

Amando M Tetangco, Jr: Financial rehabilitation and insolvency regime in the Philippines – progress and remaining challenges

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the SharePHIL's Seminar "All You Need to Know About Financial Rehabilitation and Insolvency Act", Manila, 17 March 2015.

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Good afternoon ladies and gentlemen. Let me begin by thanking the organizers for this privilege to share with you the thoughts of the BSP on an important legislative initiative – the Financial Rehabilitation and Insolvency Act (also known as FRIA).

We all know that FRIA became a law in 2010. What perhaps most of us do not know is: when then Senator Juan Edgardo J. Angara sponsored the bill on the Senate floor in 2009, it was the 100th year anniversary of the Insolvency Act of 1909, its precursor law. Talk about long gestation!

It was therefore not surprising that the good Senator clamored for its passage, arguing that it could no longer be postponed. But more than the length of time since its precursor law, the prevailing mood of global financial insecurity then demanded its enactment.

The same mood of global financial insecurity still prevails today, albeit to a lesser extent. While the rest of the world continues to grapple with the global financial crisis and its aftermath, the Philippines is in a better place. Thanks to economic reforms we have undertaken thus far. However, now is not the time to sit back and rest on our laurels. Indeed, we need to remain proactive and adopt reforms that would allow us to withstand the inevitable challenges that a growing economy such as ours faces.

When former Senator Angara spoke at the Senate in 2009, he noted that, in our country, the chances of a claimant to recover his investments from a failed enterprise are a nightmarish 4.4%. In sharp contrast, the recovery rate in Japan for failed enterprises is a whopping 92.5%.

Where we are now?

With the passage of FRIA and the FR Rules in 2013, however, our recovery rate now stands at 21.2%. Furthermore, the World Bank Group in its June 2014 Doing Business report ranked the Philippines as #50 in the Resolving Insolvency Index in a pool of 189 countries. Not bad you may think, but we clearly still have quite a long way to go.

Beyond the metrics, ladies and gentlemen, we should focus on the real goal: that of reaping the advantages of an effective insolvency regime. The FRIA is a major reform designed to promote investor confidence and contribute to financial stability and sustained growth in our economy. However, the passage of the FRIA is really just the jump-off point in achieving that goal.

What are the benefits of an effective insolvency regime?

To say that the presence of an effective insolvency regime is a pillar of market confidence seems contradictory, doesn't it? Especially because we do not expect real investors to embark on a business or an economic endeavor with failure in mind. However, part of a sound business plan is knowing what you are up against – including what would happen to you and your investment, should your business turn sour. Indeed, market exit (even if it is "forced upon you") is an integral part of the business life cycle.

The principle is this – if investors (and banks) know that there are clear rules that govern recovery, they become more willing to take on new ventures and businesses.

When you extend this principle across the many current and potential investors across markets, it then becomes intuitive and easy to appreciate that a sound insolvency regime builds confidence and is economic growth-enhancing. In addition, it also supports financial stability. Let me illustrate.

From the point of view of the investor, an effective insolvency regime provides a framework for the terms on which they can be willing or prepared to lend. More particularly, the predictability and confidence in loan recovery upon default give the investors specific parameters, including price points, for their lending. In several cases, this has led to increased credit availability, lower cost of credit, or both at the same time. The experience in Brazil shows that the broad bankruptcy reform in 2005 that established greater protection to credit had led to a significant increase in the total amount of total debt (a reported 10-17 percent increase) and in the total amount of long-term debt (23 to 74 percent increase). In other words, there was also a lengthening of debt maturities. The same study also reported a 7 to 17 percent reduction in the cost of debt financing for Brazilian firms.

From the broader macro point of view, a clear insolvency regime encourages entrepreneurship, when this provides a safety net for entrepreneurs, especially those who commit personal assets to start a business and personally guarantee loans to the new venture. A 2008 study that compared self-employment in 15 countries in Europe and North America between 1990 and 2005 found that more forgiving personal bankruptcy laws combined with ready access to limited liability protections, enhance entrepreneurial activity.

Furthermore, when the laws also provide for a well-managed redeployment of assets to more productive firms, jobs are preserved. A corporate reorganization code in Colombia enacted in 1999 dramatically improved the efficiency of reorganization proceedings, its duration fell from an average of 34 months to 12 months. Effective reorganization in countries such as Colombia allowed a company's workforce to remain employed and productive.

From a financial stability perspective, effective insolvency laws help to reduce market disruption. In Chile, for instance, the introduction of economic insolvency advisors – who were tasked to first determine the viability of firms in financial distress as basis for insolvency proceedings to commence – laid a foundation for the smooth processing of insolvency proceedings. It allowed Chile to improve the recovery rate of distressed firms' creditors from 19 cents on the dollar in 2004 to 30 cents in 2013.

What is the relevance of FRIA to central banking?

Some of you may be wondering – why the central bank governor is speaking at a seminar on insolvency and recovery. Particularly given that, the resolution processes for banks is covered under another set of laws and regulations, not the FRIA. I asked your president, Atty. Lim the same question when he invited me. He reminded me of the ardent support of the BSP during the deliberations of the law. I guess, the answer to that question therefore is – as both Francis and I agreed – the FRIA is important to the BSP as well, just as it is to you. In fact, while deliberations in Congress on the FRIA were on-going, the BSP did parallel work on formally adopting financial stability as a policy objective.

