Roll-up Rescue Financing – A New Tool for Banks to Salvage Non-performing Loans

"Old (money) - may become senior (priority)"

In a recent landmark decision, the Singapore High Court approved a US$62 million rescue financing package to the Design Studio Group Ltd and five of its subsidiaries ("**Design Studio Group**") which incorporated a "roll-up" of a bank lender's pre-existing debt ("***Design Studio***").

WongPartnership LLP represented the bank lender, Hongkong and Shanghai Banking Corporation ("**HSBC**"), in the successful application.

A "roll-up" is a feature of a rescue financing deal which upgrades the priority of a rescue lender's pre-existing debt into a super-priority debt. This is achieved by applying a portion of the rescue financing proceeds towards paying the pre-existing debt of the rescue lender. The pre-existing debt is, in effect, converted (or "rolled-up") into the super-priority rescue financing debt.

The High Court's decision signals the growing sophistication of Singapore's debt restructuring regime. It also marks the emergence of "roll-up" rescue financing as a new way for banks and finance companies to salvage non-performing loans ("**NPLs**"). By upgrading the priority of pre-existing debts, a "roll-up" allows a lender to increase the potential upside on the recovery of its pre-existing debts. This offers a strong commercial incentive for lenders to extend rescue financing to aid the successful rehabilitation of financially troubled companies in their NPL portfolios.

Background on Singapore's Rescue Financing Regime

The rescue financing regime was introduced in Singapore in 2017 as part of a wide ranging reform to Singapore's restructuring laws aimed at strengthening Singapore as an international centre for debt restructuring.

Under Singapore's rescue financing regime, a company undergoing scheme or judicial management proceedings can apply to court for orders granting super-priority status to the debts arising from the rescue financing. There are various levels of super-priority that may be accorded. The requirements to be satisfied are generally more stringent the higher the level of super-priority sought. For more details on the basics of the rescue financing regime in Singapore, please refer to our update *Singapore's enhanced corporate debt restructuring mechanisms – One year on* (see section titled "*Super-priority for rescue financing*").

Rescue financing orders have been granted in the restructurings of Asiatravel.com Holdings Ltd and Swee Hong Limited. However, neither of these rescue financing deals involved a "roll-up" feature of pre-moratorium or historical debts generated in the course of business. Prior to *Design Studio*, it was uncertain if "roll-ups" were permissible under the legislation as certain indications from the Parliamentary reports and previous case law (*Re Attilan Group Ltd* [2018] 3 SLR 898) suggested that the rescue financing regime was aimed only at giving super-priority for new monies funded.

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"Roll-up" rescue financing in the restructuring of the Design Studio Group

The court's approval of the "roll-up" feature in *Design Studio* was not only groundbreaking, but also eminently sensible in the circumstances of the case.

The rescue financing package proposed would provide fresh working capital and performance bond / advance payment guarantee facilities to the Design Studio Group, the latter being the lifeblood of the group's interior design construction business. A portion of the rescue financing proceeds was also to be used to repay existing liabilities of the rescue lenders.

There was a compelling case for the approval of the rescue financing and the "roll-up" in *Design Studio*. In the absence of the rescue financing, the group would have likely been forced into liquidation resulting in minimal to no recovery for its unsecured creditors. On the other hand, the rescue financing would give the group a valuable lifeline to continue its operations and enhance its recovery of project receivables, thereby improving the unsecured creditors' prospects of a better recovery in the restructuring.

The arguments made in favour of the "roll-up" feature were three-fold:

(a) In a financing arrangement involving a "roll-up" element, the relevant "financing" for the purposes of Section 211E(9) of the Companies Act refers to the proposed financing package in its totality, i.e., incorporating both the financing to be used to repay existing liabilities of the proposed lender and the additional financing to be used for working capital or other purposes. This is because both aspects of the financing package are inseparable, particularly where the lender's commercial basis and risk assessment for providing the additional financing (thereby increasing its risk exposure to the insolvent company) is premised on part of its pre-existing debt being repaid from the funding it will provide.

(b) The above interpretation of "rescue financing" under the legislation promotes the policy objectives undergirding the rescue financing regime in Singapore, which is to incentivise and encourage financial institutions to provide rescue financing to distressed companies.

(c) "Roll-ups" should be permitted in circumstances where it is in the best interests of the company and its creditors as a whole. In the court's assessment of whether a "roll-up" should be allowed, the court can also look at a multitude of factors such as whether the applicant is able to obtain financing on more favourable terms from other sources, whether the proposed rescue financing arrangement was negotiated in good faith and at arm's length, and whether the terms of the rescue financing agreement are fair, reasonable and adequate in the light of the circumstances.

Ultimately, the rescue financing orders were granted by the court in the terms sought.

Key Takeaways for Banks and Finance Companies

There are important takeaways from the *Design Studio* decision. Our banking partner who advised on the rescue financing transaction, Alvin Chia, is of the view that "*[b]anks and other financiers may benefit from priority in respect of indebtedness owing to them, even if by them refinancing only the*

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existing indebtedness, there is no net increase in cash available to the insolvent company. Potentially, many creditors whose existing financing is critical to the operations of an insolvent company may obtain priority following the ruling in this case, and priority need not necessarily be reserved for only what is sometimes called "new monies". It is possible that the creditors who may benefit from this include vendors who provide financing and prepaying buyers."

"Roll-ups" solve a basic collective action problem seen in many restructurings. Existing creditors and lenders of an insolvent company are usually reluctant to extend further credit or financing as this is seen as "throwing good money after bad", even in situations where some marginal additional financing can give an outsized overall return for the body of creditors by enabling the successful rehabilitation of the business. Lenders may be tempted to take enforcement action (which places further strain on the business), or even do nothing simply because it is seen as a safer or more defensible option.

"Roll-ups" rebalance the risk-reward calculus and incentivises rational rescue lending. An existing lender has a strong commercial incentive to extend rescue financing where it can reap the rewards of extending that rescue financing through an upgrade of its pre-existing debt into super-priority debt. In the long term, this may also encourage syndicated rescue financing deals from existing lenders of a company undergoing restructuring.

Following *Design Studio*, banks and finance companies should now see "roll-up" rescue financing as a valuable addition in their toolboxes for salvaging NPLs by allowing enhanced recovery with downside protection.

If you would like information or assistance on the above or any other area of law, you may wish to contact the Partner at WongPartnership whom you normally work with or any of the following Partners:

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