Tackling Over-Indebtedness in Asia

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Outline

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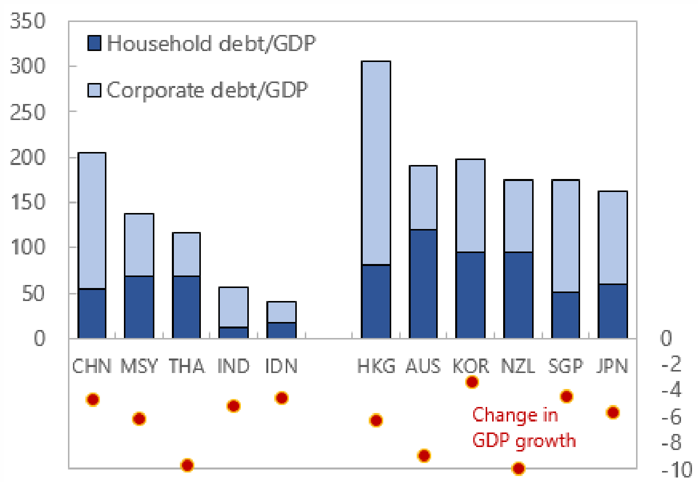
Logistics and Housekeeping

- Please **mute your microphones** when you are not speaking. It would also be great if you can have your video on.
- Please type your **questions in chat** at any time during the presentation. We will turn to these during the Q&A segments of this presentation.
- We encourage you **to ask questions and participate in discussions** – we are here to learn from each other.
- This presentation includes **polls**; your responses to these would be appreciated.
- There will be a **10-minute break** after 55 minutes.
- Please do complete the **survey** at the end of this session so that we have the benefit of your feedback.

Introduction

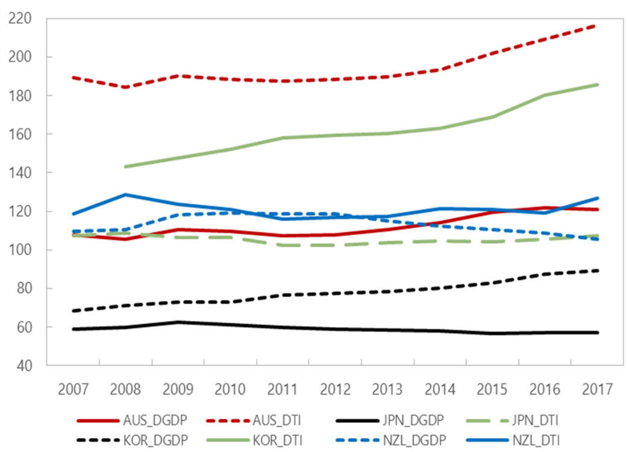
- Post global financial crisis (GFC) private debt - corporate & household – has surged to unprecedented levels due to accommodative monetary policy, search for yield
- Asia accounts for nearly one third of global private debt with several countries in Asia experiencing some of the largest increases since 2007
- Current debt levels may become unsustainable if there is a deep economic contraction



Introduction

- Moderate levels of debt can support economic activity
- High levels of debt can be counter-productive and undermine growth in medium term
- COVID-19 pandemic amplified pre-existing vulnerabilities
- Proposed multipronged approach would help tackle over-indebtedness in good times but also remain appropriate for post-COVID recovery
- The paper and presentation do not capture developments during COVID-19 pandemic

Private Debt in Asia – Some Background



- Rapid rise in private debt in Asia post-2007
  - Household debt increased sharply (China, Korea, Thailand) and remains elevated (Korea, Thailand)
  - Corporate debt has also grown rapidly (China, Korea, Singapore)
- Common feature – a growing role of nonbanks
  - Households: key drivers – housing (Australia, China, Korea, Singapore), consumer loans (Thailand)
  - Household debt: increase has outpaced disposable income in some countries

Tackling Over-Indebtedness: A Multipronged Approach

A multipronged approach can help prevent over-indebtedness and manage high debt

- Macroeconomic policies
- Institutional frameworks
- Macroprudential policies
- Fiscal policy
- Legal framework

Tackling Over-Indebtedness: A Multipronged Approach

Macroprudential Measures to Address Household Debt

Korea: upgrading non-bank financial institutions supervision to harmonize it with that for banks and promoting more rigorous bank assessments. New supervisory tools such as the Debt Service Ratio (DSR) covering all forms of household debt are being introduced in 2018-19. Mortgage contracts are being changed to insulate household from interest rate risk through a rapid shift from variable-rate bullet loans to fixed-rate amortizing mortgages. The loan-to-value (LTV) and debt-to-income (DTI) ratios were reduced to record lows of 40 percent, and are now well below recent highs of 70 and 60 percent, respectively, to which they were increased in August 2014.

