Lessons from the Crisis: A Case for Reforms in Bank Liquidation Laws in the Philippines

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I. INTRODUCTION

The collapse of the United States (U.S.) mortgage market in 2008 resulted in an economic recession whose severity was likened to the Great Depression of the 1930s.[1] Banks and other financial institutions sustained the hardest and most crippling losses as they found themselves awash with assets whose actual value had sharply declined, leading to a grossly overstated mortgage loans

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1. *See* James R. Lothian, U.S. Monetary Policy and the Financial Crisis (A Part of the Working Paper Series of the Center for Financial Innovation and Stability) 1-5, *available at* http://www.frbatlanta.org/documents/cenfis/pubscf/wp/CenFisWP0901.pdf (last accessed Feb. 25, 2011) & Sher Verick and Iyanatul Islam, The Great Recession of 2008-2009: Causes, Consequences and Policy Responses (A Part of the Discussion Paper Series of the Institute for the Study of Labor) 3, *available at* http://ftp.iza.org/dp4934.pdf (last accessed Feb. 25, 2011).

portfolio.[2] This set off a wave of bank failures and closures[3] never before witnessed in the history of the U.S. and triggered severe credit crunches and stock market plunges.[4]

The fiscal crisis in the U.S. created ripples of anxiety and turmoil in the financial systems of many countries around the world.[5] Governments

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2. *See* U.S. Financial Crisis Inquiry Commission, Conclusions of the Financial Crisis Inquiry Commission *xvi*, *available at* http://c0182732.cdn1.cloudfiles.rackspacecloud.com/fcic_final_report_conclusions.pdf (last accessed Feb. 25, 2011) [hereinafter FCIC Report]. The Report states that

   > [w]hile the vulnerabilities that created the potential for crisis were years in the making, it was the collapse of the housing bubble — fueled by low interest rates, easy and available credit, scant regulation, and toxic mortgages — that was the spark that ignited a string of events, which led to a full-blown crisis in the fall of 2008. Trillions of dollars in risky mortgages had become embedded throughout the financial system, as mortgage-related securities were packaged, repackaged, and sold to investors around the world. When the bubble burst, hundreds of billions of dollars in losses in mortgages and mortgage-related securities shook markets as well as financial institutions that had significant exposures to those mortgages and had borrowed heavily against them. This happened not just in the United States but around the world. The losses were magnified by derivatives such as synthetic securities.

   FCIC Report, *supra* note 2, at *xvi*.

3. *Id.* The crisis saw several giants of the American financial industry crumble, notably Lehman Brothers, Bear Stearns, Merrill Lynch, Fannie Mae, Freddie Mac, and the American International Group (AIG), which was the recipient of a U.S.$85 billon "bailout" package from the U.S. Government. *See* CNN U.S., AIG names recipients of its bailout money, *available at* http://articles.cnn.com/2009-03-15/us/AIG.banks.list_1_aig-federal-bailout-money-bonuses-and-compensation ?_s=PM:US (last accessed Feb. 25, 2011) & Justin Fox, Financial Meltdowns: How Big a Blow?, *available at* http://www.time.com/time/business/article/0,8599,1841214,00.html (last accessed Feb. 25, 2011).

4. FCIC Report, *supra* note 2. According to the FCIC Report,

   > [t]he crisis reached seismic proportions in September 2008 with the failure of Lehman Brothers and the impending collapse of the insurance giant [AIG]. Panic fanned by a lack of transparency of the balance sheets of major financial institutions, coupled with a tangle of interconnections among institutions perceived to be 'too big to fail,' caused the credit markets to seize up. Trading ground to a halt. The stock market plummeted. The economy plunged into a deep recession.

   Id. at *xvi*.

scrambled to contain the damage and salvage their banks from imminent breakdown.[6] Taking cue from the U.S. $700 billion rescue package passed by the U.S. Congress in early October 2008, countries like the United Kingdom, Japan, Russia, and the United Arab Emirates, have made available billions of dollars in emergency credit to provide liquidity to their banks.[7] The central banks of affected countries, such as Canada, Sweden, and Switzerland, together with the U.S. Federal Reserve, the European Central Bank, and the Bank of England, have also cut interest rates to ease the credit crunch.[8] The terms "bail-out" and "rescue package" became the buzzwords that filled the front page of newspapers, while "bankruptcy" and "bank closures" became the talk that struck fear and panic in the hearts of many.[9]

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5. *See* Sayuri Shirai, The Impact of the US Subprime Mortgage Crisis on the World and East Asia: Through Analyses of Cross-border Capital Movements (A Part of the Discussion Paper Series of the Economic Research Institute for ASEAN and East Asia) 1, *available at* http://www.eria.org/pdf/ERIA-DP-2009-10.pdf (last accessed Feb. 25, 2011).

6. *See* Jeffrey E. Garten, The Big Bang of Bailouts, *available at* http://www.newsweek.com/2008/12/12/the-big-bang-of bailouts.html (last accessed Feb. 25, 2011). The Article states that

   > Europe's combined effort has been just as aggressive. A new study by the Independent Strategy of London puts the total spent by the nine leading European economies on various moves just to shore up wobbling banks at $3.36 trillion, versus $3.35 trillion by the United States. While the Bush administration's March stimulus package came to [one] percent of U.S. GDP, France, Germany, Italy[,] and many other European nations have already produced packages that are relatively larger. And nearly every central bank on the planet has dropped interest rates so fast and so far that the banks can no longer use this basic weapon to get their economies moving.

   Garten, *supra* note 6.

7. BBC News, Financial crisis: World Round-up, *available at* http://news.bbc.co.uk/2/hi/7654647.stm (last accessed Feb. 25, 2011).

8. BBC News, Timeline: Credit Crunch to Downturn, *available at* http://news.bbc.co.uk/2/hi/7521250.stm (last accessed Feb. 25, 2011).

9. In fact, the word "bailout" was named Merriam-Webster's Dictionary's 2008 Word of the Year, as it was the most looked-up word on the dictionary's website. Five words in the dictionary's list of top looked-up terms for 2008 pertained to the global financial crisis. *See* Sign of the Times: *'Bailout' declared word of the year*, PHIL. DAILY INQ., Dec. 5, 2008, *available at* http://newsinfo.inquirer.net/ breakingnews/ world /view/20081205-176232/Bailout-declared-word-of-the-year (last accessed Feb. 25, 2011).

For its part, the Philippines reacted promptly to the crisis and took important steps to institute reforms in direct response to it. On 1 June 2009, Congress passed Republic Act (R.A.) No. 9576,[10] which increased the maximum deposit insurance coverage (MDIC) provided by the Philippine Deposit Insurance Corporation (PDIC) from ₱250,000.00 to ₱500,000.00.[11] The increase was sought principally to increase confidence in our banking industry and to shield depositors from bank failures and the impending impact of the global financial crisis.[12] R.A. No. 9576 also included measures[13] to strengthen the protection of legitimate deposits and to

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10. An Act Increasing the Maximum Deposit Insurance Coverage, and in Connection Therewith, to Strengthen the Regulatory and Administrative Authority, and Financial Capability of the Philippine Deposit Insurance Corporation (PDIC), Amending For This Purpose Republic Act Numbered Three Thousand Five Hundred Ninety-One, As Amended, Otherwise Known As The PDIC Charter, And For Other Purposes, Republic Act No. 9576 (2009).

11. *Id.* § 4. This Section provides:

> Section 4. The maximum deposit insurance coverage of [f]ive hundred thousand pesos (₱500,000.00) provided in Section 4 (g) of Republic Act [No.] 3591, as amended herein, shall be paid by the Corporation: *Provided*, That for the first three (3) years from the effectivity of this Act, the first [t]wo hundred fifty thousand pesos (₱250,000.00) of the deposited insurance coverage shall be for the account of the Corporation, and those in excess of [t]wo hundred fifty thousand pesos (₱250,000.00) but not more than [f]ive hundred thousand pesos (₱500,000.00) shall be for the account of the National Government. The Congress shall annually appropriate the necessary funding to reimburse the Corporation for any payment to insured depositors paid in excess of [t]wo hundred fifty thousand pesos (₱250,000.00).

Id.

12. *Id.* § 1.

