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Amendments to the Bankruptcy Act 1967: The Significant Changes

The new Bankruptcy (Amendment) Act 2017, which came into force on 6th October 2017, has renamed the existing Bankruptcy Act 1967 as the 'Insolvency Act 1967'. The new Act will bring about significant changes to the law and, along with these, possible uncertain ramifications.

In general, the changes provide increased protection for individual debtors, by inter alia allowing them more opportunities to restructure repayment of their debts. The increased protections are a response to the worrying trend of large reported increases in the number of bankruptcy cases.

One of the underlying objectives sought to be achieved is to create a society (comprised as it is of debtors and creditors) which is more financially literate on the issue of debt repayment.

From a creditors' perspective, some of the changes will force a review of existing business practices. We highlight below the more significant changes.

1. The increase in Minimum Indebtedness Threshold

The debt threshold for initiating bankruptcy proceedings has been increased from RM30,000.00 to RM 50,000.00. This "raising of the bar" may require creditors to now reconsider their credit and lending policies as well as their debt restructuring practices.

2. Single Bankruptcy Order

The "2-pronged" orders which used to bring about the status of a debtor to bankruptcy, namely a receiving order and an adjudication order, have been morphed into a single 'bankruptcy order'.

In other words, the debtor will be adjudged bankrupt upon the granting of the bankruptcy order. The option of having a scheme of arrangement between debtors and creditors after the granting of a receiving order previously available has been removed.

3. Absolute Protection for Social Guarantors

Under the new laws, creditors are prohibited from commencing bankruptcy proceedings against "social guarantors".

The term "social guarantors" essentially means persons who are said not to have profited from the underlying loans for which they stood as guarantors including education loans, hire purchase transactions for personal or non-business uses, and housing loans for personal dwelling.

From now on, creditors will only be able to enforce the guarantees provided by social guarantors through modes of execution limited to the writs of execution provided under the Rules of Court 2012. Bankruptcy proceedings are no longer an option.

4. Additional Protection for Other Guarantors

Meanwhile, guarantors other than those classified as social guarantors will enjoy a measure of reprieve from bankruptcy proceedings as creditors now must first obtain leave from the court to commence bankruptcy action against these guarantors and they have to satisfy the court that all other modes of execution and enforcement to recover the debt have already been exhausted.

The provision is unclear as to whether modes of execution and enforcement must be exhausted against the debtor only or against both the debtor and guarantor.


Whichever the case, this requirement would necessarily entail additional expenses to a creditor to investigate a debtor's/guarantor's finances and assets and the viability of recovery.

In addition, the time taken to exhaust all modes of execution and enforcement may also create an indirect shield should time-bar set in against a creditor.

5. Services of bankruptcy papers

Whilst substituted service is still allowed, there is now an extra burden on the creditor to prove to the satisfaction of the court, before an order for substituted service can be made, that the debtor, with the intention to defeat, delay or evade personal service:

(a) has departed from Malaysia or, being out of Malaysia, remains out of Malaysia; or
(b) has departed from his dwelling house or otherwise absented himself or secluded himself in his house or closed his place of business.

6. Voluntary Arrangement

One of the major changes involves a 'rescue mechanism' which enables a debtor, at any time before he is adjudged a bankrupt, to propose a voluntary arrangement to his creditors.

This envisages a debtor coming forward to identify all his creditors and to be in constant contact with them to enable him to propose a schedule for repayment of his debts. The process entails a debtor applying to court for an interim order which operates as a restraint of legal, execution and bankruptcy proceedings against him while negotiating a compromise with all his creditors.

The interim order will last for 90 days after which there shall be no extension. Within that period, meetings are called and creditors vote on the proposal with 75% having to agree to accept the debtor's proposal.

In the event the proposal is not accepted by the creditors, the debtor nonetheless can still be protected in that he may reapply 12 months after the interim order lapses, if the debtor has not yet been adjudged bankrupt.

The general body of creditors may benefit both from the certainty of payment (albeit over a protracted period) and equality in treatment of creditors of similar classes.

Notwithstanding the above, a creditor may file or proceed with a bankruptcy petition against the debtor if the debtor fails to comply with his obligations under the voluntary arrangement.

7. Automatic Discharge After 3 Years

Bankrupts will be automatically discharged after 3 years from their statement of affairs, doing away with the need for a bankrupt to make an application for discharge to the Director-General of Insolvency (DGI) which previously could only be done after a period of 5 years had lapsed or to the court any time after being adjudged bankrupt.

The amendments provide that the debtor only needs to fulfil a target contribution of his provable debt, which target is to be determined by the DGI, and that upon rendering an account of money and property to DGI, the debtor can then be let off.

The DGI determines, with apparently wide discretion, the target contribution of the provable debt by taking into account numerous considerations such as the debtor's monthly income, his educational and


vocational qualifications, as well as the prevailing economic conditions of the country.

