COVID-19 (Temporary Measures) Act 2020 – Impact on Banks and Finance Companies

The new relief measures for businesses that have been implemented through the COVID-19 (Temporary Measures) Act 2020 ("**Act**") have a direct impact on financiers.

This update focuses on some of the issues that financiers should be aware of.

The starting point is section 5 of the Act, which is to the effect that where a party (called "**A**"), being a party to a "scheduled contract", has an obligation to be performed on or after 1 Feb 2020, and A is, due to the pandemic, unable to perform it, A may serve a notice under the Act on its counterparty (and to be copied to any guarantor or surety for A's obligations) for relief. Following the notice being served, either A or the other party (called "**B**") to the "scheduled contract" may trigger an assessment process for a determination as to whether the contract is one where A gets relief under section 5.

The "scheduled contracts" (meaning contracts listed in the Schedule to the Act) include some financing agreements, and as applied to the financing context includes:

(a) a contract for the grant of a loan facility by a bank or a finance company to an "enterprise", <u>where such facility is secured</u> against any commercial or industrial <u>immovable property</u> located in Singapore;

(b) a contract for the grant of a loan facility by a bank or a finance company to an "enterprise":

(i) where such facility is <u>secured, wholly or partially, against any plant, machinery or fixed asset</u> located in Singapore; and

(ii) where such plant, machinery or fixed asset is used for manufacturing, production or other business purposes;

(c) a performance bond or equivalent that is granted pursuant to a construction contract or supply contract;

(d) a hire-purchase agreement or conditional sales agreement, where the good hired or conditionally sold thereunder is:

(i) any plant, machinery or fixed asset located in Singapore, where such plant, machinery or fixed asset is used for manufacturing, production or other business purposes; or

(ii) a commercial vehicle (defined to include goods vehicles, excursion buses, private buses, private hire cars, taxis, tractors, etc.).

The relief, if granted, includes the stopping of certain legal actions that would otherwise be available to banks or other creditors, such as:

(a) the commencement or continuation of an action in a court, or arbitral proceedings under the Arbitration Act against A or A's guarantor or surety (meaning that no new court action or arbitration may be filed, and that an ongoing action may not be proceeded with, but this does not restrict the commencement or continuation of *international* arbitration proceedings);

(b) the enforcement of any security over any immovable property (meaning for instance, no actions may be taken for a mortgagee's sale of real property); and

(c) the enforcement of any security over any plant, machinery or movable property used for the purpose of a trade, business or profession (meaning for instance, no seizure of machinery used in business).

The underlying aim seems to be to preserve the jobs provided by these businesses. In terms of the restrictions against banks and financial institutions taking the restrained actions as set out above, only "enterprises" as defined may benefit from these restrictions. Briefly, the Act is intended to protect small and medium enterprises, and "enterprises" (which need not be incorporated companies) must satisfy the following criteria:

(a) not less than 30% of its shares or other ownership interest is held by citizens of Singapore or permanent residents of Singapore or both; and

(b) the turnover of the group (within the meaning of the Accounting Standards applicable to it) to which it belongs does not exceed S$100 million in the latest financial year.

The temporary relief for such contracts would also not apply to any "scheduled contracts" entered into or renewed on or after 25 March 2020 (save where such contracts are automatically renewed).

The temporary relief afforded by the Act only applies to obligations to be performed on or after 1 February 2020. For banks and finance companies with existing non-performing loans ("**NPL**"), the Act does not prohibit legal action being taken to recover debts which were due and payable prior to 1 February 2020. For example, if the repayment of an NPL had already been accelerated, such that the full outstanding amount was already due and payable before 1 February 2020, the lender may take action to recover such amount. However, with respect to NPLs where repayments were accelerated only on or after 1 February 2020 (even if the default on the NPLs occurred before such date), the borrower may be able to rely on the temporary relief provided by the Act since its accelerated obligation to pay only arises on or after 1 February 2020.

Notification for relief and determination by assessors

Such relief is not automatically granted. If A intends to seek any of the above reliefs, it must serve a notification for relief on:

(a) the other parties to the "scheduled contract";

(b) any guarantor or surety for A's obligation in the "scheduled contract"; and

(c) such other person as may be prescribed.

Upon receiving the notification for relief, B cannot take or continue any prohibited action against A during the relief period.

The parties may raise any dispute for an assessor's determination. The assessor will decide whether A's purported inability to perform contractual obligations was due to COVID-19. The assessor will take into account A's financial capacity to perform the contract and will seek to achieve an outcome that is just and equitable in the circumstances of the case.

Parties will not be allowed to be represented by lawyers, and there will be no costs orders. The assessor's decision will be final and is not appealable.

