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*The Special Asset Management Companies Act of 2002:
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The Special Asset Management Companies Act of 2002
A Brief Summary of Senate Bill No. 2116

I. Background

There is currently an increasing level of non-performing loans ("NPLs") and real and other properties owned or acquired ("ROPOAs"), [the NPLs and ROPOAs are collectively referred to as the non-performing assets – or ("NPAs")], in the Philippine financial sector.

Since the onset of the 1997 Asian financial contagion, financial sectors in the region have suffered from the burden of high levels of NPLs. Data from the Bangko Sentral ng Pilipinas ("BSP") reveal that the NPL level of the country's 44 commercial banks as of June 2002 reached P288.97 billion of the P1.600 trillion total loan portfolio of all the 44 commercial banks or 18.1%, up from P267.116 billion or 1.575 trillion or 17.1% from June 2001. The ROPOAs of the commercial banks as of June 2002 increased to P167.786 billion from P 144.791 billion registered a year earlier, or an increase of 16%. On the whole, the NPAs of the commercial banking sector increased from P 411.907 billion last June 2001 to P456.756 billion as of June 2002. The NPA ratio of the commercial banking sector increased from 13.4% as of June 2001 to 14.5% as of June 2002. The NPAs of the entire banking system amounted to P 519.986 billion, exceeding the sector's total capital base of P 389 billion, endangering the banking sector's ability to survive any further contagion.

This high level of NPAs poses a grave and serious threat to the stability of the Philippine banking system and ultimately, on the national economy. The NPAs impair capital within the financial institutions, curtail new lending and create a continuing drag on the economy.

Recognizing the need for rapid reaction to restore the levels of confidence, several Asian countries, such as South Korea and Thailand have passed legislations to encourage both local and foreign investment to acquire, manage and dispose of these NPAs which are considered by some as risky. To maximize investment in domestic NPAs, these jurisdictions recognized that there is a need to lift the restrictive and exorbitant transaction fees and taxes and modify the outdated insolvency and creditor rights.

Given this background, Philippine banks, including government owned and controlled corporation ("GOCCs") and government financial institutions ("GFIs") have initiated discussion for the entry of foreign direct investment for the acquisition of their NPAs. However, investors are reluctant to invest in the banks' NPAs primarily because of the high amounts of transaction, fees and taxes and the perceived obstacles to the enforcement of creditor's rights. It is considered that to encourage foreign direct investment into NPAs, enabling legislation is required.

The Special Asset Management Companies Act ("SAMC Act" or the "Proposed Act"), which was passed by the Philippine Senate last 23 October 2002, attempts to encourage investment, both local and foreign, in the banks' NPAs by providing incentives and mechanisms

such as time-bound privileges and exemptions, clear rules in private capital participation and the removal of existing barriers and substantial risks in the acquisition of NPAs.

There has been great resistance in the passage of the Proposed Act. The proposed law was generally viewed as a reward for the imprudence of the banking sector, or a bailout for a sector which created its own problems through its imprudent lending activities. Also, the cost of the Proposed Act, approximately P80 billion of foregone tax revenue, has turned off many lawmakers, who felt that the cost of the bailout is not commensurate to any benefits expected from the proposed legislation.

The Proposed Act is currently undergoing review by a bicameral conference committee to reconcile it with the Special Purpose Asset Vehicle Act which was passed by the House of Representatives, much earlier this year. It is expected that President Gloria Macapagal-Arroyo will sign the Proposed Bill by the end of this year or early next year.

2. Characteristics of the Proposed Act

The intention of the proposed Act is to create a positive legislative regime for the investment of private capital, both domestic and foreign, into NPAs and the elimination of perceived roadblocks in the expeditious disposal of the NPAs.

The following are the substantial points of the Act:

- a. The Act provides for the creation of a Special Asset Management Companies (“SAMC”), a stock corporation whose purpose, among others, is to engage in the business of acquiring and selling NPAs.¹ The SAMC shall have a minimum authorized capital stock of Php250 million (approximately US\$4.7 million), subscribed capital stock of Php62.5 million, and a paid-up capital stock of Php15.625 million. The Securities and Exchange Commission (“SEC”) shall be the relevant government authority to approve the creation of a SAMC and shall be the primary implementing agency of the Act.
- b. SAMCs may issue Investment Unit Instruments² (“IUIs”) for the purpose of raising funds to acquire NPAs. Any person, including non-Filipino citizens or entities, may acquire or hold NPAs subject to the limitations provided in the Proposed Act and by its Implementing Rules and Regulations.

