

**ASIAN DEVELOPMENT BANK**

**TAR: CON 32395**

**TECHNICAL ASSISTANCE**

**FOR**

**INSOLVENCY LAW REFORM**

**July 1998**

## ABBREVIATIONS

DMC	-	Developing Member Country
IMF	-	International Monetary Fund

## NOTE

In this Report, "\$" refers to US dollars.

## I. INTRODUCTION

1. The promotion of law reforms to facilitate the creation of transparent and predictable legal and regulatory frameworks supportive of economic growth and development is a core element of the Bank's governance and capacity building programming.<sup>1</sup> As a result of the financial crisis currently afflicting many of the Bank's developing member countries (DMCs), DMCs have recognized the need for systemic legal frameworks for the recovery and restructuring of corporate debt in the private sector. As a result, insolvency laws<sup>2</sup> in many DMCs are currently being proposed or amended. In transition economies within the region, there is a similar recognition of the need for such legal frameworks, in the context of the restructuring of state-owned enterprises in addition to the context of the private sector.

2. This regional technical assistance (RETA) on insolvency law reform is intended to provide a regional forum for DMC government officials and others concerned with insolvency law reform and administration to discuss common problems in insolvency law reform and administration and to explore regional and international best practice. The RETA has been formulated to complement technical assistance on insolvency law reform being provided to the economies in the region by the Bank, World Bank, International Monetary Fund (IMF) and bilateral donors.

## II. BACKGROUND AND RATIONALE

3. With the Asian financial crisis, the inadequacies of many DMC's bankruptcy and insolvency regimes for the reorganization and rehabilitation of insolvent companies and for the orderly liquidation of insolvent companies incapable of rehabilitation has become evident. It has been recognized by many DMCs that modern, implementable and systematic insolvency and bankruptcy laws are important in restoring investor confidence in their economies. The lack of frameworks which enable the systematic restructuring of debt or the efficient liquidation of businesses incapable of being restructured poses an impediment to economic recovery, complicates the rehabilitation of financial sector institutions, stifles foreign investment, and inhibits the growth of the region's domestic debt markets.

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<sup>1</sup> For example, capacity building in support of insolvency law reform is an element of the policy matrix for the Bank's Financial Sector Governance Sector Development Program loan to Indonesia (SDI). Piggy-backed to the SDI, the Bank will be providing up to \$2,000,000 of assistance for training and capacity-building to the new court which is to be responsible for bankruptcy proceedings.

<sup>2</sup> For the purpose of this RETA, the terms "insolvency" and "bankruptcy" are used interchangeably to include the condition of a business enterprise being unable to pay debts as they fall due, as well as the legal proceedings affecting such enterprise under applicable insolvency and bankruptcy laws. The terms "insolvency law" and "bankruptcy law" are also used interchangeably and broadly to mean laws related to liquidations, receiverships, trusteeships, rehabilitations, administrations, restructurings, and reorganizations of insolvent business enterprises. Personal bankruptcies will not be the principal focus of the RETA, though relevant insolvency laws may cover individuals as well as business enterprises. The precise legal definitions of insolvency and bankruptcy and the detailed nature of applicable insolvency and bankruptcy laws and procedures will vary from jurisdiction to jurisdiction.

4. Outmoded laws have been cited as a key issue in insolvency law reform in the DMCs. Many of the region's DMCs have outdated bankruptcy codes which are no longer appropriate in today's business and corporate climates. For example, Indonesia's Bankruptcy Ordinance (1904) is based on the Dutch Bankruptcy Act of 1896, Thailand's present law dates from 1940, and the Philippine insolvency law has been in place since 1909. Such laws are inadequate to deal with the complex debt and ownership structures of enterprises currently operating in such DMCs, and with the sophisticated financing transaction structures now common in such markets.

5. Other constraints highlighted by the Asian financial crisis are the inadequate court systems, and the weak enforcement and implementation of existing bankruptcy laws in the DMCs. For example, while the filing of bankruptcy in Korea is easy, inaction inevitably follows. In Thailand, the overstretched court system has been ineffective in overseeing the restructuring of debts, while in the Philippines bankruptcy is considered expensive and lengthy and is rarely used. Likewise, in Indonesia, courts are not equipped to supervise bankruptcies and the agency designated by the Bankruptcy Code to act as receiver and administrator is virtually inactive in bankruptcy matters.

