Asian Principles of
Business Restructuring

Text

Guide on the Treatment of Insolvent Micro and Small Enterprises in Asia

A joint project by the International Insolvency Institute and the Asian Business Law Institute

Drafter

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Commentary by these individuals and organisations does not indicate their endorsement of this Guide.

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Preface

Micro and small enterprises (**MSEs**) represent the vast majority of businesses in all jurisdictions in Asia. Despite the economic relevance of MSEs and the importance of the insolvency process, most Asian jurisdictions do not have insolvency frameworks that are suitable for MSEs. The COVID-19 pandemic has further exacerbated the woes of these businesses.

This Guide is thus prepared with a view of seeking to provide a set of principles or policy recommendations for the implementation of an efficient and effective insolvency framework for MSEs in Asia. These principles or policy recommendations include FIVE KEY PRINCIPLES suggested for adoption by jurisdictions that seek to implement an attractive insolvency framework for MSEs (**Key Principles**), and SIX ASPIRATIONAL PRINCIPLES that should ideally be adopted over time to provide MSEs with a comprehensive legal and institutional environment to deal with financial distress (**Aspirational Principles**).

In the preparation of this Guide, current academic literature, as well as the principles and policy recommendations suggested by international organisations, including international standard-setters such as UNCITRAL and the World Bank, have been taken into consideration to achieve better alignment. As this Guide focuses specifically on Asia which has unique and region-specific features, however, some of the general principles and policy recommendations suggested in existing international literature have been further developed, emphasised or fine-tuned in this Guide.

It is hoped that this Guide will provide valuable references to policymakers and other stakeholders alike in Asia as they work towards developing suitable insolvency frameworks for MSEs.

Figure 1. Jurisdictions considered by this Guide

Sngapore. Photo by DIGBY CHEUNG on UNSPLASH

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Key Principles

PRINCIPLE 1. PROMOTE OUT-OF-COURT RESTRUCTURING FOR VIABLE MSES

Asian jurisdictions should promote the use of consensual or out-of-court restructuring (workouts) for viable MSEs facing financial trouble.

Local authorities and organisations in Asia should promulgate and disseminate good practices for workouts.

PRINCIPLE 2. IMPLEMENT A SIMPLIFIED INSOLVENCY PROCESS FOR MSES

Asian jurisdictions should adopt simplified insolvency rules for MSEs, and ideally adopt simplified insolvency processes.

The simplified insolvency process for MSEs may be a simpler, faster, and lower-cost version of the ordinary procedures or a totally new process tailored to MSEs.

The simplified insolvency process for MSEs can consist of a single-entry insolvency process or a dual-gateway insolvency process. If a dual-gateway process is adopted, Asian jurisdictions should adopt simplified reorganisation procedures and simplified liquidation procedures.

In simplified reorganisation procedures, creditors should be empowered to terminate the procedures. In jurisdictions with efficient and reliable judicial systems, courts should also be allowed to terminate a reorganisation procedure.

In simplified reorganisation procedures, a debtor-in-possession "DIP" model should be the preferred option for the governance of the procedures. The DIP model will be a more desirable option for assetless MSEs as well as jurisdictions without a sophisticated body of insolvency practitioners. If the DIP model is adopted, creditors should be entitled to appoint an insolvency practitioner.

In simplified liquidation procedures, the appointment of an administrator to take over the debtor's assets will be the preferred governance system for the process. For assetless MSEs, jurisdictions may adopt a system of public trustee or an DIP model in liquidation. If the DIP model is adopted, creditors should be entitled to appoint an insolvency practitioner.

The simplified insolvency process should provide debtors with a variety of tools that contribute to the creation or preservation of value. These tools may include a moratorium, prohibition of *ipso facto* clauses, avoidance actions, and some forms of priority eventually granted to the lender extending new financing.

Asian jurisdictions should subject the simplified insolvency process to stringent timelines. They should also facilitate the use of electronic means and standardised forms in the simplified insolvency process.

PRINCIPLE 3. PROVIDE A DISCHARGE OF DEBTS FOR HONEST BUT UNFORTUNATE ENTREPRENEURS

The simplified insolvency process should provide a discharge of debts for honest but unfortunate individual entrepreneurs. For MSEs operating as corporate entities, Asian jurisdictions should also facilitate the discharge of debts to insolvent shareholders and managers acting as guarantors of the companies' debts.

In jurisdictions with strong institutions, the discharge can be adopted after the court has verified that the debtor was indeed honest and unfortunate. Jurisdictions with weak institutions should provide an automatic discharge of debts unless the creditors or other third parties show that the debtor was not honest or unfortunate. In both jurisdictions, the law should establish certain presumptions to determine when the standard of honest but unfortunate debtor can be challenged.

PRINCIPLE 4. REDUCE THE STIGMA OF INSOLVENCY PROCEEDINGS

Asian jurisdictions should adopt active policies to reduce the stigma of insolvency proceedings. These policies may include embracing terms such as "debtor" instead of "bankrupt", as well as the promotion of education and awareness in insolvency and restructuring.

PRINCIPLE 5. BUILD UP TRAINING AND INSTITUTIONAL CAPACITY

Asian jurisdictions with less efficient or experienced insolvency courts should adopt institutional reforms to improve the efficiency, expertise and credibility of the judiciary.

Asian jurisdictions should promote training, education and research in insolvency and restructuring.

Aspirational Principles

PRINCIPLE 1. IMPLEMENT HYBRID PROCEDURES

Asian jurisdictions should adopt hybrid procedures combining elements of informal workouts and formal reorganisation procedures. Hybrid procedures should provide debtors with several restructuring tools. Creditors should be empowered to terminate the hybrid procedures at any time. In jurisdictions with efficient judicial systems, courts should be entitled to terminate the procedures.

PRINCIPLE 2. GRANT TAX INCENTIVES FOR DEBT RESTRUCTURINGS

Asian jurisdictions should not tax MSEs for the gains eventually obtained through a haircut that is achieved as part of a debt restructuring. Asian jurisdictions should provide tax credits or

other tax incentives to creditors who accept a haircut as part of a debt restructuring achieved by an MSE.

Principle 3. Promote mediation and other forms of alternative dispute resolution

Asian jurisdictions should promote the use of alternative dispute resolution methods, and particularly mediation, in the context of MSEs.

Asian jurisdictions with reliable judicial systems and a developed pool of mediators may empower courts to compel MSEs and their creditors to mediate before initiating a formal insolvency process.

Principle 4. Involve public creditors in restructurings

Asian jurisdictions should require public creditors to be subject to the same conditions, in terms of haircuts and deferrals on payments, that are eventually agreed upon by private creditors in debt restructurings involving MSEs.

Principle 5. Promote litigation funding

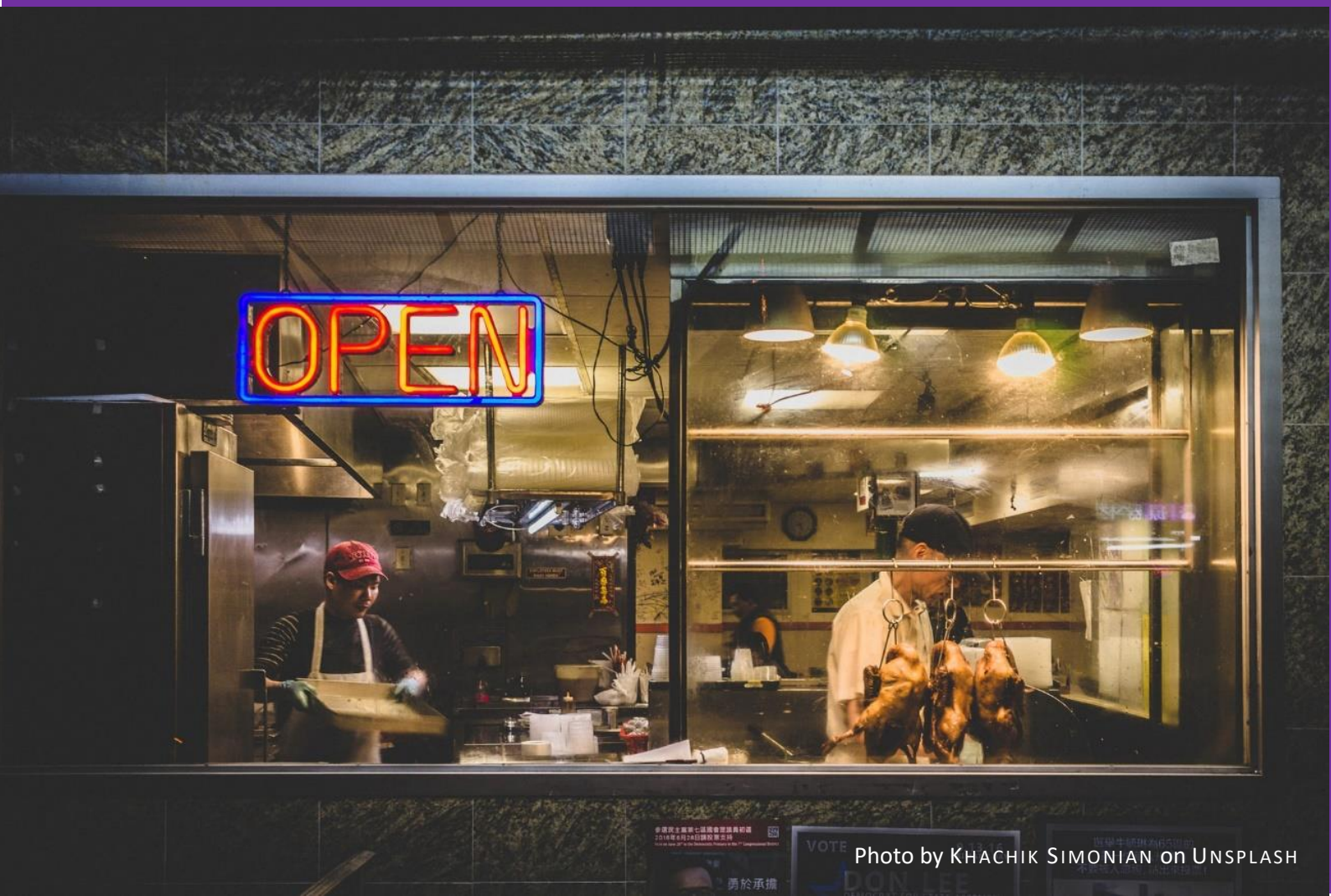
Asian jurisdictions should allow third parties to fund the simplified insolvency process for MSEs. However, litigation funding should be subject to limits and safeguards. Depending on the particular features of an Asian jurisdiction, these safeguards may consist of the involvement of courts, the empowerment of creditors and even the adoption of a licensing regime for litigation funders.

Principle 6. Create a public agency for managing simplified processes for MSEs

Asian jurisdictions should ideally have a public agency in charge of managing the simplified insolvency processes for MSEs.

Micro & small enterprises and insolvency in Asia

- The importance of micro and small enterprises in Asia
- Insolvency frameworks in Asia
- The concept of MSEs
- Features of MSEs
- Weaknesses of the ordinary insolvency system for MSEs
- The need for simplified insolvency frameworks for MSEs
- Scope and purpose of this Guide



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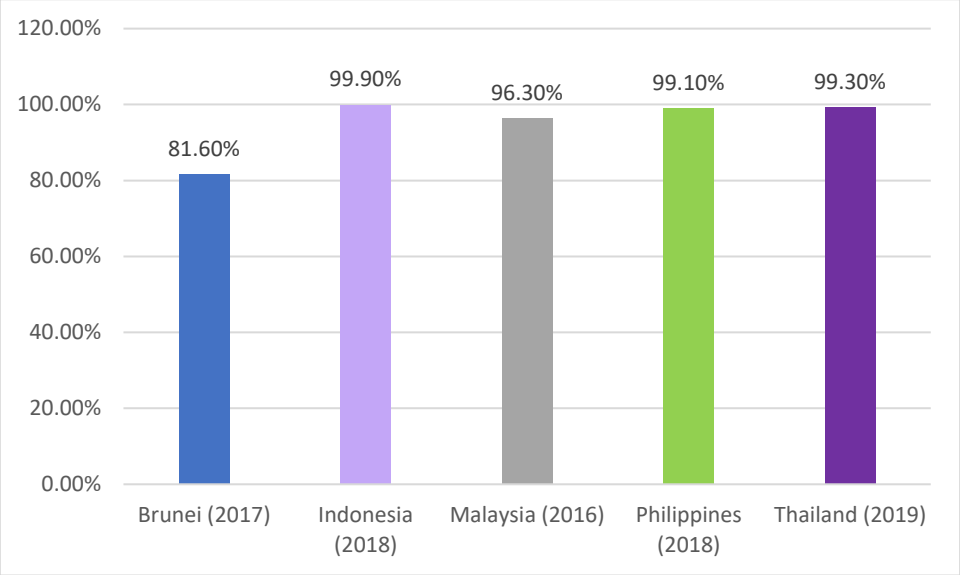
The importance of micro and small enterprises in Asia

Micro, small and medium-sized enterprises represent about 90% of businesses and more than 50% of employment worldwide. In Asia, such enterprises play an even greater role in the economy. In China, they account for 99.98% of all firms and 79.4% of the employment in the country. In India, they contribute about 30% to the country's gross domestic product and employ 111 million people. In Southeast Asia, they account for an average 97.2% of all enterprises and 69.4% of the total workforce, surpassing 99.5% of all firms in several jurisdictions, including Indonesia, the Philippines, Singapore and Thailand. Within the universe of micro, small and medium-sized enterprises in Asia, the vast majority are micro and small enterprises (**MSEs**). In fact, in most jurisdictions in Southeast Asia, MSEs represent more than 96% of the total number of firms.[1]

Figure 2. Percentage of MSEs in selected southeast Asian jurisdictions[2]



Insolvency frameworks for MSEs in Asia

Despite the economic relevance of MSEs, most jurisdictions in Asia do not provide suitable INSOLVENCY frameworks for them, although Australia, India, Japan,[3] Laos, Myanmar, Singapore and South Korea are exceptions. Most Asian jurisdictions generally provide a one-size-fits-all insolvency process. In recent years, however, several events have accelerated the process of enacting simplified insolvency frameworks for MSEs.

