



# **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**



*Non-Performing Loans, Clean up and RTC Mechanism – Taiwan Experience:  
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## Non-Performing Loan (NPLs) Clean up and RTC Mechanism-Taiwan Experience

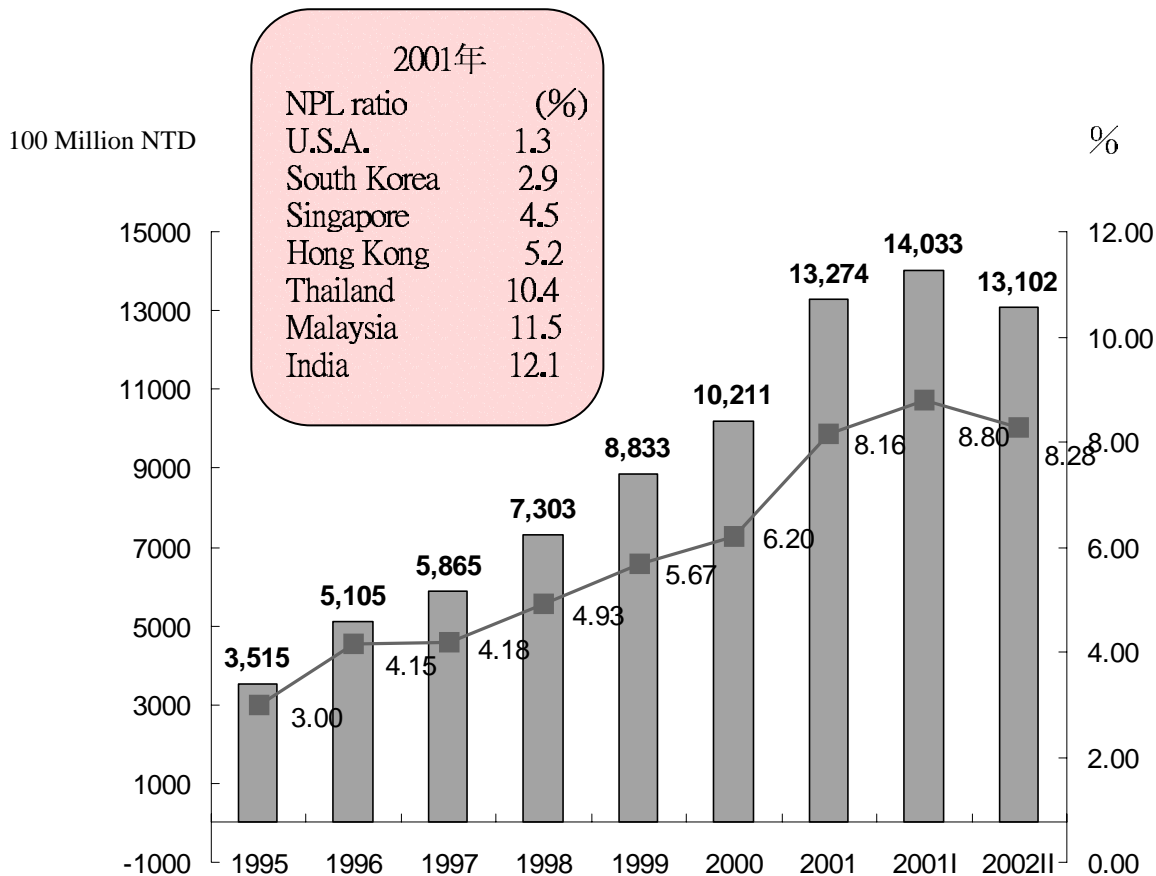
HSU-JEAN CHIU

### Profile of Taiwan's Financial Institutions

#### - Overall picture

- There are 52 local banks, 36 foreign banks plus 38 credit unions and 278 farmers and fishermen credit department in the market. Over banking situation is significant.
- Average capital ratio for banks reached 10.4% net worth plus reserves for banks reached 1.75 trillion NT dollars.
- Decreasing Profits (ROE: 3.61%, ROA: 0.26%) and increasing non-performing loans (8.28%) .

