Flattening the Insolvency Curve

WEBINAR – STI
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Logistics and Housekeeping

- Please **mute your microphones** when you are not speaking.
- Please type your **questions in chat** at any time during the presentation. We will turn to these after each poll.
- We encourage you **to ask questions and participate in discussions** – we are here to learn from each other.
- This presentation includes **polls**; your responses to these would be appreciated. Poll questions are linked to information and explanations in this presentation so please only complete the polls when indicated by the presenter.
- There will be a **5-minute break** after 55 minutes.
- Please do complete the **survey** at the end of this session so that we have the benefit of your feedback.

OUTLINE

I. Introduction

II. The Impact of the Covid Crisis

III. Three Phases of the Covid Crisis from a Private Debt Perspective

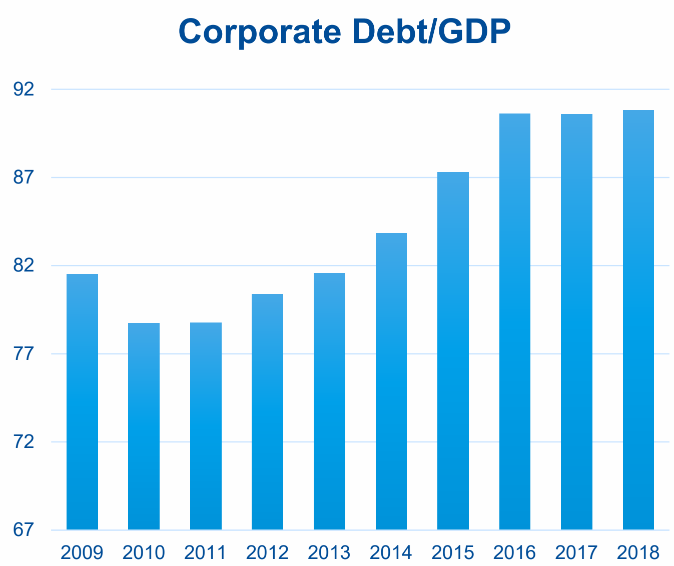
   a. Freeze
   b. Transition
   c. Normalization

IV. The Road Ahead

V. Conclusion and Q&A

Introduction – Where were we pre-Covid?

- Post-2009 era of accommodative monetary policy
- Unprecedented levels of corporate, household and public debt facilitated by low interest rates
- Private debt resolution was a focus in many Asian countries to support foreign investment and growth
- Non-performing loans weighed heavy in some Countries (official numbers and "latent" distress)

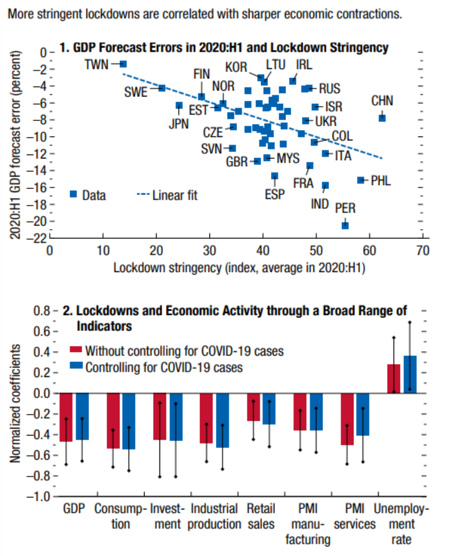


Introduction – What did Covid-19 bring?

Global lockdowns = economic contraction

Some argued that the economic impact of the lockdown would be temporary, resulting only in short term cash flow problems for businesses.

Yet many businesses would not survive; concern that SMEs would be the hardest hit.



