

Thematic Peer Review on Corporate Debt Workouts

Summary Terms of Reference

1. Objective

The objective of this peer review is to support COVID-19 response efforts by examining FSB member jurisdictions' practices, experiences and lessons on out of court debt workouts (OCWs),¹ and the implications for financial stability.

2. Relevance to financial stability

The FSB places great importance on effective restructuring and insolvency regimes for a stable financial system. The Insolvency and Creditor Rights Standard (ICR Standard) is one of the FSB Key Standards for Sound Financial Systems. The ICR Standard combines the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes and the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law. The ICR Standard's implementation is assessed as part of the World Bank Reports on the Observance of Standards and Codes (ROSC) Initiative.²

The severity of the COVID-19 pandemic-induced recession and the future expiration of official support measures, combined with high levels of indebtedness, may induce a wave of corporate defaults over the coming years, while the global economy is likely to be weighed down by (public and private sector) debt overhang following the pandemic. Deteriorating credit quality of non-financial borrowers poses risks to the financial system; indeed, growing vulnerabilities in the non-financial corporate sector may increasingly affect banks and other financial institutions.³ It is therefore important to have in place efficient procedures for the restructuring or liquidation of corporates in distress.

Effective corporate restructuring and insolvency frameworks are necessary to help minimise damage to the economic and financial system that could be caused by widespread defaults. Out-of-court restructuring frameworks can play a useful role in dealing with a high number of cases. In particular, workout procedures with limited or no court involvement can serve as

¹ OCW is used in this note to refer to informal, enhanced and hybrid workouts, as explained in Section 2.

² See ICR Reports on the Observance of Standards and Codes (World Bank, 2015) and the ROSC assessment methodology developed by the World Bank in collaboration with the IMF and UNCITRAL.

³ See COVID-19 pandemic: Financial stability impact and policy responses (FSB, 2020), Global Financial Stability Report: Bridge to Recovery (IMF, 2020) and Global Financial Stability Update (IMF, 2021).

efficient instruments to allow corporates with viable business models to restructure their debt and avoid liquidation. OCWs enable creditors to modify their lending relationships with the debtor in a coordinated action instead of forcing the debtor into insolvency, where the prospects of recovery may be significantly lower. OCWs therefore present an opportunity to reduce the flow of cases clogging courts and the cascade of insolvencies, by offering companies a way to resolve distress other than through formal court-administered liquidation proceedings. They can also help prevent non-performing loans (NPLs) from accumulating in financial institutions and therefore reduce financial sector vulnerabilities.

Out-of-court procedures and formal insolvency procedures form part of a continuum of different degrees of formality and court intervention.⁴ OCWs include purely contractual agreements between debtors and creditors that restructure the debtor's liabilities and, possibly, also its business activities ("informal workouts"). Such purely contractual workouts are in some jurisdictions enhanced by the existence of (non-legislated) norms or other types of contractual or statutory arrangements ("enhanced workouts"). Furthermore, out-of-court debt restructuring may involve courts at certain junctures, for example to order a stay on creditor action or to validate an agreement among creditors. These "hybrid workouts" comprise a mixture of the features of contractual workouts and limited court intervention.

3. Tasks

The review will:

- take stock of existing and planned OCW frameworks (e.g. informal workouts, enhanced workouts and hybrid workouts) in FSB jurisdictions;
- examine the experience of particular mechanisms that have been or are being used to address corporate stress (including the role of financial sector authorities), particularly those that involve a high number of firms; and
- identify good practices and lessons on how well they have worked in terms of preserving value for viable companies and how useful OCW debt restructurings are for resolving NPLs and dealing with a large number of distressed corporates.

The review will explore how losses to the financial system and economy could be mitigated by efficient procedures for the restructuring of financial debt of corporates, in particular in an economic environment that may entail restructuring needs for a large number of companies. To this end, the review will focus on the legal and regulatory conditions (or enabling framework) that facilitate OCWs as well as elements of the legal and regulatory regime that interact with the financial system. This includes regulatory factors that affect incentives for restructuring (e.g. prudential treatment of a restructured loan, rights of existing shareholders), in particular with regard to restructuring mechanisms to efficiently work out a high number of failing loans. The experience of asset management companies will also be considered in this context, but

⁴ See *Out-of-court debt restructuring* (January 2012, World Bank Report No. 66232).

the focus will be on how they have helped to facilitate OCWs rather than on their role in addressing problem banks.

Furthermore, the review will explore the role of financial sector authorities in facilitating enabling processes and structures (e.g. codes of conduct for debt workouts) for dealing with cases of corporate financial difficulty in which financial institutions have a significant exposure, especially in markets where the need for corporate restructuring has reached systemic levels.

The peer review will focus on OCWs for corporates, and be anchored on the relevant Principles for Effective Insolvency and Creditor/Debtor Regimes and UNCITRAL Legislative Guide on Insolvency Law (see Annex for key elements), as well as the INSOL International Principles for a Global Approach to Multi-Creditor Workouts (INSOL Principles).⁵ These key elements cover relevant features of the informal workout procedure itself, as well as desired features of an enabling legislative framework.⁶ However, the review will not monitor implementation or assess jurisdictions' compliance with these standards.

The review will cover non-financial corporates of all sizes to get a wider perspective of frameworks in place. The review will focus on OCWs for businesses organised as corporations.⁷ It will include financial institutions only insofar as they are creditors to corporates in financial distress, and will not cover legal frameworks on the insolvency or resolution of financial institutions.⁸ Given the concerns about small and medium-sized enterprises (SMEs) stemming from cost, effectiveness and administrative burden considerations, a particular focus will be on specific rules and practices for debt workouts for SMEs.

