



The Second Forum for Asian Insolvency Reform (FAIR)

Bangkok, Thailand 16 – 17 December 2002

In partnership with

The Government of Japan

and

The World Bank



Hosted by the

The Ministry of Justice of the Kingdom of Thailand



*Mr. Howard N. H. Wang Central Deposit Insurance Corp & Mr. Philip Chen,
Deloitte Touche Tohmatsu, Chinese Taipei*

1. How have bulk sales of NPLs /distressed assets been approached across the region?

NPLs in the Taiwan banking system have risen sharply since the 1997 “Asian Financial Crisis.” In view of the increasing NPL ratio, the Taiwanese banks have strengthened credit risk management and made use of the provision of loan loss reserves to write off bad loans in recent years. The NPLs written off by domestic banks amounted to US\$4 billion in 1999 and US\$4.7 billion in 2000. However, NPLs continued to increase dramatically in the recent years. The Taiwanese government decided to assist the banks in reducing their NPL ratios in order to prevent a financial crisis. Government involvement in NPL resolutions has taken in various forms.

The first measure taken by the government included the Central Bank’s announcement of the decrease in the reserve ratio on deposits for banks in February 1999. This was followed by a tax reduction for banks. The Ministry of Finance reduced the gross business receipt tax (GBRT) for banks from 5% to 2% in July 1999. The GBRT rate will be further reduced to zero effective January 2006. The additional income derived from lowered the required reserve ratio and the decrease in the gross business receipt tax rate, estimated to be NT\$35 billion (or equivalent US\$1 billion) per year, has been earmarked exclusively for the write-off of bad loans.

In addition to the above, the government has provided a friendly legal environment to accelerate the disposition of banks' non-performing assets. The Merger Law of Financial Institutions (MLFI) was enacted on November 24, 2000. The Law provides the legal framework for the establishment and operation of the Taiwan Financial Asset Service Corporation (TFASC) and Taiwan Asset Management Corporation (TAMCO). Commercial banks may dispose NPLs through TAMCO and an independent third party, TFASC, without going through lengthy court procedures.

To provide the financial sector with a high-quality operating environment, the government also set up a quasi-Resolution Trust Corporation (RTC) mechanism. The Statute for the Establishment and Management of the Financial Restructuring Fund was enacted on June 26, 2001. The Statute provides for the establishment of a Financial Restructuring Fund in the amount of NT\$140 billion (or US\$4.1 billion). Of the amount, NT\$120 billion (or US\$3.4 billion) will be generated from the collection of the existing 2% gross business receipt tax on financial institutions over the next four years, and the remaining NT\$20 billion (or US\$0.57 billion) will be generated the proceeds of the increased deposit insurance

premiums over the next ten years. The Fund will purchase the bad assets of the distressed financial institutions. In September 2001, the government used part of the Fund to restructure and liquidate NPL assets of 36 community financial institutions.

The current size of the quasi-RTC is insufficient to deal with Taiwan's distressed loan situation. The administrative department is tried to expand the quasi-RTC scale to 10% of Taiwan's GDP to clean up the banking sector; however, it is still under planning stage.

The following describes the financial crisis and resolution mechanism of Taiwan.

Causes	Measures Taken and Outcome
<ul style="list-style-type: none"> ✧ Over-banking and extreme competition caused credit quality to decline. ✧ Excessive dependence on mortgage of real estate of which value declines. ✧ Taiwan trading business was declining as a result of global economy downturn. In order to save costs and to approach the market of Mainland China, many companies moved their bases to China by financing from the Taiwan banking system. 	<p>RTC system is in function already. As to AMC, TAMCO and TFASC were incorporated (by 33 financial institutions) in 2001. First NPL transaction was completed in March 2002. In 2002, it is expected that NPLs with total book value of US\$ 6 billion will be sold. Deal prices fell between 20%~40% of UPB for transactions completed.</p>

Taiwan banks bulk sales of NPLs in 2002 and expected bulk sales in 2003 are listed in the following tables:

NPL Seller	Bid Date	NPL Sales Amount (expressed USD in millions)
First Commercial Bank	March 2002	120
	March 27, 2002	380
	July 30, 2002	1,600
Cathay United Bank	March 22, 2002	500
Fubon Commercial Bank	End of May 2002	1,400
Cosmos Bank, Taiwan	June 2002	4,100
Taiwan Business Bank	July 5, 2002	1,700
China Bills Finance Corp.	July 15, 002	1,400

