

INTERNATIONAL MONETARY FUND

STRATEGY, POLICY, AND REVIEW DEPARTMENT,
AND LEGAL DEPARTMENT

DEPARTMENTAL PAPER

Policy Options for Supporting and Restructuring Firms Hit by the COVID-19 Crisis

Prepared by Juliana Araujo, José Garrido, Emanuel Kopp,
Richard Varghese, and Weijia Yao

Cataloging-in-Publication Data
IMF Library

Names: Araújo, Juliana Dutra, author. | Garrido, José María, 1965-, author. | Kopp, Emanuel, author. | Varghese, Richard, author. | Yao, Weijia, author. | International Monetary Fund, publisher.
Title: Policy options for supporting and restructuring firms hit by the COVID-19 crisis / authors, Juliana Araújo, José Garrido, Emanuel Kopp, Richard Varghese, and Weijia Yao
Other titles: International Monetary Fund. Strategy, Policy, and Review Department (Series) | International Monetary Fund. Legal Department (Series).
Description: Washington, DC : International Monetary Fund, 2022. | 2022 February. | Departmental Paper Series. | Includes bibliographical references.
Identifiers: ISBN 9781513593463 (paper)
Subjects: LCSH: Corporate debt. | Debt relief. | COVID-19 Pandemic, 2020—Economic aspects.
Classification: LCC HG4028.D3 A7 2022

ISBN	978-1-51359-346-3 (Paper)
JEL Classification Numbers:	E65, G33, G38
Keywords:	Corporate Debt, Solvency Support to Enterprises, Insolvency, Reorganization, Liquidation, Restructuring, COVID-19
Author's E-Mail Address:	jaraujo@imf.org, jgarrido@imf.org, ekopp@imf.org, rvarghese@imf.org, wyao@imf.org

The Departmental Paper Series presents research by IMF staff on issues of broad regional or cross-country interest. The views expressed in this paper are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

Publication orders may be placed online or through the mail:
International Monetary Fund, Publication Services
P.O. Box 92780, Washington, DC 20090, U.S.A.
T. +(1) 202.623.7430
publications@IMF.org
IMFbookstore.org
elibrary.IMF.org

Contents

Executive Summary	v
Acknowledgments	vii
Glossary	viii
1. Introduction	1
2. Corporate Sector Vulnerabilities and Crisis Preparedness	4
A. Corporate Sector Vulnerabilities	4
B. Crisis Preparedness of Countries' Insolvency Systems	6
3. Moving to Targeted Support	11
4. Solvency Support	15
A. How to Allocate Policy Support	15
B. Forms of Policy Support	16
C. Lessons from Past Episodes of Solvency Support	17
5. Promoting Corporate Restructuring	20
A. Out-of-Court Restructuring	20
B. Hybrid Restructuring	23
C. Lessons from Past Episodes of Out-of-Court and Hybrid Restructuring	24
6. Building More Effective Insolvency Regimes	27
A. Reorganization	27
B. Liquidation	29
C. Institutional Framework for Insolvency	30
7. Support to Financial Institutions	31
8. Conclusion	33
Annex 1. Policy Support Measures during the Freeze Phase	35
Annex 2. Measuring Corporate Vulnerabilities	37
Annex 3. Indicator for Crisis Preparedness of Insolvency Systems	39
Annex 4. Country Case Studies	48
References	65
BOXES	
Box 1. Key Market Failures	2
Box 2. Measuring Corporate Vulnerabilities	9
Box 3. Triage: Case for Liquidation, Reorganization, and Financial Restructuring	12
Box 4. Mexico's Punto Final Program	17
Box 5. The INSOL Principles for Multi-Creditor Workouts	21

FIGURES

Figure 1. Phases of the COVID-19 Crisis	1
Figure 2. Corporate and Sovereign Spreads	4
Figure 3. Nonfinancial Firms and Household Debt Build-Up	5
Figure 4. Annual Change in Corporate Insolvencies: Distribution across Income Groups	5
Figure 5. Crisis Preparedness Indicator	7
Figure 6. Corporate Debt Vulnerability and Crisis Preparedness	8
Figure 7. Nonperforming Loans and Corporate Debt Crisis Preparedness	9
Figure 8. Tackling Actual or Potential Wave of Insolvencies: Policy Options for Corporate Support and Debt Restructuring Based on Country Characteristics	11
Annex Figure 2.1. Corporate Debt Vulnerability Matrix by Country Groups	37

TABLES

Table 1. Legal Options: Viability and Creditor's Agreement	13
Table 2. Conditional Corporate Debt Relief	18
Annex Table 1.1. Fiscal Expenditure and Revenue Measures in Support Liquidity	35
Annex Table 3.1. Indicator for Crisis Preparedness of Insolvency Systems	47
Annex Table 4.1. Out-of-Court Workouts	48
Annex Table 4.2. Asset Management Companies (AMCs)	59

Executive Summary

The COVID-19 pandemic significantly impacted the enterprise sector. Unprecedented policy measures helped avoid a wave of insolvencies, at least temporarily. But risks remain of corporate debt overhang and zombification of firms if untargeted support is prolonged and of a wave of insolvencies if support is removed abruptly.