6. In response, many DMCs have adopted or are in the process of adopting insolvency law reforms. Indonesia, for example, has recently adopted a new bankruptcy law which will become effective in August 1998, as part of economic reforms agreed with the IMF. The bankruptcy law requires a soon-to-be-established commercial court to settle a petition for bankruptcy within 30 days of its filing. Likewise, Thailand has recently adopted liberalized bankruptcy laws which contemplate corporate restructurings in addition to liquidations.<sup>3</sup> The laws permit, among other things, the reorganization of a bankrupt company, and the payment of market-based interest by borrowers during bankruptcy proceedings. Thailand will further amend the bankruptcy law to make the process of corporate restructuring easier by the fourth quarter of 1998. Similarly, Korea and Hong Kong have recently revised their bankruptcy laws. Pakistan and Malaysia are also considering proposals for bankruptcy law reform.

7. The reforms being adopted have one key principle in common: to make it easier for insolvent companies to restructure and return to running economically viable businesses. In this context, issues related to debtor-in-possession financing<sup>4</sup> and best practices and approaches to insolvency law reform are currently being debated in many of the DMCs in the region. For example, Japan, Malaysia and Thailand are considering the adoption of debtor-in-possession financing provisions. Japan has also announced plans to consolidate five corporate bankruptcy laws by 2003. Among other things, Indonesia is considering whether it is necessary to promulgate licensing requirements for administrators and receivers, and the level of appropriate procedural discretion for judges, administrator and receivers. Also being debated are the mechanisms to prevent misuse of procedures and corrupt practices among the judiciary and the need for a special chamber specializing in commercial and financial matters, including bankruptcy proceedings. In Thailand, foreclosure and related reforms, the removal of impediments

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<sup>3</sup> The adoption of more liberalized bankruptcy laws was a condition for the first tranche release of funds under the Bank's Financial Markets Reform Program Loan No. 1600-THA: Financial Markets Reform Program, approved by the Board on 5 December 1997.

<sup>4</sup> Debtor-in-possession financing allows distressed companies to reorganize while maintaining control of their assets. The US model is incorporated in Chapter 11 of the US Bankruptcy Code.

to rehabilitation of financial enterprises and the appropriate priorities of secured and unsecured creditors are currently being debated.

8. The RETA will provide a forum for the discussion of issues involved in insolvency reforms and the associated procedural and administrative changes which will be on-going in the region over the next several years. The RETA will promote regional cooperation and is consistent with the Bank's Governance programming and its Law and Development activities. The RETA will complement other Bank assistance with financial sector reforms in the DMCs among the RETA economies (defined in para. 10).

### III. THE TECHNICAL ASSISTANCE

#### A. Objectives

9. The overall goal of the RETA is to facilitate the development of legal frameworks for the recovery and restructuring of corporate debt in the private sector in the RETA economies (defined in para. 10). The RETA is designed to provide a regional forum for government officials and policy makers concerned with insolvency law reform and administration in which to discuss common problems in insolvency law reform and administration and to explore regional and international best practice. The Logical Framework is attached as Appendix 1.

#### B. Scope

10. The economies that are to be the focus of the RETA's study are Korea, Japan, Taipei, China, Hong Kong, Singapore, Indonesia, Malaysia, Thailand, India, Pakistan, and the Philippines (collectively, the "RETA economies"). These economies have been selected to permit a comparative analysis of their bankruptcy and insolvency regimes, and are either (i) economies which have recently adopted, or are currently in the process of adopting, bankruptcy law reforms; or (ii) economies within the region with more developed or effective bankruptcy law regimes.

11. The components of the RETA are:

- a) preparation of individual studies in the RETA economies which will present and analyze the current bankruptcy law regime, recent reforms to such regime and the actual operations of such regime based upon legal, banking and corporate research, including statistical sources and interviews (the "initial studies");
- b) preparation of a preliminary comparative report based upon an analysis of the initial studies and on the experience of other economies, international best practices on the subject and model laws, and which will provide an analytic framework for bankruptcy law reforms and their evaluation;
- c) creation of an Internet Home Page on Asian Insolvency Practice, containing the texts of bankruptcy legislation, regulations and rules for

each of the RETA economies and the full texts of the initial studies and the preliminary comparative report;