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1 For the purpose of this Guide, Australia and New Zealand are considered jurisdictions in Asia.

2 Michael T Schaper, "THE MISSING (SMALL) BUSINESSES OF SOUTHEAST ASIA" (2020) 79 ISEAS Yusof Ishak Institute 5.

3 The Civil Rehabilitation Act (Japan) as reflected in Figure 3 also applies to consumers who are beyond the scope of this Guide.

Figure 3. Existing simplified insolvency regimes for small businesses in Asia

Jurisdiction	Entry into force	Eligible debtors	Law
 Japan	1 January 2000	SOLE PROPRIETORS	Civil Rehabilitation Act (Act No. 225 of December 22, 1999) (Japan)
 South Korea	1 July 2015	MSEs	Debtor Rehabilitation and Bankruptcy Act (South Korea), Chapter IX
 Laos	9 June 2020	MSEs	Law on Rehabilitation and Bankruptcy of Enterprises (Laos), Part VI
 Australia	1 January 2021	Small companies	Corporations Act 2001 (Cth) (Australia), Part 5.3B
 Singapore	29 January 2021	Small companies	Insolvency, Restructuring and Dissolution (Amendment) Act 2020 (Singapore), Part 10A*
 Myanmar	14 February 2021	MSEs	Insolvency Law 2020 (Myanmar), Part VI
 India	4 April 2021	Small companies	Insolvency and Bankruptcy Code, 2016 (No. 31 of 2016) (India), Chapter III-A

* The simplified insolvency programme implemented in Singapore has been adopted temporarily until 28 July 2022. Nonetheless, some aspects of this insolvency framework for small companies may remain permanently. See Ministry of Law, "SPEECH BY MINISTER FOR CULTURE, COMMUNITY & YOUTH AND SECOND MINISTER FOR LAW EDWIN TONG SC AT THE SINGAPORE INSOLVENCY CONFERENCE"(13 OCTOBER 2021).

Hong Kong SAR, China. Photo by ANATOLIY GROMOV on UNSPLASH

First, various international organisations have published studies and policy recommendations recommending the adoption of simplified insolvency frameworks for MSEs. These publications include two relevant reports published by the World Bank in 2017 and 2018 respectively and legislative recommendations for the implementation of a simplified insolvency regime published by the United Nations Commission on International Trade Law ("UNCITRAL"). More recently, the World Bank's "Principles for Effective Insolvency and Creditor/Debtor Rights Regimes" has also included a new section exclusively focused on MSEs.

Second, various jurisdictions around the world, including the United States,[4] and several jurisdictions in Asia, such as Japan, Laos, Myanmar and South Korea, adopted special insolvency rules for MSEs, or at least some forms of MSEs (e.g., small companies) before the outbreak of the COVID-19 crisis. Nonetheless, in some of those jurisdictions, such as Laos and Myanmar, the rules only came into force during the early stages of the pandemic. These legislative developments are expected to encourage other jurisdictions to revisit the suitability of their insolvency frameworks for MSEs.

Third, the economic crisis generated by the pandemic, and how this crisis has significantly impacted MSEs, have encouraged many jurisdictions to accelerate the process of implementing an efficient insolvency framework for MSEs. In fact, when the first phase of the Asian Principles of Business Restructuring project jointly undertaken by the Asian Business Law Institute and the International Insolvency Institute was concluded in April 2020, only a few Asian jurisdictions had special insolvency rules for MSEs. In 2021, Australia and India implemented permanent insolvency procedures for MSEs, and Singapore adopted a temporary insolvency programme to facilitate the efficient REORGANISATION and LIQUIDATION of MSEs.

The concept of MSEs

Definition of MSEs

There is no universal definition of MSEs. Jurisdictions often define MSEs differently depending on the context (e.g., company law, tax law, insolvency law). As a general rule, an MSE is defined by taking into account factors such as its annual turnover, number of employees and amount of assets. In the context of insolvency law, other relevant factors often include the amount of debt and the number of creditors.[5]

4 See United States Code Title 11, Chapter 11, Subchapter V.

5 Australia and Singapore are examples. For Australia, see Corporations Amendment (Corporate Insolvency Reforms) Act 2020 (Cth), regulations 5.3B.03 and 5.5.03. For Singapore, see Companies Act (Cap. 50), Thirteenth Schedule, paragraph 2. For the purpose of the simplified restructuring process adopted as a response to the COVID-19 crisis, the concept of an MSE is defined in sections 72F(2) and 250F(1) of the Insolvency, Restructuring and Dissolution (Amendment) Act (No. 39 of 2020).

Policy considerations for the definition of MSEs

A variety of legal and economic divergences exist across Asian jurisdictions. Thus, adopting a single definition of MSEs across Asia is not desirable. That is, while an enterprise in one Asian jurisdiction may be classified as an MSE, the same enterprise may be classified as a medium or large enterprise in another Asian jurisdiction. Adopting a single definition of an MSE across Asia may prohibit regulators from achieving their intended goals for their simplified insolvency regimes. As a result, the definition of an MSE should be tailored to the particular features of a jurisdiction, as well as the regulatory objectives to be pursued.

In jurisdictions with a complex, costly and one-size-fits-all insolvency process,[6] the adoption of a broader definition of MSEs will be more desirable. That is, the ordinary insolvency framework would be mainly used by medium and large companies, which are firms that can typically afford these procedures. Moreover, since ordinary insolvency procedures usually provide debtors and creditors with more tools and safeguards, the use of these procedures will also be more suitable for medium and large enterprises.

In jurisdictions where the ordinary insolvency framework provides an affordable solution for MSEs, the concept of MSEs may be narrower. In Singapore, for example, an assetless company can be eligible for an early dissolution process if the affairs of the company do not require any further investigation.[7] Therefore, this solution can be suitable for many MSEs that might not have assets. Additionally, companies in need of a debt RESTRUCTURING can use the pre-packaged scheme of arrangement.[8] Even if a pre-packaged scheme of arrangement may still be costly for many MSEs, and both the early dissolution process and the pre-packaged scheme of arrangement are not available to a significant number of MSEs (*e.g.*, sole proprietorships), the existence of these procedures in the ordinary insolvency framework may justify a narrower definition of MSEs. Under this approach, the simplified insolvency framework would be mainly used by *micro* businesses. Thus, many small companies would use the ordinary insolvency system even if some special provisions are eventually adopted for these firms, especially in the form of shorter timelines and reduced formalities.

Features of MSEs

Despite divergent definitions of MSEs, most small businesses in Asia (and beyond) share some common legal, economic and organisational features. These features justify the special insolvency framework for MSEs suggested in this Guide.

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6 For a criticism of the "one-size-fits-all" insolvency process traditionally existing in Australia, see Jason Harris and Michael Murray, "INSOLVENCY LAW FAILING SMALL BUSINESS" (University of Sydney, 6 August 2020). As noted above, since 1 January 2021, Australia has a simplified insolvency process for micro and small companies. A one-size-fits-all insolvency proceeding still exists in many jurisdictions in Asia, including Brunei, Cambodia, China, Hong Kong SAR of China, Indonesia, Malaysia and New Zealand.

7 Insolvency, Restructuring and Dissolution Act 2018 (No. 40 of 2018), section 209(1)(c).

8 Insolvency, Restructuring and Dissolution Act 2018 (No. 40 of 2018), section 71.

First, MSEs usually have very simple organisational structures. Many MSEs, and especially micro enterprises, do not have more than 10 employees.[9] In fact, in several Asian jurisdictions, most MSEs are sole proprietorships and informal businesses with very basic organisational structures. For example, in India, 94.5% of micro, small and medium-sized enterprises operate as sole proprietors. It is also estimated that there are roughly 17 informal businesses for every formal MSE.

Second, most MSEs have simple financial structures with a few creditors. In most cases, MSEs only have debts with a bank and, if so, some suppliers, employees and tax authorities, as well as their landlords. Therefore, MSEs do not typically have the dispersed financial structure with many creditors that often exists in the case of large companies.

Third, as mentioned above, most MSEs in many Asian jurisdictions are sole proprietors and informal businesses. Even when an MSE is incorporated, the shareholders/managers often act as guarantors for the company's debts. Therefore, in practice, most individuals behind MSEs, including those who have decided to conduct the business through a corporate entity, have unlimited liability for their businesses' debts.[10]

Fourth, due to a variety of factors, including the lack of unencumbered assets available as COLLATERAL, as well as the lack of reliable financial information, MSEs often have trouble accessing finance. This problem is exacerbated in a situation of insolvency, even in the context of viable MSEs. The rise of fintech and new fundraising methods are expected to mitigate this problem. In addition, some jurisdictions in Asia are taking steps to promote bank lending to micro, small and medium-sized enterprises. For instance, Bank Indonesia, Indonesia's Central Bank, issued a regulation that requires banks to fulfil a certain threshold of financing to such enterprises,[11] in line with the 2022 work plan of the Government of Indonesia which includes the development of micro, small and medium-sized enterprises. Additionally, the existence of financing institutions for micro, small and medium-sized enterprises, such as rural banks and cooperatives, can also contribute to reducing the problem of lack of finance often faced by these enterprises.

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9 In fact, this is the definition of micro enterprises in most countries around the world. See World Bank, "Report on the Treatment of MSME Insolvency" p. 4.

10 In a study conducted in the United States, it was found that 56% of shareholders of small companies had unlimited liability due to the existence of guarantees and other contractual arrangements to be liable for the company's debts. See Douglas G Baird and Edward Morrison, "Series Entrepreneurs and Small Business Bankruptcies" (2005) 105 Columbia Law Review 8.

11 Bank Indonesia Regulation No.23/13/PB/2021.

Fifth, many MSEs only have a few assets. When an MSE becomes insolvent, it may not have any unencumbered assets. This lack of assets may reduce the likelihood of viable MSEs achieving a successful REORGANISATION PLAN. Not only because they might be unable to afford legal and financial advice, but also because their bargaining power will be notably reduced in an eventual reorganisation process. Therefore, viable MSEs may end up being liquidated in a piecemeal fashion, destroying value for creditors, shareholders and the society as a whole. As a result, creditors may be more reluctant to extend credit, exacerbating the problems that many MSEs already face in accessing finance. Additionally, if a non-viable MSE cannot afford the costs of an INSOLVENCY PROCEEDING, this situation will increase the number of "zombie" companies in the market, and the assets (if any) and human capital of such an MSE will not be reallocated towards more productive activities. Thus, a failure to provide a quick "exit" to non-viable MSEs may end up harming entrepreneurship, competitiveness, and the creation of jobs and growth.

Sixth, where MSEs are incorporated, the shareholders are typically involved in the management of the business. While this aspect will reduce the traditional agency problems existing in large corporations with a delegated management, it can create or exacerbate other problems, especially when the MSE is approaching a situation of insolvency. For instance, when the MSE has adopted a corporate form, the existence of limited liability will prevent the shareholders from incurring further losses once the MSE becomes insolvent. Therefore, the shareholders may have incentives to "gamble for resurrection" or to keep the MSE alive simply to buy time in an attempt to wait and see if the MSE's financial situation will improve in the future. In other cases, the decision to keep an MSE alive without initiating an insolvency proceeding can also be led by emotional and behavioural factors such as attachment to the business, over-optimism, or bias towards the status quo. Avoiding the commencement of an insolvency or restructuring procedure can also be due to the unattractiveness of the insolvency framework, as well as the culture of "fear of failure" existing in many jurisdictions, especially in Asia. Regardless of the motivations behind these responses by debtors, such behaviour and the failure to take corrective actions in a timely manner will destroy value, reducing recoveries for creditors and hampering MSEs' access to finance.

