Jack Langlois

Howard Snyder

In China, Foreign Firms Chip Away at Mountain Of Bad, Overdue Debt

Investors Buy Up Dud Loans, Use Hardball Tactics to Collect

By KAREN RICHARDSON and KARBY LEGGETT
Staff Reporters of THE WALL STREET JOURNAL

NANKOU VILLAGE, China -- Jack Langlois and Howard Snyder listened politely as the local Communist Party boss explained why his village couldn't pay back the $18 million loan the two men had come to collect. Then the **Morgan Stanley** bankers went on the offensive.

A grim-faced Mr. Langlois elbowed Mr. Snyder, who pulled out two sheets of paper filled with photos and names of regional Communist Party officials -- people that could make or break the career of the man facing them.

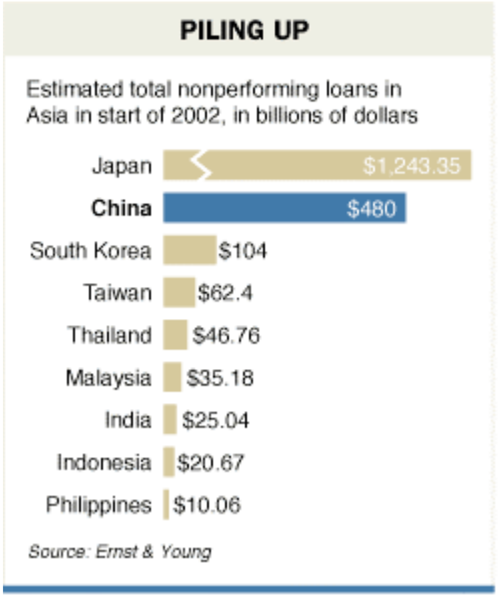
"Excuse me, Party Secretary Shen," Mr. Snyder said in rapid-fire Mandarin. "Which one of these people is your boss? We're going to talk to him about this problem."

Suddenly silent, Secretary Shen took a puff on his cigarette. Then he said in a low voice, "Let's meet again in three weeks" to discuss a payment plan. The two sides are now negotiating how much debt the village will pay back.

Collecting on overdue bank loans is difficult in any country. But in China, where banks are awash in an estimated $500 billion of bad loans, property rights are ambiguous and foreclosure laws are unclear, it has been next to impossible.

Now foreign investment companies are trying to turn a profit in this unpromising market. Big investors such as Morgan Stanley have snapped up chunks of China's bad loans for pennies on the dollar and are pushing hard to collect on them -- using tough tactics unheard of in Chinese banking. Mr. Langlois, who has relationships with Chinese officials reaching back more than two decades, seeks leverage over borrowers by appealing to senior government officials. He and Mr. Snyder threaten to use the media or Morgan Stanley's global reach to steer foreign investors away from borrowers that refuse to pay. And they use Morgan Stanley's deep pockets to pursue lawsuits that few locals could afford.

But Morgan Stanley is also running into problems. Chinese bureaucrats try to wine and dine -- and sometimes bribe -- its staff. Most courts have little or no experience with cases involving bad-loan creditors, debt collectors or even foreigners, and have been known to be influenced by local officials through political pressure.



Meanwhile, disagreements have flared up with its Chinese partners, prompting Morgan to consider restructuring its venture just as business takes off.

Foreign investors such as Morgan Stanley could prove crucial to the future of Chinese banking as it faces a looming deadline. Under its agreement with the World Trade Organization, China has promised to open up its banking system to foreign competitors such as **Citigroup** Inc. and **HSBC Holdings** PLC by 2007. Just in the past week, it has committed $85 billion to boost the capital of three of its four biggest state-owned banks, a move it said would prepare them to list their stocks on foreign exchanges.

Clearing dud loans off their books makes the banks more attractive to potential investors and helps them meet key global standards, such as low debt-to-deposit ratios. Most important, improving the health of the banks could help China avert a banking crisis by assuring its citizens their money is safe and they don't need to flee to foreign competitors.

China's banks ended up in this mess after more than a decade of shoddy lending. Throughout the 1990s, Beijing encouraged the country's biggest banks to make loans to state-owned factories, real-estate developers and construction companies -- all part of its push to kick-start the economy through infrastructure spending.

