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feature

DEVELOPMENTS IN SINGAPORE'S INSOLVENCY & RESTRUCTURING REGIME

What lessons can we learn from Singapore's recent insolvency law reform process?

Now regarded as a leading insolvency and restructuring hub in the Asia-Pacific, Singapore may provide useful comparisons and lessons for the improvement of the insolvency and restructuring framework in Australia.

In this Q&A, ARITA's Legal Counsel Dr Kai Luck talks to Aurelio Gurrea-Martinez from Singapore Management University about the insolvency reforms that Singapore has implemented in the past years, including the measures adopted as a response to the COVID-19 crisis.

Kai Luck (KL): Over the last five years, Singapore has developed a reputation as a leading restructuring hub in the Asia-Pacific. How did this come about and what are some of the legislative and policy changes that Singapore made before COVID-19?

Aurelio Gurrea-Martinez (AGM): Singapore's reputation as a leading restructuring hub is the product of several factors, including an attractive insolvency framework, a sophisticated judiciary, a qualified body of insolvency professionals, and a close collaboration between regulators, academics, and industry.

Commencing in 2010, the Singapore Government began to prioritise the modernisation of Singapore's insolvency and restructuring framework, given the importance of insolvency law for the promotion of entrepreneurship, innovation, access to finance and economic growth. It was also seen that if Singapore could become a leading restructuring hub, this would lead to greater foreign investment and trade in the country.

Following the publication of two reports from separate committees of insolvency practitioners, judges, academics and business stakeholders in 2013 and 2016, and the enriching policy discussions that took place during that period, an ambitious insolvency reform was passed in 2017 before the further enactment of the *Insolvency, Restructuring and Dissolution Act* (IRDA) on 1 October 2018.

Most of the changes adopted in the 2017 reform were focused on enhancing Singapore's restructuring laws by adopting several features of the United States Chapter 11 reorganisation process. Namely, Singapore adopted a cross-class cramdown and a more powerful moratorium in the scheme of arrangement. Likewise, it introduced a new pre-pack scheme and it allowed companies to obtain rescue financing in judicial management and the scheme of arrangement. In 2017, Singapore also adopted the UNCITRAL Model Law on Cross-Border Insolvency.

Then, the 2018 IRDA adopted additional reforms to modernise Singapore's insolvency and restructuring laws. These reforms included the imposition of restrictions on the enforcement of ipso facto clauses, new directors' duties and liability in the zone of insolvency, the promotion of litigation funding, a new licensing regime for insolvency practitioners, and the modernisation of avoidance provisions. These additional reforms, along with a comprehensive package of subsidiary legislation, officially came into force on 30 July 2020.

Importantly, the IRDA also consolidates Singapore's personal and corporate insolvency and debt restructuring laws into a single piece of legislation – something that is yet to be adopted in Australia.

The IRDA provides a balanced approach that, while remaining protective of the interests of creditors, has become more attractive to viable companies seeking

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to conduct an effective debt restructuring. In my view, this is the approach that should be followed in any insolvency reform process. Otherwise, if an insolvency regime becomes unattractive to debtors, it can harm entrepreneurship, innovation and the quick reorganisation of viable businesses. On the other hand, if the insolvency framework becomes unattractive to creditors, it can harm firms' access to debt finance. While adopting a balanced approach is certainly challenging, Singapore has shown that it is possible.

KL: With the outbreak of COVID-19, the Australian Government introduced a range of interim measures designed to help companies survive the initial demand and supply shocks that were encountered – such as a moratorium on insolvent trading liability, increased statutory demand and bankruptcy notice thresholds, and longer time periods for debtors to respond to outstanding demands and notices. Were similar measures adopted in Singapore?

AGM: Yes, Singapore adopted some similar responses, including an increase in the quantitative threshold required to initiate an involuntary insolvency petition by creditors, an increase in the period to respond to statutory demands and a suspension of wrongful trading provisions.