Weaknesses of the ordinary insolvency system for MSEs

Traditional insolvency frameworks often involve a costly and complex procedure. Navigating this procedure may require considerable resources and advice that many MSEs cannot afford.

Even if they can afford such a procedure, the ordinary insolvency procedure may not be suitable for them. For example, while the imposition of many rules mainly designed to protect a dispersed and uncoordinated body of creditors may make sense in the context of large companies, such rules might not be needed in an insolvency proceeding of an MSE with a simple financial structure consisting of only a few creditors.

Further, even if the insolvency framework is suitable for MSEs, there is an additional problem: many jurisdictions in Asia do not provide an effective DISCHARGE of debts for individuals. Even if they do, a discharge of debts usually requires the commencement of a separate procedure. Therefore, as sole proprietors and shareholders/managers often act as guarantors for the debts of MSEs, there should be greater coordination between the systems of corporate and personal insolvency. Otherwise, honest but unfortunate sole proprietors as well as the shareholders of MSEs who guarantee the debts of the MSEs will not find the corporate insolvency framework appealing. In that case, they might minimise the risk of insolvency by reducing their levels of debt and risk-taking or postponing (if possible, even avoiding) the commencement of insolvency proceedings. Thus, value can be destroyed for the society if, for example, those forms of behaviour lead to suboptimal investment decisions or delay the response to a situation of financial distress, reducing the likelihood of promoting an effective reorganisation of viable MSEs and an efficient liquidation of non-competitive MSEs.

Moreover, the lack of a quick response to a situation of insolvency can exacerbate the problem of zombie companies existing in many jurisdictions in Asia, reducing the competitiveness and efficient allocation of resources in the economy, and increasing the level of non-performing loans in the banking sector.

The need for simplified insolvency frameworks for MSEs

Insolvency law plays an essential role in promoting economic growth. First, by providing a variety of tools that can save viable but financially distressed firms, insolvency law has the ability to preserve jobs and wealth created by businesses. Moreover, if entrepreneurs know that, in the event of insolvency, they will have access to a system that helps them remedy their financial situations, they will have more incentives to start a business and take risks in the first place. As a result, insolvency law can help promote entrepreneurship and innovation.

Second, by liquidating non-competitive businesses, insolvency law can serve as a valuable mechanism to reallocate resources towards more productive activities. Therefore, the quick liquidation of non-viable businesses will help reduce the number of zombie companies potentially existing in the real economy.

Third, if an insolvency system can effectively preserve value, creditors can maximise their recoveries. Hence, they will be more incentivised to extend credit, fostering economic growth. In addition, the maximisation of returns to creditors will also improve the financial position of a debtor's lenders. In the case of financial creditors, this aspect will reduce the level of non-performing loans and can enhance financial stability. In the context of non-financial creditors, achieving this goal will reduce the risk of many of them (especially those more exposed to the debtor, usually because they do not have a diversified business) becoming insolvent themselves.

Fourth, from the perspective of debtors, if entrepreneurs know that, in the event of insolvency, the insolvency system will help them preserve value and address their financial problems (if a business is economically viable) or provide them with a quick exit (where a business is no longer viable), they may have more incentives to pursue entrepreneurial and value-creating economic activities.

Insolvency law can thus serve as a powerful tool to promote entrepreneurship, innovation, access to finance and economic growth. However, these goals can only be achieved if the insolvency system provides an attractive solution for distressed firms. Unfortunately, most jurisdictions in Asia do not currently provide a suitable insolvency framework for the majority of businesses existing in their economies: MSEs. To address this problem, this Guide recommends the adoption of a simplified insolvency framework for MSEs.

Scope and purpose of this guide

This Guide seeks to provide a set of principles and policy recommendations for the implementation of an efficient and effective insolvency framework for MSEs in Asia.[12] It considers the principles and policy recommendations suggested by various international organisations, as well as current academic literature. Most policy recommendations of this Guide are aligned with those suggested by other authors and organisations, including international standard-setters. However, as this Guide focuses specifically on Asia, the features existing in Asian jurisdictions often require the development, emphasis, or adjustment of some of the general principles and policy recommendations already suggested in relevant international literature.

Asia is a truly diverse region from cultural, legal and economic perspectives. While some jurisdictions in Asia have strong institutional frameworks, developed financial systems and high levels of economic development, these features (or some of them) are not found in other Asian jurisdictions. Such divergences, among others, often justify the adoption of different policy recommendations for the implementation of an efficient and effective insolvency framework for MSEs.

Additionally, as MSEs share many similarities across jurisdictions, some of the principles and policy recommendations suggested in this Guide may be useful for academic and policy debates in regions beyond Asia.

Finally, while this Guide focuses on MSEs, many of the principles and policy recommendations suggested can be useful for other companies, including large and medium-sized ones. This Guide focuses on MSEs for two primary reasons. First, MSEs represent the vast majority of micro, small and medium-sized enterprises in Asia. Second, medium-sized enterprises generally share more similarities with large companies than with small ones. Since the definition of medium-sized enterprises often differs across jurisdictions, each Asian jurisdiction should decide whether, based on the features and issues described in this Guide, some of the principles and policy recommendations suggested for MSEs may also apply to medium-sized enterprises.

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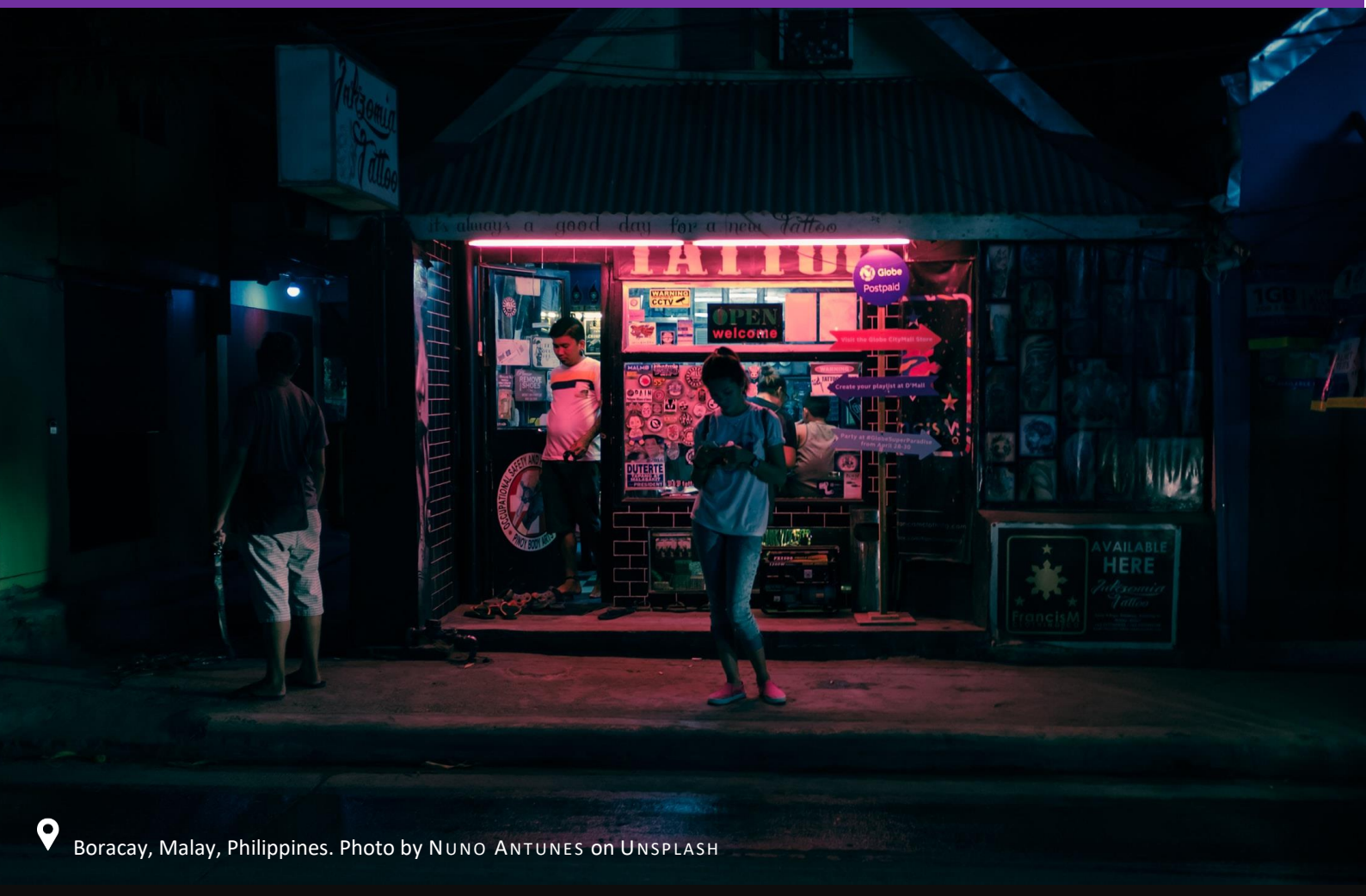
12 This Guide does not cover topics that can be relevant for enterprises of all types, such as those relating to cross-border insolvency and avoidance actions. Those topics may be considered in separate and subsequent guides to be published under the Project.

Principles for the design of an effective and efficient insolvency regime for MSEs in Asia

In this section, we suggest principles and policy recommendations for the design of an effective and efficient insolvency regime for MSEs in Asia. These principles include five essential principles suggested for adoption in jurisdictions seeking to implement an attractive insolvency framework for MSEs ("Key Principles"), as well as six principles that should ideally be adopted over time to provide MSEs with a comprehensive legal and institutional environment to deal with financial distress ("Aspirational Principles").



Boracay, Malay, Philippines. Photo by NUNO ANTUNES on UNSPLASH

Bangkok, Thailand. Photo by Pradamas Gifarry on Unsplash

Key Principles

Key Principle 1.	Promote out-of-court restructuring for viable MSEs
Key Principle 2.	Implement a simplified insolvency process for MSEs
Key Principle 3.	Provide a discharge of debts for honest but unfortunate entrepreneurs
Key Principle 4.	Reduce the stigma of insolvency proceedings
Key Principle 5.	Build up training and institutional capacity

Key Principle 1. Promote out-of-court restructuring for viable MSEs

Asian jurisdictions should promote the use of consensual or out-of-court restructuring (workouts) for viable MSEs facing financial trouble.

Local authorities and organisations in Asia should promulgate and disseminate good practices for workouts.

Introduction

Asian jurisdictions should promote the use of consensual or out-of-court restructuring ("WORKOUTS") for *viable* MSEs facing financial trouble. Even a simple form of workouts, consisting of an informal renegotiation of debts, can create several benefits for debtors, creditors and the society as a whole.

Advantages of workouts

First, achieving a workout can save significant costs associated with the commencement of an insolvency proceeding.[13] Moreover, while a situation of insolvency may lead to the destruction of value in any jurisdiction, this problem will be exacerbated in jurisdictions with inefficient or unattractive insolvency frameworks. As many jurisdictions in Asia, particularly emerging economies, have less than efficient insolvency frameworks, reducing the usage of the formal insolvency system in dealing with financially distressed firms will be more desirable than in jurisdictions with attractive institutional framework.[14]

Second, promoting the use of workouts may reduce the number of insolvency proceedings managed by the judiciary. Reducing the number of insolvency cases of MSEs managed by the judiciary can serve as a mechanism to increase judicial resources that may potentially be spent in other civil or commercial matters. The greater utilisation of workouts may thus improve the efficiency of many judicial systems in Asia.

Third, formal insolvency proceedings are heavily stigmatised in most Asian jurisdictions. Various legal, cultural and institutional factors, including the less than attractive insolvency framework existing in many Asian jurisdictions, as well as the stigma associated with business

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13 These costs include both the *direct costs* of the insolvency proceedings (e.g. fees charged by lawyers, insolvency practitioners and other advisors) and a variety of *indirect costs* generated by the initiation of the insolvency proceedings, and more generally a situation of financial distress. These latter costs include those generated by the loss of reputation, bargaining power, lenders, employees, suppliers and other factors destroying going-concern value. Some studies have shown that the indirect costs of financial distress often exceed the direct costs of insolvency proceedings, representing about 10% to 20% of the market value of a firm. See Gregor Andrade and Steven N Kaplan, "How Costly Is Financial (Not Economic) Distress? Evidence from Highly Leveraged Transactions That Became Distressed" (1998) 53 Journal of Finance 1443.

