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Coronavirus COVID-19 and the impact on asset-based lenders and their customers

The outbreak of coronavirus COVID-19 represents one of the most significant global public health crises in recent memory and is causing major disruption and unprecedented volatility in markets, economies and businesses. With such great social and economic uncertainty, it is inevitable that existing financial arrangements will be affected and asset-based lenders (ABLs) are not immune to this. They are, however, uniquely positioned – given the flexibility of the products they offer – to react to the ever-changing economic landscape.

This post provides a high-level overview of some of the issues which may affect ABLs and their customers as the economy reacts to the outbreak:

- Companies using receivables facilities should consider the impact that the economic unrest may have on operational covenants within their facility agreements, as debtors inevitably look to stretch their creditors while cashflow is affected. Debt turn covenants are likely to be strained, requiring formal waivers to be granted and customers may look to increase concentration limits allowing for continued funding, as sectors, particular businesses and even countries react and recover at varying speeds. Undoubtedly, some debtors will claim contractual rights for non-payment (force majeure, for example), which could lead to protracted legal review and recovery processes which would not typically be factored into a receivables purchaser's exit strategy.

- Because of the shift in social behaviours and government advocation for social distancing, on a practical level ABLs and borrowers alike should consider whether or not it is possible for on-site audits and valuations to be undertaken. An inability to conduct such audits and valuations may lead to issues regarding accuracy of reporting relating to funded assets, the ability to verify an underlying borrowing base and up-to-date availability calculations. Indeed, in a world of hastily arranged, siloed working arrangements, will the relevant financial controller have the means to provide reports on funded assets, deliver accurate borrowing base certificates or even have the ability to upload invoices to the system?

- Over the last few days we have seen borrowers such as Kraft Heinz, AB InBev and Boeing fully draw their revolving credit facilities in a race to obtain cash to meet their liquidity needs over the coming months. Supply chains are inevitably to be affected by the outbreak and, consequently, borrowers may see their borrowing base depleted by a decrease in inventory which is eligible for funding. This could arise due to the fact that such inventory is not in their possession or is not located at specified premises, resulting in its failure to meet the eligibility criteria. Negative impacts in availability will therefore prohibit the borrower's ability to maximise potential drawings under their revolving facilities, at times where cash in the company's accounts becomes a priority.

- Receivables financiers funding entire ledgers may be exposed to a greater risk of debtor insolvency, where they are not afforded the luxury of cherry-picking the traditionally safer blue-chip receivables for funding. In such circumstances, the financier may consider applying pre-emptive reserves, lowering debtor concentration limits restricting exposure to specific debtors, industries or geographical locations or designating debts owed by those riskier debtors simply as ineligible for funding.

- We have seen much in the press regarding the apparent reluctance in the insurance sector to pay out under business interruption policies in respect of claims relating to coronavirus COVID-19. As debtor insolvency numbers rise, so will the number of claims made against credit insurance policies and it remains to be seen how successful these claims will be and the timeline for obtaining any such proceeds if successful.

- As acknowledged by Rishi Sunak, Chancellor of the Exchequer, SMEs are likely to be greatly affected as a result of the outbreak. ABLs are exposed to an increased likelihood of fraud and/or misappropriation of funds, particularly in smaller businesses without a centralised finance function, at times where cashflow is affected. "Fresh air" or "ghost" invoices may be raised by businesses to alleviate pinch-points, or remittances used to pay ongoing operational costs (rent, wages, bills etc.) to keep the business running, as opposed to turning funds over to the receivables financier. Ensuring that remittances are instructed to be transferred to the correct trust account is pivotal, businesses will fall under greater scrutiny regarding their debt collection process and the provision of accurate information relating to the underlying debts – despite the difficulties arising as a result of social distancing – will become of increased importance as the economy and ABLs continue to react to the outbreak.

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