

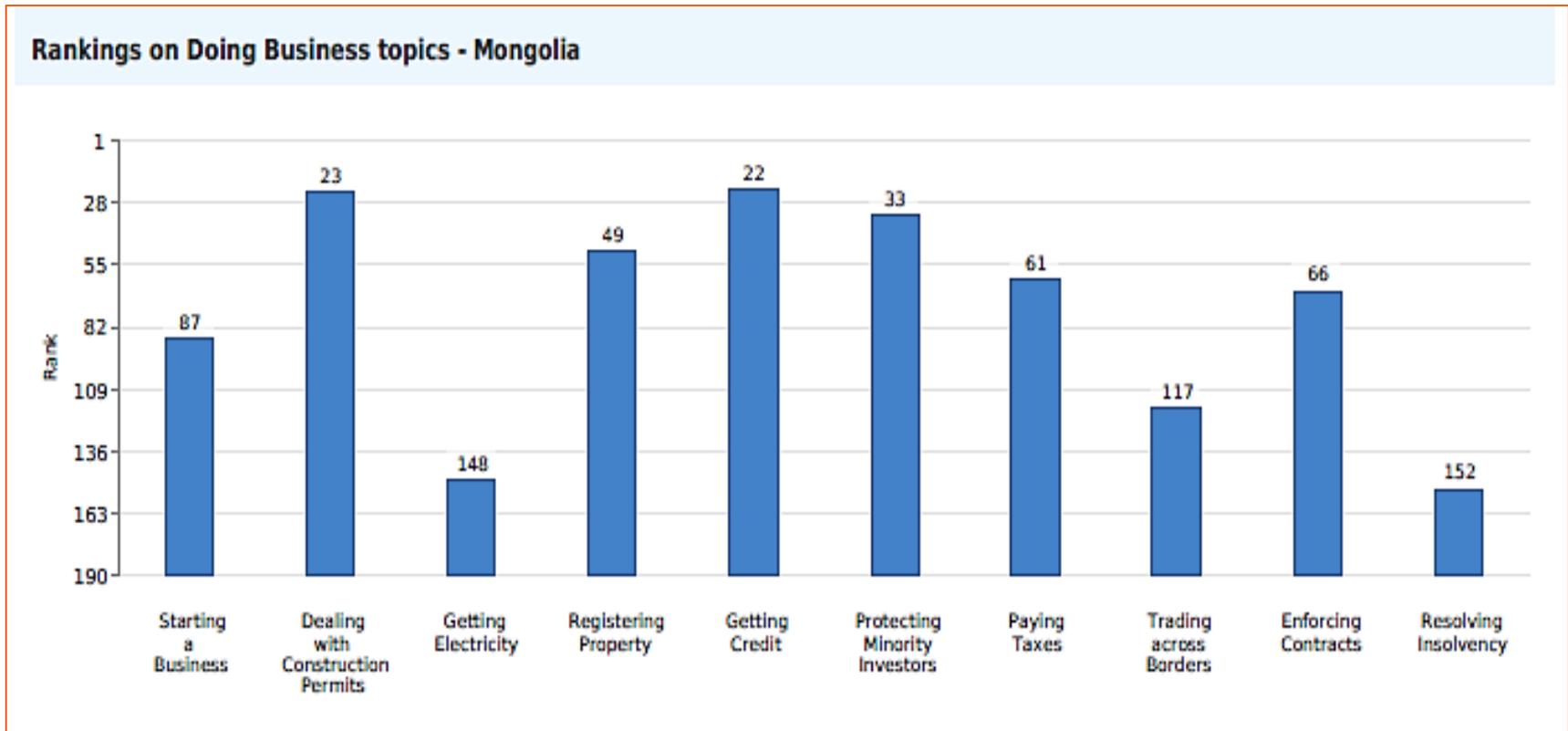


# Insolvency Reform and Investment Climate

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# Insolvency Framework is the Weakest Point for the Mongolia Doing Business