14 Factors contributing to an attractive institutional environment may include the efficiency of the judicial system, the absence of corruption, a strong commitment to the rule of law and a well-functioning public sector.

failure itself, have contributed to the unfavourable reputation of insolvency proceedings. Therefore, at least until the reputation of formal insolvency proceedings can be significantly improved in many Asian jurisdictions, the use of out-of-court solutions may provide a more attractive option for MSEs that seek to avoid the publicity and unfavourable connotations associated with the initiation of a formal insolvency process.

Fourth, MSEs usually have very simple financial structures comprising a few creditors. Therefore, it will be easier for MSEs to negotiate and reach an agreement with a few creditors than large firms with many dispersed creditors. With large firms, debtors and creditors face more coordination problems, and there is a higher risk of opportunistic behaviour by any one of the many creditors that exist in the debtor's financial structure. As a result, reaching a workout will be more feasible in firms with concentrated debt structures, as is generally the case with MSEs.

Fifth, the promotion of entirely consensual workouts does not require the involvement of any legislative body. Therefore, promoting workouts may help MSEs in jurisdictions where the political will or legislative priorities to adopt insolvency law reforms may be lacking. Moreover, the avoidance of the legislative process can save significant negotiation and temporal costs. Thus, promoting workouts may also serve as a short-term solution to support the real economy in cases of external shocks, such as those experienced during the Asian Financial Crisis and the COVID-19 pandemic.

Limitations of workouts

Despite their advantages, workouts also have certain limitations. For example, since the debtor is not protected by any statutory MORATORIUM, and a workout needs to be approved by all creditors that are supposed to be bound by the workout agreement,[15] a single creditor can easily frustrate the workout. In fact, the existence of these types of opportunistic behaviour often justifies the initiation of a HYBRID PROCEDURE or formal reorganisation procedure that typically provides debtors with a variety of provisions such as a moratorium or a majority rule, which addresses some of those issues. Nonetheless, such "holdout" problems are more likely to occur in companies with a larger number of creditors and dispersed financial structures, which is not typically the case with MSEs.

A problem commonly found in the context of MSEs seeking to reach a reorganisation agreement is the passivity of creditors.

For UNSECURED CREDITORS, the lack of significant assets in MSEs generates very limited expectations in terms of recoveries. Therefore, they may not have incentives to engage in further negotiations and incur legal costs. For secured creditors, this passivity is often due to the fact that, upon default, secured creditors are entitled to enforce their security interests and they might prefer to do so outside of a formal insolvency process.

Additionally, the rationally apathetic behaviour of both secured and unsecured creditors is exacerbated by the lack of an effective discharge of debts for honest but unfortunate debtors in many Asian jurisdictions. In other words, creditors know that insolvent debtors will be

15 There are certain exceptions in the case of "enhanced workouts" or out-of-court agreements subject to some forms of regulation. Such workouts exist in some Asian jurisdictions such as the Philippines. However, they are not the type of purely consensual workouts covered here.

unable to get rid of their debts. As a result, debtors will have little bargaining power when seeking to negotiate a workout.

Encouraging the use of workouts

The problem of creditor passivity in workouts involving MSEs can be partially addressed if, as this Guide suggests, debtors have access to a simplified insolvency process that provides protections to the debtors (including a moratorium) and an effective discharge of debts for honest but unfortunate individual entrepreneurs. Furthermore, as a simplified insolvency process for MSEs would make the procedure affordable for the debtor, the threat of initiating an insolvency process will be more credible. These factors will encourage creditors to negotiate with debtors seeking to reach an out-of-court agreement.

Additionally, jurisdictions that want to promote entirely consensual workouts should also adopt other policies. For instance, they can start by promulgating good practices for out-of-court restructuring. These practices can be promulgated by regulators, chambers of commerce, central banks, association of banks, associations of INSOLVENCY PRACTITIONERS, or other private or public actors. Thereafter, such practices must be disseminated, not only among actors involved in insolvency and restructuring but also among the entire entrepreneurial community. Doing so would allow entrepreneurs, creditors, shareholders and managers to become aware of these good practices, facilitating the adoption of early and informed actions in the event of financial distress.

Phnom Penh, Cambodia. Photo by PJ GO on UNSPLASH

Hanoi, Vietnam. Photo by Hiep Nguyen on Unsplash

Figure 4. Examples of good practices for workouts

Jurisdiction	Organisation	Guide
 Hong Kong SAR, China	The Hong Kong Association of Banks 香港銀行公會	Hong Kong Approach to Corporate Difficulties
 Japan	JBA Japanese Bankers Association 一般社団法人 全国銀行協会	Guidelines for Out of Court Multi-Financial Creditors Workout
 Singapore	abs The Association of Banks in Singapore	Principles & Guidelines for Restructuring of Corporate Debt – The Singapore Approach
 International	INSOL International	Statement of Principles for a Global Approach to Multi-Creditor Workouts II
	International Insolvency Institute	The Guideline for multi-creditor out-of-court workouts
	The World Bank	A Toolkit for Corporate Workouts

Key Principle 2. Implement a simplified insolvency process for MSEs

Asian jurisdictions should adopt simplified insolvency rules for MSEs, and ideally adopt simplified insolvency processes.

The simplified insolvency process for MSEs may be a simpler, faster, and lower-cost version of the ordinary procedures or a totally new process tailored to MSEs.

The simplified insolvency process for MSEs can consist of a single-entry insolvency process or a dual-gateway insolvency process. If a dual-gateway process is adopted, Asian jurisdictions should adopt simplified reorganisation procedures and simplified liquidation procedures.

In simplified reorganisation procedures, creditors should be empowered to terminate the procedures. In jurisdictions with efficient and reliable judicial systems, courts should also be allowed to terminate a reorganisation procedure.

In simplified reorganisation procedures, a debtor-in-possession "DIP" model should be the preferred option for the governance of the procedures. The DIP model will be a more desirable option for assetless MSEs as well as jurisdictions without a sophisticated body of insolvency practitioners. If the DIP model is adopted, creditors should be entitled to appoint an insolvency practitioner.

In simplified liquidation procedures, the appointment of an administrator to take over the debtor's assets will be the preferred governance system for the process. For assetless MSEs, jurisdictions may adopt a system of public trustee or an DIP model in liquidation. If the DIP model is adopted, creditors should be entitled to appoint an insolvency practitioner.

The simplified insolvency process should provide debtors with a variety of tools that contribute to the creation or preservation of value. These tools may include a moratorium, prohibition of *ipso facto* clauses, avoidance actions, and some forms of priority eventually granted to the lender extending new financing.

Asian jurisdictions should subject the simplified insolvency process to stringent timelines. They should also facilitate the use of electronic means and standardised forms in the simplified insolvency process.

Selecting simplified insolvency rules or simplified insolvency processes

Introduction

There are different mechanisms for adopting a simplified insolvency framework. Jurisdictions can implement a simplified insolvency process exclusively available to MSEs. Alternatively, they can adopt special rules for MSEs within the ordinary insolvency process. If both systems ultimately provide MSEs with the same level of flexibility and simplicity, both options should be equally attractive. As a general rule, however, the adoption of a simplified insolvency process is preferred as MSEs will be able to more easily navigate such a framework.

Types of simplified insolvency processes

Dual-gateway approach

If jurisdictions in Asia implement simplified insolvency processes exclusively available to MSEs, they may decide to do so through a "DUAL-GATEWAY" approach that consists of two separate procedures: a simplified reorganisation procedure and a simplified liquidation procedure. This model has been implemented in some jurisdictions in Asia that have adopted simplified insolvency frameworks, such as Australia and Singapore. If this model is adopted, the simplified reorganisation and liquidation procedures can be designed as simpler, faster, and lower-cost versions of the ordinary procedures, such as the case with Singapore. Alternatively, jurisdictions can adopt entirely new reorganisation and liquidation procedures specifically designed for MSEs, such as the case with Australia.

Single-entry approach

Alternatively, jurisdictions in Asia that wish to implement simplified insolvency processes for MSEs may adopt a "SINGLE-ENTRY" approach – that is, a sole insolvency proceeding that might end in reorganisation, liquidation or a going concern sale.[16] If so, this insolvency process can be designed in different ways. For instance, the process can be initiated as a reorganisation process. This is the case in India. In Laos, the law includes a simplified procedure for the rehabilitation of MSEs but does not include a simplified procedure for the liquidation of such enterprises. However, even if the default rule is reorganisation, the procedure should be automatically converted into a liquidation procedure if, for example, a reorganisation plan is not approved within a short period of time or if the majority of creditors decide that the MSE should be liquidated.[17]

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16 In the context of ordinary insolvency proceedings, a single-entry insolvency process exists in various countries around the world, including Germany, Mexico, Spain and Uruguay. In Asia, an example can be found in India where there is a single insolvency resolution process typically seeking to promote reorganisation.

17 A similar approach has been suggested in academic literature, see Riz Mokal, Ronald Davis, Alberto Mazzoni, Irit Mevorach, Madam Justice Barbara Romaine, Janis Sarra, Ignacio Tirado, and Stephan Madaus, *Micro, Small, and Medium Enterprise Insolvency: A Modular Approach* (Oxford University Press 2018) pp. 57-58. In Australia, while the simplified insolvency framework formally includes two separate procedures, from a functional perspective, it is not that different. After all, insolvent debtors can easily use the restructuring tools (including the moratorium) provided in the simplified reorganisation procedure, ending up in liquidation if the debtors fail to reach an agreement with their creditors within a limited period of time. Therefore, in practice, the simplified reorganisation procedure would be acting as a default rule, as it happens in jurisdictions with a single-entry insolvency proceeding initiated as a reorganisation procedure.

Tokyo, Japan. Photo by MAX BENDER on UNSPLASH

Figure 5. Types of simplified insolvency proceedings for MSEs in Asia

Since MSEs do not generally have a significant going concern value, jurisdictions in Asia may prefer to adopt a single-entry process initiated as a liquidation procedure, which may reduce the risk of opportunistic use of reorganisation procedures. Alternatively, jurisdictions in Asia can consider the possibility of implementing a single-entry insolvency process that consists of an auction process where bidders (including the individuals behind MSEs) can submit offers for the acquisition of assets as well as reorganisation proposals. Creditors would then decide which offer to accept. Thus, the auction process would conclude with a reorganisation, a piecemeal liquidation or a going concern sale.

The optimal choice

The optimal regulatory model, as well as the particular features of that model, will depend on a variety of jurisdiction-specific factors. Regardless of the regulatory model, it is important to make sure that viable businesses do not end up in a piecemeal liquidation and that non-viable businesses do not use reorganisation procedures opportunistically. Otherwise, both situations would imply a failure of the insolvency system, hampering the ability of insolvency law to efficiently allocate resources and promote firms' access to finance.

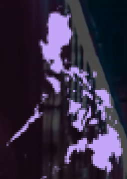
Simplified insolvency processes in jurisdictions with an attractive environment for workouts

The relative need of reorganisation procedures for MSEs

In many jurisdictions in Asia, purely contractual workouts are incentivised through different mechanisms, including the existence of a formal framework for workouts that provides various tools often existing in hybrid procedures such as a moratorium and a majority rule, the existence of tax incentives for debtors and creditors to reach an out-of-court solution, the involvement of a central bank or any other agency, and the promulgation of good practices for workouts. In these jurisdictions, viable MSEs have many chances to reorganise their business without the need to use formal insolvency proceedings. The existence of relatively few creditors and a simple financial structure may facilitate this outcome, and the destruction of value caused by the direct and indirect costs of formal insolvency proceedings should encourage debtors and creditors to reach an out-of-court agreement.

In many cases, if a workout fails or is not even attempted, it is likely that the MSE is not economically viable or that creditors do not trust the individuals behind the MSE. Thus, attempting a workout can serve as a filtering mechanism to determine the viability of an MSE, or at least the credibility of the individuals running the MSE. As a result, although many MSEs that are unable to reach a workout may still be viable, the risk associated with an opportunistic use of formal reorganisation procedures by non-viable MSEs will be higher. Jurisdictions in Asia that have an attractive environment for workouts should thus impose more stringent conditions for the initiation of reorganisation procedures by MSEs, especially given the fact that many MSEs do not have a significant going concern value and therefore might not deserve to be reorganised.