- d) an initial symposium to identify, analyze and evaluate emerging strategies of bankruptcy law reform and bankruptcy practice in the RETA economies. The symposium will bring together from each of the RETA economies government officials and policy makers responsible for bankruptcy law reform and administration and senior administrators; resource persons from within the region representing the perspectives of lenders and corporations; labor and bankruptcy practitioners (from the accounting, legal and banking professions); members of the RETA research team, and resource persons with relevant international best practices experience;
- e) publication of a summary of the initial symposium proceedings, which will also be included on the Internet Home Page on Asian Insolvency Practice;
- f) preparation of an updated study for each of the RETA economy one year following the initial symposium, to document further changes in bankruptcy law and practice and to further evaluate reforms previously initiated;
- g) preparation of an updated comparative report on a similar basis;
- h) a second symposium, bringing together the initial symposium participants, to consider the updated studies for the RETA economies, the updated comparative report and to identify, analyze and evaluate the further development of strategies of bankruptcy law reform and bankruptcy practice in the RETA economies; and
- i) publication of a summary of the second symposium proceedings, which will also be included on the Internet Home Page on Asian Insolvency Practice.

12. The RETA studies, reports and symposia will emphasize the impact of bankruptcy laws and practices, and their reform on the actual effectiveness of bankruptcy proceedings, both in effecting corporate rehabilitations and in achieving orderly liquidations.

### **C. Cost Estimates and Financing Plan**

13. The total cost of the RETA is estimated at \$550,000 as more fully set out in Appendix 2. The RETA will be provided on a grant basis under the Bank-funded TA program. Funding will cover remuneration for the international consultants and domestic consultants, travel and per diems for the international and domestic consultants, airfare and per diems for other participants in the symposia, the costs of the symposia, and the costs of communications, establishment of the Internet Home Page and publications.

#### **D. Implementation Arrangements**

14. The RETA will be implemented by OGC with the services of about five person-months of an international consulting firm (hereinafter "Consultant"). The Consultant will be recruited in accordance with the Bank's Guidelines on the Use of Consultants, using the Biodata Proposal procedures pursuant to PAI No. 3.01. The Biodata Proposal to be submitted by the Consultant is to include the resource persons (hereinafter "Resource Persons") in each of the RETA economies who will assist the Consultant to prepare the initial studies. The Consultant will have expertise in insolvency law reform, restructuring of debt, and related practices. The Consultant will be responsible for carrying out all of the RETA activities in association with the Resource Persons, and in consultation with, and with the assistance of, OGC staff. The Consultant will, among other things, prepare the initial and updated studies for the RETA economies; the detailed agenda for each of the symposia; select symposia participants; and prepare and publish all reports, including the preliminary comparative report, the updated comparative report and the summaries of the symposia proceedings. It is anticipated that the Consultant will subcontract the creation of an Internet Home Page on Asian Insolvency Practice in accordance with arrangements satisfactory to the Bank. Detailed terms of reference are set out in Appendix 3.

15. The RETA will support two regional symposia, to be held at the Bank's headquarters in Manila. The first symposium will be held at the end of 1998 and the other in late 1999. The symposia will be coordinated with the Bank technical assistance for insolvency law training and capacity building in Indonesia and other, donor technical assistance on bankruptcy law reforms in the RETA economies. The RETA is to be carried out over a period of approximately 18 months. It is expected to commence in August 1998 and to be completed in January 2001.

#### **E. Advance Action and Use of Biodata Proposal Procedures**

16. The Bank has approved advance action for recruitment of the Consultant and the use of Biodata Proposal procedures for the RETA. Advance action and the use of Biodata Proposal is necessary to ensure that the RETA preparation activities will be in accordance with the implementation schedule, which has been designed to respond to the regional financial crisis and the consequent need for insolvency law reforms.

### **IV. THE PRESIDENT'S DECISION**

17. The President, acting under the authority delegated to him by the Board, has approved the provision of regional technical assistance, on a grant basis, in an amount not exceeding the equivalent of \$550,000 for the purpose of Insolvency Law Reform, and hereby reports such action to the Board.