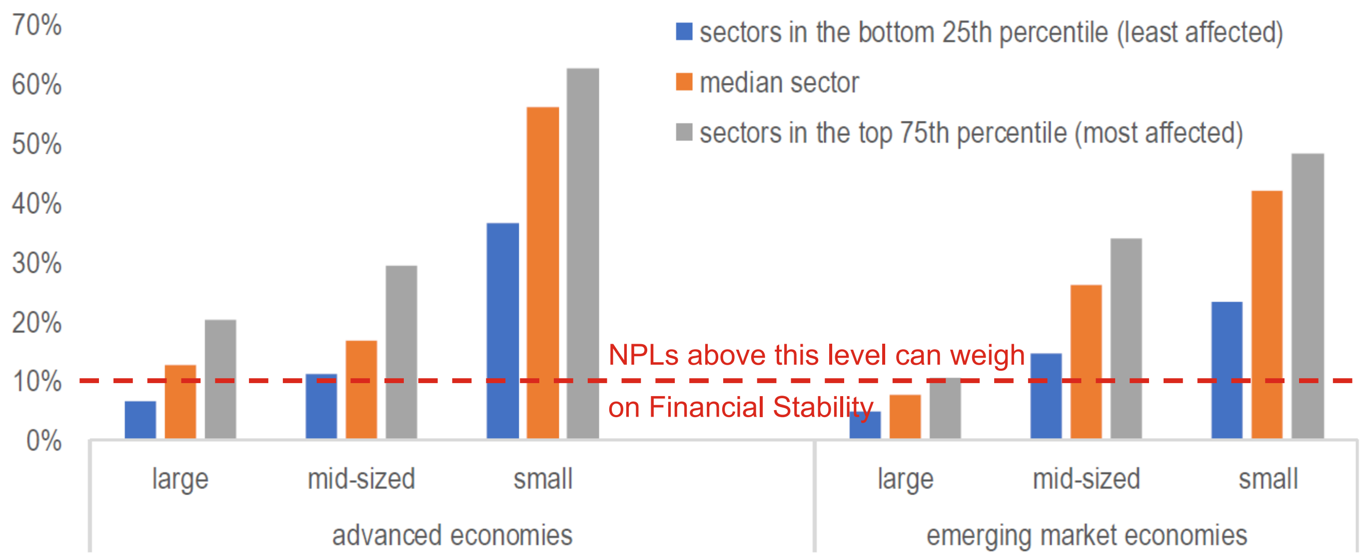
Source: IMF WEO, 2020

Poll #1: In your country, prior to covid, was there discussion of insolvency law reform?

I. The Impact of the Covid Crisis

Corporate Solvency Challenges

Share of debt at firms with solvency stress

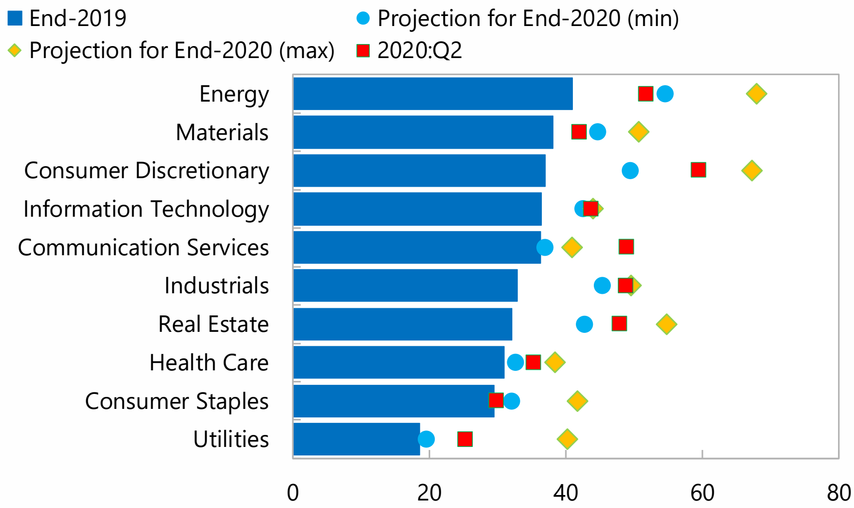


Source: GFSR Chapter 1, April 2021 – analysis of 19,500 firms (half are SMEs) in 29 countries

ASEAN: The share of firms with weak debt service capacity is expected to have increased significantly in 2020

