

Stabilizing and reviving the financial system

Employing guarantee structures, “bad banks,” and other mechanisms to combat the financial crisis

Executive Summary

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Background and acknowledgement

- As we developed our views on stabilizing and reviving the financial system, we decided to focus on ways to potentially enhance a number of current approaches that have been taken around the world to combat the financial crisis rather than to engage in a lengthy critique or propose a “one size fits all” solution. In doing so, we have attempted to develop a more holistic “framework for action,” which financial institutions, investors, and policymakers around the world can use to implement ideas and options that make sense within the context of their unique circumstances.
- In order to develop our point of view and framework, we analyzed the current and past financial crises to determine what has worked and what has not. Our research points to no single solution, but rather multiple strategies that should be tailored by country, asset class, and potentially institution. These strategies should also take into account the specific macro and microeconomic factors that exist in each situation.
- To develop our point of view, we interviewed dozens of clients, current and former government officials, and PwC partners in the Americas, Europe, and Asia. We also drew a number of ideas and insights from leading academics and participants in the financial markets. We would like to thank each of these groups for sharing their ideas, insights, and experiences with us over the last several months. Developing this point of view would not have been possible without their collective wisdom.
- We recognize that readers may have additional ideas and insights to share, either now or in the future, that could further enhance this document. We encourage you to share those ideas with us by submitting comments and feedback to us at fsviewpoints@us.pwc.com. Lastly, please look for the full research paper later in May 2009 (available on www.pwc.com/fsri) for additional analysis, case studies, and detailed implementation examples.

Section 1 – Point of view

Section 1

Point of view

The financial crisis has progressed to a point where malfunctioning credit markets, a severe capital shortage, and lack of confidence have fueled a global economic downturn.

Policymakers worldwide have gone to unprecedented lengths to maintain the solvency of financial institutions and prevent a complete collapse in confidence in the financial system. They have succeeded so far. The solvency situation was made more acute by the fact that many banks were funding themselves on a short-term or overnight basis in the wholesale credit markets. Various governments throughout the world have reacted to the liquidity crisis by injecting significant capital into the banks and providing additional short-term funding to both the banks and credit markets as needed. Overall, government support has led to more normalized activity in some areas such as interbank lending, and facilitated securitization activities in certain asset classes and markets, but the broader private credit markets are still not functioning at the levels required to support the global economy.

Policymakers, financial institutions, and citizens are witnessing the severe economic impact of continued weakness in credit markets and extreme risk aversion by investors. This, combined with continuing significant declines in asset values, has caused private capital to largely sit on the sidelines. Governments have, in effect, become the major providers of new capital to the financial system as private investors are hesitant to invest in most financial institutions or purchase financial assets—a situation that must be reversed if policymakers and business leaders are to reestablish confidence and prevent further economic deterioration.

Asset price declines have created a “deflationary mindset” for businesses, investors, and consumers, significantly complicating the task of reviving the markets.

Deflation embeds an expectation of even lower future asset values and can set in motion a downward spiral as individuals stop buying, businesses stop investing, and banks stop lending. This is where we are today. Why buy a house when prices continue to decline? Why purchase a mortgage-backed security when prices have been declining for more than two years? Why make a loan if you have to mark it down the minute you extend the credit?

Private capital will stay on the sidelines or in perceived safe government bonds until investors believe asset values have hit bottom. In our view, the vast majority of businesses, investors, and consumers are waiting for more than just real estate to stabilize—they are waiting for asset prices to stabilize across the board. When this happens, confidence will begin to return, along with private capital.

Section 1

Point of view

The impact of the deflationary mindset on the financial system and broader economy is substantial.

In the fall of 2008, the prevailing view was that aggressive central bank liquidity operations, bank recapitalization funding, and other targeted government intervention around the world would succeed in stabilizing the system and spur lending, thus preventing a severe economic downturn. While these measures prevented an immediate financial meltdown, credit availability has continued to deteriorate in the vast majority of countries.

As asset prices continue to fall, banks face tremendous pressure from management and regulators to bolster capital, reduce risk, and limit lending. Credit has also contracted as a result of lower consumer spending, business investment and confidence, pressure on capital ratios, higher write-offs, and tightened underwriting standards. Taken together, these factors have led to increased unemployment and further erosion of asset class valuations such as high-yield corporate bonds, auto loans, and commercial real estate.

The increase in consumer and investor fear and frustration can be seen in the low levels of public support for bank bailouts throughout the world. Policymakers and financial markets are hastily searching for new answers before the situation worsens further.

Section 1

Point of view

While governments are likely the only parties able to lead the efforts to break the deflationary mindset, history shows that private investors must ultimately drive the credit markets. The reestablishment of private participation in the markets is, therefore, a prerequisite for recovery.

In the late 1970s and early 1980s, it took aggressive central bank action to reign in double-digit inflation in the Organisation for Economic Co-Operation and Development (OECD) countries. Governments are now faced with similar challenges with respect to deflation. They will likely continue to encourage lending and provide targeted support for credit markets as they continue aggressive actions to break the deflationary mindset and spur economic activity. Some commentators have argued that private parties must be the lead actors in combating the financial crisis. Our research shows that governments may take the first steps to combat serious financial crises, yet private sector support must be close behind. The current crisis has reinforced the view that individual private investors are not able to turn the tide without government support. For example, most private investors who made investments in financial institutions during 2007 and 2008 have sustained spectacular losses, further contributing to fear in the market and extreme investor risk aversion. Going forward, this fear must somehow be reduced and a stable and predictable investment framework established by policymakers if private investors are to participate in the recovery plans.

Our research further indicates that if such a framework is created, private investors will likely establish markets for troubled assets once those troubled assets are removed from troubled institutions via a sovereign bad bank or sold directly to investors through a practical disposal framework that promotes price discovery. History also suggests that governments will likely need to take the first steps to spur the removal of at least some of these assets from troubled institutions before active markets can be established. This is where the policymakers, financial institutions, and investors around the world are now focused as the crisis moves to its “resolution phase.”

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Point of view

The array of programs deployed to date has had little impact on removing troubled assets from the bank balance sheets.

To date, most of the programs in place have focused on stabilizing particular institutions or encouraging certain market activities, but have not addressed the removal of troubled assets from the banks or the creation of functioning market and pricing mechanisms for these assets. Consider, for example, the recent guarantee structures put in place by the US government for Citigroup and Bank of America and the recently created UK Asset Protection Scheme (APS). These guarantees, while helpful in stabilizing individual institutions, are not currently transferrable to third parties when the underlying assets are sold or securitized. The guaranteed assets, therefore, remain more valuable on the bank balance sheets, arguably creating a disincentive to sell them to private investors.