En Tie Commercial Bank	September 2002	1,400
Ta Chong Bank Ltd.	End of September 2002	1,700
Chiao Tung Bank	September 2002	5,900
United World Chinese Commercial Bank	October 24, 2002	2,300
Chang Hwa Commercial Bank	December 4, 002	7,200
Taiwan Business Bank	December 7, 2002	7,200
Jih Sun International Bank	Early November 2002	2,100
Land Bank of Taiwan	December 6, 2002	1,400 - 1,800
Hua Nan Commercial Bank	Anticipated 2003	5,700 - 8,600
Taiwan Cooperative Bank	Anticipated 2003	8,600
The Farmers Bank of China	Anticipated 2003	1,700
Bank of Overseas Chinese	Anticipated 2003	1,700
En Tie Commercial Bank	Anticipated 2003	900
Asia Pacific Bank	Anticipated 2003	2,000
Far Eastern International Bank	Anticipated 2003	2,300
The Chinese Bank	Anticipated 2003	1,300

2. What factors are affecting buyer/seller interest in bulk NPL sales?

The factors that affect the value of loans will affect buyer/seller interest in the bulk NPL sales, which are degree of risk, overdue period, and level of the completeness of information. If banks expect to obtain favorable prices from the bulk NPL sales, the following factors should be considered:

- (1) Degree of risk : The purposes for investors investing in NPLs are to make profits from future cash inflows. Sources of future cash inflows include the sale of collateral, repayments of principal and interest by debtors, and formal or informal restructuring/reorganization. Therefore, the quality and difficulties of liquidation of the collateral, all factors of affecting debtors' revenue and costs, and possibilities and difficulties of negotiation between debtors and other creditors, can become the risk factors affecting the loans.
- (2) Overdue period : Generally, the longer the overdue period is, the lower possibility of recovery. This results in the value decrease. In addition, updated information is less likely to be as complete, further deteriorating the value.

(3) Degree of information completeness and transparency : During review periods of loans files, if investors understand the information thoroughly, and are able to estimate the degree of risk of loans more clearly, they will bid aggressively and more willing to acquire at higher prices.

3. What are the benefits/dangers of bulk sales at the micro level (for the parties involved) and at the macro level for the economy and economic recovery?

Benefits :

Benefits	Micro	Macro
Creditor	-Lower NPL ratios for banks -Cash flow injection -Improved financial structure	Overall improvement in the financial industry and general economy
Borrower	-Lower financial burden on the repayment of principal and interest -Restructure opportunity	-Overall improvement in the general economy - Positive industry outlook
AMCs	-Acquire relative lower price assets	Create flexibility in assets transactions , and increased circulation of assets

Dangers :

Dangers	Micro	Macro
Creditor	-Sales of NPL at lower prices	Deteriorate value of collateral
Borrower	-Resistance of borrower in dealing with new parties/creditors	Formation of price subsidy and result in unfair competition
AMC	-Acquisition of worthless assets	Deteriorate value of collateral

