COVID-19: PRESSURE POINTS: FINANCE BRIEFING (UK)

18 May 2020 | UK
Legal Briefings

In recent weeks we have been working with many UK corporates to support their immediate liquidity needs and to plan ahead, ensuring businesses are in good position to weather the COVID-19 storm. In this briefing we provide a snapshot of our views of the latest UK corporate debt and treasury trends:

NEW FINANCINGS - NAVIGATING NEW AND EXISTING ROUTES TO ADDITIONAL DEBT

- **Covid Corporate Financing Facility (CCFF)** from HM Treasury/Bank of England – there is huge interest amongst corporates around how to access the CCFF commercial paper programme and regarding eligibility (including for non-rated corporates), process and next steps. We have already helped a number of UK corporates in setting up their programmes so they have access to this liquidity should they need it. As the most well established Government CoVid financing response and given its wide application to corporates (investment grade or equivalent) we have provided a separate update on it below.

- **Covid Large Business Interruption Loan Scheme (CLBILS)** – here the government will provide a guarantee of 80% to enable banks to lend up to either £25m or £50m to UK corporates (depending upon size of turnover). This is an alternative to the CCFF and is implemented through a number of accredited lenders. As a commercial lending arrangements though it is subject to bank credit committees processes which we address below and certain solvency criteria. It was launched later than the CCFF and this is reflected in the low numbers of completed CLBILS loans.

- **Covid Business Interruption Loan Scheme (CBILS) and Future Fund** – financing facilities targeted at smaller corporates. Given the amounts available (max £5m) we have not focussed on them here.

- **Existing Credit Facilities:** Where possible, corporates are exercising accordion features increasing their bank facilities and/or putting in place additional liquidity lines to ensure they have sufficient liquidity going forward. Corporate bank loan markets remain active, banks remain broadly supportive (depending on the sector/business) but are nervous. Increasingly not all banks are participating in facility extensions or incremental liquidity facilities but, even if not, will approve the corporate entering into them with other banks.

- **Bank Commercial Lending Terms:** Signs that cost of capital and credit concerns are driving higher pricing for new financings and incremental liquidity facilities, more conservative lending behaviours (eg pushing for shorter tenors although there was evidence of this prior to CoVid19) and greater controls over borrowers' businesses.

- **CoVid Waivers:** We are seeing a number of CoVid related amendments and waivers including suspending financial covenants (for up to 18 months at the outside although less is more common), excluding the impact of CoVid from Material Adverse Effect provisions and waiving any suspension or change of business defaults and any defaults arising from audit qualifications and the inability to delivery audited financial statements. The initial hesitance of banks to accept these types of amendments appears to be abating although some waivers require fees to be paid. Greater concerns have been expressed as to whether US private placement consents will be obtained on the same basis or whether those processes will be much more time consuming and expensive. In any case, for a number of corporates the additional cost of these types of waivers and amendments is increased financial reporting and periodic projections as well as removing or suspending certain activities such as acquisitions, distributions and incremental debt without bank consent often together with reduced permitted basket sizes.

- **Refinancing processes:** some refinancing processes are being postponed in favour of short term facility extensions (typically 1 year) with the expectation that refinancings will be dusted off in Q3/Q4.

- **Bank credit processes**: are taking significantly longer than pre-CoVid due to the volume of lending applications they are dealing with. A period of a month is not unusual for refinancings and new financings whereas a shorter timetable can be expected for CoVid related amendments and waivers.

- **DCM:** The markets remain open for investment grade corporates with a number (for example utilities) taking advantage of the current availability of long term cheap fixed rate funding in this market.

- **USPP:** The USPP market is open and active for investment grade corporates but covenants and other key monetary terms are less issuer friendly. Waiver and consent processes are active, with a lot of large corporates surprised at the fees that agents are charging to navigate the processes where in normal times would be done for relationship basis or at minimal fees.

- **ESG:** Remains a feature of new debt raisings but understandably is much less of a discussion and negotiation topic than prior to the pandemic.

PRESERVING CASH AND IMPROVING WORKING CAPITAL

- **Preserving cash:** Intense focus on preserving cash through, for example, deferring defined pension benefit deficit repair contributions. Pension trustees have proved amenable to deferring payments provided that they have alternative recourse, such as security or a bank letter of credit. We pick up on this below.

- **Working capital:** Significant interest in both recourse and especially non-recourse receivables financing arrangements as a way of improving working capital. Key issues for corporates are ensuring that they are permitted under their existing financings and that the terms are sufficiently robust that they do not represent material cross-default risk to a corporate's principal financings.

