

INSOLVENCY LAW REFORMS IN ASIA
A REGIONAL TECHNICAL ASSISTANCE PROJECT OF
THE ASIAN DEVELOPMENT BANK
SECOND COMPARATIVE REPORT

TABLE OF CONTENTS

- 1. Introduction**
 - 1.1 Complimentary Work in the Asian Development Bank
 - 1.2 Other Projects and Studies
 - 1.3 Scope and Content of the Second Phase of This Project
 - 1.4 Areas of Particular Interest
 - 1.5 This Report

- 2. The Corporation and Corporate Management**
 - 2.1 Corporate Management and Its Relevance to Corporate Insolvency Law Systems
 - 2.2 Corporate Management in the Five Economies
 - 2.3 Korea
 - 2.4 Malaysia
 - 2.5 Thailand
 - 2.6 Philippines
 - 2.7 Indonesia
 - 2.8 Training and Education
 - 2.9 Conclusions and Proposals

- 3. The Banking Sector and Lending Practices**
 - 3.1 Relevance to Insolvency Processes
 - 3.2 Philippines
 - 3.3 Malaysia
 - 3.4 Korea
 - 3.5 Thailand
 - 3.6 Indonesia
 - 3.7 Conclusions and Proposals

- 4. Property Rights and Secured Transactions**
 - 4.1 Philippines
 - 4.2 Korea
 - 4.3 Malaysia
 - 4.4 Indonesia
 - 4.5 Thailand
 - 4.6 Conclusions and Proposals

- 5. Level of Insolvency Case Activity**
 - 5.1 Liquidations
 - 5.2 Formal Rescue
 - 5.3 Informal Rescue
 - 5.4 Conclusions and Proposals

- 6. Statistics and Information**
 - 6.1 Evaluation of the Statistical Information in the Five Economies

- 6.2 Suggestions for Improvement
- 6.3 Conclusions and Proposals

7. The Operation of and Reforms to Insolvency Laws

- 7.1 Korea
- 7.2 Indonesia
- 7.3 Philippines
- 7.4 Thailand
- 7.5 Malaysia
- 7.6 Conclusions and Proposals

8. Operation of the Courts in the Insolvency Law System

- 8.1 Korea
- 8.2 Malaysia
- 8.3 Indonesia
- 8.4 Experience of a Recent Case in Indonesia
- 8.5 Thailand
- 8.6 Philippines
- 8.7 Conclusions and Proposals

9. Informal Insolvency Processes

- 9.1 Malaysia
- 9.2 Korea
- 9.3 Indonesia
- 9.4 Thailand
- 9.5 Philippines
- 9.6 Conclusions and Proposals

10. Insolvency Case Administration

- 10.1 Indonesia
- 10.2 Thailand
- 10.3 Korea
- 10.4 Malaysia
- 10.5 Philippines
- 10.6 Conclusions and Proposals

11. Cross-Border Considerations

- 11.1 Cross-Border Insolvency Legislation
- 11.2 Regional Co-operation and Collaboration
- 11.3 Conclusions and Proposals

12. Super Priority and New Money

1. INTRODUCTION

This second comparative report presents the results of further studies undertaken as part of the second phase of this regional technical assistance project—RETA 5795: Insolvency Law Reforms (the “Project”). The first comparative report was presented at a symposium held in Manila on 25-26 January 1999. That report was based on studies of eleven Asian economies (the “RETA economies”)*. A review of the product of those collective endeavours was published by the Asian Development Bank under the title ‘Insolvency Law Reform in the Asian and Pacific Region’ in Law and Development at the Asian Development Bank, April 1999 (the ‘ADB report’).

The second phase of the project has concentrated on a more detailed examination of particular issues in five of those economies. These five economies comprise Indonesia, Thailand, Korea, Philippines and Malaysia. In this report they are sometimes collectively referred to as the ‘five economies’.

There have been significant developments in the five economies in the relatively short period of nine months since the date of the first symposium. Actual or proposed legislative reform to insolvency and related laws has been considerable. There has been a significant use of informal insolvency workout processes. In some of the economies the court system for the administration of insolvency cases has been reformed. There have been attempts to improve corporate management standards and practices. The banking and financial sector of all the economies has been the subject of extensive investigation, management, review and change.

These developments evidence that many of the issues that have been the focus of this Project have been taken seriously. The respective governments of the five economies appear to have responded positively and responsibly to the need for insolvency and related law, institutional and infrastructure reform.

The level of activity and achievement is encouraging and one purpose of this report is to highlight the major developments. However, the momentum needs to be maintained. This report will therefore endeavour to identify areas in which further improvement would be helpful and, in some cases, is necessary.

1.1 Complimentary Work in the Asian Development Bank

The work in progress on another regional technical assistance being conducted by the Asian Development Bank (RETA No. 5773 Secured Transactions Law Reform the “Secured Transactions Project”) will be of considerable in this Project. A detailed analysis is being undertaken of secured transactions in a number of Asian economies, two of which (Indonesia & Thailand) are among the five economies engaged in this Project. This work will greatly assist in an understanding of secured transactions in those economies; the areas in which reform is necessary; and, importantly for the purposes of this Project, the dynamics of and the relationship between secured transactions and insolvency processes. The second symposium to be held in Manila 24-27 October on this Project will be combined, in part, with a symposium on the Secured Transactions Project.

1.2 Other Projects and Studies

It is relevant to note that a number of other projects and studies have since been commenced or are in the course of commencement on the same or similar subject matter addressed in this project. These include:

- A combined OECD/APEC study of insolvency law regimes in five Asian economies;

- A recently published report of the International Monetary Fund on important principles of insolvency law and practice;
- A project of the World Bank that has the aim of presenting guidelines and principles for best practices in insolvency law, particularly in emerging economies; and
- A proposal by UNCITRAL to undertake work to bring together the endeavours of all of these agencies and possibly to formulate a model insolvency law.
- Many bilateral projects (for example, assistance from AGILE/USAID in the preparation and drafting of rules for reorganization procedure in the Philippines) are also ongoing.

The results of this Project have and will provide valuable information on insolvency laws and related issues in the Asian region to benefit some of these other initiatives.

The Asian Development Bank is collaborating with each of the above multi-lateral agencies on their respective projects. Co-operation is important to avoid unnecessary duplication and to promote compatibility.

1.3 Scope and Content of the Second Phase of This Project

The local consultants in the five economies have provided supplementary local studies based on a work guide that identified the following areas for research and response:

- Numbers and studies of cases of corporations whose insolvent financial affairs have been administered under either an informal debt restructuring arrangement, a formal liquidation process or a formal reorganisation process.
- Recent reforms in insolvency law and practice and related areas.
- Corporate management and its performance including accounting information, financial management, corporate governance, directors duties and responsibilities, political patronage, 'cronyism' and corruption.
- Lending and credit control practices of banks and other financial institutions.
- Secured lending transactions including enforcement of security rights over property of an insolvent corporation and the balancing of those enforcement rights with the restraint that is necessary in the case of a corporation that is attempting a formal or informal restructuring or reorganisation.
- Major substantive and practical problems in corporate insolvency laws and their application.
- The operation of the judicial system in relation to formal corporate insolvency practices.
- The efficiency of the operation of informal workouts and the problems associated with those practices.
- The development of public and private sector case management administration of liquidations and reorganisations.
- The availability and quality of information and statistics.

In addition field visits were made to each of the five economies for discussions with the local consultants, government officials, judges, policy makers, legal and accounting professionals, representatives of banks and financial institutions and others.

1.4 Areas of Particular Interest

With that background, the main areas of interest in this second phase are to discover what has occurred and what critical areas remain to be addressed in the five economies. Examples include:

- What effect have the new insolvency law reforms had in Indonesia and Thailand?

- How have the informal processes operated in Indonesia, Thailand, Korea and Malaysia?
- Has there been any improvement to security enforcement process?
- What attempts have been made to improve standards of corporate management?
- Has the quality of judicial handling of insolvency cases been improved?
- Have bank lending and credit control practices been improved?
- Has there been any advance with the introduction of a voluntary administration process in Malaysia?
- How has the 'suspension of payments' regime under the control of the SEC in the Philippines progressed?

It cannot be expected that a totality of integrated law, legal and other processes, institutional systems and infrastructure requirements will be available in many of the economies for some time. For some of the economies it is the first time that a development of an overall insolvency law and related system has been attempted. Therefore, a major interest of this Project is to determine what might be done to improve insolvency law and related processes in the five economies. In what areas is there a need for technical assistance and what form should that assistance take?

1.5 This Report

This report endeavours to combine some of the issues and conclusions reached in the first part of the Project (this will largely follow the treatment of them in the ADB report) with a review and critical evaluation of developments in respect of those issues in the five economies since the first symposium. The first comparative report and the ADB report contain a much more detailed examination of many of these issues. It is desirable, therefore, that this second comparative report be read in conjunction with that material.

It should also be observed that this report contains only a summary of the reports of the local consultants from the five economies. Reference to those reports will provide greater detail.

Following the second symposium, a final report on this Project will be published. It will incorporate discussions from the second symposium; summarize the overall results of the Project; and present a series of recommendations for insolvency and related law reform, institutional development and proposed future technical assistance.

2. THE CORPORATION AND CORPORATE MANAGEMENT

The corporation is widely utilised throughout the region for trade, commerce and the conduct of business, particularly for the conduct of medium to large business activities. The corporation has been long recognised as the most convenient and appropriate form of business organisation for the conduct of that size of business. However, it has been also long acknowledged and accepted that the corporation is a form of enterprise that is open to management and other abuse. Adequate external and internal controls are necessary.

This leads to the issue of corporate management.

2.1 Corporate Management and Its Relevance to Corporate Insolvency Law Systems

The ADB report observed that there are a number of factors that, when aggregated, may be regarded as essential for a proper standard of corporate management. These

factors are adequate accounting standards and practice, objective financial management, provision of information and other more general standards of corporate governance.