Source: *Doing Business 2019*, World Bank Group

# Insolvency Regime and Investment Climate -- Case

## After MFone, insolvency perils remain numerous in Kingdom ¶

Sat, 10 January 2015 ¶

Daniel de Carteret ¶

*Uncertainty over the law, inexperienced judges and a total lack of precedent have made bankruptcy in Cambodia a decidedly worrisome proposition¶*



Two years ago yesterday, on January 9, 2013, telecommunications operator MFone filed for insolvency in the Phnom Penh courts.¶

The failure of the company, which had run up too much debt and could no longer compete in the crowded telco sector, left more than 1,000 workers jobless - many of whom hit the streets in protest.¶

Creditors as large as Chinese telco provider Huawei Technologies, owed more than \$65 million, quickly emerged, while small claimants like mobile credit vendors owed as little as \$20 also demanded their money back.¶

After years of legal wrangling, Cambodia's first bankruptcy case is still being unravelling. One complexity is the sell-off of telecommunications assets – such as the towers scattered all over the country – whose value was severely diminished from the moment they were no longer transmitting a signal. But the other, more pertinent issue brought to light by the case, is the holes in Cambodia's insolvency law itself and the lack of judicial experience in its application.¶

# Insolvency Regime and Investment Climate -- Case

The strength of insolvency laws are an important part of a foreign company's decision-making process when eyeing a country in which to invest according to Rutherford Hubbard, a senior associate with VDB Loi, a Cambodia-based legal and tax consultancy that works with foreign investors. ¶

“In higher risk jurisdictions like Cambodia, foreign investors want to be sure that bankruptcy procedures are transparent and reliable when it comes to trying to recoup some of their outstanding debt,” he said. ¶

“If foreign investors know that they can rely on insolvency laws in a certain country, this makes that country a more attractive target for investment,” he added. “Unfortunately, the opposite is also true.” ¶

A lawyer representing one of the creditors on the MFone case who would only speak on the condition of anonymity, recalled the difficulties of interpreting the insolvency law throughout the hearing. ¶

“If there's any inconsistency or any differences then we have to seek clarification or explanation from the authorities, and it takes time,” he said. ¶

“But I can understand this, as it is the first case and no one has any precedent to refer to, and no one has any experience, so they have to refer to the law and seek explanation from the judge and the Ministry of Justice – I can say that it is really challenging,” ¶

For MFone administrator Ry, after two years he too describes the landmark case as “challenging”. ¶

Ry points to the all-to-common occurrence in the garment industry of factories shuttering and simply leaving workers stranded as an example of the need for greater confidence in Cambodian insolvency laws. Confidence in Cambodia's bankruptcy laws will give businesses more options, but that will only come through education and understanding the outcomes of other cases Ry said. ¶

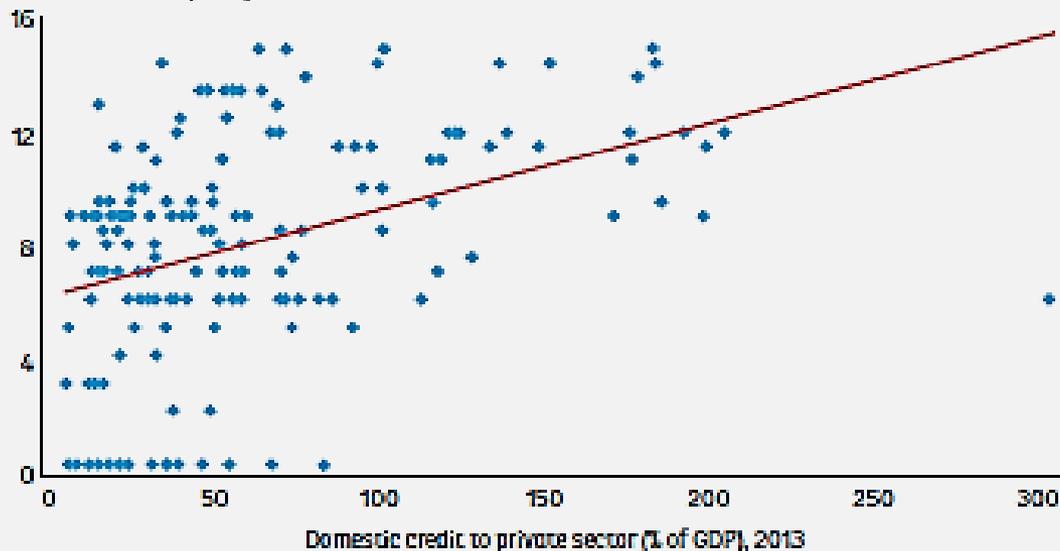
# Investors Need Predictability and Efficiency

