



24 March 2020

Overview

The world is in an unprecedented situation with the outbreak of the 2019 novel coronavirus (officially renamed, "COVID-19"). Numerous countries have instituted stringent policy measures to prevent the spread of the outbreak. While, for now, such policy measures comprise of widespread travel restrictions, workplace closures, city-wide lockdowns and mandatory quarantines, with the World Health Organization having declared COVID-19 as a pandemic, there are growing concerns of restrictions on trade with infected regions being imposed soon.

COVID-19 has now started leading to disruption of businesses across sectors and jurisdictions, which will have a direct impact on financial markets and products. In India, the banking sector continues to operate despite COVID-19. The main measure imposed by the regulator is in the context of business continuity which brings into focus the contingency plans and business preparedness of such banking firms and the expectation of the financial regulator in such times. It is important that banks, financial institutions and corporates are aware and prepared for legal issues and challenges that COVID-19 will pose on their financial and commercial arrangements.

Most important from a financing perspective is the timing of COVID-19 outbreak. March is a crucial month for any business in India, and this is particularly so for the banking / finance sector. Activities which impact the sector, such as finalisation of annual accounts, reflection of NPA provisioning in books, capital adequacy and other financial tests are all crucial, and undertaken with great vigour in March. Therefore, the timing of the outbreak brings with it the risk of significant deterioration in the books of a bank, as they would be faced with defaults on one hand, and significant reduction in funding avenues in on the other. Banks would look to the regulator for relaxations.

This edition of our series examines the impact that the disruptions caused by COVID-19 may have on financing documentation, the potential impact on lenders and borrowers, and the existing and potential response of regulators to the foregoing.

Loan Financing Documentation – Rights & Obligations

Performance of obligations by lenders and borrowers under loan financing arrangements will get delayed or disrupted because of the impact of COVID-19. The potential areas of concern under the loan financing documents, and a brief overview of how these concerns can be addressed are briefly discussed below:

- *Business Day* - Parties to a loan financing document should review the definition of business days in their financing documents. Business days usually means a day (other than a Saturday or Sunday) on which banks are open for general business in India (or anywhere else where the contract is to be performed). Since most of the State Governments have started declaring public holidays and suspension/closure of work due to COVID-19, parties should assess how these leaves/holidays will affect their obligations under the financing documents. Since business days are also relevant in cases of notices and grace periods, they will have bearing on when such notices become effective. Just because the banks are open, it does not necessarily mean that the corporate borrowers are also open and therefore calling an event of default, calculating grace periods and provisions like serving of notices would need to be properly analysed.
- *Force majeure / frustration* - Since parties may not be able to fulfil or comply with their obligations under the loan financing agreements due to COVID-19, the parties may assess the applicability of "force majeure" clauses that may be set out in such contracts. It is unlikely that loan financing transactions would contain force majeure provisions, like the ones usually seen in derivatives / structured products. Unlike a commercial contract, in financing transactions, borrowers would find it difficult to invoke this provision.

In case *force majeure* clause is not included in a contract or it is not applicable to the fact situation, then the doctrine of frustration (i.e., the performance of obligations of a party under a contract will be impossible or untenable due to an intervening or supervening event) may be sought to be applied to such contracts. Similar to force majeure, unlike a commercial contract, doctrine of frustration would be tough to argue in case of financing transactions.



24 March 2020

We have, in an earlier edition of our series, discussed the issues of force majeure and frustration in greater detail. Please reach out to us for a copy of the same if you have not received it.