It appeared to be the case that standards of corporate management in many of the economies in the region were defective for one or more of a number of reasons. Examples included:

- The effect on the management of a corporation as a result of political and government patronage, cronyism or corruption. In the minds of management this is often taken as some type of 'licence' to disregard proper or any standards of corporate conduct because it invariably operates to shield and protect those responsible for abuse of the standards;
- The existence of close family held corporations in which the influence or power of one or more family members can prevent objective assessment and management of the financial position of a corporation;
- The association of banks or financial institutions with corporations which can cause considerable commercial conflict in credit assessment, loan management and financial difficulty or insolvency;
- Inadequate accounting standards, poor standards of auditing practice and absence or disregard of internal financial controls;
- The failure to impose and enforce proper standards of corporate governance which effectively causes the corporation to disregard the interests of a number of its constituents, including creditors.

It was also observed in the ADB report that this is not an area that can or should be regulated by an insolvency law. However, it cannot be ignored because, most importantly, an insolvency law system cannot be expected to operate and produce positive results in an environment of inadequate corporate governance and financial irresponsibility. Weaknesses in this area result in considerable havoc to any form of insolvency law endeavour. It cannot be emphasised sufficiently strongly that continued reform in this area is absolutely vital.

2.2 Corporate Management in the Five Economies

In all of the five economies the issue of corporate management continues to be a troublesome area. The local consultants were asked to identify areas of weakness. A summary of their responses follows.

2.3 Korea

- There is a significant difference between the accounting standards applied in Korea and those that are generally accepted as conforming to an international standard.
- The management of directors cannot be supervised or controlled because there are few instances of the presence of outside, independent directors.
- There is evidence of poor quality auditing.
- The power of minority shareholders is very weak.
- There is evidence of corporate fraud.

The Korean local consultant has suggested that concentration on the following areas would be helpful:

- The introduction of a legal requirement that companies with a significant capital base must have a high percentage of outside, independent directors on the board of management;
- The establishment of a supervisory management committee from the board of directors which must include two thirds of independent directors;

- Enabling class and representative actions to be instituted on behalf of shareholders, particularly minority shareholders;
- Legislation to enable recovery of the proceeds of corporate fraud.

The Korean country report properly points to the problems that might arise from an excessive or over officious corporate management conduct regime. If such a regime is severely restrictive it might stifle entrepreneurial endeavour or, worse, lead to an increase in the number of 'illegal' activities. It is therefore important to maintain a fair balance between corporate regulation and corporate business endeavour.

2.4 Malaysia

In Malaysia, the important issue of corporate governance has in fact been addressed, in part. A recently published 'Code on Corporate Governance' is the result of the work of a committee under the initiative of the Minister of Finance to establish industry standards of best practice. It covers such things as appointment of directors, compositional balance of a board of directors, supply of information, communication between company and shareholders, financial reporting, internal controls and the relationship between the board and the external auditors. Interestingly, having regard to the Korean suggestion that there should be a significant percentage of outside, independent directors on the board of a large corporation, this is now provided for by the Corporate Governance Code. It requires that a board of directors be composed of at least one third outside independent directors.

Additionally, the Kuala Lumpur Stock Exchange has been armed with powers to take action against a director for failure to observe the rules and listing requirements of the exchange.

There has also been much greater attention given to the prosecution of corporate governance offences in Malaysia.

However, despite these welcome and important advances, problems still exist in Malaysia. The chief concerns are with:

- Valuation of assets. It is said that unrealistic non-objective valuations of corporate assets are common. That presents a misleading, if not false, balance sheet;
- Internal financial control. A number of cases have revealed contraventions of internal financial and other controls and failure to detect such breaches.
- Links between corporate groups, political parties and state agencies that are clearly capable of resulting in conflicts of interest.

2.5 Thailand

The Thailand local consultant comments that the application of what are termed 'traditional Thai methods and values of governance' are still more influential than the law. These 'methods' and 'values' pay little or no regard to the more sterner and exacting methods and values prescribed by law and regulation. The consultant points out that in Thailand the relevant laws or regulatory requirements exist. However, those laws are not applied nor enforced.

The main areas of concern are these:

- The requirement to keep proper accounting records is often ignored or neglected.
- Financial reports do not comply with accounting standards.
- Enforcement of standards and duties of directors is weak.

- There are still many undisguised links between large corporate conglomerates, political parties and government that result in awards of government contracts, concessions, approvals and other preferential treatment.

Despite this, the Thailand consultant points out that there are signs that a combination of the new Constitution of 1997 and the need for austerity following the economic crisis is creating a more transparent, fairer and less abused corporate governance environment.

2.6 Philippines

In this jurisdiction the areas of concern are:

- There are significant differences between what might be regarded as 'international' accounting standards and those that appear acceptable in the Philippines. This results, for example, in valuing assets otherwise than on an objectively and properly assessed basis.
- Many corporations maintain a number of different sets of accounts.
- There is evidence that audited financial statements are routinely produced without an actual audit of the corporation. It is suggested that this area can only be addressed by the imposition of a stringent code of professional responsibility for accountants and a legislative insistence that proper standards are applied.
- Although there are legislative standards of duties and conduct for directors, their abuse is rarely, if at all, prosecuted or enforced.
- There is some evidence that 'cronism' is now more rampant.

The view of the Philippines consultant is that legal guidelines on director duties and responsibilities are essential and the law should provide sanctions for breach and enforce the application of those sanctions.

2.7 Indonesia

Some attempt has been made to ensure greater transparency in the contents of annual financial accounts that some particular classes of companies are required to prepare and file. Regulations made earlier this year require disclosure of financial and cash flow reports. This should provide for greater corporate disclosure and more opportunity to access financial information. However, two matters, identified by the Indonesian consultant, might tend to limit the effectiveness of these regulatory requirements. First, only 6% of companies have submitted annual accounts. Secondly, many classes of companies are exempt from the obligation.

New anti-corruption laws have been enacted. Although not specifically directed to the corporate sector, they each assume a likely patronage or corrupt commercial link between corporations and government officials and others.

The problems of corporate management in Indonesia appear to be mainly centred upon corruption, non-enforcement of regulatory requirements regarding accounts, and inadequate laws concerning director duties and responsibilities.

The Indonesian consultant considers that two things in particular would greatly assist in raising standards of corporate governance in Indonesia. First, the enactment of legal guidelines on the duties and responsibilities of company directors together with sanctions for abuse or breach. Secondly, the establishment of an independent supervisory board with powers to control corporate practice in Indonesia would do much to help develop the application of corporate governance. The vision is of a regulatory board that would act as an

alternative means of law enforcement on business practices. It would act as an investigatory body with power to report breaches to the courts and recommend enforcement.

2.8 Training and Education

The local consultants were asked whether education and training programs for directors and managers might be of benefit.

The Thailand report considered that this would benefit only directors who might be ignorant of their responsibilities. The real problem lies with directors whose conduct is deliberate or wilfully neglectful.

The Malaysian report considers that many directors are ignorant of proper corporate governance in the areas of financial management and responsibility for which education and training is required. Further, it is considered that directors should be educated on the recognition of creditors rights, the mechanics of a work out, the initiation of work-out processes and the need for correct, up to date information concerning the company.

The Philippines report supported the proposal.

The Indonesian report considered that such a program would be helpful. The Company Law provides no or no sufficient standard of performance for officers of a company.

The Korean report says that although there are education programs on financial management and responsibility, the substance and extent of these is not considered sufficient. Also, training programs on negotiation of financial restructuring and informal work out techniques are not available.

2.9 Conclusions and Proposals

It seems apparent that, with one or two exceptions, there are fundamental weaknesses in corporate management common to the five economies. The areas of weakness are:

- Adequate accounting standards either do not exist or are not applied;
- Auditing standards are poor, particularly regarding valuation of assets;
- The need for proper internal financial management and financial control is disregarded; and
- There is either an absence of and/or a failure to enforce an appropriate legal regime of director duties and responsibilities.

It is not appropriate in the context of this Project to suggest proposals for detailed corporate governance and management. However, for the reasons stated earlier, it is appropriate and necessary to urge the need for reform generally and to identify particular areas that are vital for the operation of an insolvency law system. This leads to a consideration of the following proposals:

- Standards of corporate governance and accountability of managers and owners need to be considerably improved.
- A legal regime of basic director duties and responsibilities (or 'guidelines' that will help to establish a 'standard' that the law may recognise) is required in many of the economies. From the perspective of the subject matter of this Project, it would seem important that any such regime should include a positive duty that a director must have regard to the interests of creditors in the management of a corporation.

- It is fundamentally important that the law (but not the insolvency law) provides adequate sanctions to penalise managers and owners of insolvent corporations for fraudulent behaviour and also for behaviour that falls short of proper standards.
- Accounting standards, auditing practices and internal financial control mechanisms must be considerably improved. Objectively assessed financial information in relation to a corporation is vital. It provides an early warning of possible financial difficulty. It is important externally as an information system for financiers and suppliers, and it can be crucial to the prospect of rescue or work-out.
- Long term programs of education and training for directors appear desirable and necessary. Such programs should be directed at corporate management generally and particularly at director duties and responsibilities; financial control; and the operation of formal and informal insolvency processes.

3. THE BANKING SECTOR AND LENDING PRACTICES

Like corporate management, the position and conduct of the banking sector and the lending practices of banks are not areas in which a traditional corporate insolvency law system might or should have any direct influence or involvement. It may, for example, be argued that if the banking sector engages in non-commercial or illegal practices, if banks provide loans and credit to corporations without engaging in proper credit analysis or if banks make loans for which collateral is the only consideration, those are problems for the banking sector and not for an insolvency law system.

However, that overlooks the fact that in practically all cases of corporate financial difficulty or insolvency a bank or banks will be the major, influential creditors. There is a well founded expectation that in most cases the banks will play a lead role in determining the fate of the corporation. Other creditors will look to the banks for information, guidance and possible support (they will also, no doubt, have a healthy regard for the fact that the banks may endeavour to promote their own interest in the outcome). If the banks are in disarray as a result, for example, of loan and credit control mismanagement, one may expect that this will filter down and attempts to resolve some commercial settlement of the problems of the insolvent corporation will likely flounder.

But there is another reason why attention should be further directed at the banking sector in the context of this project. This is because of the exceptional situation that confronted the banking sector as a result of the economic crisis in the region.

