

## **4<sup>th</sup> ADB / OECD Anti Corruption Conference**

Kuala Lumpur, 4 December 2003

Case Study on Private Sector Corruption Issues

The Antarctic Bank Restructuring Authority

Alex Duperouzel  
Managing Director  
**BACKGROUND ASIA**  
Singapore  
[www.backgroundasia.com](http://www.backgroundasia.com)

### ***Introduction***

The following is a case study on the workings of the Antarctic Bank Restructuring Authority (“ABRA”).

Antarctica was selected for two reasons, firstly to emphasise that the issues involved are not limited to one or two countries in this region but rather are common to many countries faced with restructuring their financial system following some economic or political crisis. Secondly to give participants an opportunity to suggest solutions not necessarily restricted to any particular legal system. In addition to thinking about what the solution to some of the questions are it is also useful to think about what they should be if the law was either different or more flexible.

The case study, while all fiction, is based on actual events that have taken place over the last 5 years in Asia. Every issue raised has been a question considered in some part of the region during an actual restructuring.

We have deliberately blended the facts from several different transactions into one transaction for study purposes and disguised the identity of those involved.

The purpose of this case study is not to critique ABRA but rather to look at some of the problems (or benefits) that private sector companies suffered (obtained) because of ABRA's failure.

This case study may be copied and disseminated for the purposes of academic discussion or for non commercial training purposes. It may not be used for any commercial purpose without the express written permission of Background Asia (S) Pte Ltd.

### ***Part 1 – The History***

From 1995 to 1997 there was a massive influx of foreign capital, principally US dollar denominated debt, into Antarctic companies. These corporate groups had developed due to patronage from the President. Within Antarctica however there were a number of plots and schemes developing to try and push the President from power.

In May 1997, the Thai baht collapsed and the foreign love affair with Antarctica ended. Pressure on the currency (the 'ANT') began almost immediately and pretty soon those same foreign businesses that were wined and dined by the international banks, were faced with enormous increases in the ANT value of their US dollar debt.

The situation evolved into an economic crisis and the IMF was called in.

The former President's grip on the country was looking shaky and most investors recalled the last bloody time that power changed hands in Antarctica.

The Antarctic business elite, many of whom were ethnically Chinese, were frightened for their security and future in this rapidly evolving situation. There was significant capital flight from this group and that further weakened the ANT.

Their business empires had been built around cosy deals with the first family and almost all of them had family owned banks that funded these sprawling, often inefficient, enterprises.

With foreign funding of these family banks out of the question, and many of them facing a run on deposits, the Antarctic financial system was nearing collapse. The central bank stepped in and provided emergency funding and depositors' guarantees to many of these banks in late 1997.

In early 1998 the Antarctic Bank Restructuring Authority ("ABRA") was created to:

1. Manage the restructuring of banks in distress;
2. Restructure those banks;
3. Recover bank or other physical assets and loans; and
4. Recover state funds lent to the banking sector.

However while The President's efforts at salvaging the Antarctic economy were substantial; they were not enough to thwart those that wanted to seize power. In May 1998 there was an attempted coup and the aging President resigned and transferred power to President Replacement.

President Replacement put in place an interim government and put the nation on the path to democratic elections and reforms.

As the campaign and election process got underway, one soon to be government minister, said that ABRA would be the vehicle by which the government would nationalize major parts of the Antarctic economy, rationalize those sectors and

then parcel out those same assets by way of privatizations or public offerings. This would be done while preserving the strategic interests of the state and the people of Antarctic. The big losers would be those cronies who lived off their relationships with the former President and those foreign banks that carelessly lent funds to those cronies.

### **How ABRA was meant to work**

Wherever Bank Antarctic discovered a commercial bank in financial distress, it was transferred to the umbrella of ABRA.

ABRA would then ask the bank's shareholders to prepare and implement an immediate rehabilitation plan. If they were not in a position to do so, then ABRA would take over the task itself, either by restructuring the bank's operations and finances, or by merging it with other banks. ABRA would also manage the assets which it acquired as part of the bank restructuring process. In this way, bank by bank, ABRA would build a stronger healthier and more competitive banking system.