LOGICAL FRAMEWORK FOR REGIONAL  
INSOLVENCY LAW REFORM

DESIGN SUMMARY	TARGETS	MONITORING MECHANISMS	RISKS/ASSUMPTIONS
<p>1. <u>Overall Aim</u> Facilitate bankruptcy laws/reform in the RETA economies</p>	<ul style="list-style-type: none"> <li>• Collect major legal documents and data</li> <li>• Obtain views/inputs from officials and resource persons in each RETA economy</li> <li>• Review insolvency laws in each RETA economy</li> <li>• Examine experience in each RETA economy</li> <li>• Produce studies for the RETA economies and symposia summaries</li> </ul>	<ul style="list-style-type: none"> <li>• Progress reports</li> <li>• Symposia feedback</li> <li>• Studies for RETA economies</li> </ul>	<ul style="list-style-type: none"> <li>• Lawmakers have difficulty in applying best practices in particular situation</li> <li>• Commitment of Government to adopt reforms</li> </ul>
<p>2. <u>General Objectives</u> Provide regional analysis as an input for bankruptcy law reform in each RETA economy</p>	<ul style="list-style-type: none"> <li>• Identify regional best practices</li> <li>• Conduct two symposia for bankruptcy officials</li> </ul>	<ul style="list-style-type: none"> <li>• Symposia feedback</li> <li>• Review legal documents</li> </ul>	<ul style="list-style-type: none"> <li>• Time/resource constraints limit scope of analysis</li> <li>• Poor analysis of laws in each RETA economy</li> <li>• Inaccurate indicators</li> </ul>
<p>3. <u>Specific Objectives</u> 3.1 Assess regional progress and trends 3.2 Examine effectiveness of insolvency laws and their applications</p>	<ul style="list-style-type: none"> <li>• Collect data on main indicators</li> <li>• Collect/analyze available country-level analyses, legal documents</li> <li>• Bring country/territory officials and resource persons to symposia</li> <li>• Synthesize views of countries/territories and experts</li> </ul>	<ul style="list-style-type: none"> <li>• Progress reports</li> <li>• Working papers/country/territory studies</li> <li>• Seminar feedback</li> <li>• Symposia summaries</li> </ul>	<ul style="list-style-type: none"> <li>• Poor analysis of effectiveness of laws and implementation in the RETA economies</li> <li>• Diverse situations inhibit generalization</li> </ul>
<p>4. <u>Project Components</u> 4.1 Studies for the RETA economies</p>	<ul style="list-style-type: none"> <li>• Produce 11 studies for the RETA economies</li> </ul>	<ul style="list-style-type: none"> <li>• Detailed work plan and terms of reference</li> <li>• International Consultant's Progress Reports</li> </ul>	<ul style="list-style-type: none"> <li>• Inadequate time/poor quality</li> <li>• Availability of data and legal sources</li> <li>• Studies for RETA economies too descriptive and lacking in analysis</li> </ul>



DESIGN SUMMARY	TARGETS	MONITORING MECHANISMS	RISKS/ASSUMPTIONS
4.2 Preliminary Comparative Report	<ul style="list-style-type: none"> <li>Produce one comparative report</li> </ul>	<ul style="list-style-type: none"> <li>Progress/reports/symposium presentation                             <ul style="list-style-type: none"> <li>report outline</li> <li>detailed work plan</li> <li>progress report</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Diverse situations inhibit generalization</li> </ul>
4.3 Internet Home Page	<ul style="list-style-type: none"> <li>Set up Internet Home Page on Asian Insolvency Practice</li> </ul>	<ul style="list-style-type: none"> <li>Home page "hits" and uses feedback</li> </ul>	
4.4 Initial Regional Symposium and Publication of initial symposium proceedings	<ul style="list-style-type: none"> <li>Convene meeting of bankruptcy officials and other resource persons from selected economies</li> <li>Publish summary of symposium proceedings</li> </ul>	<ul style="list-style-type: none"> <li>Symposium feedback</li> <li>Study for each RETA economy</li> <li>Symposium presentation report</li> <li>Working report outline</li> <li>Detailed work plan</li> <li>Progress reports</li> </ul>	<ul style="list-style-type: none"> <li>Pre-Symposium participant preparation</li> <li>Securing participation of appropriate officials</li> <li>Relevance of issues presented to participants</li> <li>Accommodating regional diversity</li> </ul>
4.5 Updated studies for the RETA economies	<ul style="list-style-type: none"> <li>Produce final version of a study for each of the RETA economies integrating feedback from each economy and the symposium</li> </ul>	<ul style="list-style-type: none"> <li>Working report outline</li> <li>Detailed work plan</li> <li>Progress reports</li> </ul>	<ul style="list-style-type: none"> <li>Time/resource constraints</li> </ul>
4.6 Updated comparative report	<ul style="list-style-type: none"> <li>Produce final version of comparative report</li> </ul>	<ul style="list-style-type: none"> <li>Working report outline</li> <li>Detailed work plan</li> <li>Progress reports</li> </ul>	<ul style="list-style-type: none"> <li>Inadequate time</li> <li>Coordination of country/territory reports and symposium findings</li> <li>Securing participation of appropriate officials</li> </ul>
4.7. Second regional symposium and Report of second symposium proceedings	<ul style="list-style-type: none"> <li>Convene meeting of bankruptcy officials and other resource persons from selected economies</li> <li>Publish summary of second symposium proceedings, including on the Internet</li> </ul>	<ul style="list-style-type: none"> <li>Updated studies for the RETA economies</li> <li>Symposium feedback</li> <li>Internet Home Page</li> <li>Second symposium summary</li> </ul>	<ul style="list-style-type: none"> <li>Accommodating regional diversity</li> <li>Reaching consensus on best practices, trends and priorities</li> <li>Accommodating regional diversity</li> </ul>