- Perspectives of equity and debt finance providers when deciding on an investment destination:
  - ✓ Insolvency law and regulations are indispensable part of the legal foundations for a matured business environment
  - ✓ Not all equity investments may be successful. In case of financial distress, will conciliation, or dissolution, or reorganization or liquidation be efficiently and fairly completed?
  - ✓ Will there be macro-economic stability? Poor insolvency regime can lead to high debt overhang in times of financial sector pressure. Debt overhang implies instability, meaning uncertainties for both equity and debt providers
  - ✓ NPL management & debt collection is an inherent part of credit process. Poor insolvency regime leads to low credit market efficiency, inadequate access to finance by businesses, and high borrowing cost
  - ✓ For debt financiers, will they be able to exit timely if a borrower is in financial distress? What will be the recovery rate?
  - ✓ Good insolvency regime promotes entrepreneurship

# Investors Need Predictability and Efficiency

**FIGURE 12.3** Economies with strong insolvency frameworks have higher levels of domestic credit provided to the private sector

Strength of insolvency  
framework index (0-16), 2014



Note: Domestic credit to private sector refers to financial resources provided to the private sector by financial corporations, such as through loans, purchases of non-equity securities, and trade credits and other accounts receivable, that establish a claim for repayment. The correlation between the strength of insolvency framework index and domestic credit to private sector as a percentage of GDP is 0.40. The relationship is significant at the 1% level after controlling for income per capita.

Source: Doing Business database; World Bank, World Development Indicators database.

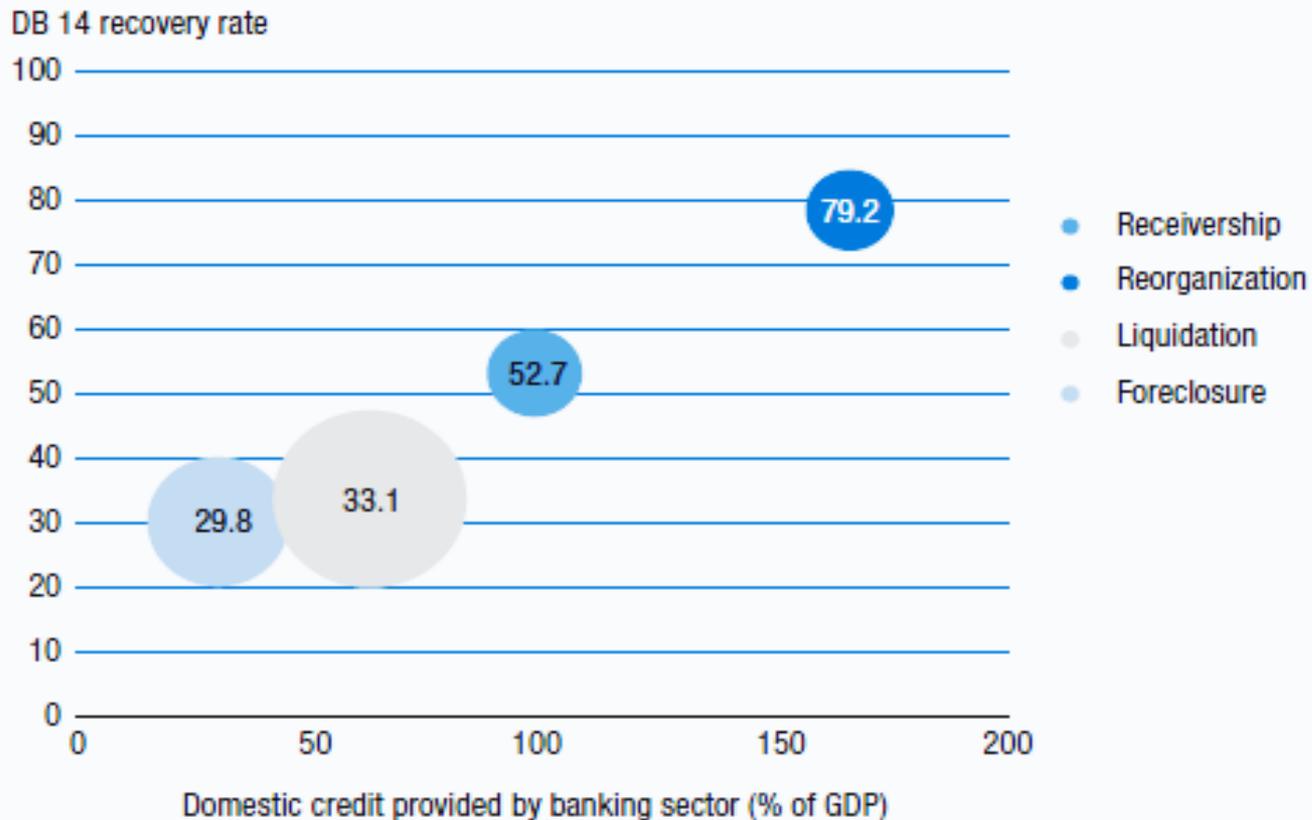
# Investors Need Predictability and Efficiency