China: systemic risk assessment of the household sector was strengthened, including by extending coverage beyond mortgages. Efforts were stepped up to collect and process data beyond the aggregate credit and housing market indicators.

Indonesia: Bank Indonesia introduced LTV ratios in 2012 to prevent higher risk in property and residential sector (housing bubble). Debt ratios have been maintained at a low and manageable level since.

Thailand: The Bank of Thailand has taken several steps, including setting limits on credit card and personal loans and tightening LTV on mortgage loans.

Role of Legal Frameworks in Addressing Over-Indebtedness

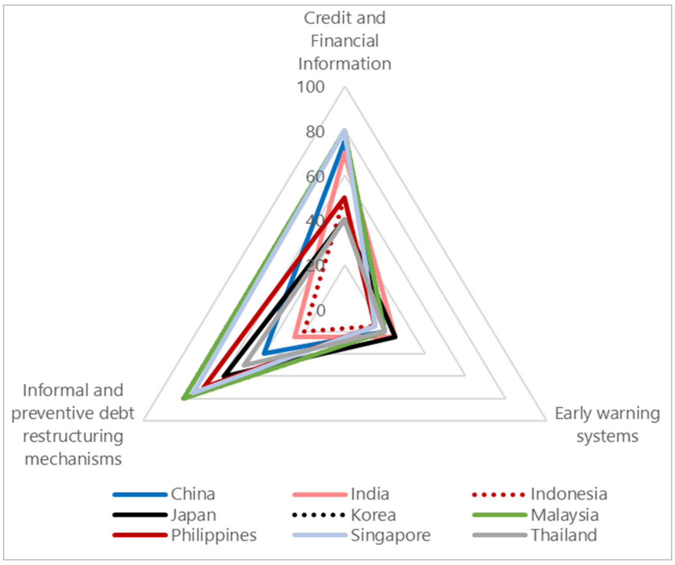
- Legal frameworks play a critical role in dealing with over-indebtedness
- Both ex-ante and ex-post measures are necessary
- Emerging trend – to emphasize **ex-ante measures** to prevent unsustainable debt
  - No international standards but best practices are emerging

Role of Legal Frameworks

Formal judicial resolution process

	EX ANTE			EX POST		
Household	Credit information systems	Advice to debtors	Informal debt restructurings	Bankruptcy: Liquidation	Bankruptcy: repayment plans	Debt enforcement
Enterprise	Financial and economic information	Early warning systems	Informal debt restructurings	Reorganization	Liquidation	Debt enforcement

Enterprises: Ex-Ante Tools



(1) Credit and financial information systems

- Limited coverage of enterprises
- Mainly cover consumer credit (Japan, Thailand, Philippines)
- Systems that cover enterprises – often main source is banking sector (China, India)
- But broader coverage in some cases (Korea, Malaysia, Singapore)
- Reliance on financial reporting and auditing rules
- Gaps in coverage (listed vs. unlisted firms) although overall improving

Enterprises: Ex-Ante Tools

(2) Early warning systems

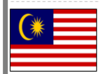
- Limited experience in Asia and elsewhere
- Some systems rely on leading banks (e.g., monitoring stress indicators)
- For large firms – internal audit and risk management perform a similar function
- Very limited for SMEs

Enterprises: Ex-Ante Tools

(3) Informal debt restructuring mechanisms

- Rich experience since the 1997 crisis (Japan, Korea, Indonesia, Malaysia, Thailand)
- Support of administrative authorities can enhance informal mechanisms
- Part of the regular restructuring toolkit in some countries
- Can be combined with preventative insolvency procedures or similar tools. Examples:
  - Schemes of arrangement (Malaysia, Singapore)
  - "Pre-packaged" reorganizations (Japan, Korea)
- Support programs for firms with high debt, including SMEs
  - Legal/accounting advice
  - Guarantee schemes

Korea has developed an enhanced restructuring mechanism under the Corporate Restructuring Promotion Act (CRPA). The CRPA supports restructuring of financial claims through a creditors committee that makes decisions by majority. Creditors who disagree with the decisions of the committee are entitled to be bought out by the majority.