¹ Section 4 of the Proposed Act.

² Section 3 (d) The Proposed Act defines IUIs as participation certificates, debt instruments and similar instruments issued by SAMCs. These IUIs shall not form part of the capital of the SAMCs.

- c. The transfer of the NPAs from a Financial Institution to a SAMC must be in a concept of a true sale.³ The concept of true sale was inserted to help ensure that the sale of NPAs to the SAMC is not just a window dressing mechanism, to improve the balance sheet of the disposing financial institution.
- d. The transfers of NPLs require prior notice to the borrowers and to the persons holding prior encumbrances upon the assets mortgaged or pledged. The borrower and transferring FI are given 90 days from receipt of the notice to restructure or renegotiate the loan.⁴
- e. In exchange for the NPAs, the SAMC may issue to the FIs, FI Participating Instruments (“FIPI”) which are debt instruments, whose claims are junior to that of the IUI holders.⁵
- f. After the transfer to the SAMC, the SAMC assumes all rights and obligations of the transferring FI, including the right to enforce contractual obligations and the obligation to recognize the rights of the borrowers, as well as to prosecute and defend suits relating to the acquired assets.⁶
- g. The transfer of the NPAs from the Financial Institution to a SAMC, and from a SAMC to a third party or dation in payment by the borrower in favor of the FI or in favor of the SAMCs shall be exempt of the following taxes:
 - a. Documentary stamp taxes;
 - b. Capital gains taxes;
 - c. Creditable withholding taxes imposed on the transfer of land/buildings treated as ordinary assets; and
 - d. Value added taxes;
- h. The above transfers shall also be subject to the following fees:
 - a. 50% of the applicable mortgage registration and transfer fees;
 - b. 50% of the foreclosure filing fees; and

³ Section 3 (k) of the Proposed Act provides that a “true sale” refers to a sale wherein the selling Financial Institution transfers or sell its NPAs without recourse for valuable consideration, to a SPAV with the following results:

- 1. the transferor relinquishes effective control over the transferred NPAs;
- 2. the transferred NPAs are legally isolated and put beyond the reach of the transferor and its creditors;
- 3. the transferee SPAV has the right to pledge, mortgage or exchange the NPAs, provided that the transferor shall not have direct management or ownership control over the transferee SPAV.

⁴ Section 11 of the Proposed Act.

⁵ Section 12 of the Proposed Act.

⁶ Section 13 of the Proposed Act.

- c. 50% of the land registration fees.⁷
- i. All transfers of NPAs from the FIs to the a SAMC or transfers by way of dation in payment by the borrower to the FIs or to the SAMCs shall be entitled to the aforesaid exemptions within two (2) years from the effectivity of the Implementing Rules of the Proposed Act. All transfers from a SAMCs to a third party of NPAs acquired by the SAMC within such two (2) year period shall enjoy the tax exemptions for a period of not more than five (5) years from the date of acquisition by the SAMC.⁸
- j. The aforementioned tax exemptions and fee privileges extended to FIs and SAMCs shall likewise be available to any person, party or entity.
- k. The SAMC shall be exempt from income taxes on net interest income, documentary stamp tax and mortgage registration fees on new loans in excess of existing loans granted to borrowers with NPLs that have been acquired by the SAMC. The SAMC is also exempt from documentary stamp taxes in the event of capital infusion to the borrower by the SAMC. These additional exemptions apply for a period of not exceeding five (5) years from the date of effectivity of the Implementing Rules of the Proposed Act.⁹
- l. Any loss incurred by the Financial Institution as a result of the transfer of the NPAs shall be treated as an ordinary loss. The loss may be carried over for a period of 5 consecutive taxable years immediately following the year of such loss.¹⁰
- m. Any person found to have abused the tax exemptions shall, in addition to being criminally liable, refund double the amount of the privileges and exemption, plus an interest of 12% per annum.
- n. The provisions of the Proposed Act apply to assets which have become non-performing as of 30 June 2002.¹¹

It is still too early to determine if the Proposed Act will be able to achieve its objectives. From the amount of controversy that the Proposed Act has solicited, there appears to be a great interest in the disposal of the banks' NPAs. While not perfect, the proposed legislation is a step in the right direction.

⁷ Section 14 of the Proposed Act.

⁸ *Id.*

⁹ Section 15 of the Proposed Act.

¹⁰ Section 16 of the Proposed Act.

¹¹ Section 25 of the Proposed Act.