According to their website, in carrying out this program ABRA upholds the following principles:

- Fairness
- Openness
- Accountability
- Optimized Asset Value
- Asset sales at most immediate time without having to lose asset value
- Antarctica first

ABRA adopted the following strategies:

- Banking sector consolidation

- Bank asset restructuring
- Bank management improvement

## **How ABRA did work**

ABRA has raked in a total of US\$20 billion from its assets sales since it was established in 1998.

The agency took over some US\$60 billion worth of assets from failed or ailing banks. It was mandated to restructure and sell the assets, in the form of bank non-performing loans and fixed assets surrendered by indebted former bank owners, and to raise cash to help finance the state budget, which is heavily burdened by the huge cost of bailing out troubled banks.

ABRA, which has been led by a number of different chairmen, has often faced strong criticism from the public for issuing controversial policies that appear to benefit big debtors. The debtors included business people with huge bad debts and former bank owners accused of violating banking regulations by channelling most of their banks' money to their own businesses and misusing government bailout funds at the expense of taxpayers. Among the controversial policies were ignoring the crimes of some former bank owners in the way they operated their business and selling assets at huge discounts, which some critics said allowed the former owners of the assets to repurchase them at the expense of the state.

Some analysts have said that there must be a mechanism to make all ABRA top officials accountable for their policies. But the ABRA chairman said that the agency had done its best to execute its mandated tasks. He said the agency had posted a respectable recovery rate of 33 percent for the assets under its control, which was higher than the recovery rates of similar agencies in countries such as China (8%), Thailand (25%), South Korea (25%) and Indonesia (28%). He also

said the country's banking sector had been restructured and all the banks were healthy, with some even having been divested.

The agency has so far sold majority stakes in several high profile banks and plans to wrap up the sale of controlling stakes in two more high profile banks early next year.

Despite the ABRA chairman's claims of relative success foreign capital continues to shun Antarctica with corruption being the main complaint of almost every foreign investor or business looking to open there or manage operations there.

List of ABRA's unfinished businesses:

1. Still holds minority ownerships in several high profile banks. A holding company is expected to be established to manage and sell these assets.
2. About USD5 billion worth of bad loan assets, the majority of which come from five debtors are still unsold.
3. Of the 40 former bankers who agreed to settle their debts through various schemes, only five have been declared uncooperative and reported to the courts.

## ***Part 2 - Case Study 'Facts'***

In December 1997, Bank Antarctic agreed to guarantee deposits held with Bank Bailout, a member of the Shady Group of companies. 70% (US\$700m) of the bank's loans were to companies both in Antarctica and abroad owned by the Shady family who were aiming to become the world's largest integrated widget company. While demand for widgets was strong and denominated in US dollars, the Shady family also had large commercial real estate interests in the capital of Antarctica (US\$50m) and other businesses which were suffering due to the crisis.

Additionally, Bailout Bank owned 49% of a successful joint venture finance company, which was the market leader in motorcycle financing. The finance company was called Cycle Life and had no US dollar debts. The other 51% of Cycle Life was owned by a foreign finance company called CanFin who had a well established reputation.

Bailout Bank also appeared to have a large deposit in an offshore Vanuatu bank thought to be controlled by the Shady family but listed in the audited accounts as an independent financial institution (US\$100m).

As part of the family's settlement with ABRA, ABRA gained 80% of the shares in the bank, whilst the Shady family retained 20%.

The auditors were the local arm of the international accounting firm, Brian Benson & Co, known in the industry as BBs.

The most recent set of audited accounts showed the following balance sheet:

In October 1998 when control of Bailout Bank was handed over to ABRA its audited balance sheet for the year ended 30 June 1997 looked like this:

<b>Assets</b>	<b>US\$ million</b>
Loans to Shady Group - in Indonesia .....	500
Loans to Shady Group – offshore .....	200
Loans to Third Parties .....	100
Monies on deposit with Vanuatu Bank .....	100
49% ownership in PT Cycle Life .....	100
<b>Total Assets</b>	<b>1000</b>
 <b>Liabilities</b>	
Third party depositors - guaranteed by BA .....	300
Syndicated loans from foreign banks .....	100
Bonds - issued to foreigners .....	300
Swap payable - Large & Co Investment Bank .....	100
Loan from Swiss Secret .....	100
Loans, equity and accumulated losses from Shady family members .....	100
<b>Total Liabilities and Capital</b>	<b>1000</b>

Of the amounts owing to foreign banks (US\$600m), US\$300m had been lent by a group of third party bond holders who were told that the Shady family was guaranteed to continue to win business in Antarctica as their number one son was going to marry into the first family, and that huge leases over icebergs were going to be granted to a Shady group company that needed to borrow US\$300m from Bailout Bank. At the time that Bailout Bank went under and was transferred to ABRA, the marriage had not proceeded and the leases were still being considered by the Minister of Extractive Industries.

