream, 2012.

Containerships

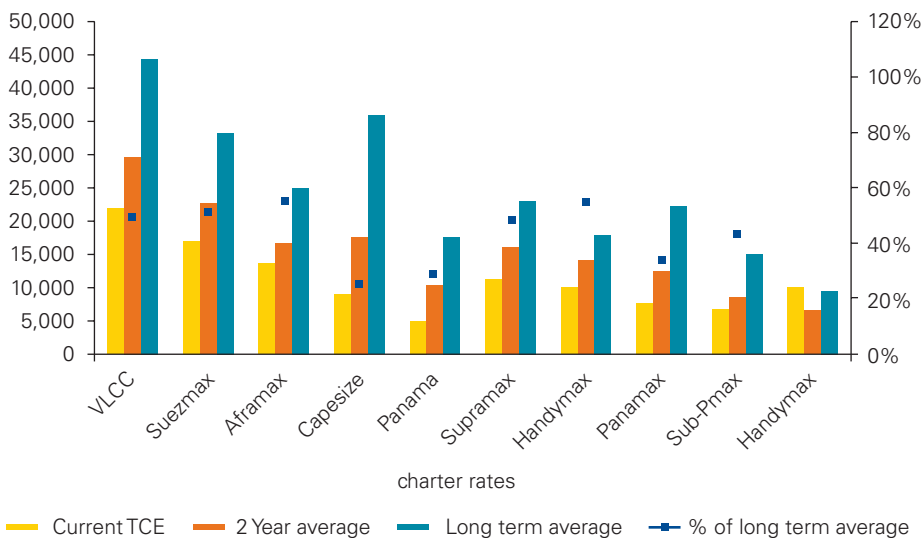


— Containership timecharter rate index



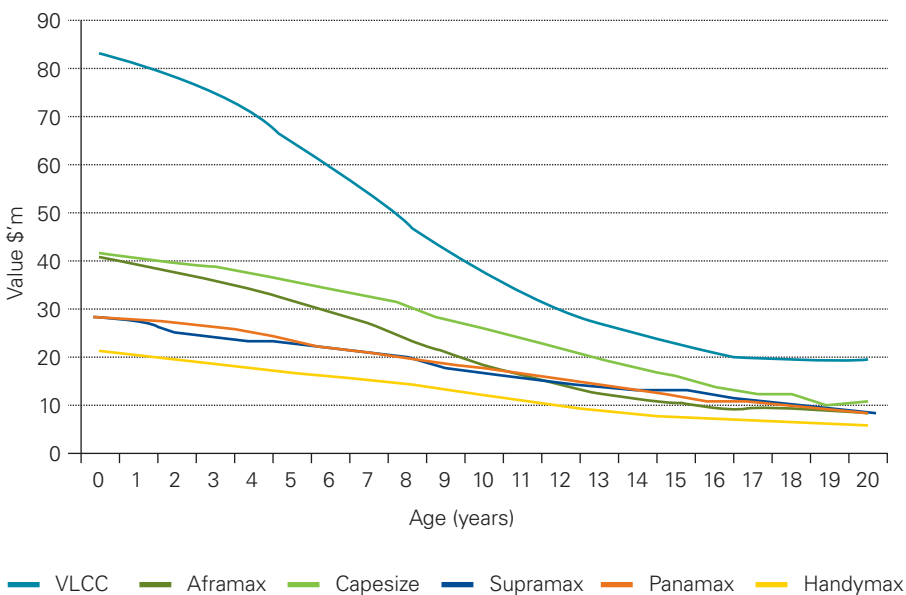
Source: Vereinigung Hamburger Schiffsmakler und Schiffsagenten e.V. (VHSS), the Hamburg Shipbroker's Association.

Current versus long term charter rates



Source: vesselvalue.com

Value decline with age by vessel type



Source: vesselvalue.com

Facing a prolonged period with charter rates hovering dangerously close (and in some cases below) to break even, a growing number of vessel owners and operators are now experiencing severe financial difficulties. Moreover, margins have been further eroded by sharp increases in 'bunker' (fuel oil) prices which has put severe pressure on those unable to pass these costs on to the shippers.

Indeed, in the six months ending March 2012, the Clarksea index (an index for shipping rates) fell by 35 percent to below USD10,000 per day. As illustrated in the graph on the left, the Bulk Carrier market experienced the most significant reduction in rates which collapsed from USD30,000 per day in December 2011 to somewhere between USD3,500 and USD7,000 per day by January 2012. Compounding these challenges are increasing costs for bunker and the cost of regulation which is further squeezing margins across the industry.

Liquidity is also under significant pressure as the impacts of the credit crisis take their toll on the traditional source of maritime debt: the Eurozone and Scandinavian banks. And with most of these sources now undergoing serious deleveraging, many are explicitly seeking to exit their shipping loan portfolios which, in turn, has placed further pressure on owners and operators seeking to refinance their pre-crash newbuild funding or fund final payments on new ships about to hit the water.

These pervasive issues, combined with a perceived lack of quality and transparency in corporate reporting, have created a number of issues for banks when dealing with, and restructuring, shipping connections in their portfolios.

Options available for owners, charterers and operators

The reality is that – in the current economic climate – shipping businesses have limited turn-around options at their disposal. In certain circumstances, cost reduction can be a viable option, but given the current depressed rates, any amount of cost reduction will still likely leave shipping businesses with insufficient funds to service overheads and finance costs.

Similarly, the ‘hot or cold’ ‘lay up’ of underutilized vessels is often ineffective, with the costs of idling vessels or taking vessels ‘out of class’ (thereby incurring various crew costs, port charges and insurance fees) remaining high. Labor costs also tend to remain fixed in the short-term. These costs differ from the airline industry where aircraft can often be kept in ‘dry storage’ in the desert at low cost.

What is more, the option of simply scrapping the worst performing assets is generally uneconomical and often unacceptable to the lenders who hold security over these assets, making this option unfeasible without the cooperation of the ship owner.

Facing limited options for turn-around, many lenders and borrowers have fallen into an ‘extend and pretend’ strategy believing there is no alternative than to ride through the cycle. But with most observers suggesting the current down-draft may last 3 to 5 years, this approach is unlikely to be sustainable.

Restructuring challenges

In our experience, the quality and timeliness of management information being presented to lenders is often very poor. As a result, neither the lender nor the borrower has sufficient

forward visibility into either the potential cash flow issues or the company’s operational and financial drivers and performance. This often means that when a shipping connection becomes distressed, it is difficult to properly assess how to even begin operational and financial restructuring.

Consensual negotiations are also frequently hampered by difficulties in ascertaining the current physical condition – and, hence, the real value – of each of the vessels within the connection; a task made even more complex in cases where the connection’s most valuable security is still under construction in an Asian yard. Many vessel owners also hold a dogged belief that an upturn in the market is ‘just around the corner’, which is dampening their appetite for meaningful negotiations.

Recently, a disturbing strategy has gained greater adoption by vessel owners under pressure from banks: applying to the US courts for Chapter 11 bankruptcy protection. This generally demands a fairly low threshold for proving jurisdiction. (For example, it can be triggered by the holding of a US bank account or the fact that vessels periodically dock in US ports). In the past couple of years, this strategy has been taken by a number of companies including Omega Navigation, Marco Polo Seatrade and General Maritime Corp.

With US Chapter 11 often being seen as a more debtor-friendly process than many of the insolvency regimes in Europe, it can be a strong draw for those vessel owners who see limited short-term options and believe that a prolonged period of protection from creditors may enable them to continue operations through the downturn. At worst, some believe the delay caused

by Chapter 11 represents a route to a better consensual negotiation.

However, once Chapter 11 protection is invoked, debtors often find that the legal and professional fees associated with the process run into the millions of dollars. Moreover, it can also result in Debtor-In-Possession (DIP) funding requirements. In order to protect their position, these DIP funds are often provided by the lenders (as new money on top of the already impaired debt) which effectively ranks ahead of any security already held by the lenders. There is also the risk that DIP funding may be provided by a party related to the borrower. And while the debtor may enjoy the benefit of keeping control of the vessels, depreciating asset values often diminish the value of the lenders’ security.

Since maritime law (particularly the complexity surrounding the risk of vessel arrest in differing jurisdictions) traditionally requires specialist maritime lawyers, it is often this group that are driving the restructuring negotiations between banks and their borrowers. That being said, we have seen banks and borrowers increasingly bring insolvency and financial restructuring experts into the discussions at a much earlier stage.

“In 2012, we have been spending a lot of time with the work out units of our banking clients to help them identify early warning signals for their shipping portfolios and to develop solutions for the shipping loans that need to be restructured.”

Justin Zatouroff

Partner, Restructuring Practice,
KPMG in the UK

Solutions available to lenders

Operational restructuring –

Operational restructuring can be a useful tool during a consensual restructuring process. Indeed, appropriate commercial and technical ship management should be put in place, particularly in cases where negotiations are protracted, to allow costs and revenues to be optimized in the new circumstances. While this may not necessarily achieve profitability, it will – at the very least – create a stable platform upon which consensual negotiations can be held. But in many cases, we have found that vessels continue to be traded uneconomically and receive poor maintenance by the distressed borrower even while negotiations are ongoing. In other words, competency should not be assumed during negotiations. Lloyd's List recently reported that Hong Kong's Wallem and other fleet management businesses are significantly increasing their business with vessels repossessed by banks.

Debt for equity swaps

While common in standard restructuring processes, debt for equity swaps will not always appeal to lenders as they tend to lead to significant public relations issues regarding the ownership of shipping assets which lenders are often unwilling to risk. That being said, debt for equity swaps may be a necessary step towards a fleet restructuring or consolidation. Moreover, it should not be assumed that the existing owners hold all of the operational knowledge required to continue trading.

Refinancing/equity cures

Given the specialist nature of ship finance, it is often difficult for alternative debt to be found, particularly given the current economic conditions and the fact

that a number of lenders now classify their shipping portfolios as non-core.

Equity cures are equally difficult as vessel ownership structures are often thinly capitalized and therefore owners are generally unwilling to commit further funds when the market starts to deteriorate.

Amend and extend

In the current economic climate, the potential for turnaround strategies based on market recovery is extremely low. Even in better times, the amend and extend strategy is seen as a last resort by lenders. With the growing realization that the market may not improve for the foreseeable future and the number of payment defaults continuously growing, this option is becoming even less feasible.

Lenders considering this strategy should note that, with the risks associated with depreciating and potentially stranded assets mounting, any waivers given by lenders should have the right terms attached (such as change of ship managers or change of charter methods) in order to provide as much leverage as possible in case consensual negotiations break down.

Secondary debt market

Since ship finance is largely a specialist field, the number of institutions involved (and therefore the liquidity of the debt in the secondary market) is limited. What is more, given the present outlook for the shipping industry and the prices being achieved at auction, values are likely to reflect the distressed nature of the industry.

Asset disposal or security enforcement

In some cases, the disposal of individual vessels – or even the entire fleet – can be agreed with the vessel owner in

order to pay down debt. However, in practice this can be difficult to achieve even with the cooperation of the vessel owner and is likely to only result in distressed prices in the current market.

But if the cooperation of the vessel owner is not forthcoming, lenders may find that the only viable option is to enforce their security and either auction or sell the vessels to a third party. However, given the complexities of maritime law and logistics this course of action must be meticulously planned both in advance of, and during, consensual negotiations. The reality is that the potential consequences of an unplanned enforcement process can be costly for lenders, particularly if the borrower simply fails to deliver the ship assets to the lenders or seeks Chapter 11 protection in US bankruptcy courts (as discussed earlier in this article).

Other solutions

With all this in mind, there are a few interim solutions available to lenders when faced with a shipping group in need of restructuring. These can be implemented as a first step in reaching an amicable restructuring solution and may give the bank more transparency over the borrower's financial situation, the fleet quality and the quality of the operator.

For example, in cases where the restructuring discussions have deteriorated between the bank and the borrower, we have seen the emergence of new solutions such as the warehousing of particular shipping assets while a buyer is found. We have also seen lenders support the continued trading of the vessels by a third party ship operator reporting to the bank, which can continue until such a time as a solution can be found which maximizes value for the lenders.

Conclusion

Overall, we have noted that the number of distressed connections in shipping portfolios is increasing and, in many circumstances, lenders lack proper forewarning or planning. With the 'amend and extend' strategy proving increasingly unsustainable – due largely to unsustainable operating cash positions and the widely-held belief that the market may not turn in the near-term – more proactive management of portfolios will be required. Given the complex nature of the shipping industry in general and shipping finance in particular, lenders must have as much information and leverage as possible at the early stages of negotiations.

The reality is that shipping negotiations are starkly different from those in real estate where once a consensual

negotiation breaks down, the enforcement process is relatively clean and clear cut. In shipping, faltering negotiations may lead the vessel owners or operators to take pre-emptive action to seek protection or cause disruption, which can be both time consuming and expensive for the lenders.

We therefore believe that it is vital that lenders dealing with distressed loans in their shipping portfolio start to build as much control as possible throughout the negotiation process and stand ready with a Plan B that can be quickly executed if a consensual agreement is not achievable.

That being said, debt for equity swaps may be a necessary step towards a fleet restructuring or consolidation. Moreover, it should not be assumed that the existing owners hold all of the operational knowledge required to continue trading.



UK consumer debt purchase market

Larger deals are closing, volumes and prices are reaching historic highs but are we heading for a crash?

The UK consumer debt purchase market has been particularly active recently. Indeed, over the last 12 months, we have seen more transaction volume and landmark market developments within the UK than we saw over the last 3 years combined. It is a sign of these very busy times when there is frequent talk of a first initial public offering of a UK debt purchaser within the coming years.

Sales volumes are increasing to a new peak

In 2011, the UK debt purchase industry returned to its pre-credit crunch peak with the value of investments rising to well over GBP800 million and 2012 continued this rising trend.

Facing an environment of improving collections, last year saw sellers bring more portfolios to market which, in turn, has led to firm pricing and a virtuous cycle of more and more assets coming to market. In KPMG International's 2012, Global Debt Sales Survey, the majority of respondents suggested that we will see a strong uptick in disposals by lenders in 2013 as banks continue to offload debt in their warehouses. That being said, many took the view that these sales would likely peak in the last quarter of 2012 or the first quarter of 2013, and then drop by between 10 to 20 percent once warehouses are cleared.

However, there are also clear indications that individual sales are becoming larger. At the same time, there seems to be a clear shift in the UK market away from regular 'business as usual' debt sales

run by the specialist debt sales teams, to instead focus on much larger 'balance sheet driven' sales, the decisions for which are made by the C-Suite executives of the banks. As a result, we anticipate a number of sales of GBP500 million to GBP1 billion (and up) in face value from some of the major lenders within the coming months.

This is further supported by a handful of well funded buyers who seem eager to invest greater amounts of money into acquiring either performing or semi-performing loans portfolios, which will clearly require much larger check sizes. Recent examples of this trend include the sale of Egg's GBP650 million performing loan book to the syndicate of Paragon, Carval and Arrow Global, and several large sales from MBNA, both in excess of GBP1 billion in face value.

Pricing is also increasing, driven by a very high level of demand

While one might see this as a virtual Eutopia for well-funded debt purchasers, the reality is that leading consumer debt sellers are reporting ever-increasing pricing for charged-off consumer debt, which is widely considered to be driven by demand exceeding (an albeit increasing) supply. One leading seller noted that three debt purchasers had independently suggested that the market may actually be heading for a pricing crash for consumer Non-Performing Loans (NPLs) as, in their view, the market is showing signs of overheating. The seller went on to suggest that, once

the collection performance metrics for recently acquired consumer NPL portfolios start to feed through into the debt purchasers' financials, we will likely see a market correction.

It should be noted, however, that this increased level of demand is predominantly being driven by six to ten well-capitalized debt purchasers who are looking to grow their portfolio size through acquisition. These include Cabot Credit Management, Arrow Global, Link Financial, CapQuest, 1st Credit, Marlin, Lowell Group and Max Recovery, to name but a few.

At the same time, at least three of these purchasers are rumored to be coming to the end of their Private Equity ownership cycles are therefore most likely to be up for sale in the coming years which, again, is fuelling competition for portfolios and driving up pricing. However, at the time of writing, RBS Special Opportunities Fund had postponed the sale process of debt buyer Arrow Global, after bids failed to meet its valuation of the business. It was rumored that the bidder interest was predominantly from other UK and overseas strategic players, denoting a shift from the historic private equity interest towards potentially greater consolidation in the sector.

A number of large overseas funds are also looking to gain a foothold in the sector by acquiring a large anchor portfolio either alone or by partnering with a UK servicer. Most of these players are looking to spend between



GBP100 million and GBP300 million in 2012, often in larger chunks rather than smaller 'Business As Usual' sales. That being said, transactions of GBP50 million to GBP100 million seem to be continuing unabated. New entrants into the market include PRA's acquisition of MacKenzie Hall's platform for a reported GBP33.5 million, Cyrus Capital's acquisition of Sigma Financial and Apollo's entry into the market through a partnership with 1st Credit.

Asset diversification is becoming key for better financial performance

As the market for traditional consumer NPLs becomes more crowded and prices increase, some of the more shrewd purchasers are looking to exploit new niches (in terms of asset classes) or new geographies. As previously noted, a number of purchasers are now looking

to acquire debt earlier in the collection cycle (as performing or semi performing loans), which not only commands higher pricing and greater transaction values, but also decreases competition from those players that are unable to write significant checks. This represents a market shift from the pre-financial crisis days when almost all debt was sold at a low value having been through several collection cycles. The trend is further supported by some of the large non-

core business disposals in the market, such as those from MBNA.

Additionally, even the UK government is now sufficiently comfortable with the standing of a number of the purchasers and their focus on treating customers fairly, that they are considering extending beyond the outsourcing of collections and actually considering running a number of more extensive pilot sale and 'right to collect' schemes.

Most of these players are looking to spend between GBP100 million and GBP300 million in 2012, often in larger chunks rather than smaller 'Business As Usual' sales. That being said, transactions of GBP50 million to GBP100 million seem to be continuing unabated.

With larger transaction sizes, deal structuring mechanisms are becoming more common

As portfolio sizes grow, and investment sizes increase, market participants will need to carefully consider their approach to deal structuring, which can have a significant positive impact on pricing, even in relatively short-term duration situations.

Indeed, structured deals can take a number of different forms from forward flows and Joint Venture/upside arrangements with assets transferred into Special Purpose Vehicles, through to price deferrals and post deal price adjustment agreements. Yet despite the variety of different forms now in use, what each of these structures have in common is that they can be mutually beneficial for both the seller and the purchaser which, in turn, can drive returns.

However, despite an obvious keenness on the part of more advanced purchasers to explore these deal structures with sellers, many of the debt sales teams within the banks still seem to prefer to 'keep deals simple' by focusing on speed and ease of execution and, as a result, there is likely value being left on the table for both parties.

Both parties may learn some valuable lessons from other loan portfolio asset class sales (such as RBS's CRE loan portfolio sale to Blackstone), which could be transposed to the UK consumer debt purchase market.

New and creative funding structures are being deployed

Perhaps one of the most significant recent market developments is Lowell Group's March 2012 placement of a GBP200 million high-yield bond, with a 2019 maturity and an annual interest coupon of 10.75 percent. With the proceeds earmarked for refinancing existing debt, this access to new types of money indicates that new ground is

being broken in the industry. This has been more recently followed by Cabot Credit Management's issuance of a similar, albeit larger, bond.

This provides a number of potential benefits for bond originators. For one, access to public money opens up a new source of funding which, to date, has been limited to the decreasing handful of senior debt providers lending to the sector (one notable new entrant being DNB Nord). But the bond issuance also better prepares Lowell and Cabot (and other debt purchasers who may follow suit) for their private equity exit through an initial public offering or sale to a new breed of buyers such as pension funds or insurers who have longer-term investment horizons.

To assist this, debt purchasers should consider matching the Estimated Remaining Cashflow (ERC) of acquired portfolios to their funding profile in order to ensure that they are able to service their debt. The simple truth is that short-tailed collections curves are not best suited to long-term funding, as they tend to lead to increased pressure to continue acquiring portfolios, at the expense of squeezed margins.

"The UK debt purchase market is going through a period of dramatic change.

On the one hand, we see a potential overheating of the consumer NPL market driven by buyers seeking refuge in less saturated markets. But on the other hand, new sources of funding are potentially opening up. Given that funding has always been a key driver in the success or failure of the sector, it will be interesting to see how this impacts the industry over the next 12 months."

Jonathan Hunt
Associate Director,
Portfolio Solutions Group,
KPMG in the UK

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Introduction to **Europe**



There is no doubt that Europe's debt sales market has been greatly impacted – for better or worse – by the global financial crisis and the evolving sovereign debt crisis in the Eurozone.

Some jurisdictions – such as Ireland and Portugal – have started to see the return of market fundamentals and, in its wake, are anticipating a rise in the strength of their local banks. Others, such as Romania and Hungary, still seem to be working to stabilize their banking and loan sectors with a variety of measures and policies set to encourage higher capital ratios and loan loss provisions.

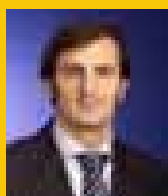
Across the board, however, we are seeing banks continue their efforts to offload non-core and non-performing debt portfolios in order to comply with local and regional regulatory requirements. In particular, we are seeing non-domestic banks step up their deleveraging activities in certain countries which, in turn, is propping up the loan sales markets.

That being said, there seems to be much room for optimism for the medium and long-term health of the debt sales markets in Europe. Most jurisdictions are experiencing rising levels of debt – both commercial and consumer – that will (given the continuing stagnation of economic growth) more than likely lead to higher levels of non-performing debt. In turn, this will lead many banks to start considering the sale of these portfolios and other non-core assets as these debts start to weigh on their balance sheets.

It goes without saying that Europe's debt sales market will rise and fall on the outcome of the ongoing sovereign debt crisis. With stability will come a return to the continuous growth of portfolio sales as banks seek to offload their bad debt and start to build their books through origination and acquisition. But should the situation deteriorate further, we will likely see a further tightening of credit facilities that will eventually lead to a lower volume market in the medium-term.

Bullish investors will undoubtedly view the current market as a singular buying opportunity marked by below-average pricing and reduced competition for larger books (due in part to the sector's reduced appetite or ability for writing 'big checks'). Risk-averse investors, on the other hand, may continue to sit on their growing nest eggs until the current instability and uncertainty starts to subside.

Regardless, our experience in the region tells us that Europe's debt sales market will soon start to pick up steam; country-by-country at first (likely led by the UK and Spain), but with growing momentum as we move into 2013 and beyond.



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United Kingdom

Introduction

Having gathered considerable pace in both the non-core performing and the non-performing markets over the past 8 months, the growth of the UK debt sales market is widely expected to continue unabated through the end of 2012 and well into 2013, led by the deleveraging programs of both UK and foreign banks.

One of the key issues facing banks in the UK is their overexposure to commercial real estate (CRE) lending. As a result, CRE has been a central component of deleveraging plans, as

evidenced by Lloyds and AIB's recent high-profile sale processes (Projects Royal, Harrogate, Forth and Pivot), the majority of which have been successfully closed notwithstanding the failure of Pivot.

Outside of the CRE sector, however, we have seen several notable transactions either being commenced or closed since late last year representing a wide spread of assets including leveraged corporate loans (Lloyds), performing residential mortgages (Bank of Ireland) and second charge mortgages (two high street

One of the key issues facing banks in the UK is their overexposure to commercial real estate (CRE) lending. As a result, CRE has been a central component of deleveraging plans, as evidenced by Lloyds and AIB's recent high-profile sale processes (Projects Royal, Harrogate, Forth and Pivot).

banks). Moreover, several banks have now closed large transactions involving project finance and infrastructure (RBS and Bank of Ireland) and aviation finance (RBS).

That being said, the past 6 months have also seen the larger UK banks – in particular – increase their focus on exiting assets and operations in non-core markets. This has led to several large transactions being undertaken by Lloyds and RBS (in Australia and Ireland), Barclays (in Spain) and HSBC (in Moldova).

On the consumer debt sales side, the past year has brought the UK debt purchase industry back to its peak with the value of investments rising to well over GBP800 million, a trend that continued through 2012. It is worth noting that this level is similar to what was reached prior to the credit crunch in 2008.

The gap narrows...

While the reasons for the narrowing of the bid/ask gap between sellers and buyers is complex and transaction specific, it has broadly been driven by several key factors:

- **The re-emergence of strategic buyers for retail assets** – over the past few months, we have seen

Market drivers:

The increase in deal activity in the UK largely reflects two key factors:

1. The bridging of the gap between buyers and sellers in both performing and non-performing loan markets.
2. The willingness of certain banks to take acceptable losses in order to clean out lower quality and distressed loans.

several of the large building societies and banks start to grow market share by acquiring portfolios of performing mortgages and consumer loans from non-core vendors. For the most part, this has been made possible through strong balance sheets and retail funding bases. While Nationwide and Coventry Building Societies have been the most notable players, several smaller players such as One Savings Bank, Aldermore and Metro Bank have also been actively seeking growth through portfolio acquisition.

- **Buyer competition and new entrants** – much activity has also been taking place outside of the prime/performing loan space, with the range and volume of buyers seeking to invest in the UK market growing considerably over the past 12 months. This has included both new entrants making marquee investments (Kennedy Wilson and Sankaty) as well as more traditional corporate private equity players shifting to direct debt acquisition (Oaktree and TPG). This same trend has also seen several large insurers and pension funds (Aviva and Pension Danmark) swoop into the market to secure higher-quality project finance and infrastructure loan portfolios, providing an important indication of where that market may be heading in the medium-term.

- **Debt finance is returning** – across the performing and non-performing loan markets, we are slowly starting to see funding lines and external financing return to buyers, thereby enabling them to leverage investments and improve pricing. This is clearly a welcome development. Apollo, for example, was able to externally fund a large portion of their recent investment in the MBNA businesses, while several large performing residential mortgage portfolio acquisitions were funded



On the consumer debt sales side, the past year has brought the UK debt purchase industry back to its peak with the value of investments rising to well over GBP800 million, a trend that is set to continue through 2012. It is worth noting that this level is similar to what was reached prior to the credit crunch in 2008.

through the successful raising of retail deposits by purchasers. We have also seen competitively priced loan-on-loan leverage for CRE loan portfolio sales being made available by a number of retail and investment banks such as JP Morgan, Royal Bank of Canada and Citibank, with several asset manager and pension funds also seeking to enter this market. A prime example of this was RBS's successful securitization and placement of its vendor finance participation and equity into the Project Isobel investment with Blackstone.

Banks take the pain...

Increasingly, banks are seeking to balance their market pricing for those loan portfolios that are below book value against their strong desire to reduce both risk-weighted assets and exposures to certain sectors and geographies. This has been particularly true for CRE-backed and corporate loans. In the UK, this has been most notably demonstrated by Lloyds, who have executed a number of high-profile sale processes across different asset classes and markets. But the trend is also evident in a number of the UK



banks operating outside of the UK and foreign banks operating within the UK. This is being driven by four key trends:

- **Non-core is front and center** – most of the UK's five largest banks have created either virtual or actual non-core banks to house both assets and, in some cases, the management and expertise charged with running these books down. RBS's Non-Core is likely the most obvious of these, particularly given their stated aim to finalize by 2013/2014 in line with their European commitments. But other banks – including those without the same level of regulatory pressures and increasingly those in the investment banking market – have also sought to replicate this approach. As a result, many banks and societies have now undertaken, at the very least, preliminary assessment of their portfolios and are now either devising or executing run-down or sale strategies.
- **Price versus exit trade-off** – up to this point, most banks have been weighing whether to sell now for a discount, or hold on for longer and potentially collect more. And while the message coming from the banks was that they would prefer to hold on to their restructured performing and non-performing loan assets, many have sought to explore clean and structured sales in the face of market uncertainty (rising provision levels, looming Basel III requirements, deteriorating

Eurozone confidence, internal fatigue with running down large non-core books, etc.). This has largely been driven by the core/non-core review of balance sheets and assessments of future capital requirements which has led even the previously stoic non-sellers to explore market soundings. As recent activity by Barclays and HSBC has demonstrated, deleveraging is no longer the exclusive domain of RBS and Lloyds.

- **Exposure to certain asset classes being reduced** – with CRE lending high on the list of assets that banks would most quickly like to exit (as evidenced by Lloyds and RBS selling down UK CRE exposures over the past 12 months) and a number of UK and foreign banks exploring options to replicate this over the coming year, we expect to see activity increasing. Activity has also been on the rise outside of the UK with LBG and RBS selling down CRE loans and assets in Ireland, Australia, Japan and continental Europe. At the same time, foreign banks (such as Bank of Ireland, AIB and NAMA) are also seeking to exit non-core CRE loans in the UK, a trend that will likely continue through 2013.
- **Certain geographies need to be exited** – while the general rule has been that the further bank assets/operations away from the UK, the more likely they are to be exited (as demonstrated by Lloyds and RBS in

Australia, New Zealand, Japan and Pakistan), 2012 saw many UK banks start deleveraging process in the Eurozone (particularly in Portugal, Ireland, Greece and Spain). Both RBS and Lloyds have large exposures to Ireland which are actively being reduced through workouts and sales, while Barclays has recently disposed of both retail and SME NPLs in Spain to reduce exposure to Western Europe. Much of this activity has been spurred on by macroeconomic, currency and real estate uncertainty within these markets, which has led UK banks to act quickly to stabilize and reduce their exposure where possible.

Looking forward

While, in late 2011, most pundits expected the pipeline for UK debt sales to be heavily focused on CRE and residential mortgage NPLs, the reality has been a focus on deleveraging with very few residential mortgage NPL sales taking place and only four notable CRE loan sales. That being said, the market has been extremely active within the corporate, performing and consumer NPL markets with little indication that this activity will slow through 2013. In fact, given the increased focus by UK banks on reducing their balance sheets and the desire of overseas banks to monetize assets in a relatively liquid market, we expect deal activity to increase across each of the main asset classes.

Recent selected loan portfolio transactions (post August 2011)

Seller	Buyer	Asset type	Face value (CUR m)	Completion date	Source
1. Bank of Ireland	Nationwide	Residential mortgage portfolio	GBP1,100	Oct 2011	Nationwide, 2012
2. RBS	Paragon	Residential mortgage loans (Buy-to-Let)	GBP43	Oct 2011	Financial Times, 2012
3. RBS – Project Isobel	RBS and Blackstone	Commercial property	GBP1,360	Dec 2011	Costar, 2012
4. Lloyds Banking Group – Project Royal	Lone Star	Commercial property	GBP900	Dec 2011	Reuters, 2012
5. Bank of America MBNA	Paragon	Credit card receivables	Undisclosed	Dec 2011	Reuters, 2012
6. Bank of Ireland	Wells Fargo	Loans sold against: Burdale Financial Holdings Limited and the portfolio of Burdale Capital Finance Inc. lending division	GBP1,600	Dec 2011	Irish Times, 2012
7. RBS	Sumitomo Mitsui Financial Group	Aviation leasing unit	GBP4,700	Jan 2012	Bloomberg, 2012
8. Bundesbank and Lehman Bros legacy – Project Gospel	PIMCO	CRE loans originated by Northern Rock	GBP1,140	Mar 2012	Costar, 2012
9. NAMA – Project Saturn	MSREI	UK development schemes	GBP216	Mar 2012	Costar, 2012
10. Lloyds Banking Group	Sankaty (Bain Capital)	Leveraged distressed loans (mix of corporate loans to the real estate sector and other industries)	GBP500	Mar 2012	Reuters, 2012
11. UKAR	Virgin Money	Residential and BTL mortgages	GBP465	Jul 2012	Virgin Money, 2012
12. NAMA – Chrome	Pears Group	UK investment and development assets	Undisclosed	Aug 2012	Costar, 2012
13. Lloyds Banking Group – Project Harrogate	Oaktree Capital Management	Non performing commercial property	GBP625	Aug 2012	Costar, 2012
14. Lloyds Banking Group – Project Lundy	TPG and Goldman Sachs	Business and real estate loans	GBP1,200	Aug 2012	Reuters, 2012
15. Lloyds Banking Group – Project Forth	Kennedy Wilson and Deutsche Bank	Commercial property	GBP779	Dec 2012	Property Week, 2012
16. Allied Irish Bank – Project Pivot	Deal cancelled	Commercial property	GBP400	Deal cancelled	Costar, 2012

Source: Defined in the table, all Public Information.



Ireland



Economic activity in Ireland is showing continued signs of improvement, particularly in export-led sectors. Leading the positive news stories are a number of significant new job announcements from both established entities as well as a number of newcomers to the Irish shores.



Introduction

Economic activity in Ireland is showing continued signs of improvement, particularly in export-led sectors. Leading the positive news stories are a number of significant new job announcements from both established entities as well as a number of newcomers to the Irish shores. In part, this is the result of certain market fundamentals such as a young well-educated workforce (likely to continue for some time given Ireland's birth rate is currently the highest in Europe) and the open nature of the economy. Ireland's commitment to the terms of the Troika bailout has been acknowledged in a number of

recent favorable reviews and Ireland is now held up as a model of reform. The success of these measures has enabled Ireland's first return to the bond markets in July 2012 since it originally received Troika support, initially through t-bills and then longer dated bonds, both healthily oversubscribed with significant overseas participation.

While covered in-depth throughout this publication, the Eurozone crisis likely represents the major risk to Ireland's recovery in the near term, however in recent months Ireland has managed to avoid the worst of the spillover

effects seen in other countries, with sovereign yields continuing to reduce to sustainable levels. The pace of Irish bank deleveraging increased throughout 2012 with Q4 being particularly active for deals closing.

Irish banking landscape

There have been a number of key developments recently in the Irish banking landscape, since our last global debt sales publication, including:

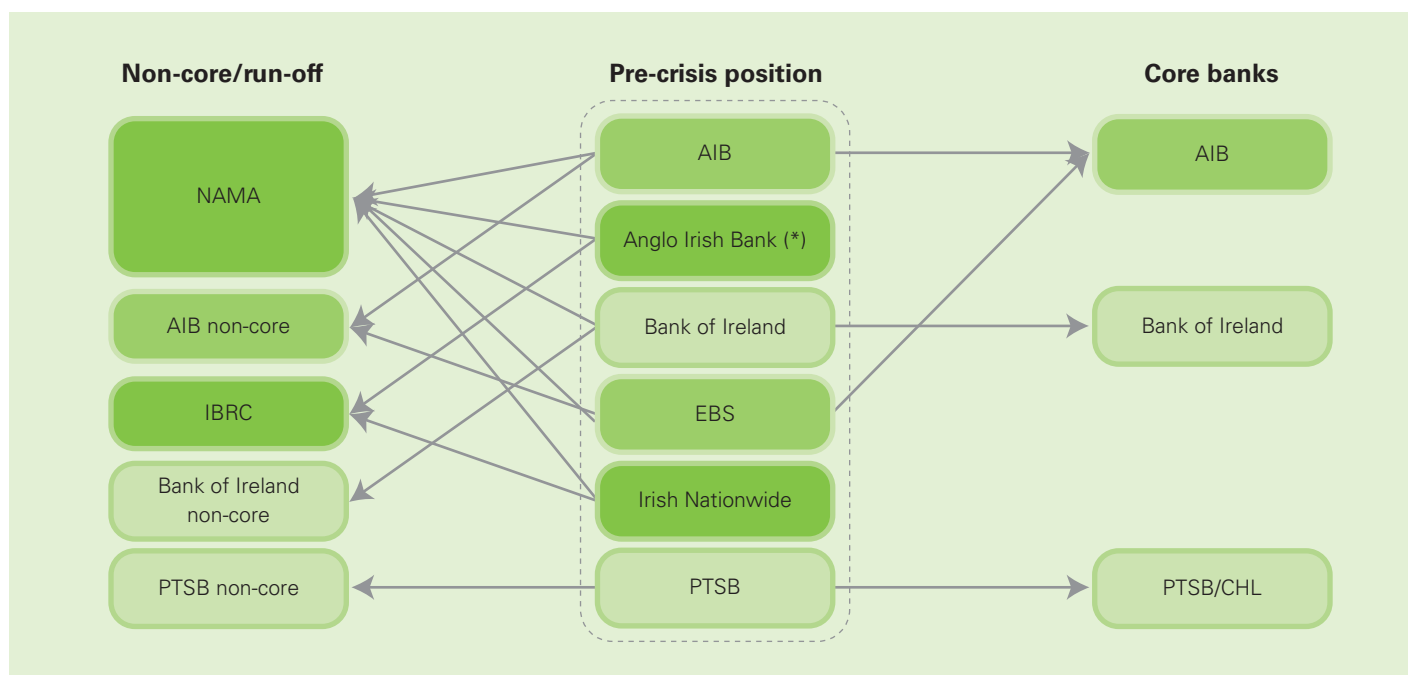
- The approval of permanent tsb's (PTSB) strategic direction, with a formal Restructuring Plan to be approved to the European Commission. The plan envisages three business units, the first being the PTSB with assets of EUR14.2 billion, the second being Capital Home Loans (CHL) with assets of

EUR7.1 billion, and the third being a separate asset management unit ('AMU') with a non-core loan book of EUR12.5 billion. This follows the transfer of the group's life business to the state as partial consideration for state recapitalization.

- Danske Bank is reorganizing its Irish subsidiary, rebranding it from National Irish Bank to Danske Bank locally. This will result in the transfer of all its commercial and investment property loans to a wind-down portfolio. The transferring loans consist of around EUR4.6 billion, with the transfer completed in early 2013.
- A recap on the current position of the domestic banking institutions, which have undergone significant change is included below:

The approval of permanent tsb's (PTSB) strategic direction, with a formal Restructuring Plan to be approved to the European Commission. The plan envisages three business units, the first being the PTSB with assets of EUR14.2 billion, the second being Capital Home Loans (CHL) with assets of EUR7.1 billion, and the third being a separate asset management unit (AMU) with a non-core loan book of EUR12.5 billion.

The domestic Irish banking landscape – summary of banking reorganization



Source: Public information and KPMG Portfolio Solutions Group analysis, 2012.
 (*) Currently in liquidation.

Since the onset of the global financial crises, the Irish banking system has undergone a complete overhaul which has reduced the number of core domestic banks from six to three. The addition of Danske Bank/National Irish Bank's wind-down entity and Lloyds/Bank of Scotland's complete exit from the market, brings the total number of non-core/run-down portfolios to five.

NAMA

No discussion of the Irish debt sales market would be complete without an update on the progress of NAMA. The agency, which acquired EUR74 billion of original face value of loans from six institutions as part a major Irish asset relief scheme and subsequent recapitalization program, has a set debt reduction target of 25 percent by 2013, 80 percent by 2017 and 100 percent by 2019. NAMA is well on track to meet its 2013 target.

To date, NAMA's asset reduction has mainly been achieved through the disposal/refinancing of assets in more liquid overseas markets (with some Irish prime exceptions in recent times). These have taken the form of either enforcement scenarios or consensual sales via the implementation of asset disposal schedules within the agreed borrower business plans. With its longer-term goals in mind, the agency has established a number of initiatives to assist the agency to further increase asset disposals, including:

- The appointment of a European and US panel of loan sale advisors (KPMG have been appointed to both panels).
- The establishment of a Qualifying Investor Fund ('QIF') in which NAMA could place pools of assets.
- The launch of vendor financing proposals which, it is hoped, will drive transaction activity and enable NAMA to obtain some initial debt

repayment while simultaneously achieving a diversification of borrower concentration. The terms are said to be maximum 70 percent LTV with a circa 3 percent margin.

- The launch of an 80/20 mortgage initiation on a trial basis. This product protects the purchaser from a fall in house prices of up to 20 percent over a 5 year period and is seen as an innovative approach to encouraging market transactions, particularly by first time buyers who may be holding off on purchasing due to concerns of further pricing falls (a buoyant rental market at relatively attractive yields suggests there is deferred demand in the market).

Given that 95 percent of its funding is sourced from NAMA Senior Bonds which pay Euribor flat, the agency continues to be cash generative. These bonds, which it issued as consideration for its assets to the participating institutions, are largely repo'd with Monetary Authorities and this is a major driving force in the requirements for asset reduction.

With a number of available asset disposals initiatives now firmly established, the agency will continue to be closely watched over the coming years. Since the agency has steadfastly stated that it will not be forced into accepting 'firesale' values for assets, these initiatives may go some way towards allowing the agency to achieve continued asset disposals at acceptable pricing levels.

Property market update

Confidence and lack of credit remain the two largest factors impacting Irish property values. Domestically, confidence is being helped by a number of successful wins on the employment front and successful implementation of reform measures. Credit supply however, is subject to the classic

availability problem that naturally occurs during a deleveraging cycle. That being said, the near-term deleveraging target on the core banks will end in 2013 and we anticipate an easing of this issue from 2014 onwards. Already we are seeing some domestic lenders becoming more active in the market. The lack of transaction activity in this space also means that there is still a difficulty in assessing market prices.

Commercial

There have been a number of significant positives in connection with the commercial property market such as:

- The stamp duty on commercial property was cut from 6 percent to 2 percent.
- The government provided certainty on its position on 'up-ward only' rent reviews and has agreed to not amend these clauses retrospectively.

In December 2011, the combination of both of these factors resulted in the first rise in the quarterly IPD Index since September 2007.

Residential

The old adage '*Location, Location, Location*' could not be more true in the current residential market. Across the country, residential real estate is experiencing the full range of market performance levels from under-supply in certain areas (particularly for houses in some prime Dublin areas) through to near obsolescence for some stock, such as poorly designed apartments in rural areas.

However, rental markets, particularly in major urban areas are performing strongly, leading a number of commentators to publicly state that they believe that Irish residential property prices have now overcorrected. Indeed, the Central Bank of Ireland economists suggest that house prices are now undervalued by between 12 percent and 26 percent due

to a perceived reluctance on the part of Irish people to buy property because of negative price expectations. Access to mortgage financing, however, is still challenging for many prospective homeowners.

Debt market update (non-transactional)

Many of the recent developments in the Irish debt markets have been connected to residential lending. For example:

- There is likely to be some change to the Code of Conduct on Mortgage Arrears (CCMA), which governs the dealings between institutions and residential homeowners in arrears. Changes are expected to focus on dealing with uncooperative borrowers, in part to stop them

from hiding behind the protections of the code.

- Each lending institution has been asked to formulate and submit a Mortgage Arrears Resolution Strategy (MARS) to the Central Bank. With arrears levels continuing to increase (currently >90 days arrears are at 10.9 percent), the focus of this strategy is to try to reach an end game on this problem so as to deal with cases where the mortgage is at unsustainable levels.
- As part of the commitments under the Troika financial support program to Ireland, a new draft personal insolvency bill has also been published. This reduces the period of existing bankruptcy and has implications for a range of debt sectors. The bill contains a number of significant protection measures to avoid abuse of these

Since the agency has steadfastly stated that it will not be forced into accepting ‘firesale’ values for assets, these initiatives may go some way towards allowing the agency to achieve continued asset disposals at acceptable pricing levels.

proposals. Given the state’s continued exposure to the banking sector, it is directly incentivized to ensure abuse does not take place.



Selected deals

The following table details several selected Irish debt and financial services transactions focusing primarily on Irish collateral. Sales of overseas

assets by Irish sellers are dealt with in the individual country section of this publication, as appropriate.

Recent portfolio transactions

Sl.	Vendor	Purchaser	Transaction details	Nominal	Date Announced
1.	BOSI	Varde Partners	Asset finance loans	ca. €500 million	January 2012
2.	MBNA	Apollo	Credit card receivables and platform	ca. €650 million	March 2012
3.	IL&P	De Lage Landen	Agri. asset finance loans	ca. €60 million	March 2012
4.	BOSI	Deutsche Bank & Kennedy Wilson	CRE loans	ca. €360 million	June 2012
5.	GE	Pepper Homeloans	Subprime RM loans and platform	ca. €600 million	June 2012
6.	BOSI	Portfolio split among Apollo & CarVal	CRE loans	ca. €2,100 million	November 2012
7.	ptsb	Deutsche Bank	Auto loans and platform	ca. €500 million	November 2012
8.	AIB	Lonestar	CRE loans	ca. €660 million	November 2012

Source: Public information and KPMG Portfolio Solutions Group analysis, 2012.

Outlook

With targets to wind-down NAMA over the next 8 years and IBRC over a similar time-scale, foreign participants continuing to wind down their Irish portfolios and with the three core banks under pressure to meet tight deleveraging targets by the end of 2013, we expect to see considerable debt sale activity in Ireland over the next few years.

While access to deal funding appears to be increasing, bid/ask spreads continue to present difficulties to completing transactions, which may necessitate moving towards the type of engineered disposal structures seen in other markets in an attempt to bridge this gap.





Germany

Interestingly, today's buyers are looking for sub-performing and performing loans with upcoming maturities and "a bit of hair" on them, suggesting an increased likelihood that a payment default will occur at maturity.