The inability of previous efforts to remove troubled assets—combined with public opposition to bank bailouts and increasing macroeconomic constraints—is spurring policy options that conserve capital and encourage private investment.

The strategies and structures deployed to date have significantly increased government deficits and contingent liabilities, largely without involving private capital. In fact, current and future policy options available will be increasingly influenced by macroeconomic constraints such as the ability of governments to borrow sufficient funds at acceptable rates in order to implement certain strategies. The recent revisions to the US bank bailout plan, for example, reflect the realization that a public-private partnership is required to create market liquidity and remove troubled assets from bank balance sheets. Further, the use of private-public partnerships and government lending to support that structure is a policy option that fits within the current funding available to the US Treasury.

A significant and growing obstacle to private participation in government bailout plans is that many investors are wary of political backlash and the imposition of additional restrictive conditions post-investment. Investors are concerned that these conditions will reduce returns and impose restrictive policies around strategic areas such as compensation, thus negatively impacting the competitive position of those institutions that participate. Given this situation, it is our view that policymakers should focus on minimizing existing uncertainties and provide assurances to investors and financial institutions that retroactive conditions or restrictions will not be imposed after disposal programs have been established.

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Point of view

Our research indicates that bad bank solutions have been the most successful structures deployed in past crises to remove troubled assets from financial institutions.

Our research shows that, in crisis after crisis, bad banks have been a consistently successful tool employed by financial institutions and policymakers to dispose of troubled assets. In the current crisis, bad banks are being employed within an increasing number of financial institutions and by some governments.

In past crises, bad bank solutions have generally been successful for a number of reasons, including:

- The management of the bad banks can focus solely on restructuring credits with borrowers and, where possible, selling troubled assets.
- The management of the good banks is not preoccupied with managing troubled assets and negative public perception.
- Investors achieve greater transparency into the potential earnings streams of the good bank and an improved understanding of the capital requirements to manage the bad bank assets.

Additionally, when a sovereign bad bank removes assets and a “good bank” remains:

- Confidence can be quickly reestablished in the remaining good bank, allowing the institution to raise new capital.
- Private investors generally begin to participate in those recapitalization efforts.
- The government’s retained ownership in the good bank often rises in value, and the capital gain can be used to offset the cost of establishing the bad bank.

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Point of view

Despite a proven track record of success, adopting bad banks is not an easy policy decision.

On a sovereign basis, bad banks have often been resisted at the outset in past crises initially for cost and political reasons, then ultimately adopted. Delaying this decision in past crises has been costly, however, as our research indicates the longer troubled assets remain on bank balance sheets, the longer the crisis tends to last. In other words, history shows that troubled assets must be removed from bank balance sheets before economic recovery can begin. The Swiss, Irish, and German governments have opted for bad bank solutions to address this issue, and we expect many other countries to follow suit in the coming months. In several countries, one of the factors preventing the adoption of a sovereign bad bank is that the absolute level of troubled assets (and, therefore, initial capital required to establish a sovereign bad bank) represents a significant portion of or may even exceed GDP. The challenge for these countries is that if a sovereign bad bank is not a practical option, the remaining policy options make it more difficult to achieve desired outcomes and success. The current US plan, for example, is taking a novel approach that seeks to provide public financing to private investors in order to buy assets directly from the banks and avoid creating bad banks.

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Point of view

Bad bank solutions, if well structured, tend to cost significantly less than the initial “headline” capital contributions.

The good news is that realized government losses in bad banks during previous financial crises have tended to be substantially less than the initial capital contributed. Some examples include:

- In Japan’s last financial crisis, the government reduced eventual losses by participating in the equity upside of the restructured loans through convertible debt issuance.
- In the Swedish crisis, capital was returned to the government once troubled assets were liquidated.
- The US Resolution Trust company cost substantially less than the initial capital committed by the US government.
- The Chinese government was able to sell stakes in its largest banks once troubled loans were moved to four government-owned asset management companies.

Today, governments are shareholders in a number of troubled institutions. In these cases, a bad bank/good bank approach would likely immediately increase their equity in the good bank, helping to offset at least some of the cost of the recapitalization of the bad bank.

In a recent *The New York Times* editorial, Max Holmes of Plainfield Asset Management outlined a plan that included transferring matched liabilities to a bad bank structure to significantly decrease the government capital required to establish bad banks, and address many of the difficulties in determining “fair value.”¹

¹: Max Holmes, "Good Bank, Bad Bank; Good Plan, Better Plan," *New York Times*, 31 January , 2009.

Section 1

Point of view

Whichever policy solutions are selected, the removal of troubled assets from the largest institutions should be the top priority.

Consolidation of financial institutions in many G20 countries over the last decade has resulted in a handful of mega-banks in each country. The recent acquisitions resulting from the financial crisis, as well as mergers in the last two decades in such countries as Japan, Spain, France, Italy, Brazil, and Mexico, have only accelerated this concentration of banking assets on a global basis. In the US, for example, as of 31 December, 2008, the four largest banks had a combined US\$7.2 trillion in assets, and the next 46 banks had a combined US\$2.8 trillion in assets.¹ Given this type of concentration around the world, it is our view that policymakers are correct to first and foremost focus on removing troubled assets from these mega-institutions in order to have the greatest impact on the financial system and the economy as a whole.

Regardless of what type of approach is taken to remove troubled assets, restructuring and asset disposal strategies will need to be creative and will likely vary by asset class.

In reviewing past crises and considering the response to date to the current financial crisis, it is clear that specific restructuring actions should be based on characteristics of the borrower (e.g., corporate versus individual) and the legal system, as well as broader considerations such as the macroeconomic and political environments.

For example, the Japanese Resolution Trust Corporation (RTC) purchased corporate loans from all but the lead syndicate bank on individual exposures and allowed that institution to restructure the borrowings for the entire syndicate. This approach greatly streamlined the restructuring process and is viewed by many to have led to fewer corporate defaults and larger recoveries.

The strategy for restructuring consumer loans would also necessarily be different to that taken to manage troubled corporate debt. Additionally, a workable solution in the US, where mortgage loans are non-recourse and tend to have high loan-to-value ratios, may differ significantly from solutions deployed in the UK or Spain, where the legal environment and lending practices are very different. These are a few examples of the diversity of challenges and potential solutions by asset class.

¹: SNL interactive, "Financial Analysis: Banking Market Data," <http://www.snl.com>, Accessed 31 March, 2009.

Section 1

Point of view

We believe that the creation of tradable guarantee structures and the use of securitization will likely further reduce the cost and risks associated with disposing of troubled assets.

Although securitization and guarantee structures have been cited as contributors to the current crisis, we believe an opportunity exists to leverage these techniques to accelerate the process of asset disposal and reduce the cost and risks to shareholders and taxpayers.

