



Risks in Lending Transactions During COVID-19 Period

Issue	Affected party	Description	Risk Analysis	Resolution
Commitment to lend under existing finance arrangements	Lender	COVID-19 is likely to affect obligations of lenders to continue funding committed facilities. Lenders may be unable or unwilling to continue lending under the terms of the committed facilities.	Refusing to lend in accordance with existing agreements could potentially expose the lender to both reputational and legal risk. Unjustified refusal to lend could constitute breach of contract.	(a) Review terms of existing finance documents to assess whether there are justifiable reasons that the lender can invoke to stop lending. Example, is the borrower unable to satisfy certain condition precedents, say has a material adverse change occurred? (b) Consider alternatives e.g. extend availability period so that the borrower can satisfy certain identified conditions.
Non-fulfilment of certain financing conditions	Borrowers	During this period, Governments around the globe have issued directives such as lockdowns and social distancing measures which have disrupted business. Owing to this, borrowers are likely to fail to satisfy certain financing conditions e.g. failure to satisfy perfection requirements due to closure of public registries or failure to provide wet ink signatures in a transaction.	Parties may be unable to achieve financial close due to failure to satisfy certain financing conditions. This means no funds for the borrower to utilize for the intended objective which could impact contractual obligations to third parties. Financiers who have already disbursed funds before completion of perfection formalities remain unsecured for an uncertain period of time due to the	(a) Parties in finance transactions should review completion checklists for existing finance arrangements to check exposure due to non-satisfaction of conditions subsequent and seek remedial measures. (b) Parties to seek amendments to existing financing arrangements and obtain the necessary internal approvals to modify financing arrangements. (c) Parties who, upon risk assessment, have agreed to proceed with disbursement and utilization to consider appropriate waivers pegged to certain timelines subject to seeking the required internal authorisations.

			Government directives and face regulatory risks and credit risks.	(d) Financiers who have already disbursed subject to certain conditions subsequent being met to review such conditions against the timelines given and take the appropriate actions.
Use of proceeds of loan for specific purpose within stipulated timelines	Lenders/Borrowers	Finance facilities are granted to borrowers for specific purposes and must be utilized in accordance with the specific timelines agreed between the finance parties and the borrowers. This may not be achieved during this COVID-19 period. In fact, borrowers may, as part of their internal COVID-19 policies, determine that certain projects be halted and available funds be instead deployed to some other purposes.	<p>Generally, finance documents will state that lenders do not have obligation to determine that loan facilities will be used for the intended purpose. Borrowers however have an obligation to ensure that the funds should be utilized for the intended purpose and non-compliance with this obligation may lead to a mandatory prepayment obligation or an event of default.</p> <p>In the event of an insolvency, depending on the manner in which the purpose was specified by a financier (i.e. funds to be used for an exclusive purpose and segregated), such funds may be subject to a constructive trust (in law known as a Quistclose trust) and cannot form part of the insolvent estate of the borrower.</p>	<p>Borrowers should ensure that borrowed funds are used for the intended purpose despite strong temptations to divert the funds towards other objectives during this period. If a borrower feels strongly pressed to deploy borrowed funds to other purposes, then the borrower should first discuss with the financier.</p> <p>Lenders should monitor the use of proceeds of loans granted to borrowers even where the underlying finance documents say they do not have to. This will enable a lender invoke the rights or actions available to it to secure the funds.</p>
Insolvency	Creditors and debtors	<p>Under the Insolvency Act (No 18 of 2015 laws of Kenya) (IA), there are two tests that can be used to determine if a person is insolvent or not:</p> <p>(a) Test 1- the person is unable to pay a debt; and</p>	<p>(a) Transactions entered by insolvent persons are reviewable under the IA (meaning that they can be voided). This is a risk that all contractual parties should consider during this period.</p> <p>(b) There is a risk that other creditors could commence insolvency proceedings against a party during this period thereby affecting</p>	<p>(a) Review existing contracts and check how insolvency events affect the relationship of debtors with creditors. Certain insolvency events are drafted in a very wide manner and could be triggered by illiquidity. Seek professional advice if unclear.</p> <p>(b) Directors must review the status of their respective companies and familiarize themselves with their roles under applicable laws. We would recommend that directors seek professional advice to understand their obligations during this period.</p>

