Responses to Financial Stability Board Discussion Paper,

'Approaches to Debt Overhang Issues of Non-Financial Corporates'

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All views on the discussion questions are being expressed in a personal capacity

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1. How do creditors or investors assess the viability of a company in the current environment, given the possible transformation of business environment and consumption patterns following the COVID-19 crisis, and considering a need to swiftly process a high number of (re-) assessments as government support measures phase out?

In general, there is a continued need for further development of tailored debt restructuring measures, which are predominantly conducted on an out-of-court basis, but which include a viability test. As a standard for admission, a report on a company's viability can be prepared by an appropriately qualified insolvency practitioner and the report may be subsequently submitted to, or filed with, a court. Following the progress of the restructuring or workout procedures, any compromise involving the company and its creditors or investors would require court approval in order to be legally binding.

Restructuring (and forbearance) will continue to be an integral element of corporate recovery following the pandemic. However, in order to ensure that rehabilitative actions are being utilised efficiently and purposefully, such measures should entail an independent confirmation of a company's ability to continue as a going concern after restructuring. If a company is unable to demonstrate prospects of survival, the measures can present the company with the option of entering formal liquidation proceedings and which would promote economically beneficial reallocation of resources. Hybrid processes of company rescue are becoming increasingly prevalent in jurisdictions worldwide.

Examinership in Ireland is a suitable example of a process which consists of an entry threshold by requiring the demonstration of the inherent viability of a company that is experiencing grave, but temporary, financial difficulties. In recent times, the process has been complemented by the introduction into Irish law of a primarily out-of-court rescue process for small and micro companies, whereby a rescue report can be prepared by a process advisor who attests to a company's reasonable prospects of survival. Following its filing with court, the rescue arrangement is subsequently made binding on the parties, provided that objections are not presented to court.

2. What type of market-led mechanisms can help determine corporate viability? How could such market-led mechanisms for conducting due diligence be incentivised or supported?

For larger companies, predictive or diagnostic techniques can be more effectively implemented within everyday practices. These practices for ascertaining viability may not even necessitate highly sophisticated technologies. It is essentially a matter of thorough due diligence. Problems can arise particularly for small- and medium-sized enterprises. The management of an SME could be reluctant about availing of early warning tools if there are substantial costs to be incurred. Furthermore, the accuracy of the techniques could be questionable when applied to companies with limited product offerings and a restricted market base, compared to larger companies.

In parallel with a gradual withdrawal of certain public supports and direct subsidies, individual jurisdictions could dedicate more resources towards enhanced information provision for SMEs regarding points of contact, including debt advisory and consultancy services. In the same manner, these mechanisms would enable SMEs to be directed towards the services of insolvency practitioners, particularly where a company is considering entering a restructuring process (be it formalised and court-centred, or out-of-court).

3. How can governments and financial authorities create favourable conditions to provide incentives for lenders and debtors to engage in corporate debt restructurings and to allow market exit of non-viable companies in a timely fashion?

It might be a simplistic analogy to suggest that 'If it is built, then they will arrive'. Nonetheless, through the presence of defined and cost-affordable processes of corporate rescue and restructuring in a jurisdiction, debtor companies and their creditors can be immediately assured that there are reliable legal measures available to protect their interests. As noted above in respect of SMEs, incentivising companies to take responsibility for any emerging difficulties is a perennial challenge. Yet, it is creditors who could be especially suspicious of any attempts by companies to strike agreements in circumstances where the creditors could have little trust in the law's ability to ensure that creditors' entitlements are being safeguarded.

Even when processes are mostly out-of-court in nature, an aspect of judicial oversight, through the approval of a compromise between a company and creditors, can be vital in assuaging creditors' concerns about their enforcement rights being unduly adversely affected. As corporate creditors span from financial institutions, as secured creditors, to the vulnerable unsecured claims of trade creditors, transparency and consideration for all stakeholders is exhibited by a process' capacity to guarantee that any arrangement is not detrimentally impacting on any specific class of creditors relative to the other creditors. To refer again to the Irish examinership process, there is discretion afforded to the judiciary in determining whether parties are being unfairly prejudiced. It is a notable example of how court approval of a compromise can be imbued with a reasoned approach, taking into account the interests of all creditors and thus instilling confidence in the procedures.