Status quo of Germany's economy and banks

It is not difficult to see why debt purchasers worldwide are looking for opportunities to put money to work in Germany. Indeed, we frequently hear from debt funds, real estate funds, private equity, asset managers and insurance companies wanting to purchase leveraged loans, commercial real estate backed loans, residential mortgages or infrastructure debt.

Clearly, interest in German debt has broadened from its focus on non-performing loans.

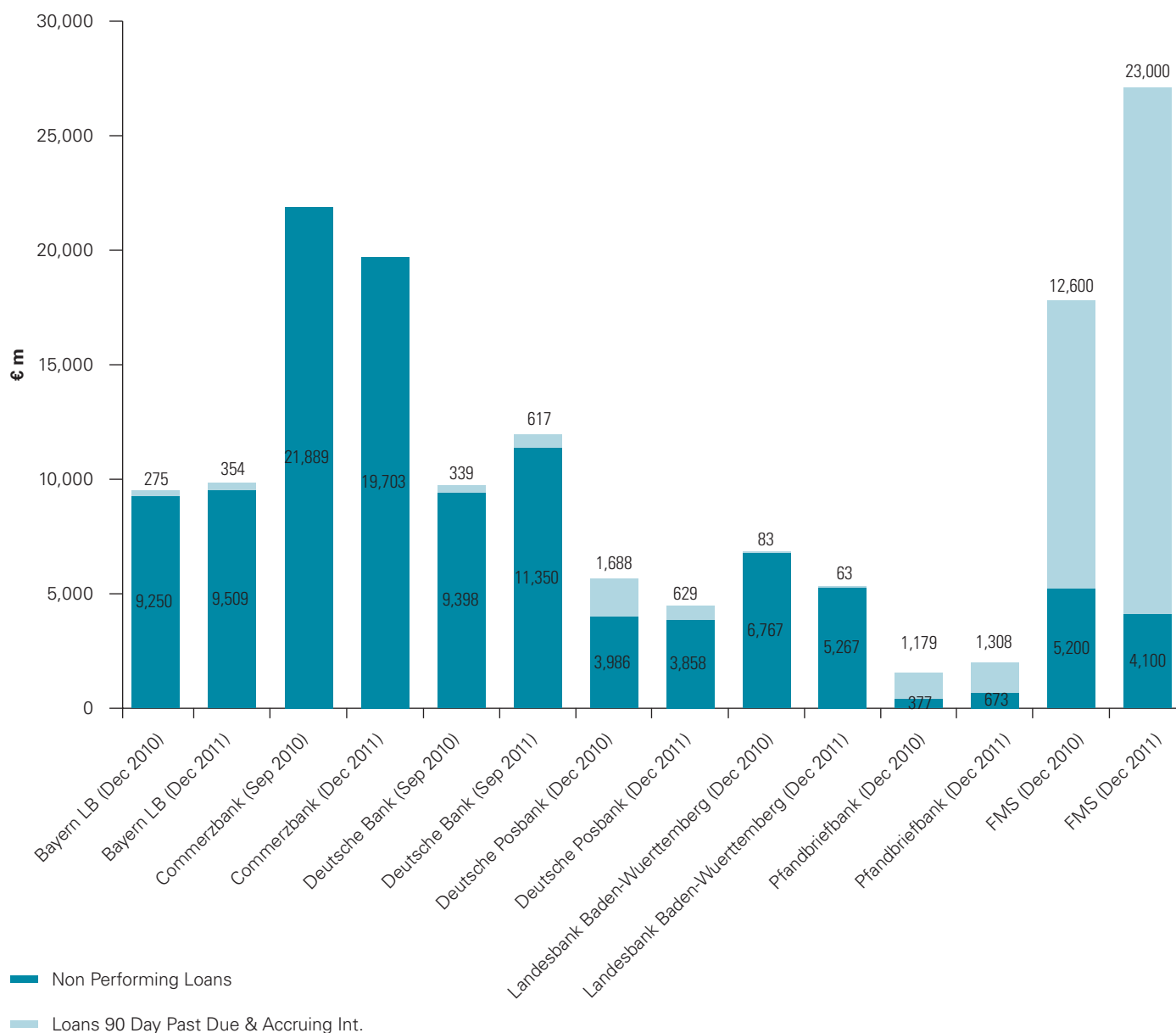
Interestingly, today's buyers are looking for sub-performing and performing loans with upcoming maturities and "a bit of hair" on them, suggesting an increased likelihood that a payment default will occur at maturity. However, our experience shows that German banks

do not currently have an appetite for disposing of significant loan portfolios in their home country. So what are the German banks doing with their NPL portfolios?

As illustrated in the figure to the right, Germany's banks have seen varied success in reducing NPLs and delinquent loans between 2010 and 2011.

German banks restructuring and refocus

NPLs, loans 90 days past due for some German banks (as of most recent available date)



Source: Capital IQ, 2012.

While some of the banks have achieved significant reductions in their levels of NPLs and loans 90 days past due, they have been achieved at (what appears to be) a slower pace than we are seeing in either the UK or the US. Indeed, when one compares German deleveraging rates to Lloyds Banking Group (where GBP4.1 billion of non-core commercial real estate exposure was shed in the

first 3 months of 2012), or RBS (which, in 2011 alone, completed GBP5.6 billion in loan run-offs, GBP2.4 billion in property disposals, enforcements and restructurings, and GBP3.4 billion in allocated provisions against impaired loans), it quickly becomes apparent that German banks are slower at deleveraging NPLs than other major markets.

The German manufacturing and export sectors continue to drive the economy

In part, this slow pace of deleveraging may be due to the competitiveness of the German export market and its ability to continue to drive German GDP growth throughout 2012 and 2013. This would suggest, therefore, that German banks would see asset prices continue to recover from the lows of 2008 and 2009 which – in turn – would allow them to exit stressed borrower situations with lower losses in the future rather than accepting lower prices today.

While the figure below illustrates the strong competitive advantage that Germany has enjoyed throughout 2009 and 2010, it must be noted that this competitiveness has seen significant deterioration over the past 2 years as consumer demand in Europe (Germany's largest trading partners) stalled.

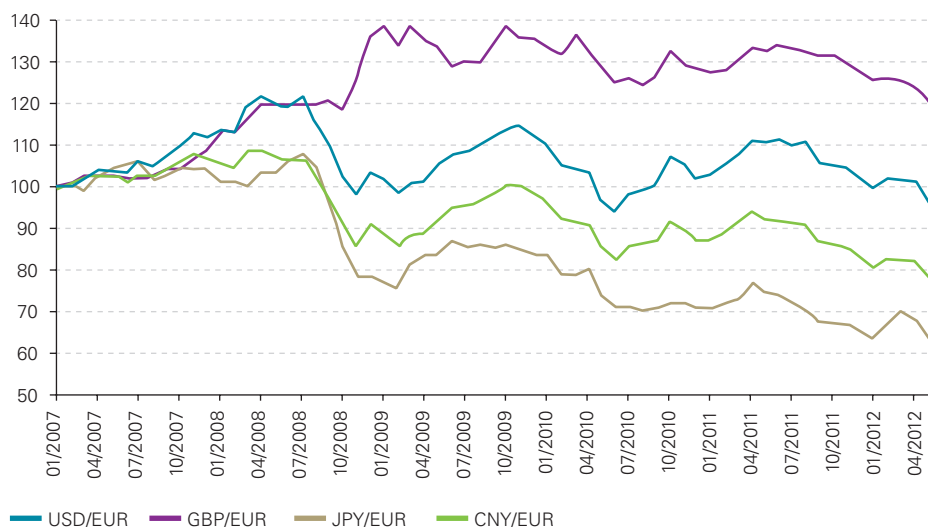
Moreover, when one looks at business sentiment and factory data up to May 2012, it seems clear that the continued stresses of the Eurozone crisis are beginning to weigh on the German manufacturing machine.

All told, these trends likely help explain the stalled activity that we have witnessed in the German market versus some of the other large European banking markets such as Ireland and the UK.

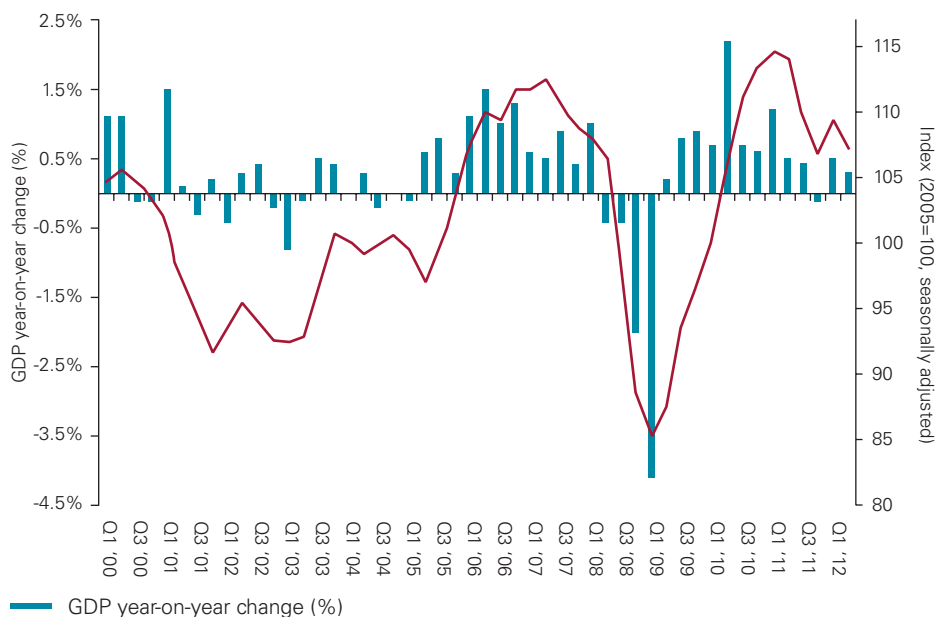
The German taxpayer continues to be a major shareholder in German banks

It is also worth noting the strong levels of support that the German government and municipalities have provided to local German banks.

Germany's competitiveness driven by weak Euro



German GDP and Ifo business climate survey results



Note: Ifo Business Climate for German trade and industry.
Source: ECB, Ifo Business Survey.



German banks would see asset prices continue to recover from the lows of 2008 and 2009 which – in turn – would allow them to exit stressed borrower situations with lower losses in the future rather than accepting lower prices today.

Take, for example, the adoption of measures by the German federal government to support the financial markets and German banks after the collapse of Lehman Brothers in 2008. Its Act on the Establishment of a Financial-Market Stabilisation Fund created the Financial Market Stabilisation Fund (SoFFin) which, in turn, spawned the Financial Market Stabilisation

Agency (FMSA), a body tasked with managing SoFFin and implementing and monitoring the fund's measures.

By the end of 2010, the FSMA had granted EUR64 billion worth of guarantees for newly issued debt securities and other debt issued by financial institutions, extended EUR29 billion worth of capital measures

(recapitalizations granted up until 31 December 2010), and established two resolution agencies: Erste Abwicklungsanstalt (EAA) and FMS Wertmanagement (FMS). In 2011, SoFFin reported a EUR13.1 billion loss, mainly as a result of Greek debt restructuring. However, since its inception, SoFFin has accumulated around EUR22.1 billion in losses.

Current beneficiaries of government aid

Type of aid	Current aid (€bn)	Initial aid (€bn)
Guarantees		
Deutsche Pfandbriefbank (HRE)	^(a) 44.0	102.0
IKB Deutsche Industriebank AG	6.1	10.0
Sicherungseinrichtungsgesellschaft deutscher Banken mbH	2.2	6.7
Düsseldorfer Hypothekenbank AG	1.5	2.4
Aareal Bank AG	1.2	4.0
BayernLB	2.8	5.0
Commerzbank AG	1.6	5.0
Düsseldorfer Hypothekenbank	1.5	2.4
Recapitalizations		
Aareal Bank AG	0.3	0.4
Commerzbank AG	6.7	18.2
Hypo Real Estate Holding AG	9.8	7.7
Of which FMS	3.0	n/a
WestLB AG/Portigon	3.0	3.0

Source: Deutsche Bundesbank, Crises, rescues, and policy transmission through international banks, 2011; Palgrave Macmillan Journals, 7 February 2012, Moody's and Fitch broker reports.

Note: (a) Deutsche Pfandbriefbank (HRE) current aid figures are as at 30 June 2011. All other figures are as at 31 December 2011.

There should be little doubt that the recapitalizations and guarantees extended to banks (not only in Germany but also around the world) was critical to the stabilization of the banking system. However, given the large amounts of taxpayer money at stake, the measures also created a knock-on effect, dampening down the ability (or appetite) of bankers to take write downs and losses. Our experience shows that this additional pressure has effectively made decision makers very cautious

about entering into transactions that will ultimately crystalize losses for tax payers in the short-term.

As a result, commercial decisions are being influenced by political pressures. For example, many banks are now facing the question of whether to sell a low yielding asset today, recognize a loss and then extend a new loan at a better margin (thereby making the bank more profitable in the medium-term); or continue to hold the unprofitable loan until a future

date when the borrower is able to repay the full amount, (making the bank more profitable in the short-term but less profitable in the medium-term).

The German state has also extended the FMSA's powers by providing them with the mandate to create and monitor resolution entities or 'bad banks'. Essentially, this initiative made it possible for German banks in financial distress to transfer assets (risk positions, non-strategic business

units and structured securities) off of their balance sheets and into a special-purpose vehicle. By the end of 2010, the FMSA had founded two resolution agencies: the Erste Abwicklungsanstalt, (to which WestLB transferred non-strategic business lines and risks) and FMS Wertmanagement (which took over HRE Group's risk exposures and non-strategic assets).

Interestingly – and in contrast to some other markets – German banks were able to transfer structured securities, risk exposures such as non-performing loans, and even entire business lines which the banks no longer viewed as strategic. This gave banks the opportunity to wind up these portfolios and obtain instant relief from capital requirements and write-down pressure.

However, the resolution bank model in Germany implies that the bank's owners must remain economically responsible for the resolution agency (in other words, they are required to offset any losses made by the resolution agency).

The table below provides an overview of the assets that were transferred to the resolution entities.

Overview of Germany's bad banks

	EAA – Erste Abwicklungsanstalt ¹	FMS Wertmanagement ¹
Deconsolidated entity of	WestLB AG	Hypo Real Estate Group
Assets	€45.3 billion (c.€150 billion including second portfolio)	€161 billion (€342 billion incl. "own issues")
Original volume	€77 billion	€176 billion
Supporter	State of North-Rhine Westphalia	German state (via SoFFin)
Support mechanism	Loss compensation duty by EEA's owners	Loss compensation duty by SoFFin
Description	<ul style="list-style-type: none"> The non-core portfolio had a (nominal) value of approx. €77.5 billion at end 2009: <ul style="list-style-type: none"> – 39.6% loans, 29.5% Phoenix (refinancing notes), 22.9% other securities, 4.4% other ABS and 3.6% European super seniors securitizations 	<ul style="list-style-type: none"> The wind-up portfolio had a (nominal) value of approx. €174 billion as at Q3 2010 and the wind-up is to be performed until 2020, with remaining assets to be sold at book value: <ul style="list-style-type: none"> • €114 billion bonds and €60 billion loans • 50% public sector, 25% structured products, 11% real estate, 10% infrastructure assets and 4% real estate
Activity/performance	<ul style="list-style-type: none"> During 2012, EAA has taken over a second portfolio of approximately €100 billion from WestLB By the end of 2011, EAA had reduced the portfolio it has taken over by more than one third. Non-performing loans in the portfolio reduced by 43% EAA closed 2011 with a loss of approx. €878 million primarily due to provisions on Greek bonds. EEA fully exited its Greece exposure in 2012 	<ul style="list-style-type: none"> FMS decreased the portfolio by about 8.7% to €160.7 billion in the first year since the transfer ECB funding was reduced from €105 billion at end 2010 to €35 billion at end 2011 A total of €8.9 billion in write-downs on the Greek portfolio particularly affected both risk provisions for the lending business and income from investments in financial assets
Cost of financing	<ul style="list-style-type: none"> <i>Recent issue:</i> USD500m, 3 year FRN, at a discount margin of 3M L+ 32bps (Coupon at 3M L+ 30bps) 	<ul style="list-style-type: none"> <i>Recent issue:</i> USD2 billion, 4 year bond at Mid Swap + 24bps (1.0% coupon)
Rating	<ul style="list-style-type: none"> AA-/Stable/A-1+ (From S&P) 	<ul style="list-style-type: none"> AAA (Long Term), F1+ (Short Term) from Fitch

Note: (1) Figures as of 30 June 2012 for EAA, as of 31 December 2011 for FMS.

Source: Financial Statements, Investor Presentations and Broker Reports.

The results of these activities are widely viewed as being beneficial. The creation of resolution vehicles certainly helped to calm the markets and stabilize the German banking system, while the loss compensation duty of the SoFFin has also allowed both entities to access very favorable funding prices from the

international capital markets. This has meant that tightly priced performing assets which were previously loss making for WestLB and Hypo Real Estate/Depfa are now generating positive net interest margins; a situation that would not have been possible for financial institutions with lower credit ratings.

Despite these workout entities appearing to be a key source of debt portfolio deal flow, our buyer contacts have highlighted the following valuation challenges when buying from the German resolution entities: bad banks have no equity return requirement, are not required to hold RWAs, are

not able to lend to new counterparties (i.e. extend new loans), have limited internal resources, and have very limited appetite for crystallizing losses in the short term. All these factors combined make executing transactions challenging in the near to medium term.

German debt portfolio transaction volume higher than in 2012

There has, however, been an increase in both the number and the quantum

of portfolio deals being brought to market and executed during 2012, and we expect this trend to continue into 2013 driven primarily by international sellers.

Recent transactions in Germany

Seller	Buyer	Asset type	Approximate Face Value	Completion date
Undisclosed	TPG Credit	Performing CRE loan portfolio	€100 million	Sept. 2011
Deutsche Bank	Lindorff	NPL portfolio	€1.4 billion	Q1 2012
German Bad Bank	RE Fund	Retail REOs	€70 million	Q2 2012
Bundesbank (Germany central bank)	Lone Star	Excalibur: Lehman Brothers' securitised real estate debt	€960 million	Q2 2012
Bundesbank (Germany central bank)	PIMCO	Excalibur: Lehman Brothers' securitised real estate debt	€240 million	Q2 2012
Wells Fargo	Cerberus	Retail Shopping Centres	c. €80 million	Q3 2012
Société Générale	Lone Star	Performing CRE loans	€220 million	Q3 2012
Société Générale	AXA Investment Management (Preferred Bidder)	European Performing CRE loans	€1.2 billion	Q3 2012
Austrian Bank	TBA	Corporate and LBO loans	€300 million	On going
German Bank	TBA	NPL portfolio	c. €800 million	On going
German Landesbank	N/A	Non performing CRE loans	€120 million	No sale ^(a)

Note: (a) Buyer pricing below seller expectations.
Source: Press Articles, 2012.

Will insurers and pension funds contribute to deleveraging in 2013?

With more than EUR300 billion worth of loans on the combined balance sheets of German life insurers, it is clear that they are already significant providers of lending, despite their general exclusion (with certain exceptions) from banking regulation.

Increasingly, we are now seeing some of the larger insurers (such

as AXA and Allianz) competing with banks to provide financing facilities on high-quality commercial real estate buildings with long lease contracts. This activity is being driven by three main factors: the preferential treatment of mortgage lending under Solvency II; yield compression on investment grade bonds; and continued volatility in the equity markets. And while only a small number of insurers have made the jump to direct lending – and even fewer into the acquisition of loan

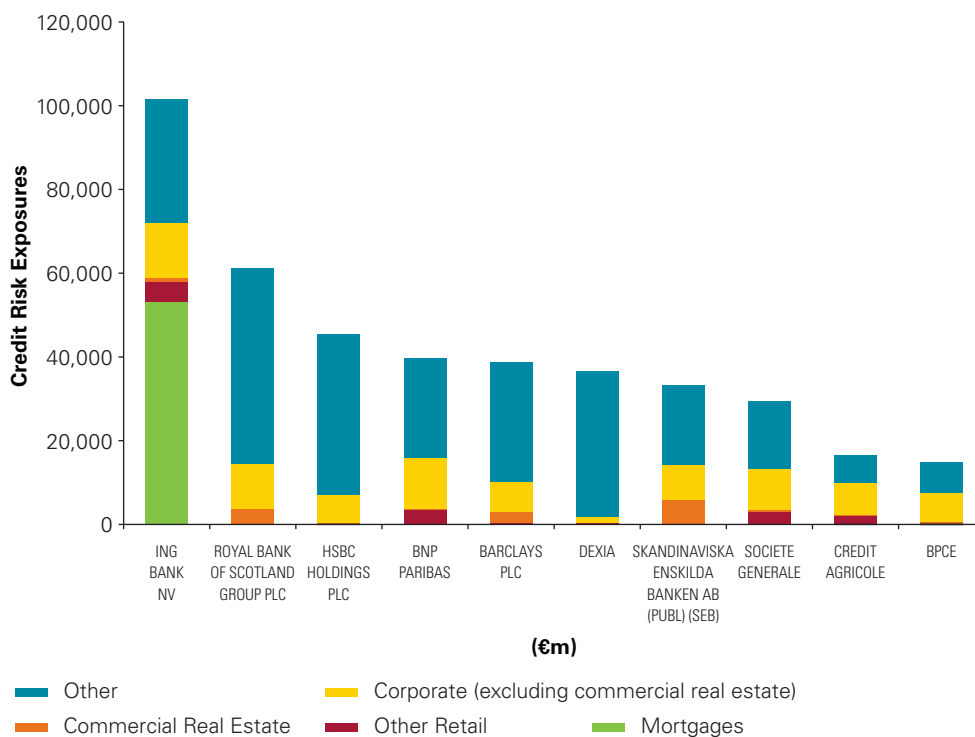
portfolios from the secondary market – we expect to see this trend increase during 2013.

A key hurdle to mobilizing this capital is structuring the acquisition vehicle in a manner that is favorable under Solvency II and also meets the internal governance needs of the insurer or pension fund.



So while Germany remains a market with huge potential for debt sales, it still seems that everyone is waiting for a seller to make the first move and create the wave we have all been waiting for.

Total exposures of top 10 foreign banks in Germany



Note: Credit risk exposures (EAD—exposure at default), as of 31 December 2010.
Source: Results of the 2011 EBA EU-wide stress test.

So, while Germany remains a market with huge potential for debt sales, it still seems that everyone is waiting for a

seller to make the first move and create the wave we have all been waiting for.

Outlook

As was the case during 2012, we expect to see the majority of portfolio sale activity to be driven by those international banks with legacy exposures to real estate and, to a lesser extent, corporate loans in Germany.





Spain

Introduction

While the Spanish economy ended 2011 with a slight annual increase in GDP (0.7 percent), the near-term outlook for Spain remains negative, with the economy falling into recession in 2012.

The Spanish economy has been severely impacted by the global recession which lifted the unemployment rate from 8 percent over 2008, to 25 percent in the third quarter of 2012, according to Spain's Statistics Institute. As a result, Spanish financial institutions have seen a high level of 'doubtful' loans (those more than 90 days past due) total

EUR194.5 billion as at 31 October 2012. Further, with the continued rises in the unemployment rate throughout 2012, the level of doubtful loans is expected increase further.

Spanish house prices continue to tumble due to a squeeze on credit, stalled demand and a considerable oversupply. As at the third quarter of 2012, the Spanish housing index fell to its lowest level in the last 4 years according to the Spanish Ministry of Housing. Many experts anticipate that prices will hit through at the end

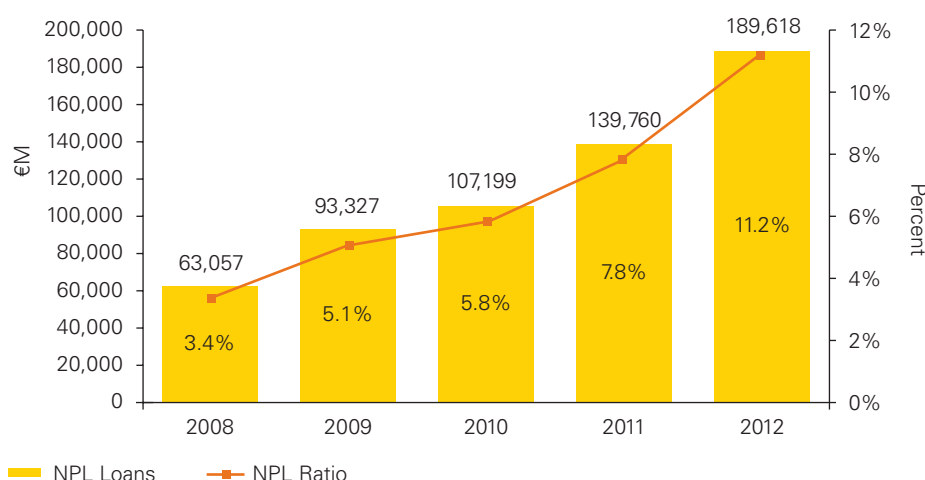


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Financial sector NPL ratio



Note(*): Data as of Oct 2012.
Source: Bank of Spain.

of 2013, which means the residential property market could subsequently see substantial growth through to 2018. While the real estate market is seeking to stabilize through new provisions

and capital requirements, the troubled assets of Spanish Financial Institutions reached EUR175 billion of which EUR88 billion represent land and on-going development projects.

The table below summarizes the exposure to real estate debt by the Spanish financial entities and the existing coverage as at 31 December 2011 (including non-problematic assets).

Spanish financial entities real estate exposure

	Stock	Coverage	Coverage (%)	Target coverage	Additional capital add on	Target coverage
EUR bn				RDL 02/2012		RDL 18/2012
Land and unfinished properties	88.0	27.6	31%	60%	20%	60%
Other NPAs (*)	87.0	23.8	27%	46%	19%	46%
Non Performing assets (NPAs)	175.0	51.4	29%	53%	20%	53%
Performing assets	148.0	–	–	7%	–	30%
Total	323.0	51.4	16%	32%	11%	42%

Note(*): Finished Housing, foreclosed retail houses, Personal Guarantee and Others.
Source: Ministry of Finance, 2012.

Notwithstanding the above, there continues to be doubts about the valuation of real estate assets and loans owned by credit institutions. As a result, we have seen increased difficulties for credit institutions seeking to gain access to wholesale funding and an overall lack of funding available to the private sector.

With the aim of substantially changing the current situation, reforms have been enacted to viably integrate credit institutions and catalyze a swift and deep-rooted restructuring of the financial sector's balance sheets.

Consequently, a major (and much needed) restructuring of the savings bank sector is now underway in the aftermath of the real estate boom-bust cycle led by reforms to the savings banks' legal framework and financial support from the state-owned recapitalization vehicle (FROB). Having experienced a series of interventions, mergers and takeovers, the number of institutions has now been reduced from 45 to 11, with the majority of these actions focused on the weakest institutions. Indeed, by 2012, institutions representing about 15 percent of the system and with total assets equivalent to more than half of the country's GDP have been resolved.

A number of external factors are also influencing the Spanish economy, resulting in some of the highest risk premiums since 1995 (on July 25th 2012 the 10-year bond yield hit 7.5 percent, with a risk premium of 645 basis points).

In 2012, Spain agreed to accept a EUR100 billion loan to recapitalize the Spanish banking sector. It is important to note that the Eurogroup approved the EUR100 billion package, after the IMF had first indicated that a sum of EUR40 billion would be sufficient. This loan was accompanied by the announcement of

new austerity measures such as the increase of 3 percentage points in the VAT.

A review of the recent financial system reforms:

February 2011 – the Spanish government adopted new capital requirements (through the Royal Decree-Law 2/2011), establishing a minimum requirement of 8 percent of core capital, and 10 percent for non-listed entities and those with higher wholesale funding levels. As a result, credit entities have been forced to make significant provisions, leaving their balance sheets and P&L accounts suffering from the effects of increased non-performing loan (NPL) ratios.

March 2011 – the Bank of Spain (BoS) published the capital requirements for banks and savings banks that had not reached these capital requirements, representing a total value of more than EUR15 billion.

July 2011 – the CEBS carried out a new stress test, which resulted in 5 entities not reaching the minimum level of 5 percent core capital (without considering convertibles and generic provisions).

November 2011 – early elections were held in Spain resulting in a new government led by the Partido Popular (conservative party) which has led to a change in the direction of the financial measures.

November 2011 – the FROB agreed to replace the management of the Banco de Valencia, in accordance with the provisions of Article 7 of Royal Decree-Law 9/2009. At the same time, the FROB agreed to subscribe for up to EUR1 billion in the bank's capital and provided Banco de Valencia with a credit line of EUR2 billion to ensure its liquidity.

December 2011 – the FROB (which had already replaced CAM's board with the FROB in order to recapitalize and dispose the company in July), announced CAM's financial business would be transferred to Banco de Sabadell. This move turned the Catalan bank into the fifth largest Spanish bank by total assets (EUR166.3 billion as of June 2011). The acquisition has been conducted in two phases: the first saw the acquisition of a 100 percent stake of CAM Bank by the FGD (through the full subscription and disbursement of EUR5.249 million in capital increase), and the second phase focused on selling the securities to Sabadell for EUR1. The FGD granted Banco Sabadell an Assets Protection Scheme lasting 10 years covering 80 percent of certain assets and assumed certain liquidity commitments.

December 2011 – the European Banking Authority established a 9 percent requirement for Core Tier 1 from the systematic entities (Santander, BBVA, Popular, Caixabank and Bankia) in order to set a reference ratio that would be sufficient to address the situation.

February 2012 – the Spanish government established new financial measures aimed at reducing the exposure of financial institutions to construction and real estate development. The measures were particularly focused on land, in order to eliminate the major uncertainties (associated to valuation) on the Spanish institutions' balance sheets.

The BoS highlighted the following three problem areas:

- Doubtful loans: those that have been unpaid for a period of more than 90 days and/or for which there are reasonable doubts as to the potential for total repayment under the existing terms.

- Substandard loans: those showing general weakness as a result of the group or sector to which they belong and/or if weaknesses are apparent in their operations (even if these operations do not individually qualify as 'doubtful' or 'write-off' grade).
- Foreclosure assets: those assets that have become the property of financial institutions as a result of unpaid debt.

The measures, which applied to the stock of assets as of 31 December 2011, were facilitated by three complimentary tools:

- General provisions: these reflect the expected migration of loans from normal assets to problematic assets which were thought to represent around 7 percent of the construction and real estate developer's normal portfolios (for which the BoS estimated a need for around EUR10 billion in additional provisions).
- Specific provisions: these were in consideration of losses incurred as a result of problematic assets, particularly in land (for which the BoS estimated an additional EUR25 billion in extraordinary provision charges through P&L).
- Capital buffers: these were to reflect valuation uncertainties related to land and housing under development (for which the BoS estimated a need for EUR15 billion to reflect a 20 percent drop in the value of land related assets and a 15 percent drop in housing under development).

Overall, the BoS estimated the need for around EUR50 billion in new provisions and established that land needed to reach 60 percent coverage, housing under development needed 50 percent coverage and finished properties would need 35 percent coverage.

February 2012 – a new Royal Decree Law was passed and included a new and specific regime designed to promote integration between Spain's financial institutions with the intention of reducing the number of entities in order to achieve a more concentrated and appropriately sized banking system.

March 2012 – BBVA (Spain's second largest bank by assets) purchased 100 percent of Unnim's capital for EUR1, with the FGD financially supporting the transaction by contributing the necessary funds to ensure the recoupment of the value of its previous participation in Unnim (some EUR953 million). Additionally, Caixabank acquired Banca Civica for EUR977 million (without the support of public aid), making the bank the third largest by total assets (EUR340 billion).

May 2012 – Bankia was nationalized with the state converting EUR4.465 billion of loans provided by the FROB in 2010 into shares in the bank's parent company (Banco Financiero y de Ahorros or BFA).

May 2012 – the government announced a new financial reform – the fourth since the start of the crisis – which increased the provision for non-problematic assets (requiring around EUR40 billion) with compliance deferred until the end of 2013. However, the reform required banks to pass all troubled real estate assets to specialist companies by the end of 2012 (whereas this was voluntary in previous drafts), and allowed the banks to make provisions as necessary.

May 2012 – Bankia asked the government for a further EUR19 billion to clean-up their balance sheet. The total rescue package of EUR23.5 billion represents the biggest loan in Spain. The government considered consolidating all of the lenders that have been taken over by the Bank of Spain (Bankia, Caixa

Catalunya, Novagalicia and Banco de Valencia) to form a large public bank.

Prime Minister, Mariano Rajoy suggested that government measures aimed at consolidating the banking sector would solve a 'good part' of the country's economic problems. He also assured the market that the new financial reforms would further 'deepen' the adjustment of housing prices to reflect their market value and thus stimulate real estate sales. Besides sparking a drop in property prices, the Prime Minister suggested that these measures would facilitate the provision of credit and eliminate any lingering 'doubts' as to the strength of Spain's financial institutions.

May 2012 – Roland Berger Strategy Consultants (Germany) and Oliver Wyman (USA) were selected by the Spanish Ministry of Finance to independently assess the assets of Spanish banks. The objective of this initiative has been to increase transparency and clear doubts about the valuation of bank assets in Spain.

June 2012 – Roland Berger and Oliver Wyman reported that the Spain banks would need as much as EUR62 billion in capital to withstand a worst-case economic scenario.

June 2012 – the Minister Luis de Guindos announced the intention of the Spanish government to accept the EUR100 billion loan offered by the Eurogroup to recapitalize Spain's banking sector. Luis de Guindos confirmed that the rescue package would be sufficient to meet the needs of the banking sector as estimated by the two independent appraisers. The IMF had indicated previously that a sum of EUR40 billion would be sufficient. However, IMF Managing Director Christine Lagarde had said that under such circumstances, it is always better to overestimate requirements.

July 2012 – Spain's government presented the draft of the Memorandum of Understanding (MOU) to establish the framework agreement with the European Financial Stability Facility (EFSF) regarding the EUR100 billion loans. The key component of the program is an overhaul of the weakest segments of the Spanish financial sector, comprising 3 elements:

- Identification of individual bank capital requirement based on bank-by-bank asset quality review.
- Recapitalization, restructuring and/or resolution of weak banks.
- Segregation of assets of aided banks to an external Asset Management Company (AMC).

July 2012 – Spain's government imposed further austerity measures on the country as it unveiled sales tax hikes and spending cuts aimed at shaving EUR65 billion off the state budget over the next 2.5 years.

August 2012 – Spain's government announced the start-up and design of a bad bank. In principle this bad bank would receive assets from the 4 entities currently managed by the government.

September 2012 – The final stress test results for the Spanish banking system conducted by Oliver Wyman were released. The Spanish banking system's capital shortfall amounted to approximately EUR53.7 billion after tax impacts. The EU Commission welcomed the results of the stress tests in a statement, saying that state aid will be determined in the coming months and that banks now had to file recapitalization plans.

October 2012 – The FROB revealed more details regarding the SAREB (Bad Bank), specifically the bad bank will be established with 89,000 REOs from the nationalized banks. These REOs will have an average discount of 63 percent applied to them; whereas a discount of 45.6 percent will be applied to RE (Real Estate) developer loans. SAREB will

have 13 million m² of land discounted at 79.5 percent.

November 2012 – European Union regulators gave the green light to EUR37 billion in Eurozone funding for Spain's stricken banking sector, setting in motion a long-term cleanup. Lenders Bankia, NCG Banco, Catalunya Banc and Banco de Valencia will need EUR37 billion to be recapitalized and the banks' bondholders will face losses. In exchange, four nationalized banks agreed to make sharp cuts in their balance sheets and payrolls.

December 2012 – In the last weeks of 2012, steps were taken to achieve an operational SAREB (Bad Bank) by summer 2013. The social objective of the Bad Bank is the management and orderly divestment of the portfolio of loans and real estate assets received from the participating credit institutions. The public presence in the resources of SAREB (about EUR5,000 million) is less than 50 percent, the rest corresponding to private investors, mainly non-nationalized financial institutions. BBVA is the only non nationalized bank that did not assist when the last capital increase was carried out. The maximum volume of fixed asset transferable to SAREB is EUR90,000 million. The period provided for its activity is 15 years.

December 2012 – It has been announced that the Bad Bank will obtain a return on equity of 14 percent, which remains to be proven like many other aspects regarding the management of this entity. The influence of the SAREB on the housing market is unknown, although it will be a fact to keep in mind from 2013. The primary stated objective of this entity is to contribute to the reinforcement of the banking system and not to solve the problems of the housing market. However, local RE developers are dissatisfied with its formation so far. Everything indicates that it will be difficult to isolate SAREB from the contingencies of the internal

market and of the interests included in its Board of Directors.

Loan portfolio sales

While the national loan portfolio market had shown low levels of activity between 2008 and 2010, 2011 and 2012 showed a noticeable uptick, with the volume of debt traded by transaction growing to levels not seen for a long time, even higher than those closed in 2007. During 2011 and 2012, transactions closed were mainly unsecured NPL transactions with a total UPB of close to EUR8 billion in 2011 and EUR10 billion in 2012.

In 2011, Santander took a leading role in the unsecured market during the period by leading the largest unsecured portfolio transactions and the largest single names transaction that took place in Spain (c.EUR300 million UPB). Subsequently, Caixabank and Banca Civica followed Santander's strategy and each sold EUR900 million in unsecured portfolios.

Separately, only a few secured transactions took place in 2011 which totalled approximately EUR500 million in terms of UPB. These were mainly led by RBS (CRE), Credifimo (residential) and Fortress (second residential).

To facilitate its country and market exit, MBNA divested its portfolio and credit card platform early into the summer of 2011. Apollo acquired the portfolio of approximately EUR600 million of UPB, which demonstrated the interest that larger overseas investment funds have in the Spanish market. Furthermore, the purchase of two of Santander's servicing platform by Lindorff and another by Centerbridge in 2012 further demonstrate this demand.

2012 mirrored the same high level of activity in the non-core assets sector as achieved during the second half of 2011. Approximately EUR7.6 billion was traded during 2012, and again Santander played a leading role closing a total of c.EUR4 billion mainly in unsecured portfolios

Recent loan portfolio transactions

Seller	Value (M€)	Buyer	Date	Type of debt	Price
2011	10,320				
BBVA	200	DE Shaw	Jan 2011	NPL Unsecured	3% - 5%
Orange	250	Calyon	Jan 2011	NPL Unsecured	2% - 3%
Santander	400	Lindorff	Jan 2011	NPL Unsecured	4% - 8%
Santander	2,000	Lindorff	Jan 2011	NPL Platform	n.a.
RBS	280	Perella Weinberg	Mar 2011	SPL Commercial	55% - 60%
Santander	250	Cerberus	May 2011	Single Names	Profit Sharing
Credifimo	160	Cerberus	May 2011	NPL + REOs	25% - 30%
MBNA	600	Apollo	Jun 2011	Unsec. PL + NPL +	60% - 70%
Barclays	100	Link Financial	Jun 2011	NPL Unsecured	4% - 5%
Cetelem	350	Credigy	Jun 2011	NPL Unsecured	3% - 5%
Bankinter	700	DE Shaw/Cobralia	Jul 2011	NPL SME + Servicing	4% - 6%
Santander	1,200	DE Shaw	Aug 2011	NPL Unsecured	Profit Sharing
Fortress	50	Banco Pichincha	Sep 2011	SPL Mortgages	40% - 45%
Cetelem	30	Credigy	Nov 2011	NPL Unsecured	3% - 5%
Banca Cívica	850	Vion	Dec 2011	NPL Unsecured	3% - 5%
Banca Cívica	2,000	Cobralia	Dec 2011	SLA of NPLs	n.a.
Caixabank	900	Credigy	Dec 2011	NPL Unsecured	2% - 5%
2012	18,556				
Santander	750	Anacap-Lindorff	Jan 2012	NPL Unsecured	3%-5%
Santander	600	Lone Star/Cerberus	Feb 2012	NPL Secured	30% - 35%
Santander	1,100	Fortress	Feb 2012	NPL Unsecured	3% - 5%
Santander	10,000	Lindorff	Feb 2012	NPL Platform	n.a.
Barclays	250	Fortress	Feb 2012	NPL SME Secured/	10%-15%
BBVA	200	Octavian	Jun 2012	NPL Unsecured	2.5% - 3.5%
Bankia	240	DE Shaw	Jul 2012	NPL SME Secured/	2.5% - 3.5%
Citibank	450	Apollo	Aug 2012	PLs + NPLs Unsecured	n.a.
Popular	200	DE Shaw	Sep 2012	NPL Unsecured	2% - 3%
GE	200	Aktiv Kapital	Oct 2012	NPL Unsecured	2% - 3%
Bankia	686	Aktiv Kapital	Oct 2012	NPL Unsecured	2% - 3%
Santander	1,000	Bank of America	Oct 2012	NPL Unsecured	2% - 3%
Aktua	400	Centerbridge	Nov 2012	Platform + REOs	25% - 30%
CaixaBank	440	Credigy	Nov 2012	NPL Unsecured	2% - 3%
Banco Santander	200	Centerbridge	Nov 2012	Resi REOs + Special	30% - 35%
Banco Popular	1,300	Anacap-Lindorff	Nov 2012	NPL Unsecured	2% - 3%
Ibercaja	540	Yorvik	Dec 2012	NPL Unsecured	2% - 3%

Source: KPMG research.

which included approximately EUR600 million of residential mortgages sold to leading overseas investment funds.

Other unsecured transactions closing in 2012 were mainly led by Bankia, Banco Popular and CaixaBank.

It should be noted the role that BBVA has started to become increasingly active in the debt sales market with the closing of a medium sized unsecured portfolio, and leading the largest sale process in Spain to date in late spring 2012 which is

expected to be closed during the first half of 2013. BBVA is expected to continue its growth into one of the most active players in the Spanish market.

Additionally, portfolios of Commercial Real Estate (CRE) have started to

be brought to the market given the reduction in yields and the expected performance over the next 3 to 5 years. Both Bankia and Barclays have sold two portfolios of 250 million in 2012 of this type of debt.

Prices remain low and averaged between 2 to 7 percent of debt value for aged unsecured debt and 25 to 50 percent for secured debt portfolios. That being said, the recent sale of unsecured NPL portfolios and a platform by Santander will likely encourage the other Spanish banks to consider a sale of their non-core

assets, indicating that the national loan portfolio transaction market will likely grow over the course of the year.

Also, foreign financial institutions have started to adopt a potential partial reduction of their exposures in Spain and have started to think about accepting discounts to their current book value, in order to achieve an earlier exit from the country and market.

Lastly, it should also be noted that Project Finance exposures in the Spanish market will be a key area

of focus in the coming 12 months.

The Spanish government is required to adjust the renewable energy and main infrastructure concessions to be compliant with the public deficit reduction policy, as part of the financial assistance from the EU.

We expect a very active 2013 driven by the Spanish financial institutions' financial positions and the creation of the SAREB. We also expect to see transactions closing totalling between EUR10 billion to EUR20 billion.

Summary of Spanish financial institution positions

Entity	Total assets EUR bn September 2012	Problematic assets/ Total assets	Percent covered	FROB and FGD support (EURm)	Capital requirement/ February 2012
Santander	451	7%	29%	–	1,610
BBVA (Unim)	440	n.a.	n.a.	1,997	1,960
Caixabank (B. Cívica)	340	13%	n.a.	–	1,705
Bankia	303	n.a.	38%	4,464	2,377
Banco Sabadell (CAM)	166	10%	n.a.	6,529	1,125
Banco Popular (Pastor)	162	12%	40%	–	1,820
Banesto	107	13%	n.a.	–	n.a.
Unicaja & CEI	80	16%	43%	1,000	299
Catalunya Caixa	75	11%	35%	2,968	n.a.
Kutxa Bank	74	16%	40%	392	n.a.
Novagalicia Banco	72	8%	36%	3,627	1,120
NBMN	68	n.a.	n.a.	915	256
Ibercaja & Caja 3	66	2%	n.a.	–	467
Bankinter	62	16%	48%	–	102
Liberbank	51	n.a.	32%	3,775	n.a.
Banco Valencia	24	n.a.	n.a.	1,000	n.a.
Deutsche Bank	17	n.a.	n.a.	–	n.a.
Banca March	13	n.a.	n.a.	–	n.a.
Banco Caixa General	7	n.a.	n.a.	–	n.a.
Banco Gallego	5	n.a.	n.a.	–	n.a.

Source: Annual accounts and Bank of Spain.





Netherlands

The Dutch economy is experiencing a weak economic period. GDP decreased by 1.1 percent in the third quarter of 2012 compared to the second quarter, on a yearly basis the economic growth declined by 1.6 percent compared to the third quarter of 2011. In large part, the economic downturn in the Netherlands is a result of declining consumption and slowing corporate investment driven by uncertainty regarding the ongoing European debt crisis as well as stagnation in the housing market and the impact of reforms to cut the country's deficit.

