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Non-Performing Corporate Loan Toolkit for Banks

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Non-Performing Corporate Loan Toolkit for Banks

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"To the man with a hammer, every problem looks like a nail."

Singapore's restructuring and insolvency regime offers a wide variety of tools for dealing with corporate non-performing loans and loan defaults. To avoid the "man-with-a-hammer" syndrome, it is important to understand the nuances of these tools and how they can be suitably deployed in different scenarios. The sophistication of the tools has greatly increased with legislative enhancements made in recent years.[1] This allows borrowers and lenders alike to formulate bespoke strategies that best suit each particular situation.

This note summarises the key features of the restructuring and insolvency options in Singapore, and sets out a decision-making matrix to guide banks and other lending institutions in selecting which options may be preferred under various conditions.

Key features of the different options

The main options available for addressing non-performing loans or defaults in Singapore are: (a) consensual workouts; (b) schemes of arrangement; (c) judicial management; (d) liquidation; and (e) receivership.

The table below summarises the key features of each option.

Option	Key features
Consensual workouts	• No formal rules on the conduct of a consensual workout, but the following measures are increasingly common in multi-lender workouts. These measures help to foster a transparent, fair and orderly process to reach a consensual solution. Many of these steps were taken in the highly successful restructuring and turnaround of Pacific International Lines, in which WongPartnership LLP advised the debtor company in its pre-negotiated out-of-court restructuring which was implemented through a scheme of arrangement.[2] • May be creditor-led, or debtor-led. By being "debtor-led", this may in certain cases mean that the major shareholders and/or founders would pave the way for the restructuring by giving certain supporting undertakings, e.g., where cash flow problems are acute, a major shareholder and/or founder could inject cash into the company, and/or pledge personal assets as security to obtain liquidity for the company in order to minimise disruption to operations. Such shareholder support

[1] For more details, refer to our previous updates *Insolvency, Restructuring and Dissolution Act – Key Changes from the Financiers' Perspective* (22 February 2021), *Singapore's enhanced corporate debt restructuring mechanisms – One year on* (30 April 2018), and *Overview of Singapore's New Restructuring Framework* (10 August 2017).

[2] The swift and silent restructuring of Singapore's Pacific International Lines | Center for Commercial Law in Asia (smu.edu.sg).

Option	Key features

	could also take the form of undertakings to support any eventual scheme and/or to refrain from taking actions to enforce shareholders loans, etc.
	• Particularly useful in cases where there is a relatively small group of creditors across a small number of classes.
	• Standstill agreement to set out conditions, milestones, timelines and processes for working towards a consensual workout.
	• Establishment of an informal steering committee ("**ISC**") of lenders (to act as a focal point for negotiations and information disclosure by the debtor).
	• Appointment of an independent financial adviser / monitoring accountant to the ISC.
	    ○ Appointments may be made on agreement for professional costs to be borne by debtor (or for the lenders to bear upfront professional costs that may be added on to existing secured debt).
	• Implementing systems for cash flow monitoring and control.
	    ○ E.g., Cash payments may be made to trading counterparties to sustain operations and/or to prevent small creditors from applying to wind up.
	• Establishment of a data room for regular disclosures on material business and financial information.
	• Periodic meetings and updates.
	• Operational restructuring to improve profitability and reduce costs.
	• Strategic asset disposals to deleverage the balance sheet and improve debt servicing ratios.
	• If there is no unanimity among parties in the consensual workout, a consensual workout plan that has been approved by a substantial majority of the creditors (75% in value and majority in number) *via* lock-up agreements may be implemented through an expedited pre-pack scheme of arrangement to bind minority dissenting creditors. Such an approach was used in the restructuring of Pacific International Lines.
	    ○ We expect to see more consensual workout plans including lock-up fees for creditors, following the decision of *Re Brightoil Petroleum (S'pore) Pte Ltd* [2022] SGHC 35. In that case, the General Division of the High Court held that the provision of lock-up fees will generally not fracture a class of creditors when voting on a scheme of arrangement, subject to certain requirements.

Scheme of arrangement	• Many of the measures used in consensual workouts (mentioned above) can also be applied when a borrower is proposing a scheme of arrangement. • A scheme of arrangement is a compromise or arrangement between the debtor and its creditors to modify or adjust their respective rights.