Malaysia revised its Corporate Debt Restructuring mechanism (CDR) to incorporate technical improvements. The mechanism is designed to apply irrespective of the existence of an economic crisis and has a special version for small and medium enterprises. This approach could be easily replicated by other ASEAN countries, especially those with experience in the design and operation of enhanced debt restructuring frameworks (Thailand, Indonesia).

The Philippines designed an informal debt restructuring mechanism with special features. Out-of-court restructuring agreements benefit from the same legal recognition as a judicially-sanctioned restructuring, if those agreements meet specified conditions of super-majorities and publication

Questions for Debate

- Poll #1
- Does you country have ex-ante prevention measures for enterprises? If yes, what are these measures?
- What ex-ante measures for enterprises work well in your country? Why? What measure do not work so well? What are the key challenges?

- What other measures do you think would work best in your country to help prevent over-indebtedness for corporates?

Households: Ex-Ante Tools

(1) Credit information systems

- Help contain household debt
- Some have wide coverage
- Need to expand coverages, including for effectiveness of macroprudential tools
- Fintech – new players (PPP?)

Households: Ex-Ante Tools

(2) Support to debtors

- Legal/financial advice
  - Can be provided by public institutions or private sector
  - Timely advice is important

Public institutions	*Malaysia*: Bank Negara's Credit Counseling and Debt Management Agency (AKPK) offers free debt counseling to consumers and facilitates a number of debt-restructuring options.
	Korea: Credit Counseling and Recovery Services (CCRS) was created as an initiative of the financial sector, but after several changes, it has re-emerged as a public agency, as part of the authorities' strategy to address household indebtedness.
Other bodies	*Singapore:* Credit Counseling Services (CCS) is a private charity that provides financial education and debt counseling services to debtors.
	Thailand: The Debt Clinic was established by the Bank of Thailand and is managed by an Asset Management Company (Sukhumvit AM). It is an example of cooperation between the public and private sectors.

Households: Ex-Ante Tools

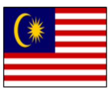
(3) Informal debt restructurings

- A variety of mechanisms typically linked to debtor support programs
- An agreement with creditors as last opportunity to avoid bankruptcy
- Mediation, arbitration

Households: Ex-Ante Tools

Informal Household Restructuring Tools

Korea: CCRS manages a restructuring procedure for household debt in the shape of two modalities (individual workout and pre-workout).



Malaysia: AKPK offers a Debt Management Program (DMP) for consumers with debts to financial institutions. The DMP is a personalized debt repayment plan agreed with the participating financial institutions, based on the advice that the debtor receives from the AKPK specialists. The DMP is designed to maintain minimum living standards of the debtor, while making monthly payments to reduce and ultimately extinguish debt.

Thailand: The Debt Clinic Program is designed to offer restructuring solutions to debtors who have debts with multiple banks and is now seeking to expand its coverage to non-bank financial institutions, given their important role in consumer finance. The debts of consumers are rescheduled with longer maturities at a low interest rate. The scheme is facilitated by the transfer of the non-performing loans to the AMC, which can then find an optimal restructuring solution.

Singapore: CCS also offers a DMP based on credit counseling, with similar characteristics, and a Repayment Assistance Scheme (RAS) that helps debtors restructure unsecured debt by consolidating it and extending the maturity with a low interest rate.

Questions for Debate

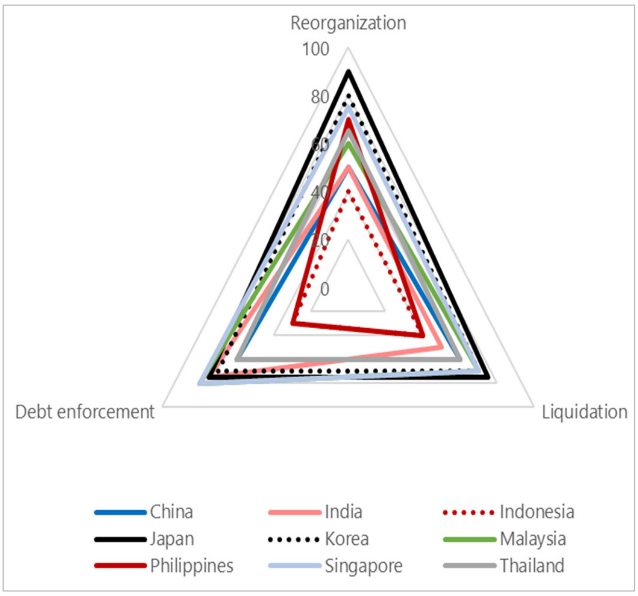
- Poll #2
- Does your country have ex-ante prevention measures for households? If yes, what are these measures?
- What ex-ante measures for households work well in your country? Why? What measure do not work so well? What are the key challenges?
- What other measures do you think would work best in your country to help prevent over-indebtedness of households?