4. Process

The primary source of information for the peer review will be responses to a questionnaire by FSB jurisdictions. The questionnaire will reflect the issues identified in section 3. In addition, the review will make use of existing information from the World Bank (including Financial Sector Assessment Program assessments and ROSCs), IMF, OECD and other international organisations and standard-setting bodies.

Stakeholder outreach will form an important part of the peer review. The collection of public feedback will be complemented by a roundtable with public and private stakeholders (e.g. financial institutions, corporates and insolvency practitioners) to exchange views on experiences, challenges and issues to consider.

⁵ The INSOL Principles presents the statements of best practice for all multi-creditor workouts. See [International Association of Restructuring, Insolvency & Bankruptcy Professionals](#) and its [Statement of Principles for a Global Approach to Multi-Creditor Workouts II](#) (April 2017).

⁶ An enabling environment encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability, for example by requiring disclosure of financial information of the distressed enterprise, by flexibly accommodating a broad range of restructuring activities and by giving creditors reliable recourse to enforcement.

⁷ Extending the scope to businesses organised in other forms would introduce issues that relate to personal insolvency. These are not covered by the anchoring principles of this review and would widen the scope of the review considerably.

⁸ In addition to debtors and financial creditors, there may be other creditors and stakeholders involved in OCW procedures. This includes, for example, equity holders (who may be required to consent to the restructuring), trade creditors, employees of the debtor, and the government (e.g. if the state provides new financing for restructuring).

5. Expected final deliverable

The FSB expects to publish the peer review report in early 2022. Drawing on the range of members' experiences, the report may identify areas where members face common challenges, document practices that have proved effective, including through the use of case studies and make recommendations (where appropriate) to address common challenges. As with any peer review, the report will not set new policies but could recommend actions for consideration by member jurisdictions and international bodies to address common challenges.

Annex: Creditor Rights and Insolvency Standard

World Bank Principles and UNCITRAL recommendations shown in **bold** are the main ones to anchor the peer review.

Italicised text provides a high-level description of the bolded principles and recommendations.

No	Part A. Creditor/Debtor rights
A1	Key Elements
A2	Security (Immovable Property), Real property)
A3	Security (Movable property)
A4	Registry for Property and Security Rights over Immovable Assets
A5	Registry for Security Rights over Movable Assets
A6	Enforcement of Unsecured Debt
A7	Enforcement of Security Rights over Immovable Assets
A8	Enforcement of Security Rights over Movable Assets
	Part B. Risk management and corporate workout
B1	Credit Information Systems
B2	Directors' Obligations in the Period Approaching Insolvency
B3	Enabling Legislative Framework <i>There should be an environment that enables debt and enterprise restructuring and encourages participants to engage in consensual arrangements. This includes laws and procedures that ensure access to timely, reliable, and accurate financial information on the distressed enterprise, encourage lending to, investment in, or recapitalisation of viable financially distressed enterprises and flexibly accommodate a broad range of restructuring activities, involving asset sales, discounted debt sales, debt write-offs, debt reschedulings, debt and enterprise restructurings, and exchange offerings (debt-to-debt and debt-to-equity exchanges). Further relevant features relate to tax treatment, regulatory impediments and enforcement measures.</i>
B4	Informal Workout Procedures <i>Informal workout procedures can be supported by informal techniques, such as voluntary negotiation or mediation or informal dispute resolution, as well as quick processing of required formal elements used to approve a pre-negotiated agreement. There may be a facilitating role for the supervisor, and a need for interim framework enhancement measures in the context of a systemic crisis.</i> UNCITRAL Legislative Guide Recommendations 160-168 <i>These recommendations cover procedural features such as commencement of expedited reorganisation proceedings, application requirements, commencement, the effect and notice of commencement, and the confirmation, effect and failed implementation of a confirmed restructuring plan.</i>
B5	Regulation of Workout and Risk Management Practices <i>A country's financial sector should promote the development of a code of conduct on a voluntary, consensual procedure for dealing with cases of corporate financial difficulty in which financial institutions have a significant exposure, especially in markets where</i>

corporate insolvency has reached systemic levels. Good risk-management practices and effective internal procedures and practices within financial institutions to effectively work out non-performing loans should be encouraged.

Part C. Legal Framework for Insolvency

C1 Key Objectives and Policies

C2 Due Process: Notification and Information

Commencement

C3 Eligibility

C4 Applicability and Accessibility

C5 Provisional Measures and Ethics of Commencement

Governance

C6 Management

C7 Creditors and the Creditors' Committee

Administration

C8 Collection, Preservation, Administration and Disposition of Assets

C9 Stabilizing and Sustaining Business Operations

C10 Treatment of Contractual Obligations

C11 Avoidable Transactions

Claims and Claims Resolution Procedures

C12 Treatment of Stakeholder Rights and Priorities

C13 Claims Resolution Procedures

C14 Reorganization Proceedings

International and Group Aspects

C15 International Considerations

C16 Insolvency of Domestic Enterprise Groups

C17 Insolvency of International Enterprise Groups

Insolvency of Micro and Small Enterprises

C18 Key Objectives and Policies

C19 Simplified Insolvency Proceedings

C20 Discharge

Part D. Implementation: Institutional and Regulatory Frameworks

Institutional Considerations

D1 Role of Courts

D2 Judicial Selection, Qualification, Training and Performance

D3 Court Organization

D4 Transparency and Accountability

D5	Judicial Decision Making and Enforcement of Orders
----	--

D6	Integrity of the System
----	-------------------------

Regulatory Considerations

D7	Role of Regulatory or Supervisory Bodies
----	--

D8	Competence and Integrity of Insolvency Representatives
----	--
