NUS National University of Singapore | Centre for Banking & Finance Law Faculty of Law

CBFL SEMINAR SERIES

Post-COVID19 Recovery Through Law: Credit, Regulation, and Technology

27 October 2022, 4.00pm to 5.15pm (SGT)
NUS Law, Lee Sheridan Conference Room and via Zoom

from left: Dr Giuliano Castellano, Associate Professor Dora Neo

The Centre for Banking & Finance Law (CBFL) at NUS Law was pleased to host the seminar, "Post-COVID19 Recovery Through Law: Credit, Regulation, and Technology" by Dr Giuliano G Castellano, Associate Professor and Deputy Director of Asian Institute of International Financial Law (AIIFL) at the University of Hong Kong. Held on 27 October 2022, the seminar was conducted both in person and online via Zoom. In his seminar, Dr Castellano analysed the principal trends driving this post-pandemic economic recovery. The seminar was moderated by CBFL's Centre Director, Assoc Prof Dora Neo.

The economic impact of the COVID-19 pandemic prompted a range of unprecedented state-led interventions. These included providing liquidity, extending relief to affected sectors, and mitigating a wave of insolvencies through mechanisms such as insolvency moratoriums. Now, as economies are moving from the emergency phase to the recovery phase of the COVID-19 crisis, the focus has shifted from public interventions to the implementation of market-based mechanisms that facilitate business financing. Contrary to the common tendency to compartmentalise different aspects of law, Dr Castellano brought together different elements to facilitate a better understanding of economic recovery through law. His seminar focused first on credit products, particularly, asset-based lending and factoring; second, on the role of regulation; and third, on the role of technology. Though the seminar primarily had in mind the context of emerging and developing economies, the underlying issues and lessons can be shared and applied across different jurisdictions.

Credit Products: Structures and Current Applications

The first theme of the seminar was credit products, their structures, and current applications. Specifically, Dr Castellano discussed the structures and compared the core legal elements of asset-based lending, factoring (or invoice discounting), and reverse factoring (also known as payable finance). He explained that in the context of a market-based recovery, such credit products are essential for supporting viable businesses and limiting the risks for financiers. In particular, collateral becomes central. In order to lift public interventions implemented during the emergency phase of the pandemic, private market-based guarantees are required, with these being represented in most cases by collateral and creditors' rights.

However, secured lending alone may not be sufficient, and regulatory interventions or adjustments may still be needed. Although domestic private law often already contains the key principles and provisions that support secured transactions, Dr Castellano pointed out that a clear regulatory framework – including licensing, supervision, and prudential regulation – may be more effective to spur sound development, especially in the receivables purchasing market. Such a regulatory framework may facilitate the provision of liquidity by regulated entities, and may be more straightforward an approach than reforming the entire system for protecting creditors' rights.

Role of Regulation: Policy Tensions and Trends

The second theme was the role of regulation. In this respect, Dr Castellano discussed policy tensions that may arise due to legal and regulatory mismatches – specifically, between secured transactions law and capital regulation. Secured transactions law places relatively few limits on the types of assets that can be taken as collateral; however, capital requirements (such as the Basel regime) typically treat only certain eligible collateral as providing valid credit risk protection. As a result, though a transaction may be "secured" under private law, it nevertheless may be treated as ultimately "unsecured" for regulatory purposes. On a bank's books, the cost of such "secured" credit may be the same as that of unsecured credit. This has an uneven impact on market incentives as between banks and non-banks, potentially even supporting the emergence of shadow banking favouring the extension of credit by unregulated institutions. As Dr Castellano explained, this may give rise to concerns relating to financial stability and access to credit.

He also discussed emerging trends, specifically, the typical anatomy of regulatory frameworks governing factoring. This generally involves defining the regulatory perimeter (usually with reference to receivables purchasing activities, rather than contracts), entry and authorisation regulation (including contractual implications of unlicensed factoring activities), prudential regulation, conduct of business requirements, and supervision. Dr Castellano pointed out that because making changes to bank regulation can be costly and carry political ramifications, the trend has often been to instead regulate non-bank institutions that provide secured lending.

Role of Technology: Regulatory Implications and Future Developments

The third and final theme was the role of technology. Dr Castellano discussed possible uses of distributed ledger technology (DLT) in access to credit and secured lending. These included the use of DLT in collateral registries, capital creation through digital assets, and DLT-based platforms that facilitate collateral disposal. He also spoke about the use of digital assets as collateral and the issues that arise, including whether such qualifies as a regulated activity and the impact of digital asset volatility.

He suggested that a more realistic use of technology may instead be in respect of receivables-based products (which may or may not involve the use of blockchain), such as invoice matching platforms and receivables platforms. Additionally, he highlighted that other new technologies, such as artificial intelligence, may be useful in identifying and calculating credit risk, and can be introduced in general FinTech strategies of digital transformation.

Dr Castellano concluded by looking forward to a strategy for post-pandemic recovery. In his view, the regulatory frame should not be seen as an impediment, but as a form of guidance and validation. Legal and regulatory coordination is also key, such as in formulating common definitions of digital assets and factoring, from which regulation can better develop. Additionally, the strategic use of technology can be a critical enabler in certain contexts.

The seminar concluded with a brief but lively question-and-answer session. Questions included: whether there is a trade-off between attracting liquidity from regulated financial institutions on the one hand, and systemic risk on the other hand; whether there is any main regulatory lacuna in relation to factoring; and whether views have been articulated on these matters by key international organisations.

Further discussion of selected themes discussed in this seminar can be found in the following papers authored by Dr Castellano: "Commercial Law Intersections" (2021) 72 Hastings Law Journal 999; and "Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer", available at https://openknowledge.worldbank.org/handle/10986/34813.