Option	Key features
	• Schemes of arrangement may be debtor-led or creditor-led. • Suitable for companies with strong business fundamentals (i.e., where the financial distress is a result of one-off events and/or external factors rather than weaknesses in core businesses), and where existing management has a good working relationship with existing customers / suppliers. • Suitable also where there are many different classes of creditors, with differing levels of sophistication, as mechanisms such as cross-class cram down and moratorium protection are available. • Similar to consensual workouts, it is common to see the establishment of an ISC of lenders to act as a focal point for negotiations and information disclosure for the debtor. • Similar to consensual workouts, it is also common to see the appointment of an independent financial adviser / monitoring accountant to the ISC. ○ Appointments may be made on agreement for professional costs to be borne by debtor (or for the lenders to bear upfront professional costs that may be added on to existing secured debt). • A scheme of arrangement must be approved by the creditors (75% in value and majority in number) and the court, following which it binds any minority dissenting creditors. • A scheme of arrangement can be used not only to restructure the terms of the debt (e.g., through debt-equity conversions, term-outs, or haircuts), but can also be tailored to establish mechanisms and processes to maximise lenders' recoveries under an overall restructuring strategy. • For example, a scheme can provide for the orderly realisation of non-core assets to maximise asset sale prices, cash sweep mechanisms to pay down debt at regular intervals, financial monitoring processes under the oversight of a scheme manager or monitoring account, etc. • There are various tools under the scheme of arrangement regime that facilitate the process for obtaining a binding scheme of arrangement, including: (a) moratorium against legal proceedings and enforcement; (b) super-priority for rescue financing; (c) cross-class cram down of dissenting classes of creditors; and (d) restrictions against *ipso facto* clauses which help ensure that while the restructuring is underway, critical contracts are not terminated or performed on more onerous terms for the debtor. • An expedited pre-pack scheme of arrangement can be used to implement a pre-negotiated consensual workout plan that has been approved by a substantial majority of the creditors (75% in value and majority in number) *via* lock-up agreements. With a pre-pack scheme, the cost and delay of having to apply to the court for permission to convene a scheme meeting as well as hold a scheme meeting is avoided and the scheme proceedings only require one hearing for the scheme to be sanctioned.

Option	Key features
Judicial management	• Judicial management involves the appointment of a judicial manager who displaces the existing management and takes control of the business and affairs of the borrower company. • Legally while both a creditor and a debtor may propose judicial management, given that incoming judicial managers would displace the function of an existing board, this is typically a creditor-led process. It has been observed in Singapore that creditors often propose judicial management, where there may be reason to suspect fraud and/or other irregularities within the debtor organisation. However, for the avoidance of doubt, judicial management can be proposed by the debtor itself. • A judicial manager is appointed to achieve one or more of the statutorily-specified purposes, namely: (a) the survival of the company; (b) the approval of a scheme of arrangement; and/or (c) a more advantageous realisation of the company's assets than on a winding-up. The key distinction between a judicial manager and a liquidator is that the judicial manager has a wider mandate to attempt a rehabilitation or rescue of the company. • A borrower company can be placed into judicial management *via* a court order or under the voluntary judicial management process[3] introduced in 2020. • Similar to the scheme of arrangement regime, the judicial management regime has features to facilitate the process including: (a) a moratorium against legal proceedings and enforcement; (b) super-priority for rescue financing; (c) cross-class cram down of dissenting classes of creditors (if the judicial manager proposes a scheme of arrangement); and (d) restrictions against *ipso facto* termination clauses. • A judicial manager can propose a scheme of arrangement with the features mentioned in the section above as part of a restructuring strategy. • A judicial manager can pursue clawback actions for unfair preferences and undervalue transactions, and claims against the directors and officers for insolvent trading.
Liquidation	• In a liquidation, a liquidator is appointed to sell the company's assets and to distribute the sale proceeds (after collectively realising all or most of the assets) to the company's creditors. • Similar to a judicial management process, liquidators in a liquidation would also displace the function of directors on the debtor's board, and may in many cases, also take over the management of the remaining affairs of the debtor. • Compared to a judicial manager, a court-appointed liquidator has a more limited scope to carry on the business and must seek the approval of the court or committee of inspection if he intends to carry on the business after four weeks of the winding-up.