In summary, that situation was attributable to three factors.

First, the problem of an over-extended banking and financial sector with non-performing loan portfolios, and extensive unhedged foreign currency debt that was made worse by deep currency devaluation, resulted in systemic problems in the banking and financial sectors in the region.

Secondly, there was evidence of significant political and government involvement and interference in lending policies and practices. This had an effect on the availability of funds for lending and also distorted debt recovery and enforcement policies. It also considerably affected the application of insolvency laws and practices.

Thirdly, the banking crisis in the region exposed some extraordinary failings in bank lending practices and credit monitoring, which can also affect the application of insolvency laws and practices.

It was necessary in four of the five economies to address those issues and to conduct a concerted program of repair to their respective banking sectors. The ADB report noted that such systemic problems cannot be addressed by traditional insolvency laws and the application of traditional insolvency methods and processes.

But the need for this repair had a 'knock on' effect into the corporate sectors of those economies because a significant part of the problem in the banking sector was due to non-performing loans for which the corporate sector was liable. This repair and the flow on effect into the corporate sector are continuing processes in those economies.

3.1 Relevance to Insolvency Processes

The two main areas of interest are:

- First, the economic crisis has resulted in the emergence of many useful and important precedents for dealing with systemic insolvency caused by an economic crisis. This required the adoption of measures to repair the banking sector. That exposed non-performing loans for which corporate debtors were liable and led, in some of the RETA economies, to the employment of complimentary insolvency related measures to deal with those corporate debtors in the form of structured informal work out processes. Those are reviewed in a later part of this report.
- Secondly, now that many of the lending and loan monitoring practices of the banking sector have been laid bare, the weaknesses may be better analysed. This is important for insolvency law purposes. The ADB report noted, for example, that dependence on collateral based lending often means that a lender does not take proper or any account of the ability of the borrower to meet interest payments or to repay the loan generally; does not monitor the financial position of the borrower; and, if insolvency of the borrower occurs, has little knowledge of the business and financial position of the borrower. This can result in the bank being either unwilling or unable to take an active and positive role in a possible corporate rescue or attempt at rehabilitation. Accordingly, this part of the report seeks to identify the main problems relating to bank lending practices and to suggest proposals for their solution.

A review of developments in relation to lending practices in the five economies follows:

3.2 Philippines

The Philippines was less affected by the crisis than its neighbours. Nonetheless, the opportunity has been taken by the Bangko Sentral to place greater protective controls in place within the commercial banking sector. Enforcement of banking regulations concerning loan documentation has been tightened. If an audit by the central bank reveals deficient or non-performing loan accounts, the bank is required to provide reserves. Measures like this have encouraged banks to require far better information and financial statements from actual and prospective borrowers.

Problems still exist however. The chief of these are in the areas of proper loan documentation, loan administration/monitoring policies (many banks are fundamentally weak in monitoring the business performance of corporate debtors) and in remedial management (banks do not have sufficient officers with experience and skill in handling formal or informal work-out processes).

In the Philippines it is considered that education and training of bank officers would be valuable, particularly in areas such as risk acceptance criteria, understanding and assessing the business of borrowers, proper loan documentation, loan administration and monitoring, and formal and informal insolvency processes.

3.3 Malaysia

In Malaysia the problems centre on four areas:

- Excessive enthusiasm for property based lending;
- Failure to make informed credit evaluations and to conduct adequate credit screenings;
- Failure to monitor collateral adequacy; and
- Over-emphasis on relationship lending. This poses problems because of the close ties over a long period of time between a lender and a borrower. The result can be that the lender pays less attention to and fails to appreciate the current debt servicing capability of the borrower.

The Malaysian consultant considers that officers and employees of banks would benefit from education programs that should include training in:

- Evaluation of loan applications and, in particular, evaluation of on going debt servicing capability;
- Critical analysis of adequacy of collateral;
- Scrutiny of corporate governance procedures of the corporate borrower;
- Formal insolvency practices and informal work-out techniques and practices.

3.4 Korea

The Korean report observes that domestic banks and other lending institutions have been heavily dependant on secured lending and are weak in analysing the borrowing strength of borrowers based on financial data. However, the Korean government has recently encouraged domestic banks to base lending practices on proper credit analysis without dependence on secured financing.

3.5 Thailand

In Thailand it seems apparent that both lending and reporting rules were deficient, as was compliance with them. For example, many cases have come to light in which banks had reported secured loans as 'performing' even though no interest had been paid for over one year.

Banks also failed to properly examine financial risks and failed to properly evaluate collateral.

The chief of the Financial Sector Restructuring Authority of Thailand has said that much of the banking and financial institution financial crisis in that country may be attributed to 'profligate lending', 'fraud' and 'dishonesty' (the number of bad or restructured financial sector debts being handled in June 1999 was 76,000). That officer also observed that the work of clearing up the bad debt portfolio was greatly hampered by the failure of the government to put 'a legal framework in place for creditors to force debtors to make good'.

3.6 Indonesia

Detailed credit policies that banks are obliged to follow have been in force since 1995. The credit policies regulate fundamental matters, including prudence in credit affairs, organisation and management of credit, credit approval policies, documentation and administration of credit and the settlement of credit problems. Despite these regulations, in practice only a few banks have complied. The amount of non-performing loans in

commercial banks is well over 50%. Banks have violated legal lending limits and credit requirements.

There is also evidence that private banks have been used by their owners to obtain funds to finance their other businesses. In many cases this has occurred in breach of legal lending limits to affiliate parties.

State banks have channelled loans to particular corporate groups, often as a result of the urgings of government officials. This type of abuse invariably results in little or no security for a loan and no real assessment of the ability of the borrower to repay.

The operation of internal bank credit and other control committees is also poor. There are numerous examples of credit committee approvals for loans that are in direct contravention of prohibitions.

Credit analysis is fundamentally unsound. For example, the practice of 'marking up' the value of assets (particularly the value of property projects) to obtain loans secured against the 'value' of those assets is said to be rampant in the banking industry. In addition, banks lack specialisation in understanding the industries in which corporations engage.

An extensive system of internal bank auditing and monitoring of credits is required by regulations issued in 1995. However, many banks have failed to conduct such audits and have even issued false financial reports. Non-performing loans are not disclosed and are sometimes covered up by the grant of other loans to repay previous loans.

The Indonesian consultant considers that the central bank must perform a greater regulatory and disciplinary role and educate Indonesian bankers to become more professional. The fact that there have been no prosecutions for the many breaches of banking regulations indicates the lack of any law enforcement in the banking sector. It may be, however, that the new central bank law, enacted in May 1999, will help to stem and prevent abuses. That law provides that the central bank is an independent institution, free from government intervention, and that one of its key functions is to regulate and supervise banks.

The Indonesian consultant considers that education and training in informal work out practices is essential. There are many corporate debtors in Indonesia that have cash flow and other financial difficulties, but few banks have officers with any experience of using informal workout techniques and practices.

3.7 Conclusions and Proposals

Although, as mentioned in the introduction to this section, this is not an area that is appropriate for any regulation by an insolvency law, it is necessary (as with the issue of corporate management) to draw attention to particular problems that weaknesses in this area cause for insolvency law and insolvency processes. The main problems are these:

- The provision of 'easy' credit by a bank to a borrower because either the borrower is an affiliate or the lending is made as a result of government or political pressure will almost certainly breach sound credit policies and will result in the borrower having considerable leverage regarding recovery. If the corporate debtor becomes insolvent, the actions (or inaction) of the creditor bank will be dictated by other than appropriate objectively assessed commercial motives. If the bank is a major creditor, the prospect of structuring a commercially based rescue or rehabilitation becomes quite remote.
- An over concentration by banks and other financial institutions on secured lending, particularly lending on the security of land and shares of the borrower or related

corporations, means that cash flow and profitability, which gives a reasonable guide to the ability to repay, is often ignored or treated as a secondary consideration in lending decisions. When analysis and decisions must be made concerning the prospect of corporate rescue, these banks can bring very little help or assistance to the negotiating table.

- Poor loan and monitoring practices are inevitably carried through into both formal and informal insolvency processes. The more that these can be improved the earlier that financial difficulty of a corporate borrower may be detected and remedial action taken (often for the benefit of both the lender and borrower).

Comprehensive education and training courses for bank and other financial institution officers and employees are necessary. These might cover loan practices, loan management and monitoring, loan enforcement and recovery practices and formal and informal insolvency processes.

4. PROPERTY RIGHTS AND SECURED TRANSACTIONS

The ADB report noted that many of the RETA economies suffered from inadequate laws or processes relating to the extent, creation and public notification of secured transactions. In some cases this was due to an inadequate development of a property rights regime (for example, recognition of intellectual property rights, recognition of lease finance transactions) or the failure to appreciate the need for a registration or filing system. But the major problem centred upon the enforcement rights of secured creditors (or the application of laws relating to enforcement in a practical and effective sense). This created a significant imbalance between the rights and expectations of secured creditors and the debtors who had granted those securities.

In nearly all the jurisdictions in the region the 'balance' seemed to be weighted in favour of the borrower or debtor. This seemed to be principally due to the requirement that enforcement requires judicial process in most of the jurisdictions.

As mentioned in the introduction to this report, the second phase of this Project will be greatly enhanced by the work being carried out on the Secured Transaction Project. That project will provide an important and extensive review of secured transactions in a number of countries in the region. In particular it will deal with the vital issues of registration/filing, priorities between secured creditors and preferential claims in far greater depth than has been possible in this Project. It will, therefore, be necessary to take into account and blend the findings and recommendations that will emerge from that project with the more limited study of secured transactions as part of this Project.

For the purpose of the second phase of this project, the consultants in the five economies were asked to report on the more major areas of difficulty and suggested reforms. A summary of their responses follows.

4.1 Philippines

In the Philippines the basic problems are these:

- The law regarding securities (or assignments) over incorporeal rights (for example, receivables) is not clear and there are considerable risks concerning the enforceability of such securities.
- There is also a problem regarding chattel mortgages because enforcement is impossible unless the chattel is in the possession of the mortgagee or lender.