A recent financial innovation has been the use of insurance, or “wrappers,” that guarantee principal and/or interest payments associated with a group of assets or securities. As noted previously, the US government is using guarantee structures to stabilize certain financial institutions, and the UK government has announced the creation of its APS for groups of assets to accomplish many of the same goals. It is our view that making these guarantees transferable to third-party investors would increase the attractiveness of the troubled assets to private investors and increase the options available to participating institutions for removing those assets from their balance sheets. Further, leveraging securitization markets and tradable guarantees in tandem could significantly accelerate the disposal of troubled assets and allow for broader investor participation, while giving significant impetus to the reestablishment of private credit markets.

We recognize that taking these steps may have political implications in some countries if it is viewed as unfairly enriching private investors; nonetheless, they should be carefully considered given their potential to reduce risk and cost.

Section 1

Point of view

A number of innovative ideas and practices have been proposed to address the difficulties of asset pricing.

Troubled asset pricing has received a great deal of attention recently, due to a number of factors, one of which being a fear that governments will pay too much for assets in a sovereign bad bank scenario or, all things being equal, not be adequately compensated for insuring those assets in a guarantee scheme. There is also concern that if investors are unable to ascertain fair prices during subsequent sales, disposal processes will not be effective.

In a number of past crises, pricing issues in sovereign bad banks have been addressed by the governments first purchasing the assets in bulk using a somewhat arbitrary but consistently applied pricing mechanism (such as audited book values or consistent discounts based on loan classification), and then conducting a sales process promoting price discovery by third-party investors. The third-party investors determine the ultimate asset values by applying their own models and analyses.

In the current crisis, inconsistency of valuation models and methods across financial institutions has been cited as a significant barrier to the creation of a sovereign bad bank. In a recently created sovereign bad bank, valuation of assets was established through a sophisticated price arbitration process where third-party valuation experts were leveraged to determine a “fair” price. We believe this type of model can be applied in other situations as well.

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Point of view

A number of innovative ideas and practices have been proposed to encourage the widest investor participation in the disposition process.

The optimal auction process itself has also been a topic of discussion. In particular, the challenges involve encouraging both auction participation and extracting the maximum prices for assets. We have studied many auction proposals and one of the more innovative examples is a three-tiered auction recently proposed to both value and auction troubled assets:

- Step 1 - Governments and sovereign wealth funds, who presumably begin with the best information, would bid for the assets at a discounted price. This would create a floor on asset values.
- Step 2 - Individual investors with knowledge of the government offer would be allowed to bid on some or all of the assets at the same or greater prices than the government entities.
- Step 3 - Professional investors would be allowed to examine the assets in detail and bid on some or all of the assets if these investors believed that they were being undervalued in the first two stages of the auction.

This three-step process may work well, for example, within the context of the current US government strategy of lending the private sector funds to purchase troubled assets directly from the banks.¹ Sovereign bad banks could simply take step 1 to buy assets from financial institutions and then sell those assets to third parties using steps 2 and 3.

¹Danyang Xie, "A Better Means to Soak Up Toxic Assets," [China Daily Newspaper](#), 10 March, 2009.

Section 1

Point of view

As policymakers and/or financial institutions implement bad bank and guarantee structures, the challenges of establishing, operating, and governing these structures and ownership stakes are formidable.

Policymakers should:

- Develop structures that make efficient use of increasingly limited government funds.
- Determine the roles and responsibilities of the various government agencies related to the establishment, oversight, and transparency of the bad banks and guarantee structures.

Financial institutions, investors, and policymakers should:

- Construct legal agreements that are comprehensive and fair to the financial institutions, government entities, and taxpayers.
- Develop governance frameworks that achieve sufficient government oversight without micromanaging the asset management activities of the independent asset managers (in a bad bank structure) or the banks (in a guarantee arrangement).
- Determine a process to “fairly” and uniformly, to the extent possible, price and value the assets being purchased, sold, or guaranteed, and updating that pricing to reflect market changes over time.
- Effectively segregate “bad” assets from “good” assets in terms of technology, reporting, and overall management.
- If the guarantees are tradable, establish an effective market for those guarantees, including auction processes, supporting technology and infrastructure, and asset tracking.
- Ensure that appropriate numbers of skilled professionals are available on both sides of the equation: the government and the financial institution.
- Develop a sufficiently transparent and effective set of metrics by which to measure results.
- Develop a transparent reporting process so that oversight bodies and the public have confidence in its operation.

Section 2 – A framework for action

Section 2

A framework for action

Whether the structure is a guarantee or a bad bank, many of the operational considerations are the same. These include the following:

The program

The overall construction of the program is key. Elements such as eligibility and terms will form the basis for the actual guarantee and/or bad bank execution.

The agreement

This provides the fundamental structure of either the sale of the assets into a bad bank or the assets being guaranteed. Included are key elements such as asset eligibility, calculation of loss, first-loss positions, ownership structures, working capital, asset disposal techniques, and key principles and elements of governance, reporting, and valuation.

Governance and reporting

If a guarantee structure is used, the government may rely on the experience of the financial institution with oversight requirements defined in the negotiated documents. In a bad bank structure, a separate management team may need to be carved out from the selling bank or third-party managers hired. It is important to note that third-party managers may likely rehire some bank staff for continuity purposes. In either structure, the establishment of the overall governance structure—including such elements as the responsibility of the government, the oversight boards and committees, and day-to-day management interactions—is necessary along with additional reporting requirements. This reporting is likely to extend beyond asset performance and agreement compliance to social-policy elements such as how money is spent and how individuals are paid.

Valuation

Regardless of structure, there is the question of the applicable transfer/guarantee price to be used. Given the lack of liquid markets and the subjectivity of many of the valuations, third-party revaluations are becoming more common along with a valuation dispute structure to arbitrate any differences. In either structure, there is a need to understand the valuation process and controls surrounding the assets as well as the stress losses and reserves. This information is critical to determining the expected transfer price or first-loss position/insurance premium.

Section 2

A framework for action

Asset tagging and demarcation

In either case, segregating and demarcation of troubled assets is a significant task that often requires changes to both technology and process to support the organization's reporting requirements. Asset tagging and demarcation is also complicated by the need to begin the process before the asset eligibility criteria are finalized. This often leads to rejection of initially proposed assets and the creation of a substitute asset pool, which must also be tested.

Accounting and taxation considerations

The accounting and taxation impacts of the various structures form a critical part of the framework. Key accounting questions surround treatment of issues such as guarantees, gaining sale treatment for certain assets, and impacts on capital ratios.

