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News release

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Debt Workouts for Corporates, Banks and Countries: Some Common Themes – Speech by David Clementi

In a speech delivered at the Sixth World Congress of INSOL* International in London on 19 July, David Clementi, Deputy Governor of the Bank of England, discusses recent developments in debt work-out arrangements for corporate, bank and sovereign borrowers.

The subject is directly relevant to the Bank of England's responsibility for financial stability. In the corporate sector, Mr Clementi argues that "Insolvency procedures which are predictable, equitable and transparent, can maximise overall value for creditors and avoid the costs and wider economic disruption involved in unnecessary corporate liquidations."

Imbalances in the information available to a company and its creditors, together with possible conflicts of interest between creditors, can lead to serious co-ordination problems. This "represents a market failure capable of amplifying financial instability". The Bank has sought to develop the London Approach to corporate workouts in response to innovations in global financial markets, such as corporate debt trading and the growing use of credit derivatives. "Active markets in credit derivatives and secondary loans, whatever their merits in redistributing risk, can make it more difficult to identify and organise creditors in order to negotiate any debt workout."

In relation to bank restructurings, Mr Clementi notes the importance of confidence for banks and the associated potential for contagion. In the context of increasing integration in financial markets and consolidation of financial groups, authorities need to consider arrangements for winding up large and complex financial institutions (LCFIs). "Winding up a firm on this scale would be a large undertaking in itself. But it would also inevitably have wider repercussions for the firm's counterparties and for markets more generally."

Nonetheless, there are common themes with corporate workouts, notably the need for an assessment of long-run viability, for co-operation between the main parties based on a full exchange of information, and for equitable treatment of similar classes of creditors, investors and depositors. He argues in particular that “single-entity” liquidation of banks is more consistent with the agreed approach to international corporate workouts.

Mr Clementi comments finally that the existing framework for sovereign debt workouts evolved in a world where official financing dominated and private financing was provided by a relatively small number of developed country banks. But private claims now outweigh official claims by a ratio of more than 2 to 1 and these private claims are increasingly held by bond investors rather than banks. That again makes the creditor co-ordination issue of crucial importance. As Mr Clementi argues, “a failure of creditor co-ordination in the sovereign context can lead to protracted exclusion from international capital markets”.

Notes to Editors

1. The London Approach is a set of principles for corporate workouts, providing guidance on how banks and other creditors should respond when a company to which they are exposed faces serious financial problems. The Approach includes arrangements for an informal standstill while an independent review of the company's long-term viability and financing needs is carried out. Besides developing the principles, the Bank, where invited to do so, has acted as a mediator, facilitating discussions between debtor and creditors (see Bank of England Financial Stability Review November 1999 pp168-183).

2. INSOL International is the worldwide federation of national associations of accountants and lawyers specialising in insolvency. An affiliated body, INSOL Lenders Group, was established in 1994 to encourage and develop cross-border support, co-operation and communication amongst lenders in pre-insolvency workouts. The Group published a Statement of Principles for a Global Approach to Multi-Creditor Workouts in October 2000, which was endorsed by the Bank of England.

3. The issue of winding down of large and complex financial institutions (LCFIs) was raised in the G10 Report on Consolidation in the Financial Sector published on 25 January 2001.

*International Federation of Insolvency Professionals

Key Resources

Debt Workouts for Corporates, Banks and Countries: Some Common Themes – Full speech
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2001/speech136.pdf