You may ask, how is financial stability related to FRIA? I submit [as I alluded to earlier] that, if FRIA is well implemented, it will help promote and advance financial stability in our country. There is no textbook definition for financial stability. But in the BSP, we define financial stability as that desirable state that is achieved when the governance framework of the market and its financial infrastructure enable and ensure the smooth functioning of the financial system conducive to sustainable and equitable economic growth.

Effective insolvency regimes, by saving struggling firms when possible, or by reallocating assets of failing firms more productively, contribute to the smooth functioning of the financial system. They help minimize market disruptions. Banks and investors are also more willing to lend when they know they can recover at least some of their investment when businesses

fail. Entrepreneurs, particularly those involved in small and medium scale enterprises, will be more willing to enter the market when they do not have to put their entire personal resources at risk. Effective insolvency regimes enable transacting parties to take calculated risks in their investment decisions.

I am sure you will agree with me when I say that such an empowerment to take calculated risks is what fuels innovation. In turn, innovation is that which is at the heart of economic growth. The current Philippine growth trajectory is on an uptrend. To sustain this, we need more investments, especially from real money funds from abroad that are accompanied by new technology for innovation. While it helps that the country is now rated two notches into investment grade territory, we should be mindful this alone won't bring in investors.

Good growth prospects and higher credit ratings are undoubtedly important contributors to improving the investment environment. But they may not be enough to entice the full range of investors to come in, build businesses and create jobs for Filipinos.

We should always recognize that investment decisions are highly influenced by investors' confidence in our domestic legal system, the quality of our laws governing private and property sectors and how effective our laws are upheld and enforced. Investors look for consistency and predictability in their commercial affairs. They would want to maximize and preserve the value of their assets or ensure that their claims are upheld, prioritized or equally treated if they become creditors of insolvent debtors. It is their confidence in our legal system that will encourage them to make use of court processes should rehabilitation and insolvency issues confront them.

The FRIA provides us with a menu of remedies for distressed debtors and new approaches to rehabilitation and insolvency. And because it expressly adopts the UNCITRAL Model Law on Cross-Border Insolvency and accordingly, FRIA gives foreign creditors in liquidations and rehabilitation proceedings direct access to Philippine courts. Thus, opportunities for cooperation between domestic and foreign courts and domestic and foreign insolvency administrators in cross-border insolvencies and restructurings are available.

What more needs to be done?

Over the past 15 minutes or so, I went through a laundry list of the benefits of an effective insolvency regime. Clearly, we all appreciate that the FRIA is our take off point for reaping these benefits. However, in the 2013 Forum on Asian Insolvency Reform that the Philippine Government hosted through the Bangko Sentral ng Pilipinas, one session exhaustively deliberated on the proposition that, in the implementation of insolvency regimes, fixing the insolvency statute is not sufficient to create a well-functioning insolvency regime.

I cannot agree more. Recent studies have shown that the critical success factor in effective insolvency regimes globally is: the continuation of reforms after laws are enacted. The failure of insolvency systems in countries that have already modernized their laws is due to inadequate implementation.

The implementation of the law is as important as the law itself. Our distinguished audience knows all too well that the successful implementation of the FRIA can only come about through a clear understanding and consistent application of the FRIA and FR Rules by our judges and insolvency administrators. Given the special and technical competence required in liquidation and rehabilitation processes, suitable and sufficient capacity building is a necessary component. Thus, we cannot stress enough the benefit of specialized training for members of our judiciary, industry practitioners, and other stakeholders. This should include basic business and accounting training, especially for those who have neither.

With the growing internationalization of finance and other businesses, we can anticipate the application of insolvency laws and rules on international corporations doing business in the country. Our courts are therefore continually called upon to be more dynamic and responsive to such economic and financial developments. We are hopeful and confident of the response

of our judiciary to this call, so as to give spirit to the more expeditious rehabilitation proceedings mandated under the FRIA and FR. This will help in ensuring that no delay will derail implementation of rehabilitation plans.

Conclusion

Ladies and gentlemen, at the core of it, the challenge to us is to help sustain the business confidence in our country and achieve financial stability. This we can do by actively playing our role in creating an environment with an adequate and functioning legal framework, where laws and rules are clear and well-defined, thereby enabling a consistent application by the members of our judiciary.

It is evident that through FRIA we have the cornerstone for an effective insolvency regime. We can build on this foundation to ensure that the advantages of such an insolvency regime are achieved.

As I close, let me congratulate the SHAREPhil led by its President, Atty. Francis Lim, and its Chairperson, Ms. Evelyn Singson, for organizing this very important seminar. I urge everyone to continue to take full advantage of this learning opportunity, to validate his/her knowledge on rehabilitation and insolvency matters, to share insights or experiences, or even to challenge ideas concerning financial rehabilitation and insolvency. Let us make this forum not just a venue to learn but also as a place to think of new ways by which we can effectively contribute in moving rapidly to an effective rehabilitation and insolvency regime and a more financially stable Philippine economy.

Ladies and gentlemen, we know our end-goal. Let's not wait another century to get there. Good afternoon and I wish this seminar great success.