October 2015

In Chart 1, our benchmarking shows that many companies significantly underestimate the risk of a default to their company compared to S&P's experience of its ratings' default rates. Also, it is our experience that many companies trivialize a technical default, thinking it is of no real consequence. Legally, any default is a default, and starts a chain of consequences that is hard to control, as Chart 2 shows.

Borrowers have a legal obligation to review their compliance with all of their covenants of all of their debt agreements on at least a quarterly basis. In addition, to justify classifying the debt as long-term per ASC 470-10, companies must verify that the debt has no covenant violations, no matter how insignificant.

For public companies, such verification is a necessary SOX control. Some 80% of the 350 companies who reported complying with Sarbanes-Oxley in the 2012 AFP Debt Compliance Benchmarking done with DCS, and in our 2015 Debt Compliance Benchmarking, include debt compliance as an explicit part of their SOX process. Please see Chart 3.

Charts 4 and 5 show the magnitude of the task: there are many covenants that can only be adequately reviewed by Subject Matter Experts (SMEs) outside of Treasury. Yet for many companies, debt compliance is an insular, silo process within Treasury. Fully 50% of the companies in both studies did not have a debt compliance policy. Lacking a policy can have these consequences:

1. An incomplete and inadequate process with no debt compliance objectives, no assignment of responsibilities, and no documentation of compliance
2. Low cooperation outside of treasury in determining compliance
3. No focus on identifying current and prospective covenant issues that need to be monitored, managed or mitigated, and, as appropriate, discussed with senior management and the lenders to avoid future surprises.
4. No covenant checklist or a focus on only the 10-15 financial ratios, permitted basket limits, and quarterly deliverable covenants, ignoring the 60 - 80 other covenants that can be included in a senior credit facility.
5. No standard interpretation of the covenants, leading to wasted time re-interpreting them every quarter, divergent and incomplete interpretations, and unnecessary legal expense.
6. With the inevitable turnover, the learning curve for new staff is steep, risking inexperienced and superficial compliance reviews later in the debt life when default risk is greater.

The attached debt compliance policy represents our best thinking on the elements that should go into a debt compliance policy. It assumes that the company is public, but the comments related to SOX and the SEC can be easily edited out. We welcome your comments for improvement and any questions.

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### Chart 1: Default Risk is Large and Underestimated