US\$100m had been lent by a syndicate of international banks that were financing Bailout Bank via normal interbank loans.

US\$100m was owed to Large & Co Investment Bank that had entered into a swap arrangement with Bailout. Unfortunately the swap had not been marked to market and if it was it would be four times this amount.

US\$100m had been lent by Bank Swiss Very Secret Private Ltd of Geneva also known as Swiss Secret. Documents surrounding the once off loan from Swiss Secret were scant and the repayment terms of the loan were unclear to the auditors.

As Bank Bailout was restructured the following occurred:

1. The bondholders threatened to sue in New York and Singapore;
2. The bondholders were contacted by a relative of the Minister of Extractive Industries who said that for US\$100,000 he would speed up the application for the granting of the licences to the Shady group company;
3. The international banks approached their governments and asked them to lobby to get them at least 50c in the dollar or to hold back government funded export financing for other Antarctic firms;

4. Large & Co called in its loan and terminated the swap crystallizing a debt of US\$400m that they now claimed;
5. Swiss Secret approached ABRA with an offer to buy out the bank (free of all liabilities) by converting its debt to equity and a once off payment to ABRA of US\$50m.

## **Questions**

1. Should the bondholders be given a hearing in either New York or Singapore?
2. Should the claims by the bondholders be taken into account in the restructuring of Bank Bailout?
3. Does your attitude to the bondholders change if they pay the facilitation fee to the Minister of Extractive industries (it is, after all, only 0.0033% of the total loan)?
4. If the Minister explains that the \$100,000 is needed to pay for two new boats to survey the icebergs so that the licenses can be issued, does this change your attitude?
5. Should the claims of the international banks be treated differently than any of the other creditors (employees, local trade suppliers, investment bank, private bank, bondholders)?
6. Should the international banks put pressure on their home governments to support their efforts to obtain repayment?
7. How valid is the claim from Large & Co?
8. Does your opinion of the Large & Co claim differ if a subsequent Wall Street Journal investigation finds that Large & Co paid a finders fee, for the introduction of Shady, to the soon to be bride of the number one son who was a consultant to Large & Co at the time?

## **More “Facts”**

In July 1999, the accounts for the year ending 30 June 1998 were produced and, to the surprise of the international banks, they showed that the US\$100m that was previously shown to be on deposit with the Vanuatu Bank was no longer there.

The international banks took up the issue with BBs and they said that the 1997 accounts contained a mistake and that in fact those funds were not deposits of Bailout Bank but rather they were deposits made by a BVI company, Bailout Bank BVI Ltd and that this company, while similarly named as Bailout Bank, was actually a private family company of the Shady Family.

The auditors had removed the bank balance from the accounts.

No inquiry was initiated and a group of the foreign creditors got so annoyed that they decided to petition for the bankruptcy of Bank Bailout's offshore subsidiary in Singapore and a Shady Family group company that had given a corporate guarantee. The family company was also domiciled in Singapore.

The Singapore judge was reluctant to proceed with the liquidation and requested an affidavit from ABRA with details of the proposed restructuring. The judge in Singapore had taken the view that it would be improper to wind up the guarantor companies if a restructuring was close to completion.

Rumours were rife among banking industry sources that an ABRA official had just taken delivery of a new Mercedes Benz 500 series (with wonderful snow tires and lovely heating) and one of the firms he worked on was Bank Bailout.

ABRA duly submitted an affidavit telling the Singapore judge that they had received a firm offer from a Swiss institution (Swiss Secret) for the purchase of

Bank Bailout and while the terms of the offer had not been finalised they thought that they could finalise the deal within the next 12 months.

Foreign banks submitted an affidavit to the judge that stated that allegations of fraud and mismanagement of Shady had been made in the press a number of times and that they thought the only way to get to the bottom of the transaction involving the disappearing \$100m was having someone independent in charge of the company who could review the company transactions.