13. *See* R.A. No. 9576, §§ 2, 5, & 11. The following can be gleaned from the said Sections:

(a) Authority granted to the PDIC to exclude certain deposit products from deposit insurance coverage such as those which are "unfunded, or [ ] are fictitious or fraudulent," or "emanating from unsafe or unsound banking practices" or anti-money laundering activities. R.A. No. 9576, § 2;

(b) Authority given to the PDIC to conduct "special examination" of banks independent of the Bangko Sentral ng Pilipinas (BSP). *Id.* § 5;

reinforce the regulation of banks in a bid to arrest "illegal schemes and machinations" that threaten the stability of the country's banking system.[14]

The worst part appears to be over. However, conventional wisdom and the benefit of hindsight dictate an evaluation of the financial and regulatory frameworks in place in order to fortify that which proved constructive and to reform whatever proved inadequate in preventing and dealing with a crisis. A case in point is the framework by which failed banking institutions are resolved by regulatory agencies. The series of bank closures in the U.S.,[15] an unfortunate consequence of the crisis, underscored the import of a functional liquidation or resolution framework for failed banks.

This Article examines the Philippine laws on bank liquidation and enumerates, based on foreign and local experience, vital proposals for their reform. When a financial crisis cannot be averted and bank failure is imminent, the next best defense is a framework in which bank failures are handled in a confident, efficient, and prompt manner, allowing for flexibility on the part of the liquidator to accomplish its tasks and with minimum negative impact on the stability of the financial system. The purpose of this Analysis is to evaluate the present framework in light of the issues and concerns that pervade the existing process and to recommend essential measures that may be the subject of legislative action.

II. BANK REGULATION IN THE PHILIPPINES

The General Banking Law of 2000[16] sums up the public interest involved in the business of banking and the State's interest in its continued stability and efficiency, thus:

> Sec. 2. Declaration of Policy. — The State recognizes the vital role of banks providing an environment conducive to the sustained development of the national economy and the fiduciary nature of banking that requires high standards of integrity and performance. In furtherance thereof, the

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(c) Authority of the PDIC and the BSP to inquire into or examine deposit accounts when there is a finding of unsafe or unsound banking practice. *Id.* § 5; and

(d) Amplification of the period within which deposit splitting is determined. *Id.* § 11.

14. *Id.* § 1.

15. *See* FCIC Report, *supra* note 2.

16. An Act Providing for the Regulation of the Organization and Operations of Banks, Quasi-Banks, Trust Entities and for Other Purposes [General Banking Law of 2000], Republic Act No. 8791 (2000).

> State shall promote and maintain a stable and efficient banking and financial system that is globally competitive, dynamic[,] and responsive to the demands of a developing economy.[17]

There are two agencies which are tasked with the regulation of banks in the country: the Bangko Sentral ng Pilipinas (BSP) and the PDIC.

The BSP is the primary regulator of banks. Created on 3 July 1993 pursuant to the provisions of the 1987 Philippine Constitution[18] and R.A. No. 7653 or the New Central Bank Act,[19] the BSP took over from the Central Bank of the Philippines[20] as the country's central monetary authority. As such, the BSP, though a government-owned corporation, enjoys fiscal and administrative autonomy.[21]

As the central monetary authority, the BSP is the sole entity empowered to "issue currency" in the country.[22] The BSP likewise serves as the financial advisor of the Government.[23] As such, the Secretary of the Department of Finance (DOF), acting in behalf of the Government, is mandated to seek, in writing, the Monetary Board's opinion on the consequences of any overseas credit operations it plans to undertake.[24] The BSP is also "the official depository of the Government, its political subdivisions, and instrumentalities,"[25] and acts as its agent in the issuance of securities representing their obligations.[26] As a "lender of last resort"[27] for banks, the

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17. *Id.* § 2.
18. PHIL. CONST. art. XII, § 20.
19. The New Central Bank Act, Republic Act No. 7653, § 2 (1993).
20. An Act Establishing the Central Bank of the Philippines, Defining its Powers in the Administration of the Monetary and Banking System, Amending the Pertinent Provisions of the Administrative Code with Respect to the Currency and the Bureau of Banking, and for Other Purposes, Republic Act No. 265 (1948).
21. R.A. No. 7653, § 1.
22. *Id.* § 50.
23. *See generally* R.A. No. 7653, ch. 5, art. III. This Chapter deals with the functions of the BSP as financial advisor of the Government.
24. R.A. No. 7653, § 123.
25. *Id.* § 113.
26. *Id.* §§ 117-119.
27. Bangko Sentral ng Pilipinas, Overview of Functions and Operations, *available at* http://www.bsp.gov.ph/about/functions.asp (last accessed Feb. 25, 2011).

BSP "extends discounts, loans[,] and advances" to provide them liquidity under certain conditions.[28]

But the more important task of the BSP is the supervision it exercises over the operations and activities of banks.[29] The General Banking Law of 2000 provides that "supervision" includes:

> 4.1 The issuance of rules of conduct or the establishment of standards of operation for uniform application to all institutions or functions covered, taking into consideration the distinctive character of the operations of institutions and the substantive similarities of specific functions to which such rules, modes[,] or standards are to be applied;
>
> 4.2 The conduct of examination to determine compliance with laws and regulations if the circumstances so warrant as determined by the Monetary Board;
>
> 4.3 Overseeing to ascertain that laws and regulations are complied with;
>
> 4.4 Regular investigation which shall not be oftener than once a year from the last date of examination to determine whether an institution is conducting its business on a safe or sound basis: *Provided*, That the deficiencies/irregularities found by or discovered by an audit shall be immediately addressed;
>
> 4.5 Inquiring into the solvency and liquidity of the institution; or
>
> 4.6 Enforcing prompt corrective action.[30]

Alongside the BSP, the PDIC is considered as a "co-regulator of banks."[31] The PDIC was created in 1963 with an original charter, R.A. No. 3591,[32] with a mandate to protect, through deposit insurance,[33] the depositors of banks, "commercial banks, savings banks, mortgage banks, rural banks, development banks, cooperative banks, stock savings and loan associations, branches and agencies in the Philippines of foreign banks, and

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28. R.A. No. 7653, §§ 83-84.

29. *Id.* § 3.

30. General Banking Law of 2000, § 4.

31. *See* Mitchelle L. Palaubsanon, *PDIC takes over embattled banks*, PHIL. STAR, Dec. 13, 2008, *available at* http://www.philstar.com/Article.aspx?articleid=423586 (last accessed Feb. 25, 2011).

32. An Act Establishing the Philippine Deposit Insurance Corporation, Defining its Powers and Duties and for Other Purposes, Republic Act No. 3591, As Amended (1963).

33. *Id.* § 1.

all other corporations authorized to perform banking functions in the Philippines."[34] It is a government entity "attached to the [DOF]."[35]

The PDIC's principal mandate is the insurance of deposits in the Philippines.[36] It insures the deposit liabilities of any bank or banking institution which is engaged in the business of receiving deposits, as defined by the PDIC's Charter, up to the MDIC of ₱500,000.00 per depositor.[37]

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34. *See* R.A. No. 3591, § 4 (b). The definition of a "bank" or a "banking institution" is provided in this Section.

35. Philippine Deposit Insurance Corporation, Corporate Profile, *available at* http://www.pdic.gov.ph/index.php?nid1=1 (last accessed Feb. 25, 2011).