[3] See our previous update, *Insolvency, Restructuring and Dissolution Act – Key Changes from the Financiers' Perspective* (22 February 2021), under the section titled "Judicial Management by Resolution of Creditors"

Option	Key features
	• A borrower company can be placed into liquidation *via* a court order or through voluntary liquidation. • A liquidator can pursue clawback actions for unfair preferences and undervalue transactions, and claims against the directors and officers for insolvent trading.
Receivership	• A receiver can be a receiver *simpliciter* (whose responsibility is to take charge of a secured asset and sell it) or a receiver and manager (who has wider powers to manage and run the business like a judicial manager but without the additional statutory powers judicial managers have). • The receiver's powers are set out in the financing documents and often include the power to manage and sell the charged assets. Receivers may or may not have the ability to replace board members and/or management. For instance, a receiver appointed in respect of a charged asset would not have the ability to displace the board, and their mandate is restricted solely to the realisation of the charged asset. • In contrast, a receiver appointed over shares in a company charged to a creditor would typically be conferred powers allowing it to replace the board of directors and/or management, which in turn would give the receivers and managers greater power and flexibility in realising the assets owned by that company, and/or realising the shares in that company. ○ The type of security, and the differences in a receiver's ability to realise such security, may be something for lenders to consider before financing is extended. • A receiver is usually appointed through a private out-of-court appointment, and will typically require the lender to indemnify him for expenses and liabilities incurred in performing his duties. If done privately, i.e., by way of notice as provided for under an existing contract, the appointment process is potentially much faster than either judicial management or liquidation. This is because the appointment may be made without the need to commence any court process. • A receiver's mandate is primarily directed at realising the secured assets. • Receivership lacks many benefits of the scheme of arrangement and judicial management regimes, such as a moratorium against legal proceedings and enforcement, super-priority rescue financing and restrictions against *ipso facto* termination clauses, which potentially limits the ability of a receiver to effectively continue the business operations and package the business for sale as a going concern. • However, the main advantage of a receivership is speed; if there are existing contractual arrangements allowing for the private appointment of a receiver, the receiver may be appointed upon notification only, and with minimal fanfare compared to judicial management or a scheme of arrangement.

Option	Key features
	• Having said that, it is also important for creditors to note that any receiver or manager appointed must lodge a notice of his or her appointment with the Accounting and Corporate Regulatory Authority (ACRA). • The current legislation also prescribes that after a receiver or manager has been appointed in respect of property of a company, or even in respect of property in Singapore owned by a foreign corporation, every invoice, order for goods, business letter, order form, internet website of that company or corporation, would need to state immediately that a receiver or manager has been appointed. Creditors would be wise to recognise that such notification may have an adverse effect on the underlying business of the debtor.

Understanding the options

When assessing how these options weigh up against one another, it is not helpful to simply regard some of these options as being more "debtor-friendly" and others as being more "creditor-friendly". It is a misconception to view Singapore's efforts to develop its restructuring ecosystem as a signal that a borrower's interests prevail over its lenders' interests. In all cases of restructurings and insolvencies, the lenders' views and interests hold significant weight and have a strong influence in shaping the process and outcome of the matter.

For example, although a scheme of arrangement is usually regarded as a debtor-led procedure, the support of the majority of the creditors is a key determinant in whether a moratorium will be granted by the court. Before filing for a moratorium, debtors are required to consult key creditors as it is a statutory requirement for the application to show evidence of support from creditors.

The court also has wide powers to impose conditions to safeguard the interests of creditors. The court exercises oversight throughout the various stages of a scheme procedure (e.g., when deciding whether to extend the moratorium, approve rescue financing that seeks priority over existing creditors, grant leave to convene scheme meetings, and/or to sanction the scheme) to ensure that creditors are not prejudiced.

Similarly, in consensual workouts, well-advised debtors will proactively and voluntarily take measures to protect creditors' rights and interests to secure their continuing support for the restructuring. Such measures might include establishing a creditor steering committee, engaging legal and financial advisors for the committee, the appointment of monitoring accountants to provide oversight over the debtor's cash flow and finances, and the regular disclosure of material information and updates. Because of the informal and confidential nature of consensual workouts, a debtor may be willing to provide more extensive and frequent disclosures than might be required to under a court-supervised procedure.

