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CORONAVIRUS: INVESTMENT GRADE LENDING: IMMEDIATE FINANCING CONSIDERATIONS FOR BORROWERS, UNDERWRITERS AND LENDERS

The global escalation of the Coronavirus (Covid-19) pandemic is likely to lead to an increased demand for working capital, even amongst investment grade corporate borrowers. Whilst the prevailing hope and expectation is that the current dislocation is temporary, interim liquidity needs may pre-empt new credit lines or utilisation of undrawn lines. In addition the current climate may create potential disruption to routine reporting by borrowers and lead to enhanced information requests from lenders. Borrowers will want to carefully consider the impact of potential rating changes and the timing of any refinancings in terms of pricing more generally. Finally borrowers will want to carefully consider the impact of potential breaches and events of default, so as to approach their relationship lenders for any required consent or amendment well in advance of difficulty arising.

Key Consideration 1: Maintaining Liquidity

1. **New credit facilities and extension of existing credit facilities**: In such an uncertain environment, the first priority from a borrower financing perspective is likely to be to ensure robust sources of liquidity that are sufficient to enable the borrower to cope with any market disruption. This is particularly the case to the extent that traditional markets such as the commercial paper market are under strain and borrowers look to back up lines in their place. The logistical challenges arising from office closures and remote working arrangements are likely to reduce speed of execution. Borrowers and underwriters will want to plan ahead, as co-ordinating signatures to facility agreements and conditions precedent, and convening of board meetings for corporate approvals, may be a more intricate process than would usually be the case. Similarly it may be prudent to address any administrative matters, such as 'know your customer' processes, up front and to discuss commercial terms that require input from specialist teams, such as sanctions language, early in negotiations.

2. **Drawing undrawn facilities**: We are aware that a number of borrowers are analysing the drawstop provisions in their existing facility agreements. Some are considering whether to draw down undrawn facilities to maximise flexibility, notwithstanding the additional interest cost of doing so. This is particularly the case where general "material adverse effect" (MAC) or similar MAC events of default may make it difficult to satisfy the standard "no default" and repeating representation drawdown conditions if the Coronavirus situation deteriorates further. Whilst financial covenants are typically few and far between in investment grade facility agreements, where they do appear there may also be concerns about future financial covenant-related drawstops.
3. **Submission of utilisation requests**: Agency departments are understandably cautious about checking completed utilisation requests against specimen signatory certificates, in line with market practice. Borrowers may want to prepare a contingency plan to address potential logistical challenges; for example, by pre-signing signature pages that can be submitted with completed utilisation requests.
4. **Business Days**: The impact of any unforeseen public holidays, for example those declared in connection with a national state of emergency, should be taken into account both in terms of submission of utilisation requests and payment dates more generally.

Key Consideration 2: Monitoring Performance

1. **Reporting**: Borrowers with a 31 December financial year end will be approaching the date for delivery of their annual audited financial statements. It may be prudent for borrowers to review pending dates for delivery of information to ensure that they are able to fulfil the originally envisaged timeframes, for example if professional advisers are unable to carry out required audit work as planned. Similarly, in light of potentially more frequent communications to stakeholders, borrowers should be mindful of any contractual obligations to share with lenders copies of documents dispatched to shareholders or creditors generally at the same time as they are dispatched.
2. **Listing requirements:** Where a borrower is listed on a stock exchange, any emergency measures on the part of the stock exchange to address difficulties faced by companies in publishing annual results and dispatching annual reports may be considered appropriate temporary fallbacks by lenders and potentially agreed as an alternative to the contractual requirements in the facility agreement.
3. **Information requests**: Investment grade facility agreements typically require the provision of information in relation to the financial condition, business and operations of any member of the group if reasonably requested by any finance party via the agent. We may see an increase in such requests as lenders seek to stay close to client businesses and to understand the impact of the Coronavirus outbreak on actual and anticipated cashflows.
4. **Going forward:** Where new credit lines are put in place extended periods for delivery of financial information may be appropriate, at least for an initial window if not for the full tenor of the facility.
5. **Rating and pricing implications:** Where the interest rate margin for the facility ratchets according to the borrower's credit rating, borrowers should be aware of any requirements to report a change in rating that may arise. More generally, with the current market volatility for deals that have not yet been underwritten, we anticipate an increased likelihood of pricing increases and tightening of terms.

Key Consideration 3: Additional flexibility

Whilst the representations, covenants and events of default in investment grade facility agreements are usually relatively few in number, borrowers will need to guard against any prospective defaults.

1. **Representations:** In terms of the day one representations, relevant provisions could include there being no default under any other agreement which is binding on the borrower or any of its subsidiaries (subject to any material adverse effect qualification), information not being misleading (where the situation is changing rapidly and financial information or projections in an information memorandum risk becoming outdated prior to first utilisation), or in the financial statements representation (where careful consideration should be given to any material adverse change provision benchmarked against previous financial statements).
2. **Covenants:** To the extent financial covenants are included in the facility agreement, they will need to be carefully monitored by borrowers. Similarly the impact of any relevant general covenants needs to be taken into account, for example, the no change of business covenant which could apply to, for example, a change from manufacturing one product to another.
3. **Material adverse change**: The ability to use a MAC clause in the context of Coronavirus largely depends upon the actual wording of the clause, which will need to be analysed carefully. It is generally accepted that the hurdle for calling a MAC clause is high and lenders should be mindful of their potential liability if they use a MAC clause to accelerate when it is unclear whether a MAC has actually occurred. Our client briefing “Financial difficulties triggered by the impact of Coronavirus: Issues for stakeholders” and other Coronavirus (Covid-19) materials which you will find here, explore material adverse effect further, as well other issues including force majeure, identifying and notifying of events of default, and communication with stakeholders.
4. **Other Events of Default:** To the extent the facility agreement includes events of default relating to the suspension or cessation of business, these might also be relevant in the industry sector.
5. **Notification of default:** Borrowers are usually required to notify the agent of any default promptly upon becoming aware of its occurrence and should check their obligations under the information undertakings in this respect.
6. **Amendments and waivers:** Borrowers will want to assess the likelihood of a breach ahead of time in order to have the requisite amendment or waiver in place in advance, to avoid the risks of triggering cross-defaults in other agreements, to avoid the risk of triggering drawstops under the facility agreement and to avoid any risk of acceleration. Borrowers may find it helpful to give context to any such request, in terms of trading performance, cashflow projections and the general impact of Coronavirus on the borrower’s business. This allows lenders to make a more rounded assessment and to properly brief their internal credit teams.

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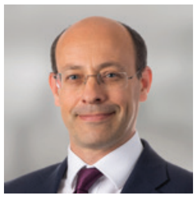

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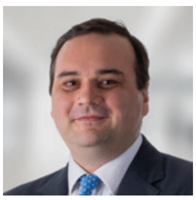

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