36. R.A. No. 3591, § 1.

37. *Id.* § 5. *See also* R.A. No. 3591, § 4 (f) & (g). These Paragraphs provide:

> (f) The term 'deposit' means the unpaid balance of money or its equivalent received by a bank in the usual course of business and for which it has given or is obliged to give credit to a commercial, checking, savings, time or thrift account, or issued in accordance with Bangko Sentral rules and regulations and other applicable laws, together with such other obligations of a bank, which, consistent with banking usage and practices, the Board of Directors shall determine and prescribe by regulations to be deposit liabilities of the bank: *Provided*, That any obligation of a bank which is payable at the office of the bank located outside of the Philippines shall not be a deposit for any of the purposes of this Act or included as part of the total deposits or of insured deposit: *Provided, further*, That, subject to the approval of the Board of Directors, any insured bank which is incorporated under the laws of the Philippines which maintains a branch outside the Philippines may elect to include for insurance its deposit obligations payable only at such branch.
>
> The Corporation shall not pay deposit insurance for the following accounts or transactions, whether denominated, documented, recorded or booked as deposit by the bank:
>
> (1) Investment products such as bonds and securities, trust accounts, and other similar instruments;
>
> (2) Deposit accounts or transactions which are unfunded, or that are fictitious or fraudulent;
>
> (3) Deposit accounts or transactions constituting, and/or emanating from, unsafe and unsound banking practice/s, as determined by the Corporation, in consultation with the BSP, after due notice and hearing, and publication of a cease

Proceeding from its deposit insurer role, the PDIC is made a co-regulator of banks with the end of ensuring the integrity of the deposit insurance system.[38] The function of deposit insurance in bringing stability to the banking industry is best achieved when regulators are able to effectively enforce prudent regulation and supervision over banks and banking institutions.[39]

> and desist order issued by the Corporation against such deposit accounts or transactions; and
>
> (4) Deposits that are determined to be the proceeds of an unlawful activity as defined under Republic Act [No.] 9160, as amended.
>
> ...
>
> (g) The term 'insured deposit' means the amount due to any bona fide depositor for legitimate deposits in an insured bank net of any obligation of the depositor to the insured bank as of the date of closure, but not to exceed [f]ive hundred thousand pesos (₱500,000.00).

R.A. No. 3591, § 4 (f) & (g).

38. *See* R.A. No. 3591, § 7. This Section provides for the sanctions against unsafe and unsound banking practices.

39. *See generally* Association of Supervisors of Banks of the Americas, Effective Deposit Insurance Schemes and Bank Resolution Practices 7, 14, & 17, *available at* http://www.asbaweb.org/ Grupos/libros/ fscommand/doc5.pdf (last accessed Feb. 25, 2011) [hereinafter Effective Deposit Insurance Schemes]. This Report states that

> [e]ffective deposit insurance systems [(DIS)] and bank resolution programs strengthen and contribute to the stability of financial systems. Thus, it is recommended that these systems be supported by laws and practices that empower supervisors and deposit insurance agents to properly evaluate banking risks and promptly take any necessary corrective measures.
>
> ...
>
> While deposit insurance is needed to instill public confidence and enhance financial sector stability, regulators and supervisors must complement the mission of the DIS with robust supervisory programs that ensure that risk taking is appropriately supervised and that moral hazard is constrained.
>
> ...
>
> Supervisory authorities need a strong legal framework to ensure financial stability. They should have the authority and the regulatory tools needed to achieve their objective of maintaining a sound and safe

More pertinent to our discussion is the vital role that the PDIC plays in the receivership and liquidation of banking institutions in the country. The PDIC Charter provides that "whenever the Monetary Board of the [BSP] shall deem it appropriate to appoint a receiver of any banking institution, it shall appoint the PDIC as the statutory receiver."[40] As receiver of closed banks, the PDIC is given the control, management, and administration of the bank's affairs.[41] It can exercise a broad range of authorities which include, among others, the power to bring suits in behalf of the bank;[42] to suspend or terminate its officers and employees;[43] to borrow loans;[44] to "mortgage, pledge[,] or encumber any asset of the closed bank;"[45] and to reduce the stipulated interest on deposits if it is "unusually high" relative to the prevailing rate.[46]

Under the present organizational structure of the PDIC, the Governor of the BSP is an *ex-officio* member of the PDIC Board of Directors,[47] which creates for better coordination and cooperation between the two institutions.

III. DEALING WITH BANKS IN DISTRESS

A. Prompt Corrective Action

One of the authorities of the BSP under the General Banking Law of 2000 is the enforcement of "prompt corrective action" (PCA).[48] A PCA refers to the intervention of the regulatory body, such as the BSP, into the affairs of a

> financial system. The legal framework should also equip the supervisory authorities to adhere to appropriate international standards as well as industry and supervisory best practices.

Effective Deposit Insurance Schemes, *supra* note 39, at 7, 14, & 17.

40. R.A. No. 3591, § 10 (a).
41. *Id.* § 10 (b).
42. *Id.* § 10 (c) (1).
43. *Id.* § 10 (c) (3).
44. *Id.* § 10 (c) (7).
45. *Id.*
46. R.A. No. 3591, § 10 (c) (8).
47. *Id.* § 2 (b).
48. General Banking Law of 2000, § 4 (6).

bank found to be not complying with certain standards or conditions.[49] Its goal is to restore, within "reasonable time," a bank to its "normal operations."[50]

The PCA program of the BSP was originally implemented through the issuance of BSP Circular (BSP Circ.) No. 181[51] in 1998. The Circular contained the policy guidelines for banks which do not adhere to the required minimum capital.[52] The BSP approved an expanded version of the PCA program with the promulgation of BSP Circ. No. 523[53] in 2006 to allow for the enforcement of the PCA not only when the bank fails to meet the capital requirements, but also when its "condition indicates higher-than-normal risk of failure."[54]

BSP Circ. No. 523 states that a bank may be subject to PCA whenever any of the following conditions are present:

(1) The bank's prescribed capital ratios (Total Risk-Based Ratio, Tier 1 Risk-Based Ration, or Leverage Ratio) fall below the minimum;

(2) Either the bank's Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Sensitivity (CAMELS) composite rating, or its Management component rating is less than "3;" or

(3) The bank faces a "more-than-normal risk of failure" due to a serious supervisory concern.[55]

The Circular likewise explains what a PCA entails, thus:

> PCA essentially involves the BSP directing the board of directors of a bank prior to an open outbreak of crisis, to institute strong measures to restore the entity to normal operating condition within a reasonable period, ideally

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49. Bangko Sentral ng Pilipinas, BSP Issues Policy Guidelines on the Enforcement of Prompt Corrective Action, *available at* http://www.bsp.gov.ph/publications/media_archives.asp?id=898&yr=2006 (last accessed Feb. 25, 2011).

50. *Id.*

51. Bangko Sentral ng Pilipinas, BSP Circular No. 181, Series of 1998 [BSP Circ. No. 181] (Nov. 14, 1998).

52. *Id.*

53. Bangko Sentral ng Pilipinas, Prompt Corrective Action Framework, BSP Circular No. 523, Series of 2006 [BSP Circ. No. 523] (Mar. 23, 2006).

54. *Id.*

55. *Id.*

within one year. These measures may include any or all of the following components:

(1) Implementation of a capital restoration plan;

(2) Implementation of a business improvement plan; and

(3) Implementation of corporate governance reforms.[56]

The BSP directives on the measures that the bank under PCA status has to implement is embodied in a Memorandum of Understanding (MOU) executed between the BSP and the bank; and by entering into the MOU, the bank obligates itself to adhere to the PCA plan.[57]

On one hand, in cases of "exceptionally serious" problems, refusal to submit to the PCA or lack of ability to "substantially comply" with the MOU, more severe measures may be recommended by the BSP to the Monetary Board.[58] These include conservatorship under Section 29 and receivership under Section 30 of the New Central Bank Act.[59] On the other hand, when the bank "fully complies with the terms and conditions of the MOU" and the BSP issues an assessment that the bank's "financial and operational condition no longer presents a risk to itself or the financial system," its PCA status may be removed.[60]

The concept of PCA is neither novel nor unique to the Philippines. In the U.S., the PCA was part of a set of measures introduced through the enactment in 1991 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA).[61] The PCA provisions of FDICIA provide for "supervisory responses" when there is deterioration in bank capital.[62] Well-

56. *Id.*

57. *Id.*

58. *Id.*

59. BSP Circ. No. 523.

60. *Id.*

61. Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. § 1811 (2006) (U.S.).

