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Credit financing in times of COVID-19

The spread of the coronavirus has far reaching economic effects.

The banking industry is a major part of our society. As a result of the social restrictions caused by the coronavirus, borrowers suffer significant losses in sales and earnings or fear the malfunction of their business processes with serious financial consequences. Borrowers are exposed to the serious risk that they will not be able to fulfil their respective loan agreement any longer.

Credit agreements do generally not contain "force majeure" clauses which allow borrowers to suspend instalment or capital payments owed for the duration of a crisis. As a complicating factor, credit agreements often provide a possibility for the lender to call in the loan and demand immediate payment in the event of an economic crisis (in case of an individual crisis for the borrower or a public crisis).

In the following, we briefly highlight typical provisions in financing agreements that need to be given special consideration in connection with the Corona crisis:

MAC-clauses (Material Adverse Change)
Financing agreements normally contain MAC-clauses which grant the lender extensive rights. MAC clauses entitle the lender to terminate a loan agreement or to refuse further pay-outs if the net assets, financial position, results of operations, business activities or earnings prospects of the borrower have worsened or are expected to worsen significantly in the near future. MAC clauses are structured individually, their wording mainly depends on the leverage of the contracting parties during the contract negotiations.

MAC clauses must be examined on a case-by-case review, if the economic consequences of the corona virus on the business activity of a borrower may trigger consequences under the financing agreements. Lenders will usually not claim a breach of a MAC-clause as sole reason for terminating a loan but will also claim a breach of contract based on the borrower not reaching its the financial key figures agreed upon in the documentation.

Financial key figures
Credit agreements mostly oblige borrowers to comply with certain financial key figures and to provide detailed information to the lenders in this regard. Requiring financial key figures is a classic early warning system for the lender, to be informed on the borrower's economic circumstances and changes or worsening on them. Examples for these financial key figures are the net-debt ratio or the debt-coverage ratio, which are set in relation to the borrower's economic reference value (e.g. EBITDA).

Borrowers are obliged to inform their lenders on an ongoing basis whether the relevant financial key figures are being met and need to issue an immediate warning if this is not happening. A failure to comply with the financial key figures or a breach of the duty to inform typically constitutes a reason for termination by the lender.

The review of financial key figures in connection with the coronavirus crisis is especially important for the borrowers. At first the financial key figures must be maintained, which is increasingly difficult because of corona-related decrease of sales. Secondly, the key figure compliance must be operationally monitored by the borrowers, which must be ensured despite a high level of sick leave. The borrowers must therefore ensure, especially in the time of a crisis, that the corresponding contractual obligations under the credit agreement are still observed and reviewed in order to prevent an agreement termination by the lender.

In order to avoid the harmful consequences of a breach of the financial key figures, the borrowers should inform the lender in good time before the possibility of a potential breach and need to apply to the lender for a waiver to refrain from the right of termination.

Risk of cross-default
Credit agreements normally contain an option for the lender to terminate the contract if the borrower is not able to fulfil its financial obligations to other creditors anymore. Due to the current economic situation, it is highly recommended to assess whether there is a risk of cross default.

Relevance for funding-commitments

Credit institutions mostly already include a MAC-clause in their commitment letters, which means that a credit institution has the possibility to withdraw its funding-commitment in case of a significant worsening of the applicant's economic situation. Furthermore, commitment letters often contain a market-flex clause, allowing the credit institution to adjust the pricing of the loan if this gets necessary due to market changes.

GTC, general terms and conditions

Irrespective of the already mentioned contractual provisions, the General Terms and Conditions of credit institutions normally include an additional extraordinary right of termination by the lender if the financial situation of the customer is worsening or is endangered to worsen.

Recommendations for practical procedures

As set out above, the crisis caused by the coronavirus could have far-reaching consequences for existing and future creditor relationships. It is necessary to assess the individual clauses of your credit-agreements for their relevance in the current crises, especially the points mentioned above and if necessary, approach your lender proactively to find a joint solution for all parties involved.

We would happily advise you, help with the review of your loan agreements and the followed negotiations with your financial institution.

Our partner Dr. Matthias Steyrer, LL.M, MBA, specialised in banking and financial law, is at your disposal for questions in connection with financing.

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We point out that the legal situation can change constantly, but we are on effort to keep the contents up to date.