LOAN RESTRUCTURING

Facilitators

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Introduction

- Accountabilities in Business
- Business as a Teamwork (Collaboration)
- Money, Credit and Loan
- Essence of a Loan
- External Conditions for Business Decisions (VUCA)
- Nigerian Market and Government Policies

Overview

Meaning of Loan Restructuring – An attempt to reconstruct and induce an ongoing loan advance between the lending institution and the borrower. It is carried out to mitigate a failing, non-performing loan and uninspiring loan repayment. By this arrangement, the structure of the loan repayment is altered or rearranged in order to induce it, bridge a gap and address critical prevailing circumstances as in this pandemic period

Reasons companies take loan – support working capital requirements, mitigate funding gaps and inject further capital, expansion, growth and strategic projections

Causes of bad loans – Poorly conceived policies, prevailing economic environment, poor corporate governance, poorly targeted revenue projections, uncontrolled and poorly managed and executed budgets, poor staffing and inefficiency, poor internal control mechanism

Loans and corporate governance issues

- Definition
- Compliance and Efficiency
- Discipline and Feasibility Study
- Patronage and Influence as a "Business Model"
- The Seed analogy
- Culture and Structure of Businesses
- Responsiveness to the Business
- Professional Advice
- The 5P's

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Loans and challenges

- Risk – Management, Types and Anticipation
- Loan – Precaution and Protection
- Pre-loan Due Diligence
- Loan Inadequacy/ Interest Rates
- Loan Mismatch
- Collateral
- Lack of financial advice
- Internal Inefficiencies/ Bureaucracy
- Dubious Proposals
- Covid-19 Issues
- Financial Literacy

Loan Restructuring

- Negotiation/Communication
- Cordiality/Business Continuity
- Bank Expertise
- CBN Intervention
- Fund Injection/Product Line/Innovation
- Knock for Knock Option

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Parting shot

"Whenever you become successful, always remember the lessons of failure"

- Bill Gates

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LOAN DEFAULT & LOAN RESTRUCTURING

Loan Default

A Credit agreement is a contract between the Lender and Borrower that specifies the right and obligation of each with regard to a certain extension of credit to be repaid over a given period in a pre –agreed manner.

This includes both the Offer letter and any or a more comprehensive loan agreement. This will contain Affirmative and Negative Loan Covenants. Breach of these Loan Covenants usually constitutes a Loan Default.

Many unforeseen and unanticipated Internal and External factors can however impede the ability of the Borrower to generate cash and repay the loan in the manner previously agreed with the Lender leading to a Loan Repayment Default.

Banks and Other Financial Institutions are required by laws governing their licenses by the CBN under NGAAP to classify accounts as Non Performing where repayment of Principal and Interest is Past Due and Unpaid after 90 Days and are required to report this on at least 2 Private Credit Bureau and CBN CRMS Platform.

Acting Quickly at the first sign of trouble in a loan is Best. A wait and see attitude may delay effective action until it is too late. Anticipating events and planning an effective action by both the Lender and Borrower may prevent the loan from becoming a Problem

Red Flags for Lenders in Loan Default

There are various red flags that sign post a possible loan default before it crystalizes.	
CUSTOMER • Customer Behavior	Large or Unexpected Borrowing Request or Renewals, Diversification, Inability to meet commitment on schedule, Changes in Personal Habit of Key People, Frequent Changes in Management
• Financial Statement	Lack of Complete Statements, Changes in Auditors Accounting Practice, Excessive Inventory, Slow down in account Receivable, increase in trade accounts payable increase in borrowing.
BANK • Loan Activity:	Reduction in or unsatisfactory account turnover, Late payment of principal and interest, borrowing continues after seasonal need is over Unexpected or excessive borrowing,
• Account Activity	Excesses against overdraft, or drawing against Uncleared effect, Returned Cheques, Unexpected cash balance decline, Decline in loan activity or account turnover
OTHERS • Legal Action(Lawsuits)	New Mortgages; Economic News, Adverse News about the Industry

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Remedial Action by The Borrower

Although many causes can be responsible for a company running to difficulty the main cause is usually a shortage of cash. If cash is not flowing through the business at an acceptable rate then the orderly operation of its affairs become more difficult. Lack of profit is serious, lack of cash is deadly.