ASEAN-6: Firm-at-Risk by Industry

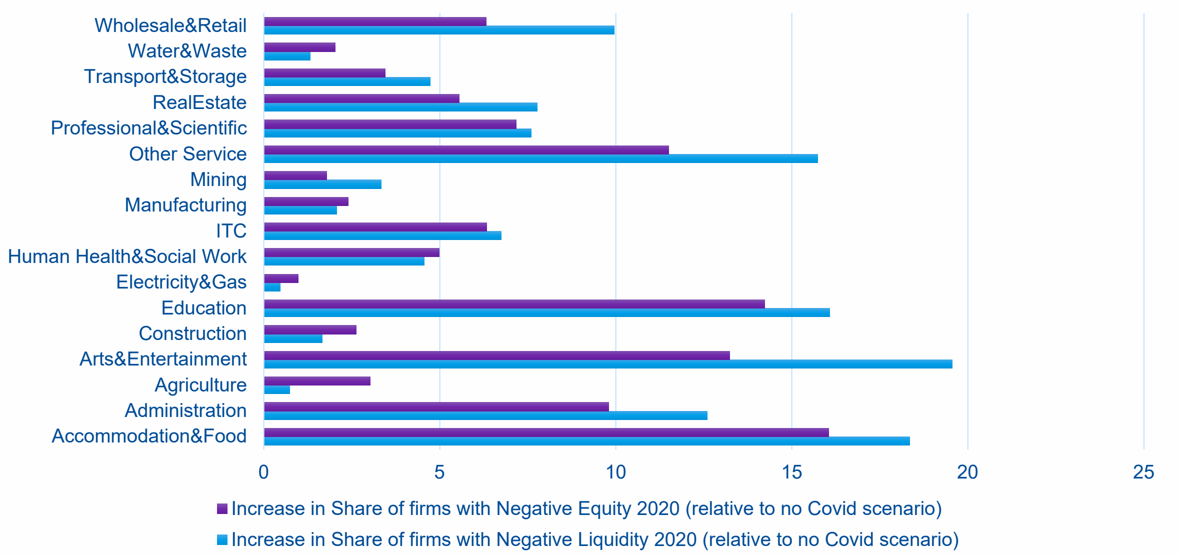
(Percent share of firms generating earnings not enough to cover interest payment)



Sources: S&P Global Market Intelligence; and IMF staff estimates

Source: Kim, Xin, and Yoo (Forthcoming)

Impact on SMEs Across Sectors



Source: IMF GFSR/WEO

What does the data tell us?

In a nutshell:

- Global economic contraction
- Increased business distress
- SMEs are particularly vulnerable
- NPLs may increase to systemically critical levels
- **A concerted policy response to counteract the impact of the crisis is called for**

Poll #2: In your country, have you observed increased corporate distress as a result of the Covid crisis?

II. Three Phases of the Covid Crisis from a Private Debt Perspective

Three Phases as we move through the Crisis

Phase 1: Interim Rules- ***Freeze***

Phase 2: Transition/Restart- **Special measures** to “flatten the curve”

Phase 3: **Normalization-** Tackle Debt Overhang with all Tools

Phase 1- Freeze: Measures vary across countries

Moratoria on

- Debt repayments
- Foreclosures and auctions
- Restrict or limit evictions
- Insolvency proceedings (both new filings and mothballing existing cases)
- Suspending directors' personal liability for not filing for insolvency

Credit support by governments

- Public guarantee schemes
- Term funding to banks to onlend to firms
- Purchase of corporate commercial paper, bonds and asset-backed securities

Prudential and accounting rules

- Use of capital buffers
- Dividend restrictions
- Reduced liquidity requirements
- Suspension of changes to credit risk grades/classification and/or underwriting standards
- Allowing full recognition of loan interest income accrued but not collected

Other measures

- Special contractual limitations
- Lower interest rates
- Grants and other outright fiscal support
- Quantitative easing programs
- Tax moratoria

Moratoria

Moratorium on debt enforcement (e.g. in Singapore, Russia, Turkey)

Moratoria on debt repayment (e.g. in India, Egypt)

- **De Jure/De facto** (Example of de facto moratoria is in the US)

Freezing Stock & Flow of Cases

Freezing the stock cases by extending deadlines and mothballing cases

Reducing the flow of insolvency cases by restricting access to insolvency by creditors and even by debtors.