However, since the strategy of the Singapore Government during the initial phase of the pandemic was to put the economy into hibernation, the Singapore response was stronger than in Australia. On the one hand, the quantitative threshold was increased more significantly – from $S10,000 to $S100,000, compared to the increase from $A2,000 to $A20,000 in Australia – making the initiation of insolvency proceedings by creditors much harder.

Secondly, Singapore allowed debtors unable to pay due to COVID-19 to obtain a type of out-of-court moratorium. This moratorium was adopted through a notification of relief. According to this system, debtors unable to pay due to COVID-19 were allowed to serve a notification to their lenders, landlords or other contractual counterparties. The notification served as a moratorium protecting debtors from any legal actions (including the initiation of insolvency proceedings) potentially initiated by the counterparty.

The Government also put in place a system to deal with any dispute arising from this notification of relief. When there was a disagreement among the parties, an assessor was appointed to handle the dispute, minimising the risk of any opportunistic behaviour.

KL: What we saw in Australia during the pandemic was that the interim measures – combined with broader Government financial support for distressed businesses and employees – led to something of a 'zombie company' trend, in which the expected tsunami of insolvencies was abated and we had a lot of businesses able to trade on essentially as empty shells. What was the experience in Singapore and was there any concern about whether the interim measures adopted in Singapore were the right course of action?

AGM: Yes, the existence of zombie companies was also another important concern in Singapore. That is why the Government was eager to ensure the initial insolvency changes had a clear end date and it quickly implemented a comprehensive plan to promote economic recovery.

The focus is now on creating jobs and providing new skills to workers that need to be reallocated towards other business activities. Since resources are limited, it is important to concentrate on saving viable companies while providing workers of non-competitive businesses with the skills and opportunities needed to find a job in other value-producing companies or industries.

Importantly, as part of the country's Smart Nation initiative, Singapore has become one of the world's leading fintech hubs, and it has also facilitated the digital transformation of companies, especially MSMEs.

This is seen as a key driver of sustainable recovery and growth as the pandemic continues, and Singapore's attractive legal and institutional environment for businesses and commercial transactions will likely encourage international enterprises to relocate to Singapore as well. In fact, various tech companies have recently announced their intention to move their offices to Singapore as an early reflection of this trend.

KL: As the pandemic has continued, the Singapore Government introduced a range of new rescue and winding up processes under the Insolvency, Restructuring and Dissolution (Amendment) Act in October 2020. Can you walk us through the main changes under this legislation?

AGM: One of the measures adopted to facilitate recovery and the reallocation of assets of non-viable businesses was the adoption of a simplified insolvency programme (SIP). This programme is available to micro and small companies (MSCs) for an initial period of six months, starting from 29 January 2021. However, the programme can be extended should the need arise.

The SIP consists of a simplified debt restructuring programme (SDRP) and a simplified winding up programme (SWUP). Both programmes are administered by the Official Receiver, who may assign private insolvency practitioners to oversee and manage the cases for individual debtors. Moreover, since many MSCs do not even have enough assets to cover the costs of the procedure, both programmes are partially subsidised by the Government.

To qualify for the programme, MSCs must satisfy the following criteria:

- have an annual sales turnover of not more than $10 million
- have company liabilities (including contingent and prospective liabilities) not exceeding $2 million
- have total creditors not exceeding 50
- have total employees not exceeding 30
- be incorporated in Singapore
- have unencumbered assets of not more than $50,000 (only applicable for SWUP).

Restructuring in Singapore

Some additional requirements have been imposed to make sure that the SDRP is not used opportunistically by non-viable MSCs. For example, debtors who are unlikely to be able to formulate a reorganisation plan within 90 days are not eligible for the programme. Additionally, one third of the company's creditors can veto the application by the debtor. Therefore, the SDRP is only suitable for financially distressed but viable MSCs.