(Reference in text, page 3, para. 9)

**COST ESTIMATES AND FINANCING PLAN**

(\$'000)

A.	International Consultant (5 person-months)	\$125,000
	Travel	40,000
	Per Diems	30,000
B.	Symposium	20,000
	Travel	80,000
	Per Diems	30,000
C.	Studies for the RETA economies (11)	145,000
D.	Creation of Internet Home Page on Asian Insolvency Practice	15,000
E.	Administrative expenses, including publication, communication costs, and other logistical support	20,000
F.	Contingency	45,000
	<b>TOTAL</b>	<b>\$550,000</b>

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(Reference in text: page 4, para.13)

**Insolvency Law Reform  
Terms of Reference for Consulting Services**

The Consultant will perform the following tasks:

- (i) define working outlines for the initial studies in each of the RETA economies in consultation with the Bank, covering analysis of insolvency laws and the actual practice of lenders and borrowers in the use of bankruptcy proceedings;
- (ii) define the scope of work and terms of reference for the local resource persons in consultation with OGC. It is anticipated that the resource persons will have expertise in domestic insolvency laws, banking, and corporate debt restructuring, and related insolvency practices;
- (iii) work with the resource persons in each of the RETA economies to revise working outlines on the basis of discussions in each RETA economy with insolvency practitioners, bankers, borrowers, economists, central bankers and government officials;
- (iv) work with the resource persons to establish in each of the RETA economies a working group consisting of lawyers, bankers, lenders, borrowers, bankruptcy practitioners, economists, central bankers and government officials;
- (v) work with the resource persons to undertake a review of the bankruptcy regimes currently in effect in the economies in question, including a quantitative and qualitative review of bankruptcy proceedings, and of institutional capabilities for compliance with and enforcement of bankruptcy laws;
- (vi) work with the resource persons to prepare the initial studies, which will include a brief summary of the insolvency regimes and deficiencies thereof, and will identify options under consideration for revising the relevant bankruptcy laws and related procedures and for improving institutional capabilities;
- (vii) produce a preliminary comparative report based upon an analysis of the initial studies, bankruptcy law reform models and experience of bankruptcy reforms in the Bank's developed member countries. It is anticipated that the report will include a comparative study and analysis of the bankruptcy regimes in the RETA economies, and with respect to each RETA economy make recommendations for best practices and implementation action plans;

- (viii) supervise creation of an Internet Home Page on Asian Insolvency Practice, containing the texts of bankruptcy legislation, regulations and rules for each of the RETA economies and the full texts of the initial studies and the preliminary comparative report;
- (ix) organize an initial symposium on insolvency to be held at the Bank's headquarters in Manila in consultation with, and with the assistance of OGC and the resource persons, including (a) identifying participants among policy makers, insolvency practitioners, economists, bankers, central bankers, government officials and scholars; and (b) structuring an agenda for the symposium to discuss the initial studies, the preliminary report, a broad strategy for bankruptcy law reform, and recommendations on actions to implement such reforms in the RETA economies;
- (x) prepare summaries of the symposium discussions at the initial symposium, supervise revisions to studies for the RETA economies and revise the comparative report based on symposium discussions;
- (xi) arrange for the publication of the revised studies for the RETA economies and summaries of the initial symposium on the Internet Home Page on Asian Insolvency Practice;
- (xii) supervise and coordinate with the resource persons to prepare updated studies for the RETA economies one year following the initial symposium to document further changes in bankruptcy law and practice and to further evaluate reforms previously initiated;
- (xiii) produce an updated comparative report on a similar basis;
- (xiv) organize a second symposium, on the same basis as the initial symposium, bringing together the initial symposium participants, to consider the updated reports for the RETA economies, the updated comparative report, and to identify, analyze and evaluate the further development of strategies of bankruptcy law reform and bankruptcy practice in the RETA economies;
- (xv) produce and publish a summary of the second symposium proceedings, which will also be included on the Internet Home Page on Asian Insolvency Practice; and
- (xvi) be responsible for preparation of RETA reports.