Figure 6. Examples of government backing of workouts in Asia

Jurisdiction	Elements
 Hong Kong SAR, China	**Support by the Central Bank.** The Hong Kong Approach to Corporate Difficulties was jointly released by the Hong Kong Association of Banks and the Hong Kong Monetary Authority.
 Indonesia	**Support by the Central Bank.** The Jakarta Initiative, now repealed, was a formalised out-of-court restructuring framework. Its key feature was to facilitate restructuring and co-ordination among regulatory agencies in response to the Asian Financial Crisis.
 Philippines	**Regulation of workouts.** In out-of-court workouts regulated under the Financial Rehabilitation and Insolvency Act (FRIA) of 2010 (Republic Act No. 10142), a standstill period not in excess of 120 days may be agreed upon by the debtor and creditors representing more than 50% of the total liabilities of the debtor, pending negotiation and finalisation of the reorganisation plan.
 Thailand	**Support by the Central Bank.** The Bank of Thailand has issued recommendatory policies on out-of-court workouts, for example, the Bank of Thailand Policy on Out-of-Court Workouts (31 October BE 2561 (2018). **Tax incentives.** Out-of-court workouts are eligible for tax exemption on gains received from the workouts under, among others, the Royal Decree stipulated according to the Revenue Code on Tax Exemption (No 340) BE 2541 (1998).

Shanghai, China. Photo by Thana Gu on Unsplash

Preventing the opportunistic use of reorganisation procedures

Dual-gateway approach

To reduce the opportunistic use of reorganisation procedures in jurisdictions in Asia that adopt the dual-gateway approach, debtors initiating a reorganisation procedure might be required to explain why an out-of-court restructuring is not feasible. Moreover, various mechanisms should be provided to easily convert the reorganisation procedure into a liquidation procedure. In Asian jurisdictions with efficient and sophisticated institutions, these mechanisms can consist of empowering courts to review the eligibility of debtors for the initiation of the reorganisation procedure and convert the reorganisation procedure into a liquidation procedure whenever it can be requested by creditors or any other third parties. By contrast, in Asian jurisdictions where judicial systems are less efficient or reliable, as often the case in emerging economies, these types of decisions should be made by creditors.

Single-entry approach

If a jurisdiction in Asia that has an attractive environment for workouts adopts a single-entry insolvency process for MSEs, the implementation of a liquidation procedure as the default rule, or the adoption of a system of auctions, is a more desirable strategy to prevent the opportunistic use of reorganisation procedures by non-viable MSEs. Moreover, under either of the approaches, an MSE can still be saved if it turns out to be economically viable. Namely, if a jurisdiction adopts the system of auctions, the business can be saved if a reorganisation proposal or a going concern sale is approved by creditors. If a jurisdiction adopts a liquidation procedure as the default rule, the *business of an MSE* can survive through a going concern sale even if, should the MSE adopt a corporate form, the *company* is ultimately dissolved. Therefore, these systems can facilitate the survival of viable businesses while simultaneously reducing the opportunistic use of reorganisation procedures by non-viable ones.

Simplified insolvency processes in jurisdictions without an attractive environment for workouts

Encouraging the adoption of the dual-gateway approach

In Asian jurisdictions where workouts are not incentivised,[18] and out-of-court restructuring has not been very popular, it is not easy to forecast whether MSEs initiating an insolvency process might be economically viable or not. Therefore, a system providing the *dual-gateway* approach – reorganisation and liquidation – is preferred. In such cases, however, the law should provide safeguards to make sure that reorganisation procedures are not used opportunistically by non-viable businesses, especially taking into account that many MSEs do not typically have a significant going concern value and therefore might not need or even deserve tools generally made available by formal reorganisation procedures.

18 Brunei, Cambodia, Laos, Myanmar and Vietnam are among them.

Preventing the opportunistic use of reorganisation procedures by non-viable MSEs

Safeguards that may potentially be adopted to reduce the opportunistic use of reorganisation procedures should always include the empowerment of creditors to convert the reorganisation procedure into a liquidation procedure. If an Asian jurisdiction decides to implement safeguards to reduce the opportunistic use of a reorganisation procedure, it should provide creditors with the power to convert the reorganisation procedure into a liquidation procedure. A variation of this type of protection already exists in some Asian jurisdictions. For instance, in Indonesia, the reorganisation procedure is expected to last 45 days,[19] albeit extendable up to a maximum of 270 days based on creditors' approval.[20] Failure to secure creditors' approval will automatically put the debtor into liquidation. In the Philippines, the approval by a qualified majority of creditors is required for the moratorium provided under the out-of-court restructuring regulated in the insolvency legislation.[21] In India, the moratorium lasts 180 days, provided that the resolution professional may ask the court for an extension of 90 days if it is authorised by a qualified majority of creditors.[22] In Singapore, at least one-third in value of a company's creditors can block the acceptance of the company into the simplified debt restructuring programme.[23]

In Asian jurisdictions with efficient and reliable institutions, this power of conversion can also be given to the courts. In such cases, the courts may convert the reorganisation procedure into liquidation if, for instance, creditors show that the debtor is unlikely to approve a reorganisation plan either because it lacks sufficient creditor support or because the business is not economically viable.

Finally, if it is shown that an MSE has initiated reorganisation procedures in bad faith, this behaviour should also be punished by, for instance, not allowing the individuals behind the MSE to obtain a discharge of debts. Such consequences should serve as additional mechanisms to deter opportunistic behaviour by debtors.

Insolvency tools included in the simplified insolvency process

Regardless of the type of simplified insolvency process adopted for MSEs, the process should provide certain tools to protect the debtor's assets, at least while creditors decide the fate of the business. These tools may include the restriction of *IPSO FACTO* CLAUSES, the availability of AVOIDANCE ACTIONS, provisions facilitating RESCUE FINANCING, and an AUTOMATIC MORATORIUM available for a short period of time. In Asian jurisdictions with efficient and well-equipped courts, this moratorium may be extended by the court. Otherwise, any extension of the moratorium should be approved by creditors.

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19 Law No 37 of 2004 on Bankruptcy and Suspension of Payment (Indonesia), Art 225(4).

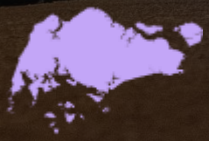
20 Law No 37 of 2004 on Bankruptcy and Suspension of Payment (Indonesia), Art 228(6).

21 Financial Rehabilitation and Insolvency Act (FRIA) of 2010 (Republic Act No. 10142) (Philippines), section 85; Financial Rehabilitation Rules of Procedure (AM No 12-12-11-SC; 27 August 2013) rule 4, section 2.

22 Insolvency and Bankruptcy Code, 2016 (No 31 of 2016) (India), section 12(3).

23 Insolvency, Restructuring and Dissolution (Amendment) Act 2020 (Singapore), section 72F(3)(j).

Figure 7. Examples of variation of creditors' power of conversion in selected Asian jurisdictions

Jurisdiction	Protection	Source
 India	Creditor approval required for extension of moratorium	Insolvency and Bankruptcy Code, 2016 (No 31 of 2016) (India), section 12(3).
 Indonesia	Automatic conversion to liquidation if extension of reorganisation is rejected by creditors	Law No 37 of 2004 on Bankruptcy and Suspension of Payment (Indonesia), articles 225(4) and 228(6).
 Philippines	Creditor approval required for moratorium under out-of-court restructuring stipulated by legislation	Financial Rehabilitation and Insolvency Act (FRIA) of 2010 (Republic Act No. 10142) (Philippines), section 85. Financial Rehabilitation Rules of Procedure (AM No 12-12-11-SC, 27 August 2013) rule 4, section 2.
 Singapore	Creditors' power to block entry to the simplified debt restructuring programme	Insolvency, Restructuring and Dissolution (Amendment) Act 2020 (Singapore), section 72F(3)(j).

Yangon, Myanmar. Photo by CHRISTIAN HOLZINGER on UNSPLASH

Reducing the length and costs of insolvency proceedings

The success of a simplified insolvency process for MSEs largely depends on the ability to design a quick and affordable insolvency procedure for MSEs. To that end, several strategies can be adopted to reduce the length and costs of insolvency proceedings for MSEs.

First, if an Asian jurisdiction permits the debtor to commence the insolvency procedure, the procedure should commence immediately upon filing of the relevant court application. Where certain requirements are met, such as the existence of unpaid debts, creditors should also be entitled to initiate the procedure. In the latter case, however, the debtor should be allowed to oppose the application by showing that it is solvent despite the default. Where a simplified reorganisation procedure (or a single-entry insolvency process initiated by default as a reorganisation procedure) is adopted, the majority of creditors should be entitled to terminate the reorganisation procedure at any time. Thus, the flexibility provided to debtors for the early initiation of the reorganisation procedure will be accompanied by additional safeguards to protect the interests of creditors.

Second, the financial conditions potentially required for the initiation of the insolvency procedure for MSEs should be broad enough to facilitate the commencement of the procedure even if the debtor is not factually insolvent yet. Therefore, the procedure can also be used to turn around businesses only foreseeing financial trouble. Any opportunistic filing for reorganisation can be addressed after the commencement of the procedure by terminating the reorganisation procedure and, if so, imposing sanctions on the debtor.

Third, jurisdictions should embrace the use of technology by, for example:

- adopting a standardised electronic form for the filing of insolvency petitions;
- conducting creditors' meetings and admitting and verifying CLAIMS through electronic means; and
- promoting the use of electronic platforms for the sale of assets.

Various jurisdictions around the world have already taken significant steps to promote the use of electronic platforms for the sale of assets in insolvency proceedings. In Asia, China and India are among jurisdictions that have adopted a more ambitious strategy in this regard.[24]

[24] For China, see *NOTICE OF GUANGZHOU INTERMEDIATE PEOPLE'S COURT ON PRINTING AND DISTRIBUTING THE MEASURES FOR THE IMPLEMENTATION OF PROPERTY DISPOSAL IN BANKRUPTCY PROCEEDINGS (FOR TRIAL IMPLEMENTATION)* (Guangzhou Intermediate People's Court, 25 February 2020). For India, see Schedule I of INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (LIQUIDATION PROCESS) REGULATIONS, 2016, Schedule I, section 1(7). The use of electronic platforms for the sale of assets has also been promoted in other jurisdictions outside of Asia, with Greece as a notable example. See the Greek Insolvency Code, Art 163.

Fourth, the involvement of judicial or administrative authorities should be significantly reduced in insolvency proceedings for MSEs. In Asian jurisdictions with efficient and reliable institutions, such reduced involvement can consist of requiring court approval only for key transactions, such as the authorisation of rescue financing, the sale of essential assets or, if available, the confirmation of a plan that has been rejected by various classes of creditors ("CRAMDOWN").[25] As a general rule, however, and even more so in jurisdictions with less efficient and reliable institutions, these major transactions should be ideally approved by creditors.

Finally, an efficient insolvency process for MSEs should reduce formality and procedural requirements that generate costs and delays without necessarily providing greater protection for creditors. For instance, the timeline to submit claims, as well as the period to challenge the allowed claims, should be reduced. Additionally, due to the passivity of creditors existing in the context of MSEs, the headcount test for the approval of reorganisation plans existing in many Asian jurisdictions (especially in the context of schemes of arrangement[26]) can be abolished, and a creditor's silence or lack of negative vote may be counted as an affirmative vote.

Simplifying the governance of insolvency proceedings

Introduction

Most jurisdictions in Asia require the appointment of either an ADMINISTRATOR taking control of the debtor's assets or, at least, a SUPERVISOR in charge of monitoring the debtor once a company initiates a reorganisation procedure. As a result, with a few exceptions, the DEBTOR IN POSSESSION MODEL ("DIP model") traditionally existing in the United States is rarely found in other jurisdictions, except in the context of schemes of arrangement.

Encouraging the DIP or DIP-SIP model in reorganisation procedures

In the context of MSEs, however, the DIP model, or a debtor in possession supervised by an insolvency practitioner ("DIP-SIP MODEL"), should be the general rule, at least in a simplified insolvency process mainly designed for the rehabilitation of the debtor's business. The adoption of the DIP or DIP-SIP model may generate several benefits.

First, both models (especially the DIP model) would reduce the fees associated with having a full-time administrator to manage the debtor's business. Moreover, by reducing the costs of the proceeding, more MSEs will be able to afford a simplified insolvency process.

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25 This provision, also known as "cross-class cramdown", is only found in Asian jurisdictions such as China, Singapore and South Korea. The possibility of imposing a plan on dissenting classes of creditors is an insolvency provision imported from the US Chapter 11 reorganisation procedure.

26 The scheme of arrangement is a procedure potentially used for debt restructuring that exists in most common law jurisdictions, including Asian jurisdictions such as Australia, Hong Kong SAR of China, India, Malaysia, New Zealand and Singapore.

Second, the adoption of a DIP or even DIP-SIP model may encourage managers to initiate the procedure earlier. Therefore, allowing managers to keep running the business will reduce their reluctance to initiate insolvency proceeding, which is a problem exacerbated in Asia due to a variety of cultural and institutional factors. This early initiation of insolvency proceeding will increase the chances of rehabilitating viable but financially distressed businesses. It will also facilitate the commencement of the procedure once the value of the assets has not been significantly dissipated, contributing to the maximisation of returns to creditors.