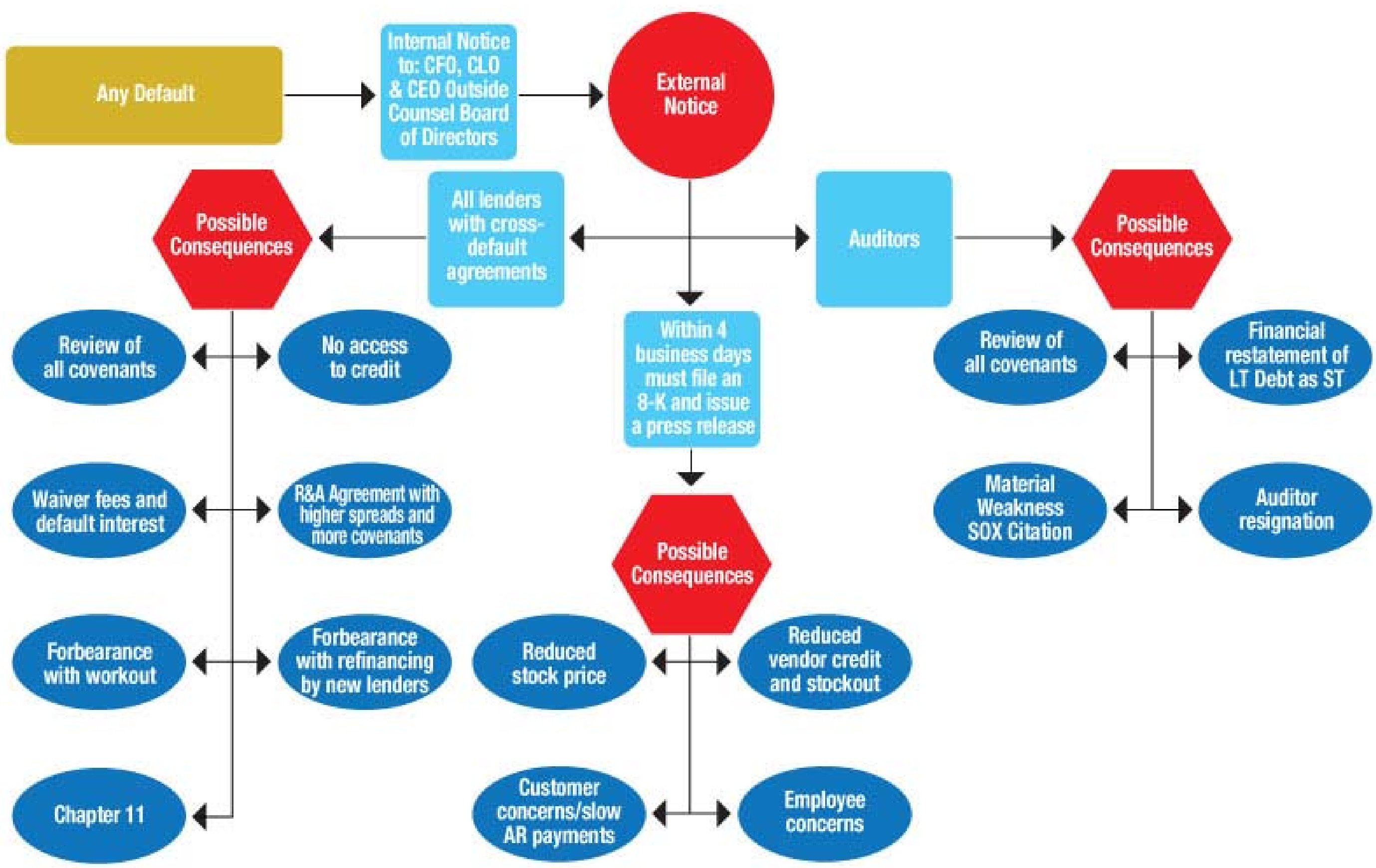
| Actual and Estimated 5 Year Hard Default* Rates by S&P Ratings | BBB | BB | B | CCC/C |
|---|---|---|---|---|
| 2014 S&P Annual 30-Year Study | 2.2% | 8.4% | 20.6% | 47.5% |
| 2012 AFP Survey Estimate** | 2.6% | 5.5% | 4.5% | 17.8% |
| 2015 DCS Survey Estimate** | 2.5% | 3.0% | 6.3% | 7.5% |
| DCS 5 Year Technical Default*** Estimate | 8% | 18% | 30% | 54% |