- The major impediments facing a secured creditor are inefficient registries of land and chattel mortgages and the inefficient judicial system to which recourse is almost certainly necessary for enforcement purposes. The consultant for the Philippines considers that a centralised and computerised registration system would considerably assist.

4.2 Korea

In Korea it is suggested that the idea of a 'collective' security (a security over all the assets of a corporate borrower—possibly similar to the concept of the 'fixed and floating' charge which is a characteristic of some common law countries) might be introduced. A suggestion in Korea is that a better system of disclosure, which would more accurately identify and publicise the amount(s) of loan covered by a security, would greatly assist the corporate process.

4.3 Malaysia

In Malaysia some curious contrasts regarding secured creditors and enforcement rights have become apparent as a result of the Danaharta legislation. The Malaysian consultant gives the following examples.

A major impediment to security over land is the requirement that enforcement requires a judicial sale. Thus, if a bank holds security over land in respect of a debt owed by a defaulting corporate debtor, the bank would be required to obtain court orders for a court controlled sale of that land. However if Danaharta acquires the non-performing loan along with the security over the land from the bank, Danaharta may sell the land as it sees fit without any need for a court order or court controlled sale. This is because the National Land Code was amended to enable Danaharta, in the exercise of its subrogated security enforcement rights, to sell land by private treaty.

Danaharta is, of course, a public authority, ultimately accountable to the government and may be expected to execute its powers in a proper manner. But, as the Malaysian consultant points out, other holders of securities over land might also be expected to exercise their powers in a proper manner, especially if the law provided suitable guidelines or standards to ensure that a power of sale was exercised in good faith and at market value.

The second area of contrast concerns the position of secured creditors. Under the Danaharta legislation there is more certainty and stability for secured creditors. Although a one-year moratorium on secured creditor enforcement rights takes effect upon the appointment of special managers, the affairs and management of the company are under the control of those special managers during that time. Thus, there is less prospect that the affairs of the company will be abused during that time. Further, the special administrators are required to submit a work-out proposal during that time or commit the company to liquidation.

By contrast, under the scheme of arrangement provisions, management is left in control while stay or restraining orders on secured and other creditors are in effect. There is thus no independent control of the company. Although a secured creditor can apply to lift the stay order, that will take a considerable time to be heard and determined, and they are rarely successful. An attempt has been made in Malaysia to redress this issue by providing, firstly, that the length of stay or restraining orders may not exceed 90 days and, secondly, by providing creditors with the opportunity of appointing a representative to the board of directors of the debtor company. However, very few of such appointments have been made because of a concern about possible director liability for such an appointee.

4.4 Indonesia

In Indonesia the position of secured creditors has not been improved. Some of the problems are:

- There is no registration system for security interests other than land and immovable property attached to land. Because there is no security registration system in movable assets it is not possible for a lender to determine whether a debtor has granted security over the same collateral;
- There is no central or integrated registration system for land.
- Security over land has become more problematic because of competing and conflicting claims to equipment or plant permanently attached to the land between holders of secured 'land' rights and holders of fiduciary 'equipment and plant' secured rights;
- It is a requirement that security interests in or relating to property attached to land may only be enforced through court ordered judicial sale. It is possible to delay or defeat enforcement actions because of continued difficulties in the court system. Jurisdiction in this area has not yet been given to the newly established Commercial Court.

The Indonesian consultant considers that a comprehensive (centralised, computerised and integrated) registration system is needed. In addition, if rights of enforcement continue to be exercised only by court order, improvements to the judicial and court system are required.

4.5 Thailand

In Thailand there is a problem of adequately securing property other than 'registerable property'. Intellectual property rights are an example. A clear legal framework is required to enable this and other forms of valuable collateral to be used for security purposes.

The major impediment to the enforcement of security rights continues to be the delay in the mandatory judicial process of enforcement. The courts continue to have many cases and it takes considerable time to obtain judgment. The problem is recognised but the long awaited reform to security enforcement has not yet materialised. Some improvement has been made in that it is now no longer necessary to obtain separate orders to enforce in the locality in which the property is situated.

4.6 Conclusions and Proposals

It will be best to revisit this area after the combined discussion of the participants in the two projects during the October symposiums. It would be premature to make conclusions without the benefit of those discussions and debate. It seems clear, however, that some aspects of secured transactions require further attention.

- Some of the economies need to address a number of unresolved issues concerning the enforcement of securities. A weak, uncertain or long delayed enforcement system means that a debtor corporation is under no pressure or persuasion to take positive action to address its financial position. It may also drive secured creditors into bankruptcy or liquidation proceedings so that they can, ultimately, exercise their enforcement rights through one of those processes. While that may not amount to an abuse of insolvency law processes, it is certainly far from the essential purpose of those processes.
- Many of the economies need to revisit the difficult task of balancing secured property enforcement rights against the practical operation of a collective liquidation or rescue

regime. There are a number of areas (such as the enforcement rights of secured creditors during a liquidation, priority rights of preferred creditors) that require more certainty.

- There is a need to develop registration systems for all forms of security. These can be a valuable aid to creditors in assessing credit risk.
- There is also a need to develop other forms of secured lending, particularly chattel or personal property secured lending and also lease financing. This development requires, however, a comprehensive legal system for the creation, registration or filing and the enforcement of such security interests.

5. LEVEL OF INSOLVENCY CASE ACTIVITY

This section focuses on the extent to which both formal and informal insolvency processes are being used. At the time of the first symposium, two of the economies (Thailand and Indonesia) had not long completed reforms to their respective laws and all of the economies (with the exception of Philippines) had only recently established informal insolvency processes. The main interest therefore is to see to what extent these processes have been used. This primarily involves presenting the statistical numbers and endeavouring to analyse their significance. In the next section of the report the value of the statistics themselves and other information is evaluated.

The statistics that follow are mainly for this calendar year to date. They are only concerned with corporate insolvency.

5.1 Liquidations

There were no cases of liquidation in the Philippines. In Thailand there were 24 cases of liquidation (or bankruptcy). In Indonesia there were 13 liquidation cases. By comparison, in Malaysia and in Korea the figures for insolvent liquidations are expected to be around the same high figures for 1998.

5.2 Formal Rescue

In the Philippines there have been 11 filings for reorganisation in the year to date. In Thailand 8 companies have filed for business reorganisation. In Korea the figure for cases of formal rehabilitation is expected to be around 160 (although to that should be added some 400 cases for composition). In Malaysia there were 20 filings for schemes of arrangement. In Indonesia there were only 6 cases for suspension of payments.

5.3 Informal Rescue

In this area, particularly in those countries in which a form of 'structured' informal process is available, the level of activity appears relatively high. For example, in Thailand more than 700 corporations have sought the assistance of the CDRAC debt restructuring process. Approximately one-half have progressed to the point of putting a standard form of debtor/creditor agreement (see the later review of this in the section dealing with Informal Insolvency Processes) in place and some 52 of that number have reached agreed restructuring plans with their creditors.

In Indonesia 350 cases have come under the Jakarta Initiative debt restructuring program. These have included some 250 medium to large-scale companies. However, there is not much other public information available concerning these cases. The only information of how many have resulted in the adoption of rescue or reorganisation plans suggests that the percentage is quite small.

In Malaysia some 63 companies have been involved in the CDRC debt restructuring process. These have included quite high profile listed public companies. The more enforcement driven Danaharta process (which follows on from the acquisition of non-performing loans from banking and financial institutions) has seen a considerable number of companies (some 1780 cases) under review in the debt settlement/recovery process. Some of these have sought restructuring arrangements through the CDRC. There are others to which special managers have been appointed through the extra judicial powers exercised by Danaharta.

In Korea about 80 companies have entered the structured workout process known as the Corporate Restructuring Accord. A high percentage of these are known to have reached agreement on workout plans. A lot of attention has, however, been directed at restructuring the top 5 chaebol and the next largest group of chaebol (known as the '6-64'). This, plus the fact that many of the subsidiaries or affiliates of these big chaebol are dependant on their restructuring plans, has tended to distract needed informal workout attention to smaller, medium sized insolvent companies. This may, in part, explain the relatively small numbers.

In all five countries (including the Philippines which does not have a structured informal process) other informal processes operate which are distinctly 'private' versions of the work-out concept. It is difficult to quantify this level of activity, except by anecdotal evidence (that is not surprising—it is not known, for example, what numbers engage in the 'London approach' work-out process in England). However, all the country consultants consider that there has been relatively high activity at this level.

5.4 Conclusions and Proposals

The level of insolvency cases has been relatively high. However, some of the figures continue to evidence a very low incidence of formal insolvency cases in the courts.

It seems clear that, apart from in Malaysia and in Korea, there has been little resort to the liquidation process. The numbers in Thailand, Indonesia and the Philippines are extraordinarily low. They do not even approach the type of figures that might be expected of corporate businesses in a time of healthy and progressive economic development and stability, which is certainly not the case in any of these economies. For that matter, the numbers in Malaysia and Korea are not consistent with the problems in each of their economies. On any reckoning there must have been (and, presumably, still are) a huge number of hopelessly insolvent corporations unaccounted for.

Of course, that is a view from the conditioned perspective of more developed and fully industrial economies. The observation on the numbers of liquidation cases is not meant to be a criticism in itself. But it is baffling and difficult to explain. Is it likely, for example, that the extraordinarily low figures in, in particular, Thailand, Indonesia and the Philippines indicate either that liquidation is not a process which sits comfortably with cultural and commercial attitudes or that there are some real problems with the law itself or the application of that law?

There has also been surprisingly little use of the new forms of formal reorganisation processes in Thailand and in Indonesia. This may be due to the relative recent introduction of these processes into societies in which they were previously not known. But it may also indicate that distinctly legal and court processes are not as suitable for the commercial culture of those countries as informal processes appear to be. The Indonesian consultant, for example, observes that 'both debtors and creditors still consider out of court settlement to be the best way to settle their debts'.

Judge Wisit Wisitsora-At, a justice of the Commercial Court in Thailand with special responsibility for insolvency law reform, has commented on the low number of formal reorganisation cases in Thailand. He observed that one reason why a company may not seek a formal reorganisation was because under the terms of the law the directors of the company would almost certainly lose control of management. He also said that because it is a new process, the persons involved had no experience and there is still an insufficient understanding of the process.