Executive compensation

Executive compensation is becoming a more critical aspect of these structures. Financial institutions must balance the need for compensation structures and incentives to comply with new government-imposed limitations, yet be competitive enough to retain the critical talent needed to manage the assets going forward for the benefit of the bank and the taxpayers. This is becoming an increasingly difficult balancing act to manage.

Public reporting and transparency

Increased government aid makes it necessary for both financial institutions and government agencies to report to the legislative branch and, by extension, taxpayers, on how the funds are being spent, and to ensure that these arrangements are not anti-competitive. Thus, establishing a strategy and framework to account for the funds and report on their use is an imperative for both the banks and the government. It is also important to prepare for the coming audits and reviews that accompany this oversight.

Workouts, asset acquisitions, and disposals

As troubled assets are restructured, bought, and sold, issues will arise such as the following: augmenting deal and workout teams, developing creative acquisition and disposal strategies, and executing on these strategies. As part of these acquisitions, due diligence and asset valuations will be key.

Section 2

A framework for action

PwC's framework for action includes specific approaches and templates for each of these critical execution streams.

Both the banks and the government agencies implementing these structures need to establish strong project management organizations (PMOs) and dedicated teams for each workstream. The following sections discuss some of the key considerations in each area, an outline of PwC's approach to each consideration, and illustrative examples of the types of deliverables required. PwC has developed these methodologies, approaches, and templates over the course of several decades of assisting financial institutions and governments in conceiving and implementing guarantee and bad bank structures.

Section 2 – A framework for action

Bad bank scope and structure

Asset separation and bad bank structure					
Themes	Selection & valuation	Accounting & legal	Capital	Liquidity/funding	Regulatory & tax
Activities	<ul style="list-style-type: none"> Determine criteria for separation of loans that are non-performing, sub-performing, and at-risk Complete value analysis: <ul style="list-style-type: none"> UPB & provisions Realizable value Transfer value Consider independent valuation of assets to be transferred 	<ul style="list-style-type: none"> Consider accounting implications of transfer: <ul style="list-style-type: none"> P&L impact Derecognition Project bad bank balance sheets under various stressed options Develop agreement for certification Develop guidelines for certifying legal documentation 	<ul style="list-style-type: none"> Assess impact of proposed group structure on capital and liquidity strategy Advise on capital structure options Develop regulatory capital projections Prepare detailed stress- testing models Embed ICAAP in management oversight 	<ul style="list-style-type: none"> Outline options available in liquidity and contingency funding plans Ensure liquidity buffer is sufficient to meet stress scenario needs 	<ul style="list-style-type: none"> Develop business plan based on capital and liquidity projections Develop and document structure to optimize tax efficiency of good bank and bad bank Prepare tax clearance Confirm that legal documentation reflects tax step plan
Outputs	<ul style="list-style-type: none"> Analysis of assets/ portfolios to be transferred to bad bank Valuation opinion of bad bank assets 	<ul style="list-style-type: none"> Model of asset performance under defined assumptions Legal certification of bad bank assets 	<ul style="list-style-type: none"> ICAAP and related capital management processes 	<ul style="list-style-type: none"> Liquidity policy and management framework 	<ul style="list-style-type: none"> Analysis of assets/ portfolios to be transferred to bad bank Valuation opinion of bad bank assets
Set-up of structure and transfer of assets					

Section 2 – A framework for action

Building blocks for a bad bank infrastructure

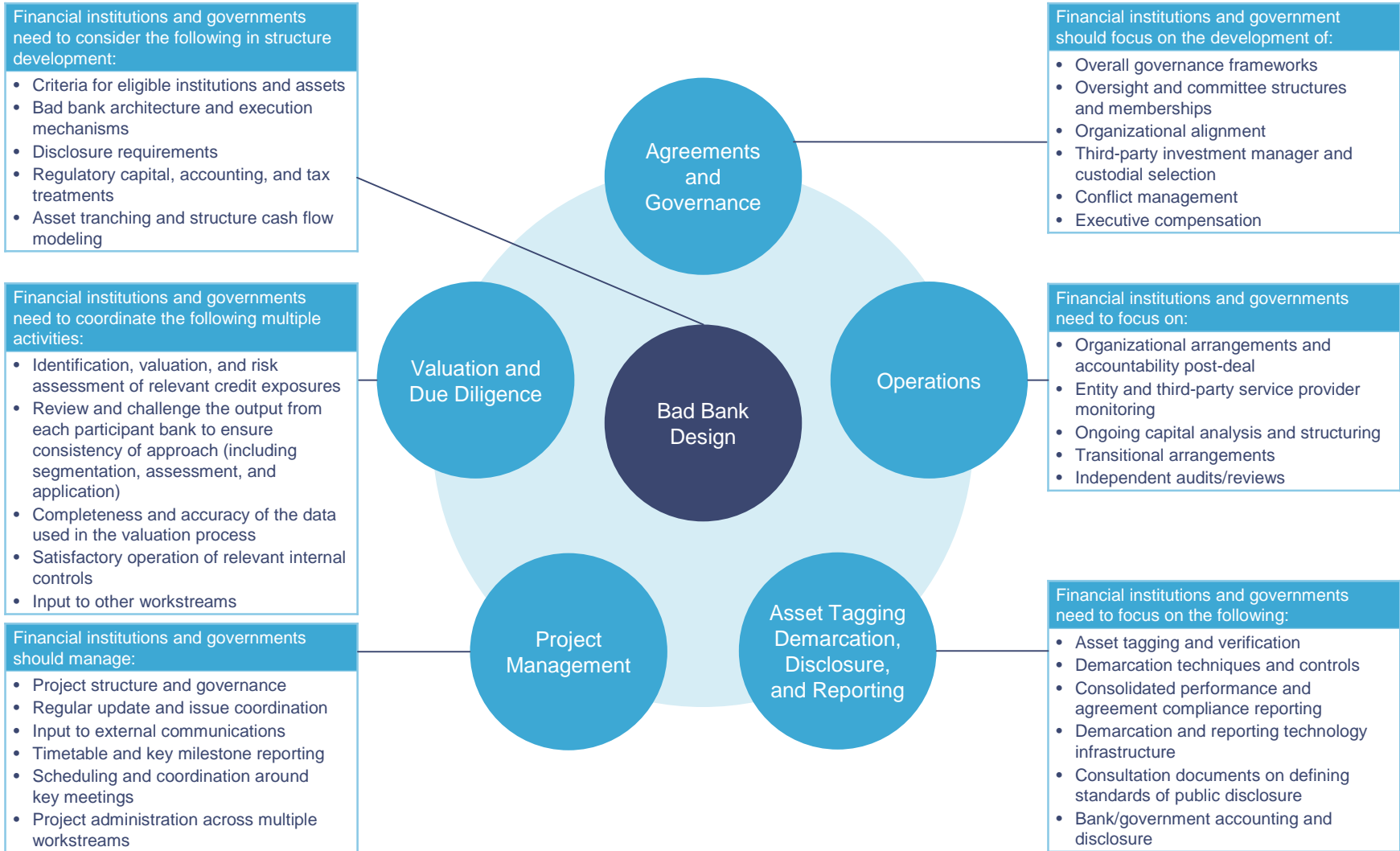
Target operating model design					
Themes	Capital, funding, tax & regulatory	Process and technology	Governance and organization	HR planning	Management reporting and performance measurement
Activities	<ul style="list-style-type: none"> Design capital allocation model Agree on risk appetite and performance measures Develop transfer pricing and intergroup funding (e.g., UK bank/GBM) Identify the most efficient tax structure Identify and meet regulatory requirements 	<ul style="list-style-type: none"> Define asset segmentation process Design/map of core processes for asset management Design risk management processes Define the best-fit technology infrastructure and data sources 	<ul style="list-style-type: none"> Design decision processes for asset management Design committee structure and terms of reference Roles and responsibilities 	<ul style="list-style-type: none"> Identify skills, resourcing needs and gaps, and training requirements Motivation and career development structure Remuneration and reward program 	<ul style="list-style-type: none"> Asset management and quantification in line with governance structure Identify MI needs Reporting mechanisms: timing/frequency Data storage Steering committee/board reporting
Outputs	<ul style="list-style-type: none"> Capital and funding model Tax structure Metrics defined and reported 	<ul style="list-style-type: none"> Model of asset performance under defined assumptions Legal certification of bad bank assets 	<ul style="list-style-type: none"> Paper establishing the governance and decision authorities for sign-off by steering committee/board 	<ul style="list-style-type: none"> People map Skills requirements Training package Leadership and coaching program 	<ul style="list-style-type: none"> Design reporting tool Reporting formats for steering committee/board Audit trails/drilldown
Implementation of operating model					