#### - NPL Chart



### NPL Cleanup

#### - Business Tax lower down

- The Ministry of Finance(MOF) reduced the Gross Business Revenue Tax (GBRT) for banks from 5% to 2% in February 1999. Banks are accordingly required to use tax savings to write off bad loans.
- NPL write off: Till June 2003, commercial bank's NPL write off reached 7.56 times of the

GBRT Tax lowered down resources.

### AMC Mechanism

- Financial Institution Merge Act
  - Promulgated on Dec. 13.2000.
  - Create AMC mechanism.
  - The AMCs may dispose of assets through an impartial third party without going through the courts.
  - The losses of the NPL sale by banks can be amortized for 5 years.
  
- AMC Operation
  - There are over 5 active AMCs participated in the Taiwan NPL Market. Local, local-foreign joint venture and foreign AMC Dated October 2002 total NPL purchase book value reached NT123.4 billion (roughly 4.1billion USD).
  - The average transaction price is less than 30% of the book value.

### **Taiwanese Financial Institutions Sell NPL to AMC (selected)**

Dated Oct. 28,2002

Unit : million NT\$

<b>Financial Institution – seller</b>	<b>AMC – buyer</b>	<b>NPL (sale book value)</b>
First Commercial Bank	Lone Star Asia-Pacific, Ltd.	13,280
First Commercial Bank	Lone Star Asia-Pacific, Ltd.	12,803
First Commercial Bank	GE Capital Commercial Finance, Inc.	13,278
First Commercial Bank	TAMCO	6,533
First Commercial Bank	Cyberus	10,931
First Commercial Bank	Lehman Brothers	3,993
Chio-Tung Bank	Merrill Lynch and Salomon Brothers	3,741
Chio-Tung Bank	Deutsche Bank AG, London	4,788
Subon Commercial Bank	Lehman Brothers	5,040
Cosmos Bank	Chung Hwa-Lone Shon Joint Venture Co.	6,240
Cosmos Bank	TAMCO	2,195
Tai-Shin Bank	Taishin AMC .	7,524
China Development Industrial Bank	China Development AMC	3,251
Cathay United Bank	TAMCO	1,895.11
United World Chinese Commercial Bank	China Development AMC	8,097

## RTC Law

- Promulgate on July 9,2001.
- Establish NT\$140 Billion public funds.
- Deal with problem financial institutions with negative net worth.
- Provide 100% protection to depositors only in limited time frame time limited to 3 years if permitted from Congress can be extended up to 4 years.
- In year 2001 the MOF successfully using RTC funds taken over 36 problem financial institutions.

## RTC Law Amendment

- The vision of Taiwan's financial reform:
  - (1) Capital adequacy ratio: more than 8%.
  - (2) NPLs ratio: less than 5%.
  - (3) Coverage ratio 40% ( Provisioning /NPLs).
  - (4) Improve over-banking situation.
  - (5) Establish market exit mechanism and enhance financial safety net.

In order to achieve above objectives, the action we will take is to amend the Statute Governing the Financial Restructuring Fund (RTC Fund). The goals and key points of the RTC law amendment are as follows:

- Goals :
  - (1) Solve problem financial institutions with negative net worth.
  - (2) Clean up NPLs.
  - (3) Facilitate mergers in banking industry.
  - (4) Help economic growth.
- Key points :
  - (1) Enlarge fund base of the RTC from NT 140 billion to 1.05 trillion.
  - (2) Expand the RTC's function to cover NPLs purchase.
  - (3) Expand the RTC's function to cover capital injection in banks with preferred shares.
- Complementary Regulatory Actions :
  - (1) Follow International Loan Classification & Provisioning.
  - (2) Adopt prompt corrective action.

- (3) Enhance corporate governance, risk management & information transparency

There are three main measures the RTC will take to handle financial institutions :

- (1) If a financial institution shows negative net worth, the RTC will close down or takeover the institution and fill asset-liability gap of the institution to protect the depositors. The RTC estimates the funds needed to compensate the losses of financial institutions will up to about NT 450 billion financed by lower business tax, government budget and other incomes of the RTC.
- (2) If the NPLs ratio of a financial institution is higher than the regulatory requirement and unable to improve, the RTC will purchase the NPLs, but a committee under the RTC will decide both of the purchase price and object of NPLs.
- (3) If the capital adequacy ratio of a financial institution is lower than the requirement and unable to improve, the RTC will inject capital to viable financial institutions with preferred shares. The funds used to purchase NPLs and inject capital totally will cost NT 600 billion. The RTC will take loans from banks or issue self-financing government bond to finance the funds, the Central Deposit Insurance Corporation also can issue financial debentures to finance the funds.