Finally, debtors might need to make business decisions while the insolvency process is ongoing. By adopting the DIP or DIP-SIP model, debtors and creditors can benefit from the expertise of managers. Consequently, the appointment of an administrator to manage the property and business affairs of the debtor should only take place in exceptional cases, such as instances involving fraud or mismanagement.

The DIP-SIP model can be desirable if the supervisor is able to effectively perform important functions during the insolvency process, such as monitoring the debtor, assessing the viability of the debtor's business and, when the business is economically viable, assisting the debtor with the formulation of a reorganisation plan. In many cases, the supervisor serves as a reliable third party who boosts creditor confidence. Unfortunately, many jurisdictions in Asia do not have a qualified body of insolvency practitioners. As such, the adoption of the DIP model would be more desirable in reorganisation while the insolvency profession is developing in those jurisdictions. In those cases, however, creditors of MSEs should be entitled to appoint a supervisor or even an administrator. If an MSE has sufficient assets to cover the costs of the insolvency practitioner, the fees charged by the supervisor or the administrator should be borne by the debtor. In the context of an assetless MSE, those costs should be borne by the creditors appointing the insolvency practitioner. Alternatively, the costs can also be borne by a third-party funder or the insolvency practitioner itself. In cases where a recovery of assets through avoidance actions or liability of directors is anticipated, many insolvency practitioners and third-party funders are expected to be willing to take up the cases.

Favouring the appointment of administrators in liquidation procedures and auctions

In liquidation procedures and auctions, the expertise of the management will not be that relevant. Moreover, the fact that the business will be shut down may exacerbate various forms of opportunist behaviour by the debtor, including the potential deviation of assets towards related parties or the act of favouring some creditors over others. As a result, the appointment of an administrator, instead of merely a supervisor, will be a more desirable governance model in these proceedings.

Due to the lack of assets in many MSEs, the appointment of an administrator might not be an affordable option. In Asian jurisdictions with efficient and well-functioning institutions, this problem can be solved by adopting a system of public trustees with expertise and special training in insolvency matters. Alternatively, a jurisdiction may adopt a "private solution" based on the DIP model even in liquidation procedures and auctions. In this latter scenario, creditors should be entitled to appoint an administrator. As it has been mentioned for reorganisation procedures, if an MSE has sufficient assets to cover the costs of the insolvency practitioner, the fees charged by the administrator should be borne by the debtor. In the context of an assetless MSE, those costs should be borne by the creditors appointing the insolvency practitioner, a third-party funder or the insolvency practitioner itself.

Facilitating post-petition financing

Giving super-priority to providers of new financing

Obtaining new financing is often difficult for MSEs, and this problem is often exacerbated in a situation of insolvency.

To address this challenge, Asian jurisdictions should facilitate new financing to MSEs subject to an insolvency proceeding. To that end, debts and expenses needed to create or preserve value (e.g., new debts and expenses incurred with critical employees and suppliers) and those potentially required to manage the insolvency procedure (e.g., professional fees) should enjoy an ADMINISTRATIVE EXPENSE PRIORITY.

In fact, this type of priority for new financing obtained by the debtor—in many cases, through the administrator appointed to manage the property and business affairs of the debtor—already exists in many jurisdictions in Asia, including Australia, Brunei, China, India, Indonesia, Japan, Malaysia, the Philippines, Singapore and South Korea. However, it is not often used if, as it happens in Australia, the administrator can be liable for the new debts and expenses incurred.[27]

Additionally, if an MSE has unencumbered assets, the debtor should be allowed to provide the new lender with a collateral over these assets, which is an option that also exists in various Asian jurisdictions, including Brunei, Malaysia, the Philippines and Singapore. Specifically, in Brunei and Malaysia, administrators are entitled to borrow money and grant security therefor over the property of the debtor. [28] In the Philippines, the new financing should be approved by the court upon recommendation of the rehabilitation receiver.[29] In Singapore, any super-priority associated with rescue financing must be authorised by the court.[30]

Preventing the wasteful dilution of the pie available for unsecured creditors

To avoid any opportunistic or wasteful dilution of the pool of assets available for unsecured creditors, the priority granted to post-petition lenders should be authorised by a third party.

In Asian jurisdictions with efficient and well-equipped courts, this exercise may be conducted by the courts. However, in jurisdictions with less efficient and less-equipped courts, such authorisation should be given by creditors. In other words, as an administrative expense priority or a new collateral over unencumbered assets may eventually reduce the pool available for distribution to unsecured creditors, the new financing should be authorised by unsecured creditors.

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27 See Corporations Act 2001 (Cth) (Australia), section 443A.

28 See Insolvency Order, 2016 (S 1/2016) (Brunei), Second Schedule; Companies Act 2016 (Act 777) (Malaysia), Ninth Schedule.

29 See Financial Rehabilitation and Insolvency Act (FRIA) of 2010 (Republic Act No. 10142), (Philippines), section 55.

30 Insolvency, Restructuring and Dissolution Act 2018 (No. 40 of 2018) (Singapore), section 67.

Singapore. Photo by Galen Crout on Unsplash

Even if some unsecured creditors might not make value-maximising decisions due to rational apathy and lack of expertise, the fact that they will bear the costs and benefits of their choices will make the general body of unsecured creditors the most suitable actor to decide whether this priority should be granted. Some Asian jurisdictions seem to be moving in this direction. For instance, in India, new financing which enjoys an administrative expense priority should be authorised by the committee of creditors.[31]

31 Insolvency and Bankruptcy Code, 2016 (No. 31 of 2016) (India), section 25(c).

Key Principle 3. Provide a discharge of debts for honest but unfortunate entrepreneurs

The simplified insolvency process should provide a discharge of debts for honest but unfortunate individual entrepreneurs. For MSEs operating as corporate entities, Asian jurisdictions should also facilitate the discharge of debts to insolvent shareholders and managers acting as guarantors of the companies' debts.

In jurisdictions with strong institutions, the discharge can be adopted after the court has verified that the debtor was indeed honest and unfortunate. Jurisdictions with weak institutions should provide an automatic discharge of debts unless the creditors or other third parties show that the debtor was not honest or unfortunate. In both jurisdictions, the law should establish certain presumptions to determine when the standard of honest but unfortunate debtor can be challenged.

Introduction

In many Asian jurisdictions, the vast majority of MSEs are not incorporated.[32] Even if they are, the shareholders behind the incorporated MSEs usually guarantee the firms' debts, exposing them to unlimited liability in practice. Thus, any effort to enhance the attractiveness of the corporate insolvency regime should be accompanied by a simultaneous reform of the regime for *personal* insolvency to allow an effective discharge of debts for honest but unfortunate debtors. Otherwise, MSEs may still find the insolvency framework unattractive if the individuals behind them cannot enjoy an effective discharge of debts.

Lack of a discharge of debts in many Asian jurisdictions and benefits of adopting a "fresh-start policy" for individual entrepreneurs

Unfortunately, many jurisdictions in Asia still prohibit, or impose very stringent conditions for allowing, a discharge of debts for individual entrepreneurs.[33] Despite the scepticism against a fresh-start policy in many Asian jurisdictions, empirical literature has shown that providing an effective discharge of debts for individual entrepreneurs can generate various positive effects for the real economy, especially in terms of entrepreneurship.

32 See FEATURES OF MSEs. It should be noted, however, that this feature generally exists in most MSEs around the world. See Riz Mokal, Ronald Davis, Alberto Mazzoni, Irit Mevorach, Madam Justice Barbara Romaine, Janis Sarra, Ignacio Tirado, and Stephan Madaus, *Micro, Small, and Medium Enterprise Insolvency: A Modular Approach* (Oxford University Press 2018) p. 58.

33 Jose Garrido, Sanaa Nadeem, Nagwa Riad, Chanda DeLong, Nadia Rendak, and Anjum Rosha, "TACKLING PRIVATE OVER-INDEBTEDNESS IN ASIA: ECONOMIC AND LEGAL ASPECTS" *IMF Working Paper* (WP/20/172), August 2020.

Figure 8. Examples of Asian approaches to personal insolvency

* A discharge (subject to restrictions) is available in the Shenzhen Municipality of Guangdong Province of China: Regulations of the Shenzhen Special Economic Zone on Personal Bankruptcy (effective from 1 March 2021). No discharge is available in the other municipalities of Guangdong Province.

Huangshan, China. Photo by Touann Gatouillat Vergos on Unsplash

Limits of the discharge of debts and definition of the honest but unfortunate debtor

Risks and limits of adopting a discharge of debts for individuals

Making the discharge of debts available to all types of debtors can lead to negligent and opportunist behaviour by borrowers. As a result, creditors may respond with an increase in the cost of debt, harming firms' access to finance and hindering economic growth. For that reason, the law should make sure that only *honest* but *unfortunate* debtors have access to such discharge of debts.[34] Therefore, the debtor should satisfy two conditions.

First, the debtor has to be a *bona fide* debtor. To that end, the insolvency legislation could establish a variety of circumstances, or even presumptions, where a debtor is considered as having not acted in good faith. For example, it can be shown that the debtor has not acted in good faith if: (1) prior to the initiation of the insolvency proceeding, the debtor transferred or destroyed property with the intent to hinder, delay, or defraud a creditor; (2) after the initiation of the insolvency proceeding, the debtor destroyed or diverted assets; (3) the debtor concealed, destroyed, mutilated or falsified any financial documents; (4) the debtor made a false oath or presented a false claim in connection with the insolvency proceeding; or (5) the debtor failed to obey any lawful order of the court.[35]

Second, the law should only provide the discharge of debts to *unfortunate* debtors. Thus, debtors behaving in a reckless manner should not have access to the discharge. Reckless behaviour may include borrowing in an irresponsible manner, as well as other forms of behaviour that hampers the understanding of the debtor's financial position as it may occur when a debtor who is required to keep accounting records failed to perform these obligations.

By adopting this approach, the implementation of a discharge of debts would not create any moral hazard or adverse impact on lending markets. In fact, since only honest but unfortunate debtors would have access to the discharge of debts, many debtors may even have incentives to behave more diligently. Therefore, the adoption of a discharge of debts can end up benefitting both debtors and creditors.

Proof of the honest but unfortunate debtor

Determining whether a debtor was honest but unfortunate on a case-by-case basis can be a costly exercise requiring the involvement of the judiciary. For that reason, Asian jurisdictions with weak institutions should ideally adopt a rebuttable presumption of good faith. Under this model, debtors would get an automatic discharge of debts unless creditors or other third parties challenge the discharge on the basis that the debtor was not honest and unfortunate based on the presumptions eventually established by law.

Jurisdictions with strong institutions, however, may opt for a system based on an *ex ante* review. Under this model, the discharge of debts would only be granted if the court verifies that the debtor had not engaged in any of the conducts that rebut the honest but unfortunate behaviour.

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34 The concept of "honest but unfortunate debtor" was popularised in the United States. See *Grogan v. Garner*, 498 *U.S.* 279 (1991).

35 A similar approach is adopted in the United States. See section 727(a) of the United States Code, Title 11.

Other aspects

Debts excluded from discharge should be kept to a minimum and should be clearly defined in the law. Moreover, due to the commingling of business and personal debts that is generally found in MSEs, there should be coordination between the system of personal and corporate insolvency. Therefore, all personal and business debts of a natural person should ideally be included in the simplified insolvency proceeding. The use of a single procedure for MSEs and the individuals behind the MSEs would save significant costs for debtors, creditors and the society as a whole.

Shenzhen, China. Photo by JUNIPERPHOTON on UNSPLASH

Key Principle 4. Reduce the stigma of insolvency proceedings

Asian jurisdictions should adopt active policies to reduce the stigma of insolvency proceedings. These policies may include embracing terms such as "debtor" instead of "bankrupt", as well as the promotion of education and awareness in insolvency and restructuring.

Stigma of insolvency in Asia and beyond

While the stigma associated with insolvency proceedings is a problem in many jurisdictions, it is more pronounced in Asia where there is a greater fear of failure. Moreover, since the reputation of the individuals behind MSEs is often associated with the fate of those MSEs, the economic and social consequences generated by the stigma of insolvency proceedings will be exacerbated in the context of MSEs.

Legal and educational strategies to reduce the stigma of insolvency proceedings

Reducing the stigma of insolvency proceedings is a challenging long-term task. Yet, Asian jurisdictions can promote a variety of legal and educational policies to address this problem.

Removing criminal punishment

First, insolvency law should be clearly separated from criminal liability. Business failure should not be punished. Only fraudulent behaviour should be punished, and such punishment can take place outside of the insolvency framework. Less egregious behaviour could be dealt with by imposing fines or a form of civil liability within insolvency proceedings.