4. How have AMCs been involved?

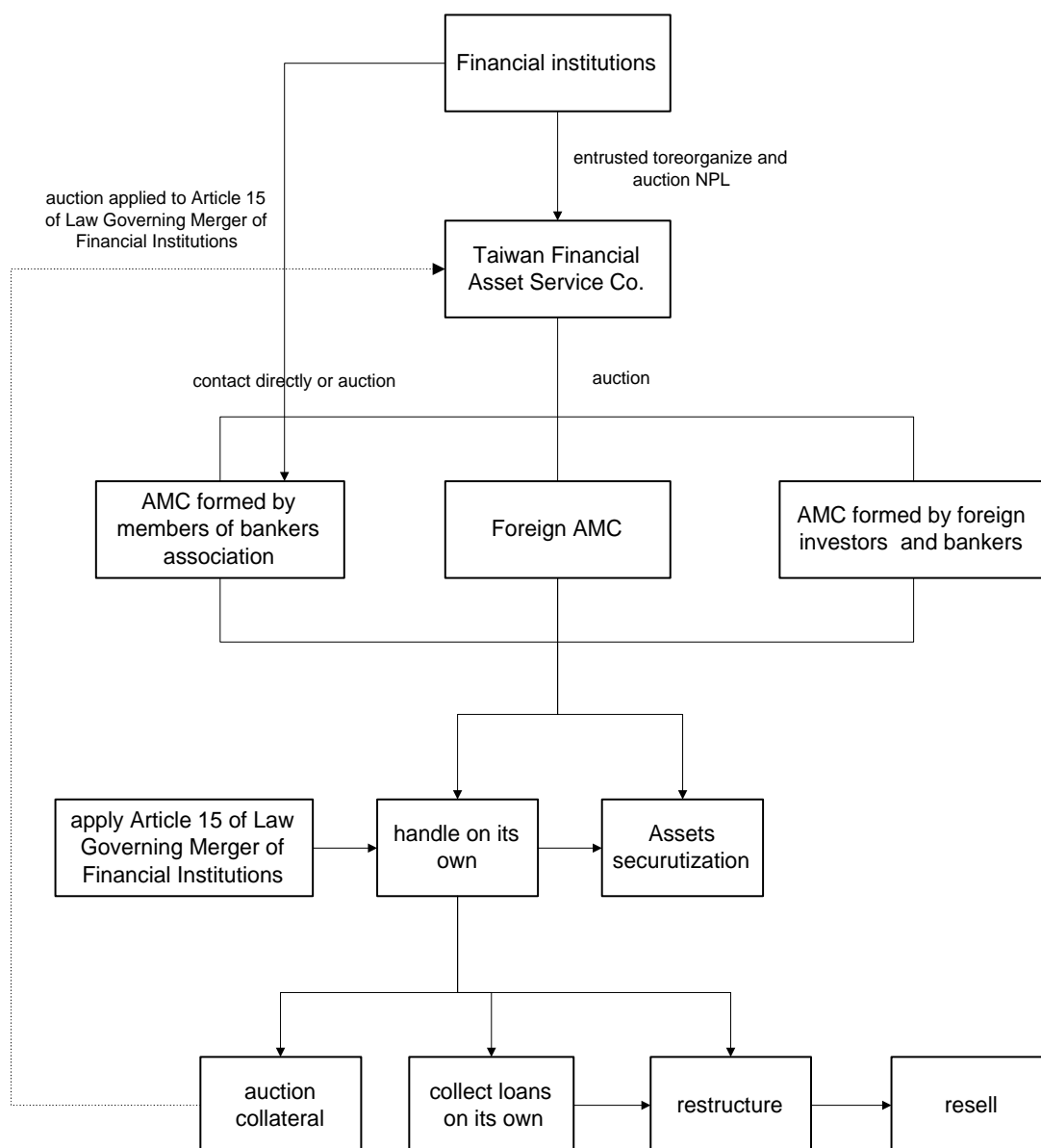
In Taiwan, TAMCO commenced operation on November 2, 2001, and its services include three areas : the purchase of NPLs from financial institutions, the management of NPLs

entrusted by financial institutions, and other related activities. The details of the activities are indicated as follows :

(1) Purchase of NPLs from financial institutions

In accordance with Laws Governing the Merger of Financial Institutions, there are two methods for financial institutions to sell their NPLs. The first method is to sell (via auctions) to AMCs after appraisal performed by third-party auction institution (TFASC) the other is for financial institutions to negotiate the prices with AMCs directly. (Please refer to the diagram of the management of NPLs below).

Diagram of handling NPLs



(2) Management of NPLs entrusted by financial institutions

TAMCO'S paid in capital is currently NTD17.62 billion, and is insufficient to acquire large amount of NPLs. Therefore, TAMCO primarily handles NPLs of categories 3,4 and personal housing loans entrusted by banks on the initial stage, and it assists financial institutions to restructure distressed companies, and dispose collaterals. Although TAMCO handles NPLs entrusted by financial institutions, the ownerships of NPLs are not transferred, and its right and obligation still belong to the banks.

TAMCO is assigned or entrusted to manage the real estate collaterals of the NPLs. When the collateral has not been auctioned successfully after compulsory enforcement, TAMCO will accept it if it estimates to be profitable. TAMCO will provide management services (including the cooperation with professionals) to enhance the quality of the real estate property. Subsequently, it will dispose or rent out to create value.

(3) Other related activities :

In addition to the core activities stated above, TAMCO will participate in other related activities. These activities include appraisals, financial advisories (corporate restructuring, reorganization, planning of financial management, and real estate investment consulting), general advertising services (i.e. advertisements of compulsory enforcement from financial institutions, and leasing activities. Foreign AMCs also purchased about 70% of NPLs sold in 2002.

5. What structures for AMCs have been successfully? What are the keys to their success/failure?

There are currently three types of AMCs in Taiwan with various structures. These include a joint venture formed by several banks, sole proprietorships formed by foreigners, and wholly owned subsidiaries formed by single banks. However, since the AMCs merely commenced operation in 2002, it is difficult to conclude at this point in time which structure is most appropriate.