That being said, the Dutch labor market continues to be highly competitive due to wage restraint and measures to increase the 'flexibilization' of labor. And while unemployment rates have increased over the past year from 5.4 to 6.5 percent, the Netherlands continues to enjoy the lowest unemployment rate in Europe. In November 2012 a new cabinet was formed between the VVD and PVDA which have presented structural reforms aimed at enforcing sustainability within public finance. Further reforms in the residential mortgage market including a tightening of underwriting criteria

“That being said, the Dutch labor market continues to be highly competitive due to wage restraint and measures to increase the 'flexibilization' of labor.”

and reduced tax-deductibility will be implemented as of 2013.

The combination of a deepening sovereign debt crisis and increasing regulatory reform has had an impact on the Dutch banking sector. In 2011 we saw a decline in net profits of 13 percent (to EUR7.8 billion) versus 2010. With capital buffers remaining the same, the banks' return on equity fell from 7.3 percent to 6.3 percent. At the same time, costs increased, in part due to the growing cost of regulatory compliance, but also as a result of increased credit losses in 2011 which have pushed up provision requirements.

Commercial & residential mortgage markets

The past five years have been a difficult time for commercial real estate

in the Netherlands, with demand for office space steadily decreasing due to slowing economic growth, an oversupply of space and the popularity of flex-working. Indeed, banks are now holding around EUR80 billion in outstanding commercial real estate loans, a quarter of which are now thought to have a greater value than the underlying real estate.

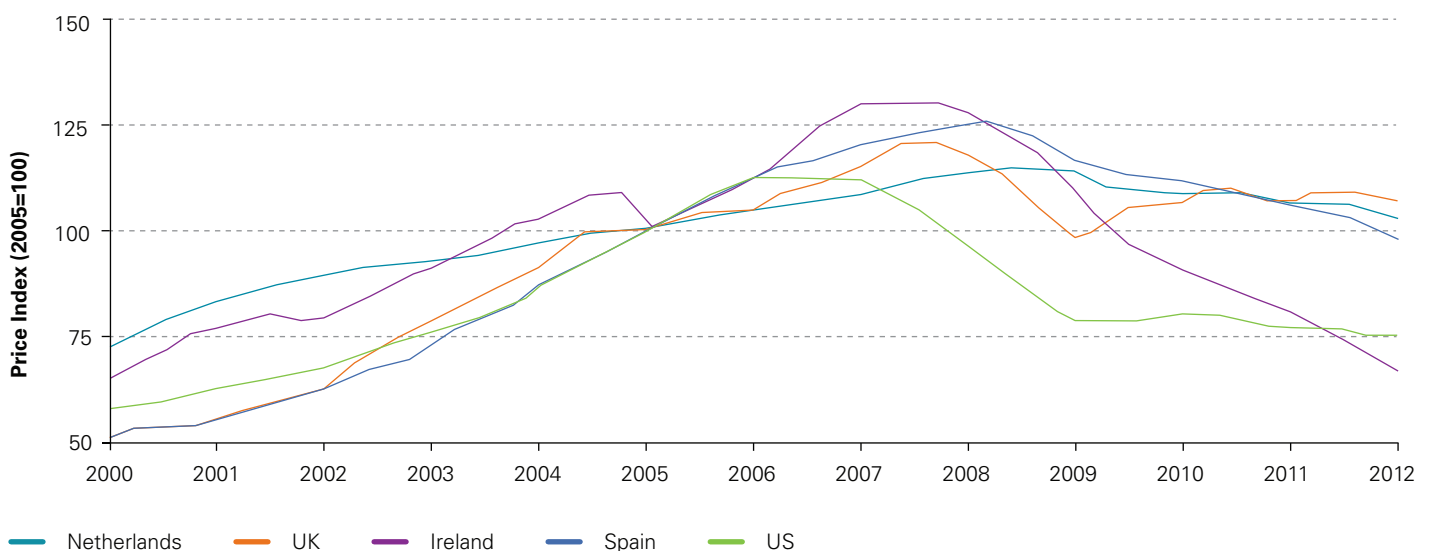
Between 2012 and 2013, almost a third of these loans will need to be refinanced which – given the high loan-to-value ratios – will be an unattractive proposition for the banks. As a result, we have seen an increase in the number of loans being rolled over at a higher interest rate, particularly when the potential losses on the current value of the assets seem high. And with continued uncertainty in the economic and financial market outlook, there are

few indications that this trend is likely to slow in the near future.

The residential mortgage market is also experiencing some instability characterized by adjustments in housing prices, de-risking and widening of gross margins. Furthermore, the tax deductibility of interest payments on mortgage loans is slowly being decreased, from 2014 each year by 0.5 percent.

While the Netherlands enjoyed high growth in housing prices in the past, the trend has been downwards since 2009; prices fell by 5.3 percent in 2009, 0.9 percent in 2010 and 4.0 percent in 2011.⁵ Delinquencies have increased somewhat over the past few years, but levels have been lower than those being experienced in the rest of Europe (less than 1 percent of households).

Increase in house prices since 2000



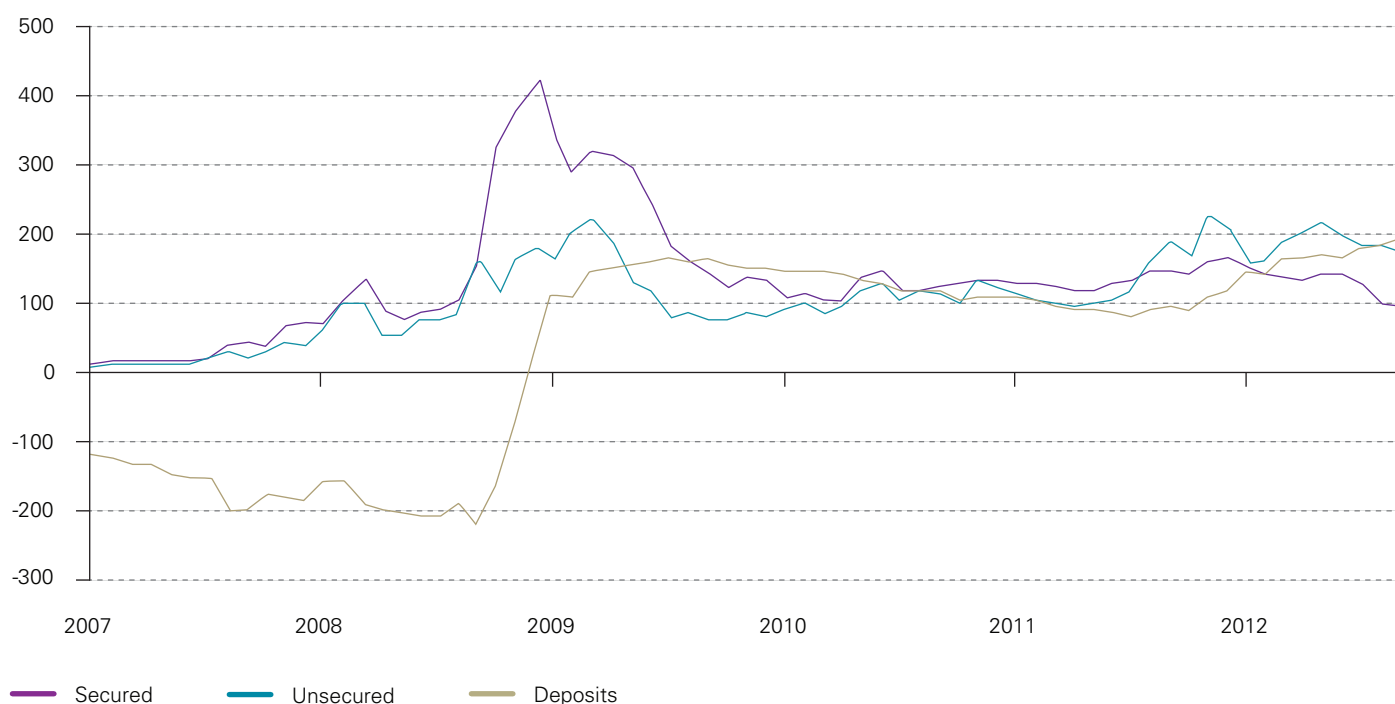
Source: ECB, Nationwide, S&P/Case-Shiller.

On 1 August 2011, the Code of Conduct for mortgage origination was revised by both the regulator and the industry, resulting in a more conservative set of underwriting criteria. At the same

time, the gross interest margins of newly originated loans have increased substantially. However, most Dutch banks rely heavily on wholesale funding (including RMBS) to fund their mortgage

portfolios and – with a lack of liquidity in the wholesale market and expensive retail deposits – have therefore seen higher mortgage spreads overall.

Spreads (bps compared to 3m EURIBOR)



Source: DNB, Bloomberg, JP Morgan.

Loan portfolio market

Generally speaking, the Dutch loan portfolio market continues to be at an early stage of development. Prior to the global financial crisis, there had been some limited activity, such as characterized by banks or specialized mortgage lenders selling sizable performing mortgage loan portfolios (often in excess of EUR500 million) to pension funds such as ABP.

That being said, there are indications that the Dutch loan portfolio market may be on the verge of growth. Driven by deleveraging requirements at the group level, many large foreign institutions are currently assessing their options for strategic exits from their Dutch residential mortgage and consumer lending operations. At the same time, domestic institutions are

also seeing pressure for sales: ING is continuously assessing options to meet restructuring demands from the European Commission, including the carve-out of WestlandUtrecht Bank from its Dutch retail banking business, while SNS Reaal is in the process of phasing out their loss-making Property Finance division which includes around EUR2.9 billion in Dutch commercial mortgage loans.

Other domestic players are also considering selling parts of their retail loan portfolios in order to improve their capital positions and/or enhance their loan-to-deposit ratios (an issue that is becoming increasingly important to the Dutch Central Bank).

Buyers

We see different types of interested buyers in the Dutch loan portfolio market. A few Dutch strategics (banks and insurers) are looking for high quality loans, such as prime residential mortgage loans. Furthermore, early stage discussions are being held to transfer residential mortgage loan exposure from the banks to their pension funds. Creating space on the banks' balance sheets would allow them to provide more new loans to consumers and businesses. In the next twelve months, we expect to see some concrete initiatives in this area.

Another expanding group of willing buyers consist of foreign asset managers, banks and specialty mortgage lenders with appetite for prime loans. Increasingly, these buyers are domiciled outside Europe. Next, we see a relatively large group of private equity parties and debt collection agencies which are focused on the lower quality and NPL portfolios.

That being said, there are also a number of investment banks active in the market, who are selectively seeking high and medium quality assets which can be securitized. It is worth noting that these banks are often able to take sizable tickets based on their clients' appetite for Dutch loan exposure.

However, despite the billions of Euros worth of assets that are currently considered "up for sale," few transactions have been successfully closed over the past 18 months. In part, this is due to wide bid-ask spreads and – given that most sellers are not distressed enough to take a sizable hit on their P&L and balance sheets (since performing loans are often reported at book value) – activity has been somewhat muted. We also note that for a few (foreign) parties the need for deleveraging initiatives has been delayed or has become less urgent, in part due to LTRO funding that was put in place.

Further, availability of secured funding influences the appetite for portfolios, and we have observed that banks have slowly overcome their fears of secured funding. This is starting to be reflected in the cost but not yet in the advance rate or maturity. Still, for non-strategic buyers, the funding cost often stays higher than the yield on assets and, with conservative

assumptions, buyers must take on refinancing conditions in one, two or three years, meaning lower bid prices.

In the longer term, Solvency II will more than likely deliver more beneficial treatment for whole mortgage loans as compared to many of the other types of fixed investments such as corporate bonds and RMBS. As a result, direct investments in mortgage portfolios may become much more appealing for insurers and asset managers under the proposed Solvency II regulations.

It is worth noting the sale of a EUR214 million non-conforming residential mortgage portfolio which was funded by capital from GI Partners Fund III and Principal Company. The deal saw Natixis provide a mortgage-backed debt package and – upon closing – a special purpose vehicle then issued EUR103.8 million in mortgage-backed securities rated Aaa(sf) by Moody's Investors Service.

Outlook

While the market certainly faces a number of challenges (e.g. bid-ask spread, funding), we anticipate increased activity in the debt sales market in the coming years. For the near-term, much of the focus will likely be on lower quality and NPL portfolios, particularly given the large number of interested buyers, the limited dependency on funding and the high impact on capital relief.

We also see potential for performing portfolios (up to c. EUR1 billion) especially when these are offered in combination with vendor finance or structured solutions.

Finally, we expect to witness increased activity from pension funds, foreign banks, insurers and asset managers seeking loan portfolio opportunities, the latter two in order to optimize their asset mix under the Solvency II rules.

Italy



In particular, the government is expected to announce new measures related to the level of public sector debt held by private firms and to identify tools to stimulate banking sector leverage in order to help firms secure sources of funding.

Economic outlook

With Italy's new government having taken a series of actions aimed at improving economic stability, the focus of the Italian economy has now shifted to concerns regarding future development and growth. Indeed, recent GDP trends seem to indicate the potential for another economic recession as growth rates begin to slump to levels not seen since the first quarter of 2010.

therefore the public sector (at both the central and local level) is now examining several potential actions aimed at raising the SME growth rate which fell to 0.5 percent in the second quarter of 2012.¹ In particular, the government is expected to announce new measures related to the level of public sector debt held by private firms and to identify tools to stimulate banking sector leverage in order to help firms secure sources of funding.

GDP per quarter

Gross Domestic Product						
	1Q-11	2Q-11	3Q-11	4Q-11	1Q-12	2Q-12
% change y/y	1.4	1.0	0.4	0.5	1.4	2.6

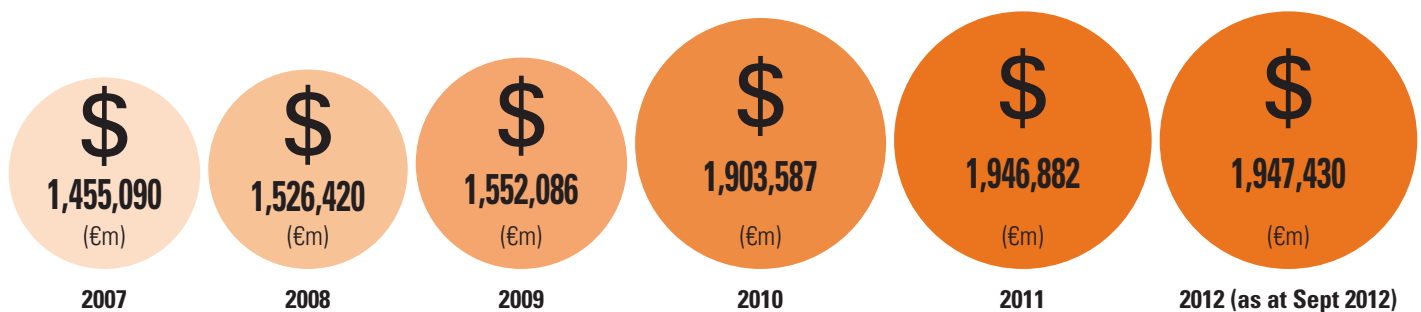
Source: ISTAT.

A 'double dip' recession will clearly have a significant effect on the nation's small and medium enterprises (SMEs), and

Loans evolution and banking sector

The overall level of loans held by the banking sector remained stable over the past year, while credit quality has been rapidly falling, leading to a jump in the level of defaulted loans of around 15 percent year-on-year.²

Total loans in the Italian Market (€m)

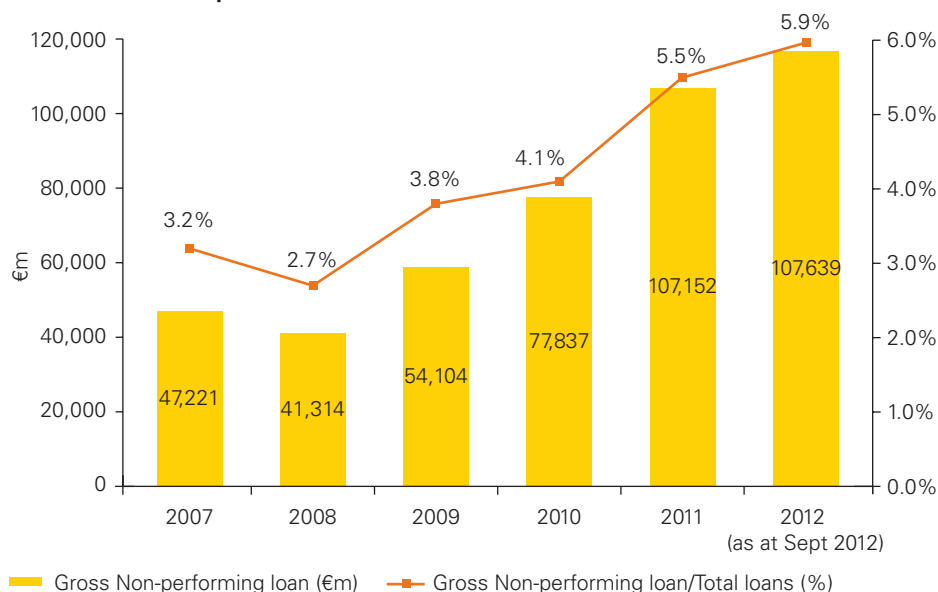


Source: ABI; Banca d'Italia.

¹ KPMG elaboration on Chambers of Commerce data

² ABI; Banca d'Italia

NPL Portfolio development in the Italian market



Source: ABI; Banca d'Italia.

At the same time, the volume of non-performing loans (NPLs) as gross book value, surged above the EUR100 billion mark in August 2011³ and is showing no sign of slowing. In the third quarter of 2012, non-performing loan volume increased by 9.7 percent.

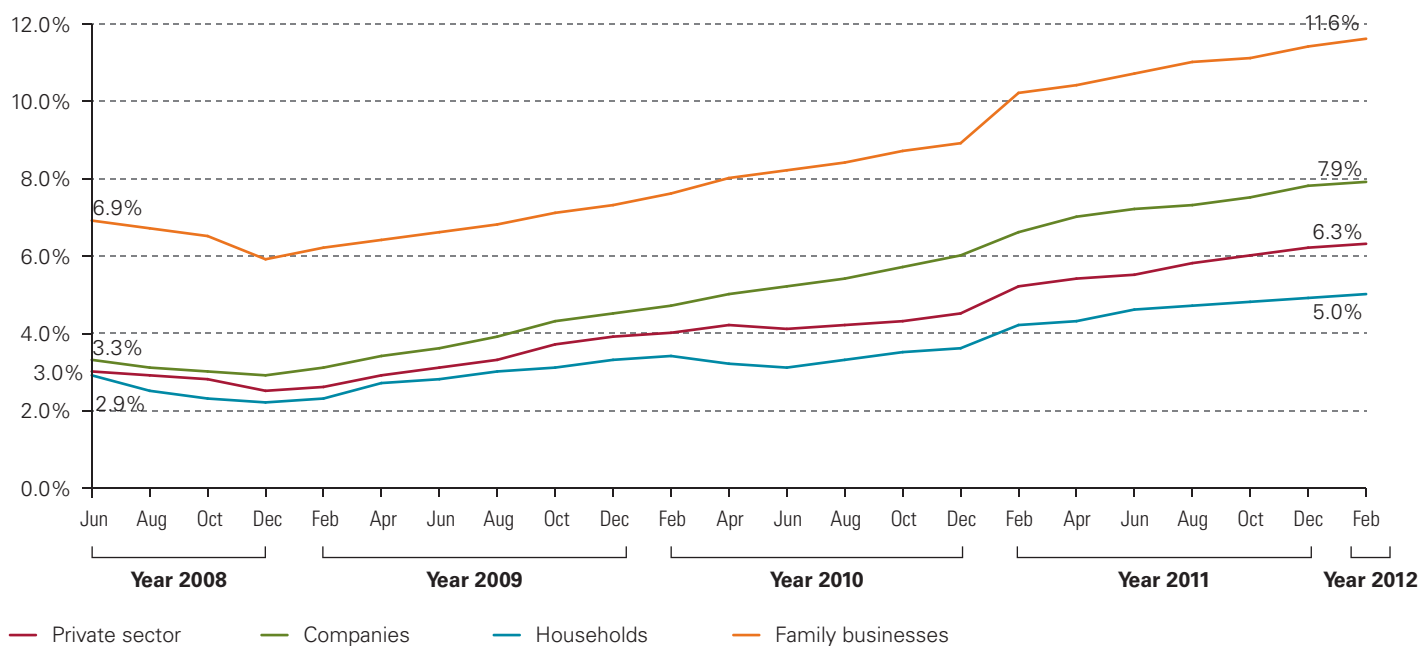
As a result, the level of NPLs as a proportion of total loans has also increased, reaching a high of 6.1 percent in September 2012.⁴ Italy's banks have therefore been depreciating their loan portfolios which has resulted in a loss of profitability. However, there are indications that the banking sector is unlikely to maintain this level of depreciation in the near-term, particularly since the requirements of Basel III will more than likely force banks to seek new resources in order to strengthen their capital ratios.

³ ABI; Banca d'Italia

⁴ ABI



Gross Non Performing loans / Total loans by sector

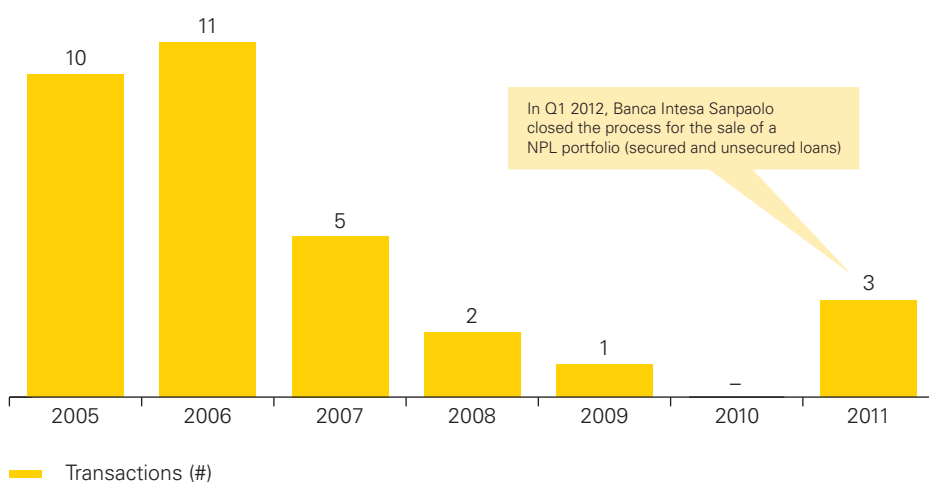


Source: ABI; Banca d'Italia.

Recent transactions

Transaction activity in the NPL market has been somewhat muted and may take a while longer to fully develop.

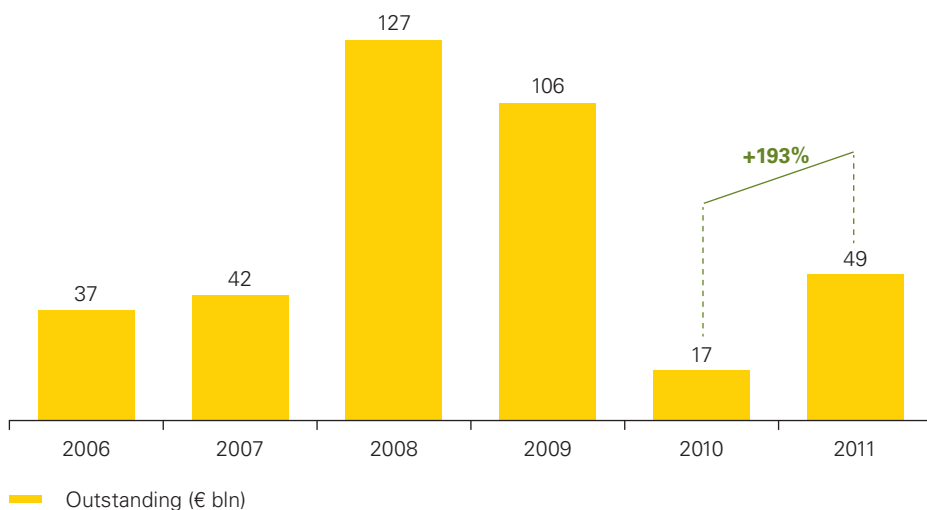
Italian loan sale market – historical transactions 2005–2011



Source: Press articles and market feedback, 2012.

Transaction activity in the NPL market has been somewhat muted and may take a while longer to fully develop.

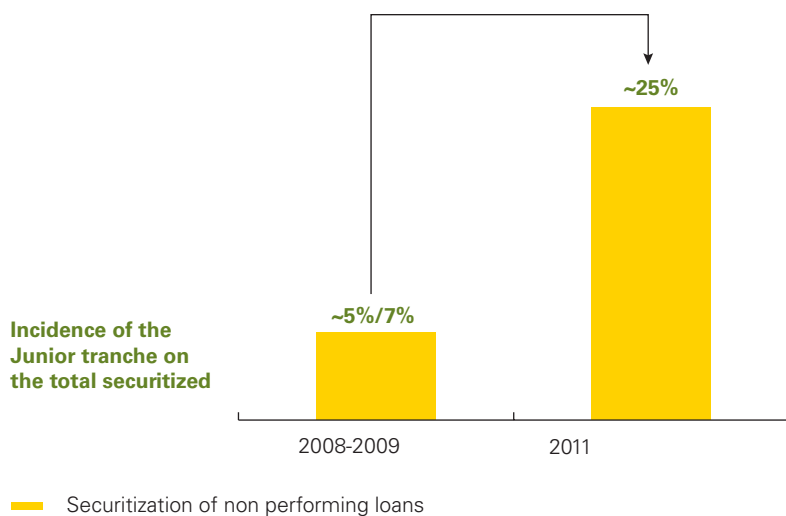
Securitization in the Italian market



Source: Press articles and market feedback, 2012.

Enhancing transaction volume in Italy will require the market to overcome a series of pressing challenges such as low investor liquidity and wide price gaps between buyers and sellers which has led to an evolution in the structuring of deals.

Securitization of non performing loans in the Italian market



Source: Benchmark analysis on market data regarding RMBS and CMBS securitization.

For NPL portfolios the incidence of the Junior tranche is directly related to the incidence of ordinary unsecured credit.
~30%/>50%

Increasing transaction volume in Italy will require the market to overcome a series of pressing challenges such as low investor liquidity and wide price gaps between buyers and sellers which has led to an evolution in the structuring of deals. In many cases, sellers are now initiating dialogue with a longer list of potential investors, conducting greater due diligence and examining new pricing structures (such

as deferred pricing, reps & warranties, etc.) in order to increase their chance of closing deals. Foreign banking groups are also experiencing divestiture challenges as they seek to sell Italian assets and portfolios.

The recent tendency towards the lowering of asset quality is also now affecting the 'refinancing' deal market and the volume of securitized performing loans.

Portugal



According to Eurostat, Portugal posted a deficit of 4.2 percent of GDP in 2011 which – while lower than the 5.9 percent target set out in the MoU – included a significant gain from the transfer of pension assets from banks.

Introduction

2011 and 2012 were difficult years for the Portuguese economy, with GDP falling in real terms, largely due to slumping domestic demand, declining levels of private and public spending and the near evaporation of investment.

The Portuguese banking sector faced an equally tumultuous year, characterized by a total lack of financing in the market and increasing credit risk in domestic activity, which were worsened by the ongoing sovereign debt crisis in the Eurozone.

Facing certain recession in 2011, the Portuguese government requested international financial assistance from the EU/IMP/ECB. The resulting bail-out package included a Memorandum of Understanding (MoU) that sought ambitious economic reforms and austerity measures, but cleared the way for a EUR78 billion rescue package, thereby allowing the country time to overhaul its economy.

Portugal's central bank, Banco de Portugal, forecasts further reductions in domestic demand. But while the bank calls for more exports in order to catalyze economic growth, they also admit that a slow-down in exports is the most likely scenario for 2012 as year end figures are finalized (as compared to the increase in exports experienced in 2011), particularly given current assumptions for external demand.

Evolution of the procedures set out in the MoU

According to Eurostat, Portugal posted a deficit of 4.2 percent of GDP in 2011 which – while lower than the 5.9 percent target set out in the MoU – included a significant gain from the transfer of pension assets from banks. Public debt stood at 107.8 percent of GDP in 2011, up from 93.3 percent in 2010.

Going forward, the MoU calls on the government to bring down the deficit to 4.5 percent of GDP for 2012 and to 3.0 percent in 2013, with continuing declines in the ratio of government expenditure-to-GDP in 2014. However, these will not be accomplished, as the EU/IMP/ECB granted Portugal one additional year to reach those targets.

Following the commencement of the austerity program, the 'troika' of the EU, IMF and ECB conducted six quarterly assessments which – overall – confirmed that the program was making good progress. However, during the most recent assessment, it started to become clear that the structural adjustment measures were having an unequal effect across the Portuguese economy. For example:

- While it was noted that the Portuguese authorities were implementing the reform policies as



planned and that external adjustments were proceeding faster than anticipated, the unemployment rate has continued to increase and has now become a pressing concern. The rate, which stood at just 3.9 percent in 2000, hit 12.7 percent in 2011. In the third quarter of 2012, the rate spiked again to 15.8 percent, leading most pundits to expect it to increase above 16 percent in 2013.

- Having experienced stronger than expected exports in 2011, there is now growing concern that external factors such as uncertainty regarding Greece's future standing in the Euro area and Spain's ongoing sovereign debt challenges represent a significant risk to the Portuguese economic recovery.
- Tax revenues have decreased higher than foreseen in the MoU, due to a significant decline of private consumption and internal demand. Nevertheless, this decrease in private consumption allowed Portugal to reach break-even in its external deficit, which is expected to reach a surplus in 2013 (the first since 1943).

That being said, the government is also enacting a series of structural and financial measures that include the reform of both state-owned enterprises and public-private partnerships, increases in all tax categories, increases in certain other tax categories such as car and tobacco sales, reductions in public sector headcounts at both the central and regional levels, and decreases in corporate and personal income tax deductions.

Recapitalization program for the banking sector

In an effort to maintain liquidity in the economy and encourage balanced deleveraging, the Portuguese government has outlined a EUR7.1 billion program of support for four Portuguese banks using around EUR5 billion worth of financial assistance from the Bank Solvency Support Facility (BSSF). These measures include:

- A EUR1.65 million injection of Core Tier 1 capital into Caixa Geral de Depósitos (CGD)
- An injection of EUR3.0 billion into Millennium bcp (BCP) by way of an issuance of hybrid instruments (eligible

as Core Tier 1) subscribed by the Portuguese government with payments anticipated to start in 2014 towards full amortization by the end of 2016

- A EUR1.3 billion injection into Banco Português de Investimento (BPI) through the issue of debt instruments (eligible as Core Tier 1), also subscribed by the Portuguese state
- A EUR1.1 billion injection into BANIF through: EUR0.7 billion of Core Tier 1 capital and the issue of debt instruments amounting to EUR0.4 billion (eligible as Core Tier 1), also subscribed by the Portuguese state
- And the availability of more funds to support other banks that meet the BSSF requirements and demonstrate a need for recapitalization.

Additionally, the Portuguese government nationalized two banks: Banco Privado Português, a small private investment bank which subsequently ceased activity; and Banco Português de Negócios, a bank believed to carry systemic risk which, in the first quarter of 2012, was sold to BIC (a private bank backed by Angolan and Portuguese shareholders) for EUR40 million.



Conclusion

2013 is expected to continue through a negative economic and financial environment, predominantly due to the significant increase in taxes and the continuing of the austerity measures.

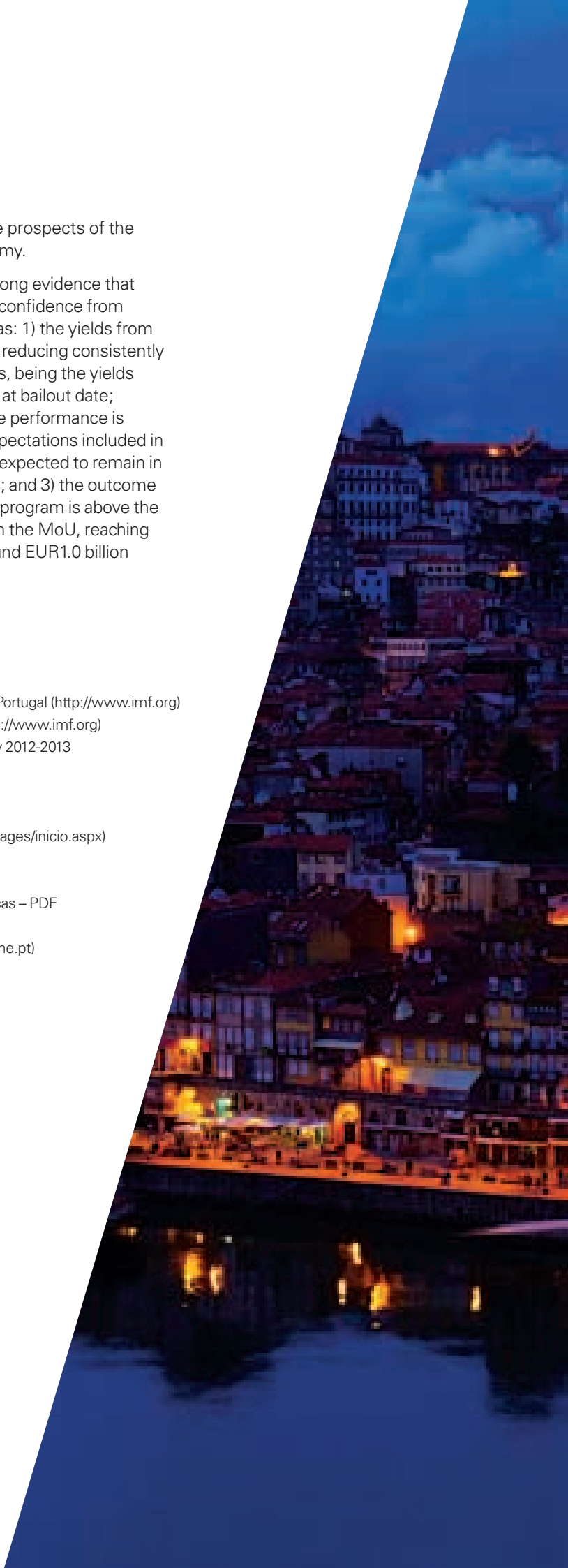
However, with the changes already put in place – to the Insolvency Law, Labour Law and other structural reforms, and the already announced fundamental reform to the Income Tax Law and the intention of the Portuguese government to cut expenses by EUR4 billion – it shows a full commitment towards the MoU and the adjustment required

to better the future prospects of the Portuguese economy.

Indeed, there is strong evidence that Portugal is gaining confidence from external investors as: 1) the yields from sovereign debt are reducing consistently in the last 9 months, being the yields actually lower than at bailout date; 2) the trade balance performance is overcoming the expectations included in the MoU, which is expected to remain in the following years; and 3) the outcome of the privatization program is above the objective defined in the MoU, reaching EUR6.4 billion around EUR1.0 billion above the target.

Sources:

- 1 Statement by the EC, ECB, and IMF on the Fourth Review Mission to Portugal (<http://www.imf.org>)
- 2 IMF Survey: Good Progress But Testing Times Ahead For Portugal (<http://www.imf.org>)
- 3 Economic Bulletin – Spring 2012: Outlook for the Portuguese Economy 2012-2013 (<http://www.bportugal.pt/en-us/Pages/inicio.aspx>)
- 4 Recapitalisation plans for banks subject to EBA stress-testing (<http://www.bportugal.pt/en-us/Pages/inicio.aspx>)
- 5 Financial Stability Report – May 2012 (<http://www.bportugal.pt/en-us/Pages/inicio.aspx>)
- 6 Banco BPI informs about Recapitalisation Plan (<http://bpi.bancobpi.pt/>)
- 7 Summary of the recapitalization plan (<http://www.millenniumbcp.pt/>)
- 8 Programa de Recapitalização para as Instituições de Crédito Portuguesas – PDF (<http://www.portugal.gov.pt>)
- 9 Contas Nacionais Trimestrais e Anuais Preliminares 2011 (<http://www.ine.pt>)







Poland



Poland's economy enjoyed solid GDP growth of 4.3 percent in 2011, largely as a result of strong domestic demand and high investment spending (which increased 3.8 percent in 2010 and 8.7 percent in 2011).

Introduction

Poland's economy enjoyed solid GDP growth of 4.3 percent in 2011, largely as a result of strong domestic demand and high investment spending (which increased 3.8 percent in 2010 and 8.7 percent in 2011). Moreover, according to the IBnGR Institute, the country's GDP is expected to see further growth of between 3 and 5 percent per annum from 2012 to 2014, albeit with a slight slowdown in 2012. This will likely trigger systematic growth in the level of loans granted, with the amount of personal loans anticipated to grow by 42 percent between 2011 and 2014 to reach Polish zloty (PLN)715 billion. Corporate loans

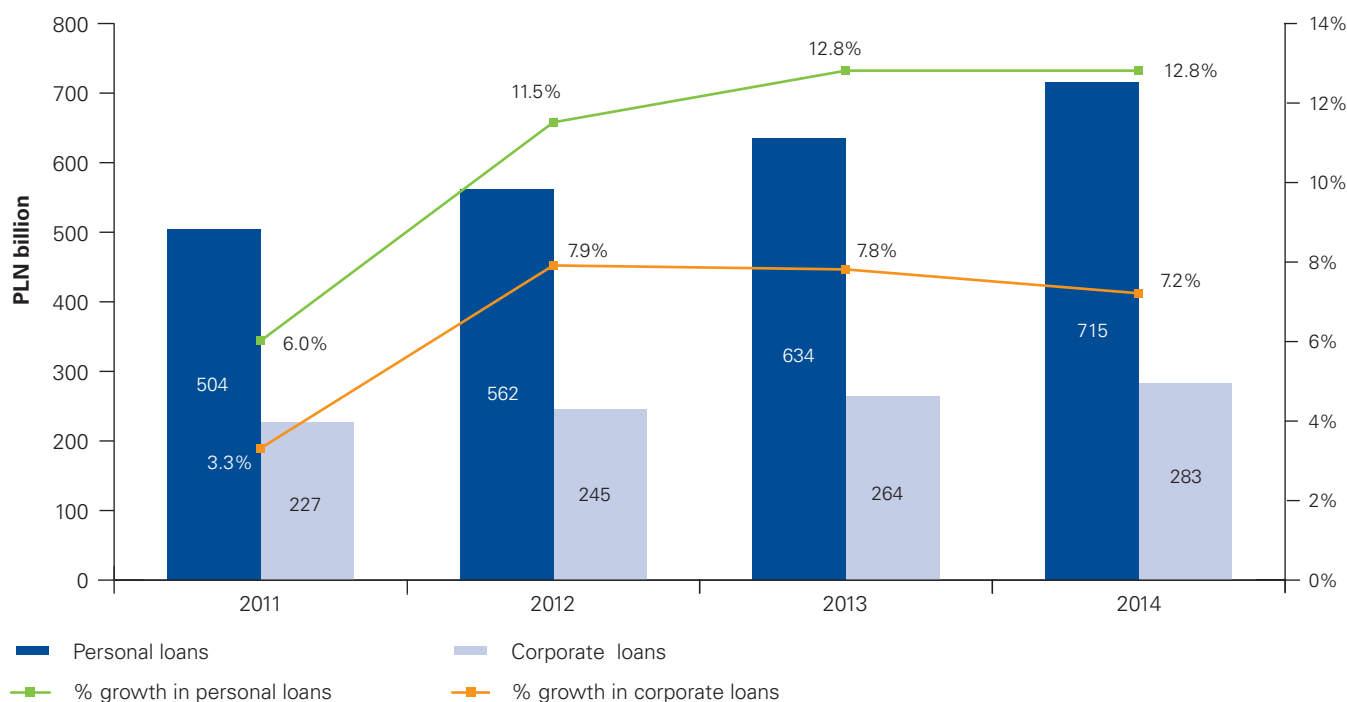
will also grow, but at a more modest 25 percent to reach PLN283 billion by 2014 (compared to PLN227 billion in 2011).

Other factors will also help stimulate the growth of the debt sales market in Poland including a large current overhang of non-performing loans (caused by deterioration in the quality of granted loans during the financial crisis in 2008 and 2009), and a positive change in the banks' attitude towards the portfolio sales process. So while, according to the IBnGR Institute, Poland's market is still lower than that of the EU-15 countries, there is every indication that Polish banks

will start to increase their sales activity for NPLs considerably.

In turn, this will likely drive demands by the debt collection companies for greater levels of funding and the wider use of securitization. At the same time, the risk-minimizing benefits associated with the participant experience, combined with the development of business-related institutions, will likely stimulate the growth of the debt sales market. Indeed, by 2014, the non-performing loan (NPL) debt sales market is expected to grow by more than 66 percent to reach PLN8.9 billion (up from the current level of PLN5.4 billion).

Value of personal and corporate loans in Poland



Source: IBnGR Institute (Instytut Badanad GospodarkRynkow) and The Polish National Bank (Narodowy Bank Polski, NBP).

Condition of the Polish banking industry

Prior to the global financial crisis, the Polish banking sector enjoyed a period of rapid expansion. In fact, between 2005 and 2008, the sector saw a 32 percent CAGR increase in total corporate and consumer loans (from PLN258 billion to PLN591 billion). However, as was the case in most markets, the outbreak of the financial crisis caused the tightening of bank lending policies, which resulted in a decrease in total loans in 2009.

Starting as early as mid-2008, the quality of loans had already begun to deteriorate sharply (particularly in the

unsecured consumer and corporate loan segments), which left a large overhang of NPLs in the market. As a result, Polish banks are widely expected to sell NPL portfolios with renewed vigor in the near-term.

That being said, according to the Polish Financial Supervisory Authority (KNF), the country's banking sector is in good condition, characterized by a sharp increase in profits (up 37 percent to PLN15.7 billion in 2011), higher credit values (up 16 percent to PLN911.3 billion in 2011) and lower bad debt allowances (which decreased by 23 percent between 2010 and 2011 to reach PLN9 billion). Capital adequacy ratios were also high at 13.1 percent and Tier 1 ratios

at 11.7 percent, while base liquidity reserves sat at PLN294 billion.

And while the cost of risk in the Polish banking sector is expected to return to its long-term values, it will likely settle above the pre-crisis level. However, the level of corporate, mortgage and non-mortgage personal NPLs will likely remain fairly unchanged over the medium-term.

On the other hand, increased capital requirements associated with the introduction of Basel III and CRD IV will put additional pressure on the industry, which may result in improvements on margins and, consequently, lower values for loans granted.

The results of the Polish banking sector in 2011 (compared to 2010)

In PLN million	2010	2011	Change
Interest income	30,899	34,933	13%
Fee and commission income	13,754	14,302	4%
Bad debt allowance	11,235	8,667	- 23%
Operating income	14,206	19,546	38%
Profit	11,420	15,699	37%
Volume of credits granted	787,454	911,313	16%

Source: Polish Financial Supervisory Authority (KNF).

Access to funding for debt buyers

Throughout 2011 and into the first quarter of 2012, Poland's debt collection companies enjoyed access to relatively cheap funding. Furthermore, due to the favorable zloty foreign exchange rates, local investors also found themselves in a better position when compared to their foreign competitors. This easy access to funding was a key factor driving the rise in volume within Poland's debt sale market.

Changes in the approach to the collection process

The supply of NPL portfolios in the market will also be catalyzed by the changing attitude of the Polish banks towards both the selling of NPL portfolios and the outsourcing of debt collection services. For example, we have started to see banks engage outsourced collection services at an earlier stage in the borrower's delinquency and many are now also putting increased pressure on their internal workout departments.

Polish banks are also beginning to show greater interest in approaches to collection processing that have traditionally been the domain of collection companies. For instance, some banks are now running pilot projects to test the use of EPU (electronic writ proceedings) and transferable court payment orders.

That being said, while most Polish banks may indeed be preparing their NPLs for sale, they are also demonstrating more reluctance to sell (particularly in

comparison to Western Europe) due to a perceived mismatch in pricing expectations between sellers and buyers.