Enterprises: Ex-Post Tools

Formal insolvency frameworks

(1) Reorganization

- An integral part of insolvency regimes (China, India, Japan, Korea, Thailand, Singapore, Malaysia, Philippines)
- Many reforms since the 1990, including more recently
- Guided by international best practices (UNCITRAL, World Bank Principles, IMF guidelines)
- Implementation/practice varies widely



Enterprises: Ex-Post Tools

(2) Liquidation

- An integral part of formal insolvency regimes
- Not the most efficient tool (value destruction)

(3) Debt Enforcement

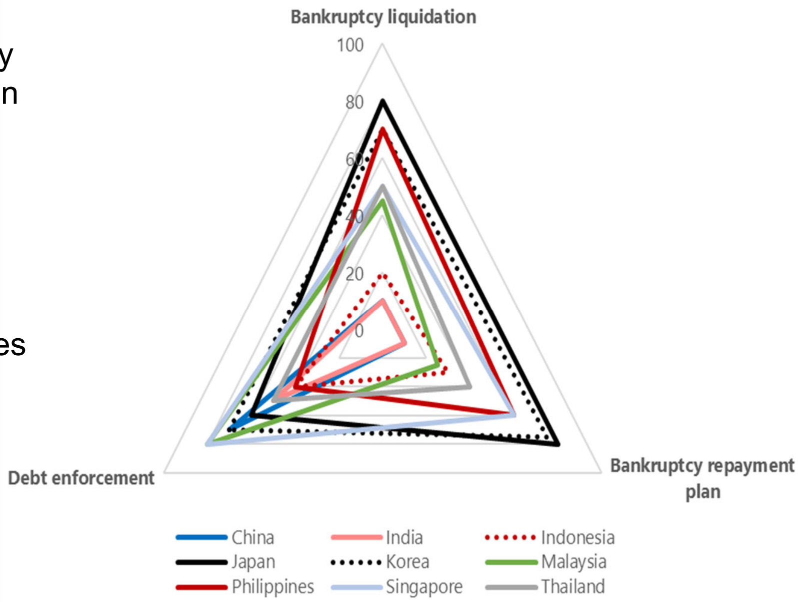
- Judicial (China, Korea, Japan, Indonesia, Philippines, Thailand) or out-of-court (India, Malaysia, Singapore) enforcement procedure, including for secured claims
- Generally effective to a varying degree
- Technology can facilitate enforcement

Questions for Debate

- Poll #3
- What ex post tools for addressing over-indebtedness of enterprises does your country have? What measures work well? What measure do not work well? Why?
- Does your country have a reorganization procedure(s) for corporates? Is it used often? Is it effective? Why? Why not? What are key challenges for effective corporate reorganization in your country?
- Does liquidation of an enterprise work well in your country? If not, why? What are key challenges?
- Does your country have an effective regime for debt enforcement against enterprises? For secured debt? Unsecured debt? If so, what makes the system effective? If not, what are some of the key challenges?

Households: Ex-Post Tools

- Emerging trend: personal insolvency procedures focusing on rehabilitation of the debtor
- Not yet widely adopted in Asian countries
- Challenges: stigma, punitive attitudes still common



Households: Ex-Post Tools

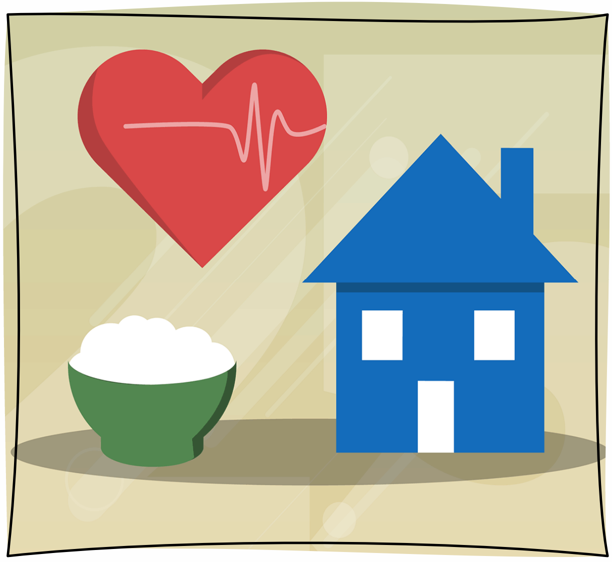
(1) Personal bankruptcy – "liquidation"