Stock

- Reduce Price to sell of obsolete or old stock , Cutting Down on Reordering , Concentrating on fewer items which are known to be saleable, Consider alternative Supplier, Just in Time Delivery

Debtors

- Are debts being collected in accordance with agreed terms. Are invoices being paid on time. Consider getting a Debt Collector for Debts over 1 year old

Creditors

Negotiate more favorable repayment terms with suppliers to improve spontaneous financing to finance working capital in the asset conversion cycle.

Non Core Assets

- Consider whether are any assets are surplus to requirement and could be sold to reduce Principal and debt service obligation. Sale and Lease back is another option

Other Areas

- Staff Cost, Travel Cost

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Strategy for Problem Loans

When you see a trouble sign the first thing to do is review the current status of the loan and check your security, then call the customer and confer. Try to determine what is causing the problem and what can be done to solve it.

The first reaction of many borrowers if they experience financial difficulties is to approach the lender with a request for additional finance. Unless viability can be established it is important that a lender doesn't make the situation worse by assisting the customer to dig an even deeper financial hole. It is therefore important to identify the type of problems being faced by the Borrower

Some of the problem identified fall into 3 categories,

- A Temporary Problem An unusual one off problem that that does not materially affect the company's ability to repay the loan.
- A Timing Problem means that the loan is fundamentally sound although the customer is not able to repay according to the original loan schedule
- A Serious problem means that the customer is having difficulty repaying the loan and that the company itself may be at risk or technically insolvent.

Strategies for Loan Restructuring

- Having identified the problem it is necessary to carefully review the current financial information of the company and repayment updates projection.
- Renew or Restructure a Challenges Loan should always be treated like you are making a new loan. You must perform a new cash flow analysis that take into account the company's present position as well as revised assumptions about the future. Critical questions that needs to be answered include:
- *-How much debt service would the current cashflow support? How much could future cashflow shrink and be sufficient to repay debt? how much would cashflow need to increase in order to meet proposed debt repayments? What financial and non risks have had the greatest impact on the customer's need to borrow and ability to repay?*
- Based on your new cash flow analysis you will have to develop a new repayment schedule perhaps giving the borrower a three to six months moratorium on principal repayment
- You might also restructure the loan to give greater flexibility to accelerate repayments with the availability of excess cash
- The longer the more difficult it may be to develop a workable plan to repay the loan. In most cases it may not be possible to structure a satisfactory workout, it may be necessary to liquidate a collateral and or try and collect from guarantors.

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Legal Anatomy of Loan Restructuring

Outline

- Introduction
- Definitions
- Anatomy of a Loan
- Imperatives for Loan Restructuring
- Overview of Informal, Multicreditor Workout and Formal Restructuring
- Imperative for Successful Loan Restructuring
- Anatomy of a Restructured Loan
- Conclusion

Introduction

About 80% of Nigerian businesses are MSME

Only 17% have credit line falling due – Punuka Client Survey

42% have impending contract issues – Punuka Client Survey

58% do not have impending contract issues

Cash v Credit economy

Why expand credit?

Types of Capital – Debt and Equity

Types of Debt

Why Gearing?

Definitions:
Loan Restructuring as continuum and process

Different restructuring techniques form a continuum to the treatment of financial difficulties. Thus from a purely contractual or informal-arrangements… to the fully formal reorganisation or liquidation procedures, there are numerous intermediate solutions - World Bank Group, Out-of-Court Debt Restructuring Study Report by Jose Garrido

Corporate restructuring is a process that involves a variation, modification, adjustment and or redesign of the financial structure (equity and debt, assets and liability) or operations and business of a company with or without resorting to a full judicial intervention, and with the objective of promoting efficiency, restoring growth, and minimizing the costs associated with the debtor's financial difficulties. See also Garrido

Loan restructuring therefore is the process of renegotiating rights of parties to a loan agreement within a formal or informal legal environment

Anatomy of a Loan

Parties

Lender(s), Borrower, Guarantor, Security Trustee, Agent Bank, etc

Recital

Historical reference and Transaction Dynamics

Operative Clauses

Commitment, Amount, Tenure, Purpose, Interest, Payment, Default, Penalties, Default Interest, Late Repayment, Principal Repayment, etc

Conditions for Utilization (Conditions Precedent, Drawdown and Conditions Subsequent), Currency,

Anatomy of a Loan cont'd

Security

Documentation, Consent, Deposits, Cost, Perfection, Enforcement and Realisation Rights, Indemnities, Undertakings