*Missed payments, distressed debt exchanges, and bankruptcy filings

**Respondents estimating the 5-year hard default rate of companies with their credit rating

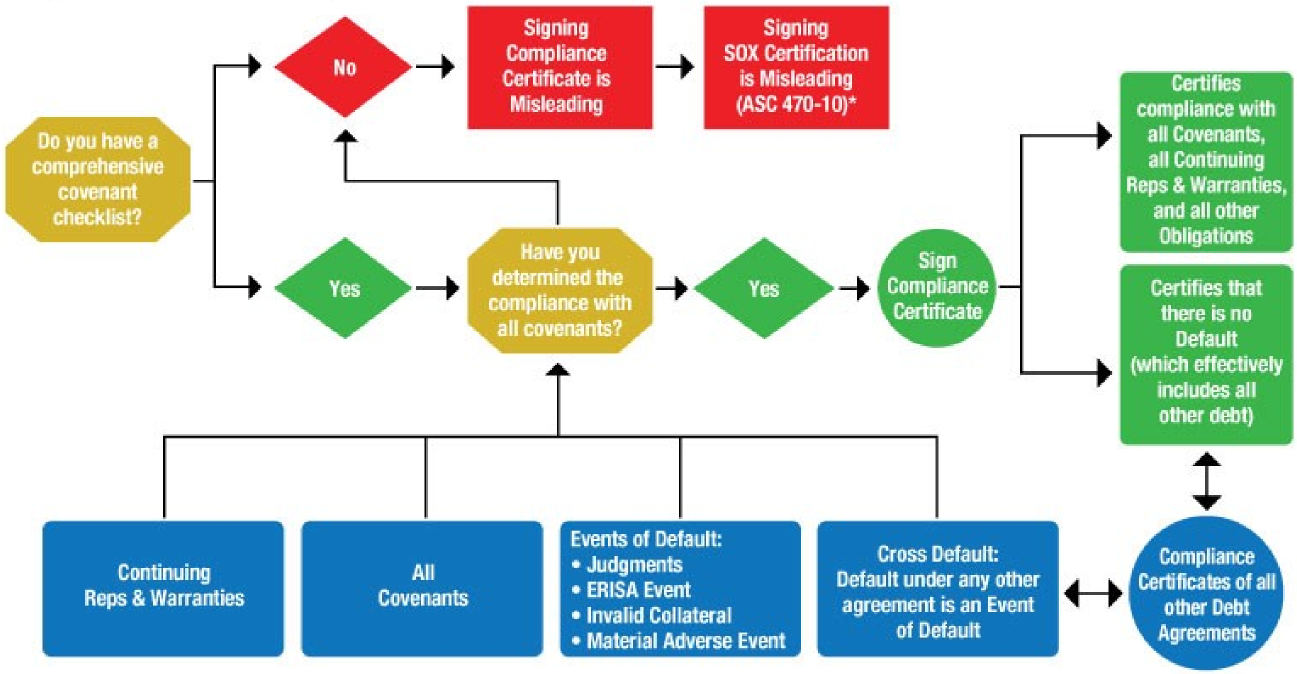
***Any other kind of default

### Chart 2: The Consequences of a Default



## Chart 3: Lenders Require a Rigorous Review of All Covenants of All Agreements

Quarterly Certification Letter: "The Company has kept, observed, performed and fulfilled its obligations under the Credit Facility and has fulfilled each and every covenant."




*ASC 470-10 requires that debt with any covenant violation, no matter how insignificant, be classified as short-term because the lenders can call the debt. To justify the classification of debt as long-term, the company must verify that the debt has no covenant violations.

### Chart 4: Many Different Kinds of Covenants

| Typical BB Agreement | Number of Covenants by Category | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Pay-ments | Reps & War-ranties | Preser-vation of Assets | Prohi-bited Actions | Repor-ting | No-tices | Unique Events of Default | Ratios | Total |
| **Credit Agreement** | 26 | 19 | 13 | 14 | 5 | 9 | 7 | 2 | 95 |
| **Senior Notes** | 4 | 0 | 4 | 15 | 5 | 0 | 5 | 0 | 33 |
| **Convertible** | 14 | 0 | 10 | 2 | 3 | 5 | 7 | 0 | 41 |
| **ABL** | 13 | 29 | 22 | 15 | 7 | 5 | 21 | 2 | 114 |
| **Total** | 57 | 48 | 49 | 46 | 20 | 19 | 40 | 4 | 283 |

### Chart 5: Many Covenants Require Review by SMEs Outside of Treasury

# [Company Name]
# Corporate Debt Compliance Policy

**Issue Date: [Date]**

**Prepared by: [Treasurer]**

**Approved by: [CFO]**

**Approved by: The Audit Committee of the Board of Directors**

# Index

## 1. Introduction

It is an important strategic objective for [Company Name] (the Company) to maintain its access to the debt markets to fund its operating and strategic initiative requirements at the lowest possible cost. This includes all types of financing available to the Company: bank credit facilities, term loans, bonds, note purchase agreements, convertible bonds, private placements, off-balance sheet financing, leasing arrangements, etc. (Agreements)

These Agreements require the Company to satisfy various financial and operating requirements (Covenants). More specifically, a Covenant is a contractual requirement for the Company to perform or not perform a specified action. Actions can be triggered by a due date or by an event. Covenants also include promises to maintain the Company's financial status, operations and activities within certain limits or constraints. The Company has a legal obligation to send to its lenders quarterly, and for some Agreements, annually, an Officer's Certification that Company has reviewed and is in compliance with all the Covenants of all of its Agreements.

Due to cross-default clauses, any covenant violation, no matter how insignificant, will trigger defaults in all of our major debt agreements. Our access to credit to fund our operations may be severely limited. To remedy the default, the Company may have to pay default interest and waiver fees, accept new and more onerous debt covenants, workout, and/or forbearance to avoid the lenders calling the debt.

As a material event, a default will require an 8-K and a press release within four business days of discovering the default. The consequences to the Company's reputation, stock price, management credibility, customer and vendor relationships, and employee morale would be substantial.