- Liquidation of the estate should provide debtor with discharge of outstanding debt ("fresh start")
- Attitude to discharge restrictive due to social norms, concerns about "moral hazard"
- Debtors with limited or no assets require a different approach

Households: Ex-Post Tools

(2) Personal bankruptcy – repayment plans

- Aims at “rehabilitating” the debtor by allowing repayment of part of debt through a 3-5 year repayment plan (Japan, Korea)
- Designing rules for repayment plans is complex
- Key principle – the “liquidation rule“



Households: Ex-Post Tools

Personal Bankruptcy Regimes in Asia

Full discharge (Fresh start)	*Japan* is the Asian country with the longest tradition of a personal bankruptcy inspired by a fresh start policy. Personal bankruptcy is a simple procedure where the assets of the debtor are liquidated for the benefit of the creditors-except exemptions for household items- and the debtor receives a discharge. The causes for denial of the discharge are limited, and listed in the law, and only certain categories of debt (taxes, salaries) are non-dischargeable. A debtor who has received a discharge cannot receive another discharge for the following ten years.
	Korea adopted a full regime for personal bankruptcy with a discharge. For a long period, judges were reluctant to grant discharges to bankrupt debtors. Nowadays, full discharge is a well-established policy.
Restrictions to Discharge	*Thailand*, after the reform of the bankruptcy law in the wake of the Asian crisis, provides a discharge after three years for the commencement of the proceedings, or when the debtor has paid 50 percent of debts. The peculiarity is that bankruptcy can only be requested by creditors, whereas the global trend is that voluntary bankruptcy is not only allowed, but it is more frequent in practice than involuntary bankruptcy
	In *Malaysia*, bankruptcy is still regarded as a credit collection technique, and is often used by creditors to put pressure on debtors. Bankruptcy imposes numerous restrictions on the debtor; there is no automatic discharge.
	Indonesian law is based on similar principles and does not generally discharge the debts of bankrupts after the liquidation of their state.
	Singapore imposes heavy restrictions on bankrupt persons (including travel restrictions) and establishes limitations to discharge.

Households: Ex-Post Tools

(3) Debt Enforcement

- Debt enforcement is generally effective, especially for secured debt
- In-court and out-of-court systems (e.g., Malaysia, Singapore)

Questions for Debate

- Poll #4
- What ex post tools for addressing over-indebtedness of households/individuals does your country have?
- Does your country have a personal insolvency/ bankruptcy regime? Is it often used?
- If your country does not have a personal insolvency regime, do you think it should have one? If yes, explain why. If no, explain why.
- Can debtor in your country get a discharge of outstanding debt, e.g., at the end of the bankruptcy process? If so, how long does it take to obtain a discharge?
- Does your country have a procedure for rehabilitation of individual debtors (e.g., through repayment plans)? If not, do you think such procedure would be useful?
- Does your country have an effective regime for debt enforcement against individual debtors? For secured debt? Unsecured debt? If so, what makes the system effective? If not, what are some of the key challenges?

Institutional Frameworks

- Effectiveness of legal tools to deal with over-indebtedness depends on the broader commercial legal system and well-developed infrastructure.
- Key elements: judiciary, insolvency representatives, auctioneers, independent appraisers
- Courts:
  - facilitate a speedy insolvency proceeding and ensure public legitimacy and integrity of the procedure
  - ensure **effective enforcement** of rights of secured and unsecured creditors outside of insolvency
- Integrity: transparency and accountability
- It is important to close the **"implementation gap"** – the law is only as good as the institutions that implement it

Questions for Debate

Poll #5

- What is your assessment of the institutions that support debt prevention and resolution in your country?
- What are key institutional strength and weaknesses in your country when it comes to institutions that support debt prevention/resolution?

- What are some of the key challenges? What can make institutions more effective?

Conclusions

- High levels of corporate and household debt present economic and social challenges
- Progress has been made in developing legal frameworks for addressing over-indebtedness both ex-ante and ex-post but more can be done
- Critical ex-ante tools for overindebted enterprises are missing
- Ex-post tools for over-indebted households need further development
- Market-based approach tends to produce better results in debt resolution
- Data is important and can facilitate decision making and design of the legal and policy frameworks
- Strong institutional frameworks facilitate effective implementation

THANK YOU!

Questions? Comments?

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