In any event, the Polish market largely remains dominated by consumer loan portfolio sales. And while corporate and mortgage loan portfolios are seeing some activity in the market, their full potential continues to be hampered by a range of complications including

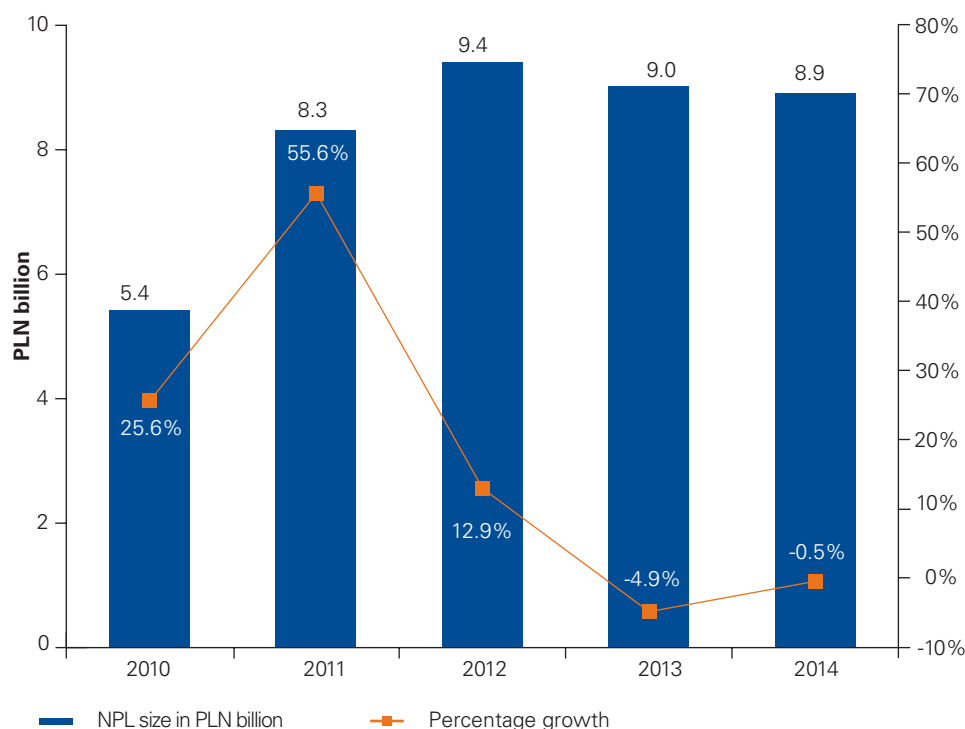
tax issues, legal obstacles influencing the efficiency on the buy-side, and operational challenges in collecting the required data and documentation.

Market perspective and recent transactions

There are, however, strong indications of growth ahead for the NPL market. Indeed, by 2014, Polish banks will be

encouraged to have sold 39 percent of their non-performing mortgages (compared to 7 percent in 2009), 20 percent of their non-mortgage NPLs (14 percent in 2009) and 33 percent of their corporate NPLs (22 percent in 2009).

Value of the Polish NPL debt sales market



Source: IBnGR Institute (Instytut Badanad GospodarkRynkow) and The Polish National Bank (Narodowy Bank Polski, NBP).

That being said, while most Polish banks may indeed be preparing their NPLs for sale, they are also demonstrating more reluctance to sell (particularly in comparison to Western Europe) due to a perceived mismatch in pricing expectations between sellers and buyers.

Recent loan portfolio transactions (since August 2011)

The largest portfolio sale transactions in the period Jan 2011-Apr 2012					
Seller	Date	Face value (PLN m)	Buyer	Loans	Assumed price
PKOBP	April 2011	542	Kruk S.A.	Consumer unsecured NPLs	17%
BRE Bank	April 2011	600	Undisclosed	Consumer unsecured NPLs	12%
Kredyt Bank	April 2011	1,015	Best	Consumer unsecured NPLs	20%

Table is continued on page 58

Seller	Date	Face value (PLN m)	Buyer	Loans	Assumed price
Santander Consumer Finance	Pending	6,000	Project in progress	Performing residential mortgage loans	At par or with a slight discount to par
BRE Bank SA	H1 2011	621.5	Kruk S.A.	Retail	c. 14.5%
PKOBP	April-June 2011	23	Undisclosed	Undisclosed	Undisclosed
PKOBP	Q3 2011	418	Undisclosed	Consumer unsecured NPLs	Undisclosed
PKOBP	Q4 2011	533	Undisclosed	Consumer unsecured NPLs	Undisclosed
PKOBP	Q4 2011	520	Undisclosed	Corporate unsecured NPLs	Undisclosed
BZWBK	December 2011	228	Kruk S.A.	Undisclosed	Undisclosed
Getin Noble	March 2012	284	Kredyt Inkaso S.A.	Undisclosed	c. 9.2%
PKOBP	April 2012	700	Undisclosed	Consumer unsecured NPLs	21%
PKOBP	April 2012	270	Undisclosed	Corporate unsecured NPLs	9%

Source: KPMG Analysis.

As a result, the value of the NPL debt sales market is expected to increase by 66 percent to PLN8.9 billion by 2014 (versus PLN5.4 billion in 2010). At the same time, we expect the number of loan portfolio transactions to also increase this year, mainly driven by the expected sale of those (now non-performing) loans granted during the credit boom period of 2006 to 2008.

All told, the banking sector remained the most important player in the Polish debt sales market between April 2011 and April 2012, with around 70 percent of sales coming from this sector. And over the next few years, this share will more than likely increase, according to the IBnGR Institute.

It is worth noting that consumer NPLs made up the vast majority of all debt sold in the year starting April 2011, followed by retail and corporate NPLs. Interestingly, almost 70 percent of all transactions were executed by PKO BP, which was – by far – the most active player in the Polish debt sales market in both 2011 and the first half of 2012.

Sources:

- 1 IBnGR Institute (Instytut Badań nad Gospodarką Rynkową)
- 2 Polish Financial Supervisory Authority (Komisja Nadzoru Finansowego, KNF)
- 3 The Polish National Bank (Narodowy Bank Polski, NBP)
- 4 <http://www.kredytinkaso.pl/artykuly/2417,1354,zawarcie-umowy-znaczej.htm>
- 5 <http://www.kruksa.pl/pl/dla-inwestora/raporty/raporty-biezace/art54,raport-biezacy-nr-522011-zawarcie-umowy-znaczej-.html>
- 6 <http://www.kruksa.pl/pl/dla-inwestora/raporty/raporty-biezace/art26,raport-biezacy-nr-242011-zawarcie-umowy-znaczej.html>
- 7 <http://www.kruksa.pl/pl/dla-inwestora/raporty/raporty-biezace/art78,raport-biezacy-nr-742011-zakonczenie-negocjacji-dot-zawarcia-umowy-na-zakup-wierzytelnosci.html>
- 8 <http://www.kredytinkaso.pl/artykuly/2472,1383,zawarcie-przez-podmiot-zalezny-emitenta-umowy-o-subpartycypacje-oraz-umowy-zobowiazujacej-przeniesienia-wierzytelnosci.htm>
- 9 <http://www.ekonomia24.pl/artykul/706164,855871-Windykatorzy-podziela-sie-dlugami.html>
- 10 <http://www.pkobp.pl/raportroczny2011/pakietowa-sprzedaz-wierzytelnosci.html>



Russia



Russia's debt sales market saw considerable activity in 2011, growing from USD2.01 billion in 2010 to USD2.62 billion in 2011.

Bad debt overview

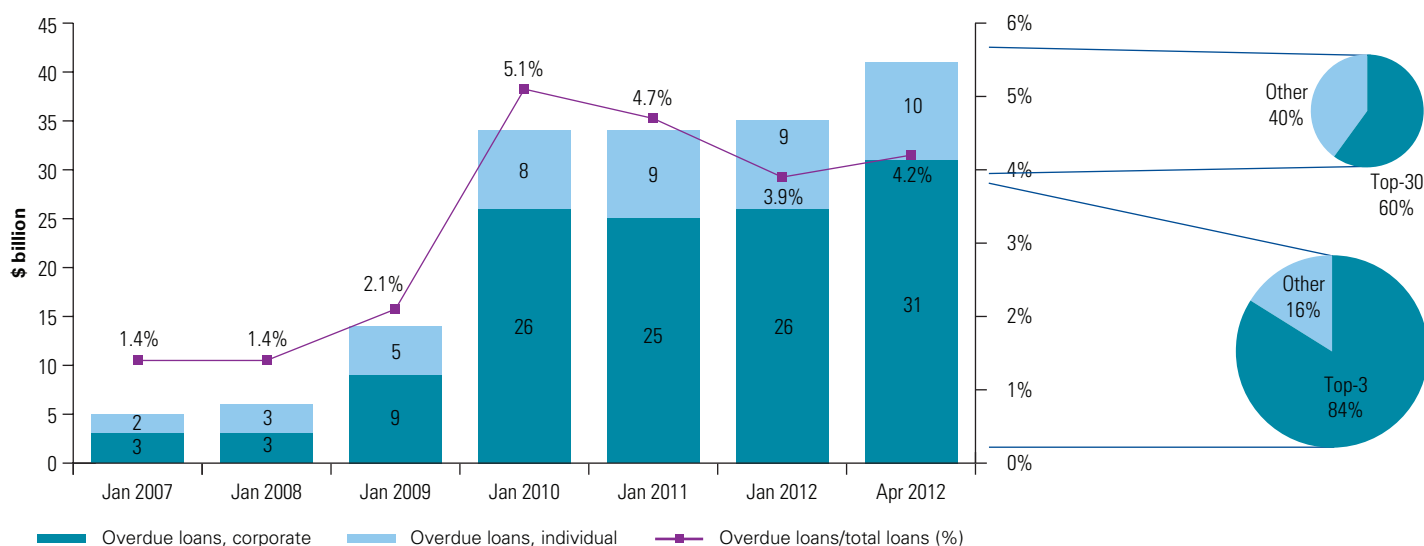
While Russia's NPL levels grew by USD3.8 billion during the first four months of 2012, allowances grew by only USD1.8 billion. Over the same time period, Russia's banks made approximately USD11.4 billion in profits. According to the Central Bank of the Russian Federation (CBRF), the level of bad corporate loan debt rose by 3.1 percent between January

and April 2012, while bad retail debts increased by 1.3 percent.

This trend continued in May 2012, with corporate NPLs (as a share of banks' total loan portfolios) increasing by 0.1 percent to reach 5.1 percent, while retail NPLs fell 0.1 percent to 5.0 percent. Overall, the level of problem debt sat at around 4.9 percent of total loan portfolios in May 2012.

However, it should be noted that these figures are calculated using Russian Accounting Principles for NPLs and provision assessments, which differ sharply from IFRS in that – rather than treating all relevant debt as impaired – Russian Accounting Principles only take into account part of the overdue debt (namely the overdue installment).

Overdue loan portfolio development



Source: http://www.cbr.ru/analytics/bank_system/svst01042012.pdf



That being said, the CBRF introduced new regulations on 1 July 2012 that established new requirements for banks' mandatory reserves. These amendments have introduced high coefficients for risk assessment in the calculation of capital adequacy which will likely reduce the banking sector's capital adequacy by between 1 and 1.5 percentage points over the course of the next three years. As of June 2012, however, 17 of the top 30 banks in Russia had a capital adequacy ratio of below 12 percent. The amendments also allow regional branches of the Central Bank to require banks to prove the reliability of their financial statements.

Debt sales trends

Russia's debt sales market saw considerable activity in 2011, growing from USD2.01 billion in 2010 to USD2.62 billion in 2011. However, analysis shows that – of those portfolios sold – there

was an increase in the average term of delay (from 30 months in 2010 to 42 months in 2011) and a reduction in the average price offered for personal loans. Around 80 percent of the debts sold had already been placed into collection with collection agencies, and around 45 percent had already obtained court judgments (up from 30 percent in 2010). The sale of personal debts were rare (accounting for around 1 percent of debt sold in 2011), particularly given the difficulties in collection.

This has led to an overall deterioration in the quality of sold portfolios and, as a result, the cost of collecting these debts will now increase (by, on average, 35 to 40 percent). As these trends began to become apparent to investors in the third quarter of 2011, the market witnessed a dramatic decline in the selling price of portfolios. In fact, in 2010 and early 2011, the average prices of cession portfolios was commonly

between 5 to 6 percent but – as of the second half of 2011 – the range dropped to between 1 and 5 percent. In part, this was because investors started to assess the real value of their offers against the quality of the debt. But it was also likely influenced by the growing maturity of investors in the Russian debt market which may have led to more objective prices overall.

Interestingly, the product structure of sold portfolios has remained little changed over the past few years. More than half of all debts sold are consumer loans, 70 percent of which are credit card debts, with the remaining 30 percent represented by auto loans and mortgages. At the same time, the sale of SME debts saw only a slight increase in 2011. However, these debts do not tend to enjoy strong demand in the market and, as a result, are increasingly being passed over to collection agencies.

Closed deals

Seller	Buyer	Portfolio characteristics	Completion date	Face value, (USD\$m)	Sales price
NRB	Delta Credit Bank	Mortgage loans	Apr 2011	33	n/d
MDM Bank	n/d	Mainly SME loans	Jun 2011	50	n/d
BNP Paribas Vostok	Uralsib Bank	Individual loans	Oct 2011	43	n/d
Trust	Promsvyazbank	SME loans	Nov 2011	7	n/d
Raiffeisenbank	n/d	Mainly corporate loans	2011	286	84%
Promsvyazbank	Unknown third party	Corporate loans	2011	279	n/d
Nomos Bank	Unknown third party	n/d	2011	238	n/d
Petrokommerzbank	n/d	n/d	2011	145	n/d
Rosselkhozbank	n/d	Corporate loans	2011	107	n/d
Unicredit Bank	n/d	Mainly corporate loans	2011	76	n/d
Bank Sanit Petersburg	n/d	Mainly corporate loans	2011	27	n/d
Vozrozhdenie	n/d	SME loans	2011	13	n/d
Sberbank	Collection agencies	n/d	2011	6	n/d
International Bank of Saint Petersburg	BFA Bank	Corporate leasing	Feb 2012	153	n/d
Promsvyazbank	n/d	Individual loans	Feb 2012	51	n/d
Altayenergobank	Bank Rossiysky Capital	Individual car loans	Mar 2012	20	n/d
Total				1,534	

Source: KPMG Analysis.

At the time of writing, Russia's economy was experiencing significant pressure from declining oil prices and, as a result, the Russian ruble (RUB) was falling. The situation was perhaps further compounded by the continuing devaluation of the euro against the dollar (a result of continuing problems and growing uncertainty in the Eurozone).

Overview of 2012

At the time of writing, Russia's economy was experiencing significant pressure from declining oil prices and, as a result, the Russian ruble (RUB) was falling. The situation was perhaps further compounded by the continuing devaluation of the euro against the dollar (a result of continuing problems and growing uncertainty in the Eurozone).

With the crisis period of 2008 and 2009 still firmly in mind, Russia's banks are currently concerned about liquidity and these concerns have increasingly been manifesting themselves in increased interest rates on loans and deposits.

Moreover, continuing negative dynamics in the foreign exchange

and stock markets can be expected, as well as a further tightening of credit conditions and more stringent assessments of borrower's financial and economic situations.

In turn, this will lead to a steady increase in the number of NPLs, the appearance of non-core assets on banks' balance sheets and increased interest in debt sales to counterparties such as collection agencies and other creditors. Market observers and participants also expect to see banks sell debt to companies interested in acquiring a competitor or entering new markets.

At the same time, changes in the market assignment in 2011 will undoubtedly lead to a more objective assessment of the value of purchases within the

investors' portfolio and, as a result, we will likely see a reduction in the cost of purchased debt.

Regardless, the market anticipates around a 20 percent increase in the volume of debt offered for sale, driven largely by an increasing number of sellers rather than growth in the sales of any one bank.

For its part, the reduction in the price of bad debt is being caused by the increased age of the debt and the growing maturity of players in the NPL market. As a result, the Russian debt sales market is demonstrating extremely high potential, particularly in light of the growth in absolute values year-on-year and the current macro-economic situation.





Romania



Many analysts and market observers expect the Romanian debt sales market to gain increasing traction with significant potential in the medium-term. ”

The Romanian debt sales market has largely been characterized by the sale of non-performing loan (NPL) portfolios (particularly provisioned retail and consumer loans) by banks and a renewed focus on the provisioning costs of corporate portfolios. Many of the most active buyers have been collection agencies who have, over the past few years, built up servicing platforms focused on consumer loans in the telecom and utilities sectors.

While 2011 also saw Romania's local banks place significant effort into the

workout of corporate NPL portfolios, effective solutions have been somewhat delayed while the banks focus on building out their experience and related capabilities in this area.

Banks' NPL portfolios are also facing rather narrow perspectives as a result of sluggish growth in the economy and the increasing scarcity of financing for companies.

That being said, many analysts and market observers expect the Romanian debt sales market to gain increasing

traction with significant potential in the medium-term.

Banking sector portfolio overview

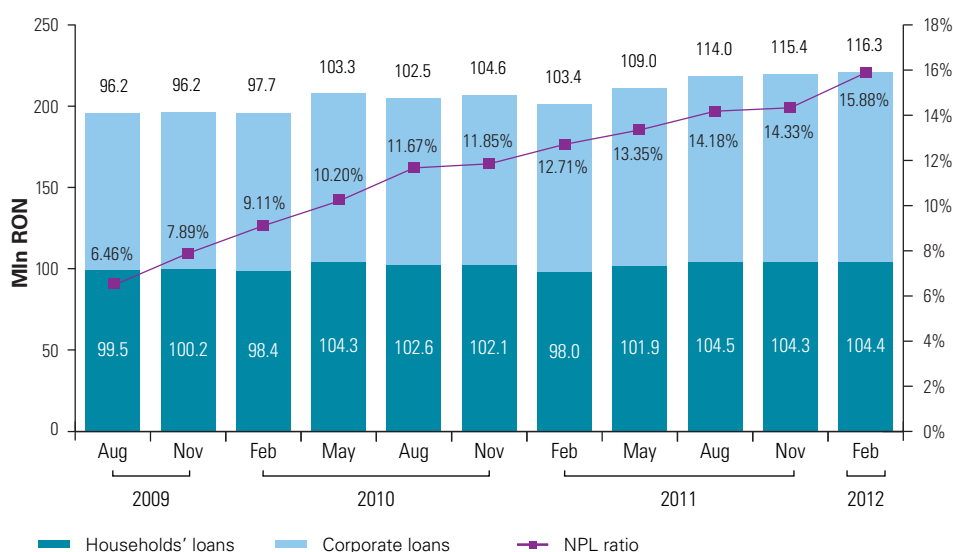
Over the last year, the Romanian market recorded relatively modest growth in loan portfolios while the market share of the top players remained largely unchanged; the top five banks accounted for 54 percent of loan portfolios, with the top ten banks holding around 78 percent of the market total. However, the



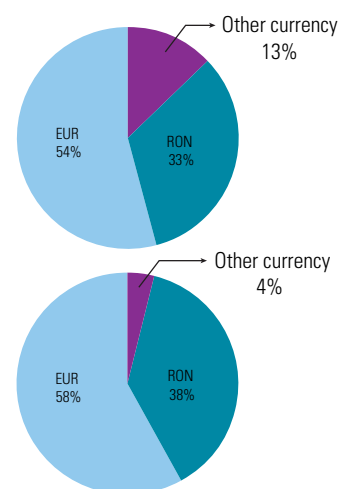
overall portfolio quality at the banks deteriorated – albeit at a manageable pace – with NPL ratios increasing from 11.8 percent to 14.3 percent during 2011, and overall provisions increasing 29 percent to USD9.2 billion.

The scarcity of financing sources for effective workout solutions in the corporate segment indicate the potential for a pick-up in the loan sales market in the mid-term.

Loan portfolio and NPL ratio evolution



Source: NBR data.



Domestic debt sale market status and potential

For 2011, the NPL transaction volume for banks and collection agencies stood at approximately EUR684 million, according to the Romanian Association of Collection Agencies, and – given that collection agencies hold around 80 percent of the market – this figure can be taken as a strong proxy for the market. It is worth noting that few – if any – investment funds are actively pursuing NPL portfolio opportunities in the Romanian market at this time.

For their part, the banks have been fairly active in their attempts to workout their consumer portfolios, and have absorbed related default costs in order to dispose of these portfolios. And while Romania's banks have also started to consider solutions for addressing defaults in the mortgage and large corporate markets, many of these solutions have focused on creating distressed asset vehicles, designed to take over NPLs or the

collateral resulting from foreclosure procedures.

At the same time, the banks have increasingly been exploring opportunities to realize the value embedded in their corporate NPL portfolios and, as a result, many market pundits now anticipate increased levels of NPL transactions in 2013, focused largely on portfolios of mortgages, SMEs and other corporate loans.

Despite the clear need for the country's banks to focus their lending activity on their core areas of expertise, few expect to see growth in non-core portfolio transaction levels in the coming months, largely due to the banks' continuing efforts to accommodate the provisioning costs of their NPL portfolios.

Latest developments on the banking sector

In June 2012, Moody's Investment Services downgraded the ratings of those Austrian banks with operations in

Romania; Raiffeisen Bank International (RBI) and UniCredit Bank Austria (UBA) were downgraded by one notch, while Erste Group Bank was downgraded by two notches.

In large part, this downgrade was attributed to the banks having low levels of capital relative to their Western European peers, particularly given the risks they face in Central and Eastern Europe. Erste's additional downgrade was also driven by the tail risk that the bank faces in Romania and Hungary.

Conclusion

With many banks now striving to work out their corporate assets and limited headroom for further provisioning costs, we are unlikely to see significant portfolio transactions in the coming year, but potential still exists for medium-term market momentum.

Sources:

- 1 National Bank of Romania's Monthly Bulletins and monetary and financial statistics (<http://www.bnro.ro>)
- 2 National Bank of Romania's Central Credit Register (<http://www.bnro.ro>)
- 3 Romanian Association of Collection Agencies (AMCC) (<http://www.amcc.ro/>)
- 4 Moody's – Global Credit Research – 06 Jun 2012 – “Moody's downgrades Austrian banks; rating carry stable or negative outlooks”



For 2011, the NPL transaction volume for banks and collection agencies stood at approximately EUR684 million, according to the Romanian Association of Collection Agencies, and – given that collection agencies hold around 80 percent of the market – this figure can be taken as a strong proxy for the market.





Hungary



Moreover, many local banks feel that the country risk premium being demanded by foreigners is unpalatable.”

Introduction

Despite Hungary's relatively high levels of non-performing loans (NPLs), the debt sales market has failed to take off.

Banks still believe that they can collect more efficiently than a foreign investor contracting a local collection company and are largely focused on preserving the investor's return. Moreover, many local banks feel that the country risk premium being demanded by foreigners is unpalatable.

However, with the quantum of bad loan portfolios now far outstripping demand from local collection companies willing to purchase, there is currently very little activity in the market.

Macroeconomic environment

Overall, the Hungarian economy continues to stagnate and is showing signs of vulnerability to pressure from external markets and economies. As

a result, the country is experiencing fluctuating credit default swap spreads,¹ weakness in the currency and volatility in treasury bond yields.

In response, the government has introduced a range of strict fiscal policy measures designed to keep the budget deficit in check, though measures have largely been 'one-off' and have had only a short-term influence on budget numbers. One of the most pronounced impacts, however, has been to put a significant burden on the financial sector through additional taxation.

Indeed, most initiatives to stimulate economic growth have had minimal effect, largely due to the fact that official economic policy has tended to prioritize the cutting of state debt and budget deficits in order to reduce the country's exposure to external shocks. In effect, this has had the perverse effect of tying the hands of policymakers seeking to spend on economic stimulus measures.

The net result has been that – as rating agencies downgrade Hungarian debt to 'not-recommended' status and risk premiums climb – Hungary is increasingly perceived as a hazardous playground by risk averse investors. However, there are clear indications that some of the more risk-tolerant investors have found Hungary to be an attractive target; over the past year alone, the share of non-residents holding government securities² has increased from 25 percent to more than 40 percent.

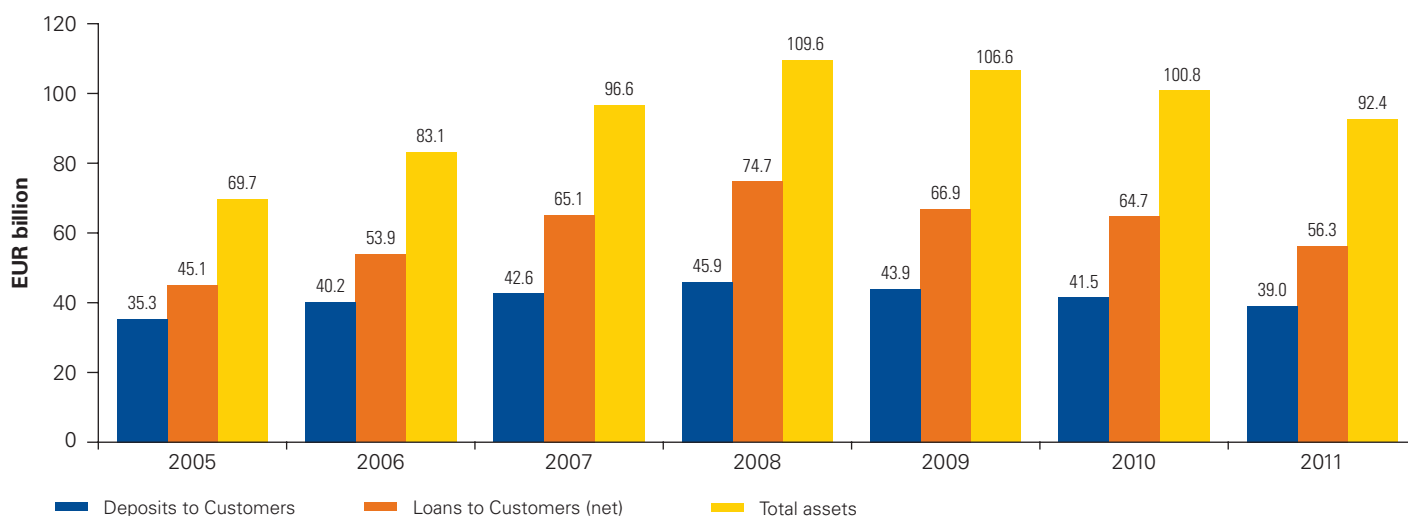
Banking sector overview

With the Hungarian banking sector largely following the deleveraging trend now underway across the rest of Europe, the balance sheets of local credit institutions have fallen by an average annual rate of around 5.5 percent (in EUR terms) since reaching their peak in 2008.

¹ For the last twelve month CDS spread has ranged between 250–750 bp.
(Source: Bloomberg, <http://www.bloomberg.com/quote/CHUN1U5:IND>)

² Share of non-residents' government securities holdings data was sourced from National Bank of Hungary (MNB): Report on Financial Stability, 11/2011 and 04/2012

Balance sheet status of Hungarian credit institutions



Note: Data was converted to EUR by using year-end FX rates (sourced from Oanda.com).
Source: PSZÁF (Hungarian Supervisory Authority).

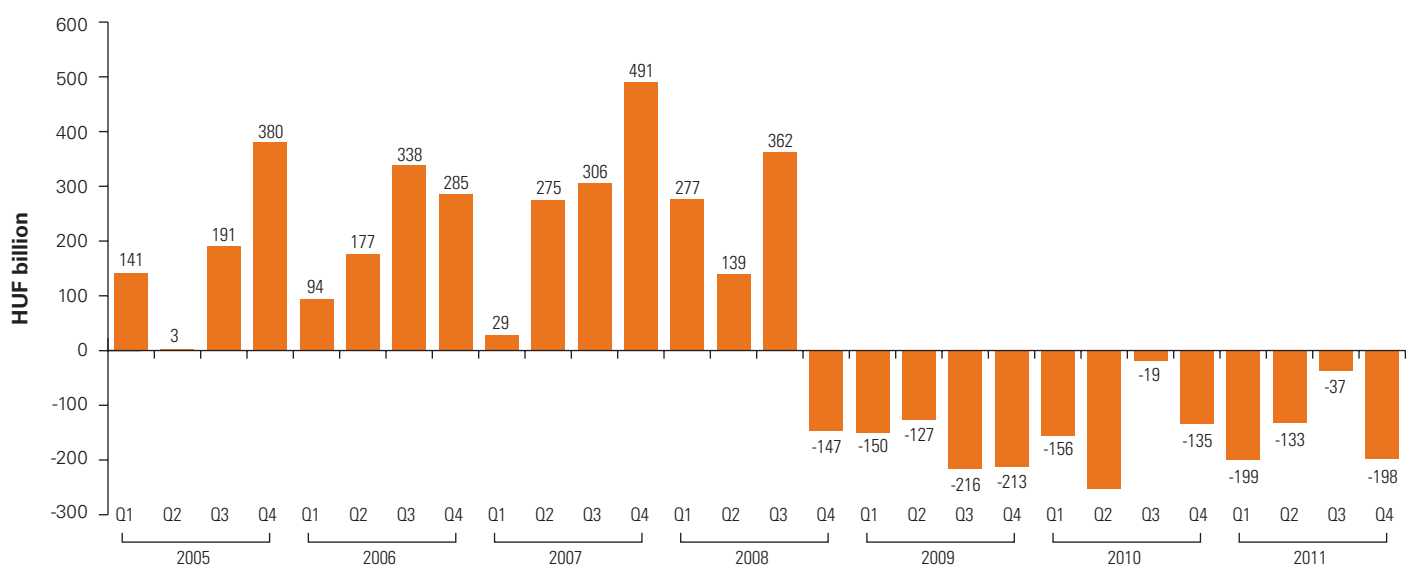
For the banking sector, the difficulties of the past year are often related to three main factors. First, loan portfolio quality continues to deteriorate, particularly in the corporate loan sector. Secondly, most banks have seen their profitability seriously affected by the provisioning costs related to the worsening of their loan portfolio quality and the extra burdens being placed on the banking sector by the government. The third factor, as

noted in the introduction, is the outflow of foreign funds that has accelerated as a result of the less appealing, more risky environment, low profitability and the more intensive shrinking of balance sheets at Eurozone banks.

These factors have led to weaker lending (particularly related to corporate loans) and a larger focus by the banks on streamlining their existing portfolios.

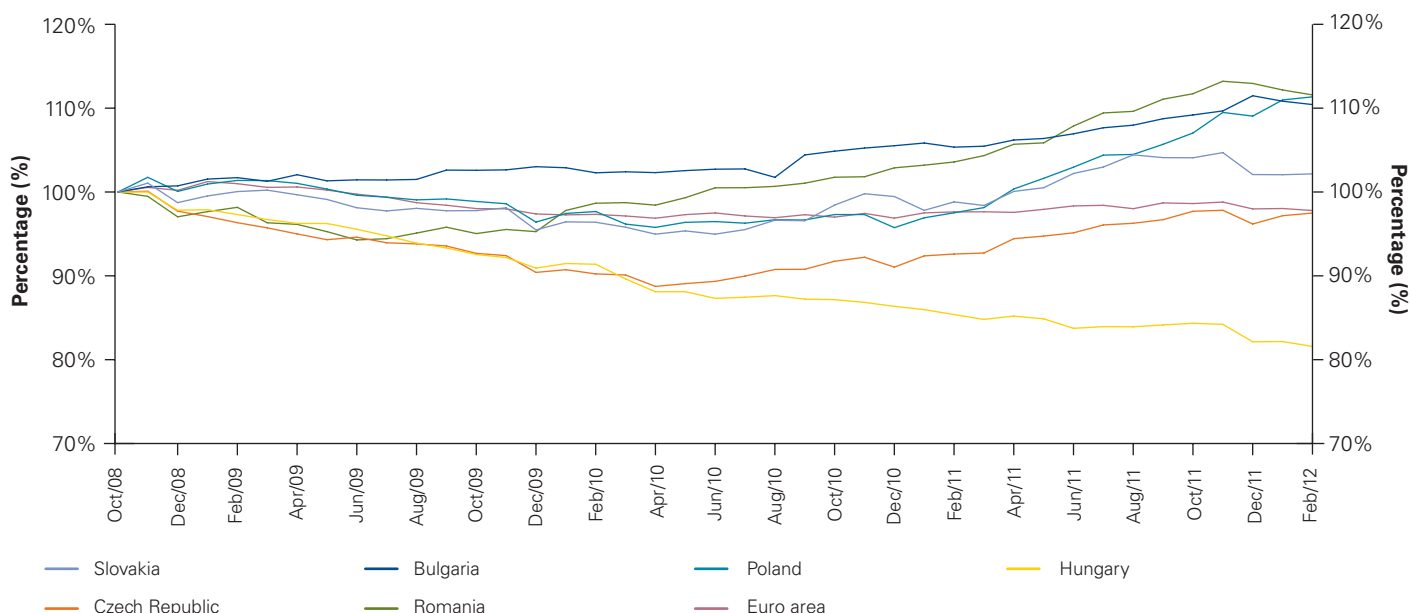
A number of Eurozone banks with smaller operations are either closing their operations or exiting business lines. For the latter, there appears to be healthy demand from more committed players hence several transactions are under way which is a notable change compared to the previous 3 years with no movement in the Hungarian banking M&A market.

Quarterly change of total corporate loans



Source: MNB (National Bank of Hungary), Report on Financial Stability, 04/2012.

Evolution of corporate loans in the CEE (Oct 2008 = 100)



Source: MNB (National Bank of Hungary), Report on Financial Stability, 04/2012.

However, it would appear that banks are still reluctant to write off the value of loans on their balance sheets by accepting significantly discounted prices. And since both buyers and sellers continue to fail to reach agreement on the value of both performing and non-performing loans, the country is now experiencing a static market for Hungarian consumer and commercial debt portfolios.

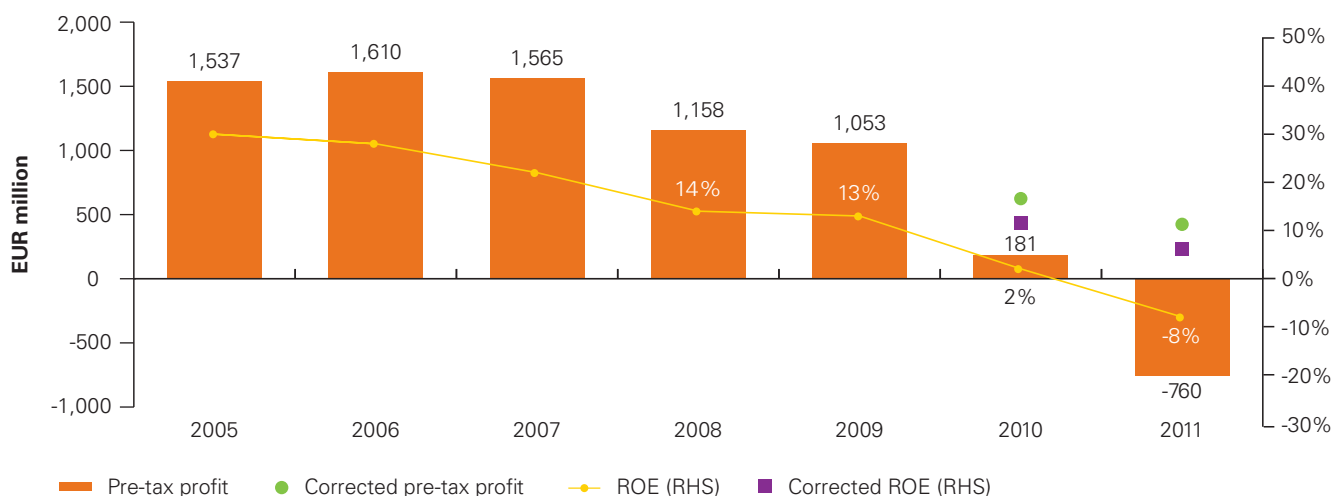
Reduction in profitability and funding

After many years of notable profitability, most Hungarian credit institutions delivered negative results for the 2011 financial year.

"A stagnant economy, an increasing number of liquidations and a banking sector in continuing decline may force banks to look for alternative solutions to clean up their balance sheets."

Norrie Sinclair,
Senior Manager,
KPMG in Hungary

Banking sector performance



Note: Corrected figures show data adjusted to exclude the effect of early repayment scheme and extra bank tax.
Source: MNB (National Bank of Hungary), Report on Financial Stability, 04/2012.

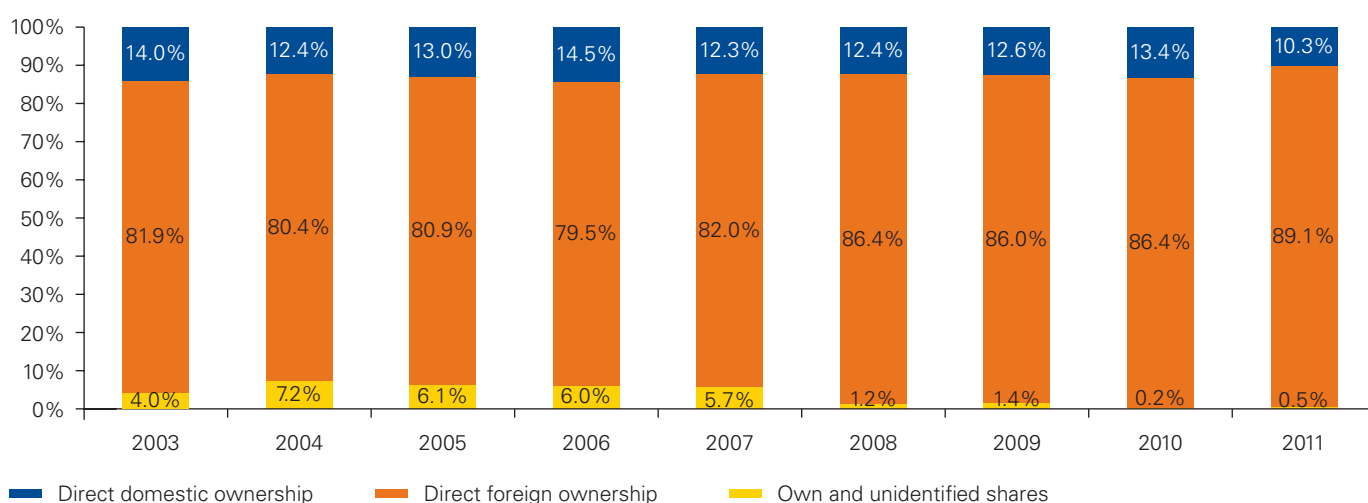
From an operations perspective, banking sector performance has been widely affected by tightening margins and high provisioning costs. Even so, the extraordinary banking tax has been maintained, even while the early repayment scheme on foreign exchange mortgage loans forced banks to take on losses as a result of the devaluation of the Hungarian forint (HUF).

But if the banks continue to deliver losses, they will find it increasingly difficult to comply with capital adequacy requirements, particularly when their (mostly foreign) owners seem reluctant to raise further capital and – instead – are busy extracting funding from Hungary.

This outflow of foreign exchange funding has increasingly forced Hungary's banks

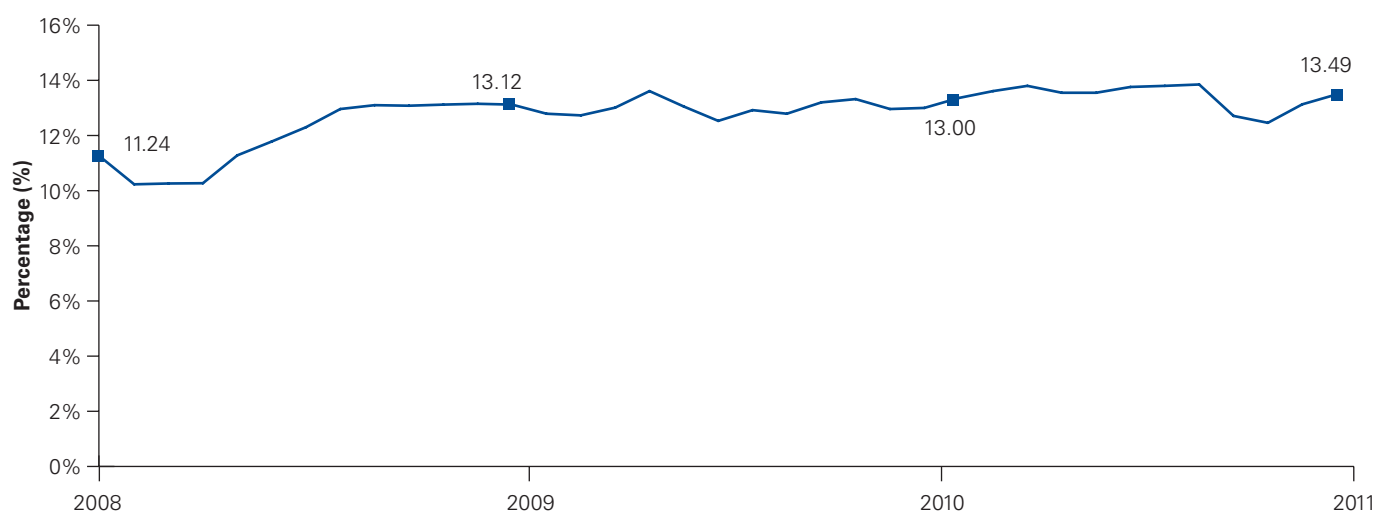
to look to the foreign exchange swap market which not only carries significant market risk, but may also cause liquidity issues, either as a result of the shortening average maturity of financial structures or if the swap market dries up.

Ownership structure of the Hungarian Banking sector



Source: PSZÁF (Hungarian Supervisory Authority).

Capital adequacy ratio



Source: MNB (National Bank of Hungary).

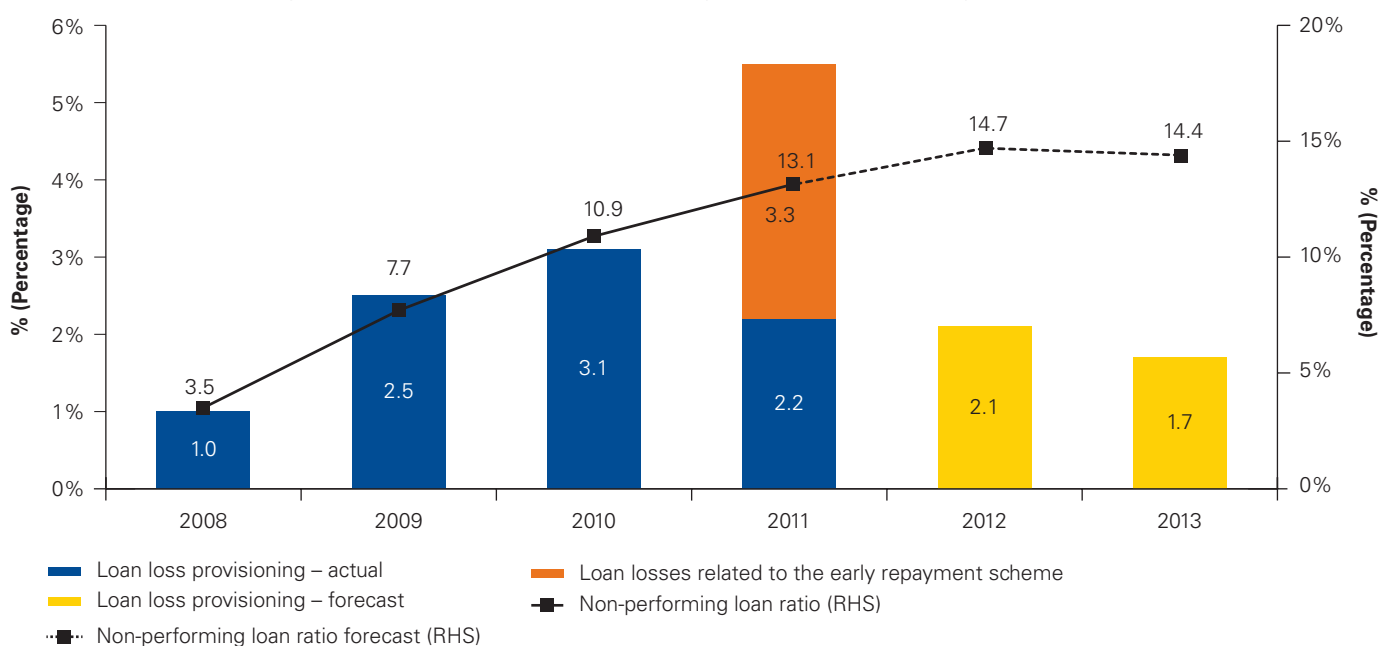
Given the current economic environment, it seems likely that liquidity difficulties and the pressure from supervisory authorities regarding capital requirements may actually encourage banks to decrease their credit exposures which, in turn, may reduce their expectations on applied multiples and potentially stimulate the debt portfolio sales market.