There are also GAAP consequences. ASC 470-10 requires debt with a covenant violation, no matter how insignificant, if uncured or unwaived at the financial statement date, to be classified as short-term, rather than long-term. If the default or an event of default is long-standing, the financial statements may need to restated and the auditors are likely to include a SOX material weakness citation. Thus, to properly classify the Agreements as long-term, reviewing the Company's compliance with all of its covenants is also a necessary SOX control.

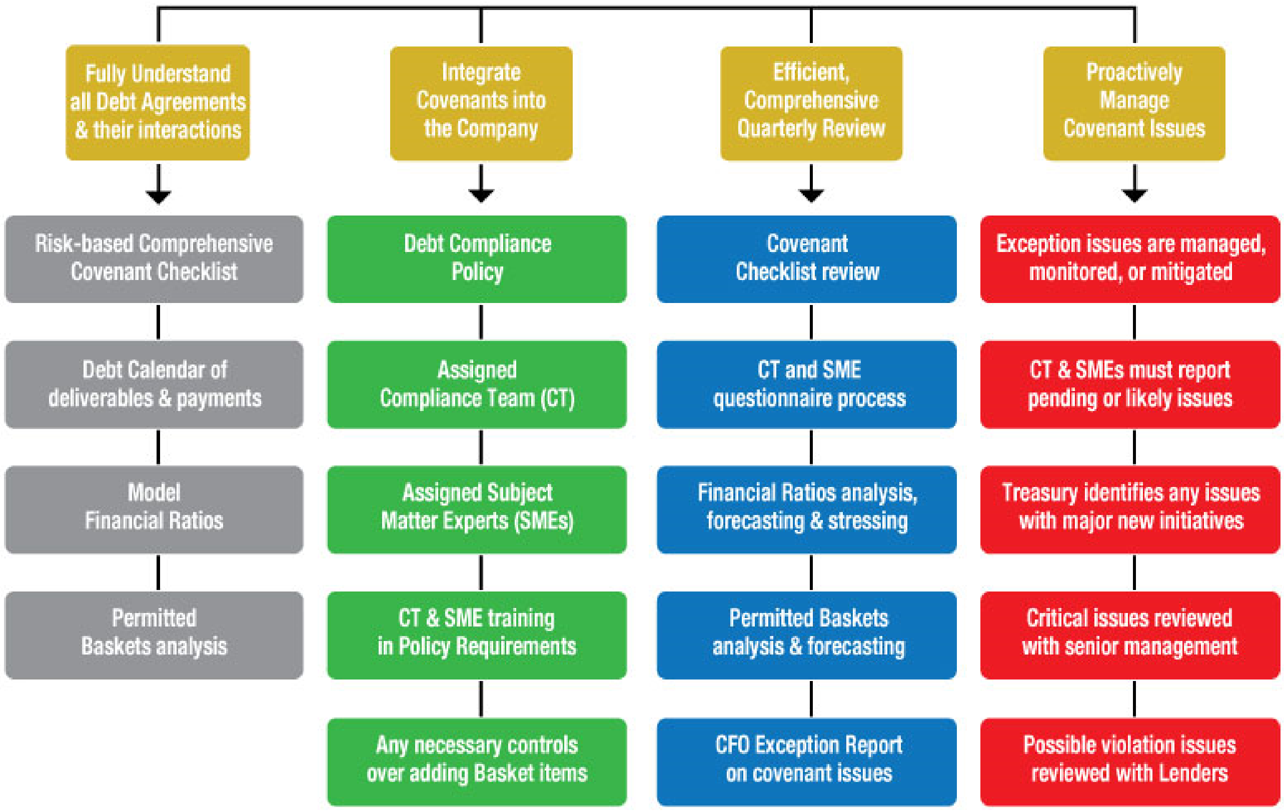
**For these reasons, it is a Company-wide priority and responsibility to both maintain compliance with its Covenants and minimize the consequences of any possible future covenant violations.**

This Policy states the objectives, means, and the major responsibilities of the

- [Executive Vice President & Chief Financial Officer] (CFO)
- The [Vice President & Treasurer] (Treasurer)
- The [Chief Legal Officer] (CLO)
- The [Head of Financial Planning & Analysis] (Head FP&A)
- The [SOX Controls Manager] (SOX Manager)
- The staff directly responsible for gathering, summarizing and evaluating the Company's quarterly debt compliance (the Compliance Manager and the Compliance Team)
- The staff who are Subject Matter Experts (SMEs also referred to as Respondents and Reviewers) participating in quarterly debt compliance process regarding covenants in their areas of expertise or responsibility.