The level of informal work-out activity under the structured and private processes has been considerable. It appears to be a more acceptable form of process, one that is essentially private and non-legal, and more suited to the commercial culture of the five economies. Also, in jurisdictions like Thailand and Indonesia, it might be that the reforms to their formal insolvency laws has raised the prospect of a corporation being forced into liquidation or a court controlled reorganisation processes. That has possibly given some impetus to debtor corporations to take advantage of the informal processes before creditors seek to have the formal processes applied. If that is the case then a necessary feature of a rounded insolvency law system may have been established in each of those economies.

It is also important to observe that the initiation and operation of the structured informal processes appears to have fuelled and provided the basic guidelines for the development of 'private' style work outs within the banking and commercial communities. That is encouraging, particularly in economies such as Thailand, Indonesia and Korea, where there had been practically no experience and very little knowledge of informal workout practices.

However, it is possibly important to appreciate that the operation of these informal processes is, in some cases, an extension of the repair of the banking and finance sector. It remains to be seen whether the structured informal process will continue to flourish once that repair has been completed. In the case of Malaysia, for example, the informal work out may be seen to operate as a semi-forced process because of the leverage that Danaharta is able to exert on debtor corporations that are subject to debt recovery through Danaharta. It is highly improbable that Danaharta will continue to operate once the banking sector has been repaired.

Another factor for consideration, amongst these statistics, is that at the first symposium it appeared that there was a strong cultural attitude of resistance toward any admission of insolvency or financial difficulty. This can also translate into negative attitudes toward both formal and informal insolvency and reorganisation processes, even though many of these might offer at least the prospect of the corporation being saved from liquidation and extinction. Further, there appeared to be a strong commercial aversion toward 'loss of control' or anything that might result in outsiders dictating the immediate and long-term future of a corporation in financial difficulty. This is consistent with the comments of Judge Wisit.

A final observation concerns some statistics from Indonesia. The country consultant mentions that '12 bankruptcy petitions' were 'withdrawn' or 'settled'. There could be cause for some concern in this because it may suggest that bankruptcy petitions are somehow being settled between the petitioning creditor/s and the debtor corporation (in other words that bankruptcy petitions are being used as some type of individual debt recovery process). That is not consistent with the view that has been traditionally taken of such proceedings, which is that a bankruptcy petition commences a communal process for the benefit of all creditors. It is not just a one-on-one process. There is a strong view in many developed countries that a bankruptcy petition, absent fundamental flaws in its form and substance, should only be permitted to be withdrawn by leave of the court after the court concludes that

there are no other creditors. This may be something that should be carefully considered by the Ministry of Justice in Indonesia.

There are no particular proposals that may be made from a consideration of the statistics alone. Other aspects of the operation of the insolvency law system need to be considered first.

6. STATISTICS AND INFORMATION

The statistics and information given in the previous section about numbers of cases of insolvency are important. They should be a valuable indicator of economic trends (both in the wider economy and industry based) and are relevant to ascertaining the impact of commercial practices on different sections of the commercial community. Statistics can also be a helpful guide in determining the possible need for reform.

The ADB report noted that very little information and statistics were available in many of the RETA economies. In part, this could be due to the fact that new and reformed insolvency procedures and practices had only been recently introduced into some of the RETA economies. It was also evident that this might also explain the surprisingly low incidence of cases of formal insolvency.

There was also an alarming absence of knowledge and information concerning insolvency generally and, in particular, the application and operation of both formal and informal rescue and workout practices.

6.1 Evaluation of the Statistical Information in The Five Economies

The statistical information has undoubtedly improved (at least in some areas, notably the structured informal area) but the quality of the statistical and other information falls considerably short of what might be expected and required for useful analysis. Bare numbers are helpful. However (and even though it cannot be expected that the identity of the corporations and their precise detail dealt with under informal processes should be divulged), there is an absence of relevant, non-invasive information such as industry type, overall level of assets/liabilities, causes of financial difficulty/insolvency, and the nature and expected results of rescue or reconstruction plans.

On another level, informed opinions and comments on the operation of both the formal and informal processes are disappointingly scarce. There is very little legal, accounting, commercial or academic writing on the subject. In Malaysia the detailed reports published by Danaharta of its activities are helpful. In the Philippines a considerable number of published writings have been generated in response to proposals for the reform of the reorganisation process by the SEC. This type of 'open' information is extremely valuable in making any assessment of the effect and in the critical evaluation of both formal and informal processes.

6.2 Suggestions for Improvement

With the exception of Korea, all the local consultants agree that insolvency statistical and other related information systems must be improved. A summary of their views is as follows:

Thailand: A system has been established through the Legal Execution Department of the Ministry of justice to gather information concerning statistics of incidence and results of formal insolvency cases. Searches can be quickly made. However, the

system does not extend to gathering information concerning values of assets and liabilities, areas of business, causes of financial failure and so forth. This information would be of considerable benefit.

Malaysia: It is suggested that statistics might be best maintained by the Central Bank, since this would cover statistics of formal and informal cases and also banks are in a position to maintain their own statistics.

Philippines: The Philippines consultant proposes that the Investment and Research Department of the SEC should continue its compilation of petitions filed with the SEC. If there is a reversion to court jurisdiction in insolvency cases, the relevant courts should compile and forward information and statistics to the Supreme Court.

Indonesia: The level of available information is very small. An 'on-line' system to provide access to bankruptcy decisions, together with information on the financial position of the debtor, causes of insolvency or financial difficulty and areas of business, is required.

6.3 Conclusions and Proposals

- The process of gathering and recording statistical insolvency information should be encouraged in a number of the economies. This information should not be limited to formal 'public' cases of insolvency but should be extended to informal processes, particularly those that are under the guidance of central bank or other government agencies.
- The need for 'anonymity' in informal processes can and should be respected, but general information on aggregate numbers, assets and liabilities, industries and causes of financial difficulty might be easily provided in the form of an annual report.
- Banks and other financial institutions might also be encouraged to provide relevant broad and anonymous data to the same effect, since they will be involved in many more 'private' informal workouts.
- There is a need for reports, writings, opinions and critical analyses of the operation of the insolvency law system.

7. THE OPERATION OF AND REFORMS TO INSOLVENCY LAWS

The actual employment of the insolvency laws of the five economies is reflected in the statistical information set out earlier. This section of the report reviews the substantive content of the laws.

The ADB report noted that most of the RETA economies had basically sound insolvency laws and processes. That seems to be further confirmed from the reports of the country consultants. It does not seem that any critical difficulty has been experienced because the laws themselves are inadequate or imperfect.

That is not to suggest, however, that the laws do not need review and improvement. Indeed, in most of the five economies there have been some considerable developments, both actual and prospective, toward reform of the insolvency law system and related areas. These are now presented.

7.1 Korea

Some reforms to the various parts of the Korean insolvency legislation that may be detailed as follows:

- The Composition Act was amended in February 1999 to widen the grounds upon which a composition application might be refused and affording creditors more rights to apply for cancellation of an application for approval of a composition;
- The maximum debt deferral period under the Corporate Reorganisation Act has been reduced from 14 years to 10 years.

In addition, the Korean government has proposed other reforms which include that the speeding up the reorganisation procedure by providing tighter time frames and deadlines for each stage of the procedure. In particular, it is proposed that:

- the court be required to make a decision for a preservation order within 14 days of a request;
- the court be required to determine whether to make a commencement order within a shorter period of time; and
- a reorganisation plan must be submitted within 4 months of the time fixed for submission of creditors claims.

The inordinate time taken to effect and execute a reorganisation in Korea has long been a subject of criticism of the process. These reforms will no doubt improve the procedure. However, they will also have the effect of putting judges under greater pressure. The Korean consultant observes that without a commensurate increase in the number of judges or a reduction in their workload, the judicial handling of formal insolvency cases may present a problem in Korea.

Finally and most importantly, it should be recorded that a full insolvency law reform process has been commenced under the Ministry of Justice and the IBRD. This is, amongst other things, designed to increase the fairness, efficiency and speed of the procedure.

7.2 Indonesia

The reforms to the bankruptcy law have brought many improvements. Among the benefits are:

- two processes under the one law—one for bankruptcy (or liquidation) and the other for suspension of payments;
- a much quicker judicial procedure (including appeals);
- simple evidence or proof requirements to establish that a corporate debtor is insolvent;
- generally, a more open and transparent process.

Some problems have arisen as a result of procedural and interpretation difficulties. For example, a decision of the Supreme Court determined that the legal term 'debts' in the Bankruptcy Law should be confined to loan type debts and not extend to other obligations which are capable of being expressed as a money obligation—for example, a debt arising from the supply of goods or the performance of services. This seems to be a particularly narrow interpretation by the Supreme Court.

A new formal reorganisation procedure (to be possibly known as the 'Restructuring Law') is being developed through the Ministry of Justice and private sector contributions. The thrust of this proposed reform appears to be to provide separate legislation for cases of corporate reorganisation and restructuring. It is, as yet, unclear as to what effect this might have on the existing 'suspension of payments' procedure under the existing bankruptcy law

and whether the new process will be incorporated into the existing law. It would be of some concern if formal insolvency processes were separated.

7.3 Philippines

In the Philippines the chief problem has been the absence of definitive rules under the SEC reorganisation procedure. The SEC is not time bound and, as a result, if it issues a stay order, all creditors, but particularly secured creditors, are precluded from exercising their rights for an indefinite and, possibly, lengthy period of time.

Thus, the main criticism of the formal reorganisation process is that it is debtor friendly and, in the absence of fair commercial rules of procedure, the balance heavily favours debtors.

Now a set of rules to give much needed transparency and certainty to the suspension of payments and rehabilitation procedures of the SEC is proposed. There is, however, some debate about the rules in a number of critical areas and, unfortunately, the scope and text of the proposed rules has not been finally determined. There is also a suggestion that the rules may be unconstitutional, even though they may be necessary and desirable. Some of that opinion maintain that the new rules should take the form of duly enacted amendments to the existing Bankruptcy Law.

