



F I R M  
Forum on Insolvency Risk Management  
THE WORLD BANK



OECD 

# FORUM ON ASIAN INSOLVENCY REFORM 2004

## INSOLVENCY SYSTEMS AND RISK MANAGEMENT IN ASIA

*New Delhi, India, 3-5 November 2004  
The Oberoi Hotel*

**Trends and Developments in Insolvency Systems and Risk  
Management: The Philippines Situation**  
by  
*Mr. Cesar L. Villanueva*

IN PARTNERSHIP WITH  
**THE GOVERNMENT OF JAPAN**

HOSTED BY  
**MINISTRY OF FINANCE,  
BANKING DIVISION**  
**MINISTRY OF COMPANY AFFAIRS  
AND INSOL INDIA**

## **Trends and developments in insolvency systems and risk management: Philippines Situation**

by  
**Cesar L. Villanueva,<sup>1</sup> b.s.c., ll.b., ll.m., c.p.a., faicd**

### **Introduction and Summary**

As this paper is being written, the Philippines is perceived to be sinking deeper into a debt crisis. The debt stock of the National Government blew up to 77.4% of gross domestic product in 2003 from only 18.9% of GDP in 1981, which totaled some P3.4 trillion as of end of 2003. The total debt servicing in 2003 was P470 Billion, equivalent to 10.8% of GDP, compared to 5.4% of GDP in 1996. In 2003, 7% of revenues went into debt servicing, and the figure is expected to climb to 80% in 2004. It has been noted that the growth in the country's debt stock can be traced to 1999 when the government resorted to pump-priming following the 1997 Asian financial crisis.

As a resultant fallout, international credit rating agencies, namely Moody's Investor Services (Ba2 downgrade in January; negative outlook), Flitch Rating (downgrade to BB in June, 2003, stable outlook) and Standard & Poor's (July, 2004 review warning), have threatened to further downgrade Philippine debts if Congress fails to pass new tax measures and the Philippine Government fails to come up with new revenue sources.

Insolvency reforms in the Philippines have taken a multiple-route approach that have seen efforts being pursued in the Legislative, Administrative and Judicial Departments, essentially on where it would be easiest to achieve early results considering the effects and aftermath of the Asian Financial Crisis of 1977.

While the system of insolvency and corporate bankruptcy has been almost a century-old institution in the Philippines (the Insolvency Act having been adopted in the Philippines in 1909), the current reforms have focused on updating the bankruptcy laws to current world-standards, creating specialized bankruptcy courts with both well-defined jurisdictions and rules of procedure and practice, reforming the legal system with respect to credit transactions to afford a healthy and equitable balance in protecting the rights of both creditors and borrowers, developing a pool of professional players who would be potent partners in enforcing the bankruptcy system in line with world best-practice standards, strengthening the financial sector to afford the backbone for the reforms, putting into place rules that would link local system with international proceedings, such as providing cross-border insolvency, and engendering a culture of compliance with the established policies, rules and procedures.

The efforts towards restructuring and reform of the insolvency system in the Philippines has had a mixed results, thus:

- In spite of the passage of Special Purpose Vehicle Act and the Securitization Act, there have been lukewarm reception from the financial sector which had been the targeted beneficiary covering their non-performing assets (NPLs) and ROPOAS
- There proposed Corporate Recovery and Insolvency Act, which is envisioned to upgrade the country's insolvency system to conform with current world standards and provide for cross-border insolvency system, has floundered in Congress with very little expectations that it would be enacted into law soon

---

<sup>1</sup>The author is the Dean of the **ATENEO DE MANILA LAW SCHOOL**, where he is also a professorial lecturer in *Sales* and *Corporate Law*. He is the Chairman for the **Commercial Law Department** and a member of the **Academic Council and Consultants Group** of the **PHILIPPINE JUDICIAL ACADEMY**. He is member of the **MCLE GOVERNING COMMITTEE** (term 2004-2006); and a Fellow of both the **INSTITUTE ON CORPORATE DIRECTORS** (Makati, Philippines) and the **AUSTRALIAN INSTITUTE ON COMPANY DIRECTORS** (AICD). He has authored the following books: *COMMERCIAL LAW REVIEW*, *LAW ON SALE*, and *PHILIPPINE CORPORATE LAW*. He is a Senior Partner of **VILLANUEVA, GABIONZA & DE SANTOS**, 20/F 139 CORPORATE CENTER, 139 Valero Street, Salcedo Village, Makati City. For queries: *attorneys@vgslaw.com.ph*.