6. What have been the successful/unsuccessful ingredients in the establishment and operation of AMCs?

Common factors that contribute to the success of AMCs include a supporting legal and regulatory environment; strong leadership, operational independence, appropriate and

structured incentives, and commercial orientations. In addition, the operations should be guided ultimately by the objective of profit maximization (or loss minimization), taking into full account market conditions as well as the funding cost to the AMCs. Experience has shown that AMCs with clearly defined, focused, and consistent goals are more likely to be effective.

7. How have RTC type bodies and restructuring funds been involved? What do you see as their future?

The Taiwan government is still evaluating the merits of the restructuring funds. Please refer to Question 1 and the paper of Ms. Jean Chiu of Bureau of Monetary Affairs.

8. How have special purpose vehicles (e.g. CRF/CRC/CRVs in Korea, REITs in Korea, SPAVs in Philippines, mutual funds in Thailand) and securitisation techniques been utilized. What factors have assisted/limited use of these techniques?

Korea has established a range of vehicles (e.g. CRV/CRC/REIC/ABS) to acquire NPLs, distressed assets and assist in the restructuring and recovery process.

The purpose of a Corporate Restructuring Vehicles (CRVs) is to purchase NPLs from creditors/financial institutions. These CRVs are managed by AMCs registered with the Financial Supervisory Commission. The distressed debtors then deal with the CRVs to formulate a workout process.

Corporate Restructuring Companies (CRCs) may invest in or purchase the assets or businesses of non-financial companies, which are in the workout or restructuring programs. CRCs are eligible for tax concessions and may issue debt securities up to 10 times the value of its net assets. There are presently approximately 70-80 CRC operating in Korea.

Corporate Restructuring Real Estate Investment Companies (REIC) for the restructuring of the property holdings of distressed companies are eligible for tax concessions relating to the acquisition and disposal of property assets.

From the experiences of Korea, KAMCO has operated CRCs in partnership with the winning bidders and has shared investment interest with the winning bidders. Through the CRC operations, KAMCO has learned the foreign advanced asset management measures and is able to successfully maximize the effect of the resolution of NPL.

Managing distressed assets through special purpose vehicles or companies (SPV/SPC) has some key advantages in the areas of tax reduction, prevention of disposal at low prices, maximize rate of recovery. In addition, the put-up capital of SPC/SPV enables the sharing of the future increased profit from assets.

Generally, the usage of the above vehicles can be described as follow:

- ◆ CRC : Used to purchase businesses which restructuring is required. After acquisition, attempts to improve operation bring in foreign capital and advanced technology through joint venture; subsequently sell it with profit when the business operates smoothly.
- ◆ CRV : Lower society costs through domestic and foreign civil capital and entrust professional AMC's for paper company with fund pattern, a type of financial institutions but with time constraint.
- ◆ ABS issuance :
Advantages - lower financing cost, improved finance structure through brand new financing method, lowered risk and broaden investor level;
Disadvantages - complexity of transaction structure
Limitation – assets that are suitable must have predictable cash liquidation (i.e. liquid, bankruptcy segregation, payments on recovery of assets need to be separated from ownership of assets, and debtors with good credit)

9. Has there been too much focus on disposal and inadequate focus on restructuring?

The Taiwan AMC's operate with a focus on the disposal of NPL's. These AMC's functioned as rapid disposition vehicles quickly selling assets to the private sector. In all cases, the goal was to dispose of the asset as quickly as possible so as to avoid further deterioration in value and to minimize the carrying cost of the government.

In other countries, the government set up vehicles with focus on restructuring. In some cases, the emphasis was on restructuring the non-performing loans so as to make them marketable. In others, the goal was to achieve broader corporate restructuring of the borrowers and the government owned banks.

Successful bank restructuring entails preserving the payment system, assuring that they are functioning banks, and that the residual troubled assets are managed and disposed of

appropriately. While loan workouts are part of the normal banking business, if the size of the distressed assets reaches systemic proportions, there are a number of reasons for the necessity of setting up separate AMCs, not the least of which is to assure that corporate restructuring occurs. When AMCs hold a large percentage of the financial sector assets, corporate workouts and restructuring should become a key part of their mission.

10. What will be the next development in use of the above techniques?

Proper management and disposition of NPLs is one of the most critical and complex aspects of successful AMCs and speedy bank restructuring. The government's overarching objectives should be to maximize the value of the impaired assets in the system, while at the same time preventing credit discipline of borrowers from deteriorating. AMCs, with proper governance and incentive structures and practical operating strategies, could play an essential role in achieving the government's objectives.