In summary these rules may provide for much of the detail that, somewhat astonishingly, had been lacking from the time the SEC was given the jurisdiction in 1982. The more important features of the proposed rules are:

- the SEC will be empowered to order the liquidation of an insolvent corporation if it appears that there is no reasonable possibility of rehabilitation;
- the 'market place' negotiation of a plan between creditors and shareholders will be subject to the provision of minimum requirements for a rehabilitation plan;
- more extensive financial and other information will be required from a debtor corporation at an early stage of the procedure;
- greater creditor involvement with provision for a creditors committee that would have considerable powers;
- more extensive powers to ensure that a corporation is properly managed during the reorganisation process and powers for an independent receiver to provide or assess accounting and other information;
- power to set aside transactions as if the corporation was subject to liquidation;
- some degree of protection for emergency financing.

Clear time limits for the performance of various steps and for the length of time of stay or suspension orders are also intended to be imposed.

These rules would create much needed credibility to the formal insolvency processes of the Philippines. They should provide greater creditor and commercial community confidence in those processes. However, there is some concern that the rules do not provide sufficient protection and involvement of creditors in the process. For example, rules that reorganisation plans should be the subject of an affirmative vote by creditors and that the position of secured creditors should be protected during the reorganisation process may not be included. That would be a matter of some concern to the commercial community.

The rules should also provide a greater degree of respect for the SEC itself.

In that respect it has always seemed somewhat unusual that a regulatory administrative body should have been entrusted with jurisdiction in an area that has

traditionally been the sole province of the courts. But the performance of the SEC, particularly over the last two years, may suggest that adherence to this 'tradition' is not necessarily the only way. The executive of the SEC is principally composed of business people. There must be some good sense in enabling business problems and difficulties to be addressed in such a commercial forum.

7.4 Thailand

In Thailand the main source of comment is that the new formal reorganisation process has not attracted many cases. There have been far more reorganisations through the informal CDRAC process. Although that process does not have the benefit of the automatic moratorium or stay under the formal process, it has the benefits of speed, the coercive power of the Bank of Thailand (for difficult banks) and a mechanism that encourages creditors to agree amongst themselves.

The Thailand consultant suggests that other possible reasons for the low formal reorganisation numbers are these:

- There appears to be some stigma attached to filing for reorganisation under legislation that is named the 'Bankruptcy' Act because it creates a perception that the company is 'bankrupt'.
- During the formal reorganisation process the directors lose many of their powers and may lose them altogether.
- There may be a perception that no court proceedings will ever be conducted expeditiously.

In addition there are two particular criticisms of the legislation. The first is that if a plan is not sanctioned by the court the process is terminated and there is no automatic conversion to liquidation. The second is that the law requires that a debtor corporation is insolvent on a balance sheet test. It is often easy to show balance sheet 'solvency', particularly if values of assets are inflated. Yet, such a corporation may (probably will) be insolvent on a cash flow test. This may serve to protect companies that are in severe financial difficulty.

A new law has established a Bankruptcy Court with exclusive jurisdiction in bankruptcy and reorganisation processes. At present only a central bankruptcy court has been established but there are proposals to establish regional bankruptcy courts.

There have also been some amendments to the newly reformed Bankruptcy Law. These cover a number of matters, including;

- speeding up the procedure by requiring cases to be heard and determined without adjournment except where necessary;
- raising the minimum amount of unsecured debt to enable a creditor to commence proceedings;
- classifying creditors into groups and requiring that reorganisation plans must be approved by each group;
- removing the discretionary power for the court to approve or reject a plan and establishing objective criteria (including, for example, a requirement that creditors must receive not less than would have been received if the company had been liquidated);
- enabling 'new money' to be supplied to an insolvent company provided it is shown to be necessary to enable the business of the company to continue; and
- introducing concepts of 'related parties' and 'insiders' and thus widening the ambit of the avoidance of transaction provisions.

These changes represent important substantive changes and indicate that progress and problems with the new legislation need careful monitoring to enable it to function more efficiently.

7.5 Malaysia

Here the chief concern appears to be about the absence of a better formal rescue process and the lengthy delay, uncertainty and possibility of abuse in restructuring cases under the present process. The concern is also expressed that there is insufficient attention given to redressing corporate fraud and mismanagement.

It was hoped that Malaysia might have attempted a major overhaul of its insolvency law system (similar to that which has occurred in Singapore and is under consideration in Hong Kong, China). Unfortunately, however, the movement for the introduction of a modern, more efficient and effective formal rescue process in Malaysia appears to have lapsed.

7.6 Super Priority and New Money

As noted in the ADB report, an essential need that has been identified in the successful operation of the formal rescue process is the provision of on going funding for a corporation that genuinely seeks a possible rescue plan. Often, such a corporation has a severe liquidity problem that affects its ability to continue its business operations. It cannot pay for critical supplies of goods or services (including the services of its employees).

Some developed insolvency law regimes have sought to accommodate this problem in various ways. It is necessary for the law to provide, firstly, the necessary legal sanction for obtaining such funding and, secondly, a statutory 'super priority' for the repayment of that funding.

None of the insolvency laws of the five economies provides for this essential need.

7.7 Conclusions and Proposals

- New legislation, such as that in Indonesia and Thailand, needs to be kept constantly under review so that changes may be quickly made to improve the efficiency and predictability of the law. It is encouraging that so many of the economies are actively engaged in a reform monitoring process. Some care should possibly be exercised in Indonesia regarding the proposal to create a separate reorganisation law, else it may result in a non-integrated insolvency law system (see the first comparative report for comment on the dangers of non-integration of insolvency processes).
- Some greater examination and enquiry may be necessary in the economies where the statistical numbers do not seem to reflect what the commercial realities appear to dictate. Is there a problem in those economies because the law is too over regulatory and too formal for the commercial culture of the economies?
- Malaysia would clearly benefit from a new formal rescue procedure. That would also present the opportunity of reviewing the position of secured creditors in an insolvency environment and drawing a better balance.
- The Philippines is clearly in need of rules to govern the formal reorganisation process. The rules proposed are to be encouraged but the opportunity should be taken to ensure that there is sufficient protection for and involvement of creditors in that process.
- The insolvency law regime should provide for the provision of funding essential for the continued operation of a corporation that is clearly eligible for a possible plan of rescue under the formal rescue process. The law should be such that it:

- Sanctions such funding;
- Provides a clear and certain first priority for the repayment of the funding; and
- Provides for such things as subrogation of existing creditors and, possibly, subrogation of existing securities over property of the corporation in favour of the 'new money' supplier.

8. OPERATION OF THE COURTS IN THE INSOLVENCY LAW SYSTEM

The great majority of countries operate their insolvency law system through the courts. With the exception of the Philippines and the Danharta regime in Malaysia, the five economies have all followed that tradition. The operation of the formal insolvency law system is therefore heavily dependant on the way in which it is applied and administered by the courts.

As mentioned in the ADB report, there have been considerable difficulties because of problems with the court and judicial system. In many economies, processes are slow, judges are not suitably qualified or experienced, and the judicial process is unpredictable and unreliable. Many judges are not competent to understand even the most basic of the complexities involved in a case of corporate insolvency. The ability to handle a complex case of corporate reorganisation and financial restructuring appeared to be beyond the knowledge and experience of many judges. There was also evidence of corruption within the judiciary in some RETA economies.

This section reviews the performance of the courts in the five economies.

8.1 Korea

The main problem is that there are insufficient judges with expertise in cases of bankruptcy and reorganisation. Although the judges presently handling such cases are, generally, competent, there are an insufficient number of them. These judges are also required to handle other, non-bankruptcy, cases and their work-load is, accordingly, very heavy. It is suggested that Korea would benefit from the creation of a specialist or dedicated bankruptcy court.

8.2 Malaysia

The main problems are identified as:

- Inexperienced judges handling formal insolvency cases with very little understanding or appreciation of the philosophy underlying insolvency law and the commercial application of such law;
- A significant volume of work load for judges and consequent delays;
- Considerable delay in appeals processes.

It is suggested that a special insolvency court(s) are required and more experienced and trained judges.

8.3 Indonesia

The judicial handling of insolvency cases has improved. The establishment of the Commercial Court has been viewed as an important and necessary step toward judicial reform. Time limits are enforced, decisions are made public and, generally, the processes of the court are much more transparent (unfortunately this is not the position regarding formal cases of suspension of payments—very little information is publicised about these). In

August, 1999 a further four commercial courts were established to help decentralise the work of the court throughout the country.

However, problems still exist and some of these appear to be severe.

A main problem is the lack of consistency in the decisions. Although not many cases have been before the courts (see earlier analysis of statistics), judicial decisions in insolvency cases often arouse seemingly irreconcilable conclusions. Part of the cause of this problem may be due to the fact that there is no real or any system of 'precedent' in the Indonesian judicial system, and thus judges are free to apply the law as they see fit. In part, this problem is compounded by an absence of published writings on decisions of the Indonesian courts that might otherwise help to establish a base for what might be considered 'good' or justifiable decisions.

This leads to considerable commercial uncertainty and scepticism about the court system and the judiciary generally. For example, of the 59 cases in which decisions were given, 25 were appealed to the Supreme Court and 14 of these went to a further review before a different panel of the same court.

Another major problem is that the judges of the Commercial Court who handle insolvency cases come from a non-commercial background. It appears that many of these judges have little commercial knowledge or experience. The Indonesian consultant comments that 'many of the (cases) involve modern and sophisticated (commercial transactions)' and the judge 'presiding over the hearing does not understand the transactions' which 'leads to misinterpretations or narrow interpretations of the documents'.

8.4 Experience of a Recent Case in Indonesia

Evidence of these problems may be found in a recent bankruptcy case involving the International Finance Corporation (IFC).

A corporation borrowed a long term facility from the IFC. Two other banks provided shorter term working capital facilities. Each of the three banks took security in some shape or form over the assets of the company. The IFC loan provided for regular payments of interest and for repayment of principal in tranches at dates in the future. The loan agreement contained the usual provision for acceleration of repayment in the event of default by the borrower. Default in the payment of interest and other terms of the IFC loan occurred. Default also occurred under the terms of the loans from the two other banks. Discussions and negotiations with the corporate debtor were unsuccessful.