Creditors do have some latitude to object to the discharge - a creditor may apply to the court for an order to suspend the discharge, provided it can prove to the court that the bankrupt has committed an offence under the Act or offences concerning fraudulent deeds or disposition of property under the Penal Code or that he has failed to co-operate in the administration of the estate or that the discharge of the bankrupt would prejudice the administration of the bankrupt's estate.

The court has the power to either dismiss the creditor's application and approve the automatic discharge, or to suspend the discharge for 2 years, in which latter case the bankrupt will be automatically discharged after that period of 2 years if he continues to fulfil his duties and obligations under the Act during the period.

A concern from a creditor's perspective is whether the discharge of a bankrupt remains a matter of record which would enable a creditor to access data to ascertain the creditworthiness of an individual. The new amendments do not discuss whether the records of an individual who have enjoyed an automatic discharge are maintained. Creditors may then not have the resources available to verify the prior status of debtors or potential debtors and are thus unable to carry out sufficient credit assessments.

The changes to the law also create a class of bankrupts whose discharge cannot be objected to by creditors, including those who fall within the Persons with Disabilities Act 2008, deceased bankrupts, bankrupts suffering from serious illnesses as certified by a Government Medical Officer, and social guarantors. Creditors may now be wary about granting loans to such persons in the first place out of concern that creditors have limited recourse should these persons default.

8. <u>Establishment of Insolvency Assistance Fund</u>

Finally, an Insolvency Assistance Fund (IAF) will be established to streamline the administration of a bankrupt's estate in terms of payments of fees and costs to facilitate effective administration of the estate.

The Act provides that "investments" go directly into the IAF and operate as a separate account from the Consolidated Fund – this is to enable a more efficient mechanism to administer the estate of a bankrupt.

To that end, creditors must also now ask whether there will be fees chargeable on them by the IAF once they have invoked bankruptcy procedures on their debtors.

Previously, creditors need only pay a deposit which sum is to be used towards defraying the costs incurred by the DGI who continues to administer the estate of the bankrupt without the need for a creditor to inject further sums towards the administration. Creditors must now wait and see as to whether the IAF will require creditors to pay administration costs especially if the IAF is not able to recover its expenses from the collection of the assets of a bankrupt.

Conclusion

The changes to the law may see lenders imposing tighter controls on their lending policies and may have them call on forms of security other than guarantees. These changes may force lenders to innovate and create financial products underpinned by multiple principal obligors rather than the more traditional lender-guarantor arrangements.

Loan qualities may also improve as lenders may be slower to part with their monies without ensuring that there are tangible securities rather than a mere personal commitment by a guarantor to repay any outstanding sum.

News Update: CDRC announced lower threshold for companies seeking aid

The Corporate Debt Restructuring Committee (CDRC) has once again lowered the minimum total aggregate debt threshold for companies seeking debt restructuring aid - from RM30 million to RM10 million. The revision took effect from 1st of September 2017.

The recent revision manifests the government's desire to open up the corporate debt restructuring option to a wider group of companies. The threshold was revised once before in 2010 - from the initial threshold of RM100 million to RM30 million. This allows small and medium enterprises or companies facing temporary operational challenges the option to apply to the CDRC to resolve their debt obligations with their creditors.

The CDRC was established in 1998 together with the then Pengurusan Danaharta Nasional Berhad (now known as Prokhas Sdn Bhd) and Danamodal Nasional Berhad (now dissolved) as part of the government's three-pronged approach to guide the country out of the then prevailing financial crisis. Whilst both Danaharta and Danamodal focused on asset management and recapitalization of the banking sector, the CDRC was set up to assist in large corporate debt restructuring. It provides a mediation forum for corporate borrowers and creditors to work out a feasible scheme without having to resort to legal action or liquidation.

The eligibility criteria include the following:-

1. aggregate indebtedness of RM10 million or more;
2. at least 2 financial creditors; and
3. not in receivership or liquidation

OR

4. Any company listed on the Main Market or the ACE Market of Bursa Malaysia that has already been classified as a PN17 company (a company in financial distress) or a GN3 company (a company with poor or adverse financial condition and operation).

Upon an application CDRC will play the role of mediator between a debtor and its creditors and attempt to come up with a viable debt restructuring arrangement. It is to be noted that the CDRC does not have any legal force of law. Co-operation among the parties is therefore critical under the CDRC framework. If necessary, consultants will be appointed to review the affairs of the debtor and to make necessary recommendations to the parties. If a restructuring exercise proceeds, a formal standstill is then executed in order for the consultants to formulate and implement the strategies.

Apart from improving the speed of debt recovery for creditors, the mechanism helps to support cash flow restoration of the debtor as parties try to work out a feasible debt restructuring arrangements instead of precipitating insolvency procedures. Values recoverable from viable debtors may therefore be higher and this in turn minimizes potential losses to creditors.

This recourse being now made available to companies whose debts are smaller than the original threshold is a positive move in that the prompt resolution of smaller debts could provide for the debtors to get back onto their feet before their liabilities snowball to impossibly unmanageable sizes which would then compel creditors to take aggressive recovery action.