- **Payment deferral:** Many corporates are discussing the deferral or adjustment of payments to suppliers and counterparties, including real estate rents in order to preserve cash. As with any discussions of this nature, corporates need to be careful to ensure that the way in which this is approached does not trip events of default in their principal financings.

- **Interplay with existing financings:** The types of steps identified above in this section are often regulated by a corporate's principal financings and care must be taken to ensure that they are implemented without breaching the terms of those financings. We are working closely with corporates to help navigate through these issues. For example, it is important to consider less obvious consequences of certain actions eg agreeing extension to payment terms with suppliers the negotiation of which might trigger an event of default or re-characterise those arrangements as debt for the purposes of financial covenants and restrictions on incurring debt.

- **Derivatives:** current expectations of continued depressed interest rates to stimulate economic activity means interest rate swap markets remain at pre-crisis levels, however volatility in foreign exchange markets has seen significant demand for hedging FX risk. Large fluctuations in equity and debt markets have seen renewed focus on strategic equity and credit transactions for clients looking to monetise or hedge significant equity and debt positions, and the turmoil in the commodities markets (particularly oil) means the benefits of existing hedges are increasingly apparent.

DEFERRING AND REDUCING PENSION CONTRIBUTIONS

- We have advised several corporates with defined benefit (DB) pension schemes that have reached agreement with their scheme's trustees to defer deficit reduction contributions and other payments (e.g. to cover scheme expenses) to the scheme. Legal advice should be sought before any approach is made to the scheme's trustees to avoid triggering banking covenants or other unintended consequences.

- We are also advising sponsors and schemes that are in the process of concluding or preparing their scheme's valuation and recovery plan on how these may be adjusted to take account of current conditions and liquidity constraints.

- Employers with defined contribution (DC) schemes may also consider reducing their employer pension contributions for furloughed staff or more generally.

CCFF: AN UPDATE

- We have been doing a lot of work with corporates around tapping the government/Bank of England Covid liquidity programmes. For instance we have spoken with over 30 clients about the CCFF, many of whom have had or are in the process of having applications approved.

- Several corporates need access to funds quickly and have issued under those programmes.

- Many others who don't need access to the extra liquidity now and/or who don't have commercial paper programmes already set up are also applying. The view being they'll take the time now to set up their commercial paper programme and get their CCFF application approved such that in the coming months they can access the CCFF liquidity should they need it if only to reduce their cost of funding.

- The CCFF is discounted so it provides short-term cheap debt. As a result some companies have borrowed under it and repaid more expensive bank debt. It is pretty straightforward even for companies without formal ratings/commercial loan programmes.

KEY ISSUES ON CCFF

- **Eligible Issuers**: The CCFF is intended to be available to companies who "make a material contribution to economic activity in the UK".

- **Eligible securities**: The BoE will purchase sterling-denominated commercial paper of eligible issuers provided that it has certain characteristics: (a) a maturity of 7- 364 days, (b) where available, a minimum short-term credit rating of A-3 / P-3 / F-3 from at least one of Standard & Poor's, Moody's and Fitch as at 1 March 2020 and (c) issued directly into Euroclear and/or Clearstream.

- **Ratings**: The eligibility application form requires ratings to be included and if not, confirmation of whether the issuer has initiated the process to gain a private rating from one of the credit rating agencies. Issuers who do not wish to engage with the credit rating agencies at this time can contact their commercial bank counterparties in the first instance to check whether they would consider the company to be equivalent to investment grade as at 1 March 2020. The Bank of England will ultimately make its own assessment of whether the issuer is deemed as equivalent to having a public investment grade rating (drawing on a range of information in order to make this determination, including the commercial bank counterparty assessments referred to above).

- **Amount and Pricing**: The BoE will purchase commercial paper subject to individual issuer limits which are confirmed at the time of eligibility confirmation. It will purchase, at a minimum spread over reference rates, new commercial paper in the primary market via dealers and after issuance from eligible counterparties in the secondary market.

- **Confirmations**: Borrowing limits /no breach: In the eligibility application form, confirmation is required that (i) Group/Issuer borrowing limits will not be breached by issuing under CP programme, and (ii) there will be no breach of financial covenant/default by the Issuer or Group that is continuing or likely to occur by issuing under CP programme.

- **Form of CP documentation**: The commercial paper programme documentation is to be substantially in the form of the International Capital Markets Association recommended template ECP programme documentation (and if not, any material deviations need to be disclosed). For those issuers that do not currently have a commercial paper programme one can be set up relatively quickly (about 7-10 days).

- **Authorised dealer**: Issuers will need to appoint an authorised dealer for the process. The BoE has published a list of authorised dealers here: https://www.ukfinance.org.uk/covid-19-corporate-financing-facilities (all the main UK lending banks and several of the US banks)

More on COVID-19

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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