Introducing “nudges”

Second, regulators can reduce the stigma of insolvency proceedings by implementing several "nudges". For example, the United States legislature decided to use the term "debtor" rather than "bankrupt" to refer to insolvent companies. In Chile, the institution in charge of overseeing insolvency proceedings has been named the "Superintendence of Insolvency and Re-entrepreneurship". Such nudges can help reduce the stigma associated with insolvency proceedings.

Improving attractiveness of insolvency systems

Third, while cultural and historical factors have contributed to the stigma of insolvency proceedings in Asia, the inability of many insolvency systems to provide an efficient and effective response to financially distressed businesses have probably exacerbated the unfavourable reputation of insolvency proceedings in the region. Therefore, improving the attractiveness of many insolvency systems in Asia will help reduce the stigma and unfavourable reputation traditionally associated with those proceedings.

Promoting education and awareness

Finally, reducing the stigma of insolvency proceedings requires the promotion of education and awareness of insolvency. These educational efforts may range from information disseminated by public authorities on their official websites, to training programmes targeting entrepreneurs, directors and other stakeholders. Additionally, it is important to change the way insolvency law has traditionally been taught and understood in many Asian jurisdictions. Namely, instead of projecting insolvency law as an area that exclusively deals with financially distressed firms, academics and public agencies should put more emphasis on the *ex ante* impact of insolvency law. It should be emphasised that the design and enforcement of insolvency law may affect the behaviour of debtors and creditors *even* in the absence of financial distress. In other words, insolvency law will also be relevant for firms that may never become insolvent. As a result, an attractive insolvency and restructuring framework can be essential for the promotion of entrepreneurship, innovation, access to finance and economic growth, even if companies do not eventually use the insolvency system.

Haridwar Station, Haridwar, India. Photo by MOHIT TOMAR on UNSPLASH

Key Principle 5. Build up training and institutional capacity

Asian jurisdictions with less efficient or experienced insolvency courts should adopt institutional reforms to improve the efficiency, expertise and credibility of the judiciary.

Asian jurisdictions should promote training, education and research in insolvency and restructuring.

Strong institutions and a qualified body of insolvency lawyers, judges and insolvency practitioners are essential for a well-functioning insolvency system. Therefore, jurisdictions should improve the market and institutional infrastructure supporting the insolvency system. Thus, jurisdictions with inexperienced or unreliable INSOLVENCY COURTS should adopt institutional reforms to improve the efficiency, expertise and credibility of the judiciary. More efforts should also be put in the training of insolvency practitioners. In fact, jurisdictions in Asia can even consider adopting a licensing regime for insolvency practitioners. If so, the license may only be obtained after the completion of a training programme and the proof of certain years of practice, followed by the passing of an exam. This system has been adopted in several jurisdictions, including some in Asia such as Australia and India where there are rigorous requirements for entering the insolvency profession.

In addition to training efforts to raise the sophistication of judges and insolvency practitioners, more research, education and awareness of insolvency and restructuring should also be promoted. These educational efforts will not only help reduce the stigma of insolvency proceedings but also help market actors to deal with, or even anticipate, a situation of financial distress. Promoting research in insolvency will also help regulators and policymakers assess the effectiveness of their insolvency systems and, if necessary, guide future reforms.

Figure 9. Examples of Asian jurisdictions with licensing regime for insolvency practitioners

Jurisdiction	Licensing Authority
 Australia	ASIC Australian Securities & Investments Commission
 India	IBBI
 Malaysia	THE OFFICIAL PORTAL ACCOUNTANT GENERAL'S DEPARTMENT OF MALAYSIA *Excellent Accounting @ Your Service*
 New Zealand	NEW ZEALAND COMPANIES OFFICE
 Singapore	MINISTRY OF LAW SINGAPORE

Kuala Lumpur, Malaysia. Photo by Izuddin Helmi Adnan on Unsplash

Aspirational Principles

Aspirational Principle 1. IMPLEMENT HYBRID PROCEDURES

Aspirational Principle 2. GRANT TAX INCENTIVES FOR DEBT RESTRUCTURINGS

Aspirational Principle 3. PROMOTE MEDIATION AND OTHER FORMS OF ALTERNATIVE DISPUTE RESOLUTION

Aspirational Principle 4. INVOLVE PUBLIC CREDITORS IN CORPORATE RESTRUCTURINGS

Aspirational Principle 5. PROMOTE LITIGATION FUNDING

Aspirational Principle 6. CREATE A PUBLIC AGENCY FOR MANAGING SIMPLIFIED INSOLVENCY PROCESSES FOR MSES

Bandung, Indonesia. Photo by MATIINU RAMADHAN on UNSPLASH

Aspirational Principle 1. Implement hybrid procedures

Asian jurisdictions should adopt hybrid procedures combining elements of informal workouts and formal reorganisation procedures.

Hybrid procedures should provide debtors with several restructuring tools.

Creditors should be empowered to terminate the hybrid procedures at any time. In jurisdictions with efficient judicial systems, courts should be entitled to terminate the procedures.

In many jurisdictions, the promulgation of good practices for out-of-court restructuring can work effectively, especially if such good practices are supported by public agencies and private actors. Moreover, in many Asian jurisdictions, especially smaller ones, market actors often repeatedly interact with each other. Therefore, these "repeated players" should have incentives to respect any informal norms generally existing in the market. Still, debtors often need certain tools that are only provided by a formal insolvency or restructuring framework. Therefore, jurisdictions, especially those where the market and institutional environment does not facilitate workouts, should consider the adoption of hybrid procedures.

Hybrid procedures consist of reorganisation procedures with minimum court involvement. In these procedures, debtors would have access to various tools generally existing in formal reorganisation procedures (e.g., majority rule, moratorium, rescue financing) while still avoiding the costly and value-destructive formal reorganisation procedures existing in many jurisdictions in Asia. In jurisdictions with less efficient and equipped courts, most of the decisions associated with these procedures should be made by creditors, and courts should only intervene if, for example, a reorganisation plan is challenged by an interested party. However, if a jurisdiction has a well-equipped and efficient judicial system, courts may be empowered to intervene in most decisions, including the approval of certain transactions and the confirmation of any reorganisation plan achieved during the hybrid procedures.

Vientiane, Laos. Photo by ADLI WAHID on UNSPLASH

Aspirational Principle 2. Grant tax incentives for debt restructurings

Asian jurisdictions should not tax MSEs for the gains eventually obtained through a haircut that is achieved as part of a debt restructuring.

Asian jurisdictions should provide tax credits or other tax incentives to creditors who accept a haircut as part of a debt restructuring achieved by an MSE.

A debt restructuring, either in or out of court, may lead to a partial reduction of some of the business debts. This debt forgiveness or "HAIRCUT" is taxed in many jurisdictions in Asia. As a result, the debtor will be required to pay taxes even if the haircut did not involve any actual generation of cash-flows. Following the model existing in the United States, the United Kingdom and various jurisdictions in the European Union, as well as the responses adopted by some Asian jurisdictions in times of COVID-19,[36] it is suggested that any haircut achieved by an MSE as part of a debt restructuring should not be taxable. Additionally, since creditors will suffer losses from these haircuts, they may be reluctant to accept a debt forgiveness that can help preserve a viable but financially distressed firm. Therefore, in order to encourage an agreement that can be beneficial for all the relevant parties, regulators may consider the possibility of providing tax benefits to creditors that grant haircuts to MSEs.

36 As a response to the COVID-19 crisis, Singapore established that any debt forgiveness (including trade debts and loans) under the simplified debt restructuring programme temporarily available will be regarded as capital in nature and hence not subject to income tax. See Inland Revenue of Singapore, "TAX TREATMENT OF DEBTS FORGIVEN UNDER MINLAW'S SIMPLIFIED DEBT RESTRUCTURING PROGRAMME" (16 October 2021).

Aspirational Principle 3. Promote mediation and other forms of alternative dispute resolution

Asian jurisdictions should promote the use of alternative dispute resolution methods, and particularly mediation, in the context of MSEs.

Asian jurisdictions with reliable judicial systems and a developed pool of mediators may empower courts to compel MSEs and their creditors to mediate before initiating a formal insolvency process.

The use of the formal insolvency system can be too costly, especially for MSEs. In addition, many value-enhancing workouts often fail because creditors do not trust the debtor or because the debtor is unable to credibly prove to creditors that the business is economically viable, that a proposed reorganisation plan is feasible and that the alternative scenario (usually a formal insolvency proceeding) will make both the debtor and the creditors worse off. To address these problems, jurisdictions should embrace the use of alternative dispute resolution. Specifically, they may consider promoting conciliation and particularly mediation.

Indeed, by appointing a reliable, independent and qualified mediator, debtors and creditors will have more chances to reach an agreement when a company is genuinely economically viable and therefore reorganisation is the most desirable outcome for all. Additionally, mediation has the potential to reduce significant costs and time, especially in jurisdictions with inefficient judicial systems. Therefore, mediation can increase the pool available for distribution to creditors and maximise the prospect of a successful reorganisation of a viable firm that is facing financial trouble. For these reasons, the use of mediation should be promoted. In fact, in jurisdictions with a reliable and well-functioning judicial system, courts may even be entitled to compel the parties to mediate before initiating a formal insolvency proceeding. Such judicial powers already exist in some jurisdictions in Asia (e.g., Australia), and have been suggested in others (e.g., Singapore). In jurisdictions with a sophisticated and ideally regulated body of insolvency practitioners, the law can also assign certain powers to an insolvency practitioner to refer matters to mediation, whether individual creditor claims and disputes, or the broader negotiations among creditors specifically in relation to the adoption and implementation of a proposed reorganisation plan.

Jurisdictions should also favour the use of conciliation. In a conciliation proceeding, a credible third party is appointed. However, unlike a mediator who usually approaches the parties so that they can reach a mutually beneficial agreement, a conciliator typically proposes a solution to the parties. The use of conciliation seems to be working successfully in some jurisdictions, including both advanced economies (e.g., France) and emerging markets (e.g., Colombia). The experience of these jurisdictions may provide some valuable references for the potential adoption of conciliation in insolvency proceedings in Asia.

Aspirational Principle 4. Involve public creditors in restructurings

Asian jurisdictions should require public creditors to be subject to the same conditions, in terms of haircuts and deferrals on payments, that are eventually agreed upon by private creditors in debt restructurings involving MSEs.

PUBLIC CREDITORS often enjoy preferential treatment in the ranking of claims in many insolvency systems in Asia and beyond. Even if their statutory priorities were hypothetically preserved in the event of liquidation, public creditors should be subject to the same conditions agreed upon by private creditors if an MSE is reorganised through a debt restructuring involving a haircut or a deferral of payments. In other words, public creditors should not enjoy any preferential treatment in reorganisation.

This suggestion seems to be justifiable on economic grounds. First, public authorities can benefit if viable companies are kept alive to create jobs, pay taxes and promote growth. Second, governments can raise finance more easily than many private actors, especially small creditors. Therefore, while a significant haircut or deferral of payments can jeopardise the financial positions of many creditors highly exposed to the debtor, public creditors are better equipped to bear the costs associated with a debt forgiveness or a delayed payment. Hence, public authorities should be subject to the terms agreed by other unsecured creditors, especially taking into account that public authorities, along with landlords and bank lenders, often represent a significant part of the liabilities of an MSE.

Melbourne, Australia. Photo by BENJAMIN ASHTON on UNSPLASH

Seoul, South Korea. Photo by CIARAN O'BRIEN on UNSPLASH

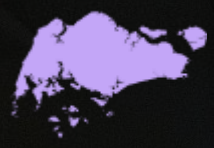
Aspirational Principle 5. Promote litigation funding

Asian jurisdictions should allow third parties to fund the simplified insolvency process for MSEs. However, litigation funding should be subject to limits and safeguards. Depending on the particular features of an Asian jurisdiction, these safeguards may consist of the involvement of courts, the empowerment of creditors and even the adoption of a licensing regime for litigation funders.

Third parties have traditionally been prohibited from funding an unconnected party's litigation under the DOCTRINES OF MAINTENANCE AND CHAMPERTY in many jurisdictions. However, due to the lack of available assets in many insolvency proceedings, especially in the context of MSEs, the use of third-party LITIGATION FUNDING should be promoted. While several jurisdictions in Asia, including Australia, Hong Kong SAR of China and Singapore, have taken significant steps to facilitate litigation funding in insolvency, it remains unclear whether the doctrines of maintenance and champerty are effective in other Asian jurisdictions. The promotion of a system of litigation funding can facilitate the initiation of actions for the recovery of assets that could not be initiated otherwise. Moreover, it can encourage the investigation and punishment of wrongly behaved directors. As a result, a system of litigation funding can be beneficial for creditors and the society as a whole.

