**105-1 財管碩士班金融倫理學教案002**

**Taiwan’s Credit Card Crisis**

**I. Facts of the Case**

Beginning in 1990, the Taiwanese government allowed the formation of new banks. These new banks lent large sums of money to real estate companies with the goal of expanding their businesses and increasing profits. However, after a couple of years of expansion, the real estate market became saturated and profits from the sector stopped growing.

The new banks turned to other new business – credit cards and cash cards. In expanding this area of business, banks lavished money on commercials encouraging people to apply for credit cards to consume, apparently without consequences. These banks lowered the requirements for credit card approvals to get more customers. In time, young people became target customers. Although young people tend not to have enough income, banks still issued credits cards to them. This case study discusses the ways in which the banks are dealing with the resulting bad debts from incautious credit card lending and the ethics of their methods.

**II. The Problem**

In Taiwan, in February 2006, debt from credit cards and cash cards reached $268 billion USD.  More than half a million people were not able to repay their loans.  They became “credit card slaves”, a term coined in Taiwan to refer to people who could only pay the minimum balance on their credit card debt every month (“News & Important policy”). This issue resulted in significant societal problems. Some debtors and their families committed suicide because of the debt, some became homeless due to repossession of their homes, others could not afford to pay their children’s tuition. Some credit card slaves sold illegal drugs to repay the banks. The sometimes violent and threatening collection practices of certain banks added pressure to lenders, particularly those in lower income groups.

The Taiwanese government was forced to solve these problems to save the financial system and prevent further societal problems. Based on the Taiwanese Department of Health report, 2,172 people committed suicide in 1997, 4,406 in 2006, and 4,128 in 2008. (“Health Statistics in Taiwan 2008, “ para. 2) The suicide rate in Taiwan is the second highest in the world. The suicide rate increased 22.9% compared to the rate in 2005, and the main reason is unemployment and credit card debt (para. 2).

**III. Dealing with the Problem**

1. ***A. Issue new regulations to banks***

In 2005, to prevent more and more new credit card or cash card slaves from appearing, the Taiwanese Finance Supervisory Commission issued some orders to require banks to modify their requirements of credit card and cash card applications. Some of the changes included raising the income and job requirements, prohibiting improper credit card commercials, prohibiting inappropriate collection behaviors and prohibiting compound interest.

In the past, banks issued credit cards and cash cards to students even if the students did not have a job. Therefore, many banks sent their credit card salesman to colleges to convince students to apply for credit and cash cards, enticing them with low interest rates. As these students lacked practical experience and financial knowledge, young people used their credit and cash cards relentlessly without paying attention to how much interest they would have to repay.

After the new regulations came into force, credit card applicants are required to have jobs and a specified level of income. Therefore, it is now difficult for young people without enough income to apply for credit cards and cash cards.

1. ***B. Sell the bad debt to an asset management corporation (AMC)***

To deal with existing bad debts, banks often sell the bad debts to an AMC.

**(a) The function of an AMC**

The main function of an AMC is to take bad debts from banks.  An AMC can help control risk for finance activities and improve a bank’s balance sheet by taking on some of its bad debts. In 2000, the Taiwanese Congress passed the Financial Institution Merger Act. Based on the Act, foreign companies like Lone Star, Merrill Lynch and Lehman Brothers are allowed to fund an AMC. At the same time, many Taiwanese banks jointly funded some AMCs.

An AMC is in a better position to deal with bad debts than banks. In Taiwan, company reorganization cases usually involve many banks because the company borrowed money from many banks. As there is more than one creditor, it is hard to reach an agreement about the company’s reorganization plan without taking years. When most banks sell their bad debt to an AMC, the number of creditors fall and it is easier to reach a company reorganization agreement.

**(b) Create a Public AMC**

However, the debtors from credit cards and cash cards are not corporations. Thus, a traditional AMC cannot use the usual ways to collect debt.  In addition, there are many AMCs in Taiwan that compete to collect bad debts. To handle these problems the Taiwanese Finance Supervisory Commission strongly advised the bankers association to create Public AMCs to deal with the credit card issue.

On March 10th, 2006, the banker’s association reached an agreement to create a Public AMC to deal with credit card debt and to help low-income people to solve their debt.

(1)  The structure of a Public AMC

The Public AMCs are funded by banks, including creditor banks. The percentage of investment of each bank is based on the amount of debt and how long the debt is expired. The banks injected bad debts that existed before 2005 and were more than 180 days overdue into the Public AMC. The Public AMC is managed by Taiwan United Asset Management Corporation.

(2)  The methods to deal with the debt

The public AMC does not collect payments on debt from low-income individuals, students, disabled people and the unemployed until they find a job and have income.

Debtors can can contact the public AMC and transfer their cases to a social welfare agency. The agency will enroll these debtors into career training programs, loan more money to help them to build their own business, and provide the financial management education or psychological counseling they require.

Based on the experience of the Korean government, debtors who want to negotiate with the Public AMC, have to repay three percent of their total debt first.