Further regulations are to be promulgated pertaining to the period for serving the notification of relief, manner of service, the forms to be used and information or documents to be furnished etc. It is expected that such details will be announced in the coming weeks.

It also appears that although a performance bond or its equivalent issued by a bank pursuant to a construction contract or supply contract is also a "scheduled contract", the issuing bank would not need to issue a notification under Section 9(1) in order to prevent calls on a performance bond. If the bank's customer, A, has obtained temporary relief under Section 5 against the counterparty, B, under a construction contract or supply contract to suspend performance, the Act would apply automatically to restrain B from making a call on the performance bond.

Issuing banks should also take note that if A withdraws its notice for relief, or if an assessor determines that no temporary relief applies under Section 5, B will no longer be restrained from calling on the performance bonds. The issuing banks will in such circumstances be obliged to make payment pursuant to the performance bonds, and A will not be able to apply to the issuing bank after that for any extension.

Available recourse for the banks and finance companies

These measures do not mean that financiers are unable to rely on all of their contractual rights during the prescribed period of 6 months.

The following may be noted notwithstanding the Act:

(a) banks may still pull all the working capital credit lines that are totally unsecured or secured only by guarantees from the owners of a corporate borrower (the restriction seems to apply when there is <u>security</u> over immovable property or plant, machinery or fixed assets used in business), so *e.g.,* the service companies to whom banks may have granted <u>unsecured</u> credit lines do not seem protected by this Act;

(b) banks may still take enforcement action against businesses that have granted security only over inventory and/or bank accounts, since the restrictions would not apply because inventory and bank accounts are not "plant, machinery or fixed assets" nor immovable property. This may be an issue for *e.g.,* second-hand car dealers as long as the security is only inventory (may be "floor stocking" in the market). However, the restrictions against the bank taking legal action would apply if the bank had an **all-assets debenture**, since the debenture would in theory cover not just the inventory but also any equipment and even office furniture (which may be "fixed assets") and hence trigger protection for the debtor under the Act;

(c) if it is not clear if a security previously entered into has been discharged, this may be an issue if the bank wishes to take legal action. It is not uncommon that when borrowers have paid off one of a few facilities secured on *e.g.*, an all-assets all-monies debenture, even if there is a common understanding to discharge that debenture, both the bank and the borrower do not give urgent attention to doing so. Also, often the de-registration of the charge (filing of the Statement of Satisfaction of Registered Charge ("**SSRC**")) is delayed/forgotten. As a matter of law, the non-filing of the SSRC is not determinative of the continued validity of the security, and whether there is still a valid mortgage or debenture depends on whether there are other discharge or release documents signed by the bank;

(d) funds, leasing companies, licensed or exempted moneylenders, corporates that give credit to intra-group entities, pawnbrokers and even insurance companies who have engaged in lending (i.e., any financier other than a bank or finance company) do not seem to be prohibited by the Act from taking legal action to recover any loan secured or unsecured (other than hire-purchase financing contracts which are under another category of "scheduled contracts" – see below);

(e) even as the Act suspends enforcement of rights, the Act does not purport to alter substantive contractual rights, and borrowers who do not pay as scheduled may still be liable for interest and default interest charges (often compounding every month), and the banks and finance companies are not prohibited from terminating and accelerating their loan facilities if an event of default occurs (except for leases or licences of immovable property where the obligation that cannot be performed by the borrower is the non-payment of rent or other moneys);

(f) banks' right of set-off continues to apply. Strictly speaking, if A has an account with a bank, the bank exercising the bank's right of set off would not be enforcing security (the right to do so is contractual under the facility letter and/or account opening terms and does not on its own amount to a charge or any security/enforcement of security). This may lead to cash flow issues in certain situations for some borrowers who operated with the expectation that a blocked deposit would in due course be released by the bank. For instance, if the bank is owed S$1,000,000 on a term loan repayable in monthly instalments, and the bank has issued a bank guarantee ("**BG**") for S$200,000, the total debt owed by the borrower to the bank is S$1,200,000. It would not be unusual if all this debt were cross-secured on a property worth S$1,500,000 and a charged fixed deposit ("**FD**") account containing S$200,000, all documented by standard "all-monies" security documents. A is unable to repay the loan instalments due in the next few months, and defaults on the loan. However, the BG is not called on and expires on 20 April 2020. The Borrower would ordinarily have expected the Bank to release the FD then but the Act does not seem to require the bank to do so, since the FD also secures the loan and the bank exercising set-off rights *per se* is not enforcement of any security.