IFC and the two other banks joined together to make an application for the liquidation of the corporate debtor. In the proceedings in the Commercial Court it was argued on behalf of the debtor that there was no debt due to IFC because the time for repayment of principal amounts had not yet been reached (this despite the clear evidence of default in payment of interest and the acceleration terms of the loan agreement). In the case of the other two banks it was argued that the money advanced had been used for swap/derivative transactions which was an illegal purpose and the loans could not be recovered by the banks. The Commercial Court upheld these arguments.

IFC and the other banks appealed to the Supreme Court. There it was further argued on behalf of the debtor that because the 3 banks held security for the loans they could only seek to recover in the District Court. The Supreme Court upheld that argument.

The case was taken further to a separate panel of the Supreme Court for a review of the appeal decision. This panel of the Supreme Court in a well reasoned and authoritative judgment rejected the previous decisions and found for IFC and the other banks.

The case has been important for investor confidence in Indonesia, but it also serves to illustrate the type of difficulties mentioned above. Some endeavour is being made to improve the standard of judges appointed to the Commercial Court by recent 'ad hoc' appointments through a steering committee of the Supreme Court. But, if the standard of the judiciary is to be raised, serious attention must be given to issues such as independence, remuneration and status. With the passage of time and the benefit of additional resources, the court may well become more consistent in its decision making and earn the confidence and respect of the commercial community. It seems clear, however, that in the meantime prolonged education and training for the judges would greatly assist.

8.5 Thailand

The new Bankruptcy Court was established and commenced operation in June 1999. This was regarded as a positive step because specialist judges and court officers can better implement the legislation and proceedings should move more rapidly. Some 60 judges were initially wanted for appointment to the court but only 12 have been appointed. They are said to be handling over 3000 cases which is a high case load (these include the many personal insolvency cases).

It is the view of some that assessment of the judicial handling of formal insolvency processes under the new law should wait a longer period of trial. Since the new court was established there has been an increase in case numbers. So far only the Central Bankruptcy Court is operating. It is intended to establish regional bankruptcy courts in the future.

Changes are also proposed by the government of Thailand to the administration of the court system in Thailand. At present this is under the control of the Ministry of Justice but a separate agency is now proposed. This may afford better administration of the courts and the judiciary and may give the latter much needed independence and transparency.

8.6 Philippines

As mentioned elsewhere, the issue of judicial control of insolvency cases really does not arise for consideration in the Philippines. In reality the courts are simply not involved because in the area where they do have jurisdiction, cases of liquidation, no cases have been filed for years. In the area of reorganisation, the courts have not had jurisdiction since 1982 when the jurisdiction was given to the SEC.

Elsewhere in this report mention has been made of the SEC and its largely administrative role in the application of the formal reorganisation law. This has not gone without criticism. Some view the SEC as having too many functions and not sufficient time or resources to administer such an important commercial area. Others are basically distrustful of a non-judicial system of administration. This may be due to the fact that up to now the SEC has largely been its own master and able to conduct its processes as it has seen fit. That has, of course, undoubtedly produced a feeling of uncertainty and the absence of 'rule of law' comfort. The proposed new rules may help to overcome some of these difficulties.

Despite the criticisms, the 'experiment' of this approach appears to have worked in the Philippines. It is a model that should not be dismissed or overlooked.

8.7 Conclusions and Proposals

- The reports of the consultants all appear to underscore the need for specialised courts and judges with experience and knowledge. A specialised court need not be one that is solely devoted to cases of insolvency. It may be one with a broad commercial jurisdiction, of which insolvency cases are a part.
- But, clearly the need is for judges who are capable of dealing with cases of corporate insolvency. That requires a wide knowledge and appreciation of commercial and corporate affairs. It seems that in some of the economies, training and education in those areas would be of considerable benefit. A high priority should be accorded for intensive and ongoing education and training of judges and court officials in those economies.
- Another area in which assistance might be appropriate (although it is an area that is clearly outside the scope of this Project) is in the organisation of the courts, the status and general accountability of judges and court officials. These are areas that appear to require considerable improvement.

9. INFORMAL INSOLVENCY PROCESSES

This is quite clearly the area of the greatest development and success in corporate insolvency in all the economies. At the time of the first symposium a number of the RETA economies had only just promoted informal workout initiatives; the experience of them was yet to come. Now, with the passage of only a short space in time, it appears from the statistics and comments and observations that all the informal initiatives are working well.

As mentioned earlier, some of these were linked to managing the crisis ridden banking sector and may be viewed as part of that overall policy direction. However, with one or two exceptions, most of these are capable of being used or adapted to a stand alone approach directed at assisting corporations in financial difficulty.

These initiatives are important and deserve appropriate recognition, response and support. The informal workout technique is now being employed in many countries as an alternative to formal rescue processes under insolvency laws. In the context of the cultural, social and commercial environment of many of the economies in the region, the development of this technique may prove to be of greater utility, though not necessarily of greater importance, than the development of formal rescue processes.

In all the economies there has been significant use of informal rescue processes. The country reports give examples of their successful employment.

9.1 Malaysia

Malaysia has had the experience of two structured informal processes. One is the 'special manager' style of imposed work out process under the Danaharta legislation. The other is the voluntary work out under the CDRC.

Regarding the Danaharta regime, the Malaysian report gives an example of a company that had three attempts to resolve its problems under the formal scheme of arrangement process, all of which failed. Danaharta appointed special managers to the company and within 3 months a workout had been approved by secured creditors. If the workout is successful, all classes of creditors will be paid in full over a period of time.

The Danaharta regime is interesting for two reasons. First, the extraordinary range of its powers, under which it may:

- Endeavour to broker an informal work-out with other creditors;
- Participate in an informal work-out through the CDRC (in reality it can prove the catalyst in encouraging or persuading a debtor corporation to submit itself to this informal process);
- Participate in a formal scheme of arrangement;
- Appoint receivers and managers to a debtor corporation (assuming there is power to do so in the security documentation);
- Enforce security rights through power of sale unaffected by the usual restraints on sale that might affect other secured creditors (as mentioned earlier in this report);
- Appoint special managers to a debtor corporation and then assume an extra-judicial role of approving a proposed plan of reconstruction.

These powers give Danaharta a very considerable leverage to bring about a speedy and efficient determination of the affairs of a corporate debtor.

A major aspect of interest of the Danaharta regime is that under the informal rescue process Danaharta may employ through the appointment of special administrators, there is no involvement of a court in the process at all. It is an entirely administrative process. In that respect it invites comparison with the formal reorganisation process of the Philippines under the administrative control of the SEC.

In respect of the CDRC informal work-out process, the Malaysian consultant observes that although it is not very efficient or fast, it has been a major step in the right direction for Malaysia. The biggest problems seem to be that:

- CDRC does not cover small/medium sized corporate debtors;
- There is a problem with 'new money' requirements for urgent working capital needs;
- There is difficulty in ensuring that secured bank creditors, particularly foreign bank secured creditors, fully participate in the informal process. In this respect, if Danaharta is one of the creditors, its extra-leverage can help;
- There is a problem with the appointment of consultants to ensure that the financial and other affairs of the corporate debtor are fully analysed to provide the basis of a plan.

The views of some foreign bank officials in Malaysia indicate that their experience of CDRC is fairly favourable. They comment, however, that sometimes the rescue proposals that are made are not in the best interests of creditors as they might be or are too optimistic and non-commercial. There is not sufficient attention to detail, analysis, verification of future income, cash flow projections and the like. Local banks tend to favour acceptance without proper analysis.

One way to remedy this is to expand the committee of the CDRC to ensure that there are people with more experience. Other comments include that local banks are not yet experienced enough; they send junior staff to meetings and do not respond to proposals and other deadlines on time. This can be particularly frustrating for lead bank and steering committees.

The CDRC itself is proposing administrative and other changes to improve the process. These proposals include that CDRC will itself take over the negotiation of appointment of consultants if there is prolonged disagreement and that 3 more members (from the banking sector) will be added to the steering committee. It is the steering committee that analyses proposals before they are considered by creditors. At present too

many of these proposals are slipping through that process without adequate analysis, causing inefficiency and delay.

It seems to be generally considered that the CDRC initiative has greatly assisted in developing the informal work-out process in Malaysia.

9.2 Korea

There has been a significant concentration on informal techniques for cases of corporations that are in financial difficulties. In particular, the structured informal process that was created under the auspices of the Korean Financial Supervisory Commission has been well utilised. This process, as explained in the first comparative report, involved more than 200 Korean banks and other financial institutions agreeing to an accord known as the 'insolvency deferral agreement' or 'work-out agreement'. If one of that number invoked the agreement in respect of one of its corporate debtors, all of the subscribing institutions would be bound by the terms of the agreement. Those terms provided for a standstill, negotiation of a plan of restructure, mediation of disputes and so forth.

The Korean report evidences a number of successful work-outs through the employment of this process in which a variety of restructuring and refinancing techniques have been employed. These have included reduction of share holding of owners; debt/equity swaps among bank creditors; sale of non-core assets.

However, despite the apparent success of the process, there are some concerns that it is not operating as efficiently as it might. Problems are seen in a number of areas, such as:

- The agreement only binds those financial institutions who have signed it. Thus, other creditors may still pursue their individual rights and frustrate or impede the process;
- There is a fundamental difference of approach between financially troubled companies and the financial institutions. The former are seeking the input of new capital, the latter emphasise short term retrieval of loans;
- Often there is a considerable dispute regarding the continued management of the corporation.

It is considered that training and education, especially at bank and corporation management level, in work out techniques, assessment of long term risk and negotiation would be of assistance.

9.3 Indonesia

The experience of the Jakarta Initiative is more difficult to discover. The Indonesian consultant suggests that progress under this initiative has been a lot slower than anticipated and only a few restructurings have been put in place. The process has been also hampered by a lack of co-ordination between the relevant authorities.

The report of the World Bank, Corporate Restructuring & Governance Group, of April 1999, stated that the progress in finalising cases of informal restructuring has been slow. Reasons attributed for this include that both creditors and debtors have been reluctant to recognise losses, the new bankruptcy law has been ineffectively applied, and financial and operational restructuring is sometimes complex.