Status of loan portfolios

The past two years have seen an acceleration in the deterioration of the banks' loan portfolios which has resulted in increased provisioning costs even while new lending remains depressed by the economic environment. This has led to unfavorable dynamics in NPL

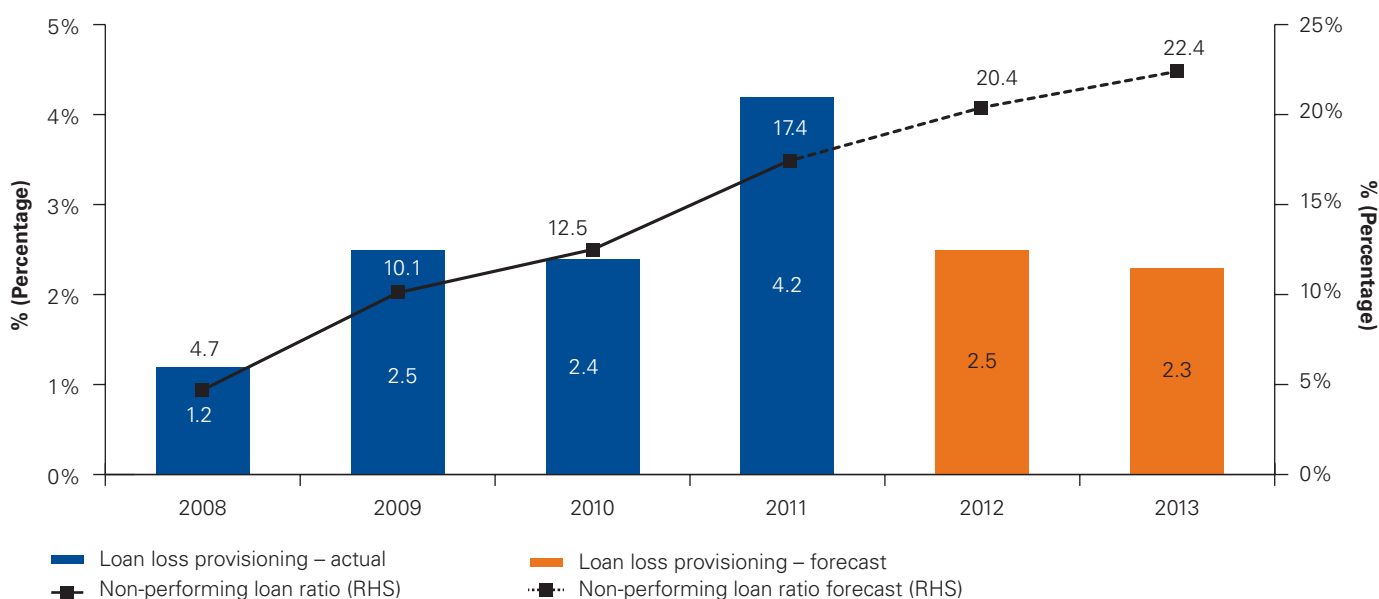
ratios, largely due to good loans being repaid while reinvestment remained limited. This decrease in portfolio quality is likely to continue – albeit at a slower pace with moderate relative provisioning – according to the National Bank of Hungary.

Ratio of non-performing loans and the cost of provisioning in the household segment



Source: MNB (National Bank of Hungary), Report on Financial Stability, 04/2012.

Ratio of non-performing loans and the cost of provisioning in the corporate segment



Source: MNB (National Bank of Hungary), Report on Financial Stability, 04/2012.

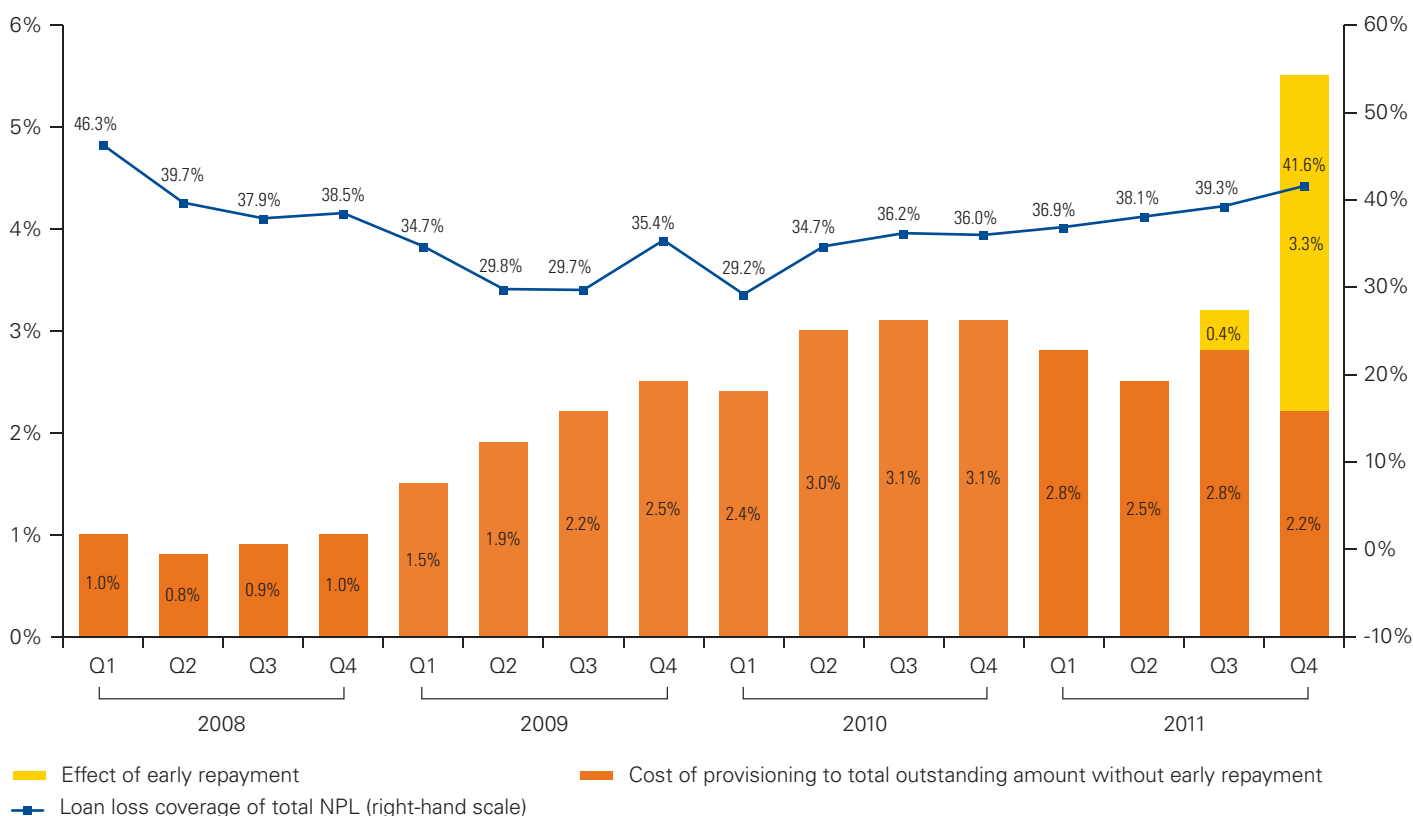
The reality is that the average NPL coverage has been gradually increasing for both retail and corporate loans since the beginning of 2010. And while the coverage ratios hugely vary depending on the market participant (particularly in the

corporate banking segment), provisioning for loan losses has been extended in both segments.

It is also worth noting that the early repayment scheme has caused

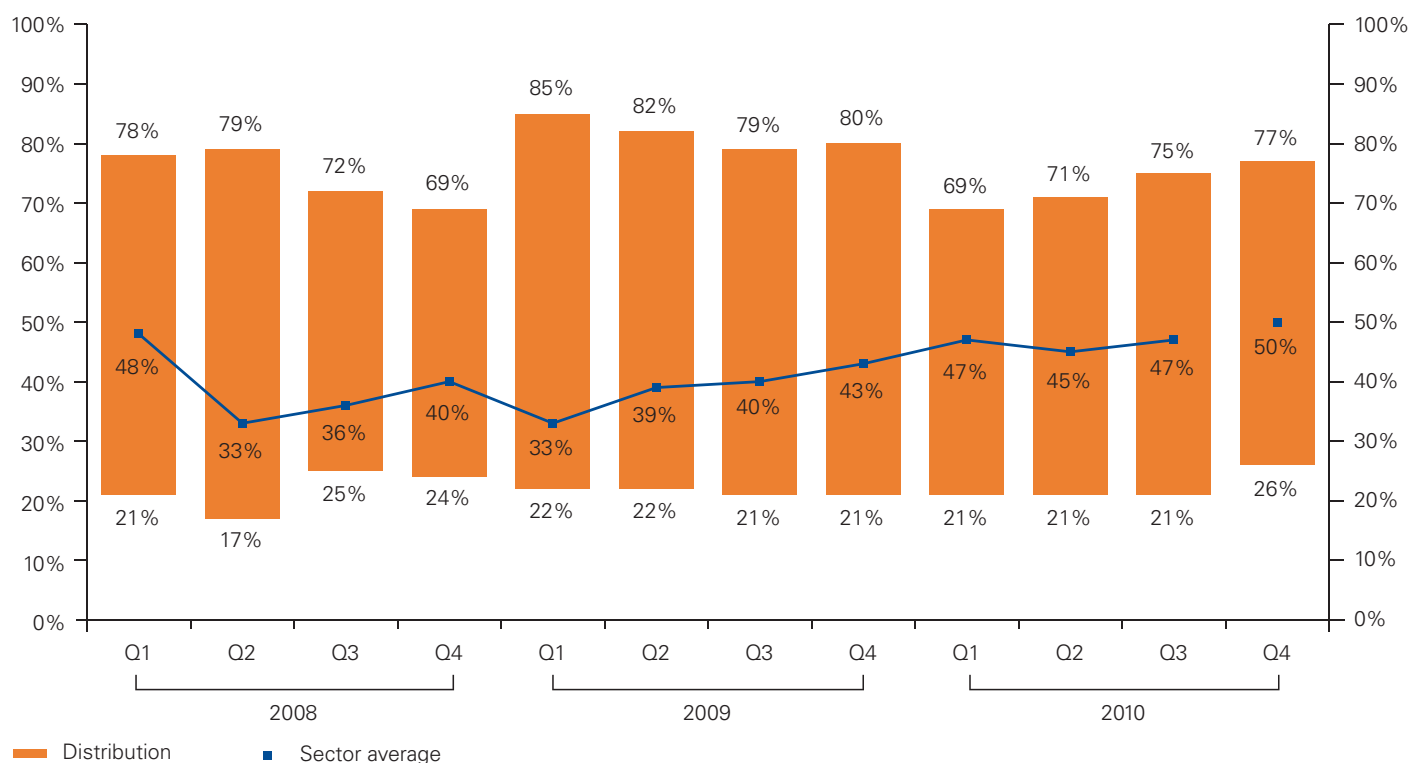
immediate and significant losses within the household segment, while in the corporate segment, it is weak economic growth that is currently delaying portfolio recovery.

Ratio of cost of provisioning to total loans (12 month rolling average) and loan coverage ratio in the household segment



Source: MNB (National Bank of Hungary), Report on Financial Stability, 04/2012.

Loan loss coverage of corporate loans in the banking sector



Source: MNB (National Bank of Hungary), Report on Financial Stability, 04/2012.

Outlook of portfolio sales market

While the Hungarian portfolio sales market is clearly small scale, there have been a number of small deals (in the range of EUR1 million to EUR5 million) carried out annually over the past four years.

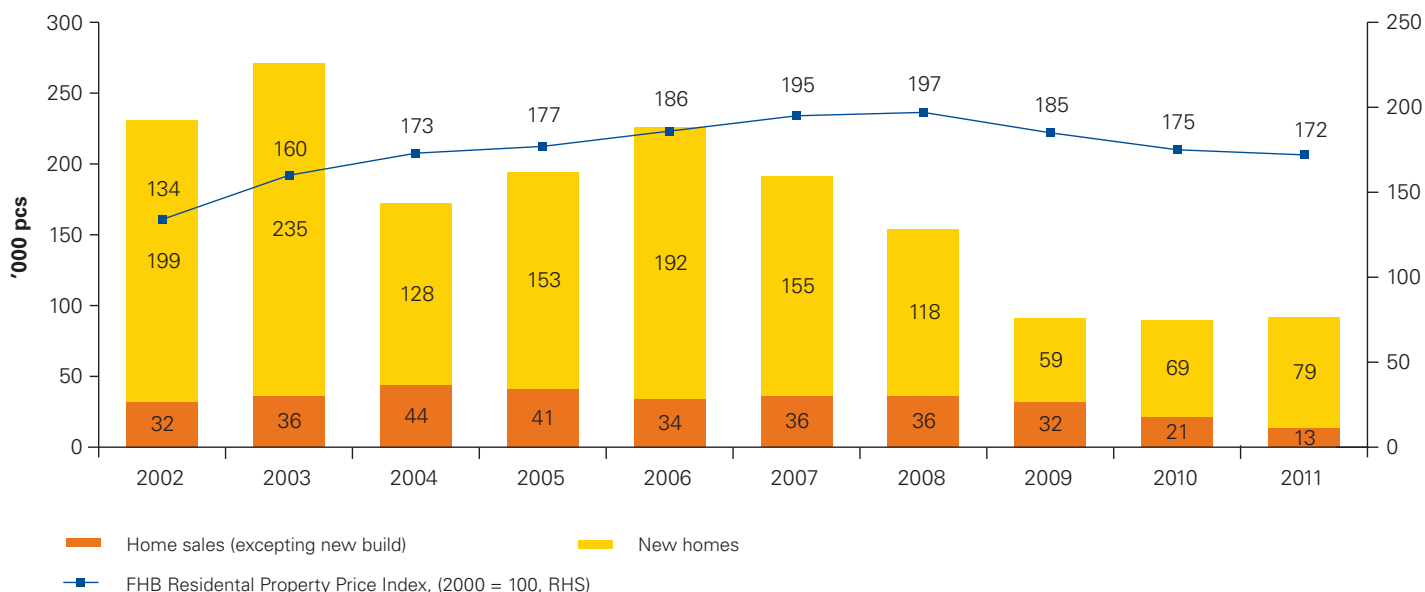
There is, however, little sign of movement in the retail portfolio sales market and the collection of non-

performing mortgages continues to pose some of the greatest challenges for the retail banking sector. Indeed, while the demand-driven property market continues to stagnate, the number of homes with loans categorized as 'non-performing' has already exceeded yearly turnover.

And, as the stock of residential property sales deemed enforceable continues to rise, the government has introduced a quota system which allows

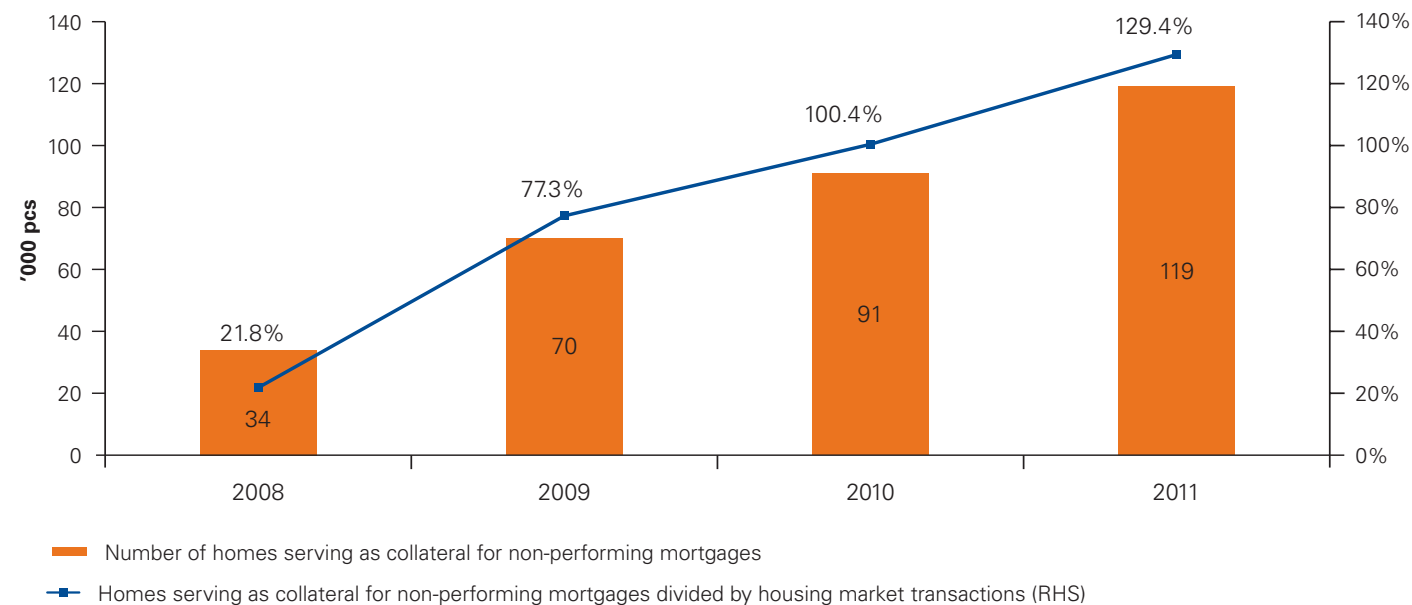
for a gradually increasing number of properties to be sold in each quarter (3 percent in each quarter of 2012, 4 percent in 2013 and 5 percent in 2014). And while this will likely make retail mortgage portfolios less appealing from a buyer's perspective, the measure will prevent turmoil in the residential market which, left unchecked, would lead to significant downward pressure on property prices.

Residential property market



Source: MNB (National Bank of Hungary), Report on Financial Stability, 04/2012.

Residential property market is expected to become even more saturated by enforced sales of domestic real estate



Source: MNB (National Bank of Hungary), Report on Financial Stability, 04/2012.

In the corporate segment, few banks favor lending to SMEs due to their general lack of transparency and high potential risk factors. As such, SME lending will likely continue to remain linked to international and government programs.

Non-performing project loans and loan-to-value based loans also continue to cause headaches for the banking sector with many projects failing to complete as a result of the economic downturn and the underlying collateralized assets of the LTV loans falling short of their original value.

But while many banks would likely consider disposing of these loans, they face little market demand and largely unpalatable prices.

Conclusion

Looking ahead, the Hungarian debt sales market will continue to feel the effects of the ongoing crisis

within the European banking sector, which largely finances Hungary. But while the banking sector seems to be coming under increasing stress, foreign shareholders seem ready to recapitalize rather than see their hard-earned market shares go for a song. However, the simple truth is that – even if they did decide to pull the plug – there are hardly any investors looking to take on substantial banks at this time, particularly in an environment where business plans can simply be rewritten every other week.

Indeed, the gap in price expectations on portfolio sales is such that it would require a sea change of perspective to catalyze the market. The bottom line is that – for the time being – bank managers would prefer to sit it out rather than realize a loss of value on their portfolios.

Sources:

- 1 National Bank of Hungary (MNB): Report on Financial Stability, 11/2011 and 04/2012, http://english.mnb.hu/Kiadvanyok/mnben_stabil
- 2 Banking database of the Hungarian Supervisory Authority (PSZÁF), http://www.pszaf.hu/en/left_menu/pszafen_publication/creditdata.html
- 3 Raiffeisen Research: CEE Banking Sector Report - Banking Sector Convergence 2.0, 10/2011, <http://www.rb.cz/en/financial-markets/research/>
- 4 KPMG Corporate Lending Sentiment Index, May 2012, KPMG in Hungary

Introduction to **Africa**



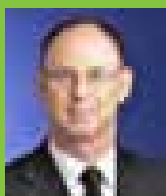
The debt sales market in Africa is – as always – a complex story to tell. Throughout most of Africa's 54 independent countries, debt sales is often an opaque and ad-hoc experience that provides opportunities to only the most intrepid of investors. However, in Nigeria and South Africa – two veritable anchors of the African economy – the debt sales market has been rather positive. Indeed, our experience shows that investors are increasingly looking at these two markets as a secure spring-board upon which to enter the continent.

In some ways, Africa has been shielded from the worst symptoms of the global economic crisis and ensuing sovereign debt crisis. In large part, this is because the trade volumes and FDI coming from the developed markets have always been rather low, allowing many markets to remain somewhat insulated from dropping productivity rates and the souring investment environment.

South Africa, in particular, has benefited from a strong financial system and regulatory regime that has left its banks well-capitalized, liquid and independent. Nigeria, while taking a dramatically different path, has also now arrived at a place where its banks now exhibit strong growth prospects, consolidated debt exposures and low levels of non-performing loans (of course, this required the government to step in to recapitalize certain banks, consolidate others and take over a few).

Of course, one impact of the ongoing financial crisis is that the appetite of potential and existing investors for assets in what are perceived to be 'riskier markets' has fallen as investors look for safe havens. Should the crisis continue in the medium-term, Africa's markets may not be able to withstand the pressure and may see an overall dampening of the market.

As for the rest of Africa, there are signs that maturity may soon be coming to their markets. South African banks (and to some extent Nigerian ones) are rapidly expanding into the continent and – with them – are bringing a more sophisticated approach to debt origination, collections and sales.



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Nigeria

The Nigerian banking sector: Milestones, outlook and opportunities

Government consolidates banking reform efforts

As the Nigerian government continues to implement policy measures aimed at stabilizing the banking sector and positioning it for growth, the sector is now showing signs of recovery in terms of solvency, liquidity and asset quality.

Following the successful acquisition of non-performing loans worth USD2.68 billion,¹ the Asset Management Corporation of Nigeria (AMCON) injected USD1.17 billion¹ into the affected banks through the issuance of zero coupon bonds with the objective of recapitalizing eight troubled banks to zero Net Asset Value in the hopes of making them more attractive to potential investors.

¹ AMCON, April 2012

As a result, the industry has started attracting increased investment by local and foreign players.



As a result, five of the banks have now been acquired, which has sparked a wave of merger and acquisition activity

in the Nigerian banking industry. Indeed, between 2010 and 2012, the industry attracted more than USD1.5 billion²

in private capital, indicating improved investor confidence in the industry. (Please see the table below).

Schedule of loans acquired by AMCON

Transaction date	Nature loans purchased	Loan value (US\$'bn)	Purchase price paid (US\$'bn)
31 December 2010	All banking sector margin loans and all NPLs of intervened banks	15.9	5.6
6 April 2011	Non-Margin NPLs acquired from 22 Nigerian banks	4.4	2.4
28 December 2011	Systemically important loans and repricing of acquired loans	5.7	3.3
Total		26.0	11.3

Source: AMCON, April 2012.

Analysis of M&A activities in the Nigerian banking sector – 2011

Target bank	Stake	Strategic investors	Status of acquirers	Mode of consolidation	AMCON's capital contribution (US\$'m)	Strategic Investors' consideration (US\$'m)
Oceanic Bank	100%	ETI	Pan African bank	Acquisition	1,333	366.6
Intercontinental Bank	75%	Access Bank	Nigerian bank	Acquisition	973	333.3
FinBank	100%	FCMB	Nigerian bank	Acquisition	1,037	40
Union Bank	60%	ACA	Private equity	Acquisition	1,593	750
Equatorial Trust Bank	100%	Sterling Bank	Nigerian Bank	Merger	NPA	NPA

Source: AMCON, Afrinvest, FSDH Banking Industry Report (Dec 2011) and Securities and Exchange Commission.
NPA: Not publicly available.

However, three of the banks were unable to find suitable investors by the 30 September 2011 deadline set by Central Bank of Nigeria (CBN), and were therefore taken over by the Nigeria Deposit Insurance Corporation (NDIC) through a purchase that included the assumption of all their assets and some of their liabilities. From these

assets, the NDIC went on to form three new bridge banks: Mainstreet Bank Limited (formerly Afribank); Keystone Bank Limited (formerly Bank PHB); and Enterprise Bank Limited (formerly Spring Bank). AMCON subsequently acquired a 100 percent equity stake in the bridge banks from NDIC for USD4.9 billion¹ and recapitalized them

to minimum regulatory capital levels. (See table above)

In addition, AMCON also acquired a set of syndicated loans (worth USD1.9 billion)³ from selected banks which, due to their size, were considered to have the potential to pose systemic risk to the banking sector.

¹ AMCON, April 2010

² FSDH Nigerian Banking Industry Review, December 2011

³ RenCap Report on Nigerian Banks, February 2012

Schedule of nationalized banks – August 2011

Nationalized banks	Stake	New names	Amt. (USD – Millions)
Bank PHB	100%	Keystone Bank	1,979
Afribank	100%	Mainstreet Bank	2,124
Spring bank	100%	Enterprise Bank	809
Total amount injected			4,912

Source: AMCON, April 2012.

From recovery to growth

The measures introduced by the government have largely been successful and have impacted positively on the banking industry; Nigerian banks are now stronger and compare fairly with banks in other emerging markets in terms of risk management, capital base and corporate governance. Moreover, the full adoption of IFRS by Nigerian banks for the purpose of financial reporting is expected to result in improved transparency in the sector. And, according to recently published 2011 financial results, most banks recorded robust earnings and improved asset quality.

As a result, the industry has started attracting increased investment by local and foreign players. For example, JP Morgan recently announced its proposed entrance into the sector, while International Finance Corporation (IFC) has made equity and debt investments in GT Bank Plc.

Sector outlook and opportunities

The CBN has also announced that – through a technical partnership with the IMF and World Bank – a second round of stress testing will be carried out to assess the health of Nigeria's existing banks.⁴ This announcement will likely prompt banks to conduct a self-check in order to internally assess their readiness as they prepare for the test.

The second round stress tests may catalyze further consolidation and should help highlight the attractiveness of Nigerian Banks to foreign investors who may be seeking investment opportunities in the Nigerian market.

With AMCON's sale of the nationalized banks expected to be completed in 2014, we expect to see a deepening of the market and the creation of some attractive opportunities for prospective players or foreign investors.

The second round stress tests may catalyze further consolidation and should help highlight the attractiveness of Nigerian Banks to foreign investors who may be seeking investment opportunities in the Nigerian market.

⁴ Nigerian Business Day Newspapers, 2012



South Africa



The South African banking sector: Robust and extending their African footprint

As the global economic downturn wreaked havoc around the world, South Africa's banking institutions remained resilient, thanks largely to its robust and well-regulated financial sector. Indeed, according to the World Economic Forum's Global Competitiveness Report of 2011-2012, the country's banking industry stands out as a beacon of

stability (see table below): South Africa placed 4th out of 142 countries for financial market development (indicating high confidence at a time when trust is proving increasingly fragile) and 50th overall (ranking the market highest in Sub-Saharan Africa and second among the BRICS economies).

Selected competitiveness indicators

Indicator	Rank/142
Regulation of securities exchanges	1st
Strength of auditing and reporting standards	1st
Soundness of banks	2nd
Efficacy of corporate boards	2nd
Availability of financial services	3rd
Protection of minority shareholders	3rd
Financing through local equity market	4th

Source: WEF Global Competitiveness report 2011-12.

Confidence in the country's banking sector has been reflected locally in an improved financial services index which has mainly been driven by strong net profits for the retail banking sector on the back of high income growth. At the same time, a number of reports indicate that local confidence in the investment banking sector has also grown in the past few years as a result of increased trading volumes. That being said, there are now

growing concerns that a prolonged economic slowdown may result in reduced demand from developed economies (particularly Europe), continued business uncertainty and a decrease in expenditure which will likely hamper deal flow and slow financing.

The ongoing global economic environment is also – to some extent – reducing the appetite of potential and

The ongoing global economic environment is also – to some extent – reducing the appetite of potential and existing investors for assets in (what some perceive as being) riskier emerging markets, resulting in a movement of assets to safer investment environments.

existing investors for assets in (what some perceive as being) riskier emerging markets, resulting in a movement of assets to safer investment environments. This trend is being further compounded by the European debt crisis which has dampened demand for South African exports from what has traditionally been the country's biggest trading partner. As a result, the country's currency has recently experienced increased volatility.

South Africa has also seen strong developments on the regulatory front and is currently the only country in Africa actively implementing the Basel III capital requirements which will be phased in over a five year period starting in 2013. This has led the domestic

banking sector to focus heavily on core equity capital and has catalyzed the phasing out of hybrid debt instruments in favor of approved instruments such as Contingent Capital (CoCo) bonds which – as a new and developing global sector – have few international examples

to emulate. But while the market will inevitably face challenges, the country's banking sector remains stable and on track to meet the Basel III requirements by the inception date (see table below).

Key financial soundness indicators

Indicator (% , unless otherwise indicated)	July-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11
Market share (top four banks*)	84.75	84.35	83.96	84.06	83.84	84.07
Capital adequacy						
Capital-adequacy ratio	14.92	15.06	14.84	14.89	14.94	15.09
Regulatory Tier 1 capital to risk-weighted assets	11.97	12.13	11.96	12.03	12.20	12.22
Credit risk						
Gross loans and advances (R billions)	2,368.00	2,424.00	2,428.00	2,448.00	2,499.00	2,516.00
Impaired advances (R billions)	130.04	128.20	122.62	120.07	120.10	118.06
Impaired advances to gross loans and advances	5.49	5.29	5.05	4.90	4.81	4.69
Specific credit impairments (R billions)	42.58	42.24	42.23	41.40	40.99	41.17
Specific credit impairments to impaired advances	32.74	32.95	34.44	34.48	34.13	34.87
Specific credit impariments to gross loans and advances	1.80	1.74	1.74	1.69	1.64	1.64
Profitability						
Return on assets (smoothed)	1.05	1.07	1.12	1.13	1.13	1.15
Return on Equity (smoothed)	15.06	15.30	15.92	16.16	16.03	16.38
Interest margin to gross income (smoothed)	48.86	48.81	49.04	49.08	49.70	50.34
Operating expenses to gross income (smoothed)	56.82	56.68	55.90	55.67	56.02	55.20
Liquidity						
Liquid assets to total assets (liquid-asset ratio)	8.25	8.18	8.20	8.39	8.33	8.31
Liquid assets to short-term liabilities	16.89	16.88	16.97	17.42	17.18	16.58
Effective net open foreign-currency position to qualifying capital and reserves	-0.06	0.30	0.78	-0.43	0.14	0.78

*ABSA group limited, The Standard Bank of South Africa Limited and Nedbank, First Rand Limited.
Source: South African Reserve Bank. Data on share prices were obtained from the JSE Limited.

It is worth noting that the sector's capital adequacy ratio currently sits at approximately 15 percent which is far beyond the minimum requirement of 9.5 percent, and that the Regulatory Tier 1 capital to risk-weighted assets ratio has also steadily increased. Towards the end of 2011, the return-on-assets and return-on-equity ratios also followed an upward trend on the back of higher fee

income, the write-back of provisions, as well as a decrease in impaired debts of roughly ZAR12 billion over the six month period. As a result, liquidity in the sector has remained stable and at fairly high levels under the existing regulations.

Indeed, by the end of 2011, South Africa's largest banks were well capitalized, producing acceptable returns and coping well under the tough

global financial circumstances, with limited exposure to the sovereign debt crisis gripping most of Europe.

Despite the seemingly healthy state of the country's banking sector, however, South Africa's sovereign debt rating was revised to a negative outlook on 10 November 2011, after being placed under review by Moody's Investor Service. And while the findings of the

review credited the country's enabling macroeconomic conditions, the sector's adequate capital buffers, steady profitability and decrease in impaired loans, the ratings were weighed down by certain perceived concerns such as funding and liquidity challenges (resulting from a reliance on short-term wholesale deposits), increased credit risk in the retail sector and weak loan growth.

Moody's also posited a view that South Africa faced constrained public finances which, it argued, may strain

the ability of authorities to provide extended financial support to a number of financial institutions. In turn, this led to the downgrading of the senior debt and deposit ratings of the country's five largest banks⁵ by one notch on 28 February 2012.

However, the credit exposure of these five banks to the economies of Greece, Italy, Ireland, Portugal and Spain (GIIPS) as a percentage of total gross credit exposure amounted to a mere 0.13 percent in the fourth quarter of

2011. Moreover, the banks' exposure to direct sovereign debt is negligible with most holding only derivatives with banks and private-sector non-bank counterparties with legal jurisdiction in the GIIPS countries.

Sectoral distribution* of credit

Sector	Jun-11	Sep-11	Dec-11
Agriculture, hunting, forestry and fishing	1.77	1.66	1.73
Mining and quarrying	3.41	3.70	3.69
Manufacturing	4.25	4.14	4.25
Electricity, gas and water supply	0.87	0.78	0.85
Construction	1.30	1.21	1.18
Wholesale and retail trade, hotels and restaurants	3.97	3.69	3.92
Transport, storage and communication	3.36	3.29	3.40
Financial intermediation and insurance	22.83	26.36	25.20
Real estate	6.52	6.34	6.35
Business services	3.61	3.40	3.69
Community, social and personal services	5.60	5.46	5.38
Private households	36.07	33.86	34.35
Other	6.44	6.10	6.01
Total**	100.00	100.00	100.00

* The classification of credit exposure according to the sectors or industries is based on the directives and industries specified in the Standard Industrial Classification of all Economic Activities.

** Figures do not necessarily add up to 100 due to rounding.

Source: South African Reserve Bank.

Looking ahead, the South African banking industry is clearly keen to further expand their respective footprints on the African continent: Standard bank – which is already active in 17 African countries – aims to quadruple its branch network in Angola by the end of this year; ABSA Bank, trailing its peers in this regard, intends

to use Barclays to lead its African expansion and has expressed interest in pursuing investments in Zambia and Kenya; FirstRand is considering investment opportunities in Ghana and Nigeria; and while Nedbank is mulling the option of acquiring a 20 percent stake in its strategic partner, Ecobank, a pan-African banking conglomerate

based in Togo and active mainly in West and Central Africa.

The public sector has also indicated its interest in investing deeper into the African continent with South Africa's Public Investment Corporation (PIC) – the agency responsible for investing government pension funds – purchasing a 20 percent stake in Ecobank in April 2012.

5 ABSA Group Limited, the Standard Bank of South Africa Limited, Nedbank, First Rand Limited and Investec.

Unsecured retail credit

By December 2011, the total gross unsecured credit exposure of South Africa's six major banks amounted to ZAR334.9 billion (USD41 billion), while total gross unsecured credit exposure as a percentage of total gross credit exposure sat at approximately 8 percent. This includes the banks' exposure to unsecured lending in the form of credit card lending, overdrafts, personal loans and financing provided to SMEs.

The banks' year-on-year growth in credit risk exposure to unsecured lending was 11.3 percent in December 2011, with the highest growth being felt in the two 'retail other' categories, namely exposures greater than R30 000 (which grew at 39.8 percent to ZAR16.7 billion or USD2.05 billion), and exposures less than or equal to R30 000 (which grew at 15.6 percent to ZAR7.9 billion or USD967 million). Annual growth in the 'retail revolving credit' category amounted to just 5.4 per cent (to ZAR8.2 billion or USD1 billion).

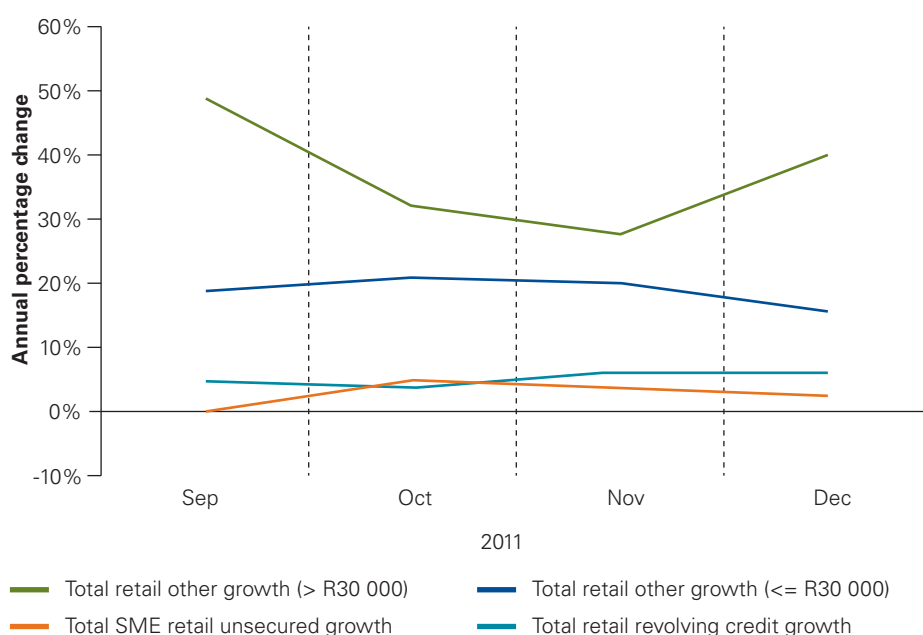
That being said, the South African Reserve Bank does not see unsecured lending as a current threat to the financial system, as it believes that the banking sector carefully manages its exposure to unsecured lending by following well established models. But while the Reserve Bank does not currently deem unsecured lending as a 'bubble', it is continuously monitoring the situation.

Unsecured credit exposure of banks remains at less than 10 percent of total gross credit exposure.

The National Credit Act

South Africa enjoys highly advanced legislation regulating its retail lending and its debt collection industries, with the National Credit Regulator (NCR) enforcing the National Credit Act (NCA) and responsible for the registration of industry participants such as credit providers,

Growth in selected categories of unsecured lending



Source: South African Reserve Bank.

* The categories 'retail other' and 'SME retail' are based on a survey of six banks that are prominent in the unsecured credit market.
 ** The 'retail revolving credit' category is based on the exposure measured using the advanced credit risk based approaches of the four largest banks in the sector.

*** The major part of 'retail revolving credit' consists of exposure to credit card lending and overdrafts.

credit bureaus and debt counselors as well as the investigation of complaints.

The impact of this regulation should be carefully considered by any party seeking to buy distressed debt in South Africa or interested in purchasing retail loan portfolios, as the regulations can influence the collection process for these loans.

Corporate retail lending

With a strong liquidity profile, the corporate sector has clearly demonstrated its stability through the recent financial crisis, a fact reflected in the associated credit default swap spreads (see Figure 2 below). But while Moody's agreed, the ratings agency also felt that the domestic corporate sector might be left vulnerable should the sovereign debt crisis in Europe have a global spillover effect, which could

potentially force a reduction in corporate lending by domestic banks.

Moody's also noted that a large number of South African corporations will have large debt maturities falling due over the short- and medium-term and – as a result – the agency advised that it would be prudent to proactively manage this (particularly for corporations with speculative grade profiles) or risk the potential for negative rating actions through 2012.

Recent key indicators for the corporate sector in South Africa suggests that bank credit granted increased throughout 2011, while gross fixed capital formation maintained a steady growth trajectory. And while profitability contracted during the second and fourth quarter of 2011, the trend remained largely positive.

South African corporate sector credit default swap spreads



Source: Bloomberg.

Selected indicators for the corporate sector

Indicators (annual % change, unless otherwise indicated)	Q4	Q1	Q2	Q3	Q4
Bank credit granted*	1.00	2.60	3.20	5.00	8.10
Gross fixed capital formation**	6.60	7.60	6.80	7.50	8.40
Credit as a percentage of GDP	45.00	44.90	45.20	46.90	47.90
Credit as a percentage of annualised profits***	160.00	156.10	130.70	131.60	151.00
Net operating surplus****	18.80	17.30	7.40	21.90	14.60

*Bank credit to the corporate sector in this case includes instalment sale and leasing finance, mortgage advances, overdrafts, credit card debtors and other loans advances.

** Gross fixed capital formation at current prices (seasonally adjusted rates) is used as a proxy for investment by private business enterprises.

*** Bank credit to the corporate sector and net operating surpluses of corporations were used as proxies for corporate debt and for corporate profit.

**** Gross operating surplus minus depreciation (seasonally adjusted rates).

Source: South African Reserve Bank.

It is worth noting that the corporate sector has generally increased its deposits with financial institutions and had largely held off on initiating new projects as a result of both the lingering global economic climate and the sluggish domestic business confidence level. But while corporate sector deposits with banking institutions reached a high of almost ZAR540 billion (USD66.1 billion) in December 2011 (representing a growth rate of 14.2 percent y-o-y), levels fell somewhat to about ZAR520.5 billion (USD63.7 billion) by February 2012.

Concluding thoughts

Overall, South Africa enjoys a well-developed financial sector with strong growth prospects in both the pan-African market and in unsecured lending. This stability, when combined with the sector's sophistication and the country's legal framework, makes South Africa a viable gateway into the rest of the continent (despite the sometimes large geographic distances involved).

Introduction to the **Americas**



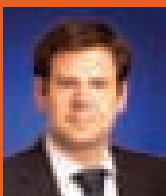
Across the Americas, there are growing signs that – barring another economic meltdown – debt sales markets are heating up, particularly in North America. In the US market (a bellweather jurisdiction for the global market), activity was expected to pick up at the end of 2012 and through 2013. In part, this is being driven by a large volume of maturing debt, improving capital and debt financing markets and the slow convergence of bid/ask prices. But regulatory pressures will also force many US and foreign banks to offload portfolios in order to meet or maintain their capital ratio requirements.

The US regulatory environment is also influencing the markets in other jurisdictions. In Canada, for example, the five major banks are – on the whole – well capitalized and fairly shielded from the challenges in the European market. But while they have been increasingly active in purchasing distressed assets (particularly within the emerging markets), there is concern about the impact of changing regulation in the US which may be dampening cross-border deals between the two nations.

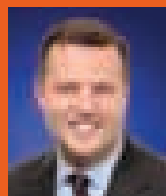
For its part, Mexico seems to be on the cusp of further growth in sales volumes over the next year or more as the inventory of mortgage loans and commercial loans continues to grow by double digits (CAGR), and buyers and sellers both become more sophisticated in their approach to deal structuring.

South America, on the other hand, offers a much more mixed bag. In the high growth market of Brazil, the pace and volume of debt sales seems to be continuing unabated. Indeed, with heightened credit expansion, an increasing stock of NPLs and record high default rates, there are notable indications that the market will – if anything – pick up pace in 2013.

But outside of the high growth markets, the debt sales environment seems positively sedate with little activity having been recorded across the region over the past year. In part, this seems to be due to a reluctance on the part of the banks to sell their portfolios. However, in a number of cases – such as that of Argentina – lowering levels of bad loans and a steady increase in banks' net incomes has somewhat tempered any urgency to jettison questionable portfolios.



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The United States

Introduction

After years of disappointing sales volumes, there is growing consensus that 2013–2014 could finally be the breakthrough years for US distressed loan portfolio transactions. Pundits point to a slew of factors that will drive activity over the next two years: a large volume of debt coming due in a challenging refinancing environment,

a sense of urgency within the investment community to deploy its available capital in the near-term, the increased regulatory pressures on banks, and the convergence of bid-ask spreads. That being said, several financial institutions have – until now – managed to extend maturities with various degrees of success.

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Potential drivers of transaction activity

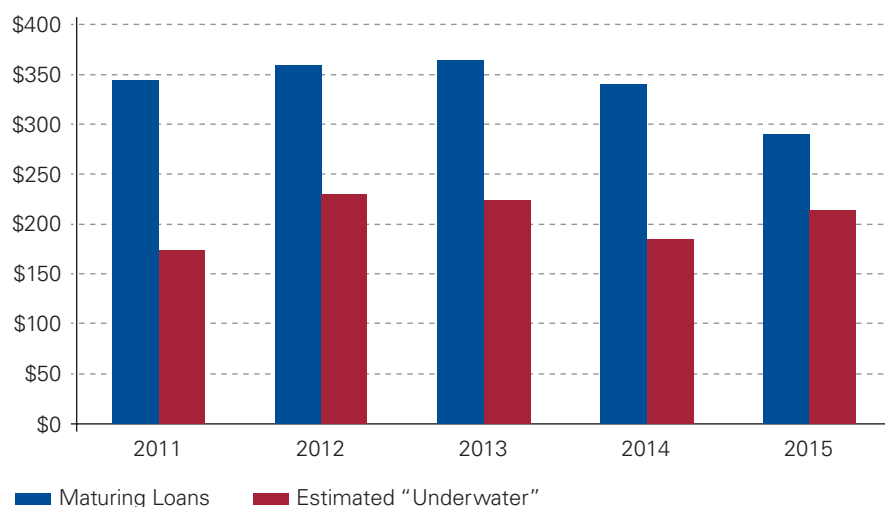
Maturing Debt

According to Trepp, a US-based CMBS analytics firm, around USD350 billion worth of Commercial Real Estate (CRE) loans matured in 2011, with another USD362 billion and USD370 billion scheduled to mature in 2012 and 2013, respectively. It is worth noting, however, that (based on the revised data from the fourth quarter of 2011) the amount of loans maturing in 2012 was actually revised up from an initial estimate of USD340 billion, clearly indicating that further additions to the volume of available loans for sale are likely in the medium-term, particularly if market conditions fail to improve markedly.

But in spite of the large volume of loans maturing, several banks have so far been reluctant to sell loan portfolios due to the belief that extending maturities may heighten their potential net present value. As a result, there is still considerable distress in the market. Indeed, according to a Delta Associates Journal report, distressed commercial real estate in the US totaled USD166.9 billion at the end of January 2012.