### **Questions**

9. What are the issues that ABRA needs to consider when evaluating the bid from Swiss Secret?
10. What sort of inquiry should be initiated into the circumstances of this amendment to the accounts?
11. Who should do it?
12. What does the judge in Singapore do?
13. Shady have said to some of the creditors that they are going to restructure the management team and appoint a new audit committee made up of non executive directors. Should the judge take this into account if Shady makes these representations to him?

### **More “Facts”**

While all this was going on another issue was developing.

ABRA had found that Cycle Life was profitable and they decided to sell the 49% interest that they had. The logical purchaser was the owner of the other 51%.

Discussions began and negotiations were going well when ABRA announced that they had made a mistake. The 49% of Cycle Life had already been sold to Cycle BV Ltd, another BVI company, prior to ABRA taking over the management of Bailout Bank. This had only been brought to their attention recently by Cycle BV Ltd who had tendered a number of sale and purchase agreements signed by the former directors of Bailout Bank.

ABRA confirmed to CanFin, the foreign majority owner, that they accepted the transaction and that the foreign party should deal with Cycle BV Ltd. Cycle BV Ltd offered to sell the 49% interest for \$100m, roughly double what ABRA had been negotiating for from CanFin.

Negotiations dragged on for another two months with neither party being that flexible with their stance and then CanFin were presented with a petition to wind up the operations of Cycle Life due to irreconcilable differences regarding the ownership and management of Cycle Life. The petition would be heard in the Antarctic Bankruptcy court.

Cycle Life was represented by Shark & Fin, a well known Antarctic law firm who had won a number of high profile commercial cases over the last two years.

Mr Shark of that firm was widely suspected of having bribes one or more of those judges that he had appeared in front of before.

## **Questions**

14. CanFin have been told that the judge is for sale and that for 5% of the value of their investment he will rule in their favour. What do they do?
15. Foreign banks suspect that something fishy went on in relation to ABRA giving up its interest in Cycle Life. What do they do?

## **More “Facts”**

With these two transactions (the removal of the Vanuatu Bank loan asset and the removal of the profitable finance company); the realisable assets of Bailout Bank are getting lower and lower.

ABRA decides to sell the bank. By this time all of the depositors have withdrawn their money and been replaced by Bank Antarctic as the guarantor.

ABRA converts this debt to equity such that it now controls 100% of the shares of the bank.

The bank is to be sold with all other debts in place, at least in that they are claims against the bank, and it will be up to the new owners to resolve them.

Two bidders are short listed:

1. Big Regional Bank –who have been in Antarctica for many years, are looking to expand their branch network in Antarctica and bring in new capital and technology. They also intend to vigorously pursue recovery of some of the Shady company assets.
2. Swiss Secret – who have no experience in operating any banks outside of Switzerland but are willing to give it a go.

Big Regional Bank submits its bid of US\$60m and following receipt of this bid Swiss Secret submits its bid and ABRA announces that with the forgiveness of debt they are of the opinion that it equates to slightly more than this figure.

ABRA’s rules prohibit any sale to the former owners.

The sale to Swiss Secret takes place. The Antarctic Government applauds the transaction as an example of ABRA effectively restructuring a defunct firm. All creditors are offered a deferred payment plan from the new owners such that they will receive 25 cents in the dollar in one year if they agree to freeze their loans now and make no further claims after that. All creditors are to be treated equally. Anyone who does not accept this offer will get nothing at all.

Several of the foreign creditors have been looking into a possible negligence suit against BBs. Unfortunately BBs has recently filed for Bankruptcy in the United States and all of its partners (who were not really partners but just international franchisees) have joined a variety of other firms. BBs has claimed since the start of the case that they did nothing wrong and all of their work was done using internationally accepted standards.

### **Questions**

16. What should be the process by which the bidders submit their bids to ABRA and how transparent should the decision-making process be?
17. Swiss Secret is being advised by a large European based investment bank. Does that investment bank have any obligation to know more about Swiss Secret's bid?
18. Big Regional Bank suspects that someone at ABRA may have tipped off Swiss Secret about the value of their bid prior to the tenders closing. What should Big Regional Bank do?
19. ABRA seems to have had trouble in keeping its executive from making questionable, if not, corrupt decisions. What sort of oversight should there be?
20. What sort of penalties should there be for any foreign firms found to be corrupting ABRA?
21. When a country's judiciary is compromised what sort of options do foreign firms have?