

Joint Rules on the Financial Restructuring of Companies

1. Introduction

These Rules have been adopted in accordance with Article 3 of Act No. 107/2009, on Actions for the Benefit of Individuals, Households and Corporates in Response to the Banking and Currency Crisis, and shall apply while its provisions are valid. The Rules apply to the legitimate claims of financial institutions, i.e. claims that enjoy legal protection under Icelandic or internationally recognised law. If a debtor considers a claim by a financial institution to be unlawful or unwarranted, the debtor shall submit detailed reasoning in support of the case to the financial institution in question. Should the financial institution conclude that the claim is unlawful or unwarranted, it shall be cancelled to the appropriate extent. Financial institutions shall have these Rules for reference in the financial restructuring of companies in order to ensure procedural consistency across cases. The Rules are based on the views expressed in comments on the Bill which became Act No. 107/2009, on Non-discrimination and Transparency in Dealing with Individual Cases, as well as a general demand for sound and good business practices.

The aim of restructuring corporates is for financial institutions to maximise recovery with regard for the conditions and views set forth in these Rules and Act No. 107/2009.

Furthermore, financial institutions operate in accordance with other laws that apply to their activities, cf. Act No. 161/2002, on Financial Institutions, Act No. 87/1998, on Public Supervision of Financial Activities, etc. Based on these laws, all financial institutions to which these Rules pertain have established internal lending and write-off rules to govern implementation and decisions in individual credit cases. In addition, the activities of financial institutions must comply with the provisions of general legislation, including Act No. 44/2005, on Competition, Act No. 77/2003, on Personal Data Protection and Treatment of Personal Data, and Act No. 64/2006, on Measures to Prevent Money Laundering and Terrorist Financing.

2. Conditions for financial restructuring

Below is a list of conditions a company must generally fulfil before financial restructuring is considered. For the purposes of these Rules, financial restructuring refers to measures that may lead to debt forgiveness or other concessions to the provisions of contracts:

- 2.1. The restructuring of the company's debt will, in the financial institution's opinion, lead to better recovery of the claims of the financial institution than would the winding up of the company.
- 2.2. The company can show that cash flow will support payment of liabilities following restructuring. In assessing residual debt following restructuring, regard shall be had for expected payment capacity, the total institution value of the company and the value of its assets.
- 2.3. Trust and confidentiality must characterise the relationship between the company and the financial institution. Accordingly, the company's business history, its owners and management shall be reviewed.
- 2.4. The company must show a readiness to co-operate and supply the financial institution with all necessary information on which to base financial restructuring.
- 2.5. The company must authorise the financial institution to conduct financial restructuring in collaboration with other creditors, as applicable.
- 2.6. The company must authorise the financial institution to perform a due diligence analysis on the company, if considered necessary.
- 2.7. It is not deemed likely that other creditors will demand that the company enter bankruptcy.

3. Evaluation of a company

In determining whether conditions for financial restructuring have been satisfied, the financial institution assesses various aspects of the operations, management, finances and operating environment of the company, including:

- 3.1.** Assets and liabilities, assessing for instance:
 - 3.1.1.** Value of collateral and the company's main assets.
 - 3.1.2.** Opportunities for increasing efficiency, e.g. through divesting of unprofitable assets.
 - 3.1.3.** Liabilities and obligations of the company, including guarantees.
 - 3.1.4.** Security provided to the financial institution, including a valuation of the useful life of pledged assets and guarantees underpinning debt.
- 3.2.** Payment capacity, assessing for instance:
 - 3.2.1.** Budget, cash flow and key assumptions.
 - 3.2.2.** Planned cost-efficiency measures, e.g. whether operating costs can be reduced.
- 3.3.** The company's total institution value with respect to estimated cash flow.
- 3.4.** Reputational risk for the company and the financial institution as a result of financial restructuring.
- 3.5.** Evaluation of connected parties as a whole, as appropriate.

4. Assessment of the feasibility of further involvement by company owners and management

In assessing the feasibility of further involvement by company owners and management, the financial institution shall consider their business histories, readiness to co-operate in financial restructuring and their importance to the company's future. In assessing these factors regard shall be had, for instance, for the following points:

- 4.1.** The following aspects shall be considered in assessing the business history of owners and management:
 - 4.1.1.** Have agreements between the customer and the financial institution generally been honoured?
 - 4.1.2.** Has information provision been good?
 - 4.1.3.** Have dividend payments and wages been in line with operating premises?
 - 4.1.4.** Is the company's operating history strong despite current difficulties?
 - 4.1.5.** Has management and divestment of the company's assets been in violation of contracts or legislation?
- 4.2.** In assessing readiness to co-operate in the financial restructuring process, the following aspects shall be considered:
 - 4.2.1.** Has all necessary information been provided?
 - 4.2.2.** Has the company promoted collaboration among creditors as appropriate?
 - 4.2.3.** Has trust been established between the parties?
- 4.3.** In assessing whether the continued involvement of owners and management will aid debt recovery, the following aspects shall be considered:
 - 4.3.1.** Do the individuals possess expertise and/or knowledge valuable to operations?
 - 4.3.2.** Do they have business connections valuable to operations?
 - 4.3.3.** Do they hold licenses valuable to operations?

- 4.3.4. Is their contractual position such that recovery by the financial institution is likely to suffer should they be removed?