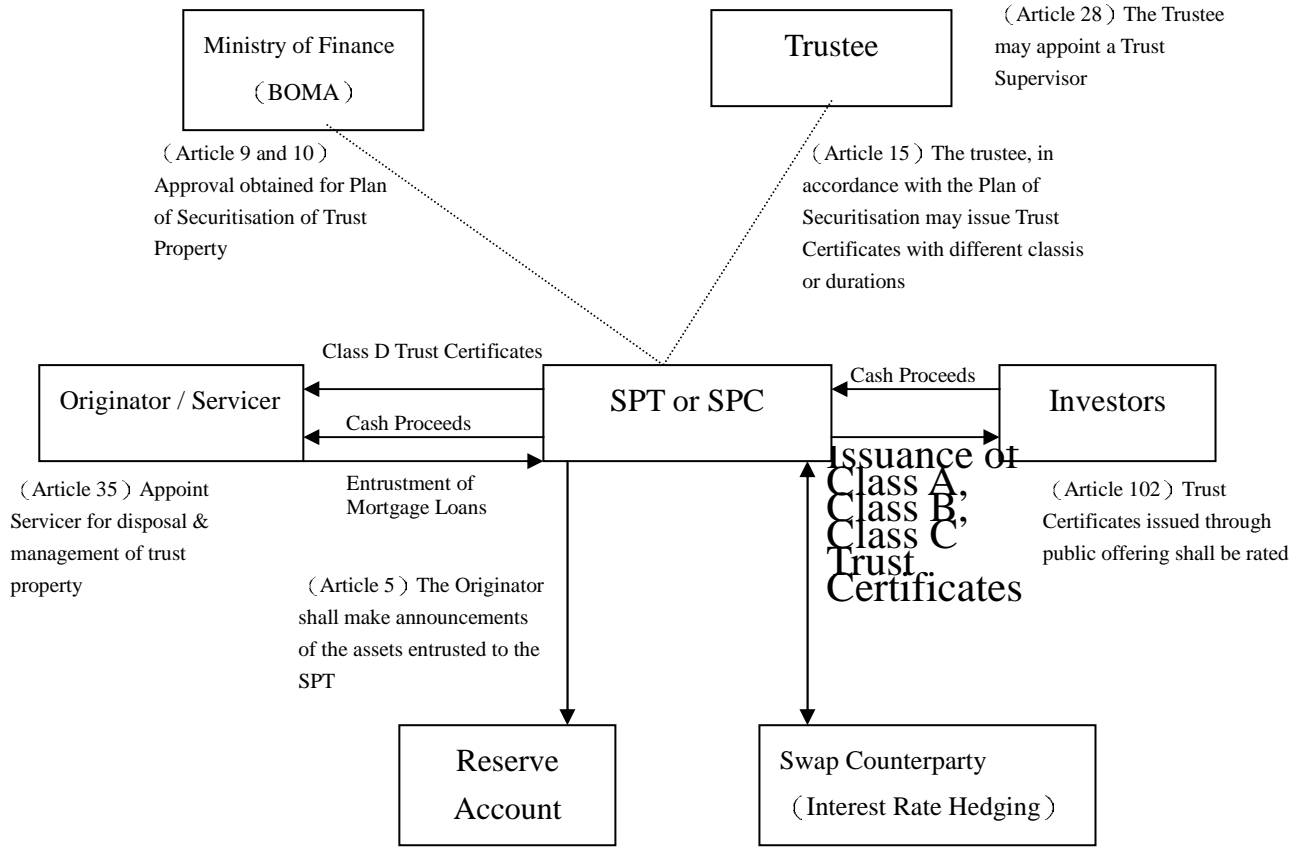
### Securitization

#### —The Financial Assets Securitization Law

The Financial Assets Securitization Law was promulgated on 24th July, 2002 in Taiwan. The main thrust of the law are as following:

1. to create Special Purpose Trust (SPT) structure and Special Purpose Company (SPC) structure as the conduit for asset securitization.
2. to remove the legal barriers concerning the transfer of asset and provide taxation incentives to promote the circulation of securitized trust certificates and Asset-backed securities.
3. to establish the prudent supervisory mechanism to protect the investors. Besides, in order to enhance the liquidity of the security, the withholding tax of income from the securitized securities is decided 6%.