Once a company is admitted into the SDRP, debtors enjoy a simplified restructuring procedure which is mainly based on the pre-pack scheme existing under the IRDA. Since the pre-pack scheme only requires one court application – to sanction the scheme – and it dispenses with the need for the debtor to convene a meeting of creditors, the use of this mechanism provides MSCs with a more affordable and expedited restructuring procedure.

However, the SDRP is even more flexible than the pre-pack scheme insofar as a reorganisation plan can be approved with a majority of at least two thirds in value of creditors (a pre-pack scheme requires a majority in number and 75% in value). At the same time, it also provides additional protections for creditors due to the mandatory appointment of a restructuring advisor to monitor the procedure and formulate the reorganisation plan.

The SWUP facilitates the orderly winding up of non-viable MSCs in an efficient and cost-effective manner. For that purpose, it adapts the existing creditors' voluntary winding up process in the IRDA. By removing the need for a court application to begin the winding up process, the MSC itself can make a direct application to the Official Receiver.

Moreover, the SWUP allows for an early dissolution of the company so that, where the liquidator verifies that the assets of the company are insufficient to meet the expenses of winding up, and its affairs do not require further investigation, the company may be dissolved within 30 days.

KL: Had those reforms been on the modernisation agenda for some time in Singapore? Why did the Government act when it did?

AGM: Insolvency reforms targeting MSMEs have been a recent phenomenon worldwide. I think the international community started to pay more attention to the treatment of MSMEs in insolvency after the publication of two World Bank reports in 2017 and 2018, as well as the publication of a draft text on simplified insolvency regimes by UNCITRAL (2019) and the adoption of the Small Companies Reorganization Act in the United States (2019).

Then, even though some regulators were already considering insolvency reforms for MSMEs, the outbreak of the COVID-19 pandemic accelerated this process.

Singapore was, along with Australia, one of the first countries to announce insolvency reforms for MSMEs in the early stages of the pandemic. It did so because, even though Singapore already had an attractive restructuring framework in place, the ordinary insolvency system can be very costly and complex for MSMEs. Therefore, it was important to implement a simplified process for MSMEs, especially taking into account that, as it happens in most countries around the world, MSMEs represent the majority of businesses in Singapore.

So the Government and industry felt that it was appropriate to provide MSMEs affected by COVID-19 with a suitable framework to either restructure their debts (viable MSMEs) or have access to a quick liquidation process (non-viable MSMEs).

KL: Similar reforms – a dedicated rescue process for SMEs and a small business liquidation process – took effect in Australia on 1 January 2021. We have also seen reforms around the world over the last 12 months designed to similarly provide more flexibility for viable businesses to be able to restructure – such as the UK informal restructuring moratorium and new reorganisation plan, the Dutch scheme reforms and the new Subchapter V process to Chapter 11 in the United States. How would you compare each of these processes?

AGM: The insolvency reforms for MSMEs in Australia, the United States and Singapore go in the same direction: providing MSMEs with a more expeditious, simplified and suitable insolvency procedure. However, there are some differences. For instance, while Australia and the United States have adopted a permanent insolvency framework for MSMEs, Singapore has decided to enact a temporary framework with the primary purpose of assisting MSMEs affected by COVID-19.

After the initial six-month operational period, it will be decided whether the program is extended, abolished or made permanent and, if so, with any adjustments.

I think the situation in the United Kingdom and the Netherlands is a bit different. Instead of implementing COVID-19 related reforms targeting MSMEs, they have recently done what Singapore did a few years ago: revise their ordinary restructuring framework. In fact, in the case of the Netherlands, the adoption of a new restructuring framework was mandated by the EU Directive on Preventive Restructuring Framework.

The new preventive framework adopted by the European Union also adopts several features of the United States Chapter 11 reorganisation process, such as cramdown provisions, a debtor in possession (DIP) model (even if it is under the supervision of an insolvency practitioner), restrictions on the enforcement of ipso facto clauses, and the adoption of DIP financing provisions.