Raising insolvency thresholds is another measure to limit the flow of cases

Other Common measures

Suspending directors' personal liability	Special Contractual Limitations
Protecting Fresh Money	Fiscal Support Measures

Poll #3: What interim "freeze" measures have you observed in your country?

Considerations for "Freeze" Measures

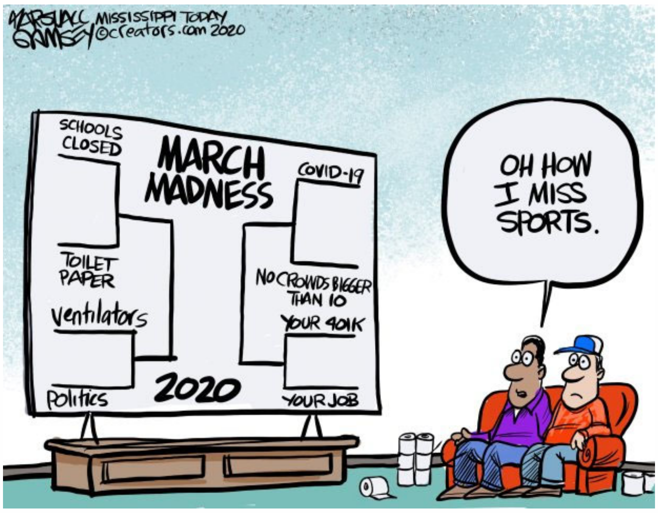
Key motivation of a freeze is to avoid deepening of the recession

Duration: Temporary rather than long-term

Coverage: Targeted coverage preferred over blanket measures

Stimulus: Total fiscal costs; an element of burden sharing?

Unintended Consequences: (i) Impact on credit discipline and investment; (ii) zombie companies; (iii) moral hazard concerns; (iv) not a substitute for social safety net

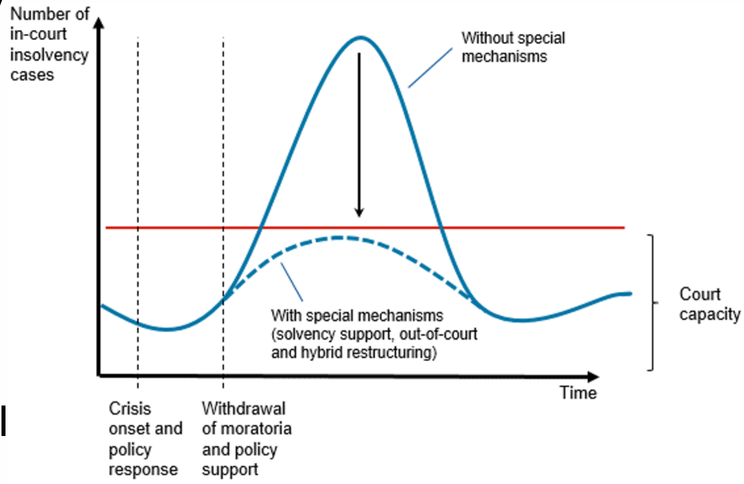


Phase 2: Transition

Debt resolution restarts; support measures are withdrawn (gradually or immediately)

May need special measures to "flatten the curve" of insolvencies

Scope and duration depend on:
- Withdrawal of support
- Severity of the crisis
- Quality of the law and institutional framework



Risks of a Poorly Designed Transition

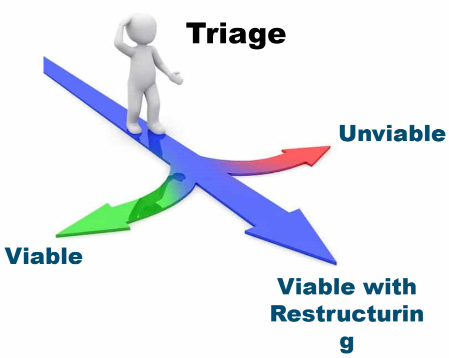
- Sudden spike in insolvency cases
- Insufficient capacity in the formal system to deal with cases and huge backlogs in the courts
- Delays result in failed reorganizations and protracted liquidations
- Bank's inability to efficiently recover non-performing loans could pose a threat to financial stability

What Policies Could Help in Transition?