The lending lured lots of shaky and shady enterprises that eventually defaulted on their debt. But Chinese law prevented state-owned banks from carrying out debt-collection practices common in other countries, such as farming out the collections to third-party operators, selling the loans directly to distressed-debt investors or accepting payments smaller than the original value of the loans. And conflicts of interest were rampant. Local governments, for instance, often control both banks and the companies that borrow money.

So the government decided to auction off the bad loans to foreign investors, who were given greater leeway to operate within the bounds of the nation's archaic banking laws and who often had extensive experience in debt collection. In the first sale three years ago, an investment group led by Morgan Stanley picked up $1.3 billion in debt for just $65 million. That makes Morgan Stanley by far the biggest player in the Chinese debt market. **Goldman Sachs** grabbed just $300 million in that auction, and in the most recent sale, held last month, Citigroup and **J.P. Morgan** snapped up less than $400 million.

Morgan Stanley says its debt-collection unit, Beijing Kaili Asset Management Co., is meeting internal targets. Kaili, a joint venture with two Chinese partners, had a record month in September, collecting about $18 million, Morgan Stanley says.

Just over a year ago, neither Mr. Langlois nor Mr. Snyder imagined he would be chasing debtors across 18 Chinese provinces. Mr. Langlois, a tall 61-year-old with round glasses and wavy gray hair, had retired after 17 years as an investment banker in the U.S., Japan and China for J.P. Morgan, and was teaching graduate-level classes on the Chinese banking system at Princeton.

When he accepted the job, one of his first moves was recruiting Mr. Snyder. A stocky 41-year-old with a penchant for colorful ties, Mr. Snyder had studied Ming Dynasty history under Mr. Langlois in the early 1980s. Mr. Snyder, who was working as a private investigator and security consultant in Japan, leapt at the chance to move to China and work with his mentor.

After arriving in Beijing late in 2002, they hired nearly three dozen people for the new venture and formed five collection teams to work different regions of the country. Messrs. Langlois and Snyder, both fluent in Chinese, typically deal with the most difficult cases after their local staff fail to get money out of the debtors.

The loan to Secretary Shen's Nankou Village, a zone of billboards and derelict construction sites about 25 miles north of Beijing, was made a decade ago. Caught up in the 1990s building craze, Nankou officials guaranteed loans from state banks to developers with wildly ambitious plans for tourism projects, mostly theme parks with names such as "Old Beijing" and "Dutch Wonderland." To make room for them, they tossed dozens of farmers off their land, with little or no compensation.

One such project was Oriental Nightclub City, a casino and brothel done up in classical Greek style. The main borrower skipped town before the project was finished, leaving his brother and the village government on the hook for the loan. The collateral: an 82-acre wasteland of crumbling colonnades, garbage piles and unfinished concrete villas.

"How can I pay you when I can't even pay the peasants?" Mr. Shen, who wasn't in charge of Nankou when the loan guarantees were issued, asked the Morgan bankers in his office. "You're not even our biggest creditor," he snapped.

That's when the bankers threatened to go over Mr. Shen's head.

Returning to their car afterward, Mr. Langlois ordered Mr. Snyder to make good on their threat. "Put in a call to the county boss when we get back," he said. "We need to let these guys know we're not afraid to ruin their reputations."

A few miles outside Nankou Village, Messrs. Langlois and Snyder stopped to get a closer look at the Ming Tomb Wax Museum, which houses wax figures depicting life in the Ming court that ended some 350 years ago. The museum, now deserted but for cheery staff, backs an $11 million loan Morgan now owns.

"A lot of thought went into this," said Mr. Langlois, snapping photos and admiring the silk costumes and authentic-looking weapons on display.

"No offense, but this thing isn't going to make any money," countered Mr. Snyder, stifling a yawn.

Morgan is trying to sell the loan to a Chinese investor who has no interest in the Ming Dynasty or in running a museum. But the company that runs the museum does have something the investor wants -- a corporate registration and government approvals, which are typically difficult and time-consuming for a new company to obtain.