- Structure



## **Observation and lessons learned on Efficient Cleanup of NPLs**

### ➤ Regulatory Requirements:

Regulatory requirement of loan provisioning and adopting NPL ratio as a supervisory index will provide a continuous pressure also a driving force for banking industry's cleanup their NPL.

### ➤ AMC as a channel: Role of a private AMC

1. Providing its expertise to efficiently cleanup NPL.
2. Injecting liquidity to banking industry to help bank's perform its intermediary function through NPL purchase.
3. Helping bank's target their human resources on business strategy instead of dealing with NPL.

### ➤ Ingredients for a successful AMC operation:

#### ➤ From the NPL purchase side:

1. Transparent market price  
Transparent market price help to build buyers and sellers trust. If there is no market price there is no NPL deals.
2. Government shall help to create the NPL market  
Regulatory requirement on provisioning and NPL control will create NPL volume trading in the market.
3. Government shall help to find market price
4. Taking Korean case as an example, Korea divided its national land into 24 using purpose and 242 zone based on using purpose of the land and zoning. Monthly courts will publicly notice the average auction price, and the bid rate on each zone land for different using purpose. This price would be reference as a purchase price.
5. Losses on NPL sales can be amortized for several years as an incentive.  
Banks suffer big losses in a bulk of NPL sale. Amortization losses in a period of time rather than in one year would encourage banks to sell. However striking balance between pushing NPL sale and financial information transparency is crucial.

In Taiwan, we adopted:

Disclosure the losses on financial statement while the losses before amortized shall be reserved. No dividend payment is allowed on this losses reserve portion.

➤ From the NPL sale, restructuring side:

1. Efficient Bankruptcy Law

Shorten courts' reviewing period for a bankruptcy application.

Creditors have more roles in bankruptcy procedure.

2. Create a mechanism that realizes real estate collaterals do not need to go to the courts.

Create an impartial third party to evaluate and bid the property to substitute court's auction function.

Empowered by Law that courts' auction function can be outsourcing to a private AMC.

3. Out of court workout

AMC needs to analyze the business and financial viability of a company and to choose between restructuring and liquidation.

AMC shall require expertise to negotiate approval of , implement, and monitor the restructuring plan and to manage operations of the company.

4. Securitization

Assets securitized based on NPL shall be cautious on its cash flow. After restructuring the debts to a relatively stable situation, the assets' cash flow would then become clear. Because the NPL backed securities embedded a high risk nature, how to protect investors or when a bank as an investor how to calculate its capital adequacy needs continuously making efforts on it.

➤ Public fund RTC as a supplement channel for NPL purchase

Regulatory requirements on NPL control could place a great pressure on bank's continuing selling of NPL. If there are no other supporting measures, the market would be a buyer's market. Banks will suffer big losses.

RTC is able to soften the price bias by acting as a NPL purchase competitor. Besides, a relatively longer NPL stocks resale returned plan would ease the collapse of the real estate market. The RTC role hereby in the NPL market is able to play as a Watergate role on the NPL pricing and its supply. In implementation, however, it shall be cautious that regulatory authority gives banks enough time to meet the NPL control requirement either by selling it to AMC or write of f with their own funds. That is, commercial-based approach before RTC.

➤ The future of RTC

NPL purchase shall be returned to market-based approach. Using public fund RTC to purchase NPL shall be limited to a time frame. In terms of problem financial institutions resolution, RTC function shall also be back to depositor insurance scheme. Accordingly, regulatory authority may consider taking prompt corrective action as a supervisory tool to let financial institutions clearly know when and what regulatory action will impose on them.