(3)  The purpose of the Public AMC

The AMC will not try to modify the conditions of negotiation, but put all the debt under one creditor to reduce the need and stress of dealing with multiple creditors. The AMC encourages borrowers who do not have the ability to repay loans to report to the AMC. The AMC can help borrowers to negotiate with banks to suspend interest payments during negotiations.

1. ***C. Pass “Debtors Repayment Regulation”***

In 2005, the Taiwanese Finance Supervisory Commission required banks to create a negotiation system between banks and the debtors. At that time the Taiwan’s bankruptcy laws applied to corporations and individuals who had assets. The law was unable to deal with credit card debt.

In July 2006, the Taiwanese Congress passed the Debtors Repayment Regulation. There are four sections in the regulation: general rules, regenerate, liquidate and supplementary provisions. The main purpose of the regulation is to help people who do not have money and who cannot repay their debts to clear their debts and start over.

The Regulation protects borrowers from losing their homes during the debt restructuring process.  Borrowers can negotiate with their creditors directly but if they cannot reach an agreement, the court can make a decision for them.  In negotiating the settlement amount, borrowers are allowed a stipend to pay living expenses.  The stipend is modest and does not afford the borrower any luxuries.  Borrowers are not allowed to borrow more money to maintain a luxury lifestyle.

In November 2005, the average debt of a credit card holder who was unable to repay his debt was US$20,000 USD (“News & Important Policy” 2005). After the Debtors Repayment Regulation had been in effect for 2 years, the average debt increased to US$88,000 USD.   During that period, sixty percent of debtors could only pay their minimum monthly balance every month (“News” 2008). Half the debtors admitted they had considered suicide (“News” 2008). However, in February 2010, the average debt decreased to US$43,000.  The Debtors Repayment Regulation had forced banks and borrowers to work together to solve the problem (“News & Important Policy” 2010).

**IV. Ethical Issues**

**Consequentialist theories** hold that only the consequences, or outcomes, of actions matter morally. In this case, banks wanted to make more money, so they allowed a lot of young people to apply for credit cards and cash cards. In the short term, bankers made a lot of money. In the longer term most credit card users were unable to repay their debt, resulting in serious social problems. Therefore, banks’ actions were morally wrong.

**Deontological theories base morality on certain duties**, or obligations, and claim that certain actions are intrinsically right or wrong, that is, right or wrong in themselves, regardless of the consequences that may follow from those actions. In this case, making money is not morally wrong in itself.  However, the banks’ method of attracting young people without sound financial support to borrow money using credit cards and cash cards, is morally wrong. By lending money to people who did not have the ability to repay the loans, banks violated their fiduciary duty of acting (as agents) in the interest of their customers. In addition, the banks were using their credit card customers as a means to an end (making profits). This act further violates the second version of Kant’s duty based ethics. The banks should have applied stricter borrowing requirements and had the intent of helping customers rather than using them to make money. In Kant’s ethical theory, intention counts.

**Utilitarianism** states that actions are morally right if and only if they maximize the good. Here, in the short term, the banks made a lot of money. However, the outcome of the credit card issue is serious social problems. The banks did not maximize the good.

According to the three moral theories, the banks’ actions were morally wrong.

**V. Conclusion**

After the credit and cash card issue exploded, the Taiwanese Finance Supervisory Commission issued some orders to require the banks to change their credit and cash card policy, and strongly advised the banks to fund a public AMC to deal with this issue. Taiwanese Congress also passed the Debtors Repaying regulation to give a way to these debtors to repay their debt and rebuild their life. Although regulation provides new ways to help the debtor, there are still some problems.

First, after the regulation was implemented, many debtors complained about the difficulty of reaching an agreement with banks under the settlement procedure as banks’ conditions were too severe. For example, a bank required a monthly repayment of US$930 per month from a debtor even though his salary was US$1,000 per month but the bank wants him to repay the money by $930 USD per month.

Second, an AMC is not included in the settlement procedure. Thus, when the debtor reaches an agreement with the bank, and if the bank subsequently sells the debt to an AMC, the agreement between bank and debtor is negated.  The AMC can therefore can once again, require the debtor to repay all the money.

These solutions are a temporary solution to the credit card problem. The real problem is the bankers’ lack of ethics. Consequently, the Taiwanese government should give educate bankers and people on ethics. The best way to prevent similar occurrences is to teach people to regulate their behaviors by themselves.[[1]](http://sevenpillarsinstitute.org/case-studies/taiwans-credit-card-crisis#_ftn1)

To that end the leading universities in Taiwan such as National Taiwan University’s Executive MBA, National Chengchi University, National Taipei University, and National Cheng Kung University make business ethics classes a requirement. Yet, a class in business ethics generally is not a guarantee that graduates will be ethical in their work. Perhaps however, the classes will raise the moral consciousness of a few.

**"Taiwan’s Credit Card Crisis" Website linkage**

[**http://sevenpillarsinstitute.org/case-studies/taiwans-credit-card-crisis**](http://sevenpillarsinstitute.org/case-studies/taiwans-credit-card-crisis)