## 2. Policy Objectives

The Company's policy objectives and how those objectives will be achieved are:




## 3. Covenant Compliance Process

### 3.1 Covenant Checklist

The Treasurer and CLO are responsible for developing and maintaining a comprehensive list of **all** of the Covenant requirements contained within **all** of the Company's Agreements. Such a list must be completed within 60 days of the closing date of each Agreement. The Covenant Checklist must be approved by the Treasurer, the CLO, and the CFO. Any new Agreement or an amendment to an existing Agreement that changes any Covenant must be updated in the Covenant Checklist within 30 days of such Amendment and also must be also approved by the Treasurer, the CLO, and the CFO.

The Covenant Checklist will have the following elements for each Covenant:

a. Reference to the Agreement section containing the Covenant

b. Subject, a two or three-word categorization or description

c. A brief synopsis of the Covenant and/or questions about whether the required or prohibited actions did or did not occur

d. Listing of the department or operating unit that has primary responsibility for ensuring compliance with that covenant. This would include people whose management authority can affect a given Covenant or who would be most knowledgeable of any conditions that may indicate that a Covenant has been violated.

e. The default section reference of the Agreement describing the consequences of breaking the Covenant including the cure period.

f. An evaluation of the Covenant's risk, determining what are the controlling, unique covenants that are truly at risk that need to explicitly managed, which can include covenants in the junior debt that override the senior debt. Many covenants are stand-alone, independent of other covenants. They may trigger dependent convenants. Other covenants may be standard lender boilerplate that will never happen, while others may be covered by other compliance processes. Risk is also identified by the lenders by specifying covenants with no 0-3 days cure periods.

## 3.2 Compliance Determination

To determine compliance with each Covenant Checklist item, the Compliance Team will develop a questionnaire process in which a person or persons in the department that has primary responsibility the covenant – and sometimes person(s) from other departments – state yes or no whether the actions required or prohibited by the covenant did or did not occur. If a negative response to question is given, indicating a potential or real covenant issue, the Respondent is required to give an explanation.

All questions should be fully and properly answered, with the Compliance Team following up with the Respondent and ensuring that the Reviewers have reviewed and agreed with the Respondents' responses, making adjustments or corrections as appropriate. Critically, neither a Respondent nor a Reviewer is to make a judgment about whether this required information is too immaterial to be reported. Their responsibility is to make full and accurate responses to the questions. The responses of the Respondent and the review by the Reviewers must be documented.

It is then the responsibility of the Compliance Team, and in particular, the Compliance Manager, to validate the responses and evaluate the exceptions, the negative responses against the actual covenant text, not the Covenant Checklist. In the Exception Report, the Compliance Manager summarizes the issue and recommends such actions as:

- Ignoring it because it is not really a potential or actual exception.
- Monitoring or managing it because it is an emerging issue or a potential issue that could cause a future covenant violation
- Reporting it to the Lenders either to proactively manage them about potential covenant issues or because it is a covenant violation and how it is being remedied.

The Exception Report is reviewed and approved by the Treasurer and the CLO before being submitted to the CFO. The responsibility for making materiality judgments about the responses are to be made by the Compliance Manager, the Treasurer, CLO, and the CFO.

## 3.3 Calendar

The Compliance Team will prepare a calendar, showing by month and date, when financial statements, certifications, specific reports or notifications are due to the Lenders as well as the dates in which all fixed fees, principal amounts and predetermined interest payments are to be paid. The latter can be dispensed with if the payments are already covered satisfactorily elsewhere in Treasury. It is the responsibility of the Compliance Manager, or other treasury member so delegated by the Treasurer, for ensuring that all such reports, notifications and payments are made on time. The Treasurer and the CLO shall approve the Calendar.

### 3.4 Financial Covenant Ratio Analysis

Using financial inputs from the Controller's Department and forecasts from Financial Planning & Analysis, the Compliance Team will prepare a Financial Model to determine the current quarter's financial covenant ratios as well as a forecast the covenant ratios for the next four quarters. The Financial Model will also stress test the ratios to see how much leeway exists in the numerator and denominator of the ratios before the Covenant ratio is breached.

