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Coronavirus Impacts on Loan Documentation (Financial Reporting)

Steven S. Grieco, Partner | sgrieco@shumaker.com | 813.221.7427
W. Kent Ihrig, Partner | kihrig@shumaker.com | 813.227.2354



The disruptive impact of the current novel coronavirus (“COVID-19”) global pandemic on virtually all aspects of the social and economic fabric of the United States and most of the rest of the world is unprecedented in recent history and continues to evolve at a rapid pace. Like many practice groups at Shumaker, Loop and Kendrick, LLP, our Financial Services practice group has been continuously monitoring and assessing the current and likely future impacts of COVID-19 on our clients and their businesses. On March 19, 2020, we published our initial Client Alert addressing in general terms some of the potential issues relating to commercial loan documentation resulting from the COVID-19 outbreak and the unprecedented government policy initiatives designed to contain and minimize the spread of the disease ([Commercial Loan Documentation: Effects of COVID-19](#)). This Client Alert is the first supplement to our March 19 edition and focuses on borrowers’ financial reporting obligations under commercial loan documents.

Commercial loan documents generally contain multiple covenants. Affirmative covenants require the borrower, and in many cases guarantors and other obligors (collectively with the borrower, the “**Loan Parties**”), to undertake certain actions (such as paying taxes when due, compliance with laws, providing the lender with notices of certain events, permitting the lender with access to books and records, etc.) or maintain a certain status (such as maintaining certain financial ratios (often called “**Financial Covenants**”, which can sometimes be drafted as negative covenants), maintaining its legal existence and good standing, maintaining insurance, etc.). Negative covenants, on the other hand, prohibit the Loan Parties from undertaking certain actions or permitting certain events or circumstances to arise or exist (typically including restrictions on incurring other indebtedness, granting or permitting liens on the Loan Parties’ assets, paying dividends or other

restricted payments, entering into merger or consolidation transactions, selling material assets, entering into affiliate transactions, etc.).

Included among these loan document covenants are certain financial reporting obligations with which borrowers and other Loan Parties are nearly universally required to comply (collectively, “**Financial Reporting Obligations**”). Financial Reporting Obligations typically include some or all of the following (or variations thereof): annual financial statements prepared in accordance with Generally Accepted Accounting Principles (“**GAAP**”) (and often audited by independent accountants acceptable to the lender); quarterly GAAP-compliant financial statements (which, for larger borrowers, may be required to be reviewed by independent accountants acceptable to the lender); monthly internally-prepared financial information; compliance certificates with financial covenant calculations demonstrating compliance with Financial Covenants (delivered with the annual and quarterly financial statements); annual budgets/projections; copies of federal and state income tax returns; and, in the case of guarantors that are natural persons, annual personal financial statements disclosing account balances and other “balance sheet” information for such guarantors.

Loan Parties are required to comply with these Financial Reporting Obligations within specified timeframes. For instance, annual, quarterly, and monthly financial statements are required to be delivered to the lender on or before a specified number of days after the end of the year, quarter, or month, as applicable, while tax returns are generally required to be delivered within an agreed number of days (often 30 days) after filing, but with an end date tied to normal extension deadlines for federal tax returns.

For publicly traded borrowers (or guarantors if borrower financial statements are consolidated with a publicly traded holding company guarantor), the annual and quarterly financial statements are generally required to be delivered within the 90-day and 45-day timeframes, respectively, prescribed by the U.S. Securities and Exchange Commission (the "SEC") for filing annual reports on Form 10-K and quarterly reports on Form 10-Q (assuming the borrower or guarantor, as applicable, is a domestic non-accelerated filer). Lenders and non-publicly traded borrowers (or holding company guarantors) negotiate similar reporting deadlines for the Financial Reporting Obligations in commercial loan documents, often holding larger private borrower groups to the SEC-mandated timelines to the extent possible, with smaller, middle market borrower groups given somewhat more time under negotiated commercial loan documents (generally, up to 120 days and 60 days for annual and quarterly financial statements, respectively).

With the dramatic increase in remote working arrangements in the current COVID-19 dominated environment, and dealing with resulting productivity challenges from, among other things, technological interruptions and less-than-ideal home office settings, it seems probable that adhering to the delivery timelines required by Financial Reporting Obligations set forth in current commercial loan documentation, and those prescribed by the SEC (to the extent applicable), will present challenges, and may prove impossible in the short term, for many borrowers and other Loan Parties, with internal finance teams and outside accountants all learning how to work efficiently and effectively in this new reality. Even delivering on annual Financial Reporting Obligations for 2019 may become problematic where outside audits are required even though the period being reported on was not impacted by COVID-19 containment policies.

The SEC publicly recognized the potential impact of COVID-19 on audit quality as early as February 19, 2020, indicating that it will "monitor, and to the extent appropriate, provide guidance and other assistance" to issuers, borrowers and market participants, although the focus of this statement was on financial reporting and audit quality (including considering whether "subsequent events" disclosures should be required) with respect to Chinese companies or other companies with significant operations based in China. Then, on March 4, 2020, the SEC announced "conditional relief" for filing obligations of publicly traded companies, including providing an additional 45 days to file certain disclosure reports. Public companies seeking such relief must show why such relief is needed in its particular case. Although the SEC has issued additional relief for certain market participants affected by COVID-19, it has, as of this writing, stopped short of issuing a blanket, generally applicable extension for financial reporting requirements of public companies.

Commercial lenders will need to monitor further actions and statements by the SEC to align Financial Reporting Obligations in commercial loan documents with public company Loan Parties. In addition, private borrowers and commercial lenders should review their current loan documentation and be proactive in anticipating, communicating, and addressing, as appropriate, difficulties Loan Parties will likely have in complying with current applicable Financial Reporting Obligations as result from this crisis.

Lenders should understand the need for flexibility for certain borrowers experiencing problems complying with Financial Reporting Obligations. However, lenders will also need to conduct the diligence necessary for the flexibility to be tailored and minimal so practical borrower hardships are balanced with increasing lender credit risk exposure. Lenders should test and verify timing difficulties with Loan Parties and, to the extent applicable and possible, any outside auditors of the Loan Parties, to minimize any extensions in Financial Reporting Obligation compliance by Loan Parties. Lenders rely heavily on Financial Reporting Obligations to test Financial Covenants and provide "early warning" of looming credit issues that may require proactive solutions to protect the lender's credit exposure. Informed and tailored timeline extensions will help lenders and Loan Parties avoid being "surprised" by default scenarios that could significantly deteriorate further by delay-for-delay's sake.

For the most up-to-date legal and legislative information related to the coronavirus pandemic, please visit our Shumaker COVID-19 Client Resource Center at shumaker.com. We have also established a 24/7 Legal & Legislative Helpline at 1.800.427.1493 monitored by Shumaker lawyers around the clock.

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