62. Maria J. Nieto & Larry D. Wall, Preconditions for a Successful Implementation of Supervisors' Prompt Corrective Action: Is There a Case for a Banking Standard in the European Union? (A Part of the Working Paper Series of the Federal Bank of Atlanta) 4, *available at* http://www.frbatlanta.org/filelegacy docs/wp0627.pdf (last accessed Feb. 25, 2011).

capitalized or adequately capitalized banks operate under fewer limitations.[63] For banks with relatively low capital ratios, bank activities are limited, and when its "tangible equity capital drops below two per cent of total assets," the bank, within a period of 90 days, will be required to go into receivership.[64]

Countries such as Japan, Korea, and Mexico have adopted a similar scheme where standardized capital/asset ratios determine the activation of structured regulatory measures.[65] Under this uniform system, "a minimum regulatory capital ratio is predetermined, at which level, banks are resolved either through sale, merger, or liquidation."[66]

B. Conservatorship

A bank in distress may be placed under conservatorship pursuant to Section 29 of the New Central Bank Act when the Monetary Board finds that it cannot or will not "maintain a condition of liquidity deemed adequate to protect the interest of depositors and creditors."[67] A conservator shall be appointed by the Monetary Board with such powers as may be necessary to:

(1) To take charge of the bank's assets, liabilities, and the management thereof;

(2) To reorganize the management [of the bank];

(3) To collect all monies and debts due said institution; and

(4) To exercise all powers necessary to restore its viability.[68]

The conservator is directly answerable to the Monetary Board and can make null and void the actions of the bank's management.[69] The period of conservatorship shall not be longer than one year, unless sooner terminated because the banks can already operate independently, making the

63. R. Alton Gilbert, The Effects of Legislating Prompt Corrective Action on the Bank Insurance Fund 3, *available at* http://research.stlouisfed.org/publications/review/92/07/Prompt_Jul_Aug1992.pdf (last accessed Feb. 25, 2011).

64. *Id.* at 4.

65. *Id.* at 1.

66. *Id.*

67. The New Central Bank Act, § 29.

68. *Id.*

69. *Id.*

conservatorship unnecessary, or when losses will probably be incurred by its depositors or creditors if it continues in business.[70]

In the Philippines, a conservatorship is established primarily for the "[preservation of] assets and [restoration of] the viability of a financially precarious bank."[71] However, the provisions of the New Central Bank Act do not expressly grant the conservator the power to dispose or transfer the assets and liabilities of the bank.[72] As practiced in the country, conservatorship is a remedial measure that may be utilized to aid an ailing bank.[73] It is a power distinct from receivership, which contemplates a closed bank.[74] Simply put, conservatorship is a preliminary step that *may* be undertaken *before* a bank is closed and placed under receivership pursuant to Section 30 of the New Central Bank Act.

To compare, in the U.S., conservatorship has a broader application and is deemed an alternative to receivership. In fact, the grounds for the appointment of a conservator and that for a receiver are the same under U.S. banking laws as enumerated under the Federal Deposit Insurance Act (FDIA).[75] A conservator (which may be the Federal Deposit Insurance

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70. *Id.*

71. Producers Bank of the Philippines v. NLRC, 355 SCRA 489, 500 (2001).

72. *See, e.g.*, First Philippine International Bank v. Court of Appeals, 252 SCRA 259, 307 (1996). In this Case, the Supreme Court held that a conservator may not unilaterally revoke a valid and enforceable contract that a bank had previously entered before his appointment as conservator. It further held that

> [t]o rule otherwise would be to enable a failing bank to become solvent, at the expense of third parties, by simply getting the conservator to unilaterally revoke all previous dealings which had one way or another come to be considered unfavorable to the bank, yielding nothing to perfected contractual rights nor vested interest of the third parties who had dealt with the bank.

First Philippine International Bank, 252 SCRA at 307.

73. *See* The New Central Bank Act, § 29. One of the conditions for the Monetary Board to terminate the conservatorship is its satisfaction that "the institution can continue to operate on its own and the conservatorship is no longer necessary." The New Central Bank Act, § 29.

74. *See, e.g.*, Banco Filipino Savings & Mortgage Bank v. Monetary Board, Central Bank of the Philippines, 204 SCRA 767, 800 (1991). The state in which a bank may be placed under receivership is a one of insolvency, which is the condition that exists when the liabilities of a bank are greater than its realizable assets. *Banco Filipino Savings & Mortgage Bank*, 204 SCRA at 800.

75. Federal Deposit Insurance Act, Pub. L. 109-171, 110 Stat. 9 (U.S.).

Corporation or the FDIC) may be appointed whenever it is determined that "one or more of the grounds found under Section 11 (c) (5) of the [FDIA] exist."[76] The conservator appointed is then vested with all the "powers of the shareholders, directors, and officers of the bank and may operate the bank in its own name."[77] Section 11 (d) of the Act also vests the conservator with almost the same set of powers, duties, and authorities as a receiver.[78]

Clearly, the concept of conservatorship in the Philippines is more confined in theory and application when compared to the concept as established and used in the U.S. The powers and functions of a conservator appointed for banks in the Philippines are far more limited than the authorities granted to their U.S. counterparts. Through such broad powers, a conservator in the U.S. does not only encompass the management and day-to-day operations of the bank; it can virtually take any action necessary to restore the bank to a sound and solvent condition.

C. Receivership

The heart of the Philippines' bank liquidation process is found in Section 30 of the New Central Bank Act. It is a two-phased process that begins with

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76. Bank Conservation Act, 12 U.S.C. § 203 (a) (2006) (U.S.). *See also* 12 U.S.C. § 1821 (2006) (U.S.). The grounds stated are:

    (a) Assets insufficient for obligations;
    (b) Substantial dissipation;
    (c) Unsafe or unsound condition;
    (d) Cease and desist orders;
    (e) Concealment;
    (f) Inability to meet obligations;
    (g) Losses;
    (h) Violations of law;
    (i) Consent;
    (j) Cessation of insured status;
    (k) Undercapitalization;
    (l) Critically undercapitalized institution, or otherwise has substantially insufficient capital; and
    (m) Money laundering offense.

    12 U.S.C. § 1821 (a) (5).

77. 12 U.S.C. § 206.
78. 12 U.S.C. § 1821.

the Monetary Board placing a bank under the receivership of the PDIC, thus:

> Section 30. Proceedings in Receivership and Liquidation. — Whenever, upon report of the head of the supervising or examining department, the Monetary Board finds that a bank or quasi-bank:
>
> (a) is unable to pay its liabilities as they become due in the ordinary course of business: *Provided*, That this shall not include inability to pay caused by extraordinary demands induced by financial panic in the banking community;
>
> (b) has insufficient realizable assets, as determined by the Bangko Sentral, to meet its liabilities;
>
> (c) cannot continue in business without involving probable losses to its depositors or creditors; or
>
> (d) has willfully violated a cease and desist order under Section 37 that has become final, involving acts or transactions which amount to fraud or a dissipation of the assets of the institution; in which cases, the Monetary Board may summarily[,] and without need for prior hearing[,] forbid the institution from doing business in the Philippines and designate the Philippine Deposit Insurance Corporation as receiver of the banking institution.[79]

Upon appointment, the receiver shall

> immediately gather and take charge of all the assets and liabilities of the institution, administer the same for the benefit of its creditors, and exercise the general powers of a receiver under the Revised Rules of Court[,] but shall not, with the exception of administrative expenditures, pay or commit any act that will involve the transfer or disposition of any asset of the institution: *Provided*, That the receiver may deposit or place the funds of the institution in non-speculative investments. The receiver shall determine as soon as possible, but not later than ninety (90) days from takeover, whether the institution may be rehabilitated or otherwise placed in such a condition so that it may be permitted to resume business with safety to its depositors and creditors and the general public: *Provided*, That any determination for the resumption of business of the institution shall be subject to prior approval of the Monetary Board.[80]

79. R.A. No. 7653, § 30.

80. *Id.*

"Receivership" and "liquidation" are two distinct concepts or processes in Philippine law.[81] Receivership refers to the 90-day period that ensues after a bank is ordered closed by the Monetary Board pursuant to the bases under Section 30 of the New Central Bank Act.[82] The PDIC is, by law, the sole entity that may be appointed by the Monetary Board as the receiver of a closed bank, as emphasized by the PDIC Charter, thus:

> Section 10. (a) The provisions of other laws, general or special, to the contrary notwithstanding, whenever it shall be appropriate for the Monetary Board of the Bangko Sentral ng Pilipinas to appoint a receiver of any banking institution pursuant to existing laws, *the Monetary Board shall give prior notice and appoint the Corporation as receiver*.[83]

