

Restructuring State-guaranteed Loans: the French Experience

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Abstract

The COVID-19 pandemic posed a significant challenge for the economies of the European Union and the world at large. Ensuring that businesses could overcome the liquidity shortages resulting from the limitations on their ability to trade arising from health policies, namely lockdowns and other restrictions on the operations of businesses, was critical.

Given limited information and the need for a swift reaction to stabilize the economy, governments across the globe deployed significant amounts of capital in general schemes destined to allow the businesses to survive the restrictions until the situation was under control, and appropriate measures could be decided with the benefit of additional information and a full understanding of the prospects of those businesses. One of these schemes was the implementation of programs of State-guaranteed loans ('SGL') to support the liquidity of companies across the board. This ensured that the assessments as to the viability of businesses were not rush judgements made with limited information. They succeeded while requiring a lower risk to public budgets than other more direct interventions.

Once the immediate emergency has lapsed and (almost) all of the restrictions have been lifted, the next step needs to be anticipated. For some companies, it is clear now that their current capital structure, including the SGLs, represents too high of a burden (be it in terms of liquidity or strategic restrictions) and, in order for them to continue operating, it will need to be restructured. The need for such a restructuring is complicated by the presence of the State as an indirect stakeholder. Given its limited resources, the design of any restructuring proceedings to be used for a relatively large number of SGLs relies heavily on the infrastructure of the private lenders, with a design focused on eliciting (and relying on) as much private information in the hand of the lenders as possible, while controlling additional agency costs.

Using the specific details of the French SGL program (some of them, 'soft' or informal regulations), we discuss how the restructuring of liabilities of this type should aim at efficiently differentiating between viable and nonviable businesses and optimally restructuring the former, while minimizing risks of strategic behavior detrimental to the public economic interest.

In particular, attention will be brought to three key issues (level of recourse to the borrower, relative treatment of SGLs compared to other liabilities and the use of 'better fortune' instruments as a tool for option preservation), not only in the way that they are addressed by the French regulations but also considering other potential policy designs that may have not been adopted in the practical implementation of the 'French solution'—but that we consider of significant interest on a policy design level.