

Debt Resolution Mechanisms for Viable Businesses Facing Temporary Financial Distress

A strong debt resolution framework remains vital to mitigate an insolvency cliff and provide critical support to distressed but viable firms. During periods of crisis, large numbers of such firms could precipitate widespread premature bankruptcy proceedings and hamper economic recovery. Drawing upon experience from the Asian Financial Crisis (AFC), Malaysia has in place well-established out-of-court debt restructuring mechanisms for different business segments. Coupled with court-sanctioned corporate rescue mechanisms, businesses can avail themselves of different platforms that facilitate efficient and effective debt workouts with creditors. These mechanisms collectively aim to:

- Assist balance sheet and cashflow restoration and avert the premature failure of viable borrowers;
- Improve the speed and value of debt recovery; and
- Mitigate potential losses to financial institutions which could adversely affect economic growth and recovery prospects.

The significant impact of COVID-19 on many businesses underscores the important role of these mechanisms which are being further strengthened to enhance their efficacy.

Court-sanctioned Corporate Rescue Mechanisms

Viable businesses that are facing difficulties in servicing their debt obligations can avail themselves of three different court-sanctioned rescue mechanisms under the Companies Act 2016 (CA 2016). The CA 2016 introduced two new rescue mechanisms, namely the Corporate Voluntary Arrangement (CVA) and Judicial Management (JM), in addition to the Scheme of Arrangement (SOA) which has been a widely used rehabilitative tool for businesses (Table 1.1).

More recently, the Companies Commission of Malaysia had issued a consultative document on the Companies (Amendment) Bill 2020, which will widen the coverage of firms that will benefit from these rescue mechanisms while embedding sufficient safeguards¹⁷ against potential abuse. This would be complemented by ongoing efforts to enhance the capacity of the court system in Malaysia to support the effective implementation of these mechanisms. In 2020, the take-up for court-sanctioned rescue mechanisms already registered a notable increase (2020: 53; 2019: 30)¹⁸ as more borrowers sought redress, particularly given lingering uncertainties surrounding the pandemic.

Out-of-court Rescue Mechanisms

The Bank has established two out-of-court debt resolution platforms, namely the Corporate Debt Restructuring Committee (CDRC) and Small Debt Resolution Scheme (SDRS) (Diagram 1.1), which help businesses restructure debt without resorting to lengthy, costly and complex legal proceedings. The out-of-court mechanisms provide greater flexibility in terms of the scope, size and focus of debt workouts to take into account prevailing conditions. In crisis, this can include the ability to adapt processes and resources more quickly to mitigate systemic risks posed by distressed firms. They also help avoid overwhelming the court system, especially during a crisis. These out-of-court platforms, coupled with the increased capacity of banks to manage debt workouts since the AFC, have enabled successful debt restructuring plans for SMEs and corporates.

¹⁷ These safeguards include codifying provisions to, among others, empower the Court to grant automatic moratorium on SOA, allow super priority for rescue financing, introduce cross-class cramdown mechanism and restrain disposition of properties during moratorium.

¹⁸ Up to December 2020 (Source: Companies Commission of Malaysia).

Table 1.1: Court-sanctioned Corporate Rescue Mechanisms

	Corporate Voluntary Arrangement	Judicial Management	Scheme of Arrangement
Establishment date	2016	2016	1965
Process	<ul style="list-style-type: none"> Restructuring is management-driven with minimal court involvement An insolvency practitioner, who may be nominated by the board of directors of the company, will assess the viability of the scheme 	<ul style="list-style-type: none"> The management power of a company will be placed under a court-appointed judicial manager who will prepare a restructuring scheme and manage the borrower's company affairs and property 	<ul style="list-style-type: none"> A court-approved arrangement is made between the company and creditors Upon filing of the application, the court may appoint a liquidator to assess the viability of the scheme proposed for the arrangement
Moratorium	<ul style="list-style-type: none"> Upon lodgement of documents to the court, an automatic moratorium of up to 28 days, which is extendable to a maximum of 60 days, is given 	<ul style="list-style-type: none"> Upon filing of the application, automatic moratorium will be in force for a period of 6 months and, with the approval of the court, may be extended for a further 6 months 	<ul style="list-style-type: none"> Upon application, the court may grant a restraining order for an initial period of 3 months, which may be renewed for a period of up to a further 9 months subject to fulfilment of its pre-statutory requirements
Application eligibility	<ul style="list-style-type: none"> Excludes: <ul style="list-style-type: none"> Public companies Private companies with secured creditors Licensees under the Financial Services Act 2013 (FSA 2013), Islamic Financial Services Act 2013 (IFSA 2013) and Capital Market and Services Act 2007 (CMSA 2007) 	<ul style="list-style-type: none"> Excludes: <ul style="list-style-type: none"> Public companies Licensees under the FSA 2013, IFSA 2013 and CMSA 2007 	<ul style="list-style-type: none"> For all companies
Court supervision	Minimal (for lodgement of corporate voluntary arrangement documents only)	Minimal (for granting of judicial management order only)	Yes