On the other hand, procedures such as receivership are perceived as more "creditor-friendly" because they give the creditor a greater degree of control and oversight over the recovery process. However, when inappropriately deployed, receivership can be counterproductive to the creditor's own interests. Receivership might not be the best way for a secured creditor to recover its debts if the secured assets do not have a ready market, or if the asset prices are depressed due to a cyclical downturn in the industry. In some circumstances, the secured creditor may even have to incur substantial costs in maintaining or mothballing the asset to preserve its condition and saleability. Depending on the nature of the industry, placing a debtor (or a debtor's assets) under receivership (with its requisite notice requirements as described above) could potentially alarm the debtor's key suppliers and trade partners, as well as trade creditors, who may react disproportionately by e.g., shifting business away from the debtor in fear of insolvency, or taking enforcement actions to recover their debts, all of which could contribute to a "perfect storm" that could accelerate the demise of the debtor's business. A savvy secured creditor may be better off working out arrangements with the debtor to continue deploying the secured assets in the business (e.g., through a consensual workout, scheme, or judicial management) and concurrently run a structured or controlled sale process for the assets.

Decision-making matrix

There are no definitive rules as to which option is the most suitable in any given situation, but there are general factors and considerations which make some options preferable to others. The Singapore restructuring and insolvency regime is flexible in that there is no formal priority of certain procedures over others. This gives the borrowers and lenders the ability to negotiate and tailor a best-fit solution.

The matrix below lists several important factors to help guide the decision-making process for selecting the appropriate restructuring or insolvency process. A tick (✓) indicates that a particular process may generally be preferred under the specified conditions, but all the factors should be looked at holistically and weighed accordingly in the eventual decision.

Factor	***Consensual workout***	***Scheme of arrangement***	***Judicial management***	***Liquidation***	***Receivership***
The realisable value of the borrower's assets is uncertain, or in the lender's assessment, could be higher at a later time (e.g., if the market is cyclical and facing a downturn, which the lender may wish to ride out), or where an asset is under construction or development, with a potentially large increase in value upon completion.	✓	✓	✓		

The book value of assets and historical valuations of collateral can be poor indicators of the breakup value of business in a liquidation or receivership scenario. It is not uncommon that companies face financial difficulties and suffer loan defaults due to cyclical industry factors. In a cyclical downturn coinciding with the operational and financial decline of the business, the business's asset and collateral values might also be below market value due to shrinking capital expenditures and demand for such assets in the industry. The realisable assets of the business might also not have a ready market of buyers, e.g., if the assets are specialised inventory or property, plant and equipment. Some other assets, particularly in the construction or real estate industries, would require additional construction, upgrading, or other developmental works before they can fetch a much better value. The assets could also require significant maintenance or mothballing cost while awaiting a sale. In other situations, a significant portion of the assets on the books may be accounts receivable from customers, which could be set-off against counterclaims for damages that arise from contractual breaches if the business ceases trading.

A useful strategy in such scenarios is to implement a controlled and orderly sale of non-core assets to maximise the realisable sale prices, while undergoing a rehabilitative process (i.e., consensual workout, scheme of arrangement or judicial management). With appropriate cash flow monitoring and controls (e.g., by a monitoring accountant), a lender can ensure that the borrower redeploys the cash flow generated from the business prudently so that the financial condition of the business does not worsen over time.

Factor	***Consensual workout***	***Scheme of arrangement***	***Judicial management***	***Liquidation***	***Receivership***
The realisable value of the borrower's assets is reasonably certain and adequately covers the debt, and the assets are liquid and quickly saleable.	✓	✓	✓	✓	✓

Where a lender has reasonable certainty of receiving a full recovery from the sale of the borrower's assets (whether secured or unsecured), all options are potentially feasible platforms for selling the borrower's assets.

A complication usually arises if a borrower wants to delay or stall the sale of assets to optimise the surplus value for shareholders. In such situations, a lender should seek arrangements to ensure that its position is not made worse off (e.g., through the borrower servicing interest / principal amortisation payments and setting clear milestones / processes for selling the assets).

Lenders should also note that mortgagees (and receivers) owe a duty of good faith to ensure that proper steps are taken to obtain the best possible value of the asset. Hence, careful assessment of the available market for each asset needs to be undertaken, and lenders need to be mindful that they could be exposed to liability if they execute (or instruct their receivers to execute) sales of security assets to pre-selected buyers at pre-agreed prices, which could potentially be below market value.