The results of the Financial Model will be summarized in the Financial Covenant Ratio Analysis, which is to be reviewed and approved the Treasurer and the Controller before being submitted to the CFO.

### 3.5 Permitted Baskets Report

Using financial inputs from the Controller's Department, supplemental reporting from other areas of the Company, the Compliance Team will determine the current quarter's permitted basket amounts and forecast them for the next four quarters, determining how much leeway exists before the limits are breached. The Permitted Baskets Report is to be approved by the Treasurer before it is submitted to the CFO.

### 3.6 Quarterly Debt Compliance Package

The approved Exception Report, the Financial Covenant Ratio Analysis, the Permitted Basket Report, and the appropriately filed out Officer's Certificate for each Agreement are then submitted to the CFO for his or her review and approval no later than 5 business days prior to when the Officer's Certificate(s) are due to the Lenders.

### 3.7 Debt Compliance Communications

All written communication with the Agreements' Agents, Trustees, and Lenders shall be saved and filed to a centralized filing repository maintained by Treasury.

All internal written communication, including analyses regarding an Agreement and its interpretation shall be done with care and with the assumption that such communication is discoverable in the event of a dispute with the Lenders. All communication directly with outside counsel is privileged. Legal must be consulted if there are any questions regarding what may or may not be privileged.

## 4. CFO Responsibilities

The CFO has the responsibility and authority for managing:

- The Company's debt compliance objectives and that the Company has sufficient internal controls in place to ensure that the CFO has all of the information necessary to support the Compliance Certificate and SOX certification.
- The Company's relationships with capital market providers and the rating agencies.
- Ensuring that the Company has sufficient access to funding for its operating and strategic initiative requirements.

The CFO is the primary signer for all Officer's Certificates and for ensuring that all Officer's Certificates, all other communications, deliverables, and payments to the Company's lenders are accurate and done on a timely basis.

The CFO is also responsible for approving this policy prior to its submission for approval by the Audit Committee of the Board of Directors.

## 5. Treasurer Responsibilities

Reporting to the CFO, the Treasurer is directly responsible for managing the Company's debt compliance, the Company's relationships with capital markets providers and the rating agencies, and ensuring that the Company has sufficient access to funding for the Company's operating and strategic initiative requirements. To assist the Treasurer in carrying out these responsibilities, the Treasurer may delegate initial responsibility to a Compliance Manager and a Compliance Team, which may include non-Treasury members. The Treasurer's responsibilities specifically include:

a. The timely and accurate payment of principal, interest expense, and fees per the terms of the Agreements.

b. Ensuring the timely delivering of all information to the Agent and Lenders required by the Agreements. This would include financial statements, notifications, auditors' certificates, Officer's Certificates, etc.

c. Developing a Financial Model which will monitor current and future compliance with all financial Covenants. The Financial Model will incorporate the current financial plan or forecast and will have the capability to stress test the various leeway under each financial Covenant. Quarterly, the results of the Financial Model will be summarized in the Financial Covenant Ratio Analysis.

d. Quarterly, preparing the Permitted Basket Report. Intra-quarter, monitoring as appropriate the risks and activity of each basket. If approved by the CFO, develop an approval process in which Treasury must approve the addition of a permitted basket item before it can be initiated by the Company.

e. Monitoring and managing the compliance with all loan Covenants including both financial and non-financial with the development of a comprehensive Covenant Checklist, and the assignment of the Covenants to appropriate Respondents and Reviewers. This includes developing questions about the compliance of each identified Covenant in the Covenant Checklist and quarterly distributing the questions in tailored questionnaires to all Respondents and Reviewers about the Company's compliance with their assigned Covenants.

f. Training the Respondents and Reviewers so that they are aware and knowledgeable about the Covenants that may be impacted by areas of responsibility and their responsibilities under this Policy.

g. Preparing the Quarterly Debt Compliance Package, which includes the Financial Covenant Ratio Analysis, the Permitted Baskets Analysis, the Exception Report, and the Officer's Certificates for the review and approval of the CFO.

h. Reporting annually to the Audit Committee of the Board on the operation of the Company's Debt Compliance Policy.