Source: Companies Act 2016

Diagram 1.1: Corporate Debt Restructuring Committee and Small Debt Resolution Scheme

Corporate Debt Restructuring Committee (CDRC)

CDRC was first established in 1998 to facilitate debt workouts during the AFC. It was reactivated in 2009 as an out-of-court platform for viable corporations and their creditors to work out feasible and holistic solutions to resolve debt obligations (i.e. bank borrowings and/or debt securities). Drawing upon the experiences of the London Approach in the United Kingdom, CDRC is guided by principles that ensure the fair treatment of borrowers, while maximising value for financial creditors.

CDRC assists in managing debt workouts of firms that meet the following criteria:

- i. Aggregate indebtedness of RM10 million or more;
- ii. Debt is owed to at least two financial creditors;
- iii. Not in receivership or liquidation, except for those where receivers have been appointed only over certain specified assets and the directors remain in control over the companies' overall operations; and
- iv. Experiencing difficulties in servicing their debt obligations but have not defaulted, provided they meet criteria (i) & (ii).

CDRC has assisted 38 firms to resolve RM14.1 billion in aggregate debt since 2009.

Small Debt Resolution Scheme (SDRS)

SDRS was established in 2003 as a platform for financial institutions and viable SMEs to work out debt rehabilitation solutions without resorting to legal recourse, allowing SMEs to focus on plans to revive their business.

SDRS supports debt workouts for SMEs that meet the following criteria:

- i. SME has business-related financing from participating financial institutions;¹
- ii. Business owner/shareholder(s)/guarantor(s) is not bankrupt; and
- iii. Business is not under advanced legal action i.e. winding-up order obtained, company wound-up, receivers and managers have been appointed/ in receivership, judicial manager has been appointed under judicial management.

In addition, businesses that have ceased operations would also be eligible to apply for SDRS, provided the business owner has other income sources to meet repayment obligations.

SDRS has facilitated debt workouts for more than 1,300 SMEs with total debt amounting to RM2 billion since 2003.

¹ All commercial banks, Islamic banks, and development financial institutions as prescribed under the Development Financial Institution Act 2002

Source: Corporate Debt Restructuring Committee and Credit Counselling and Debt Management Agency

Since CDRC's reactivation in 2009, its admission criteria¹⁹ have been refined several times to help more firms. Meanwhile, SDRS was absorbed into the Credit Counselling and Debt Management Agency (Agensi Kaunseling dan Pengurusan Kredit, AKPK) in September 2020 to foster greater synergy, expand its footprint through AKPK's established online channels and create a one-stop platform that provides holistic debt restructuring as well as financial education and advisory services for individuals and SMEs, including micro entrepreneurs. These changes enable CDRC and SDRS to effectively support the potential increase in firms requiring restructuring assistance, thereby mitigating economic scarring and broader risks to financial stability.

¹⁹ The minimum threshold for aggregate debt was revised from RM100 million to RM30 million in 2010, and subsequently reduced to RM10 million in 2017. The minimum threshold for the number of financial creditors to whom debt is owed was revised from three to two financial creditors in 2010.

The overall household sector has remained resilient throughout the crisis, but some segments are experiencing increased financial stress

The growth in household debt²⁰ normalised to pre-COVID-19 levels in the second half of 2020 as the country emerged from stringent movement control restrictions (Chart 1.14). Growth was mainly driven by car and housing loans, which expanded by 6.1% and 7.4% (June 2020: -0.7% and 7.2%), respectively, lifted

by the strong response to the sales and service tax (SST)²¹ incentives for the purchase of cars and various home ownership incentives. Personal financing also registered higher annual growth of 7.1% (June 2020: 4.4%), partly due to the suspension of repayments during the automatic loan moratorium period. On aggregate, the household debt-to-GDP ratio rose to 93.3% mainly due to GDP remaining below pre-crisis levels (Chart 1.15). A concern over high household debt is that it may lead to a rapid deleveraging by households in the aftermath of a crisis, thus dampening or derailing economic recovery. There has not been significant evidence of this, with new banking system disbursements to households

²⁰ Extended by both banks and non-bank financial institutions.

²¹ Effective 15 June 2020 until 30 June 2021.