Section 2 – A framework for action Realizing the value of a bad bank

Sale/run-off of asset and businesses					
Themes	Lead advisory	Distressed debt advisory	Vendor assistance	Vendor due diligence	Restructuring
Activities	<ul style="list-style-type: none"> • Prioritize and prepare business for sale • Develop disposal strategies and timetables • Provide valuation advice and opinions • Market to list of potential buyers • Facilitate negotiations with potential buyers 	<ul style="list-style-type: none"> • Advise on sale of sub- or non-performing loans • Analyze portfolios and determination of stratification criteria • Estimate realizable value • Manage due diligence process and data room • Assist in negotiations with investors 	<ul style="list-style-type: none"> • Prepare business for sales process • Assist with “packaging” information for prospective purchasers • Outline information requirement for due diligence • Identify issues that may be raised by potential purchasers 	<ul style="list-style-type: none"> • Full-scope review driven by likely buyer requirements • Develop comprehensive, independent, and robust due diligence report • View achievability of projections • Consult with management on key issues, findings, and report content 	<ul style="list-style-type: none"> • Develop project plan to estimate recovery time and run-off costs • Identify reporting structure • Revalidate wind-down decision • Implement recovery plan • Advise on ultimate exit strategy once recovery targets achieved
Outputs	<ul style="list-style-type: none"> • Sale documentation and marketing materials • Data-room information 	<ul style="list-style-type: none"> • Sale documentation and information memorandum • Data room processes and information 	<ul style="list-style-type: none"> • Flexible (to meet vendor requirements) • Analysis on specific areas for inclusion in data room 	<ul style="list-style-type: none"> • Vendor due diligence report for release to potential purchasers • Reliance on VDD report by ultimate purchaser 	<ul style="list-style-type: none"> • Project office • Project plan, processes and individual programs of work
Sale completion/run-off and exit					

