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**TRENDS AND DEVELOPMENTS IN INSOLVENCY SYSTEMS AND RISK  
MANAGEMENT: THE EXPERIENCE OF THE PHILIPPINES**

by

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## **TRENDS AND DEVELOPMENTS IN INSOLVENCY SYSTEMS AND RISK MANAGEMENT: THE EXPERIENCE OF THE PHILIPPINES**

### **Introduction and summary**

Recent developments in the financial system of the Philippines and the growing clamor to update antiquated laws relating to rehabilitation and insolvency to comply with international best practices have led to a series of new legislation and proposed legislation. Philippine legislators have been busy revising and updating the legal framework of the Philippine capital markets with the aim of attracting investors, both foreign and local, in the capital markets and, at the same time, adopting the values of good governance.

Recently, the Special Purpose Vehicle (“SPV”) Act of 2002 and its companion law, the Securitization Act of 2004, were passed by Congress to spur foreign investment and economic growth in the banking and securities sector. Currently, Congress is deliberating on the passage of the Corporate Rehabilitation and Insolvency Act, which is envisioned to introduce and harmonize the antiquated insolvency law with world’s best insolvency practices.

Together with the other recently passed laws and regulations such as the General Banking Law of 2000 (the “GBL”), the Securities Regulation Code of 2000 (the “SRC”) and the Interim Rules on Corporate Rehabilitation (the “Interim Rules”), the aforementioned laws and regulations have updated the Philippine corporate finance and insolvency legal framework to enhance the Philippines’ competitiveness in the international capital markets.

### **A. TRENDS AND DEVELOPMENTS IN INSOLVENCY AND CREDITOR RIGHTS: FRAMEWORKS AND PRACTICES**

#### **I. Current Legal And Institutional Developments**

##### ***Interim Rules on Corporate Rehabilitation***

The principal laws governing insolvency and rehabilitation are the Insolvency Law, enacted in 1909, and Presidential Decree No. 902-A (“PD 902-A”), enacted in 1976. P.D. 902-A vested the Securities and Exchange Commission (SEC) with jurisdiction over, among others, petitions for suspension of payments and rehabilitation of corporations. However, on July 19, 2000, Congress enacted the Securities Regulation Code (SRC, or R.A. 8799). The SRC transferred jurisdiction from the SEC to the regular courts over petitions for suspension and rehabilitation, and allowed the Supreme Court to designate branches of the appropriate Regional Trial Courts to hear and decide cases of such nature. Pursuant to the Securities Regulation Code, the Supreme Court promulgated in December 2000 the Interim Rules of Procedure on Corporate Rehabilitation (“Interim Rules”) setting forth the procedure for corporate rehabilitation.

The Interim Rules authorize a distressed debtor to file a petition for rehabilitation. They also authorize a creditor or a group of creditors holding at least twenty-five percent of the total liabilities of the debtor to file a petition to rehabilitate the debtor.

If the court makes a determination that the petition is sufficient in form and substance, it then issues a stay order which, among others, stays enforcement of all claims against the debtor. All claims, whether secured or unsecured, are stayed for duration of the rehabilitation proceedings, which must not exceed eighteen months from the filing of the petition. If no rehabilitation plan is approved within said period, the petition is dismissed.

The rehabilitation court also appoints a rehabilitation receiver, whose primary tasks are to monitor the operations of the debtor under rehabilitation, evaluate the feasibility of rehabilitating the debtor, and implement the rehabilitation plan if approved by the court. Once the rehabilitation plan is approved, it is binding upon the debtor and the creditors, whether or not they participated in the proceedings or opposed the plan. An approved rehabilitation plan may, on motion, be modified if, in the judgment of the court, such modification is necessary to

achieve the targets or goals set forth therein. If the plan is successfully implemented, then the rehabilitation proceedings shall be terminated by the court.