4. Is there likely to be a need to swiftly process a high number of restructurings as government support measures phase out?

In all likelihood, it will vary from jurisdiction to jurisdiction, depending on two factors: firstly, the degree of public supports implemented within a jurisdiction during the COVID-19 pandemic; and, secondly, the availability of accessible corporate rescue and restructuring processes within the jurisdiction.

As of yet, the common pattern has been an unusually subdued rate of corporate insolvencies, which is borne out by recent OECD data. From a European perspective, direct supports and subsidies were readily made available and were used by businesses during the pandemic, as demonstrated in findings produced by the European Investment Bank. However, various guarantee schemes - whereby public funds cover a proportion of financial institutions' loan facilities for certain eligible businesses (typically SMEs) - have rather minimal uptake, even though the implementation of many of these schemes predated the pandemic.

There will inevitably be different features across different economic sectors. For example, traditional manufacturing activities seemed to have been hit more profoundly by supply chain disruptions. Unfortunately, it does appear inevitable that there will be steady increases in the rates of insolvencies over the next year.

5. How can favourable conditions be created to incentivise investors to provide new financing to distressed but viable companies, for example through equity capital and in particular for SMEs? What other (new) forms of market-based financing may be used to address debt overhang issues and how?

The EU's Preventive Restructuring Directive (Directive (EU) 2019/1023) makes provision for priority status for interim or new financing in the course of the restructuring procedures as set out in the legislation. Through the Chapter 11 process, the US is no stranger to the granting of priority for lenders who extend further credit to companies who are engaged in formal reorganisation or rehabilitation. By incentivising investors, there is a compelling rationale for giving prioritised status to new lending. However, there can be practical challenges, especially when an existing principal creditor (such as a debtor company's bank) is unwilling to offer supplementary financing. There may not be many other creditors with the appetite to advance fresh funds.

In accordance with an incremental reduction in public supports, there is a genuine opportunity to sponsor the use of risk capital, venture capital and angel financing for companies which have demonstrable potential for growth, and which were dependent on public supports during the height of the pandemic. For all of the ambitions of the European Commission's plans for Capital Markets Union, the prospect of a post-pandemic withdrawal of certain support measures creates the conditions to examine whether alternative financing sources can occupy the space being vacated by public supports. A diversification of funding sources would ultimately reduce potential burdens on banks and thereby diminish systemic risk.

6. How can public policy support private sector financing for a smooth transition out of the debt distress post COVID? Which forms of public-private partnerships can be considered effective, and under what conditions?

As indicated in the previous response, jurisdictional approaches (such as at an EU level in relation to Capital Markets Union and alternative financing) to encourage the growth of funding networks would be a key instance of giving the impetus to the private sector and of helping to sustain the recovery of viable firms in the aftermath of lockdowns. Although some jurisdictions are more advanced than others in cultivating clusters of entrepreneurial supports (notably for digitalisation), much can be achieved by an initial state-level emphasis on nurturing market-based finance for business growth (and, indeed, more risk-intensive finance for companies that are in the midst of rehabilitative procedures).

For more drastic situations or when envisaging an escalation of non-performing loans within financial institutions, asset management companies can be an expedient means of public intervention to alleviate the pressures of debt overhang on banks. The European Commission has formulated and endorsed its blueprint for such agencies, which could be adopted by EU Member States where necessary. A core task of an asset management company would be to transfer loans to private purchasers. In light of the effects that these measures can have for distressed debt markets, the introduction of an asset management company in a given jurisdiction should be matched by a robust insolvency and restructuring framework to enable companies to be efficiently liquidated or rehabilitated. Otherwise, the establishment of an asset management company could simply result in fire sale practices, which could prove to be counter-productive in the medium- to long-term for economic recovery.