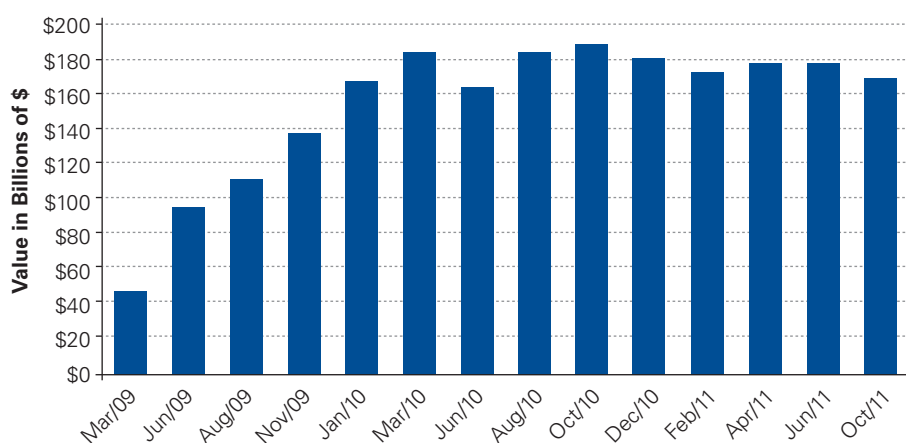
With a large portion of commercial mortgage loans typically not self-amortizing, many will require a balloon payment upon maturity. But in the current market environment, lenders seem to have little appetite for the risk resulting from these highly leveraged loans. Indeed, given that the five-year loans maturing in late 2012 were originated during the height of the real estate bubble, some may face very limited refinancing options. This situation is further complicated by the fact that the universe of lenders has also been shrinking (take, for example, the European banks who have – for the most part – stopped underwriting loans in the US), and it becomes clear that not all of these loans are likely be refinanced.

Commercial real estate loan maturities 2011-2015 (US\$ billions)



Source: Trepp LLC.

US distressed commercial real estate volume March 2009 – October 2011



Source: Real Capital Analytics, graphic by Delta Associates; October 2011.

Note: Includes properties in default or foreclosure, plus lender REO.

The market has also seen significant volatility over the past year, punctuated by the European debt crisis and the downgrading of US debt. As a result, some lenders are now more eager to find solutions to troubled loans (including their sale), rather than postpone the resolution in the hope that the market will improve in the future as it did in prior quarters and years.

Availability of capital

There is significant capital available for debt purchases in the US. In fact, since 2005, the distressed private real estate funds have successfully raised USD80.3 billion¹ and have been patiently waiting on the side-lines for the right investment opportunities. What is more, these funds have continued to raise new capital in anticipation of material deal flow in 2013. For instance, Blackstone recently announced that it has raised a USD6 billion distressed real estate fund;² Starwood Capital Group raised USD1.2 billion (targeting USD3 billion);³ and Oaktree Capital is seeking to raise a USD4 billion fund dedicated specifically to distressed opportunities.⁴

We have also seen a change in the attitude of several lenders – including Citigroup, Doral Bank, GE Capital, Macquarie Bank and Wells Fargo – who are increasingly willing to finance buyers of distressed assets.⁵ In fact, some commercial banks are actually pursuing loan portfolio opportunities themselves as a means to increase their footprint and/or their asset base (albeit mainly in performing loan portfolios). US Bancorp, for example, recently acquired a USD180 million performing commercial real estate loan portfolio from Eurohypo.

Some of this capital is already being put to good use with a handful of large investors (such as Blackstone and Lonestar) recently deploying a significant amount of funds in a handful of high profile deals. But with only a limited number of quality opportunities, there are still large pockets of undeployed capital, and this has led to an increasing sense of urgency to deploy this capital in the near-term rather than return it back to limited partners, especially in this current low interest rate environment.

Interestingly, a number of existing funds have also managed to get extensions on their investment horizons. For instance, Morgan Stanley Real Estate Fund (MSREF) has secured an extension of an additional year on their MSREF VII vehicle and is still looking to invest USD1.5 billion in real estate backed assets by June 2013⁶ (although this extension did include a number of concessions in terms of fee reductions).

Availability of debt financing

Given the industry's high dependence on leverage, we have recently seen improvements in the US debt market which could result in a further increase in the volume of loan portfolio transactions. A KPMG survey⁷ of investors in real estate and related assets indicated that most buyers are now experiencing fewer obstacles when trying to secure debt financing. In fact, almost 60 percent of respondents to the survey suggested that their access to leverage was either significantly better or somewhat better than the previous year, while 30 percent found that they were experiencing the same access to

debt finance; only 10 percent indicated that their ability to access financing had deteriorated.

However, while lenders may be willing to expand their lending facilities, we have seen a general tightening of the conditions being required by lenders for financing on real estate and loan portfolio deals. Almost 40 percent of respondents to the KPMG survey expressed that the cost of third party debt was either significantly more expensive or somewhat more expensive than in the prior year, with only 13 percent of buyers disclosing that their cost of debt has actually gone down.

This strong demand from investors and increased access to debt financing, combined with the additional mark-downs in banks' loan portfolios and the growing reclassification of assets to 'Held for Sale' status (see graph on page 95), has led buyers to start their bidding at a clearing price on a number of recent transactions. As a result, many banks now have an additional incentive for considering an immediate transaction in the sale of their troubled assets.

Regulatory pressures on banks

The pace of bank closures accelerated in the first half of 2012 with the FDIC closing 40 banks between 1 January and 6 May 2012 (as compared to 92 for all of 2011). With US regulatory agencies continuing to pressure banks to improve their asset quality, we could likely see an increase in troubled asset sales by banks going forward.

1 Preqin, "Distressed Private Real Estate Funding" article dated January 20, 2012

2 Reuters

3 Wall Street Journal

4 Businessweek

5 Commercial Mortgage Alert, January 6, 2012

6 Wall Street Journal

7 2011 Real Estate Market Pulse Survey Report, KPMG in the US

Financial details for last 20 bank closures – as of May 7, 2012

Institution (State)	Date of Failure	Year Established	Total Assets (\$M)	(NPAs+90 PD)/(Tang. Equity + LLR) (%)
BankEast (TN)	1/27/2012	1968	261.95	454.38
First Guaranty Bank and Trust Company of Jack	1/27/2012	1947	397.08	791.90
Patriot Bank Minnesota (MN)	1/27/2012	1998	105.03	486.13
Tennessee Commerce Bank (TN)	1/27/2012	2000	1,009.15	601.11
SCB Bank (IN)	2/10/2012	1891	182.56	549.98
Charter National Bank & Trust (IL)	2/10/2012	1980	92.89	721.01
Home Savings Bank of America (MN)	2/24/2012	1934	434.11	NM
Central Bank of Georgia (GA)	2/24/2012	1910	278.86	404.63
Global Commerce Bank (GA)	3/2/2012	1995	143.68	574.56
New City Bank (IL)	3/9/2012	2003	71.20	390.48
Premier Bank (IL)	3/23/2012	2000	268.70	422.75
Covenant Bank & Trust (GA)	3/23/2012	2006	95.73	641.86
Fidelity Bank (MI)	3/30/2012	1994	818.24	261.42
Fort Lee Federal Savings Bank FSB (NJ)	4/20/2012	2000	48.86	247.46
Palm Desert National Bank (CA)	4/27/2012	1981	129.25	935.95
Plantation Federal Bank (SC)	4/27/2012	1986	433.51	NM
Inter Savings Bank FSB (MN)	4/27/2012	1965	481.59	245.31
Bank of the Eastern Shore (MD)	4/27/2012	1986	162.46	268.94
Security Bank NA (FL)	5/4/2012	1980	101.03	375.30

Source: SNL Financial & FDIC.

For example, Hudson Valley, a New York based bank, recently conducted a loan sale with the stated goal of satisfying a directive from the Office of the Comptroller of the Currency (OCC). Based on a routine safety and soundness exam, the bank found that it would also be required to reduce its concentration in classified loans and, as a result, Hudson Valley disposed of a loan portfolio amounting to USD474 million. The company sold the loans in two tranches: the first tranche consisted of USD200 million of both performing

and non-performing CRE loans that was sold to four undisclosed buyers through a broker for a pre-tax gain of approximately USD8 million. The second tranche was made up of USD274 million of performing, non-classified multi-family loans which the bank sold on its own at above par value, resulting in a pre-tax gain of another USD8 million.

With European banks coming under severe pressure from their local regulators to increase their capital and to shrink their balance sheets, many will be looking

to dispose of their “non-core” assets including any assets in the US.

For example, Eurohypo, the troubled real estate arm of Commerzbank in Germany, sold a USD300 million portfolio to Blackstone in December 2011 and, more recently, has reached an agreement to sell a USD560 million CRE portfolio to a Wells Fargo & Co. and Blackstone joint venture at a price that – reportedly – was between 5 and 10 percent of face value.

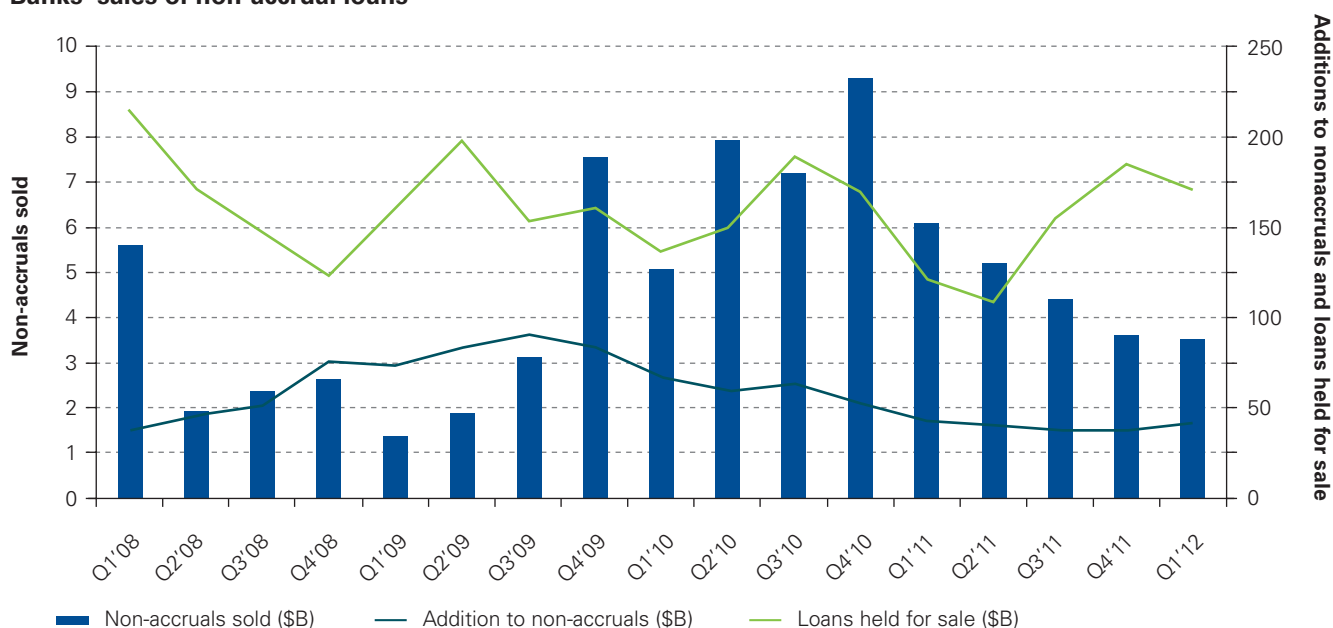
Convergence of bid-ask spreads

2011 saw a significant drop off of selling activity in the US market after investment sentiment toward banks soured and capital raising became more difficult. In fact, non-accrual sales totaled USD19.37 billion in 2011, with just USD3.61 billion trading hands in the fourth quarter. The first quarter of 2012 brought no relief, with non-accrual sales falling to USD3.54 billion, even though net inflows of non-accruals actually increased from USD37.77 billion in the fourth quarter of 2011 to USD41.88 in the first quarter of 2012.

That being said, there was a marked increase in the amount of loan portfolios classified as 'Held for Sale' by banks who seem to be anticipating a narrowing price gap in the future. However, some deals have closed successfully – even in the midst of material volatility in the global equity markets – indicating that the bid-ask spread is likely converging.

As illustrated in the table opposite, many of the largest US banks were amongst the most active sellers of non-accrual assets.

Banks' sales of non-accrual loans



Data based on commercial and savings bank regulatory filings. Does not include savings institutions.
As of May 30, 2012.
Source: SNL Financial.

Largest sellers of non-accrual assets – Q4 2011 – (\$ in millions)

Company	Non-accrual assets sold LTM (\$M)	Addition to non-accrual assets (\$M)	Total assets non-accrual LTM (\$M)	Total assets LTM (\$M)
Citigroup Inc.	703	3,882	12,332	1,873,878
JPMorgan Chase & Co.	395	6,442	22,317	2,265,792
Ally Financial Inc.	368	1,413	3,949	183,940
U.S. Bancorp	292	647	3,084	340,122
Bank of America Corporation	216	5,214	29,027	2,136,578
BB&T Corporation	196	712	1,872	174,579
Wells Fargo & Company	186	4,794	21,433	1,313,867
Regions Financial Corporation	185	725	2,700	127,050
Southwest Bancorp, Inc.	154	146	19	2,383
CIT Group Inc.	111	98	702	45,251
Zions Bancorporation	99	211	1,036	53,151
Morgan Stanley	92	4	700	749,898
Capital One Financial Corporation	58	278	1,060	206,104
Synovus Financial Corp.	52	189	913	27,163
PrivateBancorp, Inc.	49	75	280	12,417
BancWest Corporation	49	166	953	78,118
BBVA USA Bancshares, Inc.	46	202	1,441	63,135
Hanmi Financial Corporation	45	14	67	2,745
KeyCorp	39	231	763	88,763
Fifth Third Bancorp	38	395	1,576	116,967

Source: SNL Financial & FDIC, 2012.

Commercial real estate emerging transaction trends

Both buyers and sellers are increasingly willing to pursue various structuring transactions and – despite the additional complexity – joint ventures (JV) and other structures are increasingly being utilized across investment opportunities.

Another recent trend in the marketplace is the renaissance of the securitization of distressed commercial mortgages. While distressed-loan securitizations have not occurred since the 1990s, three such transactions have been completed in 2012: the securitization of an approximately USD200 million portfolio for Rialto Capital, a Miami high-

yield investment firm, and a USD300 million portfolio backed by mixed-quality hotel loans for a partnership between Blackstone and Square Mile Capital; and a USD300 million portfolio comprised of distressed commercial and residential real estate assets by Oaktree and Sabal.

The housing market

Despite the recent market recovery currently being experienced in a select number of ‘gateway’ cities such as New York and San Francisco, average house prices in the US have fallen by about 33 percent from their 2006 peak, according to data from CoreLogic. Moreover, the Federal Reserve Board’s Flow of Funds Accounts shows that the ratio of home equity to disposable personal income

has also declined to 55 percent. For the most part, the continued problems facing the US housing market are the result of weak demand due to relatively high unemployment and heightened uncertainty; a persistent excess supply of vacant homes on the market; and a marked and potentially long-term downshift in the supply of mortgage credit.

This continued weakness poses a significant barrier to a more vigorous economic recovery. But while some of the weakness can be attributed to the poor labor market conditions (which will likely take some time to recover), there is a growing expectation from regulators that some of the pressure could be relieved through policy changes. The Federal Reserve Board

has called for policies that would help moderate the in flow of properties into the already large inventory of unsold homes, remove some of the obstacles currently preventing otherwise creditworthy borrowers from accessing mortgage credit, and limit the number of homeowners who find themselves pushed into an inefficient and overburdened foreclosure pipeline. Should they be successful, these policy changes could lead to a decrease in the number of residential property portfolios available for investors of distressed debt.

Compounding these issues is the unresolved role of the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac, who since September 2008, have operated in conservatorship under the direction of the Federal Housing Finance Agency (FHFA). This has created uncertainty (both in the near-term and long-term) about the future of the GSEs who either hold or guarantee significant shares of delinquent mortgages and foreclosed properties. Given the weight of their market presence, the actions of the GSEs affect not only their own portfolios, but also the wider housing market.

Under FHFA oversight, the GSEs are now pursuing sales as part of the recent Real Estate Owned (REO) initiative. For example, Fannie Mae is currently believed to be working with Credit Suisse to market a portfolio of about 2,500 tenant-occupied and vacant REO single family residential properties.

It is expected that this will be an area of focus for both the Federal Reserve Board and other regulators, and that the supply of assets from the GSEs could (at least partially) offset the current lack of significant REO or residential mortgage opportunities in the market.

The retail unsecured credit market

There is ample evidence that the US retail unsecured credit market is entering a period of marked improvement. Delinquency rates at major US credit card issuers eased during the first quarter of 2012, and US retail credit defaults have now dropped to below 2008 figures.

Indeed, according to Fitch Ratings, delinquencies have reached their lowest level in six years with accounts more than 90 days past due sitting at just 0.73 percent as of the end of March 2012. Chargeoffs for the industry as a whole are also down roughly 40 percent in comparison to their peak in March 2010. For Citigroup, the level of 30-day delinquencies in April 2012 fell to 2.71 percent from 2.94 percent in the previous month, while at J.P. Morgan they slid to 2.21 percent in April, down from 2.34 percent in March, according to filings with the SEC.

But while delinquencies were basically flat or lower when compared to the prior year, average debt per borrower actually rose by USD280 to a yearly-average of almost USD5,000 which may indicate that consumer confidence is improving as well.

That being said, the latest improvement seen at the end of the first quarter of 2012 may have been fueled by tax refunds and, according to Barclays Capital, the pace of credit recovery may actually be decelerating. In fact, despite the overall positive picture, some banks and issuers are still wrestling with past losses on uncollectable retail loans.

This stable environment has largely led banks to refrain from selling significant

distressed or non-core retail consumer portfolios. Indeed, over the past few quarters, there have been only a few sizeable, public transactions involving this asset class. One notable exception is a deal closed between FirstBank of Puerto Rico and FIA Card Services to acquire a USD400 million FirstBank-branded credit card portfolio (involving about 150,000 active credit card relationships), according to a May 7 2012 news release. FIA Card Services (a unit of Bank of America) will continue to service the accounts under an interim servicing agreement into 2013. Also, Barclaycard, the unit of Barclays US, has acquired the USD1.3 billion promise by Sallie Mae credit card portfolio from FIA Card Services.

Conclusion

With favorable market conditions prevailing, all indicators point to a very active 2013 for distressed and non-core commercial real estate portfolio loans. Buyers seem eager to invest their available capital in the short-term and sellers are finally becoming open to the idea of taking immediate action to transact and resolve these troubled loans, rather than postponing their resolution into the future.

Two concerns prevail, however. The first is that a sudden flood of distressed real estate assets in the market could materially depress pricing. At the same time, there are concerns that large sales of retail unsecured (i.e. credit card) portfolios may not materialize as a result of improving credit quality metrics for these assets, therefore reducing the attractiveness of conducting sales as a tool to manage risk.





Canada

Introduction

Canadian banks continued to outperform their international peers in 2011, thanks largely to their conservative lending practices, relatively high capital ratios, low loan loss experiences and limited exposure to the debt crisis in Europe. In fact, 2011 saw Canadian banks post their third consecutive year of increased profits following the 2008 crisis, with many banks posting record profits.

With Basel III, Dodd-Frank and FATCA in play, regulatory reform will be one hurdle for the Canadian banks to manage. That being said, efforts to ensure regulatory compliance

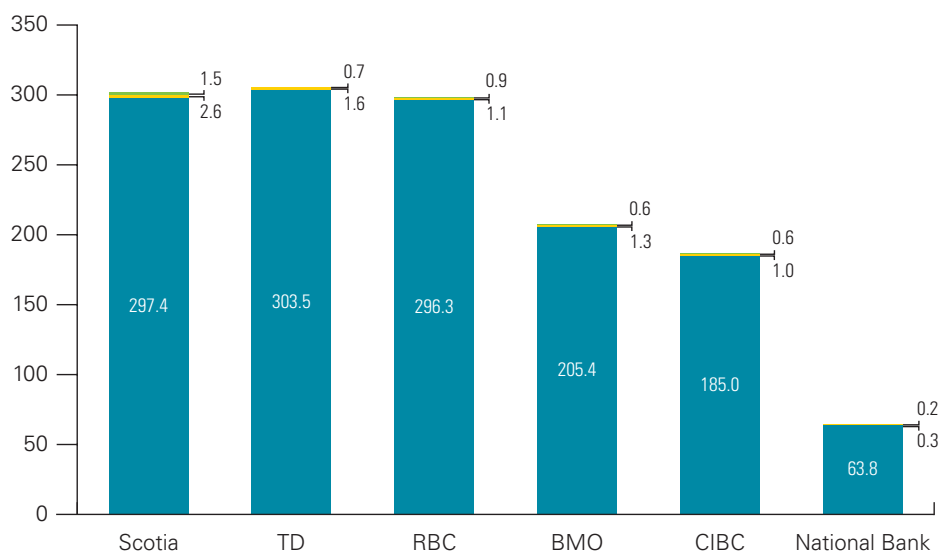
may mean that the banks sacrifice opportunities which will undoubtedly impact growth.

Other major areas of concern with the potential to negatively impact the 2013 outlook include (i) the sputtering recovery of the economy in the United States, Canada's largest trading partner, (ii) relatively high levels of domestic household debt (which reflected a 153 percent debt to income ratio in Q3 2011) and (iii) the increasing value of Canadian dollar which has a direct impact on the ability of Canadian manufacturers to compete on a global basis.

As illustrated in the graphs on page 101 and 102, the Canadian banking landscape continues to be dominated by five major banks, all of which have kept non-performing loan (NPL) levels in check in 2011. Indeed, on a national basis, NPLs represented only 1.1 percent of loan book values in fiscal 2011, a decrease of 10 basis points from 2010. So while the percentage of NPL loans still remains above pre-crisis levels, the overall downward trend since 2008 is encouraging and continues to suggest that the banks have – for the most part – avoided problem loans.



Composition of total loans for some of the Canadian banks as of October 31, 2011 (CAD billion)

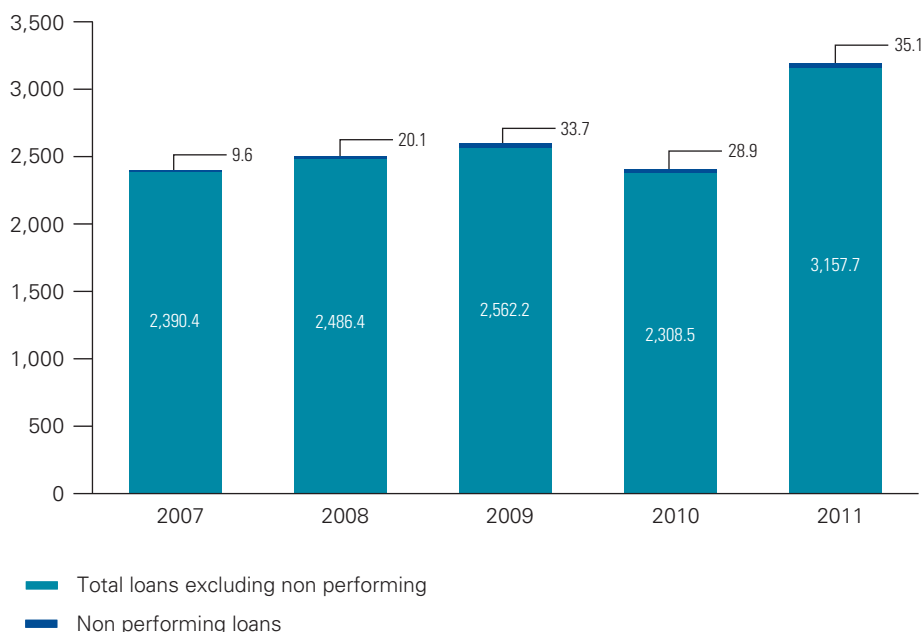


- Book value of total loans less NPL and LLP
- Loan loss provision
- Non performing loans

Source: Financial Statements.

While Canadian banks are increasingly utilizing the insurance provided by the Canada Mortgage and Housing Corporation (CMHC) to insure mortgages, the agency has recently approached its CAD600 billion limit and the government has publicly stated that the limit will not be increased.

Canadian loan performance (Last 5 Years – CAD billion)



Source: Loans (<http://www.bankofcanada.ca/publications-research/periodicals/bfs/>).
Non-performing loan % (<http://data.worldbank.org/indicator/FB.AST.NPER.ZS>).

Canadian economic conditions and outlook

Canadian household indebtedness has risen sharply in recent years and is currently outpacing the rate of income growth. Rising house prices (largely due to the all-time low level of interest rates) are mostly to blame for the recent run up and the Bank of Canada is growing increasingly worried that households would be vulnerable to an adverse economic shock.

While Canadian banks are increasingly utilizing the insurance provided by the Canada Mortgage and Housing Corporation (CMHC) to insure mortgages, the agency has recently approached its CAD600 billion limit and the government has publicly stated that the limit will not be increased.

Recent economic indicators show that the previously vibrant real estate market is beginning to cool (especially in the Province of British Columbia) as Canadians slowly begin to de-leverage. Regardless, household debt will continue to be the biggest domestic risk for the Canadian economy in 2013 with household debt to income rates forecasted to soon reach 160 percent, roughly the rate of both the UK and US shortly before the implosion of their real estate markets in 2008 to 2009.

Recent transactions

Canadian banks continued to be purchasers of distressed assets. The Bank of Nova Scotia continued making international acquisitions and is widely considered to be the Canadian bank with the most international exposure. In recent years the Bank of

Nova Scotia has had a particular interest in acquiring South American assets.

In Canada there are no disclosure requirements for individual portfolio transactions between banks, unless they are deemed to be material which (given the immense size of the banks) none were.

However, disclosures on public acquisitions and divestitures are made and (as illustrated in the graph on the left), Canadian banks continue to have a mixed view of retail banking in the United States. So while the Toronto Dominion Bank and the Bank of Montreal continue to view the US retail market as a buying opportunity, the Royal Bank of Canada took an alternate view and sold their US retail banking business to PNC in an attempt to focus their US strategy solely on Capital Markets and Wealth Management.

2011 Notable Canadian bank transactions

Canadian bank transactions					
Seller	Buyer	Asset type	Deal size (CAD m)	Book value of loan portfolio	Location
Banco Multibanca Colpatría	Bank of Nova Scotia	Bank	\$1,006	Undisclosed	Bogota, Colombia
Bank of Guangzhou	Bank of Nova Scotia	Bank – 20% stake	\$721	Undisclosed	Guangzhou, China
Dresdner Bank, Brasil S.A.	Bank of Nova Scotia	Bank	Undisclosed	\$149	Brazil
Marshall & Ilsley	Bank of Montreal	Bank	\$4,000	\$29,000	Wisconsin, US
Chrysler Financial	Toronto Dominion	Auto Finance	\$6,390	\$7,500	US
American Century Investments	Canadian Imperial Bank of Commerce	Asset Management – 41% stake	\$848	\$112,000 AUM	Kansas City, US
Royal Bank of Canada	PNC Financial Services Group	US Banking Operations	\$3,600	Undisclosed	US

Source: Capital IQ, 2012.

Conclusion

Canadian banks remain liquid and have generally avoided significant NPLs. Supported by the relatively high value of the Canadian dollar, the Canadian banks

should continue to be net buyers in the debt sales market in 2013. That being said, the Canadian banks are expected to remain somewhat conservative in

their assessment of these opportunities, with the fear of regulatory reforms and the resulting effect on capital ratio requirements remaining a top priority.

Sources:

- 1 Capital IQ
- 2 Financial Statements and MD&A of Major Canadian Banks
- 3 Financial System Review – Bank of Canada December 2011
- 4 Statistics Canada



Brazil

Introduction

We are entering a challenging year for the Brazilian banking sector, characterized by a slowdown in credit growth, higher rates of delinquency and significant margin compression.

Throughout the past decade, Brazil has enjoyed substantial growth supported by high commodity prices, cross-border capital flows and disciplined policies. Underlying these factors has been rising household income and credit expansion which has fuelled domestic consumption and driven economic growth overall. Against this backdrop, Brazil's banks continued to see a robust increase in lending volumes to the private sector which – subsequently – led to an increase in the volume of non-performing loans (NPLs).

Today, however, the country is feeling the pressure of the global economic crisis which has sparked a slowdown in Brazil's economic activity. Indeed, Brazil reported a substantial drop in GDP growth between 2010 (when the growth rate stood at around 7.5 percent) and 2011, which saw GDP growth of just 2.7 percent. As a result, a number of analysts have now lowered their growth forecasts for Brazil.

When combined with the effects of an increasingly cautious private banking sector and record high default rates being reported in May 2012, this slowdown in GDP growth has significantly depressed credit growth. In fact, according to the Central Bank of Brazil, the financial system reported a year-on-year increase of 19 percent in credit portfolios by the end of 2011, down from the five-year historical average of 22 percent. At the same time, we have seen an increase in the market share held by Brazil's public banks which rose from 42 percent in December 2010 to 44 percent a year later.

In an effort to stimulate economic activity, the Central Bank of Brazil has focused on systematically reducing the Selic benchmark rate. Starting in August 2011, when the rate stood at 12.5 percent, the bank has achieved significant success, bringing the rate down to a record low 8.5 percent by May 2012. At the same time, the government also ordered the two state-owned banks (Banco do Brasil and Caixa Economica Federal) to cut their spreads on loans which, in turn, forced the private banks to follow suit in order to remain competitive.



Brazil has enjoyed substantial growth supported by high commodity prices, cross-border capital flows and disciplined policies.



These measures, however, may not provide a significant boost to the credit market, with banks largely becoming more reluctant to lend due to an increase in delinquency levels. As reported by the Central Bank of Brazil, the level of NPLs (those loans in arrears for at least 60 days) reached 6 percent in May 2012, the highest level since records began in 2000: consumer default rates rose to 8 percent (from a revised 7.8 percent in April); while the default ratio on corporate loans remained unchanged at 4.1 percent.

Structure

Generally, the securitization of NPLs in Brazil is structured through a bankruptcy remote receivables fund called Fundo de Investimento em Direitos Creditórios (FIDC).

While income is tax exempt at the fund level, taxation is instead applied

directly on the individual investors, with variable rates depending on the term of the investment:

- up to 6 months: 22.50 percent;
- 6-12 months: 20 percent;
- 12-24 months: 17.50 percent; and
- longer than 24 months: 15 percent.

Loan portfolio sales

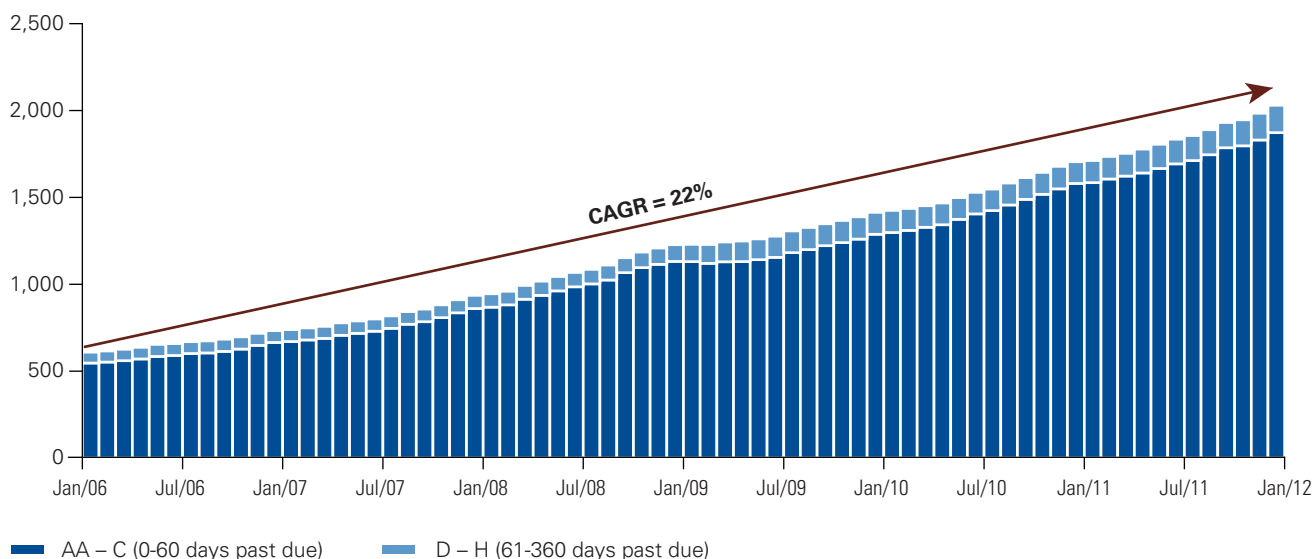
Active since 1996, the Brazilian loan debt sale market continued to enjoy reasonable levels of sale and purchase transaction activity between 2008 and 2012. However, given the levels of credit expansion of the past six years (which had an average CAGR of 22 percent), the increasing stock of NPLs (estimated at USD220 billion including write-offs) and the record high default rate set in May 2012, we

expect to see a significant increase in both the number of transactions and the size of deals in 2013 and 2014.

For the next five years, the expected volume of assets traded in the market is expected to range between USD10 and 20 billion per year including a strong pipeline in consumer together with an increasing volume in corporate loans, including B2B and single names.

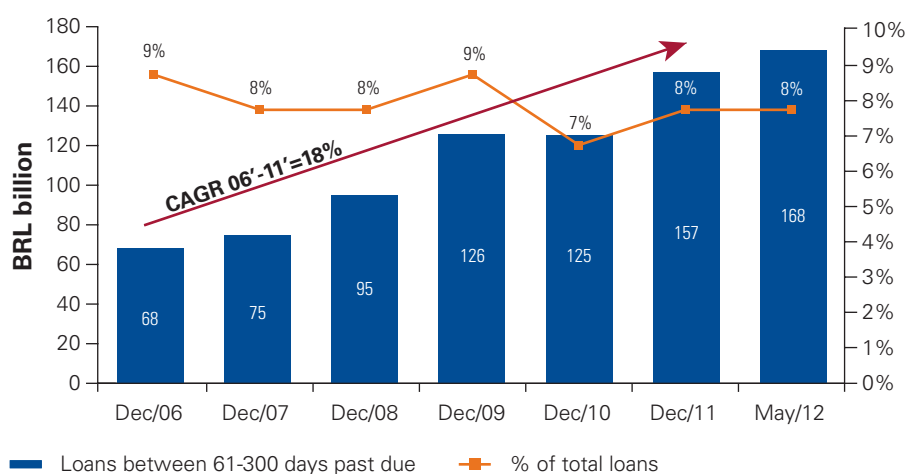
In Q3 2012, the level of activity in the Brazilian market started to increase when 5 transactions (for approximately BRL8 billion) went to market including consumer unsecured, auto loans, SMEs, Corporate and Residential mortgages. The size of the NPL market, the volume of assets in the market and the expected returns have attracted new investors, particularly from the US where a high level of competition has reduced IRRs to single digits.

NFS total loans – BRL billion



Source: Central Bank of Brazil.

Loans between 61 to 360 days past due



Source: Central Bank of Brazil.

Selected recent transactions

Seller	Year	UPB (R\$ Millions)	Asset Class
Brazilian bank	2011	15	Commercial
Brazilian bank	2011	150	Commercial
Consumer finance	2011	370	Consumer
Brazilian bank	2011	43	Commercial
Brazilian bank	2011	80	Corporate
International bank (several transactions)	2011	16.000	Consumer and SMEs
Total - 2011	2011	16.658	
Brazilian bank	2012	50	Consumer
Brazilian bank	2012	115	Corporate and Consumer
International bank	2012	1.600	Corporate and Consumer
Brazilian bank	2012	1.700	Consumer and SMEs
International bank	2012	1.300	Consumer and SMEs
International bank	2012	1.600	Consumer and SMEs
International bank	2012	2.600	Consumer and SMEs
Total - 2012	2012	9.815	

Source: KPMG and public news.

Servicing capabilities

The outlook for the Brazilian debt collection market is positive and the country is widely expected to enjoy continued growth over the next couple of years. Today, the servicing industry consists of approximately 1,500 DCAs who together employ around 325,000 people and generate revenues of more

than BRL8.5 billion (approximately USD4 billion).

But consolidation is also anticipated within the fragmented debt collection market in Brazil. This is expected to bring greater sophistication, largely driven by the entry of foreign players and the concentration of local players.

Facing a significant growth opportunity, the market has attracted players from Europe and the US, as well as strategic/industrial investors who are expected to focus solely on the servicing business while others are interested in exploring the acquisition of NPL portfolios.



Mexico

Introduction

Mexican banks in a healthy situation

Mexico's banks are currently rather healthy, with non-performing loans (NPLs) as a percentage of total loans sitting at around 2.5 percent across the banking system. This compares favorably to the 2.8 percent historic average over the past 10 years and is significantly lower than the high of 9.0 percent seen in 2000.

Furthermore, all of the 42 Mexican banks enjoy capitalization rates at or above the 10 percent required by the Mexican authorities which – in large part – is due to the early adoption of Basel III measures.

However, as illustrated in the tables on the right, there are variations in the rate of growth for both performing

and non-performing loans within Mexico's ten largest banks who hold more than 80 percent of the country's total loans. And while the growth rate of commercial loans has significantly outpaced that of the consumer and mortgage segments, we have also seen a dramatic rise in the growth of commercial NPLs.

Mortgage loans have also shown strong growth rates. However, it should be noted that much of these gains have come on the back of Mexico's 'non-bank banks' (known in Mexico as either Sofomes or Sofoles) who had previously dominated the market. Indeed, having shunned the

42 Mexican banks enjoy capitalization rates at or above the 10 percent required by the Mexican authorities which – in large part – is due to the early adoption of Basel III measures.



mortgage market after the 1995 Tequila Crisis, banks lost much of their market share to these new entrants who, for their part, enjoyed healthy growth between 1995 and 2005. However, over the past few years, several of the Sofomes and Sofoles have suffered financial difficulties (worsened, in part, by the 2008 global financial crisis), allowing the banks to regain a significant share of the mortgage market.

While growth rates have been rather low in the performing consumer loan segment, it is worth noting that NPLs have also decreased in the past few years. This is due to a number of factors, including more cautious lending policies on the part of the banks and a growing prevalence within the banks towards disposing of consumer NPLs as a way to clean up their balance sheets.

That being said, the aggregated performing consumer loan balance of Mexico's banks grew at a double digit rate in March 2012 (versus a year earlier) which suggests a possible recovery in the consumer loan market.

An active NPL market

The Mexican NPL market has evolved somewhat over the past few years,

Growth in Mexican loans

	Performing loans CAGR 2008-2011	Non-performing loans CAGR 2008-2011
Consumer	0.9%	-9.0%
Commercial	12.1%	31.0%
Mortgage	10.5%	12.2%
Total Bank Loans	9.2%	8.1%

Source: KPMG estimates based on National Banking and Securities Commission (CNBV).

with an increasing number of banks disposing of their NPL portfolios across the three major categories of loans (consumer, commercial and mortgage). Simultaneously, we have seen a rise in the number of parties showing interest in purchasing these types of assets.

Mexico's banks have typically employed two main mechanisms for disposing of NPLs: auctions (organized either by external advisors or the banks themselves) aimed at different types of investors, or through direct agreements with other banks or financial institutions interested in expanding their presence in certain segments. In general, these transactions have included both the performing and non-performing parts of the portfolio.

On the demand side, we have seen the emergence of a number of

frequent investors including loan collection agencies ('servicers'), law firms and, increasingly, private equity firms. Loan collection agencies have shown a tendency towards consumer loans, while law and private equity firms have tended more towards the commercial and mortgage loan segments.

Included below is an updated table of our most recent sounding, regarding Price Range for NPL as of July 2012.

Price range for recent NPL Transactions

	Price range (as a % of UPB)
Consumer	0.2%-1.0%
Commercial	1.5%-7.0%
Mortgage	16.0%-20.0%

Source: KPMG, Telephonic sounding as of July 2012.

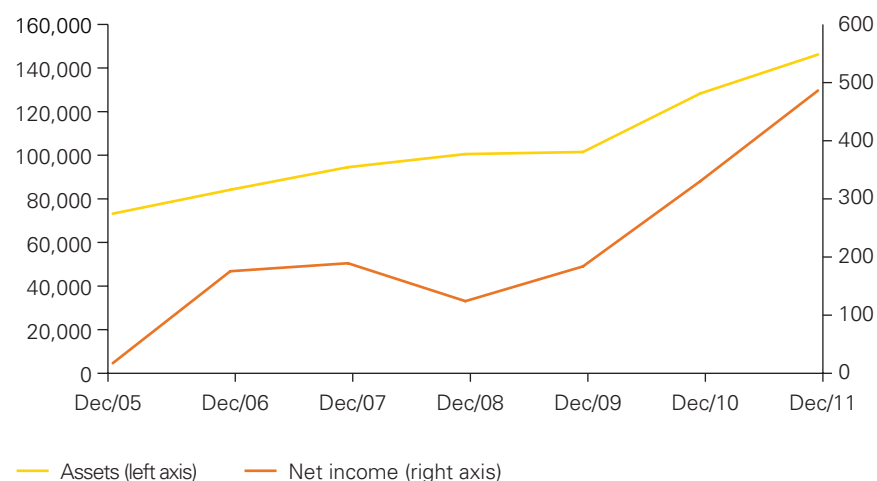


Argentina

Since 2005, Argentina has seen continuous growth in both GDP and banking activity. Indeed, according to the Central Bank of Argentina, the total assets held by the Argentinian financial system doubled between December 2005 and December 2011 to USD146 billion. At the same time, Argentina's banks have seen significant rises in net income (see graph illustrated on the right).

Total loans also grew substantially from USD30 billion in December 2005 to USD86 billion in December 2011, and saw a 71 percent increase between 2010 and 2011

Assets, net income – USD million – total financial

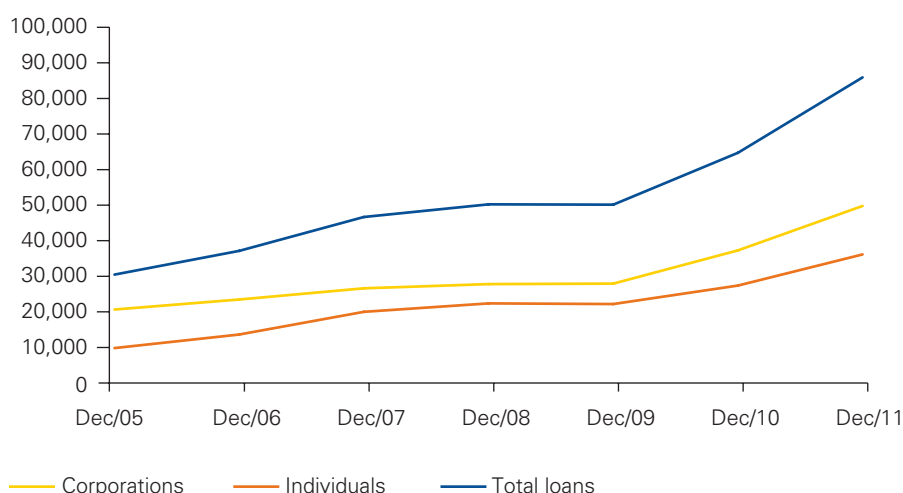


Source: Central Bank of Argentina.



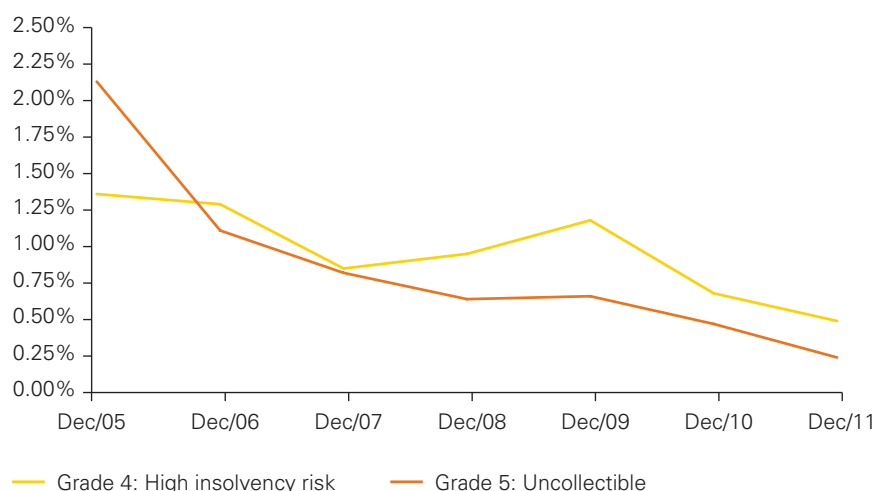
Taking a deeper look into the loan composition, credits to corporations increased from USD28 billion in December 2009 to reach USD50 billion in December 2011, while over the same period, credits to individuals grew from USD22 billion to USD36 billion.

Loans – USD million – total financial system



Source: Central Bank of Argentina.

Percentage of bad loans with respect to total loans – total financial system



Source: Central Bank of Argentina.