This departmental paper presents principles that could guide the design of more targeted policy support and facilitate the restructuring of firms adversely impacted by the COVID-19 pandemic. To this end, the paper takes stock of vulnerabilities and risks in the enterprise sector and assesses countries' preparedness to handle a large-scale restructuring of businesses. Crisis preparedness of insolvency systems is measured according to a newly designed indicator that includes five dimensions of the insolvency and restructuring regime (out-of-court restructuring, hybrid restructuring, reorganization, liquidation, and the institutional framework). Vulnerabilities tend to be more pronounced in jurisdictions with shortcomings in crisis preparedness, and those countries need to step up efforts to improve their insolvency systems.

The paper discusses options for the development of policy strategies, including targeted support measures to viable firms and legal reforms to facilitate debt restructuring, liquidation, and reorganization of firms. Some broad considerations for the elements of such policy strategies include:

- First, policy support schemes require clear objectives as to what market failures are meant to be addressed. Complementary policies, beyond the scope of this paper, can support other objectives and further ensure the transition to a sustainable corporate sector in the post-COVID-19 economy.
- Second, policy support schemes should include strong governance and transparency safeguards to mitigate risks and put in place clear ex ante exit plans. Burden sharing and debt-restructuring schemes that make use of the informational advantage and skills of private creditors can be particularly advantageous. Public creditors should actively participate in debt restructuring.
- Third, countries wherein fiscal space is depleted and insolvency systems are ineffective should rely more on out-of-court and hybrid restructuring approaches, while embarking on deeper medium-term reforms of legal and institutional frameworks. Out-of-court restructuring is based on the negotiation between debtors and major financial creditors, with the possible support of the state and avoids interaction with the courts. Hybrid restructuring refers to a similar negotiation supported by limited judicial intervention. Countries with remaining fiscal space have more options and can provide continued support to firms while implementing reforms, where needed, but should be mindful of the risks of zombification and moral hazard.
- Fourth, countries with insufficient policy tools or ineffective legal and institutional frameworks to restructure, reorganize, and liquidate firms should urgently address these shortcomings. Some reforms may take time to bear fruit and should be tackled immediately to strengthen preparedness over the medium term alongside with improvements in or development of out-of-court and hybrid restructuring options that take less time to implement. In contrast, improvements in out-of-court and hybrid restructuring can be made relatively quickly and support the short-term performance of the insolvency framework.
- Fifth, all countries can improve their crisis preparedness, but priorities differ across them. Advanced economies tend to have well developed insolvency systems and strong institutional frameworks, but there are still areas where improvements are warranted, such as simplifying liquidation procedures; improving technical aspects of their reorganization proceedings, including for small firms; making better use of

out-of-court restructuring; continue using modern technology in insolvency proceedings; and creating a legal environment more conducive to restructuring. In emerging market economies, there have been improvements in insolvency legislation in recent years, but there is space to strengthen the court system and the regulation of insolvency administrators. Furthermore, most emerging market economies could also introduce or improve hybrid restructuring techniques. Low-income countries need improvements in out-of-court and hybrid restructuring to speed up crisis preparedness, while broad legal and institutional reforms are introduced.

- Finally, lenders' balance sheets need to remain sound. To this end, contingency planning may include reactivating tools used in the past, including during the global financial crisis. Any use of asset management companies should consider that their success hinges on the overall design and governance framework.

Acknowledgments

This Departmental Paper was prepared under the guidance of Martin Čihák and Fabián Valencia and oversight of Kenneth Kang, Yan Liu, and Sanjaya Panth. The authors thank Asim Abdullah Abobakr, Aseel Turki Alaqla, Gerard Almekinders, Sergei Antoshin, Andreas Bauer, Mohamed Belkhir, Jorge Ivan Canales Kriljenko, Ruo Chen, Woon Gyu Choi, Nada Choueiri, Mai Dao, Daniela Enriquez, Domenico Fanizza, Francesco Grigoli, Mark Horton, Minsuk Kim, Sung Jin Kim, Maria Soledad Martinez Peria, Margaux MacDonald, Brad McDonald, Aiko Mineshima, Jacques Miniane, Ben Naceur, Marco Pani, Miha Pucnik, Lev Ratnovski, Andre Santos, Magnus Saxegaard, Cesar Serra, Thierry Tressel, Erica Tsounta, TengTeng Xu, and Luisa Zanforlin for their helpful comments and to Emelie Steward and Ilgim Sumer for their administrative support.

Glossary

ADR	alternative dispute resolution
AE	advanced economy
AMC	asset management company
AQR	asset quality review
BIS	Bank for International Settlements
CRCC	Corporate Restructuring Coordination Committee
CRI	Credit Research Initiative (National University of Singapore)
EM	emerging markets
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
GDP	gross domestic product
GFC	global financial crisis
IG	investment grade
IMF	International Monetary Fund
LIC	low-income country
NPL	nonperforming loan
PD	probability of default
ROSC	Report on the Observance of Standards and Codes
SME	small- and medium-sized enterprise