Once placed under receivership, the closed bank is under the control of and its assets are "deemed in *custodia legis* in the hands of the receiver."[84]

D. Liquidation

When the bank can no longer be "rehabilitated or permitted to resume business," a written notice shall be sent by the Monetary Board to the bank's board of directors, and the receiver shall be ordered to proceed with the liquidation of the bank.[85] At this point, the receiver is directed to:

> (1) file *ex parte* with the proper regional trial court, and without requirement of prior notice or any other action, a petition for assistance in the liquidation of the institution pursuant to a liquidation plan adopted by the Philippine Deposit Insurance Corporation for general application to all closed banks[;]
>
> ...
>
> (2) convert the assets of the institutions to money, dispose of the same to creditors and other parties, for the purpose of paying the debts of such institution in accordance with the rules on concurrence and preference of credit under the Civil Code of the Philippines[,] and he may, in the name of the institution, and with the assistance of counsel as he may

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81. *Id.* When a bank is placed under receivership, the receiver may still determine whether a bank "may be rehabilitated or placed in a condition that would allow it to resume business with safety to its depositors, and creditors and the general public." Liquidation, however, contemplates a situation when rehabilitation is no longer possible. *See* R.A. No. 7653, § 30, ¶ 4.
82. R.A. No. 7653, § 30, ¶ 4.
83. R.A. No. 3591, § 10 (a) (emphasis supplied).
84. R.A. No. 7653, § 30 & R.A. No. 3591, § 10 (b).
85. R.A. No. 7653, § 30.

> retain, institute such actions as may be necessary to collect and recover accounts and assets of, or defend any action against, the institution.[86]

The actual liquidation process begins with the filing in the appropriate Regional Trial Court of a Petition for Assistance in Liquidation (PAL) by the PDIC in its capacity as the statutory liquidator of closed banks.[87] The court acquiring jurisdiction over the petition shall "adjudicate disputed claims against the [closed bank], assist the enforcement of individual liabilities of the stockholders, directors[,] and officers, and decide on other issues as may be material to implement the liquidation plan adopted."[88]

The liquidator shall then pay the debts of the closed bank, taking into account the rules on concurrence and preference of credits as provided in the Civil Code.[89] Nonetheless, "reasonable receivership expenses" as well as liquidation expenses, as approved by the court, may be charged against the bank's assets before they are distributed.[90]

The costs of proceedings, salaries of personnel employed during the liquidation, and other additional expenses shall be paid with whatever revenues and earnings are realized during the winding up of the bank's affairs.[91] Any balance shall accrue to the pool of assets to be used to discharge liabilities to creditors.[92] After this, surplus dividends shall be paid to creditors and claimants before the shareholders of the bank.[93] This shall be at the "legal rate of interest from date of takeover to date of distribution."[94]

The banking franchise of a bank under liquidation may, in the interest of the public, be awarded to an institution, on the condition that the Monetary Board shall have exclusive disposition over the appropriation of any proceeds realized from such award.[95]

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86. *Id.*
87. *Id.*
88. *Id.*
89. *Id.* § 31. *See also* An Act to Ordain and Institute the Civil Code of the Philippines [CIVIL CODE], Republic Act No. 386, bk. 4, tit. XIX (1950). This Title deals with the rules on concurrence and preference of credits.
90. R.A. No. 3591, § 12.
91. R.A. No. 7653, § 32.
92. *Id.*
93. R.A. No. 3591, § 12.
94. *Id.*
95. R.A. No. 7653, § 33.

III. PROPOSED REFORMS IN THE BANK LIQUIDATION LAWS

The primary goal of bank regulation is to promote a sound and stable financial system.[96] But regulation also extends to such time when a bank is closed down by the Monetary Board of the BSP, liquidated, and its affairs wound up by the PDIC pursuant to existing laws.[97] Thus, bank regulation must also result to efficient processes when dealing with failing institutions in order to "ensure the least disruption to the financial system, the preservation of the public's confidence in the banking industry, and the protection of the bank's creditors, most especially its depositors."[98]

In the performance of its functions as receiver and liquidator, the PDIC perennially encounters issues and problems that unduly protract the process of closed bank liquidation, diminish the value of the convertible assets of the closed bank, or prejudice the closed bank's creditors. The following reforms, rooted in the experience and problems encountered under the current practice, are aimed to reflect the practicalities of the actual closed bank liquidation process, and to augment the conversion of the assets of the closed bank and the settlement of its obligations.

A. Removal of the 90-day Receivership Period

Ideally, the 90-day mandatory receivership period prescribed by Section 30 of the New Central Bank Act is the time when the regulators determine whether the closed bank "may be rehabilitated or otherwise placed in such a condition so that it may be permitted to resume business with safety to its depositors and creditors and the general public."[99] However, the existing process is such that "rehabilitation is no longer feasible" after closure.[100]

Two related factors come to mind to explain why the success rate for the rehabilitation of closed banks is dismally so.

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96. *See* General Banking Law of 2000, § 2.

97. *See* An Act Providing for the Takeover, Liquidation, and Winding Up of a Closed Banking Institution, S.B. No. 2128, 15th Cong., 1st Sess. (July 27, 2010). In his Explanatory Note, Senator Edgardo J. Angara states that "[t]o be responsive and thorough, bank regulation must likewise deal with the systematic and efficient process for handling banking institutions when they fail." S.B. No. 2128.

98. *Id.*

99. R.A. No. 7653, § 30.

100. S.B. No. 2128.

The first factor has to do with the unreasonably extended period within which a failing bank is allowed to undertake corrective measures and business improvement plans prior to being placed under conservatorship or receivership. It is a situation which is inevitable under the general framework for the implementation of the PCA and compounded by the limited grounds for placing a bank under conservatorship or receivership. As succinctly observed in the International Monetary Fund (IMF) Financial System Stability Assessment Update on the Philippines:

> The periods for corrective actions are overly long. In case of supervisory concerns following an examination, a bank is obliged to take 'required' (in case of safety and soundness concerns) or 'expected' actions. 'Required' actions should be taken within 90 days; the timeline for 'expected' actions is not defined, and often stretches over several months. If a bank has failed to take 'required' actions, or meets the conditions for PCA under [BSP Circ. No. 523], it is placed under PCA. Once under PCA, a bank has 30 days to submit an MOU, and 90 days to implement it. *While the bank is encouraged by the BSP to correct its deficiencies within one year, it may be allowed a maximum of [three] years under the MOU if capital deficiencies are very large.*
>
> *The BSP's authority to place a bank in receivership or suspend shareholder rights, even when a bank is very close to failure, is strictly circumscribed in the law.* PCA failure of a critically undercapitalized bank does not necessarily mean that a bank goes into conservatorship or receivership; the conditions for conservatorship or receivership as defined in the law do not include a specific capital threshold. Moreover, the law or regulations do not specify a time period within which critically undercapitalized banks must be capitalized or be put into receivership. Furthermore, once a bank is placed in receivership there is a 90-day period during which shareholders could seek to rehabilitate [the] failed bank. [101]

The delay in placing a failing bank under receivership contributes significantly to the incidence of the second factor, i.e., the decrepit financial condition of the banks upon closure. From 2005 to 2009 alone, all the 93 banks that were ordered closed within the period had negative capital averaging from about ₱90.73 million for 17 banks closed in 2007 to as high as ₱258.62 million for all 25 banks closed in 2008.[102]

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101. International Monetary Fund Monetary and Capital Markets and Asia and Pacific Departments, Philippines: Financial System Stability Assessment Update, IMF Country Report No. 10/90 23, *available at* http:// www.imf.org/ external/ pubs/ft/scr/2010/cr1090.pdf (last accessed Feb. 25, 2011) [hereinafter Financial System Stability Assessment Update] (emphasis supplied).

102. Philippine Deposit Insurance Corporation, Paper Submitted to the Department of Finance, Annex B (on file with author).

The steep capital deficiency of the banks upon their placement under receivership serves little to attract strategic third party investors, and tends to offset whatever franchise value is attributable to the closed bank. Securing a new banking license may even be cheaper to third parties than investing in the closed bank. These considerations virtually negate the chances of a successful recovery after closure.