These procedures are similar to the restructuring framework existing in Singapore, and also to the new restructuring plan adopted in the United Kingdom. The COVID-19 crisis has just accelerated the process of implementing these attractive restructuring frameworks in the United Kingdom and the European Union.

KL: The new processes for MSMEs in Singapore are only temporary. Why is that the case and what do you think the prospects are of the changes becoming permanent?

AGM: The insolvency law reform process in Singapore has occurred over many years following thoughtful policy discussions among many stakeholders. These discussions led to the current laws which, while remaining attractive to creditors, provide more significant tools to debtors seeking to achieve a successful debt restructuring.

The new processes for MSMEs under the SIP can be seen as a continuation of that approach. The temporary nature of the SIP has allowed the Government to implement a quick and effective tool to support financially distressed MSMEs while still keeping its options open in the longer-term by assessing how the new process works after analysing the evidence and getting feedback from the relevant stakeholders.

KL: How have the reforms worked so far?

AGM: The adoption of the SIP has been very well received by the legal and business industry. In addition to providing MSMEs with an efficient option to restructure their debts or to quickly liquidate when they are not viable, the fact that the remuneration of insolvency practitioners is partially subsidised by the Government under the SIP is something relatively unique among the insolvency responses to MSMEs observed around the world.

This is critical to incentivise appointments where there are few assets available for distribution – an issue that remains problematic in many other jurisdictions, including Australia.

The ordinary insolvency and restructuring framework is also working quite well. For example, several companies have already made use of the new rescue financing provisions and we have had various successful cases of companies achieving a debt restructuring through the new pre-pack scheme.

KL: Leaving aside the MSME processes, what other features of Singapore's insolvency laws do you think might be beneficial for Australia to further incentivise rescue and restructuring?

AGM: As it happens in other insolvency regimes inspired in the English insolvency framework, Australia provides debtors with two main restructuring options (leaving aside the new SBR process for SMEs): a creditors' scheme of arrangement and a formal administration procedure.

In theory, a scheme of arrangement is an attractive restructuring option for viable companies run by honest and diligent managers. However, a difficulty with the Australian scheme is that it does not provide enough tools to achieve an effective debt restructuring.

For example, it does not provide debtors with a cross-class cramdown (making dissenting classes of creditors bound by the scheme if certain conditions are met) or DIP financing provisions. Moreover, the debtor cannot apply for a statutory moratorium pending the negotiation and implementation of the scheme.

These additional tools, currently available under the Singapore scheme of arrangement process, could significantly increase the effectiveness of the Australian scheme as a restructuring tool.

The voluntary administration process in Australia, which is also replicated – with similar or different names – in many other common law jurisdictions seems to be based on the idea that 'the fox cannot guard the hen house'. For that reason, the existing management is replaced by an external administrator. I think this is a mistake. This approach seems to assume some type of misbehaviour by the management team, and that is not always the case.

In my view, removing honest and diligent managers can actually do more harm than good. Ex ante, it may discourage the early initiation of restructuring procedures. Ex post, it may prevent the company from having the hands-on expertise provided by the managers. Moreover, it can also increase the costs of the procedure due to the heavier workload of the insolvency practitioner acting as an administrator.

Apart from the new SME rescue process adopted in Australia, it may also be worth considering, for other companies, a 'light touch' administration, where insolvency practitioners would be appointed as 'supervisors' instead of formal administrators unless the company's managers have engaged in any kind of misbehaviour.

A pre-pack process may also be beneficial, either in the form of a 'pre-packaged reorganisation procedure' (the United States/Singapore approach) or in the form of a 'pre-packaged asset sale' (the United Kingdom approach). In both cases, several safeguards should be put in place to avoid any opportunistic behaviour by insiders. These safeguards may include creditor voting to approve a pre-pack reorganisation procedure or sale, an enhanced system of disclosure, and the appointment of a restructuring advisor to supervise the process.