## 6. CLO Responsibilities

a. Advising on the legal interpretation of all Agreements, including assisting in determining whether a given Covenant issue is a breach, the cross-default consequences, and whether it is material enough to require communication, and what kind of communication, with the applicable Agent and Lenders.

b. Ensuring that the Covenant Checklist and related Covenant questions are correct, comprehensive, and sufficient to fulfil the Company's Covenant obligations to its Lenders.

c. Approving the Exception Report and assisting the Treasurer in the preparation of the quarterly Debt Compliance Report.

d. Conforming the Agreements for the effects of all amendments and providing conformed copies of the Agreements to the Treasurer within 30 days of such amendments.

## 7. Controller Responsibilities

a. Reviewing the adequacy from a GAAP and accounting system standpoint of producing any required inputs into the Financial Covenant Ratio Analysis and the Permitted Baskets Report.

b. Ensuring the accuracy of all actual inputs into the Financial Model and Permitted Baskets.

c. Ensuring the timely delivery to the Compliance Manager of any required reporting to the Lenders that are either completely done by the Controller’s Department or for which the Controller’s Department provides input in their preparation.

d. [Optional]Approving the quarterly Financial Covenant Ratio Analysis for the current quarter data.

## 8. Head of FP&A Responsibilities

a. Ensuring that the Company’s forecasting process can forecast all of the inputs into the Financial Model.

b. Ensuring that the most recent, approved financial plan or forecast are used in the preparation of the inputs into the quarterly Financial Model.

## 9. SOX Manager Responsibilities

Evaluating as appropriate, but at least annually, the controls over:

a. The fully conformed debt agreements, reflecting all amendments, used by the Compliance Team, the Treasurer, the CLO, and the CFO.
b. Calculating the financial covenant ratios.
c. Calculating the amounts in the permitted baskets.
d. Developing and updating a Covenant Checklist.
e. Reviewing the quarterly testing of the Covenant Checklist.
f. The process for ensuring that all regularly scheduled deliverables (financial statements, CFO letter, special reports, etc.) have been delivered on time.
g. Obtaining management signoff that the Company is in compliance with all covenants before the Officer’s Certificates are released.
h. The archiving process for all debt compliance work papers and communications about debt compliance with the lenders.

## 10. Compliance Manager and Compliance Team Responsibilities

a. Quarterly, gather, validate, evaluate and summarize the information necessary for the preparation of the Financial Covenant Ratio Analysis, Permitted Baskets Report, and the Exception Report.

b. Interact as appropriate with the Respondents and Reviewers, ensuring the individual Respondents and Reviewers are the appropriate people for the questions about their assigned Covenants, making changes where necessary.

## 11. Respondent and Reviewer Responsibilities

a. Informing the Treasurer or the Treasurer's delegate on an accurate and timely basis all questions the Treasurer may have regarding the Company's compliance with its Covenants.

b. Answering or reviewing requested sections of the Questionnaire as required to their best of their knowledge as would be expected given their position and responsibilities.

c. **Immediately informing** the Treasurer, the CLO, the CFO or the Compliance Manager of any event, potential event or possible Company action that may cause the Company to be in violation of an assigned Covenant.

d. Neither a Respondent nor a Reviewer are to make any judgment about whether the required Covenant information is too immaterial to be reported. All such information shall be reported, however immaterial it may appear to be, because an objective of this Policy is to pro-actively manage potential debt compliance breaches before they become serious enough that they need to be reported to the Lenders.

## 12. Audit Committee of the Board Responsibilities

a. Approving this Policy

b. Annually reviewing the Company's compliance with its Covenants

## 13. Policy Changes

The Treasurer has the responsibility for updating and maintaining this Policy, including ensuring that the Exhibits are accurate. Any changes in the existing Agreements or any new Agreements require at a minimum a revised Covenant Checklist, and could include revised Questionnaires, a revised Financial Model, or a revised the Permitted Baskets Analysis, all of which would need the appropriate approvals.

The CFO has the responsibility for approving all changes and modifications to this Policy prior to its submission for the approval of the Audit Committee.

**Optional Exhibits:**

**A. Covenant Checklist**

**B. Listing of Respondents and Reviewers by Covenant**

**C. Listing of the Covenant Questions**

**D. Financial Covenant Ratio calculations**

**E. Listing of Permitted Baskets with limits**

**F. Approval Process for Adding New Permitted Basket Items**