5. Terms of agreements upon restructuring

Financial institutions may require that special terms and conditions are included in agreements on the financial restructuring of companies. Such terms may include:

- 5.1. A demand that owners inject new equity into operations and/or pay off debt owed to the financial institution.
- 5.2. Cessation of dividend payments and limitations to withdrawals by owners.
- 5.3. Setting a cap on remuneration and other benefits to owners and directors.
- 5.4. Restrictions to changes in the management of the company and its purpose without approval by the financial institution.
- 5.5. Requesting added security for debts, for instance, in company assets and cash flow and/or the owners' share in the company.
- 5.6. Power to appoint a supervisor, advisor and/or independent director for the company.
- 5.7. Regular information disclosure on operations, finances and cash flow.
- 5.8. Conversion of debt into equity and/or issuance of financial instruments convertible to shares.

6. Methodology and considerations

The methodology governing financial debt restructuring will primarily be based on commercial and competition considerations, as well as transparency demands.

- 6.1. In accordance with Opinion No. 3/2008 from the Icelandic Competition Authority, dated 12 November 2008, regard shall be had for the impact of restructuring efforts on competition. The Opinion requires that the restructuring efforts aim to strengthen the competitive environment or inhibit it as little as possible. The obvious stakes of financial institutions in maximising value, safeguarding their interests and resolving matters promptly shall, however, not be impaired.
- 6.2. While work on resolving the debt issues of companies is underway, it may be necessary to continue debt collection in order to safeguard the interest of the financial institution. Debt collection refers to collection as defined in Act No. 95/2008, on Debt Collection, or legal collection as defined by procedural rules.
- 6.3. Debt forgiveness is not intended as a means to change negative capital adequacy to a positive ratio. It is, however, intended to strengthen the balance sheets of companies in the long term.
- 6.4. Financial institutions shall seek to maintain transparency in all procedures insofar as possible. This entails that all decisions on debt restructuring and term amendments shall take place following a detailed process, pre-defined by creditors, and shall be entered and retained with the records of the creditor. The process shall correspond to processes governing lending. Objectivity in decision-making must be ensured.
- 6.5. Where it is foreseeable that payment capacity is none or very limited, no option remains but to seek recovery of claims in the debtor's assets.

7. Principal data in assessing and processing cases

Before financial restructuring can begin, financial institutions will require the following information and data, as appropriate in each case:

- 7.1. Confirmed and/or reviewed and annotated data on operations, finances and cash flow for the past few years.

- 7.2. A 3-5 year budget that includes a forecast budget, balance sheet and cash flow, in addition to historical figures, and a summary of principal factors and assumptions.
- 7.3. A breakdown of the company's obligations, including debt owed to financial institutions, other creditors and public parties, asset leasing agreements and guarantees by the company and its owners.
- 7.4. An investment plan detailing the investments necessary for the company to maintain operations and attain performance goals.
- 7.5. Information about business contracts, business connections and income composition, in particular special expertise or patents.
- 7.6. Organisational chart of the company and information on management.
- 7.7. Information on connected organisations/companies and transactions with related parties, including any guarantees.
- 7.8. Survey of assets necessary for the company's operations.
- 7.9. Aged accounts receivable and payable, as well as an overview of expected recovery and collection status.
- 7.10. Aged inventory and reassessment of its value.
- 7.11. Statement of encumbrances detailing assets, fixed and current, and updated status of all liens.
- 7.12. Information on changes to accounting presentation.
- 7.13. Decisions about business contracts and insurance matters taken in the past two years.
- 7.14. Information on involvement in any current legal disputes.
- 7.15. Other information that the financial institution deems necessary in order to assess grounds for financial restructuring.

8. Sale of assets

Financial institutions may need to take over companies in part or in full to ensure payment of claims or as an aspect of the financial restructuring process. Nonetheless, the aim shall always be to accomplish financial restructuring without resorting to takeovers. If a financial institution assumes ownership of shares in a company it shall have regard for the following points in divesting such assets, as appropriate in each case:

- 8.1. Holdings in corporates shall be divested as expeditiously as is economically viable.
- 8.2. Asset management companies or financial institutions, as appropriate, shall manage the sale process of assets in accordance with Articles 21 and 22 of Act No. 161/2002, on Financial Institutions, and FME Guideline No. 1/2004, which includes information on temporary authorisation for banks to retain stakes in commercial businesses.
- 8.3. The sales process shall aim to be open and transparent, ensuring equality among investors.
- 8.4. In certain cases the interests of the company or financial institution may require closed offerings or another type of sale process, for instance due to provisions of shareholder agreements or on pre-emptive rights, considerations of other owners, creditors or holders of operating licenses, when the expected sale price does not justify the cost of an open tender or other obvious interests of the company or financial institution.
- 8.5. Grounds shall be given for decisions to divest the holdings of a financial institution and for the type of sale process selected. The rationale shall be documented, along with other arrangements linked to the financial restructuring of corporates.
- 8.6. In divesting assets, regard shall be had for Opinion No. 3/2008 from the Icelandic Competition Authority, dated 12 November 2008, and Discussion Paper No. 2/2009, on Banks and the Financial Restructuring of Corporates, from the Competition Authority, cf. Point 6.1 of these Rules.