- The passage of the Anti-Money Laundering Act to ensure that the Philippine financial system remains within the ambit of legitimate global financial network
- Much of the reforms in insolvency law has come from the Supreme Court, exercising its power under the Philippine Constitution to promulgate rules of procedure and practice, which saw:
  - Designation of special commercial courts in various judicial regions of the country with original and exclusive jurisdiction over corporate suspension of payments and rehabilitation cases
  - Promulgation in 2000 of the Interim Rules of Procedure for Corporate Rehabilitation
  - Consolidation of money-laundering cases within the exclusive jurisdiction of the special commercial courts
  - Consideration and expected promulgation of Interim Rules of Procedure for Corporate Insolvency and Dissolution, and the consolidation of such cases within the exclusive jurisdiction of special commercial courts
  - Continuous training of judges of special commercial courts
- The reliability that the corporate bankruptcy system, under the framework set-up by the Supreme Court, has seen resort to proceedings on corporate rehabilitation by some of the large corporations in the Philippines:
  - Philippine Airlines
  - Victorias Sugar Milling
  - Maynilad Water System
  - Uniwide Supermarket
  - Pryce Gases

Many of companies have continued to operate and exhibit viability under the protection of the rehabilitation proceedings

- On the corporate front, corporate governance principles have been pushed by the Administrative Departments, essentially through the Securities and Exchange Commission and the Bangko Sentral ng Pilipinas covering banking institutions, listed and public companies

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

### **I. Current legal and institutional developments**

**1.** Re-filed with the new Philippine Congress as urgent legislation is the bill entitled “Corporate Rehabilitation and Insolvency Act” (CRIA) which is aimed at overhauling and consolidating the entire system governing corporate rehabilitation, dissolution and liquidation, and containing provisions on such important matters such as cross-border insolvency, etc.

The bill seeks to provide speed and efficiency in the resolution of rehabilitation and insolvency cases, but at the same time achieve a balance between the rights of creditors and debtors, all in accordance with international standards.

**2.** Pending the passage of CRIA, the Judiciary has taken-up the cudgels to bring about an interim modernization of laws and practice pertaining to corporate rehabilitation and insolvency. Pursuant to its constitutional power to promulgate rules of procedure (Section 5(5), Article VIII of the 1987 Constitution), the Supreme Court promulgated the “*Interim Rules of Procedure on Corporate Recovery*” which not only contained rules and procedure, but contained key provisions that bordered into substantive laws, since such provisions created substantive rights which previously did not exist, or which have the effect of supplanting or adversely affecting existing property rights.

(a) The proceedings under the *Interim Rules* are mandated to be *in rem*: through compliance with publication requirements, the results of the proceedings are binding on creditors and other affected person even when they do not participate in the proceedings;

(b) The proceedings are declared “summary”, “non-adversarial”, and “technology friendly,” such that there are prohibited pleadings that unduly delay, causes of actions and oppositions are established based of sworn statements filed, attaching thereto the actionable documents when necessary, and that service of pleadings may be effected by fax or e-mail;

(c) The proceedings are strictly “time-bound” and the whole process cannot exceed 18 months; and

(d) The orders of the courts are immediately executory, even on appeal, unless enjoined by the Court of Appeals or the Supreme Court.

The Supreme Court also passed a memorandum circular that consolidated with the commercial courts handling corporate rehabilitation case, intellectual property cases and anti-money laundering cases.

Currently, the Supreme Court is reviewing proposed Consolidated Rules on Corporate Insolvency and Dissolution, to be accompanied by a memorandum circular that will also consolidate such cases with the commercial courts.

**3.** Another related bill that is pending in Congress in the “Corporate Reform Act” which essentially seeks to mimic the Sarbanes-Oxley Act under the Philippine setting (House Bill No. 5260) by:

- (a) Introduce stricter measures in the production of financial reports
- (b) To establish new or enhanced standards for corporate accountability
- (c) Seeks to impose significant criminal liability for corporate wrongdoing
- (d) Establish a Public Company Accounting Oversight Board
- (e) Provide for mandatory registration of public accounting firms

**4.** Another bill that has been filed with Congress for the Personal Equity Retirement Account, which is intended to provide financial security to millions of Filipinos who are not covered by a retirement plan. PERA will encourage Filipinos to save for their retirement, by institutionalizing savings among public and private employees and offer the environment that encourages savings. Contributions will be deductible from taxable income and earnings of contributions will also be tax-exempt; while only withdrawals from PERA will be taxed.

Patterned after Singapore’s Central Provident Fund, PERA will offer investment vehicles that offer higher returns, such as common trust funds, mutual funds, approved annuity contracts, or pre-need pension plans. Investments in any of these vehicles will be reinvested in national government securities or issues, corporate or government bonds, deposits in local or foreign currencies in the Philippines , financial institutions, foreign currency denominated investments authorized by the BSP, and non-speculative equities listed in the Philippine Stock Exchange.

## **II. Institutional Developments**

**1.** The training of commercial law judges has been pursued in earnest by the Philippine Supreme Court. In September and October, the commercial law judges all over the country (there are sixty-four (64) duly designated judges around the country) attended seminars-workshops to discuss reforms on the existing corporate rehabilitation structures in the country. They also received training seminars in properly handling intellectual property and anti-money laundering cases.

