Secured Finance Network



August 9, 2021

Financial Stability Board
fsb@fsb.org

Re: FSB Thematic Peer Review on Corporate Debt Workouts

The Secured Finance Network, Inc. wishes to provide feedback regarding its members' practices, experiences and lessons relating to out-of-court debt workouts (OCWs) and the implications for financial stability.

The Secured Finance Network, Inc. ("SFNet") (www.sfnet.com) was founded in 1944 and is the principal U.S. trade organization that represents the asset-based lending, factoring, trade and supply chain finance industries. SFNet has over 260 member organizations throughout the United States and Canada, and also has a European chapter based in London. Our members include regulated money center banks, independent finance companies, community banks, factors and leasing companies that provide hundreds of billions of dollars annually in working capital to thousands of middle-market and small businesses.

The United States enjoys a robust OCW environment. Specifically, there are three categories of OCWs that enjoy widespread acceptance.

(a) Sale of Distressed Business. A distressed business will engage an investment bank or other professional to market some or all of its business. The terms of the sale will be substantially negotiated between the buyer and seller outside of a court proceeding, but most often a buyer

will want a court order confirming that it acquires the assets of the business free and clear of liens and other claims with minimal or no successor liability. This court order provides more certainty and generally leads to a higher price being paid for the assets than might otherwise be the case.

(b) Debt for Equity Swap. A distressed business will engage insolvency professionals to negotiate with different classes of creditors for the restructuring of their existing debt. This often involves exchanging such debt for a combination of equity and debt, the terms of which may be generally set out in a Restructuring Support Agreement or some form of exchange agreement. Such arrangements may provide for the new terms to be effective upon obtaining the necessary approvals provided for in the loan documentation or, if not obtained, having an agreement with those creditors that are willing to proceed on the basis of the negotiated terms to approve such arrangements in the context of a court proceeding.

(c) Forbearance Agreement. A common example of a more "informal" or "enhanced" workout that does not involve a judicial proceeding is a "forbearance agreement." In a forbearance agreement, key creditors agree to forbear (commonly referred to as a "moratorium") from the exercise of remedies on the basis of existing defaults for a very limited period of time, subject to the ongoing fulfillment of certain conditions by the distressed business. Conditions to forbearance may include, among other things, any or all of the following: (i) the debtor engaging consultants and restructuring professionals that are expressly authorized to provide information to, and work with, the creditors, as well as, having full access to the company, its officers and its records, (ii) the establishment of a budget of revenues and expenses (customarily for a 13-week period), (iii) increased scope and frequency of reporting of key elements of the business, (iv) the raising of additional capital within a certain period of time, (v) providing additional security for the debt, (vi) steps toward the sale of all or some portions of the business within certain specified time periods (commonly referred to as "milestones"). The agreement also typically includes the acknowledgement by the debtor that it is in default and that, if the debtor fails to fulfill any of the conditions, the creditor may immediately exercise its remedies against the debtor and any security that has been pledged to the creditor by the debtor. The key to this process is the establishment of the "budget" by the distressed business which demonstrates that there will not be a material deterioration of the creditor's prospects for recovery of its debt during the forbearance period.

Some or all of these OCW strategies, however, are not peculiar just to the U.S. OCW regimes come in many different forms and types. Any rules and principles set by governments, supervisory agencies and institutions should take into account the multitude of OCW regimes and allow for new practical usage of old rules and procedures. By way of example:

1. Pluriformity. In some countries, such as the Netherlands, use is made of proceedings for the enforcement of a pledge over shares in a holding company. Share pledge enforcement or enforcement of all-asset security may present a useful alternative to more formal debt restructuring procedures.

2. Director Liability. In other countries, a director of a company may incur civil liability, or even risk criminal prosecution, if the company continues trading while insolvent. A prominent example is Germany. Rules that penalize a director for not filing, or for filing an insolvency proceeding too late provide an adverse incentive to file for insolvency sooner rather than later. Such rules may jeopardize attempts to achieve an OCW. In Germany and in the UK, the rules on wrongful trading were temporarily suspended during the Covid-19 crisis.

3. Living Wills for Companies. Rules or principles that incentivize directors to do contingency planning in case of financial distress may increase the likelihood that boards of directors are prepared, that assets or activities (good or bad) are ring-fenced and that timely attempts at an OCW are initiated. A living will, such as already required for financial institutions, also may be beneficial for large corporations or even for smaller entities and in simplified form.

Covid-19 Related Approaches. There were at least three ways in which governmental authorities facilitated debt restructurings in 2020:

i. Fiscal and social security claims: Many governments succeeded in keeping companies in financial difficulty from liquidation by generously providing loans and/or grants to cover short-term working capital shortfalls and permit delays for the payment of tax claims. This also included relief in the form of the deferral of tax or other government obligations, particularly for payroll taxes and other employee-related claims.

ii. Lender Liability: Regulated financial institutions were allowed to take a more relaxed approach to borrowers in financial difficulty without concern that their actions would be criticized by regulators.

iii. Moratorium: In many jurisdictions, creditors were prevented temporarily from petitioning for insolvency of borrowers if their financial stress was cause by

COVID-19. Creditors also were barred from taking other enforcement action, such as enforcing collateral or levying attachment.

The Role of Asset Based Lending and Secured Finance Generally. The structure of asset-based lending, with its use of accounts, inventory and other assets as the basis for a revolving credit facility that provides loans for working capital, can be critical to a successful resolution of the workout. The asset-based lender can support a company through the course of the workout while the company negotiates with creditors or plans for a sale of the business. The lender generally will allow the company time to effectuate an OCW so long as the company stays within its collateral values and there is a legal framework that provides the asset-based lender with the certainty of its recourse to its security and the priority of its rights to the proceeds from the realization of its collateral ahead of other claims. Such certainty, together with access to information about the assets and the ability to establish, with confidence, the values of its security, put the asset based lender in a unique position to work with a distressed borrower as it pursues its plan to sell or restructure the borrower's business. Failure to provide specific allowances for asset-based lending controls and structures to apply in any pertinent legislation and policy standards and thereby ensure continuity of financing during an OCW negotiation would compromise all parties' ability to come to an optimal agreement.

As the U.S. experience clearly illustrates, if a given country fosters a legal environment that encourages OCW, it increases the likelihood that businesses in that country will survive if they encounter financial distress. Also, an established OCW environment promotes the availability of lower cost credit by encouraging prospective lenders who are considering making loans to businesses in that particular country.

Another lesson from the U.S. OCW experience is that OCWs have better outcomes, and offer the most comprehensive relief, to distressed businesses in countries that have adopted a modern secured transaction regime (such as that envisioned by the UNCITRAL Model Law on Secured Transactions, in the development of which SFNet had the privilege to participate).

I hope that these observations are helpful. I urge the Board to provide a forum for further discussion of these points so that we may further elaborate on this important matter. We will make our subject experts available upon your request.

Very truly yours,

SECURED FINANCE NETWORK, INC.

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