The foregoing factors notwithstanding, the PDIC, as receiver, must comply with the law and must wait until the 90-day receivership period lapses. Within this period, it only exercises administrative powers over the remaining assets of the closed bank and is explicitly prohibited from transferring or disposing such assets, except to pay administrative expenditures.[103] During the lag time between closure and actual liquidation, the receiver incurs expenses for the maintenance, preservation, and security of the assets of the closed bank, which it holds in *custodia legis*.[104] This translates to an average of ₱1,210,934.77 per bank that was expended for asset administration and manpower services during the receivership period.[105]

Thus, it is proposed that the mandatory 90-day receivership period prior to liquidation under Section 30 of the New Central Bank Act be removed to allow for an automatic or seamless transition from bank closure to liquidation.

The regulatory measures available while the bank is still operating, such as the PCA and other quick resolution methods, should be optimized and implemented adequately to rehabilitate a distressed bank. The regulators' intervention should be triggered at the first sign of distress and the corrective measures imposed on the bank must be monitored closely to ensure strict compliance. However, when the Monetary Board issues the order which closes the bank, the BSP should be expected to have exhausted all opportunities for the rehabilitation of the bank and to have passed upon the viability thereof. In so doing, after closure, all that should be left to do is for the PDIC to liquidate the closed bank.

The seamless transition is similar to the policy observed in the U.S., which finds legal basis in the FDIA. The supervisory measures are taken

103. R.A. No. 3591, § 10 (b).

104. *Id.*

105. *Id.*

while the bank is still alive in order to "minimize risk of failure."[106] Once a bank is closed, receivership begins, leading to the liquidation of assets.[107] This system is calculated to promptly respond to circumstances that could result in "risk of loss or damage to a financial institution."[108]

The counter-argument may be raised that, given the insidious effect of closing a bank, not only on the community it serves, but also on the deposit insurance fund, all possible opportunities for rehabilitating a bank, whether through the bank owners themselves, third party investors, or even by a grouping of the depositors, should be allowed. However, it is submitted that all such efforts should be explored and evaluated prior to actual closure under Section 30 of the New Central Bank Act. The stigma attached to bank closures and the huge capital gap that the closed bank has by the time it is closed negatively impacts the chances for success of any rehabilitation plan. Hence, the data derived from the PDIC's experience over the years that show that the 90-day period after closure has not been useful or beneficial in giving a second life to closed banks. On the contrary, the available information indicates that the receivership period merely delays the commencement of the inevitable liquidation process. This delay, in turn, "adds to the cost of liquidation and contributes to the diminution in [realizable] value of the assets of the closed bank" in the hands of the PDIC as liquidator.[109]

B. Uniform Rules of Procedure for Liquidation Proceedings

As discussed above, the General Banking Law states that Sections 30 to 33 of The New Central Bank Act shall govern the liquidation of banks.[110] The provisions of the PDIC Charter as well as the Rules of Court[111] supplement the aforecited banking provisions to complete the laws or statutes that lay down the process for bank liquidation in the Philippines. While the

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106. Fred Carns, Failure Resolution: Early Detection and Timely Intervention and Resolution (A Presentation During the Conference on Core Principles for Effective Deposit Insurance Systems, Sep. 23-24, 2009, Basel, Switzerland), *available at* http://www.iadi.org/ 2009AGM andconference/Presentations/ 11_ Fred%20Carns%20%20Panel%203%20Reviewed%20BLANK%20NOTES.pdf (last accessed Feb 25, 2011).

107. *Id.*

108. *Id.*

109. S.B. No. 2128.

110. General Banking Law of 2000, § 69.

111. *See* 1997 RULES ON CIVIL PROCEDURE, rule 59.

foregoing statutes provide the general sketch for the process of bank liquidation, there are as yet no formally established rules of procedures for court proceedings. The conduct of closed bank liquidation operations by the PDIC is still governed by a myriad of statutes and regulations.

The PDIC has drafted its own Master Receivership/Liquidation Plan (MRLP),[112] which contains the general procedure followed in the liquidation of closed banks. However, the MRLP is an internal policy of the PDIC, having been approved only by its Board of Directors and circulated for the guidance of its personnel. It does not have any binding effect on the courts that take cognizance of the PALs filed by the PDIC as liquidator for every bank that the Monetary Board closes.[113] As a result, each liquidation proceeding ensues subject to the discretion of the presiding judge on whether to abide by the process laid down in the MRLP.

It must be noted that for ordinary corporations, Congress has enacted what is known as the Financial Rehabilitation and Insolvency Act (FRIA) of 2010.[114] The FRIA was drafted as part of the State policy to encourage the resolution of claims between debtors and creditors, and to provide for the "timely, fair, transparent, effective[,] and efficient rehabilitation or liquidation of debtors."[115] It was conceptualized to modernize and consolidate the corporate rehabilitation and insolvency laws of the Philippines.[116] It prescribes several modes of corporate rehabilitation, which may or may not be supervised by the courts depending upon the approval of creditors.[117] In case the debtors can no longer be rehabilitated, the new

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112. Philippine Deposit Insurance Corporation Board, Adopting the Master Receivership/Liquidation Plan for General Application to All Closed Banks, PDIC Board of Directors Resolution No. 2007-12-207 (Dec. 20, 2007). *See also* The New Central Bank Act, § 30. This Section requires that every PAL filed by the PDIC before the Regional Trial Court "must be pursuant to a liquidation plan adopted by the [PDIC] for general application to all closed banks." The New Central Bank Act, § 30.

113. R.A. No. 7653, § 30.

114. An Act Providing for the Rehabilitation or Liquidation of Financially Distressed Enterprises and Individuals [Financial Rehabilitation and Insolvency Act of 2010], Republic Act No. 10142 (2010).

115. *Id.* § 2.

116. An Act Providing for the Recovery of Financially Distressed Enterprises and the Resolution of their Indebtedness, S.B. No. 1847, 13th Cong., 1st Sess. (Nov. 10, 2004).

117. *Id.*

legislation states that they must go into liquidation, and it lays down the procedure for an orderly settlement of debts and liabilities.[118]

For all its timeliness and modernity, the FRIA nonetheless excludes banks from its coverage, thus:

> Sec. 5. *Exclusions.* — The term debtor *does not include banks,* insurance companies, pre-need companies, and national and local government agencies or units.[119]

While the provisions of the FRIA can be referenced in drafting the proposed rules of procedures for bank liquidation, the public interest involved in the business of banking is such that the foregoing rules cannot be adopted and applied *in toto*. Banks, while essentially corporations themselves, are not similarly situated with ordinary corporations. They are governed by specific banking laws and supervised primarily by the BSP rather than the Securities and Exchange Commission (SEC).[120] Their business also directly affects not only its depositors, but also the financial stability of the country.[121]

Hence, there is a clear and pressing need for a comprehensive liquidation law, parallel to the FRIA, to be enacted specifically to govern banks, which will consolidate the closed bank liquidation laws of the Philippines, establish

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118. *See generally* Financial Rehabilitation and Insolvency Act of 2010, ch. 2. This Chapter provides for the liquidation of insolvent juridical debtors.

119. Financial Rehabilitation and Insolvency Act of 2010, ch. 2 (emphasis supplied).

120. *Compare* General Banking Act of 2000, § 4 (which subjects the operations and activities of banks to the supervision of the BSP), *with* The Securities Regulation Code, Republic Act No. 8799 (2000), § 5 (which confers upon the SEC "jurisdiction and supervision over all corporations, partnerships or associations who are the grantees of primary franchises and/or a license or permit issued by the Government").

121. *See* Metropolitan Bank and Trust Company v. Cabilzo, 510 SCRA 259, 269 (2006) (citing Simex v. Court of Appeals, 183 SCRA 360, 361 & 366-67 (1990)). In this Case, the Supreme Court held that

> [t]he banking system is an indispensable institution in the modern world and plays a vital role in the economic life of every civilized nation. Whether as mere passive entities for the safekeeping and saving of money or as active instruments of business and commerce, banks have become an ubiquitous presence among the people, who have come to regard them with respect and even gratitude and, most of all, confidence.

Metropolitan Bank and Trust Company, 510 SCRA at 269.

uniform rules of procedures for courts in dealing with the PAL of closed banks, and make these laws responsive to the practical realities of closed bank liquidation.