Lenders also ought to consider the ongoing expenses that may need to be expended to preserve the sale value of the asset. For example, certain assets such as vessels may depreciate more quickly in price if they are left idle as buyers would have less confidence in the condition and operability of the asset. Continuing to employ or utilise the assets on a going concern basis (e.g., in a consensual workout, scheme of arrangement, or judicial management) can help to preserve the asset value and offset operating expenses while the assets are being marketed for sale, as opposed to placing the assets under the control of a receiver whose main objective is to realise and sell the asset rather than employ it.					
Factor	***Consensual workout***	***Scheme of arrangement***	***Judicial management***	***Liquidation***	***Receivership***
The borrower has profitable, cash flow generating lines of business.	✓	✓	✓		
A defaulting borrower might still continue to have profitable, cash flow generating lines of business or projects. A rehabilitative process such as a consensual workout, scheme of arrangement or judicial management can be used as a platform for the borrower to close down unprofitable lines of business, strategically dispose of non-core assets, and preserve the profitable lines of business. The remaining core of the business can then be used to service the restructured debts or be sold as a going concern. In relation to such borrowers who are able to keep servicing their monthly principal and interest liabilities, lenders are often better off not relying on breaches of non-financial covenants to call an event of default as the consequential cross-defaults on the borrower's other key contracts could be what increases the distress and reduces recovery prospects.					
Factor	***Consensual workout***	***Scheme of arrangement***	***Judicial management***	***Liquidation***	***Receivership***
The borrower's business requires regulatory licences to operate, or there is high "flight to safety" risk among its customers and suppliers.	✓				
In many regulated industries, licences may potentially be revoked if the business is insolvent or enters a formal insolvency process, or the regulators may step in to take control of the business and its assets. In competitive industries, customers and suppliers might flock to safety and prefer doing business with companies that do not have a cloud of negative publicity surrounding it. Commencing formal insolvency procedures in such scenarios could risk severe deterioration of the parts of the business that can be rehabilitated. Consensual workouts that take place outside the public sphere can provide a better platform for the borrower and lenders to rehabilitate the company and maximise the value of the business as a going concern.					

Factor	Consensual workout	Scheme of arrangement	Judicial management	Liquidation	Receivership
The creditor classes of the debtor are highly fragmented and disorganised.		✓	✓		
Where debtors owe significant trade and financial debts to a diverse group of creditors whose rights are disparate (e.g., secured vs unsecured, secured over different types of assets of varying value) and whose risk assessments and motivations are too varied, controlling an orderly restructuring process through a consensual workout can be highly challenging. If creditors are unable to come to a formal or informal standstill arrangement with the debtor, there is a perpetual risk of some holdout creditors commencing court proceedings (such as a winding-up application) that could jeopardise the debtor's ability to continue its operations effectively and any restructuring efforts supported by the majority of the creditors. In such situations, there may be an overriding need for the debtor to obtain a moratorium (e.g., under a scheme of arrangement or judicial management proceeding) to obtain breathing space to formulate and implement a restructuring plan as well as ensure no one creditor steals a march over other creditors. However, such a course should be carefully weighed against the considerations relating to the impact on the debtor's business (e.g., termination of licences and "flight to safety" risk) arising from commencing court-supervised restructuring proceedings.					

Factor	Consensual workout	Scheme of arrangement	Judicial management	Liquidation	Receivership
The borrower's management is strongly suspected of having committed wrongdoing.			✓	✓	✓
In such a scenario, there should be a clear preference for procedures in which an independent insolvency practitioner is appointed over the borrower and/or its assets (i.e., judicial management, liquidation, or receivership). Where the borrower's management is suspected of having carried out undervalue transactions, unfair preferences, or insolvent trading, judicial management and liquidation may be preferred over receivership. This is because judicial managers and liquidators have powers to bring clawback actions, whereas receivers do not.					

Conclusion

With the growing sophistication of the Singapore restructuring and insolvency regime, it is increasingly important to understand how the toolkit can be adeptly deployed under various conditions. A clear understanding of the borrower's assets, business, industry, competitive factors, contracts, licences and relationships will help shape and inform the commercial judgment in choosing the best tools to use in any given situation.

In our Special Situations Advisory Practice, we strive to avoid the "man-with-a-hammer" syndrome by drawing from the depth of knowledge and experience of our multi-disciplinary Tier 1 transactional practices, including Debt Capital Markets, Banking & Finance and Mergers & Acquisitions. This enables our Practice to provide holistic and calibrated advice to cater to each specific situation and to formulate versatile and bespoke solutions.

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