How to Identify and Support Distressed Loan Portfolios

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Introduction

The chaotic economic environment brought on by the coronavirus pandemic has led to a rise in distressed companies. Lenders and creditors face an unprecedented challenge of navigating a high volume of loans in distress. Legal teams supporting lenders need to quickly assess best practices for dealing with these distressed loans while navigating tightening budgets and a hazy timeline for recovery.

In Axiom's recent webinar, experts on workouts, loan restructuring, and special asset management outlined steps legal leaders can take to address this growing issue.

Speakers included:

Marc Allon
Financial Restructuring and Bankruptcy Lawyer
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Step 1

Identify clients at risk

Identify industries with the greatest risk, based on the following experiences:

Structural issues

- Commercial real estate *- Tenants looking to move out of offices or retail spaces and break their leases*
- Retail *- Retailers under duress from e-commerce and closures during the pandemic*
- Energy and production *- Companies carrying a high debt load prior to the crisis*

Heavy impact from COVID

- Travel, such as airlines and car rental companies
- Leisure and hospitality
- Education, entertainment, and sports

Political risk, which will increase as the US election approaches

- Mergers and acquisitions *- Increased opposition to M&A could impact PE and VC portfolios*
- Oil and gas
- Financial institutions and non-bank lenders

Proactively identify and address risk:

While each institution may have its own methodology for risk assessment, general counsel, as stewards of the business, should compel their institutions to proactively identify and work closely with high-risk borrowers in order to stay ahead of any challenges that might arise around high-risk companies.

To triage high-risk borrowers before their loans become unsalvageable, companies must:

- Understand what purposes the loans serve – for example, are they for structural issues like maintaining payroll, or opportunistic borrowing for in-need products?
- Review and identify every potential at-risk loan

Step 2
Manage clients in high-risk situations

➡ Rethink the binary of either relationship-building or relationship-terminating with clients. Instead:

Define four key buckets of loans:

- Performing
- Performing but at-risk
- Underperforming but salvageable
- Unsalvageable

Establish a “bridge group” to assess and manage the process:

- Consider special asset group professionals, loan officers, legal team members, and compliance officers
- Give them authority for loan deferral or forbearance
- Identify best practices and ensure there is sufficient support for the group to be successful

➡ Consider thresholds for terminating a relationship:

**The decision to end a relationship with a distressed borrower is not strictly financial.
Other considerations include:**

- Reputational challenges, especially in heavily regulated or consumer-facing industries
- Repeat players
- Accounting rules, especially for banks
- Tax treatment
- Impact on other loans
- Future business considerations
- Debt load, especially if a company is without a collateral cushion, or where a lender has a subordinate lien
- Assets – note, many service businesses may have no significant assets beyond intellectual property or receivables

**Before terminating a relationship with a client, consider bringing in a fresh set of eyes.
Keep in mind:**

- The decision to terminate or salvage a relationship should not be made by someone who established, or is invested in, that relationship
- Set up best practices and advise to avoid conflicts of interests

Step 3
Get ahead of deteriorating loan portfolios

Steps you can take now:

- Invest in constant monitoring and a focus on liquidity
- Establish guideposts and a decision tree about how to handle problematic loans
- Empower a bridge team to move quickly to either salvage or end the relationship
- Be realistic – bankruptcies are challenging and not all relationships will survive

Manage the workouts and restructuring process at scale

Recognize the challenge of securing funding for a group that is terminating relationships and delaying loan repayments

- They are not generating revenue, so it could be hard to get an investment
- Take the big-picture view. The prior financial crisis took years to unwind
- Invest in a bridge group today to save money and trouble down the road

Don't simply reallocate resources

- Avoid relying on people from less-busy parts of your organization to manage the restructuring process – while they may have bandwidth, expertise is critical
- Bring in the right people who have experience in bankruptcy, workouts, and loan restructuring to oversee the process
- Set up a rapid decision-making process so those new resources can act quickly and independently

Key actions you can take right now

- Identify which relationships to maintain and which to terminate
- Dedicate specialized resources, and consider building a bridge group to support
- Advocate for the tools necessary to help the situation, such as forbearance and deferment
- Prepare for fast-moving and dynamic situations
- Stay open to creative, unusual, or different options, even if they would not be approved by a committee in normal circumstances

GET IN TOUCH

If you need legal support for workouts and restructuring, Axiom's credit-focused talent pool of 100+ lawyers can provide flexible, on-demand solutions that can be customized based on your needs. Get in touch today.

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