The proposed law will redound to the benefit of the courts, the statutory liquidator, and the parties interested in the liquidation of the closed bank. For the courts, a comprehensive bank liquidation law that lays down clear rules of procedure leaves little room for discretionary decisions and mitigates the probability of an error or mistake in judgment.[122] On the part of the liquidator, the enactment of these rules of procedures will minimize, if not eliminate, a considerable number of legal risks and obstacles[123] faced by the PDIC in the discharge of its functions as statutory receiver and liquidator of closed banks. It will set in stone the policies and practices that presently guide the PDIC's actions in the takeover and liquidation of closed banks. Finally, for the bank's creditors, including the depositors to the extent of their uninsured deposits, such rules of procedure will facilitate the swift settlement of the closed bank's affairs.[124]

Founded not only on legal but also on practical considerations, the proposed law is the ideal opportunity to institutionalize policies that will better protect the closed bank's depositors and creditors and optimize the

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122. *See* S.B. No. 2128. The Note states that "clear procedures for the takeover of closed banks and for the filing of the [PAL]" should be laid out "in order to prevent any delay in takeover which often gives opportunity for records tampering, destruction of bank documents, or illegal asset disposal by the bank's personnel." S.B. No. 2128.

123. *Id.* These delays are described in the Note as caused by uncooperative or conflicting factions of stockholders, directors, and officers.

124. *Id.* The Explanatory Note calls for two measures in liquidating a closed bank's assets:

> (1) Explicit authority for the Liquidator to determine the liquidation price of the closed bank's assets based on generally-accepted valuation principles and internationally-accepted valuation standards and practices. Through such authority, the Liquidator would be able to attract buyers or acquirers and quickly dispose of the closed bank's assets even before their values diminish or before their maintenance result in additional costs of liquidation; and
>
> (2) Explicit authority for the Liquidator to avail of various modes of disposing real and personal properties of closed banks in order to maximize the conversion of the closed bank's properties into cash for payment of its obligations.

Id.

liquidation process to the end that most, if not all, of the obligations of the closed bank are fully settled. Above all, a clear set of rules on bank liquidation will put in place a quick, efficient, and cost-effective bank liquidation process, thereby contributing to the stability of the financial system and the preservation of the public's trust and confidence in the banking industry.

C. Alternative Liquidation Processes

Looking beyond the recent crisis, the Philippines would do well to adopt alternative tools for the orderly liquidation of a bank. At present, there is only one option available to the liquidator, i.e., a conventional liquidation involving the straight out conversion of the assets of the bank into cash for the payment of creditors.[125] However, this framework does not sufficiently protect the public's strong interest in the business of banking, and does little to contain or prevent risks or threats to the stability of the financial system.

Philippine legislators may consider two alternative liquidation processes, which are already being utilized in other jurisdictions, in addition to conventional liquidation. These are: (i) Purchase of assets and assumption of liabilities (P&A) transaction and (ii) Bridge Banking.

1. Purchase of assets and assumption of liabilities (P&A) transaction

A P&A transaction is a process whereby some or all of the assets of a failed bank are purchased and some or all of its liabilities are assumed by a third party.[126] However, this third party does not take over the license or charter of the failed bank.[127]

The P&A transaction, as a process or mode of failed bank resolution, is one of the resolution methods commonly implemented in the U.S. by the FDIC to deal with failed banking institutions.[128] The FDIC Resolution Handbook describes the process in this light:

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125. R.A. No. 7653, § 30.

126. FEDERAL DEPOSIT INSURANCE CORPORATION, RESOLUTIONS HANDBOOK 19, *available at* http://www.fdic.gov/bank/ historical/reshandbook/ ch3pas.pdf (last accessed Feb. 25, 2011) [hereinafter FDIC RESOLUTIONS HANDBOOK].

127. J.M. Chikura, Resolution Transaction: Purchase and Assumption, Zimbabwe (Presentation During the International Association of Deposit Insurers (IADI) Executive Training Programme: Resolution of Failing Banks) (Apr. 5-9, 2010) (on file with author).

128. FDIC RESOLUTIONS HANDBOOK, *supra* note 126, at 19.

> In a P&A, the liabilities assumed by the acquirer include all or some of the deposit liabilities and secured liabilities, for example, deposit accounts secured by U.S. Treasury issues and repurchase agreements.[129] The assets acquired vary depending on the type of P&A. Some of the assets, typically loans, are purchased outright at the bank or thrift closing by the assuming bank under the terms of the P&A. Other assets of the failed institution may be subject to an exclusive purchase option by the assuming institution for a period of 30, 60, or 90 days after the bank or thrift closing.[130]
>
> Some categories of assets *never* pass to the acquirer in a P&A; they remain with the receiver. These include claims against former directors and officers, claims under bankers blanket bonds and director and officer insurance policies, prepaid assessments, and tax receivables. Subsidiaries and owned real estate (except institution premises) pass infrequently to the acquirer in P&A transactions. Additionally, a standard P&A provision allows the assuming institution to require the receiver to repurchase any acquired loan that has forged or stolen instruments.[131]

There are many cited advantages to utilizing P&A as a mode of resolving a failed bank. It is said that a P&A transaction is "less disruptive to communities than payoffs,"[132] and is often the least expensive resolution method.[133] Since the deposit liabilities and assets of the closed bank are passed on to a healthy bank, there is a continuity of banking relationships for the depositors as well as the borrowers which engenders a constructive

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129. *Id.* The FDIC Resolutions Handbook defines "repurchase agreements" as "agreements between a seller and a buyer whereby the seller agrees to repurchase securities, usually of U.S. Government securities, at an agreed upon price and, usually, at a stated time." *Id.*

130. *Id.* The FDIC Resolutions Handbook notes that these assets cover "premises owned by the failed institution, some categories of loans, rights to an assignment of leases for leased premises, data processing equipment, and other contractual services." *Id.*

131. *Id.* (emphasis supplied).

132. FDIC RESOLUTIONS HANDBOOK, *supra* note 126, at 19.

133. International Association of Deposit Insurers, General Guidance for the Resolution of Bank Failures 28, *available at* http://www.iadi.org/docs/Guidance_Bank_Resol.pdf (last accessed Feb. 25, 2011) [hereinafter Guidance for the Resolution of Bank Failures].

attitude towards bank closures in general.[134] It likewise preserves the banking functions of the failed bank which sustains its corporate value.[135]

On the part of the deposit insurer, a P&A transaction is preferred to resolve large failures because, as opposed to a cash payout, a P&A resolution method preserves the liquidity and financial status of the deposit insurer.[136] As the deposit liabilities of the closed bank are assumed, the deposit insurer need not pay deposit insurance for 100% of the insured deposits.[137] In addition, the deposit insurer need not likewise expend for the costs of maintaining the closed bank's assets, which are purchased by another entity.[138] More importantly, the experience in other jurisdictions show that a P&A helps to preserve the value of the assets of the closed bank, which depreciate when taken from the private marketplace and placed in the hands of the receivers.[139]

2. Bridge Banking

A bridge bank is an alternative tool that may be made available to the PDIC, as the deposit insurer and statutory receiver of banks, to deal with bank failures.

The concept of bridge banking was first introduced and utilized in the U.S. Under the Competitive Equality of Banks Act (CEBA) of 1987,[140] the FDIC was granted the authority to act as a temporary acquirer which shall

134. *See* Financial World, Bad Bank, Good Idea, *available at* https://www.financialworld.co.uk/Archive/2008/2008_07jul/Features/financial_instruments/14639-print.cfm (last accessed Feb. 25, 2011).

135. Guidance for the Resolution of Bank Failures, *supra* note 133, at 28.

136. Financial World, *supra* note 134.

137. *See* FDIC RESOLUTIONS HANDBOOK, *supra* note 126, at 20. The Handbook states that "in a P&A transaction, acquirers may assume *all* deposits, thereby providing 100% protection to all depositors." This is in contrast to a deposit payoff, where the "FDIC does not cover that portion of a customer's deposits exceeding the insurance limit." FDIC RESOLUTIONS HANDBOOK, *supra* note 126, at 20 (emphasis supplied).