Representations and Warranties

Management, Financial Statements, Purpose, etc

Boilerplate Clauses

Waivers, Assignment, Variation, Amendment, Entire Amount, Communication, Notices, Prepayment, Cancellation (Voluntary, Change of Control and illegality, Severability, Force Majeure, Fees and Costs

Choice of Law and Dispute Resolution

Execution Clause

SAMPLE LOAN AGREEMENT – Simple and Syndicated

Imperatives for Loan Restructuring

Businesses contribute to economic development

- Profit/Dividend
- Salaries
- Tax
- Charity/CSR
- Debt Income/Interest

Insolvent businesses through default on payments distort economic expectation because system built on credit with money circulating from one party to the other – Cork Report

Insolvent casualties are removed from system by correlative insolvency procedure to prevent pollution, meltdown and systemic collapse

Positive correlation between efficient formal insolvency and restructuring

- Lada Busevac Debt Resolution and Business Exit in ECA Feb 2012 https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/doing-business-reform-advisory/upload/ECA-PPT-for-P2P_February-2011-LBusevac.pdf)
- INSOL Statement of Principles for a Global Approach to Multi-Creditor Workout
- Jose Garrido(supra) https://openknowledge.worldbank.org/bitstream/handle/10986/2230/662320PUB0EPI00turing09780821389836.pdf?sequence=1

Imperatives for Loan Restructuring (Continued)

- Formal insolvency can have drastic consequences
  - Collective, public proceedings against informal restructuring that can be completely out of court
  - Receivership
  - Liquidation and end of business
  - Loss of opportunity for better recovery
  - Loss of jobs
  - Loss of value, business, ownership and control
  - Race to collect – winners and losers
  - Slow judicial process
  - High cost
  - Stigma
  - Criminal prosecution
  - Bankruptcy
  - Judgment Debtor Summons/Imprisonment

Overview of Informal, Multicreditor Workout and Formal Restructuring

- Informal Workout
  - Contingency Planning- managing payment risk
    - Escrow
    - Sinking/Reserve Fund
    - IGR
  - Standstill and Forbearance Arrangements
  - Debt Restructuring/Rescheduling
  - Refinancing
  - Equity Raising and capital restructuring
  - Bridge Financing
  - Distressed M & A transaction
- Multicreditor Workout Approaches
  - The London Approach
  - The Hausbank Model
  - INSOL Principles
- Formal Restructuring

Overview (Contd) Types of Formal Restructuring

- Schemes of Compromise and Arrangement
- Debt Equity Swaps
- Exchange Offers
- Business Rescue
- Asset Purchase/Sale
  - Asset Management Company model
- OHADA Uniform Act
- State Enterprises
  - Privatisation
  - Commercialisation
- Cross Border Insolvency

Imperative for Successful Loan Restructuring

- Choosing the correct restructuring solution
  - Which Country
  - Required Majority
  - The Creditor
    - Capitalisation requirement
    - Provisioning requirement
    - Unrestricted
  - Available Assets
  - Location of Assets
  - Skill of Professional
  - Others?

- Negotiation and Workout
  - The Harvard Principles
    - Parties
    - Positions
    - Interest and
    - Options
- Effective Role for Professional Advisers
  - Independent Business Review
  - Competent Insolvency Lawyer
- Overcoming Inhibitions
  - Fear
  - Governance

Anatomy of a Restructured Loan

- Swap Arrangement
  - Debt to Equity
  - Debt to Property
  - Novation/Third Party
- Debt Restructuring
  - Discharge of Interest Amount Outstanding
  - Discharge of Principal Amount Outstanding
  - Payment Period Extension
  - Reduction of Interest Rate
  - Down or Good faith payment
  - Additional Security
  - Release of Security
  - Currency swap
  - Representations and Warranties
- Refinancing
  - New Loan from same lender or different lenders
  - Pay off of old expensive loan with new loan amount
  - Issue new bond with better terms and get old bondholders to accept new bond
  - Manage holdout

Conclusion

- Be Proactive
  - Debtor
    - Plan repayment – reserve, escrow, etc
    - Don't dip hand into capital
  - Creditor
    - Monitor debtor – warranties, representations, file review, client visitations, reports and financial statement receipt and reviews and feedback, etc

- Be Disciplined
  - Debtor
    - Loan is an obligation not gift
  - Creditor
    - Security is a fallback and not primary repayment source
- Collaborate
- Don't ignore red flags
- Watch for early warning signs
- Be Decisive

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