#### *Proposed Corporate Rehabilitation and Insolvency Act*

Considering the current piece-meal legislative state of the insolvency and rehabilitation laws of the country, the Philippine Congress is currently deliberating on the proposed Corporate Rehabilitation and Insolvency Act which attempts to harmonize the aforementioned laws taking into account the current world's best insolvency practices. There are two bills now pending in both houses of Congress.

#### *SPV Act of 2002*

As a response to the growing non-performing assets problem besetting the Philippine banking sector, Congress passed the SPV Act of 2002, essentially granting tax exemptions and fee privileges to transfers of the non-performing assets (i.e., non-performing loans and real and other assets owned and acquired by financial institutions) to and from the SPVs. The law calls for the creation of SPVs as the corporate vehicle to acquire such non-performing assets and, in turn, dispose of them in the market.

While the law was principally designed to address the non-performing assets of the financial sector, it is also an attempt to encourage private sector investments in the banking and financial sector. The law mandates the issuance of investment unit instruments ("IUIs") by the SPV as a means of raising funds. Such IUIs are securities and therefore required to be registered with SEC.

The SPV Act of 2002 provides an 8 April 2005 deadline for the disposition of the non-performing assets by the financial institutions. There have been several banks which have transferred or are currently planning to transfer their non-performing assets under the SPV Act of 2002, including the Bank of the Philippine Islands, Rizal Commercial Banking Corporation, United Coconut Planters Bank, Philippine Bank of Communications, Land Bank of the Philippines and the Philippine National Bank.

The sale of the assets of the National Steel Corporation, the Philippines' only steel plant, to the Ispat Group of India was conducted under the provisions of the SPV Act of 2002, as well.

There are moves in Congress to have the law amended by extending the deadlines on the transfer of the non-performing assets.

#### *Securitization Act of 2004*

Crafted primarily as the companion bill for the SPV Act 2002, the law calls for rationalization of the laws, rules and regulations relating to securitization or the sale on a without recourse basis to special purpose entity ("SPE") and the issuance of asset-backed securities ("ABS") by the SPE, which depend, for their payment, on the cash flow from the sale of the assets.

The law likewise rationalizes the various regulations on the development of a secondary market for ABS. As with the SPV Law of 2002, the law grants certain tax exemptions and fee privileges to the transfer of assets to the SPE and the issuance of ABS related to the securitization transaction.

The appropriate regulatory agencies have yet to issue their respective implementing rules and regulations.

#### *General Banking Law of 2000 and the Anti-Money Laundering Act, as amended*

The General Banking Law of 2000 ("GBL") is the basic law governing the banking sector, including the grant of loans and other forms of credit accommodation, enforcement of security by banks, allowable equity investments of banks and determination of the banks' prescribed risk based capital.

In enacting the GBL, Congress took into account the role of banks in providing an environment conducive to a sustained development of the national economy and the fiduciary nature of banking that requires high standards of integrity. The General Banking Law is an attempt by the government to promote a stable and efficient

banking and financial system that is globally competitive, dynamic and responsive to the demands of a growing economy.

In response to the requirements of a stricter post 9/11 financial community, Congress, taking into account the recommendations submitted by the Financial Action Task Force, enacted stricter guidelines in handling of bank accounts and transactions to prevent money laundering. The Anti-Money Laundering Act, as amended, requires banking institutions to maintain a system of verifying the identity both individual and corporate clients and develop clear customer acceptance policies and procedures for various bank transactions. The law mandates the creation of the Anti-Money Laundering Council, with broad powers of inquiry and examination of bank deposits in cases contemplated by the law. The Anti-Money Laundering Act was recently amended to, among others, expand the powers of the Anti-Money Laundering Council.

### *Securities Regulation Code*

Signed into law on 19 July 2000, the Securities Regulation Code (“SRC”) is the charter governing the issuance, trading and settlement of securities. Basically, the Securities Regulation Code requires in general that all securities sold or offered for sale within the Philippines be registered with the SEC. It likewise regulates all the players in the securities market including, the buyers, sellers, issuers, market professionals (brokers and dealers) and exchanges, providing for penalties for prohibited or regulated acts such as insider trading, manipulation of security prices and option trading.