Nonetheless, promoting litigation funding can lead to creditor exploitation, for example through excessive funding fees and mandatory terms that can often be abusive. For that reason, the promotion of litigation funding should be done in conjunction with the adoption of proper safeguards. In jurisdictions with reliable and sophisticated courts, these safeguards may consist of requiring prior approval by the courts, or at least subject the terms of a litigation funding agreement to a hypothetical after-the-event review. In jurisdictions where the courts are less reliable and sophisticated, these safeguards may consist of the empowerment of creditors in any decision that involves the assignment of any action, or the funding of that action, to a third party. Finally, a licensing regime for litigation funders may also be implemented in jurisdictions with efficient and well-functioning institutions.

Figure 10. Examples of steps taken by selected Asian jurisdictions to facilitate litigation funding in insolvency

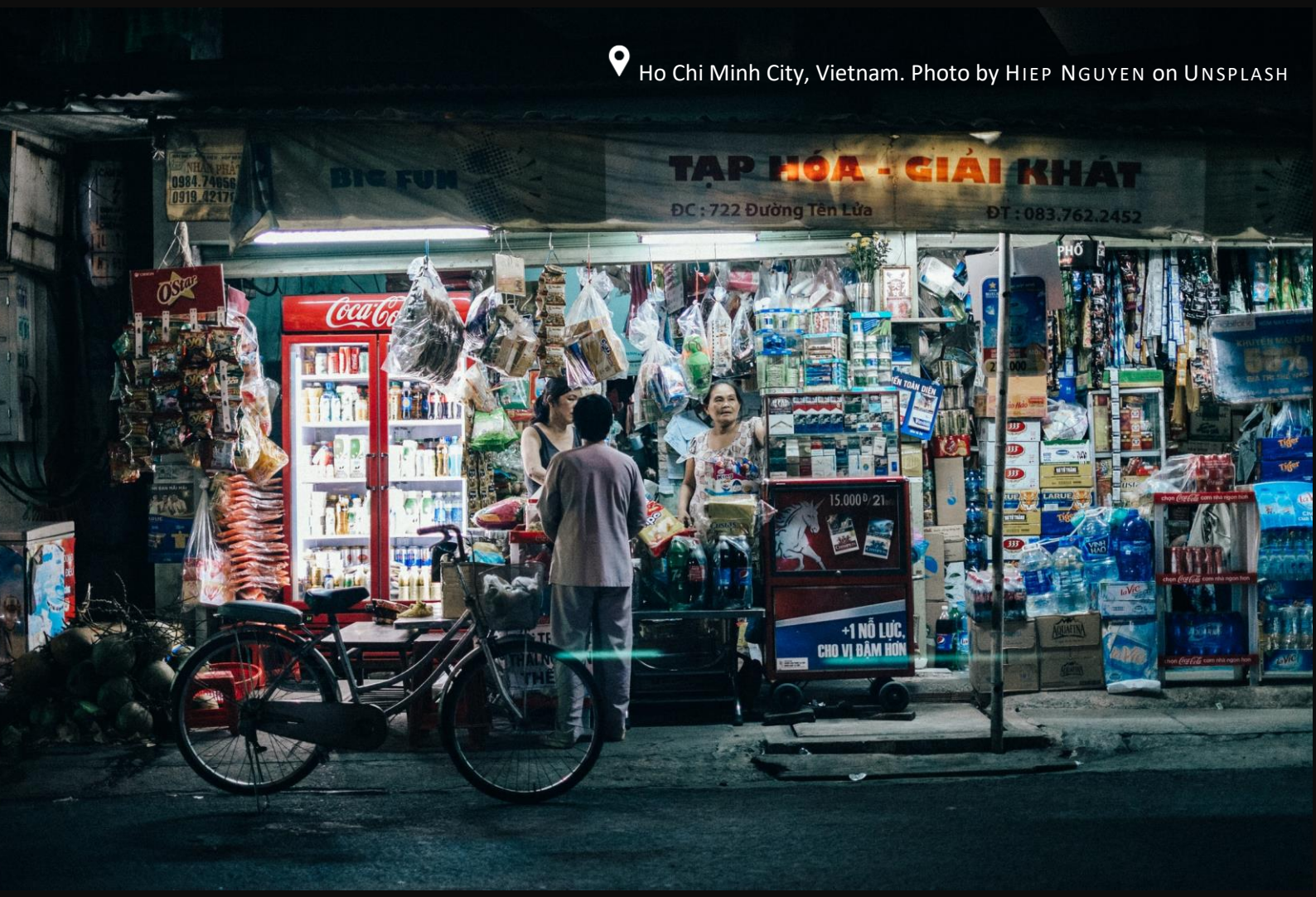
Jurisdiction	Steps Taken
 Australia	**Regulation.** Litigation funding of insolvency proceedings is regulated. See Corporations Act 2001 (Cth), Schedule 2 ("Insolvency Practice Schedule (Corporations)") section 100-5. **Courts.** The use of litigation funding is supported by the courts. See *Movitor Pty Ltd (Receiver and Manager Appointed) (In Liquidation) v Anthony Milton Sims* (1996) 64 FCR 380; [1996] FCA 1320, where the Federal Court of Australia held that a LIQUIDATOR is permitted to enter into an agreement to assign an insolvent company's right of action to a third party.
 Hong Kong SAR, China	**Courts.** The use of litigation funding is supported by the courts. In *Akai Holdings Ltd (in compulsory liquidation) & Ors v. Ho Wing On Christopher & Ors* [2009] HKCU 172, the liquidators received court approval for third-party funders to fund the insolvency proceedings. In *Re Cyberworks Audio Video Technology Ltd* [2010] 2 HKLRD 1137, the Court held that a party can seek third-party funding to fund proceedings in insolvency cases.
 Singapore	**Regulation.** Litigation funding of insolvency proceedings is regulated: see Insolvency, Restructuring and Dissolution Act 2018, sections 144(1)(g) and 177(1)(a). **Courts.** The use of litigation funding is supported by the courts. See *Re Vanguard Energy Pte Ltd* [2015] 4 SLR 597; [2015] SGHC 156.

Aukland, New Zealand. Photo by JAMES GARMAN on UNSPLASH

Aspirational Principle 6. Create a public agency for managing simplified processes for MSEs

Asian jurisdictions should ideally have a public agency in charge of managing the simplified insolvency processes for MSEs.

Many MSEs might not even be able to afford the costs of a simplified insolvency process. Additionally, many judicial systems in Asia do not yet have the capacity to efficiently deal with a large number of insolvency cases of MSEs. Therefore, Asian jurisdictions should consider the possibility of establishing a public agency in charge of managing the simplified insolvency process for MSEs. If a SYSTEM OF PUBLIC TRUSTEES is eventually adopted for the management or supervision of assetless MSEs, this public agency would need to have a pool of insolvency practitioners acting as public trustees.



Ho Chi Minh City, Vietnam. Photo by HIEP NGUYEN on UNSPLASH

Glossary of Terms

Administrative expense priority is a debt or expense that is usually incurred during, or as a result of, an insolvency or restructuring procedure and that is paid ahead of any other preferential or unsecured claims.

Administrator is an insolvency practitioner appointed to manage the property and business affairs of a debtor subject to an insolvency proceeding. For the purpose of this Guide, the term administrator will include functionally equivalent actors such as the judicial manager existing in various Asian jurisdictions such as Brunei, Malaysia and Singapore. The concept of administrator, however, should be distinguished from other insolvency practitioners who only supervise, rather than manage, the insolvency process. As mentioned below, these latter actors will be termed "supervisors".

Avoidance action is an action under the insolvency law that provides for certain transactions for the transfer of assets or undertaking of obligations involving the debtor prior to the commencement of insolvency proceedings to be cancelled or rendered ineffective and for any assets transferred, or the value thereof, to be returned to the debtor.

Claim is a right to payment from the estate of the debtor, whether arising from a debt, a contract, or any other type of legal obligation, whether liquidated or unliquidated, matured or unmatured, disputed or undisputed, secured or unsecured, or fixed or contingent.

Collateral is an asset that is given by a borrower or a third party to secure a loan or the extension of credit. The lender can seize the asset, or collect proceeds associated with the sale of the asset, if the borrower breaches its obligations.

Cramdown is a mechanism available in some jurisdictions which enables a reorganisation plan to become binding on dissenting classes of creditors that have not voted in favour of the reorganisation plan.

Debtor-in-possession ("DIP model") is a governance system of insolvency and restructuring proceedings that permits debtors to keep running the business after the commencement of the insolvency proceedings, without being subject to the appointment of any insolvency practitioner.

Debtor in possession supervised by an insolvency practitioner ("DIP-SIP model") is a governance system of insolvency and restructuring proceedings consisting of allowing debtors to keep running the business after the commencement of the insolvency proceedings subject to the supervision of an insolvency practitioner.

Discharge is the cancellation of the debtor's pre-existing obligations under an insolvency procedure.

Dual-gateway insolvency process consists of insolvency proceedings that provide at least two different avenues for initiation, typically reorganisation and liquidation.

Doctrine of champerty is an aggravated form of maintenance, the distinguishing feature of which is the receipt of a share of the proceeds of the litigation by the intermeddler.

Doctrine of maintenance is a common-law invention which is directed against wanton and officious intermeddling with the disputes of others in which the intermeddler has no interest whatever, and where the assistance rendered is without justification or excuse.

Haircut is a partial debt forgiveness granted by creditors as part of a debt restructuring.

Hybrid procedure is a reorganisation procedure with limited court intervention that combines features of an out-of-court workout and a formal reorganisation process.

Insolvency is when a debtor is unable to pay its debts as they fall due or when its liabilities exceed the value of its assets.

Insolvency court is the judicial or administrative entity in charge of managing an insolvency proceeding.

Insolvency practitioner is the person formally appointed to manage or supervise the debtor's property and business affairs in an insolvency proceeding. Therefore, the term includes administrators, liquidators, judicial managers, and similar actors formally appointed to manage or oversee a formal insolvency proceeding.

Insolvency proceeding is a collective proceeding in relation to a debtor and subject to court supervision, and includes both reorganisation and liquidation procedures.

Ipso Facto clauses are contractual clauses that allow a party to terminate or modify the contract upon the occurrence of an event typically involving a situation of insolvency or the commencement of an insolvency proceeding.

Liquidation is a proceeding in which the debtor's assets are sold and the proceeds are distributed to creditors in accordance with the ranking of claims established in insolvency legislation.

Liquidator is an insolvency practitioner appointed in a liquidation procedure.

Litigation funding is a system allowing third parties to fund legal proceedings for a claim by a debtor.

Moratorium is a mechanism providing debtors with a limited period of time during which creditors' rights to seek legal remedies are suspended or restricted. An automatic moratorium exists when the effects of the moratorium arise automatically upon an application by a debtor seeking to initiate an insolvency procedure. In some jurisdictions, the term "moratorium" or "automatic moratorium" are known as "stay" or "automatic stay", respectively.

Public creditor is a creditor exiting when a claim is held by a tax authority or any other public agency.

Reorganisation is a procedure by which the financial situation of a debtor is sought to be restored by using various means including debt forgiveness, debt rescheduling, debt-for-equity swaps, and sale of the business (or parts of it) as a going concern.

Rescue financing is new financing obtained by insolvent debtors, generally by providing a super-priority to the lender, with the purpose of facilitating the survival of the debtor as a going concern, or a more advantageous realisation of the debtor's assets.

Restructuring is an exercise undertaken by a debtor in relation to its business, operations or financial structure which seeks to restore the debtor's viability and competitiveness. This Guide only deals with financial restructuring, and therefore with the adjustment of the debtor's financial obligations. For the purpose of this Guide, financial restructurings include both workouts and formal reorganisations.

Reorganisation plan is a plan by which the financial situation of a debtor is sought to be restored by using various means, including debt forgiveness, debt rescheduling, debt-for-equity swaps, and sale of the business (or parts of it) as a going concern.

Secured creditor is a creditor or lender that has been given collateral for the extension of credit, loans, or bond issuance, and that is recognised as such by insolvency law.

Sole proprietorship is a form of business organisation that does not involve the creation of a separate legal entity.

Single-entry insolvency process consists of insolvency proceedings that provide a single avenue for initiation, even if the procedure may eventually end up in reorganisation, liquidation or other outcomes.

Supervisor is an insolvency practitioner appointed to supervise a debtor subject to a reorganisation or liquidation procedure.

Unsecured creditor is a creditor or lender which has not been given collateral for the extension of credit, loans, or bond issuance. It also includes a creditor who is owed money as a result of breach of contractual claims, tort claims or other claims such as tax claims.

Workout is an out-of-court agreement between a debtor and some or all of its creditors with the purpose of achieving a debt restructuring without the involvement of courts. For the purpose of this Guide, workouts are entirely consensual agreements not regulated by insolvency legislation. The terms workout, informal workout, out-of-court restructuring and out-of-court workout are used synonymously.

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