- Key priority at this stage is to **manage the flow** of insolvencies

- Temporary measures to **reduce the volume** of insolvency cases:

  - State support to enterprises (i.e., direct solvency support grants, guarantees, taxes; or restructuring support). Requires strong governance controls.
  - If there is a high number of distressed enterprises, there may be a need to implement a *triage:*



Triage

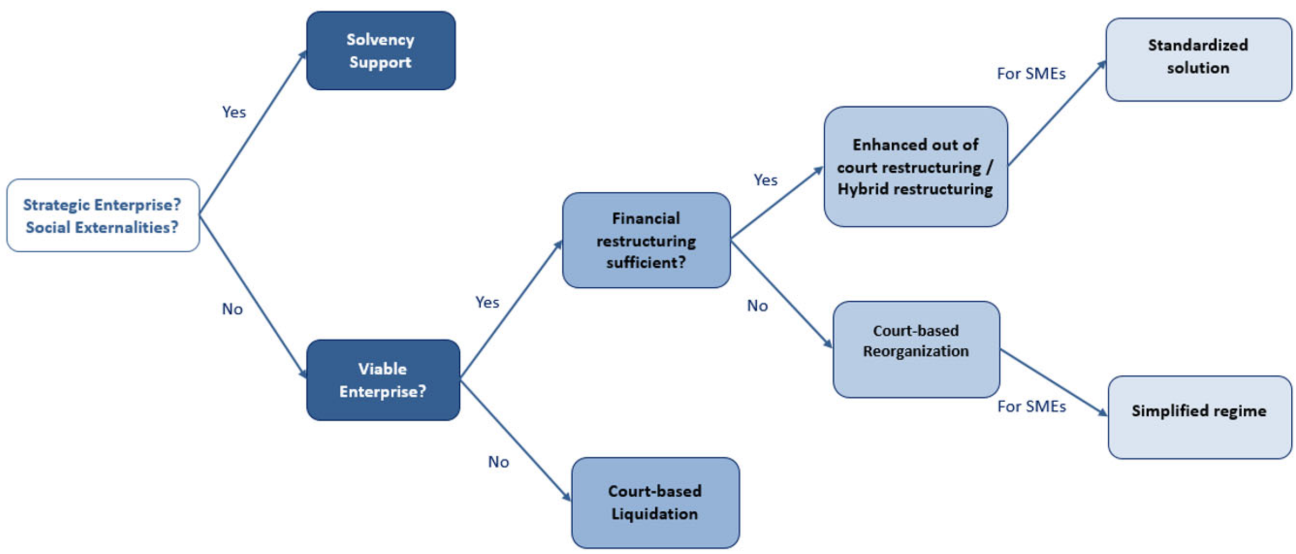
Large enterprises that are viable but need financial restructuring can be directed to **special out-of-court restructuring** schemes (example: schemes in the Asian crisis of 1997)

- Multi-creditor workout negotiation assisted by specialists
- Needs "carrots and sticks" to work effectively

SME triage selects SMEs that are viable and require financial restructuring.

- Use of Simplified schemes based on **standardized restructuring**: i.e., simple operations that reduce debt to sustainable levels (example: **Iceland** (2011-2012)).
- Difficulties in analyzing viability and establishing valuations during the pandemic.

Decision Tree for Triage of Enterprises in Distress



The Other Extreme: Flatlining

- In some countries, especially low-income countries, the problem may be the opposite: the **lack** of insolvency cases
- Corporates especially SMEs may operate informally and exit informally
- The insolvency system plays a very limited role in resolving enterprise debt, possibly due to high costs, lack of trust and/or low capacity of the judicial system
- Medium term strategy: increase access to credit, improve quality and capacity of the insolvency system

"WE'VE EXPERIENCED SOMETHING OF A RECESSION, MR. BOSWORTH, BUT IT SEEMS TO HAVE BOTTOMED OUT."

Poll #4: What changes in insolvency filings have you observed in your country?