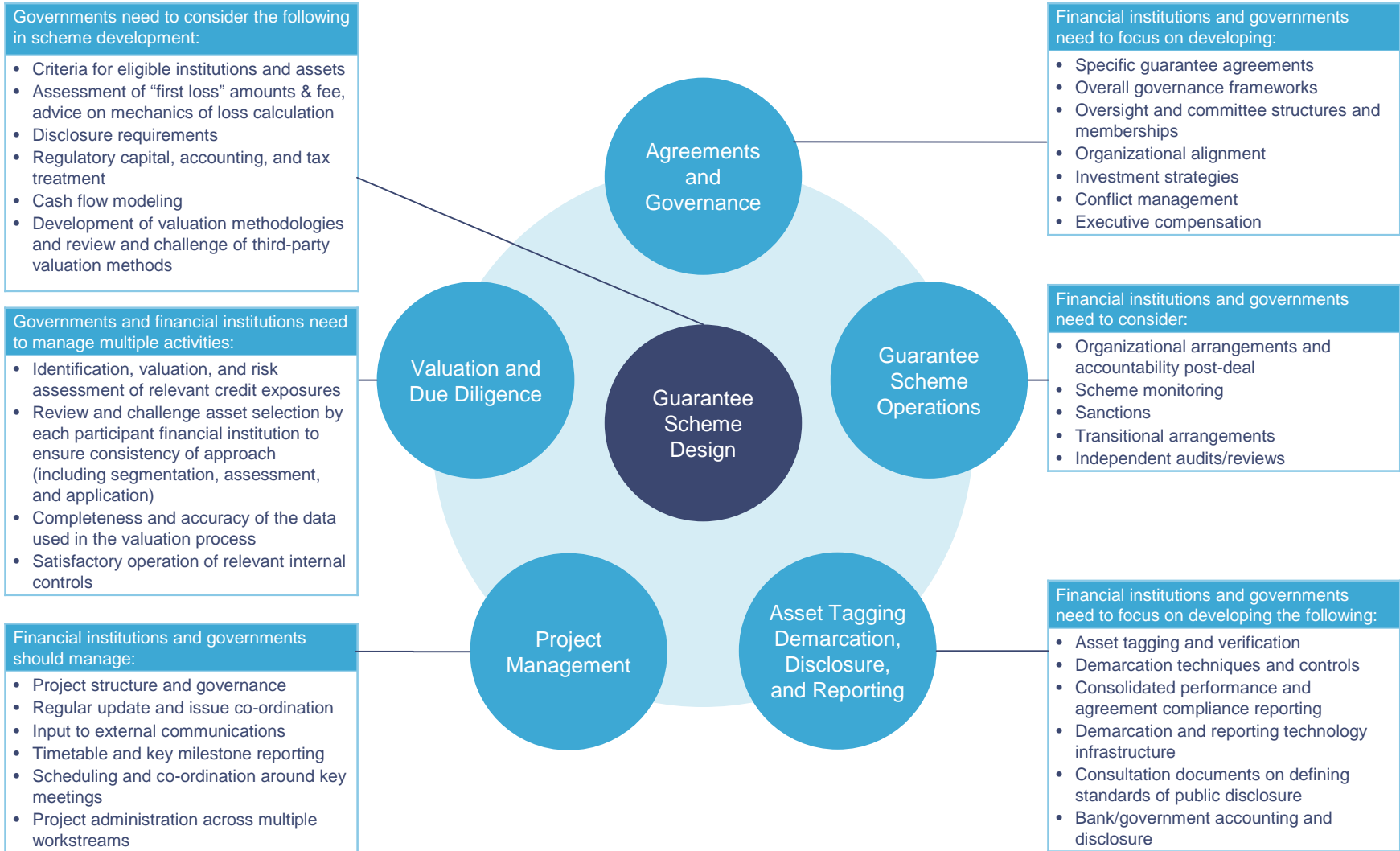
Section 2 – A framework for action

Bad bank structures



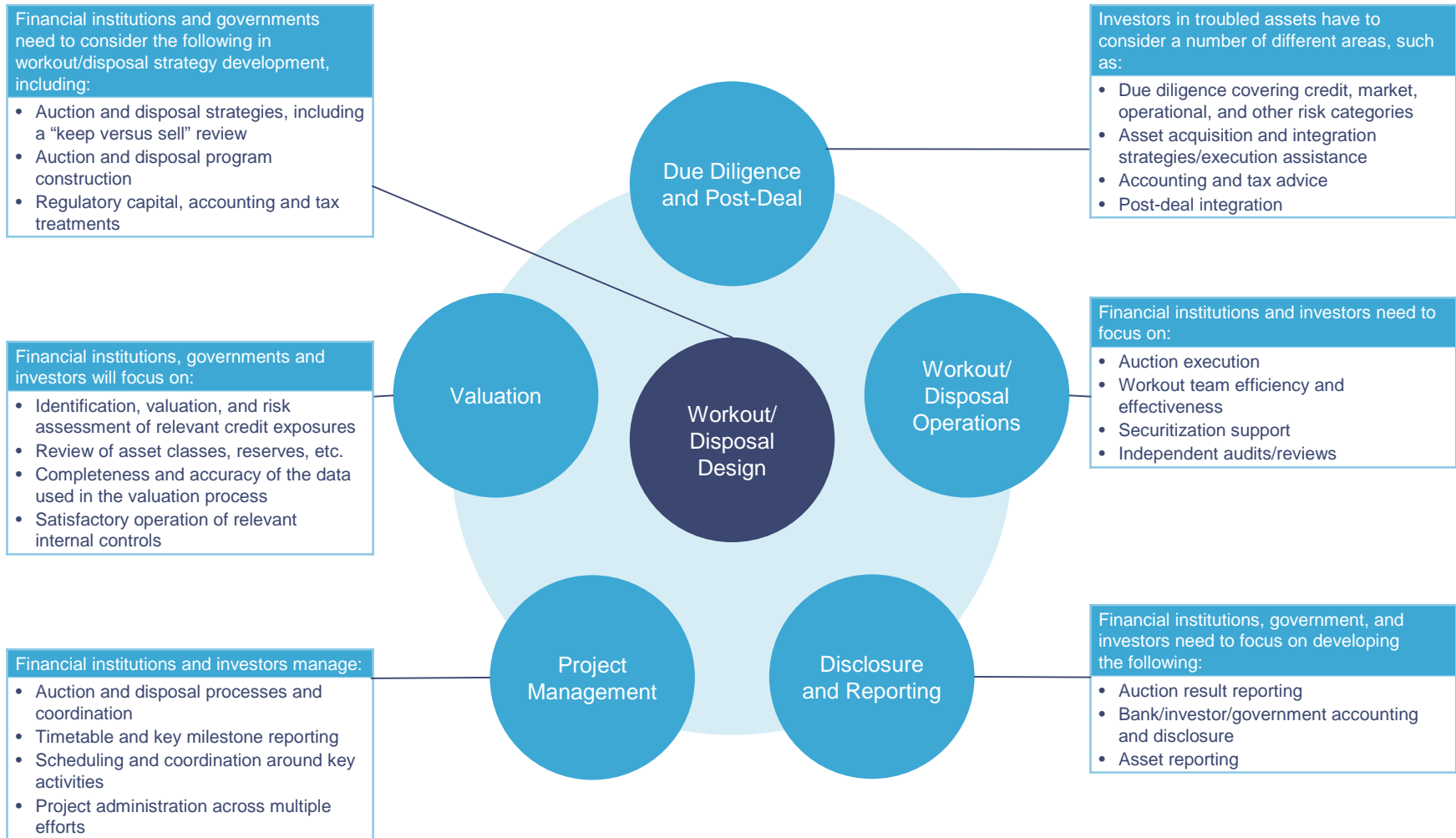
Section 2 – A framework for action

Guarantee scheme design & implementation



Section 2 – A framework for action

Workouts and asset sales



Section 3 – How PwC can help

Section 3

How PwC can help

Specific experience within relevant product classes and different industry sub-sectors

In addition to our experience in specific asset classes:

- Advisors or auditors to 44 of the world's top 50 banks—we provide both financial institutions and government entities with unparalleled views of global industry leading practices in areas such as valuation, and unique insights into technology, risk management, and operations considerations inherent in these structures.
- Leading service provider to investment managers, pension funds, and hedge funds around the world, providing deep insights into custody and asset management aspects of these structures.
- A world-leading Transaction Services business providing pre- and post-deal services related to asset acquisition, disposals, and joint ventures to private equity and hedge funds, financial institutions, and governments. In addition, PwC can utilize the services of its in-house registered broker-dealer for contacting US investors in the event of asset/entity sales.
- Advisor or consultant to 46 of the world's top 50 insurance companies.

Independent, global view

The PwC network provides a global perspective on structuring, design, implementation, and monitoring strategies for bad banks and guarantee structures:

- The firm's 34,000 financial services professionals around the world in more than 150 countries have a long history of leveraging lessons learned and experience across borders.
- We have created a Public-Sector Financial Services (PSFS) practice that combines the best of our financial services experience and the global network's leading government practice around the world.
- We have 30 years of experience in assisting governments, multi-lateral institutions, and the financial services industry in successfully managing financial crises.
- We have a dedicated Distressed Debt Group (DDG) that operates globally and has extensive experience in advising banks, finance companies, vendors, investors, governments, and international organizations on non-performing, sub-performing, and non-core loan management and sales. In the last 12 years, the DDG has conducted loan portfolio due diligence, valuations, and sales of more than 100 portfolios globally.