Through the Philippine Judicial Academy (PHILJA), the Supreme Court is also promoting the following reforms in the Judiciary:

- Commercial mediation and ADR forms of resolution of conflicts
- Distance learning and training of judges through internet facilities
- Case loading and monitoring through internet facilities

Much of the training and upgrading of facilities and skills is

- Number of judges, qualifications, independence, appointment procedures and transparency, extent of interference by government, standards of performance, use of and dependence on professionals and experts, use of information technology;
- Role of professionals (lawyers, accountants and others), institutionalization of the insolvency profession, qualifications, training, admission criteria, disqualification, standards on fees, training, synergies between different professions, best practices and standards, their regulation etc.
- Powers of regulators, their qualifications, appointment, training, efficiency, remuneration, transparency, independence, disqualification/removal, penalties etc.
- Status on other institutions, such as AMCs – continuing, about to expire, who will inherit their tasks

**2. The Special Purpose Vehicle Act of 2000** (Republic Act 9182), seeks to engender the speedy recovery of the Philippine Financial Sector, but providing for tax and financial incentives for the liquidation of existing non-performing assets (NPAs) and their ROPOAS of banks and financial institutions. Under the SPV Law, a highly capitalized corporation is formed for the purpose of purchasing and thereafter disposing of the NPAs of banks and banking institutions, consisting of non-performing loans and real and other properties owned or acquired. The SPV will assume all of the rights and obligation of the financial institution so that it can collect and restructure the NPLs or sell the ROPOAS. The SPV can also issue debt instruments in the form of IUI or investment uit instruments, backed by the receivable from the NPAs. The purchase and sale of the NPAs are tax-free (exempt from documentary stamp tax, capital gains tax, creditable withholding tax, gross receipt tax and value-added tax). On the side of the banks, the losses incurred from the true sale of the NPAs is considered ordinary loss and carried over for a period of ten (10) years (extended by the BSP from the previous five year period).

The SPV Law incentives are time-bound, and the primary deadline has ended in the middle of 18 September 2004: SPV must be registered within 18 months from the effectiveness of the IRR which ended last September. Transfer of NPA from the financial institutions to SPVs enjoying incentives only for two years from the date of effectiveness of IRR. Transfers of NPAs by SPV to third parties enjoy the incentives only from five (5) years from start of operation. The SPV Law will expire on 18 April 2005. Response to the SPV Law has been very disappointing, with the only notable taker being the P10 Billion disposition of NPAs by Philippine Bank of Communications, which was a condition to the extension of an P8 Billion credit to the bank by the Philippine Deposit Insurance Corporation (PDIC). The only other bank which has expressed intention to avail of the SPV Law is the United Coconut Planters Bank (UCPB) which is targeting to dispose of P15 Billion worth of NPAs, but no report on having been able to beat the 18 September 2004 deadline for setting-up the corresponding SPV has been noted.

The following reasons have been attributed by both the public and private sector on why the SPV Law has not met its objectives:

- (a) The tax breaks and fiscal incentives being offered could not outweigh the huge amount of capitalization required in setting up the SPV, the large discounts demanded by interest (mostly foreign) buyers of NPAs, the difficulty of getting fair return on the NPAs considering the lackluster property market in the Philippines;
- (b) Constitutional ban on foreigner from owning real estate in the Philippines;
- (c) The big gap between what sellers (Philippine financial institutions) expect and what buyers (mostly foreign entities) are willing to pay for the idle assets.

Even in August, 2004, the BIR Commissioner was quoted by newspapers that the BIR may no longer issue a revue order that would serve as guidelines on how the tax exemption granted under the SPV Act

would be availed such “revenue regulation may no longer be needed given the lukewarm response of the private sector on the reform.”

**3. The Securitization Act of 2004**, which allows assets to be sold without recourse to a special purpose corporation or in the case of banks, a special purpose trust. The special purpose entities (STE) can then issue securities backed up by a pool of similar assets, in the process of distributing risk.

To help spur the Philippine housing sector, only securities backed up by residential mortgage and other housing-related financial instruments can be resold in the secondary market, to be carried out through secondary mortgage institutions (SMIs), similar to the US Fannie Mae and Freddie Mac set-ups.

The acts grants several tax incentives to encourage financial institutions to transfer housing mortgages to SPEs:

- (a) SPEs will pay income tax as any other corporation but transfers of assets will be exempt from value-added and documentary stamp taxes
- (b) SPEs will also be given a 50% discount on all applicable registration and annotation fees;
- (c) SPEs will be classified as bank, quasi-banks and financial intermediary, and thereby be exempt from the 5% gross receipts tax
- (d) Asset-backed securities will not be classified as deposit substitutes, but yields will be subject to a 20% final withholding tax;
- (e) Property transfers through *dacion en pago* (payment in kind) will be exempt from the 6% tax on capital gains