(g) the Act restricts legal actions by parties specifically defined by their roles as contracting parties. In the context of factoring and other instances of assignment of contractual rights, it remains arguable what the position is as to whether the bank as assignee may take legal action, especially if the assignments took place **before** the new Act came into force, *e.g.* in January 2020, an events manager may have assigned to a bank the events manager's debts. The events manager itself cannot sue for the debts owing to it ("event contract" is one of the other "scheduled contracts"). The Act specifically restrains the events manager (as a party to the event contract) from taking enforcement action, but it is not clear if a bank, as assignee of the event manager's rights to be paid those debts, is also similarly prevented from taking enforcement action, since on principle, being an assignee of contractual rights does not per se make the assignee a party to the event contract.

An opposing view is that the intent of the Act is to restrain the enforcement of contracts where the inability to perform is caused by COVID-19 and so the restrictions should apply to both the event manager and the bank. It is arguable that the bank, as assignee of the event manager's rights, cannot be in a better position than the event manager in being able to enforce the debts. This would be all the more so in the case of equitable assignments (which encompasses assignments by way of charge) where the assignee (the bank) would typically have to join the assignor (the event manager) as the party to the action to recover the debts.

(h) Banks may be the issuers of performance bonds. To the extent that the performance bond was issued "pursuant to a construction contract or a supply contract", and the bank's customer (the applicant for the performance bond, *e.g.,* a building contractor) has served the notice for relief from liability to the beneficiary of the performance bond (*e.g.,* the landowner who hired the building contractor), the beneficiary is prohibited from calling on the performance bond any earlier than 7 days before the expiry of the performance bond.

Given that the timeline for the issuing banks to make payment under performance bonds is often very short, banks that have issued performance bonds should consider reminding their customers (the applicants for such performance bonds) that any notifications for relief they may issue to a counterparty (the beneficiary under such performance bonds) should also be copied to the issuing banks, and to keep the banks updated if they withdraw their notification for relief subsequently, or if any assessor determines that they are not entitled to relief under Section 5.

Banks who receive calls on performance bonds should check with their customers if they have served the notifications for relief under the Act, before paying out on the performance bonds. If notifications for relief under the Act have been served on the beneficiary, then any calls made on the performance bonds by the beneficiary would be void;

(i) the restriction against enforcing hire purchase and conditional sale agreements is not restricted to banks and finance companies, *e.g.*, leasing companies are also similarly restricted; and

(j) the Act does not purport to have any extraterritorial effect, and it appears that the banks and finance companies would not be restricted from enforcing security against A's immovable property or movable property <u>outside of Singapore</u>.

Changes to bankruptcy and insolvency laws

The Act also grants temporary relief for individuals and businesses in financial distress during the prescribed period (i.e., a period of 6 months from 7 April 2020).

The monetary threshold for commencing a **bankruptcy** application against an individual has increased from S$15,000 to S$60,000. The time period for an individual to satisfy a statutory demand, failing which he is presumed to be unable to pay his debts, has increased from 21 days to 6 months.

The monetary threshold for a statutory demand against a company has increased from S$10,000 to S$100,000. The time period for a company to satisfy a statutory demand, failing which it is presumed to be unable to pay its debts and hence liable to be **wound up**, has increased from 21 days to 6 months.

However, unlike the sections allowing for temporary relief, there is no requirement for these debts to arise only on or after 1 February 2020.

The easing of the statutory demand requirements will make it more challenging for creditors to succeed in bankruptcy or winding up applications against individuals and companies (assuming in the first place that such applications are not prevented by the temporary relief afforded to "scheduled contracts" as mentioned above). Creditors usually have to rely on the failure of an individual or company to satisfy a statutory demand in support of their **bankruptcy or winding up applications**, as the failure to satisfy a statutory demand invokes a statutory presumption that the individual or company is insolvent. Nevertheless, creditors who are able to prove the insolvency of the debtor by other means, *e.g.*, by way of financial statements of the debtor, may still be able to succeed in bankruptcy or winding up applications.

The Act also provides directors and other officers of companies a safe harbor from **insolvent trading** liability. Ordinarily, an officer of a company who knowingly incurs a debt where there is no reasonable ground of expectation that the company would be able to pay the debt may be guilty of a criminal offence and made personally liable to repay the debt. This insolvent trading liability deters officers of a company from irresponsible borrowing when the company is hopelessly insolvent. However, given the uncertain economic climate, the Act now provides officers of a company a **safe harbor** by stipulating that an officer of a company is not to be treated as having no reasonable ground of expectation of the company being able to repay a debt if the debt is incurred in the "ordinary course of business" during the prescribed period. Banks and financial companies should be mindful of the potential repercussion of borrowers looking to take on more risky or speculative borrowings.

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