- Key features of a good NPL management & insolvency regime:
  - ✓ Recognizing the likelihood of business failures, and balancing the need for creditor protection with the social benefits of “re-birth”
  - ✓ Providing multiple options, particularly possibilities for reorganization, conveniently accessible
  - ✓ Maximum availability of out of court resolution mechanisms
  - ✓ Propensity for saving still-viable businesses
  - ✓ Efficient process for concluding agreements among the creditors and with the debtor
  - ✓ Existence of competent insolvency professionals, work-out agencies, and debt collection companies
  - ✓ A market for the trading of distressed assets
  - ✓ Active financial regulators preventing the emergence of undue new NPLs and encouraging the fast resolution of NPL stocks

# Investors Need Predictability and Efficiency

Figure Reorganization proceedings present the best outcomes

2



Note: Size of the bubble shows the number of economies. Number inside the bubble shows average recovery rate.

Source: World Bank Group (2017)

# Insolvency Reforms Required in Mongolia

Figure - Resolving Insolvency in Mongolia and comparator economies - Ranking and Score



Note: The ranking of economies on the ease of resolving insolvency is determined by sorting their scores for resolving insolvency. These scores are the simple average of the scores for the recovery rate and the strength of insolvency framework index.

Source: *Doing Business 2019*, World Bank Group

# Insolvency Reforms Required in Mongolia

- “***Resolving Insolvency***” has the lowest ranking among the 10 dimensions covered under the 2019 Doing Business Mongolia
- **Mongolia has one of the lowest recovery rates** and one of the longest resolution time in the world: **16.9%, and 4 years**
- The current *Strength of Insolvency Framework* has a score of 6.5 out of total 16 points:
  - ✓ Commencement of Proceedings Index: 2.0 out of 3
  - ✓ Management of Debtor’s Assets Index: 4.0 out of 6
  - ✓ Reorganization Proceedings Index: 0.5 out of 3
  - ✓ Creditor Participation Index: 0.0 out of 4

# What Could Be Done in the Medium Term?

- **To approve the Insolvency Law as soon as possible**
- To grow up an insolvency professionals industry, and develop out-of-court mechanisms
- To develop a market for restructuring/debt collections/trading of distressed assets
- To encourage financial regulators to be more active in pushing for financial infrastructure development, raising governance and underwriting/loan management standards in the lending industry, facilitating the existing NPL resolution (*e.g., promoting voluntary agreements, allowing for the financing of the restructuring enterprises*)

# Thank You !

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