The next morning, the bankers, along with one of their regional managers, headed out to visit another problem borrower: Tianjin Seagull Wrist Watch Group. In 1955, it produced China's first wristwatch, earning brief fame and years of government subsidies. These days, the freebies are gone and Seagull's business has dried up. Of its 5,000 workers, 1,600 have been laid off but still collect salaries. Another 1,600 workers are retired but receive benefits. Some remaining workers recently started a private watch factory, and Seagull makes much of its revenue from renting out its equipment to the staff who defected.

As the train pulled into Tianjin, an industrial city near Beijing, Messrs. Langlois and Snyder strategized about the meeting. Morgan Stanley sued Seagull last summer, in an attempt to recoup a $5 million loan. With the case languishing in a local court, the goal this morning was more modest: "We should ask for 12 million" yuan, or $1.2 million, said Mr. Snyder.

Shortly after, in a conference room at Tianjin Seagull's factory, two managers and three secretaries from the company were seated across from the bankers.

"We can't accept this situation," Mr. Langlois said to open the meeting. "You could repay us part of the loan now, or we'll just go through with the lawsuit."

Wang Deming, Seagull's portly general manager, shook his head. "We've already been sued by another creditor for 500,000 yuan [$60,480], and we can't even afford that."

"We understand Tianjin isn't as rich as Beijing, but it's also not as bad off as Ningxia," said Mr. Snyder, referring to a poor northern province. "So you should pay us back something in the middle" like 12 million yuan.

"Please tell your boss we'll offer two or three million," Mr. Wang countered, suddenly addressing the bankers' regional manager.

"No way, that's way too low," Mr. Langlois fired back. "If you don't pay, we could sue all six of the borrowers in the holding company."

Mr. Wang exchanged a worried glance with a colleague. Then he agreed to meet with the Kaili manager again soon, and to open up Seagull's books, giving the bankers a rare, up-close look at the factory's accounts. The end result, after more talks: The two sides agreed upon an amount to be paid back, which Morgan Stanley won't disclose, and Seagull has paid three-quarters of it. Mr. Snyder says he expects to "pick up a check for the rest" soon.

The threat of lawsuits is another powerful weapon for Morgan Stanley. Mr. Langlois has filed suit against more than a dozen debtors this year in China's antiquated court system, paying tens of thousands of dollars in court fees. He has yet to have a day in court, but he says he uses the suits to embarrass the debtors with their superiors or the government, as well as to show debtors he intends to pursue them over the long term.

Soon after the initial meeting at Seagull headquarters, Mr. Langlois dialed into a global Morgan Stanley conference call from the train station. He was quickly drawn into another set of problems: The company's relationship with its two joint-venture partners.

Late last summer, Morgan became embroiled in a feud with one partner, Hong Kong-based KTH Capital, headed by a mainland Chinese husband-wife team with U.S. university degrees and Chinese government connections. Morgan claims KTH overcharged the joint venture by up to $750,000 -- a claim that KTH denies. Morgan has hired an accounting firm to conduct an audit and both parties have mobilized lawyers to hammer out their claims and salvage their respective stakes.

At the same time, Morgan Stanley is contending with speculation among some of its own executives and other distressed-debt bankers that its other joint-venture partner, Zhongjin Fengde Asset Management Co., is connected to China's secret police. Zhongjin Fengde says it is simply a state-owned company. Morgan Stanley declines to comment on the charges.

Morgan Stanley executives now say they are leaning toward restructuring the venture, possibly excluding one or even both Chinese partners. But doing so will take time and possibly a lot of money, if they end up buying out one or more partners. What's more, alienating Zhongjin Fengde would be difficult since most of the joint venture's 40 employees were transferred from the Chinese company.

Back at the Beijing train station, Mr. Langlois jammed his cellphone to his ear. Blaring loudspeakers and shouts from threadbare migrant workers and beggars made it difficult for him to hear his colleagues, who were discussing China's next loan auction -- and the status of the joint venture. Soon after Mr. Langlois hung up, Mr. Snyder demanded his boss's attention. The staff, Mr. Snyder said, were calling to ask about their year-end bonuses.

Working his way across the crowded platform, Mr. Langlois mustered a tired smile. "Sometimes I wonder why I'm not retired in Colorado," he said.

Updated January 13, 2004