## **II. Institutional Developments**

To implement the provisions of the Securities Regulation Code and in the interest of speedy and administration of justice, the Supreme Court, through A.M. No. 001103-SC, dated 21 November 2000, designated 60 branches of the various Regional Trial Courts all over the country (including 14 within the Metropolitan Manila Area) to hear, among others, petitions for rehabilitation. These courts are referred to as Special Commercial Courts.

The Insolvency Law does not provide for the qualifications of insolvency administrators, nor is there a system of regulation of insolvency administrators in the Philippines. For rehabilitation proceedings, Section 13 of Rule 4 of the Interim Rules specifies the qualifications for rehabilitation receivers as follows:

- expertise and acumen to manage and operate a business similar in size and complexity to that of the debtor;
- knowledge in management, finance, and rehabilitation of distressed company;
- general familiarity with the rights of creditors in suspension of payments or rehabilitation, and general understanding of the duties and obligations of a rehabilitation receiver;
- good moral character, independence and integrity;
- lack of a conflict of interest; and
- willingness and ability to file a bond in such amount as may be determined by the court.

To train and update the commercial court judges, the Supreme Court, through the Philippine Judicial Academy (Philja) has been regularly conducting training sessions and seminars. Also, several projects have been undertaken by the Philja to engage commercial law experts to draft benchbooks to guide the commercial court judges. Some of these benchbooks include topics on insolvency laws and corporate rehabilitation.

Professional associations such as the Integrated Bar of the Philippines (“IBP”) and the InsolPhil conducts regular seminars on insolvency and corporate rehabilitation for lawyers as well as the judges.

Nevertheless, there is still much to improve in the Philippine legal insolvency regime. The judges of the Special Commercial Courts cannot as of yet be considered specialists in insolvency and rehabilitation proceedings, in terms of mastery of the applicable law/procedure or experience in handling these types of cases. The RTCs are courts of general jurisdiction. While the Insolvency Law was enacted way back in 1909, there have been relatively few petitions for insolvency filed since then. As for rehabilitation, jurisdiction was transferred to the RTCs only in August 2000, and the Interim Rules were promulgated only in December 2000. In this sense, the experience of Special Commercial Courts the court in handling these cases is limited.

Additionally, the commercial court judges are likewise required to handle other cases which may not be commercial in nature (e.g., criminal or other civil cases). This is a continued drain on the time and efforts of the commercial court judges.

There is also a perception that there is difficulty seeking qualified private individuals who will act as receivers, either because of lack of training, or because of inadequate compensation for serving as such. At present, there is no institutionalised system of accreditation for these private individuals, so that it becomes more difficult for the courts and other interested parties to identify who can be appointed as liquidators. There is also no system of training for court-appointed liquidators, nor is there a Code of Conduct governing them. These are believed to be important components in improving the administration of corporate liquidation.

### **III. Current Practices In Various Areas**

As more and more companies avail of the remedy of corporate rehabilitation and insolvency, there has been a realization that the current legal regime governing insolvency (which is almost 100 years old) is antiquated and requires an updating to conform to current international best practices on insolvency. Likewise, the recent rehabilitation case involving Bayan Telecommunications Inc. has prompted legal experts to review the status of secured and unsecured creditors in relation to a rehabilitation proceeding.

As there is no central database for petitions for insolvency and corporate rehabilitation filed before the various RTCs all over the country, it is very difficult to determine the rate of recourse to liquidation or rehabilitation (to total NPAs).

The summary of the recent developments and shortcomings of the insolvency regime have been discussed in other areas of this paper

## **B. CURRENT RISK ASSESSMENT AND MANAGEMENT SYSTEMS AND POLICIES**

### **I. Risk Assessment and Management Systems**

Many have opined that one reason for the reluctance of financial institutions to continue extending credit (especially during these times of economic difficulty) is the view that the secured transactions and insolvency regimes existing in the country is not only amorphous, but even debtor-friendly. The legal and/or administrative process to enforce one's security is described as arduous and protracted. And recovery of loans, even when fully secured, is always uncertain. There have also been reports that, due to the difficulties being encountered by export credit agencies in the debt-relief petition of Philippine Airlines, export credit agencies are not inclined to extend credit to Philippine companies for fear that recovery of machineries and equipment, the object of the credit, may be difficult to recover once a petition for suspension of payments or other similar proceedings is filed before the courts.