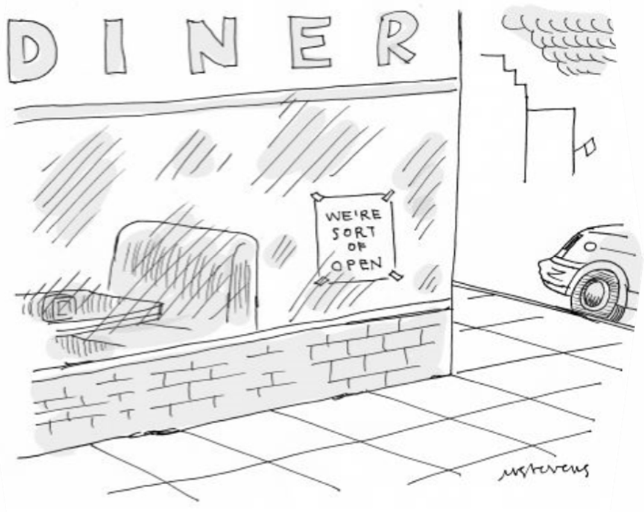
Phase III: Normalization

Key motivation: Use and strengthen the standard toolkit

Countries begin to tackle debt overhang using all tools available in the standard insolvency toolkit.

Countries conduct an overall assessment of the system and undertake any legal reforms.

The measures in phase 3 are not incompatible with those in phase 2, but they become exclusive at this point (except legacy cases).



Cartoo

Some Tools in Modern Insolvency regimes

- **Out-of-Court restructuring** is promoted
- Availability of **pre-arranged and pre-packaged insolvency**
- **Hybrid insolvency proceedings**: negotiations supported by a stay of creditor actions, and fast confirmation of a restructuring plan
- Eliminate bottlenecks in **liquidation –**use technology for sale of businesses and assets
- Remove obstacles to **debt enforcement**- credible threat for all debt restructuring tools

Strengthening & Modernizing Institutions

- Increasing the specialization of the judiciary: *China, Thailand, Korea*
- Improving the quality of insolvency professionals: *India*
- Wider use of technology in court: *China*
- Data collection: IMF Working paper on use of data in insolvency

"I want you to find a bold and innovative way to do everything exactly the same way it's been done for 25 years."

Poll #5: Which phase do you think is your country in?

III. The Road Ahead

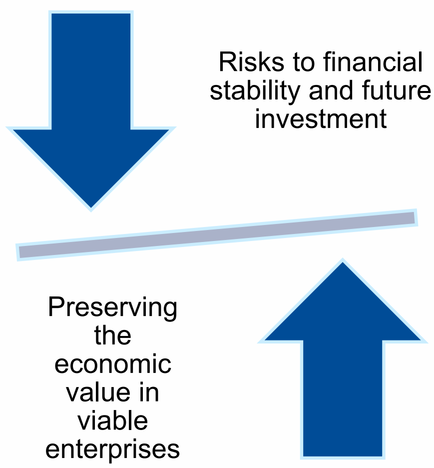
When and How to exit Temporary Measures?

Both Phase 1 and 2 involve the use of temporary measures. When and how do we exit these?

No standard model, this will vary from country-to-country

Aim is to return to rules consistent with international standards

Informed, holistic decision-making and comprehensive, sequenced strategy is key



Some Early Thoughts

The nature of the COVID-19 shock supports more active involvement of the public sector in restoring corporate solvency than in a typical recession.

- **Reinforcing private debt resolution frameworks** to flatten the insolvency curve and facilitate large scale restructuring of firms
- Ensuring **availability of financing** to support restructuring of firms in the post-pandemic recovery (both leverage and equity through a variety of sources such as banks, private equity investments, etc)
- Facilitating **access to risk capital** for existing firms and startups to speed up the reallocation of resources into growth sectors

Conclusions

- The crisis is far from over
- Policy-making will need to evolve to suit changing circumstances
- avoiding a premature withdrawal of policy support remains an immediate priority
- Coordination among various domestic stakeholders will be important for effective corporate restructuring

Continued IMF Legal Department Engagement

- Article IV consultations
- Fund-supported programs
- Technical Assistance
- FSAPs
- Outreach

THANK YOU!

Questions? Comments?

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