138. *Id.* at 22. As the FDIC began managing an extremely large portfolio of failed banks (in the 1980s) it became more desirable to pass assets to acquirers rather than to incur additional costs of acquiring, maintaining, and subsequently remarketing or collecting those assets.

139. Chikura, *supra* note 127.

140. Competitive Equality of Banks Act, Pub. L. No. 100-86, 101 Stat. 552 (U.S.).

take over and maintain banking services for the customers of a failed bank.[141] The temporary bank "bridges" the gap between the time of the bank's failure and the time when a third party can successfully intervene.[142]

The bridge bank resolution method addresses situations wherein a bank that is closed and placed under receivership by regulators still has a considerable franchise value but more time is needed to permit its least costly resolution.[143] The deposit insurer may organize a bridge bank in the interim, which will assume the insured deposits, acquire the good assets of the failed bank, and continue its operations for a specified period. The receivership, on the other hand, retains the liabilities and the most problem-ridden assets of the failed bank, and liquidates said assets to pay off the failed bank's creditors.[144]

The deposit insurer also takes the place of the board of directors of the failed bank.[145] An exchange likewise occurs: the deposit insurer shells out whatever capital is needed for the reorganization, and in return, acquires an equity stake in the bank which it will recover when the bridge bank is finally resolved.[146]

Utilizing a bridge bank resolution method supplies the additional period which the deposit insurer needs to "stabilize the failed bank's business, effectively market the bank's franchise, and determine an appropriate resolution."[147] Bridge banking encourages the participation of potential acquirers, and gives them the opportunity to assess the franchise value of the bank in a "more stable environment."[148] The seamless transition, which is a hallmark of the bridge banking resolution method, guarantees the failed bank's depositors that their deposits are safe and accessible in the hands of the deposit insurer-controlled bridge bank.[149] Similar to a P&A transaction, the establishment of the bridge bank may also prove to be a cost-effective

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141. FDIC RESOLUTIONS HANDBOOK, *supra* note 126, at 35.

142. *Id.*

143. *Id.* at 36.

144. *Id.* at 37.

145. Deposit Insurance and Bank Failures, *available at* http://wfhummel.cnchost.com/depositinsurance.html (last accessed Feb. 25, 2011).

146. *Id.*

147. FEDERAL DEPOSIT INSURANCE CORPORATION, MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE 171 (1998).

148. *Id.* at 175.

149. *Id.*

alternative to the traditional straight deposit payoff.[150] All these features lessen the possibility that a failure of a single bank would greatly impact the industry.

In both P&A and Bridge Banking, the process allows for the assumption by, or the transfer to, another entity of the actual deposits of the closed bank.[151] The payment of deposit insurance or the filing of insurance claims by the depositors may not be necessary.[152] In this manner, there is less cause for the depositors to fear the loss of their hard-earned money, or to panic and cause a bank run in other institutions.

The IMF has expressed support for the PDIC's adoption of these additional modes of liquidation, to wit:

> The mission welcomes the envisaged enhancement of the banking resolution tool kit, including the proposed introduction of a bridge-bank facility. However, a more flexible application of the [P&A] tool, not contingent on the finalization of depositor payout, should also be considered. It could make takeovers more attractive and possibly lessen the need for activation of deposit insurance. To further enhance the effectiveness of the banking resolution framework, rights of existing shareholders of ailing banks should be limited; restructuring decisions should be legally irreversible; and PDIC staff should be protected against litigation.[153]

D. Early Intervention by, and Participation of, the PDIC

In the aftermath of the recent global financial crisis, the Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience[154] pointed out "the importance of effective depositor

150. *Id.*

151. FDIC RESOLUTIONS HANDBOOK, *supra* note 126, at 19.

152. This is because in both transactions, a healthy institution may choose to assume all the liabilities of a failed bank, including all insured deposits.

153. International Monetary Fund Staff Representatives for the 2008 Consultation with the Philippines, Philippines: 2008 Article IV Consultation — Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Philippines, IMF Country Report No. 09/62 12, *available at* https://imf.org/external/pubs /ft/scr/2009/cr0962.pdf (last accessed Feb. 25, 2011).

154. Financial Stability Board (Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience), *available at* http://www.financialstability board.org/publications/r_0804.pdf?frames=0 (last accessed Feb. 25, 2011).

compensation arrangements in giving depositors confidence, thereby reducing the likelihood of a run on the bank, and in supporting confidence in the financial system as a whole."[155] Thus, it emphasized the need to "review, and, where necessary, strengthen, deposit insurance arrangements."[156] The report also stressed the necessity for authorities to come up with an international benchmark against which national deposit insurance systems of different countries can gauge their own performance.[157]

In response to the report, the Basel Committee on Banking Supervision (BCBS) and the International Association of Deposit Insurers (IADI) worked together to establish a set of Core Principles based on the IADI Core Principles for Effective Deposit Insurance Systems.[158] The result of this effort is 18 internationally agreed upon Core Principles which are designed to be applicable to a wide array of country circumstances and perspectives.[159]

One of the 18 Core Principles emphasized the need to involve the deposit insurer early on in dealing with troubled banks, thus:

> Principle 15 — Early detection and timely intervention and resolution: The deposit insurer should be part of a framework within the financial system safety net that provides for the early detection and timely intervention and resolution of troubled banks. The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well-defined criteria by safety-net participants with the operational independence and power to act.[160]

The manner and timing by which troubled banks are dealt with has a major impact on the financial capabilities and operations of the deposit insurer. Hence, the PDIC must have access to certain information during the time that a bank is distressed.

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155. *Id.* at 50.

156. *Id.*

157. *Id.* at 51.

158. Basel Committee on Banking Supervision (BCBS) and the International Association of Deposit Insurers (IADI), Core Principles for Effective Deposit Insurance Systems, A Consultative Document 1, *available at* http://www.iadi.org/NewsRelease/JWGDI%20 CBRG%20core%20 principles%20BS0911% 20final.pdf (last accessed Feb. 25, 2011) [hereinafter Core Principles].

159. *See* Core Principles, *supra* note 158, at 2.

160. Core Principles, *supra* note 158, at 4.

The IMF Financial System Stability Assessment Update[161] succinctly explains that the authorities granted to the PDIC with the passage of R.A. No. 9576 still fall short of helping the deposit insurer perform its functions in a timely and efficient manner:

> While the PDIC charter amendments and the creation of the [Financial Sector Forum] have improved the former, access to deposit information is still limited: the recent Legacy Bank group failure highlighted that, despite operational improvements in claims processing, prompt payouts can be hampered by the PDIC's lack of timely access to individual deposits (as well as by the often poor state of records by the time the PDIC has been appointed receiver). *For the PDIC to play its role effectively, it should be given access to asset and individual deposit information at an early stage when the viability of a bank is in question.*[162]

Access to asset and individual deposit information, among other things, will only be possible if the PDIC is involved early on in the detection, timely intervention, and resolution of troubled banks. These proposals will allow the PDIC as deposit insurer to prepare for a possible payout and claims settlement scenario. At the same time, the PDIC, in its capacity as statutory receiver/liquidator, will be able to lay down the necessary preparations to implement the appropriate resolution method in the event of closure.

IV. CONCLUSION

A timely and effective bank liquidation strategy plays a crucial part in creating and implementing a successful financial safety net framework. In the Philippines, the PDIC is at the helm of any bank liquidation, being the statutory receiver or liquidator of closed banks. The functions it performs as such, and as deposit insurer and co-regulator, complement the operations of the BSP in ensuring the stability of both the banking and the financial system in the country.

The global financial crisis has offered an opportunity to advocate a review of the existing financial and regulatory landscape. Identifying the gaps and weaknesses in the financial system and strengthening the will and ability of the regulatory agencies to perform their functions have resulted in regulatory reforms through legislative action. The recurring problems encountered by the PDIC in undertaking receivership and liquidation proceedings under existing laws will continue to hinder an efficient and effective liquidation of closed banks unless reforms are passed. The proposals

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161. Financial System Stability Assessment Update, *supra* note 101.

162. *Id.* at 6 (emphasis supplied).

enumerated and discussed above are aimed at addressing these issues, thereby contributing to the greater stability of our banking and financial systems.