Certainly, the Indonesian informal process initiative does not appear as successful as those of Thailand, Korea or Malaysia. There are a number of differences.

- First, the bank restructuring authority, IBRA, does not appear to exert the same leverage on corporate debtors as does its Malaysian counterpart, Danaharta. IBRA

appears to have concentrated on the acquisition of non-performing loans and not on their recovery or management.

- Secondly, recourse by a creditor to the formal insolvency processes (in particular, liquidation) in respect of an intransigent corporate debtor does not pose as great a threat in Indonesia as in Malaysia. Thus there is less motivation for a corporate debtor to engage in a voluntary informal work-out. The 'shadow' of recourse to the insolvency law is not as sharp and pointed.

9.4 Thailand

The structured informal process has been significantly assisted by the production of standard form 'Inter-Creditor' and 'Debtor-Creditor' agreements. These were settled in March 1999 as part of the operation of the structured informal work-out process through the CDRAC. The agreements are quite elaborate.

The first provides the basic conditions under which the creditor parties to a work-out will conduct themselves in endeavouring to reach consensus on proposed plans for corporate restructuring. It deals with such things as voting on plans, time limits for decisions, mediation of inter-creditor disputes, and the appointment of an 'executive decision panel' to review and approve or reject a proposed plan. The decision of the executive panel is final and binding on the creditors who have executed the inter-creditor agreement.

The 'debtor-creditor' agreement is required to be made by a debtor corporation that seeks to invoke the CDRAC informal work-out process. The debtor must be first 'approved' by the CDRAC. In essence, this agreement is made with the banks and other financial institutions that have agreed to the inter-creditor agreement. The 'debtor-creditor' agreement binds the parties to the inter-creditor agreement. The 'debtor-creditor' agreement provides for such things as convening of meetings, lead creditor, steering committee, provision of information, promises by the debtor while the negotiation process is under way, mediation of disputes, debt trading, voting and approval of plan, implementation of plan. The agreement contains reasonably detailed schedules for the commencement and advancement of the workout process and of information that the debtor is required to provide.

This is an interesting and important advance for the informal process. It possibly enhances the efficiency of and avoids unnecessary delay in the process.

Another development in Thailand is that the CDRAC process has been used in some cases to develop 'pre-packaged' plans. This technique is necessary if all creditors are to be bound by a plan (the CDRAC process only binds creditors who agree to the plan—it does not bind those who dissent nor other creditors who have not been involved in the process). The plan is thus 'agreed' by a dominant number of creditors through the CDRAC process and the corporation then applies for reorganisation under the insolvency law. The pre-packaged plan becomes the reorganisation plan. Creditors are notified and required to vote. If approval from the requisite majority is obtained the plan binds all creditors.

It should also be mentioned, however, CDRAC normally only involves financial sector creditors and the process is really designed for reasonably complex restructurings. It is relevant that some 46% of corporate debtors under the guidance of CDRAC have not signed the debtor-creditor agreements and have sought to negotiate simpler debt restructuring arrangements.

Indeed, according to the country consultant for Thailand the clear majority of corporate debtors in Thailand have sought informal private work-outs.

9.5 Philippines

There is no structured form of informal rescue process. However, there has been an increasing tendency to utilise essentially private informal processes. The report for the Philippines contains details of some recent actual attempts at private workouts. One of the commercial techniques that is used in some of the private workouts is that which is known as 'dacion en pago'. This is, in effect, an outright transfer of assets of the debtor to the creditor(s). The creditors may then thereafter treat those assets as their own.

The biggest difficulty in the private style of workout, as might be expected, is obtaining agreement from all the creditors. Still, it is encouraging that a commercial practice is gradually emerging without the assistance of government intervention or encouragement.

9.6 Conclusions and Proposals

- Further education and training among banks and financial institutions and owners and managers of corporations about the methodology and processes involved in informal insolvency workouts would be desirable (see earlier sections on corporate management and bank lending and monitoring practices).
- The procedures are also dependant on the availability of professional and other advisors with experience and knowledge of the processes of informal insolvency workouts. There should be education and training courses to encourage the development of these professionals (this would compliment the training and education of private professional insolvency case managers).
- The presence of a facilitating agency to bring debtors and creditors together has clearly been very useful and should be continued.
- Once the systemic debt problem of the banking sectors in many of the economies is arrested, the informal processes should be retained and certainly should not be dismembered. They might be reviewed to ensure that they are capable of dealing with corporate debt problems generally and, in particular, that they take proper account of the important collective characteristics of insolvency practices.

10. INSOLVENCY CASE ADMINISTRATION

The success of formal and informal insolvency processes is very much dependant on the availability of both public (government) and private professional insolvency case administrators or advisors. The liquidation process cannot function without the presence of a government agency staffed by experienced officials. Both the formal and informal reorganisation processes need either private professional case managers or advisors.

The development of government institutions and a private sector base of trained and educated administrators varies among the five economies.

10.1 Indonesia

In Indonesia the Bankruptcy Law provides for alternative methods for the appointment of receivers in the administration of formal insolvency cases. These are the 'custodians' of the public service and qualified persons from the private sector. In regard to the latter, some good progress has been made for the private administration of insolvency cases by private professionals. An association of Indonesian Receivers and Administrators has been formed and now has some 80 members from both the legal and accounting professions. The association was established in response to suggestions by both the IMF

and the Ministry of Justice to provide qualifications for private receivers and custodians under the Indonesian insolvency law.

It is now a prerequisite that a private professional must be a member of the association before that person may be registered as a custodian with the Ministry of Justice. The association provides an initial training session to qualify persons for membership. They may then seek to be registered with the Ministry of Justice.

A number of appointments have been made of these private professionals to insolvency administrations. Enquiry is made regarding possible conflicts of interest before an appointment is made. The availability and level of fees is sometimes an issue.

The association considers that it does not compete with public sector custodians and that it is important that the public sector should remain and be strengthened because there will be many cases in which fees will not be available because of limited assets of a company that is being liquidated.

The formation and structure of the association is an important step in providing a professional organisation of private professional insolvency administrators. The Indonesian country consultant comments that there has been a quite discernible improvement in the administration of corporate liquidations since the appointment of independent receivers commenced. Most of the liquidations are conducted by independent receivers.

The further development of the association and its members may be encouraged through assistance with training and education. The association considers that this training should be also extended to the public sector administrators or custodians.

10.2 Thailand

Although it might have been expected, no similar association has as yet been established in Thailand but the reasons for this are not clear.

10.3 Korea

In Korea the chief concern is that there are not sufficient specialists available to handle the volume and complexity of cases. There is a need for an increase in the number of government officials and experts in the private sector. The pool of bankruptcy trustees and receivers must be expanded.

10.4 Malaysia

In Malaysia both public and private administration of insolvency cases appears adequately provided. Administration of most cases of liquidation is through the government Official Receiver's department. It does not become involved in reorganisation cases. Both Danaharta and CDRC are either staffed or have access to experienced professionals. Private professional administration of formal scheme of arrangement and some liquidation cases is provided through licensed insolvency practitioners.

10.5 Philippines

In the Philippines there is a perception that the appointment of private professionals to act as receivers or members of rehabilitation committees in reorganisation cases is difficult because of lack of knowledge and experience or because of inadequate remuneration. There is no system of accreditation or registration for such persons so that the identification of suitable persons becomes difficult. Consequently a practice has developed

where the SEC has appointed business persons to the management committee of a company that is seeking reorganisation.

There would appear to be a need for education and training in the Philippines, particularly of professionals who wish to practice in the area of insolvency reorganisation and for officers and employees of the SEC if it is to continue to administer the formal insolvency processes.

10.6 Conclusions and Proposals

- A high priority should be accorded for intensive and ongoing education and training of both public and private insolvency case administrators in many of the economies.
- The development of a private sector association of insolvency case administrators should be encouraged. Such an association should be accorded recognition under the insolvency law and, ideally, should be the body able to determine the suitability and fitness of persons to be registered or licensed as insolvency practitioners. Compulsory on-going education and training should be required of licensed practitioners.

11. CROSS-BORDER CONSIDERATIONS

Cross-border insolvencies occur when the trading and business activities of a corporation or corporate group extend across two or more countries and the corporation or a member of the corporate group becomes insolvent. It is important and it may be vital in a rescue context, that the relevant insolvency regimes provide for co-operation in the administration of the affairs of the debtor corporation.

11.1 Cross-Border Insolvency Legislation

The ADB report recorded that the RETA economies would benefit from a detailed consideration of, and a multilateral approach, to cross-border insolvency issues. It has become essential to cross-border trade and commerce that the insolvency law of a country permit and respond to requests from another jurisdiction for recognition, assistance and co-operation. This is the essential thrust of the UNCITRAL model law on cross-border insolvency.

The ADB report noted that there was a lack of knowledge generally of the problems of, and the different approaches to, cross-border insolvency. This should be of particular concern to the economies in the region, since most, if not all, are economically dependant on regional and international trade and commerce. With one or two exceptions, none of the insolvency law regimes of the economies in the region contained any provision relating to this issue. Further, it did not appear that any of the economies were contemplating the adoption of the UNCITRAL model law nor, indeed, of making any attempt to respond to the need.

A survey of the five economies involved in this second stage of the project has revealed that none of them appear to have taken any initiative in the development of a cross-border insolvency co-operation regime.

11.2 Regional Co-operation and Collaboration

On another aspect of 'cross-border' relations, the ADB report suggested that all the economies in the region may benefit from the establishment of a semi-permanent forum for the exchange of experience, information, new developments and education in the area of

insolvency law and practice. Such a forum could bring together, on an annual or bi-annual basis, government policy makers, legislators, judges, officials and insolvency practitioners.

11.3 Conclusions and Proposals

- It is desirable that the economies in the region adopt uniform cross-border insolvency legislation that equips each of them with similar and reciprocal provisions regarding recognition, relief and co-operation between and with the courts, regulators and administrators of each economy.
- It would be beneficial if a forum in the region was established for the exchange of information and developments in insolvency law and practice.

12. SUPER PRIORITY AND NEW MONEY