Section 3

How PwC can help

As a long-term trusted advisor to financial institutions and governments around the world, especially those participating in the OECD, PwC has a wealth of experience in structuring and executing bad bank and guarantee structures. Key areas of focus include:

Structures and agreements

Decades of experience in advising on the business, accounting, taxation, governance, valuation, and other key aspects of these types of agreements such as modeling assistance, designing systems to monitor scheme, and operational design.

Governance and reporting

The PwC network is a world leader in governance, risk management, and compliance. The firm was the primary author of the COSO ERM standard, widely viewed as the authority in enterprise governance and risk management. Furthermore, PwC has applied this model in a variety of financial institutions, public-sector entities, and public-private partnerships, including bad bank and guarantee structures.

Valuation

PwC's valuation professionals have deep product and industry experience regarding valuation processes and controls, and are knowledgeable about current practices of leading industry players. This allows us to provide insights, recommendations, and comparisons of leading practices to both financial institutions and government entities.

Asset tagging and demarcation

Our technology, operations, and audit skill sets are invaluable in efficiently establishing and verifying the appropriateness of asset pools. Furthermore, we devise cost-effective strategies for the types of asset tagging and demarcation that are necessary to operationalize bad banks and guarantee structures.

Distressed debt transactions

PwC's Transaction Services practice is a trusted and experienced advisor in such areas as financial due diligence and non-performing loan (NPL) sales around the world. The practice brings increased transparency, independence, as well as tried and tested methodologies and approaches, to the NPL asset acquisition and disposal processes, fostering and enhancing investor participation.

Section 3

How PwC can help

Asset management advisory
PwC has vast experience in developing procedures for organizational structuring, asset stratification and transfer, HR management, governance, training and workout policies for asset management companies and bad banks on behalf of governments, financial institutions, investors, and aid-funded bodies (such as the World Bank, International Monetary Fund, and the Asian Development Bank).
Accounting and tax
The PwC network is one of the world's leading accounting and tax advisors. Our deep experience in such areas as fair value and purchase accounting, IFRS and US GAAP, reserving methodologies, and transfer pricing are invaluable when financial institutions and governments are considering significantly improved structuring and implementation strategies for bad banks and guarantees.
Executive compensation
PwC's Global Human Resource Services team is a world leader in executive compensation structuring. Our team has worked with financial institutions and government entities on recent efforts to significantly revamp and align compensation policies to better address the current environment.
Public reporting and transparency
PwC has been at the forefront of advising our government and financial services clients in the area of reporting and transparency.
Business strategy
PwC can help businesses rethink their strategies (in terms of markets, geographies, channels, and clients), restructure their organizational model (in terms of structures, policies, roles, etc.), and perform sustainable cost-reduction exercises.

Section 3

How PwC can help

For further information please contact

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Section 4 – Selected qualifications

Section 4 – Selected qualifications

Government nationalization of major bank

Issues	A government was forced to nationalize one of its major banks. Once it was nationalized, the government was faced with the need to quickly assess the institution's state and to develop a comprehensive strategy to stabilize the bank, reassure depositors, and minimize taxpayer losses.
Approach	<p>PwC provided assistance in the following areas:</p> <ul style="list-style-type: none">• Asset analysis and valuation• Development of management information• Operations and technology assistance• Risk management and governance experience• Program management <p>The approach leveraged PwC's global network knowledge of leading practices in these areas combined with proven project management organization and execution capabilities.</p>
Benefits	With PwC's proven approach and deep subject matter specialists, PwC was able to assist the government in assessing the situation, stabilizing the institution, and preventing a further "run on the bank." Once the analysis was complete, PwC was able to work with the government to integrate the new management team and determine longer-term strategies and funding requirements for the bank.

Section 4 – Selected qualifications

Asset guarantee for major financial institution

Issues	A government provided a guarantee against principal loss on a group of troubled assets at a major institution. The term sheet for the agreement was developed quickly, but there was a need to translate this term sheet into a long-term workable agreement and to execute upon that agreement.
Approach	<p>PwC provided assistance to the government agencies in the following areas:</p> <ul style="list-style-type: none">• Advice regarding the construction of various aspects of the agreement• Asset analysis and valuation advice• Due diligence support, including post implementation verification mechanisms• Development of the operational aspects of the agreement• Development of technological support to manage and report on the guaranteed assets• Accounting and tax considerations• Executive compensation advice• Program management <p>The approach leveraged PwC’s deep subject matter capabilities in the areas listed above combined with defined frameworks and knowledge of leading practices to create innovative solutions in these areas.</p>
Benefits	PwC assisted the government entities and the financial institution in reaching a balanced agreement that enabled both to achieve the objective of stabilizing the financial institution while allowing the bank the operational flexibility it needed to effectively manage the assets. Once the agreement was put in place, PwC played an important role in allowing the government to exercise its continuing oversight in the asset demarcation, reporting, and governance processes.

Section 4 – Selected qualifications

Asset guarantee for a government

Issues	A government wished to establish an insurance guarantee against principal loss on a group of troubled assets at major institutions.
Approach	<p>PwC provided assistance to the government regarding the construction of various aspects of the program, including:</p> <ul style="list-style-type: none">• Overall scheme design, including eligibility, terms, payment, etc.• Identification, valuation, and risk assessment of various credit exposures• Satisfactory consideration of relevant internal controls• Development of governance and disclosure structures, policies, and procedures• Accounting considerations• Program management <p>The approach leveraged the PwC network’s multi-disciplinary skill sets and global experiences, capitalizing on the firm’s prior work in developing and implementing similar structures during the financial crisis.</p>
Benefits	PwC is assisting the government entities in constructing a balanced program that will provide greater market stability by introducing a scheme that is comprehensive in nature, encourages appropriate participation, and properly quantifies and prices the insurance risk and potential losses to the taxpayer.

Section 4 – Selected qualifications

Construction of a bad bank structure

Issues	An OECD central bank was faced with one of its largest banks incurring significant losses on troubled assets and threatening the stability of the financial system. They decided to create a bad bank structure (a special purpose vehicle), purchase these assets from the financial institution, and transfer them into the special purpose vehicle, managed by the bank. An independent custodian was hired to perform the back office functions for the central bank and to provide greater independence from the bank asset management functions.
Approach	PwC provided assistance in the following areas: <ul style="list-style-type: none">• Advice regarding implementation of various aspects of the agreement• Asset analysis and valuation• Development of governance structures, policies and procedures• Asset demarcation and management reporting• Program management The approach leveraged PwC's deep subject matter specialists in the areas listed above combined with defined frameworks and knowledge of leading practices to create innovative solutions in these areas.
Benefits	PwC assisted the government entities, the financial institution, and the independent custodian in implementing various aspects of the agreement that enabled the objective of stabilizing the financial institution while allowing the central bank to oversee the management of the assets, thereby minimizing the risk of loss to the taxpayer.