		<p>(b) Test 2- balance sheet test i.e. the value of the person’s assets is less than the amount of its liabilities.</p> <p>With the COVID-19 pandemic debtors may become (i) illiquid meaning that they have cashflow problems and not necessarily technically insolvent (ii) temporarily insolvent but with potential to reverse the situation post COVID-19 provided the pandemic ends within a certain period or (iii) insolvent.</p>	<p>performance of contractual obligations by the affected party.</p> <p>(c) Directors of companies facing insolvency issues risk personal liability for wrongful trading.</p>	<p>(c) Debtors should familiarize themselves with the pre-insolvency protections such as alternatives to bankruptcy for natural persons and voluntary arrangements for companies as well as the statutory moratorium provided under the IA and where necessary invoke these protections.</p> <p>(d) Creditors to assess the financial status of their debtors and make informed decisions based on their analysis. We recommend that creditors seek professional advice relating to insolvency when taking the necessary remedial actions.</p>
<p>Events of Default (EoDs)</p>	<p>Obligors</p>	<p>The following EoDs, among others, are likely to arise during the COVID-19 pandemic period:</p> <p>(a) insolvency events as indicated above;</p> <p>(b) breach of financial covenants by obligors due to decreased revenue during this period;</p> <p>(c) cross-default especially where it covers default by a member of a group due to the disruption of supply chains during this period;</p> <p>(d) non-payments whether or not caused by disruption events;</p> <p>(e) cessation of business due to the social distancing measures taken by governments around the globe;</p> <p>(f) expropriation especially in essential sectors where some</p>	<p>Occurrence of EoDs (and in some finance documents potential EoDs) entitles financiers to any of the following:</p> <p>(a) cancel any outstanding commitments from the financier;</p> <p>(b) accelerate the facilities and demand immediate payment of outstanding loans; or</p> <p>(c) declare that outstanding loans are repayable at any time on demand.</p> <p>This could also entitle the financier to exercise its security rights over the collateral provided by an obligor as security and also demand that guarantors pay the outstanding loans.</p>	<p>(a) Creditors and debtors should review underlying documents to understand the EoDs that apply to existing financing arrangements and the consequences of occurrence of EoDs;</p> <p>(b) Creditors and debtors should review business performance to determine if EoDs are likely to arise.</p> <p>(c) Use notice provisions in the underlying documents to communicate any potential or actual occurrence of EoDs and propose cures if possible or seek alternative solutions with financiers.</p> <p>(d) Enter discussions with financiers for:</p> <ul style="list-style-type: none"> ○ the default to be waived; ○ forbearance agreements to be agreed with the financiers; ○ the finance documents to be amended (and restated as appropriate);

		<p>Governments may likely nationalize certain critical entities such as pharmaceutical industry;</p> <p>(g) material adverse changes that could lead to material adverse effects; and</p> <p>(h) misrepresentation arising from breach of certain repeating representations such as compliance with the applicable law.</p>		<ul style="list-style-type: none"> ○ the facilities to be restructured as necessary; and ○ debt moratoria or grace periods to be provided. <p>(e) Look for remedial measures such as equity cures while being cognizant of the effect of such measures on any other existing contracts.</p> <p>(f) Seek professional advice relating to any of these issues.</p>
Roles of finance parties and other parties in finance arrangements	Finance parties	Finance parties have different specific roles set out in the various finance documents. During COVID-19, these roles could increase e.g. duty to communicate or act as instructed by other parties.	Non-compliance with provisions of the terms of the finance documents could have varied repercussions to the responsible party as set out in the finance documents.	Finance parties in syndicate transactions should review finance documents to sufficiently understand their roles and indemnities available due to the likely heightened administrative roles that could arise during this period. Finance parties should seek professional advice.
Information undertakings	Lenders and borrowers	Due to government directives in place to combat COVID-19, it may become difficult for borrowers to promptly furnish information required by lenders from time to time. It could be the case that the delay is on an obligor (internal inefficiency due to say, work from home measures) or third parties such as auditors who may be affected by similar challenges.	Failure to provide information promptly may trigger EoD if it constitutes breach of an undertaking. Additionally, it could affect calculations of finance covenants at the agreed calculation dates and thus lead to EoD.	Lenders and borrowers should work out ways in which to address the expected challenges in obtaining accurate information in a timely manner. Lenders should consider invoking the right to request for additional information from borrowers to obtain more information from borrowers to assess any anticipated issues that are likely affect a borrower.
Enforcement of security	Lenders	Due to government directives to combat COVID-19, it may be necessary to enforce security rights during this period. Enforcement may be delayed or become impossible during this period.	Lenders may be viewed as having a cavalier attitude to their customers if they enforce their security rights triggered by events associated with COVID-19. Out of court enforcement of collateral could be tricky due to challenges in sending notices to affected	Lenders should internally come up with a policy on enforcement of security during this period. In particular, lenders should consider factors such as regulatory issues, reputation issues, industry wide practice and prudential measures adopted by peers, ease of enforcement of collateral during this period and alternatives to enforcement.

			parties during this period. Enforcement of collateral in court could be delayed due to limited court operations during this period. Further, access to some collateral could be difficult due to the social distancing and lockdown measures.	
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If you have any queries regarding the financial services practice area generally, please do not hesitate to contact Peter Mwaura at pmwaura@mwlegal.com. Please note that this e-alert is meant for general information only and should not be relied upon without seeking specific subject matter legal advice.