- **Reporting** - Almost all loan financing documents contain certain reporting requirements (in the form of financial statements, auditors certificates, and in some cases, technical advisors certificates), that borrowers are required to adhere to. Due to the impact of COVID -19, borrowers or their technical advisors may not be in a position to perform or fulfil such reporting requirements in a timely manner. This would also be relevant from the perspective of certain other regulators / authorities, who have granted additional time for certain kinds of reporting (MCA / SEBI for example). Parties to loan financing documents should be proactive in considering whether flexibility can be provided in complying with these reporting requirements. Such reporting obligations may be waived or extended so as not to result in a breach of such provisions under the loan financing documents.
 - **MAC** - Typically, loan financing documents contain material adverse change (MAC) clauses. These clauses essentially provide the rights of a party to terminate a contract in case of occurrence of events which materially alters the financial condition, business, property, prospects of the counter party. Whether the MAC clauses can be used in the in the context of COVID – 19 depends on the construct of the clauses, and these must be examined carefully.
 - **Events of Default and Waivers** - Responsibility of Borrowers: Loan financing agreements set out a number of events which may be considered as an event of default vis-à-vis the borrowers, and thereby resulting in acceleration or termination of such agreements. It becomes imperative for the parties to assess the clauses in the loan financing documents. If any obligation of the borrower (such as repayment, information covenant, representations or any other performance) is impacted due to COVID-19, then the same should be intimated by the borrower to the lenders and suitable extensions or waiver from the lenders for performance of such obligations should be obtained, so that they are not considered as an event of default / termination event. Borrowers should clearly state the reasons for waiver or extensions and explain the impact COVID – 19 has had or will have on their businesses. This will help lenders in arriving at their decisions in an expeditious manner.
- Borrowers should also ensure that they continue to perform obligations which are not impacted by COVID-19 events so that they are not in breach of such obligations in loan financing documents.
- **Suggested Borrower Strategy:** Borrowers may consider one or more of the following strategies:
 - Reach out to lenders with a plan: identify covenants that will likely be breached and write to lender groups with an alternate plan for compliance that is practically feasible with specific revised timelines; to be structured as a waiver for a limited period. Advisable to seek an “alternate compliance waiver” as opposed to a blanket waiver without any defined time periods.
 - Map repayment schedules with cash flow: to the extent possible, informally communicate revised repayment schedules to match cash flow; and again, to the extent possible, try and work out repayment schedules that will not require any provisioning of assets by lenders as an NPA.
 - Adequacy of security: evaluate existing security structures; identify alternate pools of security that may be used to strengthen security packages (particularly in LAS structures).
 - **Events of Default and Waivers** - Responsibility of Lenders: It is certain that banks and financial institutions are going to receive requests from the borrowers for waivers from performing their obligations. This is all the more relevant in light of the approaching financial year end. Lenders must be prepared to deal with such requests of waivers and must have a coordinated approach within the system to deal with the same. Lenders should also be mindful of the fact that these such waivers may be required to be granted within the timeline specified in the financial documents, which will require close examination of the loan financing documents to avoid disputes at a later stage.

Banks and Regulatory Measures

At present it appears that the Reserve Bank of India (RBI) will continue to hold the expectation that banks continue with their business operations and regulatory obligations, given the role banking sector plays in the economic growth and stability, both at national and individual level, which requires continuous and reliable services. However, there are important considerations that regulators and banks will have to bear in mind, including the following:



24 March 2020

- **General Business Continuity Planning Measures:** The RBI in 2011 had issued guidelines pursuant to a working group committee report led by Mr. G. Gopalakrishna, which recommended that banks should set up *business continuity plans* (BCP) as part of a bank's overall business continuity management, for "preparedness of an organisation" during a disaster/pandemic, which includes policies, standards and procedures to ensure continuity, resumption and recovery of critical business processes, at an agreed level and limit the impact of the disaster on people, processes and infrastructure; or to minimise the operational, financial, legal, reputational and other material consequences arising from a disaster/pandemic.
- **Special Business Continuity Planning Measures:** On March 16, 2020, the RBI released operational and business continuity measures for regulated entities in light of COVID-19 outbreak, highlighting banks to take stock of critical processes and revisiting their BCP and suggested additional measures such as:
 - devising strategy and monitoring mechanism by regulated entities to stop the outbreak amongst its employees;
 - taking stock of critical process and revisiting business continuity plans by regulated entities with aim to continue critical interfaces and preventing disruption of services;
 - assessing the impact of Covid-19 on the balance sheets, asset quality, liquidity by the regulated entities; and
 - encouraging their customers to use digital banking facilities as far as possible.
- **BCP Compliance:** Banks are critical to the economy and therefore they should evaluate and revisit their BCP norms. At present, there is no specific regulation issued by the RBI or regulatory guidance which permits 'temporary' shutdown of a banking businesses in India in such times. To the contrary, banking is deemed as "essential service" and there is a requirement that these services continue to be provided. Each bank have their own set of peculiarities in terms of their product offerings, bank branches etc., as they have functions which are 'customer facing' such as bank branches and centers and 'back end' such as headquarters, IT, data centers and call centers. The norms applicable to these entities, including on the basis of guidelines issued by State Governments would require close examination. It is also important that Banks continue to maintain a dialogue with the RBI regarding their ongoing steps and measures that are being taken during such time to ensure compliance and banks should at all times keep their customers informed regarding the steps that are being taken and the services that may get impacted during the COVID-19 outbreak.
- **Asset Classification and Provisioning:** In the already existing stressed financial markets, Banks and financial institutions will be faced with additional burden on asset classification and provisioning for bad assets. As this is not just an industry specific issue (as was the case with infrastructure in the past), the regulator may need to consider blanket waivers / relaxation on SMA-0/1/2 and NPA classifications and consequential reporting. Similarly, the burden that the NCLTs / DRTs in specific may face on account of such defaults which is inevitable would also need to be considered and evaluated.
- **Seek Timely Advice:** The impact is global and no person / industry is alone. Any bank / financial institution / corporate house which *feels* that its businesses are getting impacted and / or they require guidance on compliance / functioning norms, should seek appropriate legal and professional help to evaluate their options and find remedies in a timely manner.

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