Section 4 – Selected qualifications

Due diligence and post-deal work for a large US regional bank

Issues	<p>A large US regional bank was implementing its strategy to leverage the financial crisis to acquire failed community banks in regions with attractive asset and customer acquisition opportunities. As part of the US Federal Deposit Insurance Corporation's (FDIC) bank liquidation program, our client was the winning bidder to acquire several such institutions. In addition, once acquired, each entity's portfolio, business, and operations needed to be integrated into the regional bank. Lastly, given the level of overall deal activity at the bank, the client's internal integration team was structurally short of resources.</p>
Approach	<p>PwC provided assistance in the following areas:</p> <ul style="list-style-type: none">• Pre-deal due diligence regarding loan quality, reserving, and charge-off practices• Specific asset analysis and valuation processes• Post-deal portfolio and business integration• Program management <p>The approach leveraged PwC's deep subject matter specialists in the areas listed above combined with defined frameworks and knowledge of leading practices to create innovative solutions in these areas.</p>
Benefits	<p>PwC has been a long-time business advisor to the bank and had worked with the bank prior to the deal to assist the client in augmenting their current skill sets and resource levels to manage multiple simultaneous due diligence and integration efforts. With this prior experience and planning, PwC was able to quickly mobilize resources, partner seamlessly with the corporate development and integration teams to complete the due diligence, win the bidding process, and successfully integrate the acquired entity into the bank.</p>

Section 4 – Selected qualifications

Creation of a National Asset Management Company (NAMC)

Issues	During the Asian crisis of the 1990s a government set up a public NAMC to absorb the bad loans from banks. The banks were saddled with a large and increasing volume of non-performing loans (NPLs). PwC was mandated to advise on structure, developing “carrots and sticks” (incentives and penalties), resource plan, and identify strategic objectives.
Approach	PwC provided assistance in the following areas: <ul data-bbox="464 618 1339 821" style="list-style-type: none">• Project Management• Structure• Incentives to encourage banks to participate in the scheme• Plan operations• Tax and SPV structuring The approach leveraged PwC’s multi-disciplinary skill sets and global experiences. The team involved with the project included PwC employees of our Australian firm. The approach also leveraged PwC’s deep subject matter specialists in the areas listed above combined with defined frameworks and knowledge of leading practices to create innovative solutions in these areas.
Benefits	The AMC was a success and a local office staff member was seconded to the AMC for a period of 2 years to assist with workouts. The AMC exceeded all objectives and returned a profit to the banks and taxpayers. Strategic acquisitions of larger loans removed “inter-lender differences” and operational workouts were facilitated, resulting in fewer employment losses as restructurings were able to proceed.

Section 4 – Selected qualifications

Sale of residual assets and servicing platform for a National Asset Management Company (NAMC)

Issues	<p>Following the crisis of the late 1990s the Colombian government set up CISA, a semi-public NAMC, to absorb the bad loans from failed State Owned banks. In 2007, and after having generated returns in excess of the initial investment, the government decided to analyze the sale of its remaining assets. PwC was retained to conduct the sale process of CISA's US\$1.3 billion NPL and Real Estate portfolio, including whole corporate and consumer loans, secured and unsecured, and approximately 4,000 real estate properties. Incorporated in the scope of PwC's work was the analysis of the various sell/keep options regarding the servicing platform.</p>
Approach	<p>PwC provided assistance in the following areas:</p> <ul style="list-style-type: none">• Project Management• Pre-deal due diligence regarding loan quality• Specific asset analysis and valuation• Review of the Servicing Platform's IT and Accounting Systems and Operations• Comprehensive legal support and drafting of transaction legal documents (such as Sale and Purchase Agreements)• Post-deal support, including portfolio integration• Tax and SPV structuring <p>The approach leveraged PwC's multi-disciplinary skill sets and global experiences. The team involved with the project included PwC employees of our Colombian, US, Spanish, and Brazilian firms. The approach also leveraged PwC's deep subject matter specialists in the areas listed above combined with defined frameworks and knowledge of leading practices to create innovative solutions in these areas.</p>
Benefits	<p>PwC was able to attract the largest and most sophisticated global investors in the industry and to run a smooth process actively involving the local regulators and government officials. As a result, the auction process adopted for the sale of the assets was a success and the price received was significantly above the NAMC's expectations. PwC's post-deal work has allowed the firm to maintain and develop a strong relationship both with the seller and the winning investor consortium.</p>

Section 4 – Selected qualifications

Strengthening powers of banks to recover debts

Issues	<p>During the Asian crisis of the 1990s the Indian government sought to provide banks with stronger powers to assist recovery. Legal action took significantly long periods (in one case up to 30 years) to sell collateralized assets. PwC was mandated to analyze SARFREISI legislation and recommend changes to the operational and legislative process in order to streamline the recovery process. The legislation affected Asset Reconstruction Companies and PwC was tasked with preparing a case study of how the legislation would assist them. Furthermore, the mandate required PwC to research the level of NPLs for the country as a whole.</p>
Approach	<p>PwC provided assistance in the following areas:</p> <ul style="list-style-type: none"> • Project Management • Due diligence regarding NPL quantity • Assess and recommend legislative change • SPV structuring and funding <p>The approach leveraged PwC’s multi-disciplinary skill sets and global experiences. The team involved with the project included PwC employees of our Indian and Australian firms and external legal counsel. The approach also leveraged PwC’s deep subject matter specialists in the areas listed above combined with defined frameworks and knowledge of leading practices to create innovative solutions to overcome the challenges in these areas.</p>
Benefits	<p>PwC was able to recommend changes benefiting the financial sector, provide the government with an independent assessment of the NPL level, speed up recovery processes, and affect legislative change.</p>

Section 4 – Selected qualifications

Construction of a bad bank structure/asset management company

Issues	An Asian central bank was faced with several large banks incurring significant losses on troubled assets, eroding capital and threatening the stability of the financial system. They decided to create a bad bank structure (a special purpose vehicle) to purchase these assets from the financial institutions and transfer them into the SPV.
Approach	PwC provided assistance in the following areas: <ul style="list-style-type: none">• Advice regarding the structure of the SPV Asset analysis and valuation• Development of governance structures, policies, and procedures The approach leveraged PwC's subject matter specialists in the areas listed above combined with defined frameworks and knowledge of leading practices to create innovative solutions in these areas.
Benefits	PwC assisted the government in creating a solution to distressed debt resolution that enabled it to achieve the objective of stabilizing the financial sector while allowing the central bank to oversee the management of the assets, thereby minimizing the risk of loss to the taxpayer.

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