

# WHY ARE DEBENTURES CONSIDERED FINANCIAL LANDMINES?



WHY BUSINESSES ARE **CLOSING**  
DOWN DUE TO THE  
ACCEPTANCE OF **DEBENTURES**  
AT THE TIME OF LOAN  
APPROVALS.

Lately I have been involved in several legal tussles on behalf of our Clients, who have unwittingly signed a Debenture during the acceptance of a Loan Offer Letter from Financial Institutions. Not understanding the true significance of their actions, they have metaphorically stepped on a financial landmine. This sadly has led to situations where they were about to lose their Business, Properties and everything they had, due to payment delays.

Taking this into account, I felt that we at TBC had to inform the Business community on what exactly is a **Debenture** and what are the *Advantages and Disadvantages of accepting a Debenture based loan.*

**What exactly is a DEBENTURE?** – Simply put, a Debenture *is the document that grants lenders a charge over a borrower's assets, giving them a means of collecting debt if the borrower defaults.*

Debentures are commonly used by traditional lenders, such as banks, when providing high-value funding to larger companies.

What I am going to express now is just my Personal and Professional opinion. I would be giving some of my views based on personal dealings with clients who have and are wrestling with the issues of the above stated Debentures.

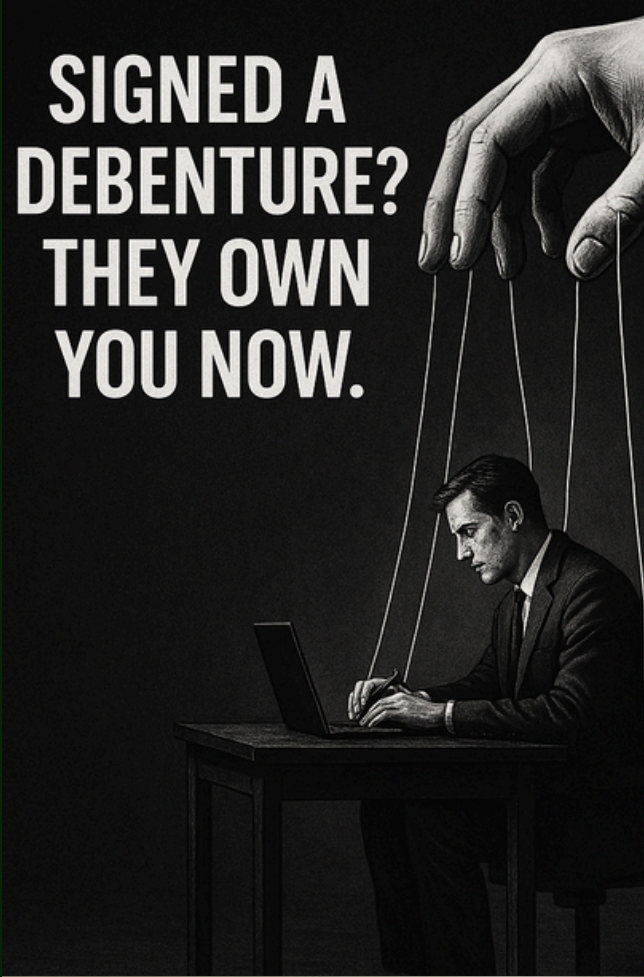
Let's Begin with the historical definition of a Debenture! When the term Debentures were first created it signified a type of Debt Instrument that was **NOT** secured against Physical Assets nor Collateral in anyway.

They were only backed by the general creditworthiness and the reputation of the issuer. In the past, Corporations and Governments frequently used this type of Bond to secure capital.

Enter the Banking world of the 1900's, the issuers have involved from Investors to Financial Institutions.

Now they believed that though Creditworthiness of an applicant was important, however the usage of the term "**Debenture**" was No Longer significant without a Collateral tied to it.

As Non-Performing loans were on the rise, how do they appraise an applicant on Creditworthiness alone? **What if the borrowers defaulted during economic depressions?**



**SIGNED A  
DEBENTURE?  
THEY OWN  
YOU NOW.**



**Inventory  
Liquidation  
Sale**

**This Location Only.**

Some exclusions may apply.

If we were to analyze the Economic Depressions of the 1900's we will see that it began as early as 1901.

It started with the First financial crisis of **The Northern Pacific Railway**, it was followed by 1907 Bank Failures, and eventually was made worse by the **Economic recession of 1920-21 after the First World War**.

This eventually led to the **Great Depression that lasted 10 years from 1929-1939 (Considered the worst depression in Modern History)**. This went on to the 1970's, 1980's and let's not forget the Asian Financial Crisis in 1997 and beyond. The point is that, these have been the Historical Financial data's that Financial Institutions have been accumulating over the past 110 years or more.

**With the KEY QUESTION!** If this happens again! How do we recoup our money from the borrower?

Due to this alarming question, the Financial Institutions began to relook at secured loans and their applications. How do they secure any and all loans issued by them, so that they would not end up with the US Subprime Mortgage issues of 2007-2011?

So how does this help the Business Borrowers? Well when a Financial Institution enforces a Debenture on your borrowings, you need to understand that the following situations would arise:

**1) SECURED CREDITOR:** This means in terms of loan repayment default and liquidation of the company, The Financial Institution that holds any debenture(s) against the properties given as collateral would be the main beneficiary to be repaid as they are **"The Secured Creditors"**.

**2) RESTRICTION IN RAISING NEW CAPITAL :** Any Financial Institution that embarks on the path of lending funds for whatever reason, basically wants to ensure that their investment is secured.