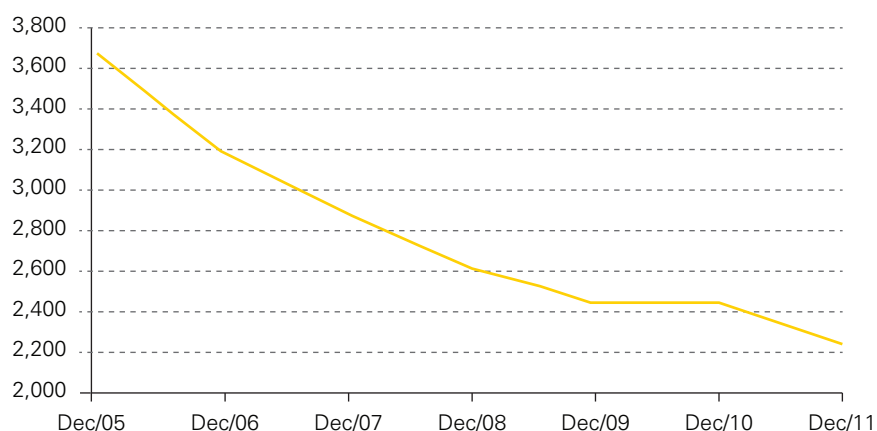
(see graph illustrated on the left). Taking a deeper look into the loan composition, credits to corporations increased from USD28 billion in December 2009 to reach USD50 billion in December 2011 while, over the same period, credits to individuals grew from USD22 billion to USD36 billion.

At the same time, the financial system has experienced a persistent decrease in the level of bad loans as a percentage of total system loans. In the two most risky credit categories, for example, we have seen Grade 4 credit (those with high insolvency risk) decrease from 1.36 percent in December 2005 to 0.49 percent in December 2011. A similar trend can be seen for Grade 5 credit (uncollectable loans) which decreased from 2.13 percent to 0.24 percent in the same period (see graph illustrated on the left).

Moreover, the aggregate value of NPLs within the financial system also decreased within the same period, from USD3.7 billion in 2005 to USD2.2 billion in 2011 (see graph illustrated on the left).



NPLs – USD million – total financial system



Source: Central Bank of Argentina.



As noted in the previous edition of KPMG's Global Debt Sales publication, the country's financial institutions continue to carry NPLs on their balance sheets.

As noted in the previous edition of KPMG's *Global Debt Sales* publication, the country's financial institutions continue to carry NPLs on their balance sheets. That being said, nearly half of all remaining NPLs are owned by the state-owned banks who do not seem eager to sell at this time.

It is also worth noting that Argentina's utility companies also generated huge NPL portfolios during the 2001-2002 crisis, most of which have yet to be offered up for sale.

Argentinian bank NPL levels

Bank	NPL Level
Banco de la Provincia de Buenos Aires	USD413 million Public bank belonging to the Province of Buenos Aires
Banco Nación Argentina	USD227 million Public bank belonging to the Argentine Nation
Banco de la Ciudad de Buenos Aires	USD104 million Public bank belonging to the city of Buenos Aires (Federal District)
Banco Macro	USD204 million
Banco Hipotecario	USD138 million
HSBC	USD130 million
Banco Galicia	USD112 million
Banco Patagonia	USD76 million
Banco Santander Rio	USD56 million
BBVA Banco Francés	USD73 million
Citibank N.A.	USD29 million

Source: Central Bank of Argentina – December 2011.

Introduction to **Asia**



Since 2007, many of Asia's debt sales markets have become somewhat sedate. Obviously, one cause of the declining volume has been the global financial crisis which has reduced capital and debt financing across the board.

However, some softness in the market can also be attributed to the record low levels of NPLs held by banks almost across the region (the notable exceptions being Australia, India and Korea who have all seen NPLs rise recently). Having tumbled between the start of the century and 2007, NPL levels have continued to fall, albeit at a slower rate than before. At the same time, many of Asia's banks seem to be at – or well above – their minimum capital ratio requirements, which has led to more debt being kept either in-house for reworking or written off.

There are strong indications that debt sales will start to rise over the coming year. For one, the slowdown in China's economy is dragging on regional trade and, as a result, a number of markets are seeing rising default rates, particularly amongst small to medium enterprises. This may be especially true for the markets in Japan and Thailand where, following natural disasters, a moratorium was enacted on loan refinancing which – in 2013 – will more than likely be allowed to expire. As a result, we are likely to see growing activity in the NPL market once these loans are revisited and risks are assessed.

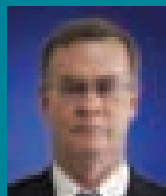
In many markets, there also seems to be a trend of increasing defaults in the 'other household' sector and the real estate sector, likely as a result of stagnating household income growth and weakening housing markets in many countries. China's banks, for example, have an average of 8 percent exposure to property loans at a time when sales prices of newly constructed residential buildings is decreasing in the majority of cities surveyed.

While almost every market in the region employs some form of Asset Management Company (AMC) to sop up portfolios of NPLs, they have seen variable success in many cases. In Korea, for example, KAMCO and UAMCO purchase trillions of Won's worth of NPLs and distressed project financing loans. In Thailand, TAMCO has recently closed and assets are now either being sold or resolved. In India, poor AMC financing has resulted in a lackluster performance, but with a new series of recommendations on the table for reform of AMC-related regulations, India's market may once again pick up.

Overall, we anticipate that Asia will soon become a key focus for debt sales investors and strategic acquirers – particularly from the West – who may soon be attracted by large volumes, supportive regulation and maturing markets.



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China

Since 1999, China has experienced a dramatic reduction in the level of non-performing loans (NPLs) held by the country's main commercial banks.

At that time, the NPL ratio of key commercial banks in China was assessed at 39 percent, representing RMB2.5 trillion, or approximately 31 percent of China's GDP. Having experienced a substantial accumulation of NPLs during the Asian financial crisis in 1997, the government of China introduced several measures in 1998-1999 with the intention of tackling bad loans in the banking sector.

Likely the most significant measure enacted by the Ministry of Finance was the creation of four asset management companies (AMCs) in 1999 with the sole purpose of acquiring and then either restructuring or selling bank NPLs to investors. Each AMC was aligned with one of the country's four major banks: the Industrial and Commercial Bank of China, Bank of China (BOC), the Agricultural Bank of China, and the China Construction Bank. Since then, the government has also undertaken various other initiatives targeted at curbing sub-standard lending, maintaining asset

“The NPL ratio of key commercial banks in China was assessed at 39 percent, representing RMB2.5 trillion, or approximately 31 percent of China's GDP.”

quality (including measures intended to increase reserve requirements), and encouraging commercial banks to deal with impaired assets by means of collection, auction, write-offs, and increased provision coverage.

As a result, China's banking sector has witnessed a significant decline in non-performing loans, with the NPL ratios of commercial banks dropping to just 2.4 percent by the end of 2008. It is worth noting that the decline in NPL ratios was particularly significant in 2008, primarily due to the Agricultural Bank of China writing off RMB818 billion of NPLs during the year.

Improvements in NPL levels have continued steadily, with the NPL ratio declining to 1.0 percent by the end of 2011. Clearly, however, the declining NPL levels in recent years has had a moderating effect on NPL sales activity in the country. The AMCs have managed to offset the drop in NPL sales revenue source through management of large real estate and financial services subsidiaries

(these subsidiaries themselves were originally bankrupted institutions that were subsequently restructured and recapitalized as subsidiaries of the AMCs). However, while some of these subsidiaries are large institutions, the AMCs are nonetheless largely reliant on NPLs as their key revenue source. They have also expanded the purchasing of NPLs beyond the banking sector to purchase of non-bank financial institutions' NPAs.

Outlook

The credit stimulus program initiated in 2009 to offset the effects of the global financial crisis may in fact result in an increase in impaired loans due to a rapid increase of lending over a short period of time. Banks extended RMB9.6 trillion worth of new loans (more than twice the total lending in 2008), and RMB8.0 trillion in 2010.

The potential for defaults has been further aggravated by the pressures of a slowing economy, lower exports due to the Eurozone crisis, and increasing

operating costs in areas such as labor and fuel, which are challenging the repayment capacity of borrowers.

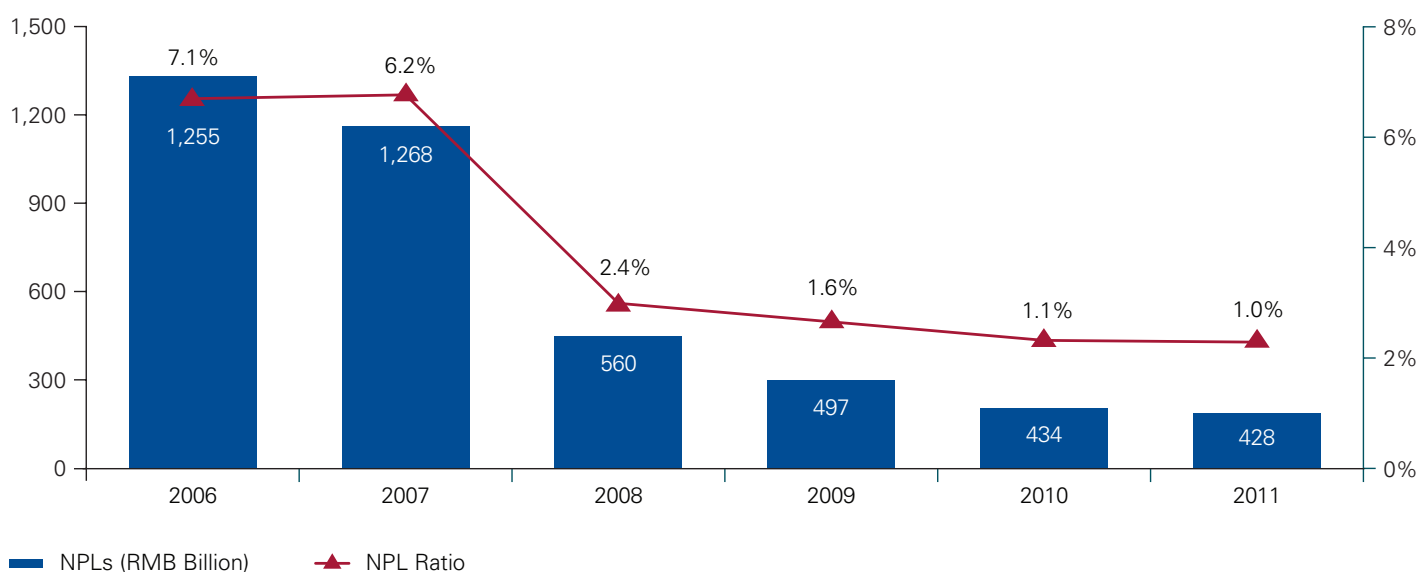
Key sources of defaults are therefore likely to arise, particularly from loans extended to local government financing vehicles (LGFVs), SMEs and the real estate sector.

Local government borrowing

Following the global financial crisis, we witnessed a significant increase in local governments raising loans through special purpose companies to fund the construction of large infrastructure projects such as roads and bridges. The vast majority of the funding was provided by the Chinese banks and the strategy was as a result of the 1995 PRC algorithm law (Chapter 4, Article 28) that prohibits local government raising debt through municipal bonds or loans directly from banks.

At the end of 2011, total outstanding local government borrowing was

Commercial banks – non-performing loans (RMB billion)



Source: CBRC Annual Reports.

Note: Commercial banks include large commercial banks, joint-stock commercial banks, city commercial bank, rural commercial banks and foreign banks.

estimated to be in the region of RMB 9 trillion, or US\$1.43 trillion with about one-third coming due in the next 3 years (Bloomberg LLP), and there are well documented concerns that many of the underlying projects offer insufficient cash generating ability to service the incumbent debt.

During 2012 it was widely reported that the Chinese authorities instructed local governments to examine the ability of companies to repay debt maturing in 2012 and in 2013, and the China Banking Regulatory Commission (CBRC) are also in the process of introducing new rules to cap banks total lending levels.

It is likely that banks will be allowed to refinance loans to the local government financing vehicles for completed projects that are not generating income if estimated future cash flows can cover payments. Banks may also be allowed to revise repayment arrangements for the financing vehicles if the loans mature before the projects are completed. The government also continues to look at a municipal bond markets as a potential avenue to diversify the financing of local government expenditures, and in November 2011, the State Council authorised the governments of Shanghai and Shenzhen and the provincial governments of Zhejiang and Guangdong to issue bonds directly, as part of a pilot program designed to help cash-strapped local governments curb debt risks.

While local government funding remains a challenging issue for the Chinese banks, we would not expect to see a significant increase in the levels of non performing local government debt in the short term.

SMEs

The small and medium-sized enterprise (SME) sector is anticipated to become a growing source of NPLs in China. While

historically SMEs have had the worst access to bank credit after personal and consumer loans, a combination of factors has dramatically expanded lending to this space over the past two years, namely an increasingly competitive lending market for state-owned borrowers, strong regulatory support and incentives for banks lending to SMEs, and the rapid growth of credit guarantee companies which provide loan guarantees on many SME loans, helping to share credit risk with the banks. However, entrance into SME financing has at times been a haphazard approach at best for banks.

Estimates of the size of SME lending in the banking sector indicate that SME loans may account for as much as 25 percent of total bank lending although these figures are distorted by the lack of differentiation between state-owned and privately owned SMEs – the privately owned entities likely representing a greater source of credit risk than their state-owned peers. Nonetheless, estimates by Moody's show that the small business sector is already generating a level of NPL ratios three times higher than the overall loan average. Moreover, the increasing variance between net interest margins between the large state-owned banks, which still primarily lend to SOEs, and smaller rural and city commercial banks, who are the key driving force behind SME lending, indicates growth of risk-based pricing for SME loans.

The majority of SMEs though still lack access to any bank financing but this also poses a risk and may lead to an indirect surge in NPLs. At 25 trillion RMB, the shadow banking sector is estimated to be roughly a third of the size of the formal banking sector, of which underground or private lending alone is 4.8 trillion RMB. This private lending often involves individuals and

SMEs with surplus capital lending to SMEs starved of capital. These relationships often span the supply and distribution chain networks within a sector and, when under stress, can trigger a domino-type effect that makes its way down the chain to larger corporates, with potential repercussions for the formal banking sector.

Real estate

With exposure to property loans estimated at an average of 8 percent for several key banks, real estate companies represent another potential source for loan defaults. In large part, this is being driven by strict property price control measures imposed in China over the past two years which have led to declining property prices. According to the National Bureau of Statistics of China, the sales price of newly constructed residential buildings decreased (on a month over month basis) in 46 out of the 70 cities surveyed in March 2012. This is up significantly from March 2011 when declines were registered in just 38 cities.

Declining prices are likely to impact asset quality by not only rendering property projects less profitable (and therefore impacting the loan repayment capacity of borrowers), but also by reducing the value of property held as collateral.

Conclusion

Over the coming years, potential defaults from SMEs, the real estate sector and to a lesser extent LGFVs will likely result in an increase in NPLs which, in turn, will increase the NPL ratios of the key commercial banks.

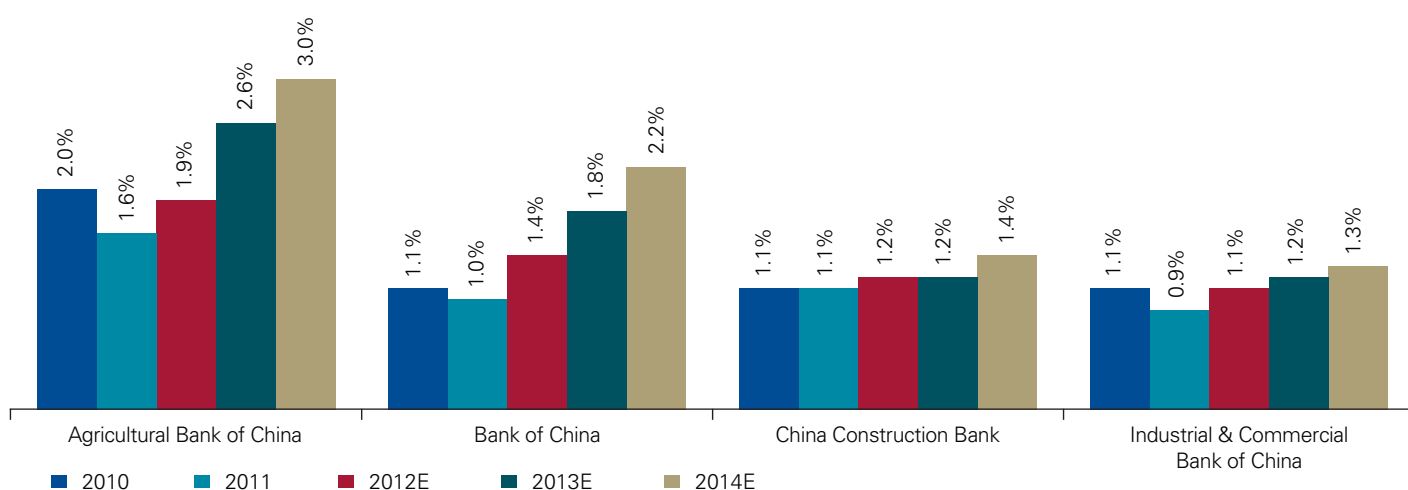
Estimated shadow banking size in China

Outstanding balance (Rmb bn)	2H10	1H11	2H11	1H12	3Q12
1) Entrust loans	3,480	4,366	4,903	5,001	5,376
2) Bill acceptance	5,016	6,277	6,281	6,816	6,966
3) Leasing business	689	809	930	1,165	1,400
4) Trust sector total AUM	3,040	3,742	4,811	5,538	6,320
a) Loans	1,573	1,668	1,735	2,097	2,442
b) Others	1,468	2,074	3,076	3,442	3,878
5) Pawnshops	98	111	132	148	178
6) Private lending (underground)	2,963	3,481	4,000	4,400	4,800
7) Micro-credit companies loan	198	287	391	489	533
Total credit shadow banking (1+2+3+4a+5+6+7)	14,016	17,001	18,373	20,116	21,695
Growth rate (y/y) *			31%	18%	18%
Total shadow banking including other trust investment (1+2+3+4+5+6+7)	15,484	19,075	21,449	23,558	25,573
Growth rate (y/y) *			39%	24%	19%
WMP outstanding balance	2,520	3,657	5,096	7,321	8,803
Growth rate (y/y) *			102%	100%	73%

Note: Growth rate of 3Q12 is q/q growth rate.

Source: PBOC, CBRC, MOC, Wind, China Leasing Union, Barclays Research estimate.

NPL ratio of key banks in China



Source: Capital IQ; Analyst Reports, 2012.



Korea



At the same time, debt repayment capacities are generally weakening due to a slowdown in income growth.

Until 2008, Korea had been remarkably successful in reducing non-performing loan (NPL) ratios. Between 1999 and 2001, for example, the ratio dropped from 12.9 percent to 3.4 percent, largely driven by aggressive write-offs and the sale of NPLs as asset-backed securities to both domestic and foreign investors. NPL ratios continued to decrease – albeit at a slower pace – between 2001 and 2007, partly in response to various government measures such as the strengthening of legal and regulatory frameworks and

the continued sale of NPLs to KAMCO (an asset management company).

However, NPL levels began to increase in 2008, largely due to higher default rates from SMEs who had been battered by the economic slowdown and credit crunch. Defaults on project financing loans and household loans have also been a contributor to the increase in overall NPL levels since 2008. The first quarter of 2012 saw an 11 percent jump in the level of NPLs held by Korea's local banks, bringing the total value up to KRW21 trillion.

Key sources of NPLs

High and rising household debt

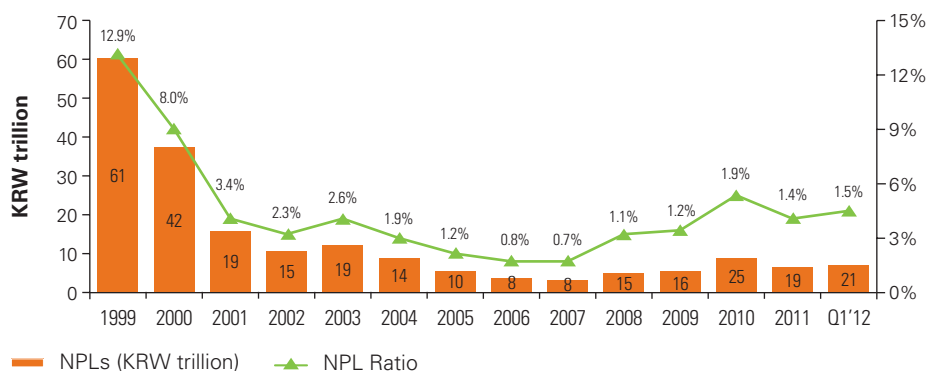
Rising household debt is one of the major sources of non-performing loans for Korea's banks. At the same time, debt repayment capacities are generally weakening due to a slowdown in income growth. As a result, household debt had risen to 145 percent of GDP by May 2012 and debt-to-disposable income ratios increased to 135.5 percent in 2011 (up from 131.7 percent in 2010).

However, Korea's savings banks continue to extend loans to cash-strapped households, and are therefore further aggravating default rates. In December 2011, Korea's savings bank loans to households totaled KRW10.6 trillion (representing a 25 percent increase over December 2010), and the household loan default rate was measured at 11.8 percent (versus approximately 10 percent in December 2010).

Real estate project financing loans

Real estate project financing loans account for a disproportionately large

Non-performing loans of Korea's local banks



Source: 2011 Korea NPL Market Review, KPMG PSG.

share of the banking sector's total non-performing assets. As of the end of December 2010, Korea's local banks held KRW6.4 trillion in troubled real estate project financing loans, which – while accounting for only 3.2 percent of the banks' total loans – represented 26.2 percent of the total distressed debt.

The challenge is being further exacerbated by an expanding inventory of unsold homes (particularly in Seoul and its surrounding areas) which rose from around 5,000 units in January 2007 to 29,200 units by January 2012. Indeed, facing economic uncertainty, decreasing demand for housing and a large inventory of unsold homes, we are already seeing a rise in NPLs from this sector. At the end of the first quarter of 2012, the NPL rate for real estate project financing loans sat at 9.1 percent, versus 1.9 percent for corporate loans and 2.4 percent for the SME sector.

Small and medium-sized business

SME defaults are another source of bad debt for Korea's banks. And while the NPL ratio for the SME sector saw a significant decline in 2011 (dropping from 3.1 percent in 2010 to 2.2 percent in 2011) the market experienced an uptick in the first quarter of 2012, bringing the ratio up to 2.4 percent.

The reality is that the financial health of the country's SMEs has been stressed since the beginning of the global financial crisis in 2008. Smaller businesses have been facing insolvency risk, with overall operating income to sales ratios recorded at –4.8 percent

and debt-to-asset ratios of more than 200 percent in 2011. Clearly, the potential for further weak financial performance and increasing insolvency risks may result in fresh bad loans from the sector.

Debt sales

South Korea has established special asset management companies (commonly referred to as 'bad banks') to handle the distressed assets of the country's banks. The country's two bad banks (namely KAMCO and UAMCO) purchase and hold non-performing assets from banks, and then resell these loans as asset backed securities.

KAMCO

The state-run Korea Asset Management Corporation (KAMCO) was set up in 1962 as a clearing-house for Korea Development Bank's loans. During the Asian financial crisis in 1997 it was consequently revamped into a bad bank with a mandate to buy non-performing loans.

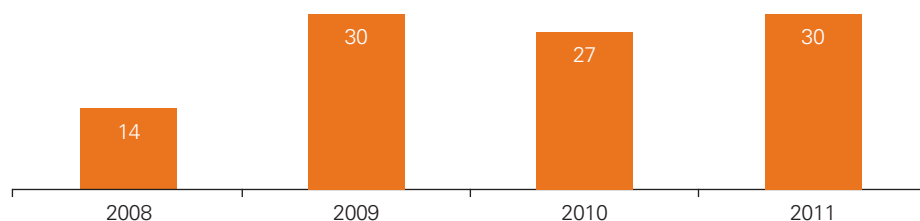
report, KAMCO had purchased approximately KRW17.5 trillion worth of non-performing loans since 2008, including soured project financing loans from 16 savings banks that had been suspended in 2011. Last year alone, KAMCO purchased KRW2.3 trillion worth of distressed project-financing loans held by savings banks.

UAMCO

The United Asset Management Corporation (UAMCO) is a private operator, set up by seven domestic banks in 2009 with the express intention of buying up the increasing stock of non-performing assets resulting from the economic crisis. In the first half of 2011, UAMCO purchased KRW1.2 trillion worth of non-performing loans (NPLs).

Outside of the two bad banks, Korea's local banks disposed of approximately KRW30 trillion of NPLs in 2011 (up 10 percent over 2010), largely through write-offs and sales.

NPL disposals by local banks (KRW trillion)



Source: 2011 Korea NPL Market Review, KPMG PSG.

According to an April 2012 industry

Outlook

Despite stringent government efforts to effectively manage bad loans, the level of non-performing loans in Korea is likely to increase in the coming years, particularly in the wake of a slowing economy and the resulting pressure placed on debt within the SME, real estate and household sectors.

Further, banks are also likely to increasingly divest bad loans from their books to reflect stricter capital rules and upcoming BASEL III accounting standards which will lead to an increased NPL supply in the market.

Accordingly activity is expected to be high. Key domestic player KAMCO is expecting to acquire over KRW2.5 trillion of bad debt in 2012, while another local player UAMCO intends to raise capital through an IPO expected by September 2013, in anticipation of an increased NPL supply in the market.



Japan

‘ The composition of NPLs within the Japanese market has also been changing. The level of bankrupt loans – which had risen significantly following the ‘Lehman Crisis’ – declined by 50 percent since 2009, and as of September 2011 accounted for only 10 percent of total NPLs. ’

Japan’s NPL market – overview

Since 2009, the balance of non-performing loans (NPLs) within Japanese banks has been steadily declining. And while the Great Eastern Japan Earthquake did not change this trend for Japan’s major banks, it did have a significant impact on those regional banks located within the disaster areas which saw a significant increase in both the balances and ratios of NPLs for the six months period ending September 2011.

The composition of NPLs within the Japanese market has also been changing. The level of bankrupt loans – which had risen significantly following the ‘Lehman Crisis’ – declined by

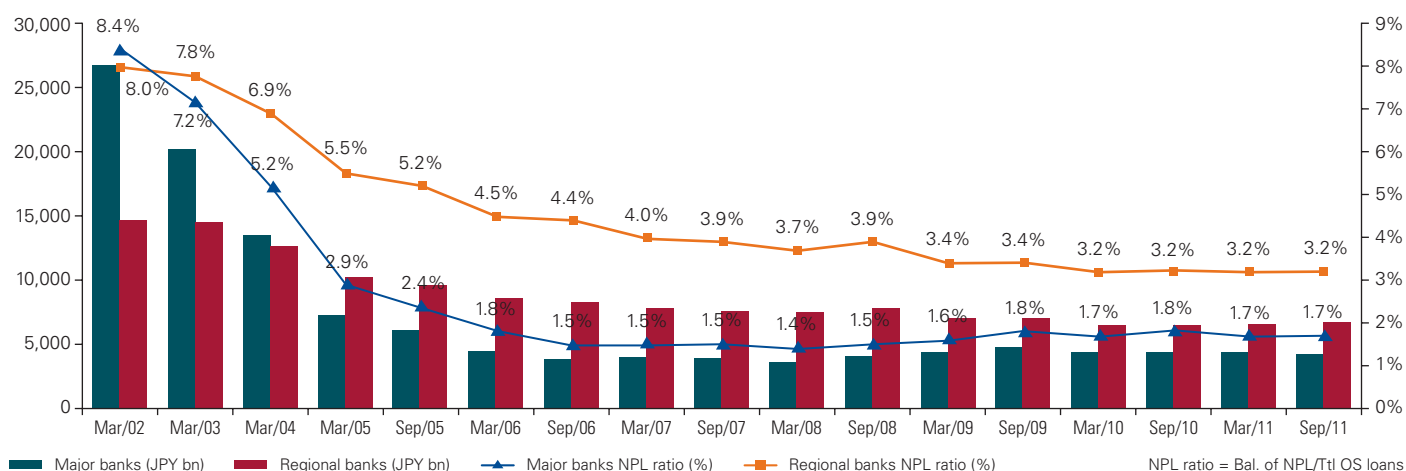
50 percent since 2009, and as of September 2011 accounted for only 10 percent of total NPLs.

Restructured loans, on the other hand, have seen the reverse trend: balances fell considerably following the Lehman Crisis, but have since been rising and now account for more than 20 percent of total NPLs. It should also be noted that – having enacted and then extended the SME Financing Facilitation Act (otherwise known as the ‘Moratorium Law’) through the end of March 2013 – it is anticipated that the market will see an accumulation of what could potentially be considered

restructured loans once the Act comes to an end.

While the number of NPL sales remained fairly consistent throughout the Lehman Crisis, the value of those sales has been considerably smaller, resulting in an overall decline in deal values of between 30 to 50 percent. Even so, the total number of NPLs offered to the market over the past 3 years has remained largely unchanged. Japan’s NPL market does, however, continue to be characterized by the bulk sale of portfolios made up of large volumes of smaller loans including Ponkasu (loans with low recovery rates and no collateral/unsecured).

NPL balances

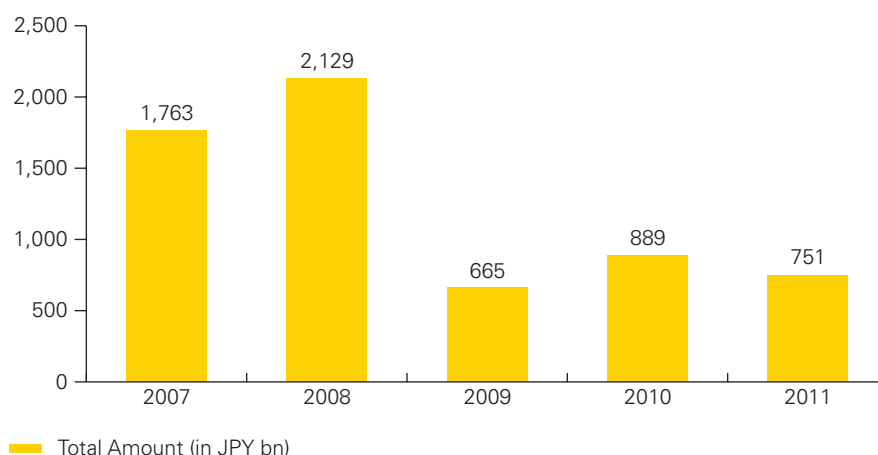


Source: Financial services agency.

In addition to the primary deals initiated directly by the banks, there has also been an increase in the number of 'secondary' deals being made, largely by existing NPL investors who are revisiting and replacing their portfolio of loans with new portfolios.

Based on market feedback, it seems that the appetite for Japan's NPLs remains strong. Indeed, many of those buyers who exited the market after the Earthquake have since returned and are now actively seeking opportunities to invest. As a result, demand for large and open deals is running high which, in turn, has driven up pricing and forced bidders to expect lower returns.

Amount of NPL transferred



Source: Japanese Bankers Association.

Japan's economy – overview

Over one year after the earthquake, Japan is continuing to make concerted efforts to recover; the appreciation of the Japanese Yen has finally started to settle down, and Japan's export industry is now catching its breath. At the same time, certain industries such as housing, construction and public infrastructure are enjoying a strong economic environment fueled largely by the recovery effort and low cost funding made available by the Bank of Japan.

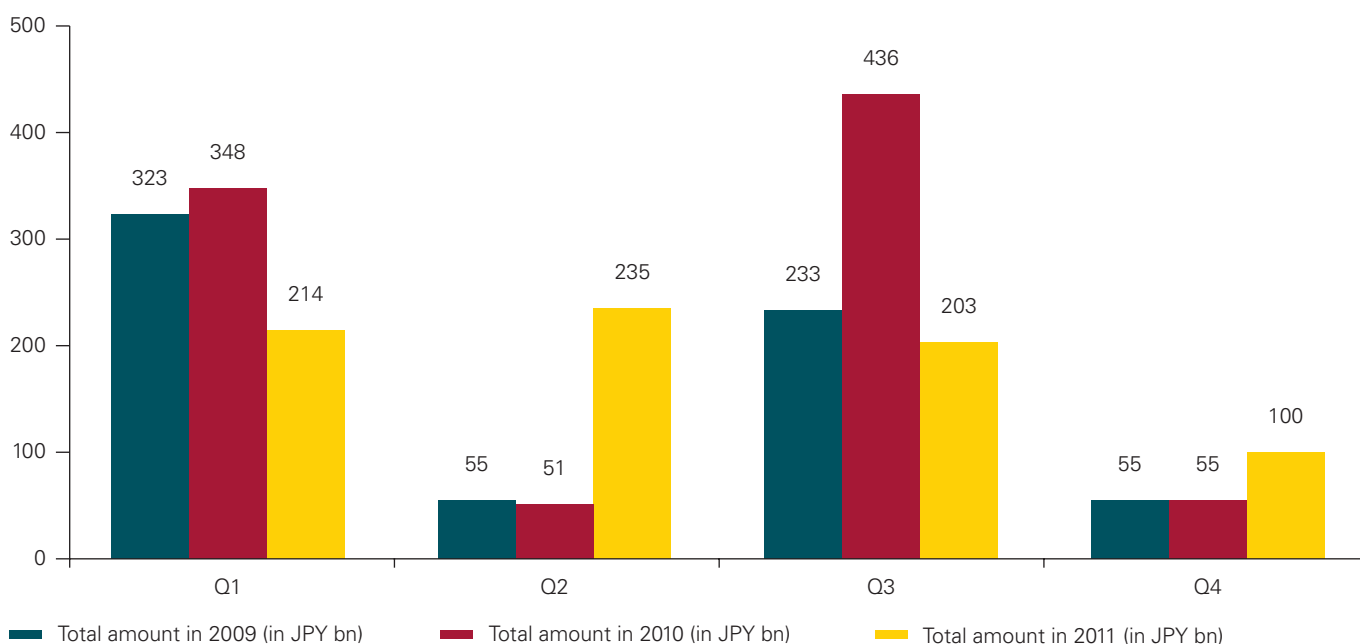
According to a report by Japan's Ministry of Land, Infrastructure and

Transport (MLIT), Japan's real estate market continued to struggle in the first half of 2011 with land prices showing a considerable decline from 2010. However, in the second half of 2011, prices outside of the worst hit disaster areas seem to have leveled off.

The government has enacted a number of measures aimed at helping those businesses that were directly impacted by the earthquake and subsequent Tsunami. Likely the most significant is the establishment of two organizations dedicated to purchasing the loans of

affected businesses from the holding financial institution. Sangyo Fukko Kiko was established after November 2011 as a limited partnership for investment in each prefecture by a combination of the Organization for Small & Medium Enterprises and Regional Innovation, local government and local financial institutions; and in March 2012, Saisei Shien Kiko was established by Deposits Insurance Corporation of Japan (DICJ) and Agricultural and Fishery Co-operative Savings Insurance Corporation (AFCSIC).

Amount of NPL transferred by quarter



Source: Japanese Bankers Association.

Outlook

The Moratorium Law, in particular, will have a profound impact on Japan's debt sales market. The Law, which provided many borrowers (including SMEs with financial difficulties) with almost automatic extensions or loan rescheduling opportunities, is set to expire at the end of March 2013. As a result, financial institutions have begun to reassess these borrowers which will likely lead to a significant down-grading of loan classifications and a heightened potential for financial institutions to consider disposing of loan portfolios.

In response, the Cabinet Office, Financial Service Agency (FSA) and Small and Medium Enterprise Agency of Japan formulated the "Policy Package to Support Business of Small and Medium-size Enterprises (SMEs) based on the final extension of SME Financing Facilitation Act," in April 2012 to improve the management of SMEs and promote business revival. In part, the Policy aims to aggressively enhance the role played by organizations such as the Small and Medium Enterprise Turnaround Support Committee who are actively setting up a special situation fund to acquire interest in and/or loans from the SME sector which will likely serve as a catalyst to bringing more deals to the market.

It is also worth noting that a number of European banks are now seeking to exit their loan positions in Japan in order to raise much-needed capital. While these transactions may include underlying platforms, they are performing loans and will therefore command high pricing.

Given the pace of activity in the market, it is widely expected that Japan's NPL and debt markets will soon shape up to be one of the most active markets in the region over the next few years.





Australia

Australia's secondary debt markets saw substantial activity between the second half of 2011 and the first quarter of 2012, largely due to a number of European banks reducing their Australian non-core exposures and an increase in the level of trading in single non-performing loans. In general, the focus of these sales has tended towards non-core corporate and project finance loans by the European banks coupled with one-off non-performing commercial mortgage loan books.

Indeed, according to the Bank of International Settlements in Switzerland, European banks cut more than USD8 billion (AUD7.56 billion) in loans from the

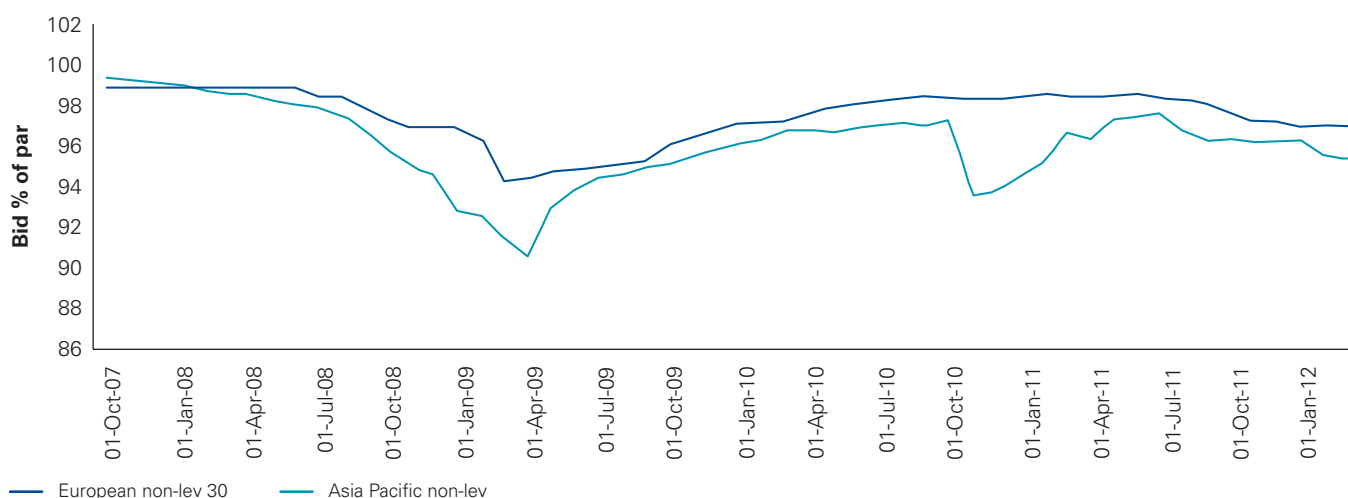
Australian banking system in the second half of 2011 alone.

It is worth noting, however, that these European departures have been partly offset by new entrants into the market including Asian lenders, new debt funds, sovereign wealth funds and pension fund/life company investors seeking to build their books in this market.

The entry of new players into the Australian market has brought with it new capital and, as a result, the gap between Australian and European loan bids is now decreasing, with some loans now being acquired by strategic investors at prices either close to or at par.

Australia's secondary debt markets saw substantial activity between the second half of 2011 and the first quarter of 2012, largely due to a number of European banks reducing their Australian non-core exposures and an increase in the level of trading in single non-performing loans.

APAC loan bids remain below European counterparts



Source: Thomson Reuters.

That being said, there have been a number of significant portfolio transactions recently including the sale by Lloyds of its approximately AUS2 billion property portfolio, which sold to a consortium of buyers including: Morgan Stanley Real Estate Investing and Blackstone funds, Societe Generale's sale of its AUS900 million portfolio of project finance and corporate loans, and the completed AUS1.7 billion sale of BOS International's property loan book, which sold to Morgan Stanley and, separately, a consortium led by Goldman Sachs and Brookfield which

attracted prices of around 35 cents on the dollar.

The Bank of Queensland also placed a range of non-performing property loans up for sale after suffering impairment charges of AUS328 million which directly led to the bank reporting a half yearly net loss of AUS91 million. Market reports indicate that half the portfolio was sold to Goldman Sachs and discussions are ongoing regarding the remainder.

However, outside of the Bank of Queensland, it appears that no other Australian banks are currently exploring a proactive public portfolio sales process

at this time. In part, this is likely because they are relatively well capitalized and may therefore seek to selectively sell their debt on an asset by asset basis. Others, however, may instead look to structure their assets into tailored funds thereby aligning them to a particular institution and eliminating the need for tenders.

There has also been talk of the potential for tranches of bank debt in a corporation being sold to outside investors which, after being subsequently restructured, may be wholly or partly converted into equity, as well portfolios of mortgage debt.

Recent transactions

Seller	Status	Bidders/buyers	Details
BOSI	Completed, June 2011	Morgan Stanley and Blackstone	<ul style="list-style-type: none"> sale process of the remaining AUD2 billion portfolio in Australian commercial property loans
Soc Gen	Current	Range of undisclosed bidders – still in progress	<ul style="list-style-type: none"> AUD900 million portfolio of performing infrastructure loan portfolio
Bank of Queensland	Current	Withdrawn	<ul style="list-style-type: none"> range of property non performing loans with outstanding balances of approximately AUD230 million
BOSI	Completed, Nov 2011	Morgan Stanley and separately a consortium led by Goldman Sachs and Brookfield	<ul style="list-style-type: none"> AUD1.7 billion in commercial property in Queensland and New Zealand sold for approx. 35 cents in the dollar
RBS	Completed, Nov 2011	BTMU	<ul style="list-style-type: none"> acquired RBS's circa GBP4 billion global project financing portfolio and Australian team of 20 staff
BOI	Completed, Nov 2011	Commonwealth bank of Australia	<ul style="list-style-type: none"> sold an AUD300 million portfolio of project finance loans
RBS	Completed, Oct 2012	Macquarie	<ul style="list-style-type: none"> acquired RBS's Australian reverse mortgage loan portfolio

Source: KPMG Analysis, 2012.



Thailand



The Thai Asset Management Company (TAMCO), a state agency created in 2001 to tackle growing NPLs, has now also closed and is in the process of transferring remaining loans and assets under management.

Over the past year, Thailand's Commercial Banks have experienced a slight decline in the number of gross non-performing loans to reach THB256.72 billion in September 2012. This decrease was primarily due to moratoriums offered to those impacted by the severe flooding that affected the country in 2011 and a larger focus on risk management protocols by the banks.

However, in the past year there have been numerous bank auctions of mixed (primarily secured) loans with a face value in excess of THB40 billion, and

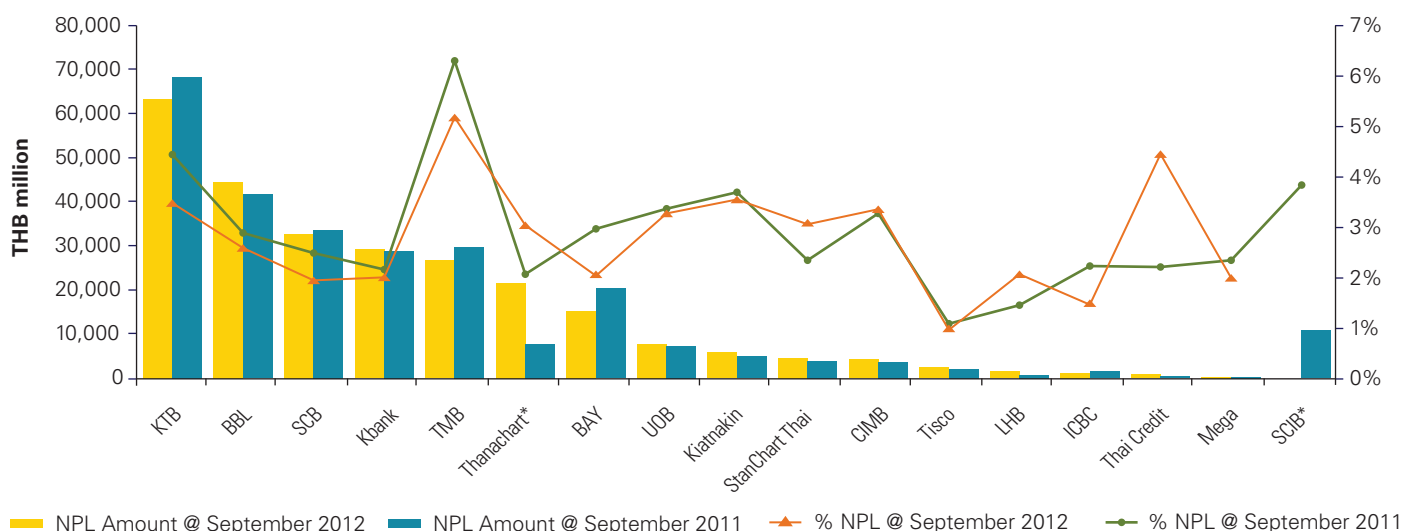
one secondary sale, all of which were successful.