There are disclosure requirements provided under the rules implemented by the SEC pursuant to the Securities Regulation Code. These rules apply to public companies or companies having issued registered securities. Likewise, the Philippine Stock Exchange has its own disclosure requirements for listed firms.

Considering the limited resources of the SEC, the enforcement of the disclosure rules under the Securities Regulation Code has sometimes been described as wanting. The Philippine Stock Exchange is viewed as more vigilant in the enforcement of its disclosure rules.

The majority of the large debt security issuances in the Philippines are conducted by the National Government (including Government Financial Institutions and Government Owned and Controlled Corporations). The private domestic market is less developed in terms of product range, profile of issuer and investor base.

In the past few years, both the government and private sectors have attempted to help develop the domestic market by broadening the investor base, granting more licenses for primary dealers, and developing new debt instruments for retail investors.

There is a recent move to establish a fixed income exchange. The Bankers Association of the Philippines, and the Philippine Stock Exchange have made significant developments in establishing a fixed income exchange for the trade of debt instruments. In addition to the Fixed Income Exchange, there are plans to establish a Qualified Buyers Board similar to the Rule 144A Market in the United States.

Because of this development, there is an expected improvement in the quality of debt instruments. The Fixed Income Exchange would serve as similar role (for debt instruments) as that of the Philippine Stock Exchange (for listed shares). With more private sector involvement, it is hoped that the Philippine debt market would improve.

## **II. Credit Information Systems**

Currently, there is no centralized computer database for cases filed in the various Regional Trial Courts and other lower courts in the country. The legal framework for information sharing, information dissemination, credit scoring and credit rating is next to nil. It is expensive and time-consuming to conduct a thorough legal due diligence covering all courts in the country.

PhilRatings continues to be the prime credit rating service in the Philippines. It has assigned ratings since 1985 to hundreds of debt issues with an accumulated face value of P302.9 billion as of end-December 2003. It has evaluated commercial papers and bonds in the following sectors: manufacturing (i.e. cement, food and beverage, chemicals, personal care products, tile, steel, copper wires, aluminum products, appliance, tire, oil products, packaging, paper), construction and property development, port services, broadcast, telecommunications, electric utilities, gaming and leisure, and financial institutions (i.e. leasing and finance, credit card, investment house). PhilRatings is Standard & Poor's affiliate in the Philippines. Aside from rating commercial paper issuers, PhilRatings also offers ratings for banks and financial institutions, local government units, project finance transactions, and asset-backed securities. Other services include: credit training, financial or credit indicators based on publicly-available information, business valuation, and due diligence studies.

## **C. CONCLUSIONS AND RECOMMENDATIONS**

In sum, there has been significant developments in the Philippine insolvency regime, including the passage of the SPV Law, Securitization Law, General Banking Law and the Securities Regulation Code. However, more significant bills are still pending in Congress, such as the Corporate Recovery and Insolvency Act. The Corporate Recovery and Insolvency Act, if properly drafted, will be a big step towards the development of the insolvency regime of the Philippines in accordance with international best practices.

Likewise, there is a need to improve the credit rating system, specifically information dissemination system of the Philippines. Without proper information dissemination and sharing systems, the Philippine debt market will not improve. Hopefully, with the establishment of the Fixed Income Exchange, the Philippine debt market will progress.

Finally, there is a need to further educate both the Philippine commercial court judges and practitioners with international insolvency and rehabilitation best practices. A consistent legislative policy on insolvency and training of the judges and practitioners are both required to improve and update the Philippine insolvency regime.