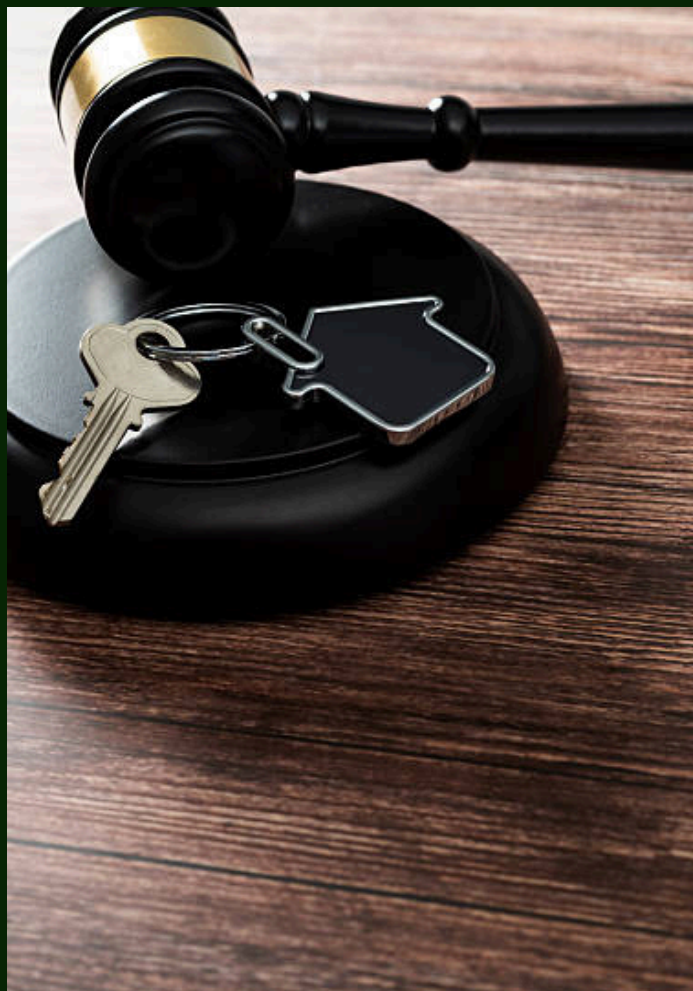
However when a Debenture is issued to the said Lender, then usually the new Financial Institutions are hesitant to come in for further lending purposes.

This is because as mentioned earlier, the recovery of payments at liquidation always goes to the debenture holders first. Therefore the risk of lending becomes exponentially higher.

### **3) AUTHORIZATION FROM THE DEBENTURE HOLDER :**

Another problem is, even if new financial institutions are willing to lend funds to the company, they would most probably **require an authorization from the Debenture holder before releasing the funds**.

Here the Debenture holder has the right to refuse the said authorization if they feel that the lender is over extended in their current liabilities or may have problems in future repayments to both financial institutions.



Now that we have seen the reasons why Financial Institutions enforce a Debenture, we need to see exactly if these practices are being followed through in an ethical manner. Based on our current client problems we are noticing is a surge of **Financial Institutions in Malaysia that are in fact distressing the business owners over the issuance of these Debentures.**

In the last 12-15 Months we have seen the changes in the trends in the lending market as a whole.

Malaysia has experienced increased inflation driven by the higher domestic fuel prices alone.

Now this is a simple fact that shows that the country's economy for the period above has given rise to a decreasing revenue pattern for most SME based companies.

So what is the solution by the Financial Institutions? **A) Help the said Businesses by helping them restructure their payment options** or **B) Recoup their borrowings any way they can, by imposing Debenture agreements, fixed and floating charges, Directors Personal Guarantees and bankrupt the company and Directors?**

Now if you were a Financial Institution! Which path would you take? Well though most of you are more inclined to see the best path as A) and which seems the most practical approach, you would find it hard to believe that the option practiced by most Financial Institutions today is B).

**SCARY...But TRUE!** The sad truth about Asian Business owners are that most of the time they look at the amounts approved for the loans they apply for. They tend to overlook the conditions attached to them. In fact very few even read through the loan documents offered by Financial Institutions before they sign on the dotted line.

Of course we have to understand that the Financial Institutions are being cautious based on the examples that we had examined earlier. However where does that leave the business owner?

We at SKB are currently facing these problems for a lot of our clients who have a tremendous business potential that have been hit by the economic crisis and the GST issues of the past in Malaysia and had some trouble in keeping up with their loans, hence missing a few payments.

However we find that the *Financial Institutions are more interested in extinguishing these businesses, and in the process putting hundreds of people out of work instead of logically resolving the situation by allowing these business owners to restructure their debts.*





### **Please do not get me wrong!**

It's not that I am against the Financial Institutions here. As I said earlier, explained these drastic measures had to be taken by them from a historical perspective.

However, if this persists the entire economy of a nation will be greatly affected. **Business owners would be forced out of business.**

This would definitely lead to workers and staffs who would be out of jobs soon, which will create a fundamental clog and a chain reaction in the economic gears of a country.

However from a personal standpoint I still believe that the **Borrowers should always be aware of what they are signing!**

Its human nature to sign blindly and accept everything on face value. It is only when things turn for the worse that such important factors are even considered.

**Look out for our case studies on the related topic soon.**

In the event that your company is going through such a turmoil and all hope seems bleak and you have No Idea what to do!

Please do give us a call and let's see if we are in a position to guide you through it...**What have you got to lose anyway?**