The Thai Asset Management Company (TAMCO), a state agency created in 2001 to tackle growing NPLs, has now also closed and is in the process of transferring remaining loans and assets under management, which, at the time of closure, was estimated at approximately THB600 billion, to local AMCs Bangkok Asset Management Company Ltd (BAM) and Sukhumvit Asset Management Company Ltd. (SAM).

Changes to asset foreclosure proceedings

Thai banks are widely expected to continue exploring loans sales as a method of balance sheet management, and buyers continue to express interest. However, recent changes to foreclosure proceedings will potentially have an impact on both sales and pricing for loans, particularly in situations where foreclosure and the sale of underlying collateral is considered the most likely method of resolution.

Gross NPL – Thai commercial banks



*Thanachart and SCIB merged in 2011.

Source: Bank of Thailand.

The conclusion of foreclosure proceedings is a court auction process where reserve prices are set by the Legal Execution Department (LED) and the property placed in auction. Under previous rules, the LED would set the minimum bid price at 100 percent of the appraised value (as determined by the Treasury Department) for the first auction, with further reductions in the minimum bid in the event of no sales (to 80 percent of appraised value in the second auction and 50 percent in the third). The previous rules also allowed the mortgagee to 'credit bid' for the asset, thereby enabling the ownership of the asset to be transferred to the mortgagee along with a corresponding reduction in the debt.

As of July 2011, however, regulation changes now require the initial minimum bid price to be based on the highest value from seven price indicators including appraised values from the Office of Asset Appraisal, the Treasury Department, third party appraisers, the judgement creditor and the owner of the assets mortgaged. Furthermore, there are now minimal reductions in reserve pricing

for subsequent auctions. Changes to credit bidding rules have also made it more difficult for a mortgagee to credit bid; the new rules require at least two independent bids be received before a credit bid can be accepted, while in the past, only one bid was required which could be the mortgagee.

While the regulatory changes were conducted in order to achieve sales at higher prices and therefore provide a better result for the debtor (such as reducing bankruptcy actions for shortfall claims), the result has actually been higher reserve prices leading to reduced buyer interest. With credit bidding now also more difficult, auction clearance rates have subsequently also dropped.

So where the LED process had led to average property disposals of around THB20 billion per month before the changes, the market has experienced a dramatic decline, dropping to around THB200 million per month. A low clearance rate has also led to auction backlogs estimated at THB360 billion which is causing frustration among creditors (who are not being repaid) and debtors (who are seeing

accumulating interest charges while they wait for a sale).

This has, understandably, led to an increase in the number of complaints regarding the new rules and the low auction clearance rates, which has spurred the Office of the Council of State to implement further revisions to the process in order to improve the clearance rate. These changes include delegating reserve price setting to a Price Setting Committee and introduction of protocols to achieve a sale in cases where there is a sole bidder for the asset.

While the above two changes are now in effect, it may however be some time before the backlog of pending auctions can be processed. Until such time as auction clearances return to "pre-regulation change levels," market feedback indicates that future pricing for portfolio acquisitions may be affected.

Notwithstanding this, we expect to see a number of banks and AMCs continue to explore debt sales, with transactions expected to continue over the next 12 to 18 months.

Taiwan

“The trend towards greater asset quality is also reflected by a substantial increase in the ratio of NPL coverage within the domestic banks which rose from 59 percent in 2006 to reach 252 percent in 2011.”

Since 2006, the asset quality of Taiwan's banks has seen continuous improvement with consecutive yearly decreases reported in NPLs through 2011. In large part, this is the result of stringent regulations and an increased focus by banks on risk management. As a result, the NPL ratio has fallen from 2.1 percent in 2006 to just 0.4 percent in 2011. Indeed, out of the 37 domestic banks, only two reported an NPL ratio of between 1 and 2 percent in December 2011, and only one bank reported a higher rate (Cosmos Bank reported an NPL ratio of 7.6 percent).

The trend towards greater asset quality is also reflected by a substantial increase in the ratio of NPL coverage within the domestic banks which rose from 59 percent in 2006 to reach 252 percent in 2011.

Debt sales

Faced with historically high levels of NPLs in the banking sector, the government passed the Financial Institutions Merger Law in 2000, which provided the legal framework for the establishment of asset management companies (AMCs) in Taiwan. The law was also structured to assist banks in disposing of their NPLs to the AMCs, thereby enabling them to concentrate on their core banking business.

As a result, Taiwan's NPL sales market picked up pace during 2002 and 2003, moderating slightly between 2004 and 2005. In 2006 and 2007, however, the market experienced a dramatic surge in NPL trading driven by two main factors: the onset of a consumer credit crisis in 2006, and the expectation that a provision allowing banks to amortize losses from

NPL sales over a five year period would be removed in 2007. But while this led to a peak of NPL sales in 2007 (reaching TWD236.8 billion), the market has since slowed to record sales of TWD64.1 billion in 2008, TWD57.5 billion in 2009 and TWD41.6 billion in 2010.¹ Market feedback indicates that approximately TWD14.4 billion worth of loans were sold through multiple auction processes between January and September 2012.

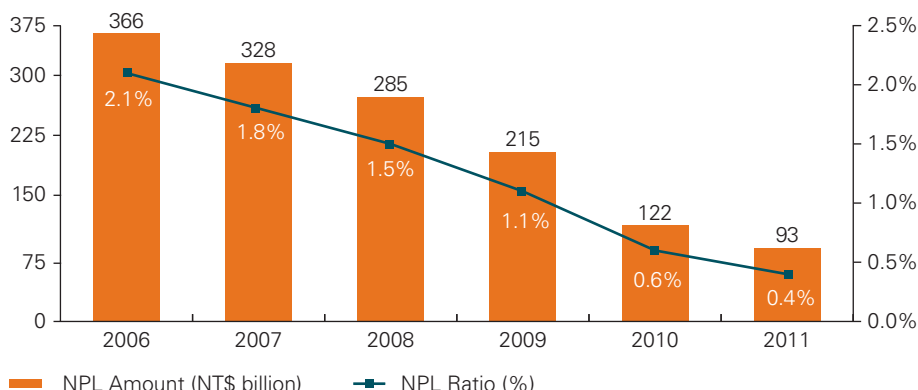
Faced with a declining NPL sales market, the AMCs are now shifting their focus away from traditional corporate financing, construction and other large-scale transactions, towards more frequent, small-scale consumer NPLs. A number of AMCs are also looking to expand their presence in newer geographies such as China.

Real estate market

In an effort to keep the banking sector sound, Taiwan's Financial Supervisory Commission (FSC) has recently been focusing on reducing banks' over-concentration in the real estate sector. For example, in March 2011, the FSC announced a string of measures aimed at tightening mortgage lending by financial institutions including:

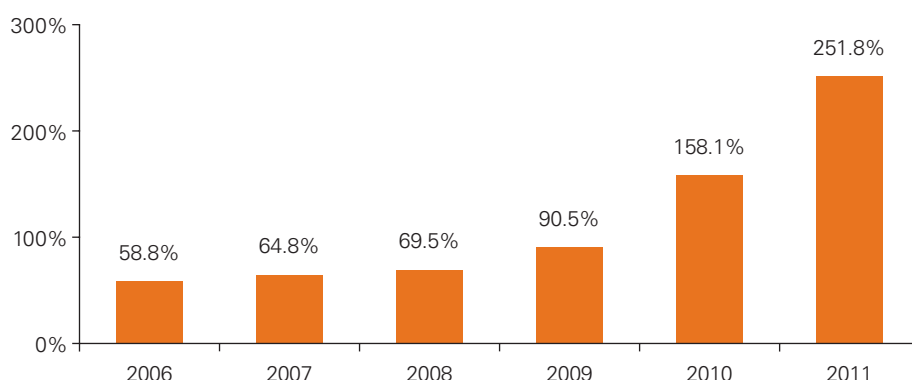
1. A 100 percent risk weighting for loans on properties that do not qualify as an owner-occupied residence.
2. An obligation to conduct an onsite appraisal for real estate properties involved in the transaction.
3. A requirement to bring the proportion of construction loans to below 30 percent of the total outstanding loans.

Non-performing loans of domestic banks



Note: Year-ending December 31.
Source: Financial Supervisory Commission, Taiwan.

Average NPL coverage ratio of domestic banks



Note: Year-ending December 31.
Source: Financial Supervisory Commission, Taiwan.

The FSC is also aiming to curb soaring realty prices by controlling speculative real estate purchases. Indeed, in June 2011, the government introduced a luxury tax on non-self use homes, levying a 15 percent tax on homes sold within one year of purchase, and a 10 percent tax on those sold in the second year.

Given new taxes and tighter lending norms, these regulations are likely to lower the level of real estate transactions which, in turn, may strain sales and impact the debt repayment capacity of real estate developers, resulting in higher ratios of NPLs.

Outlook

Looking ahead, it seems that banking sector NPLs may rise as a result of both the downturn in the global economy (thereby impacting the ability of some companies and individuals to make debt repayments), and a tightening of the domestic real estate market. Market observers and participants may therefore find renewed debt sale opportunities in the Taiwanese market in the near future.

¹ Financial supervisory commission

http://www.banking.gov.tw/ch/home.jsp?id=192&parentpath=0,4&mcustomize=multimessage_view.jsp&dataserno=21212&aplistdn=ou=disclosure,ou=multisite,ou=chinese,ou=ap_root,o=fsc,c=tw&toolsflag=Y&dtable=Disclosure



Philippines

“ At the same time, loan growth in the country has quickly been accelerating, particularly within the manufacturing, utilities, business services and construction sectors. ”

The Philippines' banking sector has experienced a significant improvement in asset quality, marked by steadily falling NPL ratios and adequate loan loss provisions. At the same time, loan growth in the country has quickly been accelerating, particularly within the manufacturing, utilities, business services and construction sectors.

Non-performing loans

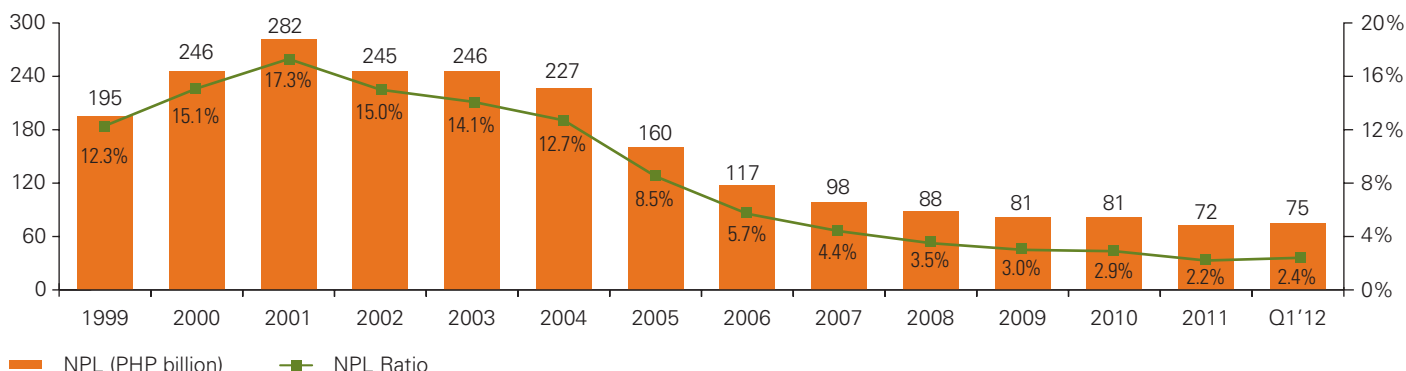
Since 2001 – when the ratio of non-performing loans (NPLs) reached a peak following the Asian financial crisis – the level of NPLs has been in

steady decline in the Philippines. In part, this is a result of more stringent lending regulations introduced in 2002 and the establishment of special purpose vehicles intended to absorb the banking sector's NPLs and thus help curb the rise in bad loans. These measures have largely worked; NPL ratios for commercial and universal banks were estimated to be 2.2 percent as of December 2011, a 15 year low. However, the sector did experience a marginal rise of 0.2 percent in the first quarter of 2012.

Key sources of NPLs

NPL ratios within the Philippines' universal and commercial banks are largely being driven by consumer loans, particularly auto loans, credit card receivables, residential real estate loans and other household loans. In fact, by the end of 2011, the consumer loans sector reported an NPL ratio of 7.2 percent (down from 9.3 percent in 2009), versus an overall banking NPL ratio of just 2.2 percent. Interestingly, while consumer loans accounted for just 11.3 percent of the banks' total loan portfolios, they made up 24.7 percent of their NPLs at the end of 2011.

Non-performing loans



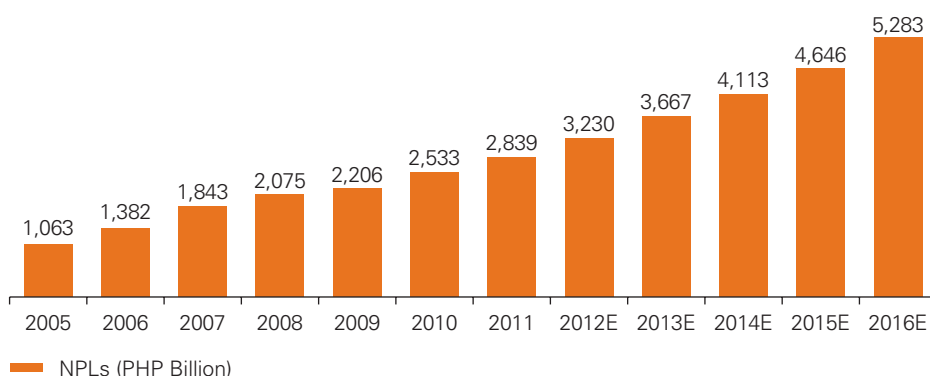
Note: Includes non-performing loans for universal and commercial banks.
Source: Bangko Sentral ng Pilipinas (BSP), Banking Statistics.

NPL resolution market

Following the Asian financial crisis in 2001, the Philippine government established the Special Purpose Asset Vehicle Law in 2002 to deal with the significant build up of NPLs. Under the law, banks could receive certain tax exemptions and fee benefits by transferring their bad loans to privately-owned asset management companies or SPVs. The law was notably successful; initially approved for implementation until 2005, the law was extended to 2008 to allow more than PHP200 billion of NPLs to be sold. Given that most banks had improved their asset quality and lowered their NPL ratios by 2008, the law was not extended further.

Currently, banks primarily dispose of their assets through either direct joint venture agreements with property firms or public auctions. In April 2010, for example, the Philippine National Bank entered into a PHP6 billion joint venture with Ayala Land, a property developer, to develop a 2.3 hectare property in Mandaluyong City. As part of the deal, PNB would provide the land, while Ayala would offer its expertise for the development and marketing of the property.

Bank loans (PHP billion)



Note: Numbers have been converted from USD to PHP using exchange rate of PHP43.71/USD as on December 31, 2011.
Source: EIU.

Outlook

Partly due to a rise in liquidity and increasing demand for loans, domestic banks are expected to increase lending over the coming years. Consumer loans are likely to experience the most substantial growth as rising household incomes trigger purchases of household items, vehicles, and residential properties. But, as they head into an era of improving profitability, businesses are also undertaking expansion initiatives, which will largely be funded by bank loans. At the same time, government policy aimed at boosting the country's economy is also likely to spur growth in bank lending.

However, despite the potential for lending growth, the banks' NPLs are likely to remain in control, particularly in light of more robust risk management policies, low interest rates and an upbeat business environment.



Indonesia

It is also worth noting that the state-owned and foreign-owned banks tend to be holding higher levels of NPLs when compared to other banking groups.

Introduction

Having mandated banks to maintain a capital adequacy ratio above 8 percent and a non-performing loan ratio below 5 percent, Bank Indonesia (Indonesia's central bank) has effectively ensured that the country's banks are operating at a healthy asset quality.

Since the regional monetary crisis in 1998, the country has experienced further declines in NPL ratios, largely thanks to economic development and more stringent risk management processes by the banks. Indeed, in the past decade, NPL ratios have

declined by more than 10 percent (from 12.2 percent in December 2001 to 2.2 percent in 2011) and now sit at approximately IDR48 trillion.

And while NPL ratios at the key commercial banks continued to decline between 2009 and 2011, Morgan Stanley analysis indicates that levels are projected to increase in 2012 and 2013, largely due to an expected increase in lending.

Interestingly, while working capital loans accounted for the largest share (59 percent) of total non-performing loans

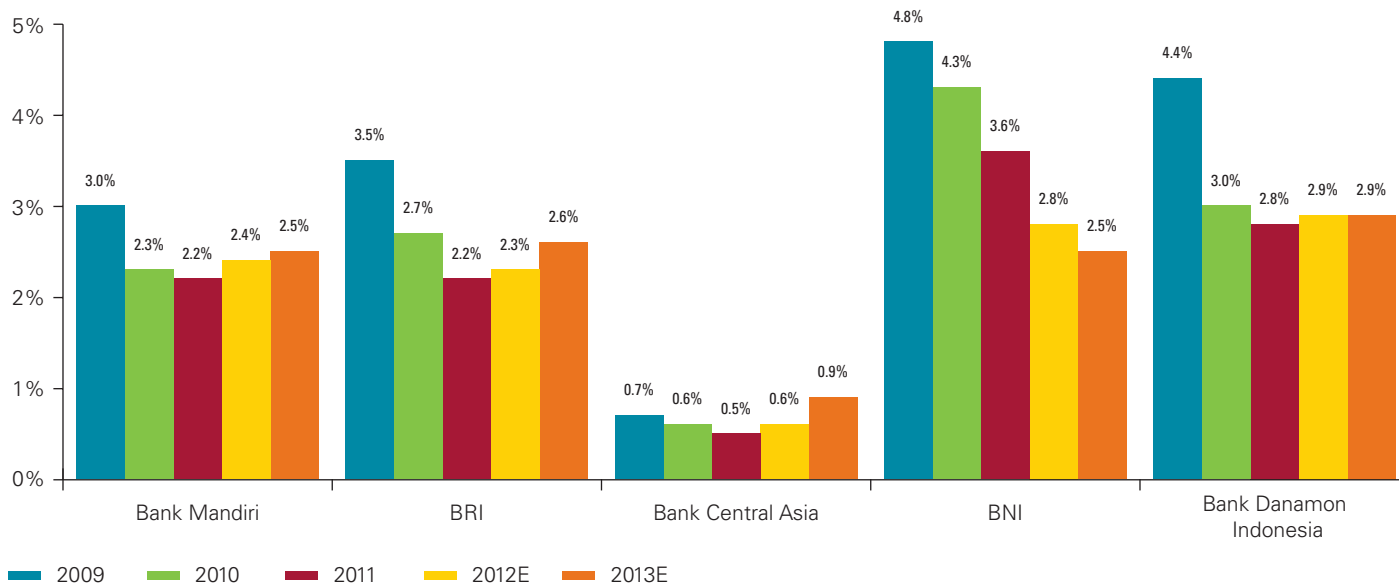
in December 2011 (followed by consumer loans at 22 percent and investment loans at 19 percent), it is the consumer credit segment that has seen the most remarkable growth over the past few years. In the ten years between 2001 and 2011, consumer credit NPLs experienced a CAGR of 24.3 percent compared to a 3.5 percent CAGR for both the working capital segment and the investment loan segment. It is also worth noting that the state-owned and foreign-owned banks tend to be holding higher levels of NPLs when compared to other banking groups.

Commercial banks – gross NPLs



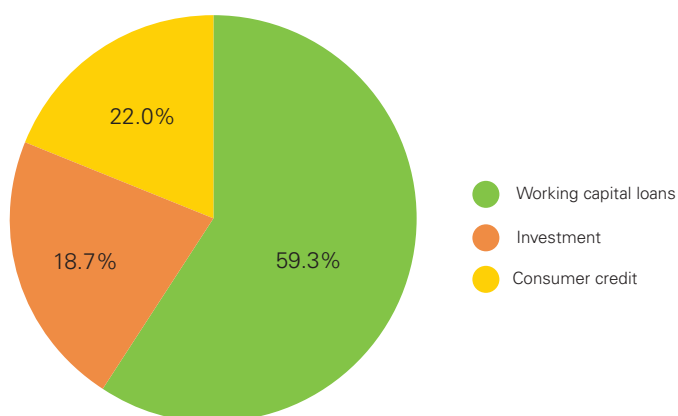
Note: Commercial banks include state-owned banks, foreign-owned banks, foreign exchange commercial banks, non-foreign exchange commercial banks, Regional Development banks and joint venture banks.
Source: Indonesia Banking Statistics.

NPL ratio of key Indonesian banks



Source: Morgan Stanley Research Reports.

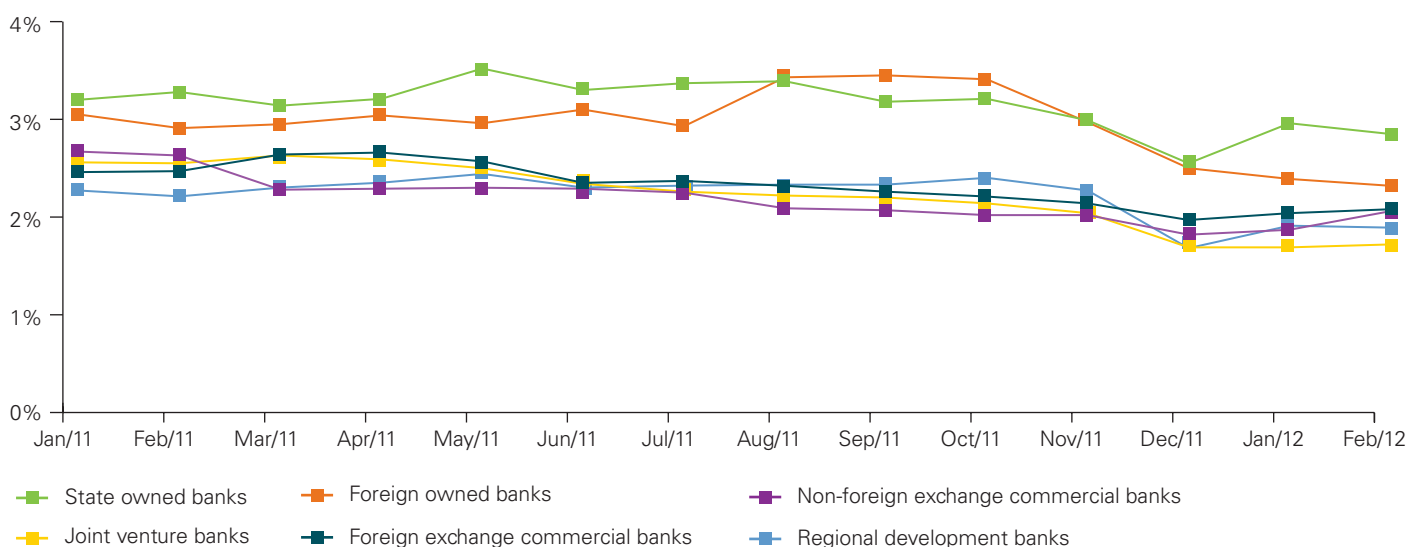
NPLs of commercial banks breakdown (2011)



Note: Total NPLs (2011) = IDR 48 trillion.
Source: Indonesian Banking Statistics.

Ministry of Finance now aims to establish an improved regulatory framework for NPL resolution. In March 2010, the government released new NPL settlement regulations, which are widely expected to encourage international investors to invest in Indonesian NPLs.

NPL ratio of key banking groups



Source: Indonesian Banking Statistics.

NPL resolution market

While NPL settlement activity by Indonesian state-owned banks has historically remained somewhat subdued as a result of regulatory restrictions, the Ministry of Finance now aims to establish an improved regulatory framework for NPL resolution. In March

2010, the government released new NPL settlement regulations, which are widely expected to encourage international investors to invest in Indonesian NPLs.

On September 25, 2012, the Constitutional Court of Indonesia ruled on a case affecting banking rules for state-owned banking institutions. The ruling

allows state-controlled/owned banks to claim uncollected loans attached to the state, which are currently being taken care of by the Finance Ministry's State Receivables Affairs Committee. The ruling ended a restriction that was contained in a 1998 banking law that had banned state-owned banks in Indonesia from using a financial mechanism, known as

the 'credit haircut'. State banks could not discount bad loans; such loans were considered state receivables, and the Finance Ministry's State Receivables Affairs Committee attempted to fully collect them.

Fitch Ratings said that the ruling would benefit state-owned banks. The decision overturning the ban puts state banks on the same ground as privately owned financial institutions. This could bolster their core capitalization to maintain rapid loan growth amid limited fresh capital. The ratings assessor calculated such recoveries could improve state lenders' CARs by an average of 2 percentage points. It is estimated that the combined value of uncollected loans held by state

lenders was USD9.5 billion, equivalent to 54 percent of their equity bases.

However, in order to be implemented, the ruling needs a regulation from the finance ministry and formal recognition from other law enforcement partners.

Real estate

A combination of strong domestic demand, low interest rates and increased foreign investor confidence has effectively been driving the Indonesian residential and commercial real estate sectors and this trend is expected to continue into 2012.

However, Indonesian banks still remain cautious in lending to the real estate industry. According to

the Residential Property Survey conducted by the Bank Indonesia in the second quarter of 2011, a total of 55.4 percent of residential property development projects were financed internally, 29 percent were financed through bank loans and 12 percent of projects were financed by consumer payments (primarily by pre-selling).

Regulation may also create another mitigating factor going forward. In March 2012, Bank Indonesia imposed a regulation on the allowable level of credit disbursement for housing and automotive loans. The regulation sets the maximum loan to value ratio of 70 percent which may further restrict the growth of housing loans in the country.

Outlook

With Bank Indonesia keen to spur bank lending to support overall economic growth, the Central Bank has reduced their benchmark rate by around one percent since October 2011, providing a further catalyst to the growth of lending overall. However, the ICRA Indonesia has forecasted total bank loans to grow at between 20 to 23 percent in 2012, which is slightly slower than the 25 percent growth experienced in 2011. Loan growth may also slow due to the unfavorable macroeconomic conditions being experienced around the world.

Indonesia's level of outstanding bank loans is expected to exceed that of its regional neighbors such as Malaysia and Singapore over the next 5 to 6 years and loan-to-deposit ratios are expected to increase from the current level of around 77 percent to about 91 percent by 2014.

However, despite the substantial growth in lending and the potential impact of macroeconomic factors, the Indonesian banking sector is expected to maintain its overall credit quality through 2012, largely as a result of the banks' conservative approach to lending.

Sources:

- 1 "Indonesia: Court Decision Changes Banking Rule"; http://www.loc.gov/lawweb/servlet/lloc_news?disp3_l205403352_text
- 2 "Bank Mandiri may restructure Rp 32 trillion in Loans"; <http://www.thejakartaglobe.com/corporatenews/bank-mandiri-may-restructure-rp-32t-in-loans/547434>
- 3 "State banks welcome equal treatment with private competitors"; <http://www.thejakartapost.com/news/2012/10/01/state-banks-welcome-equal-treatment-with-private-competitors.html>



India



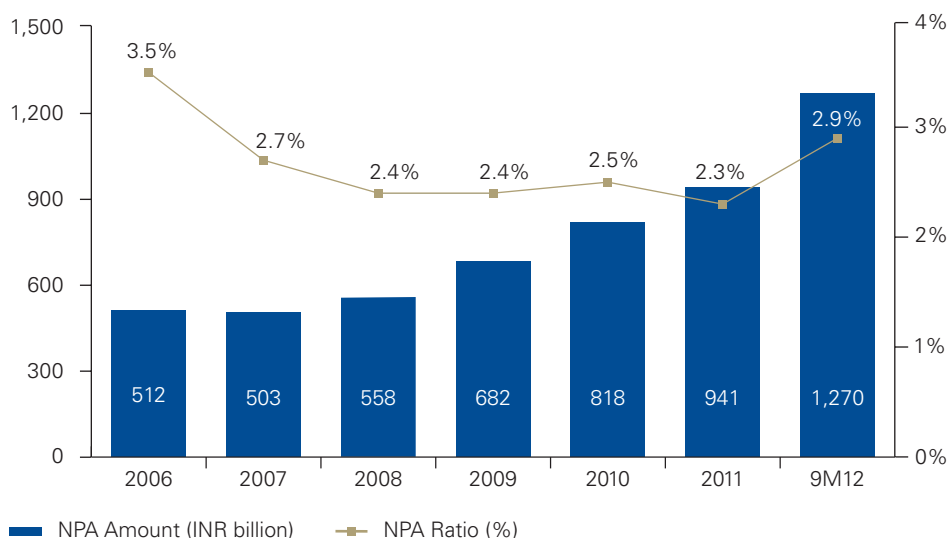
It is worth noting that the rise in NPLs was also influenced by the migration of most of the public sector banks to a new computerized calculation system for bad debts in 2011 which increased the reporting of NPLs overall.

In India, the value of non-performing loans (NPLs) has been steadily increasing, leading to asset quality concerns within the banking sector. Indeed, as at Q3 2012, India's banks reported gross NPLs of INR1.27 trillion representing an increase of more than 35 percent during the last three quarters of the year. NPL ratios also saw a significant increase over the same period, rising from 2.3 percent to 2.9 percent in the three quarters ending December 2011. The problem is particularly acute for public sector banks which accounted for 82 percent of NPLs by the end of Q3 2012.

In large part, this rise in NPLs is the result of aggressive lending by banks in the recent past, coupled with insufficient internal quality control mechanisms. The situation has been further exacerbated by high interest rates and the impact of the economic slowdown that together have greatly affected the ability of borrowers to service their debt.

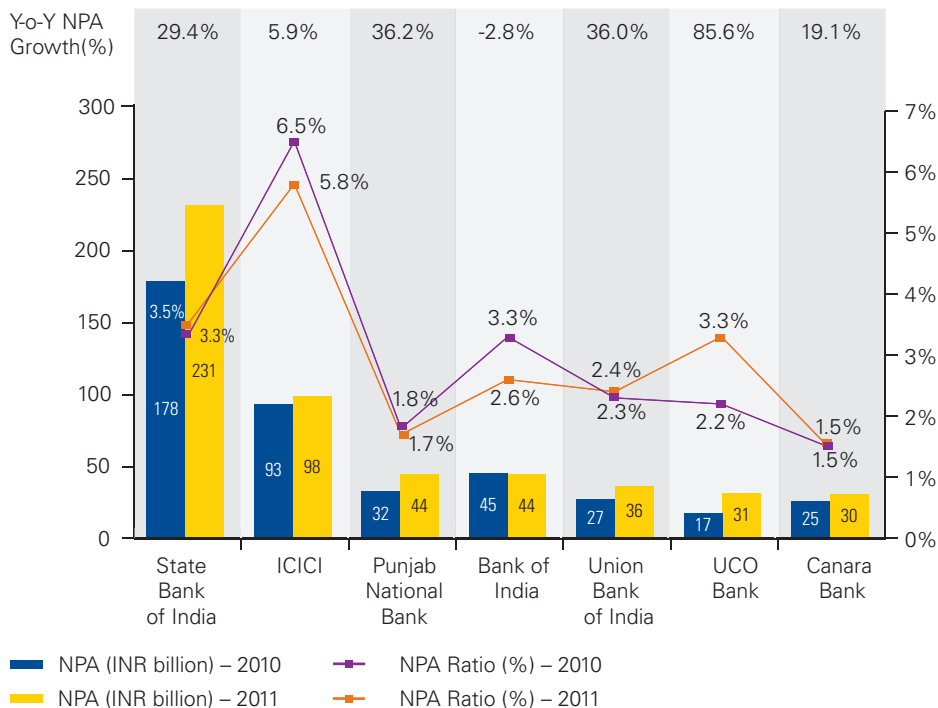
It is worth noting that the rise in NPLs was also influenced by the migration of most of the public sector banks to a new computerized calculation system for bad debts in 2011 which increased the reporting of NPLs overall.

Banking sector NPAs



Source: Reserve Bank of India (FY ending 31 March); figures for 9M12, (i.e. period ending December 31, 2011) have been sourced from industry articles.

Asset quality indicators



Source: Reserve Bank of India (FY ending 31 March).

While several sectors have contributed to the increasing levels of NPLs, activity has been led by India's 'priority sectors'. By March 2011, fully 58 percent of the public sector banks' NPLs were related to priority sector lending, up from a 54 percent share a year earlier. Interestingly, around 70 percent of the priority sector's NPLs were attributed to the agricultural and SME sectors.

That being said, real estate lending has also been stressed due to high interest rates and soaring realty prices which have negatively impacted sales and – as a result – weakened the debt repayment capacity of the realty companies.

While to a lesser extent, other priority sectors have also contributed to rising NPL levels. In the textile sector, slowing demand and falling output prices have created specific challenges while, in the power sector, the continued absence of periodic tariff revisions are placing increasing pressure on generators.

Unfortunately, there does not seem to be a near-term end in sight. According to CRISIL, a credit rating agency, the asset quality of Indian banks is expected to remain under pressure. The agency expects the Indian banking sector's NPL

ratio to rise to 3.2 percent by March 31, 2013, up from an estimated 3 percent at the end of March 2012.

NPLs in the banking sector may be further strained by an increase in the number of loans being referred for corporate debt restructuring (CDR). CDRs reflect stressed accounts, some of which may well become NPLs over the coming years. For the year ended March 2012, a total of 84 corporate loans worth INR645 billion were referred for restructuring, compared to just 49 cases valued at INR250 billion referred during the previous year. In large part, this is due to high interest rates and a subdued macroeconomic environment which is driving the surge in restructuring applications.

Debt sales

While the level of NPLs has steadily increased, we have not seen a commiserate increase in activity for the asset reconstruction companies (ARCs), which buy NPL portfolios from banks. For example, India's largest bank (the State Bank of India) holds nearly INR400 billion worth of NPLs yet – between 2009 and 2011 – sold just six bad loans on to the ARCs for a combined

book value of INR0.4 billion. However, the ARCs face a number of hurdles including weak policy frameworks for debt sales, lack of capital to fund debt purchases and expected valuation gaps between the ARCs and the banks.

These valuation gaps are particularly drastic with most banks seeking to recover between 40 and 50 percent of their NPL values while ARCs typically offer only 10 to 20 percent. Believing this hefty discount to be unacceptable, many banks prefer to rely on their in-house recovery teams to collect the dues.

Deals between ARCs and banks are also being challenged by the small capital base of most ARCs in India. Facing a constrained ability to pay cash for NPL purchases, many banks prefer to issue security receipts for the majority of the portfolio amount which often discourages banks from conducting NPL sales.

Outlook

Much of the outlook for debt sales in India may depend on the regulatory initiatives currently being contemplated to support the ARCs. For example, in September 2011, an advisory committee that includes members from the government and industry was set up to look into the regulations and policy frameworks related to ARCs with the intention of suggesting changes that would lead to the improvement of their performance and functioning.

A series of recommendations have now been proposed including the establishment of standard processes, the public listing of ARCs, and increasing foreign investment limits in these companies to strengthen their capital. Regulatory support may also help streamline the functioning of ARCs which, in turn, will likely encourage banks to conduct NPL portfolio sales to these companies in the near future.







Malaysia



In 2009, CIMB Bank went on to sell a book of NPLs with a gross value of MYR8.4 billion (and a book value of MYR928 million) to South East Asia Special Assets Management Berhad (SEASAM), a special purpose vehicle (commonly referred to as a 'bad bank') of the CIMB Group.

Banking sector developments

Overall, the Malaysian banking sector has remained resilient over the past few years, with strong capital, sustained profitability, ample liquidity and stable loan quality.

In an effort to maintain a stable and sustainable property market, the Central Bank implemented a maximum loan-to-value (LTV) ratio in November 2010, capping the LTV ratio at 70 percent for any third house financings taken by borrowers.

With risk-weighted capital ratios standing at 14.6 percent in the fourth quarter of 2010 and 14.8 percent in the

third quarter of 2011, capitalization has been strong and often far in excess of the 8 percent minimum requirement. Moreover, the banking sector continues to enjoy healthy profits, reporting some MYR5.7 billion in pre-tax profits in the third quarter of 2010 and MYR6.7 billion during the same period in 2011. Loan quality has also remained stable over the past few years.

Debt sales in Malaysia

Since 2005, when Bank Negara Malaysia (the Central Bank) issued new guidelines, both the Malayan Banking Berhad and CIMB Bank Berhad undertook sales of non-performing loans (NPLs) to third parties in 2007 and 2008 respectively. As a result, the banks

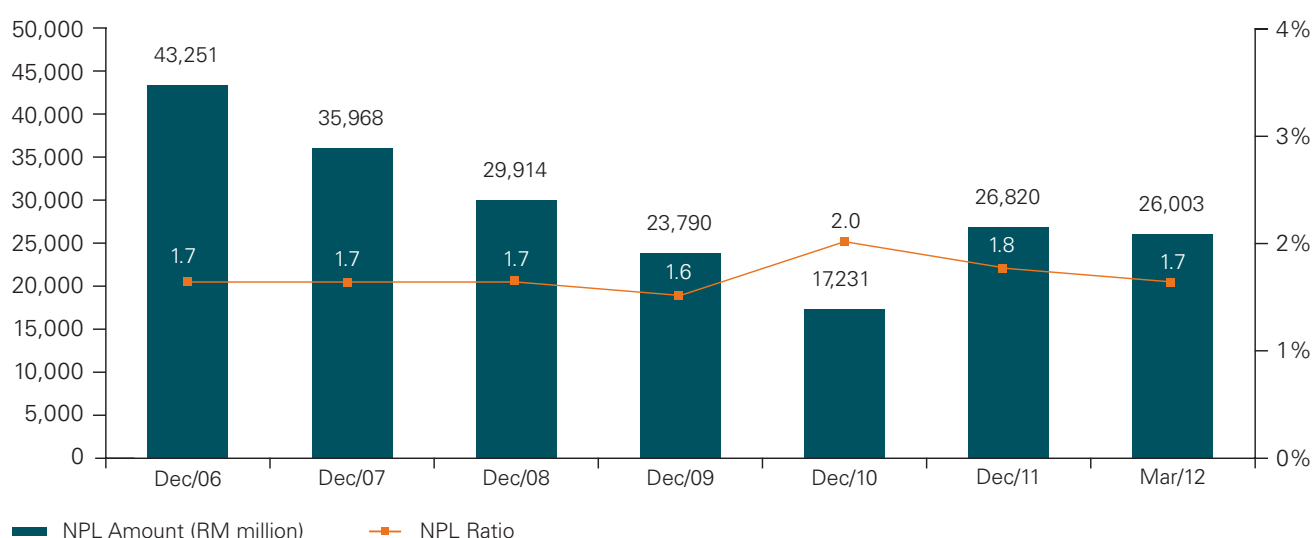
have now been able to write-back their bad debt provisions.

In 2009, CIMB Bank went on to sell a book of NPLs with a gross value of MYR8.4 billion (and a book value of MYR928 million) to South East Asia Special Assets Management Berhad (SEASAM), a special purpose vehicle (commonly referred to as a 'bad bank') of the CIMB Group. But while it was reported that CIMB had been in talks with several specialist parties to sell at least 51 percent of its stake in order to deconsolidate SEASAM, the sale did not materialize.

However, since 2009, there has been very little activity in the Malaysian NPL market.



Non performing loan/impaired loans of Malaysia banks



Source: Bank Negara Malaysia.

Outlook for Islamic Finance

Interest in Islamic Finance has increased dramatically in the face of growing global economic uncertainty. Indeed, in 2011, the Islamic Finance industry surpassed the USD1 billion mark, having experienced growth of 21.41 percent in Shari'a compliant assets. In fact, the top 500 Islamic banks maintained average CAGR growth rates of 18.82 percent, eroding the position of many of the conventional banks.

With increasing assets and facing new opportunities, the industry will likely see a rise in the number of mergers and acquisitions. Moreover, the consistent asset and revenue growth now being experienced by the Islamic financial institutions will likely bring new players into the market, thereby helping the sector expand beyond its traditional boundaries.

Given the growth in regulatory and infrastructure support (such as the Financial Sector Blue Print), Malaysia is rapidly becoming a global hub for Islamic finance, luring a number of foreign Islamic banks (including AlRajhi Bank, Standard Chartered Saadiq, HSBC Amanah Malaysia, Kuwait Finance House, and OCBC Al-Amin Bank) to set up operations in the country.

KPMG's Portfolio Solutions Group's service offering

A dedicated Portfolio Solutions Group

KPMG's Portfolio Solutions Group understands the complexity of loan sales. In the last 24 months alone, our team of professionals has helped both buyers and sellers close numerous transactions and secure real value for their loan portfolios and related assets.

KPMG member firms can offer both buy-side and sell-side clients balanced, independent advice based on years of hands-on experience and extensive global insight.

We have worked with a wide variety of vendors and purchasers, including financial institutions, commercial banks, development banks, utility providers, governments, private equity funds, insurers and government asset management companies, and have built a strong reputation for cutting through the complexity of loan sales to deliver highly tailored and insightful advice.

Sell side services

With extensive experience closing numerous portfolio transactions around the world, our team works with portfolio vendors to guide them through each stage of the sales process. From early preparatory steps of portfolio analysis and buyer identification through to the execution of SPAs and financial closing, KPMG firms' professionals provide a wide range of services, including:

Assessing current portfolio values and market demands.

Face value and market value can often be substantially different. By leveraging our strong relationships with investors, KPMG professionals undertake market soundings and indicative bid processes to provide vendors with clear insight into the existing appetite and potential market value of their debt portfolios.

Identifying buyers and selecting assets. KPMG's global Portfolio Solutions Group tracks specialist buyer preferences and uses this knowledge to attract the right buyers to deals throughout Europe, Asia Pacific and the Americas. The additional benefit of having a dedicated in-house broker dealer based in KPMG in the US's New York office, means that KPMG has a network of experienced professionals in key locations around the world to support multi-jurisdictional sales.

Aligning sale processes and portfolios to maximize value. Not all debt portfolios can be pushed through the same sale processes. Indeed, by investing the proper time into reviewing the underlying portfolio information and understanding buyer preferences, sellers are better able to meet their own objectives and align to buyer demand.

Navigating buyer negotiations and optimizing sale terms. KPMG professionals leverage their experience gained from numerous successful portfolio sales around the world to deliver

insight into drafting and negotiating the vendor Sale and Purchase Agreement (SPA), including methods for getting vendors comfortable with the "must have" versus "nice to have" clauses in the contract. This in turn results in buyers bidding with more confidence as a number of transaction risks are already dealt with in the SPA.

Understanding the implicit value of portfolios. Selling a portfolio is not always the best outcome of a strategic portfolio review. KPMG experts spend time prior to starting a sales process to determine whether buyer and seller expectations are aligned. Being able to understand and communicate the key drivers of the portfolio's performance, and – by closely monitoring the keep/sell value – can help clients select the strategic best outcome to match their corporate objectives.

Independent and transparent process. By acting as independent sales advisors, KPMG professionals provide both buyers and sellers with confidence that the sales process will be fair and at arm's length, particularly in bids or transactions involving state-owned entities.

Buy side services

KPMG firms' professionals are well placed to support buyers in sourcing, valuing and reviewing loan portfolio assets. And by combining our strong market relationships and global



network, we provide buyers with the confidence of knowing that their purchases align with their core business assets, achieve competitive pricing and provide sustainable value for their business. We deliver a wide range of buy-side services, including:

Deal Sourcing. KPMG professionals maintain deep relationships with dedicated portfolio and strategic buyers to identify and source portfolio opportunities that match buyers' unique investment criteria.

Due diligence and valuation. Whether for a stand-alone portfolio or as part of a wider asset acquisition, KPMG professionals leverage local expertise and global processes to provide market pricing assessments, due diligence services, and assessments on underlying portfolio data, and deliver

expert insight into prevailing market conditions and industry benchmarks.

Deal structuring. Our deal structuring services cover securitization, tax, regulatory and accounting considerations, meaning that KPMG can help buyers understand the implications of their asset purchases – both from their own perspective and that of the vendor – to help clients better negotiate and close deals, and achieve greater value from their portfolio over the long term.

Post deal services. Following successful acquisitions, KPMG professionals work with buyers to develop and implement sustainable implementation plans with the aim of ensuring a seamless integration of assets into their overall portfolio. With extensive experience conducting in-house and external

servicer reviews, we also provide trusted assessments of borrower restructuring plans, compliance with processes and internal control reviews.

Global strategies with local execution

In today's global marketplace, both buyers and sellers must be able to work together to confidently structure deals across multiple jurisdictions and markets at once. With offices in more than 156 countries, KPMG firms' professionals understand the benefits of creating global strategies with local executions. Our Portfolio Solutions Group is supported by KPMG's global network of member firms that seek to provide our clients with a consistently high level of quality and expertise no matter where the assets are located.





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