

# COVID-19: Considerations for EU Receivables Sellers

## In brief

The COVID-19 pandemic has significantly affected market participants in different ways. This alert focuses on the specific impact of the COVID-19 pandemic on sellers of receivables - whether as securitisation originators or as sellers directly to banks or factors. We will collectively refer to receivable sellers as "originators" in this article.

At this stage, in relation to existing transactions, originators should consider:

- identifying their rights and obligations under the transaction documents (including any covenants to maintain rating levels or to meet any tests applicable to them or the assets);
- detecting any actual or potential breaches of covenants and undertakings;
- determining whether short term measures (e.g. payment holidays, waiver of late payment fees, discounts) are permitted under the transaction documentation;
- seeking appropriate solutions to address any actual or potential issues identified, including but not limited to seeking waivers or consents to amendments to the transaction documentation; and
- adjusting their internal processes and systems to reflect any changes to their obligations, to market conditions and to enable them to operate as efficiently as possible in the current environment.

These challenges present a renewed opportunity for originators to revisit their existing arrangements, identify issues and plan for the future.

## In depth

The COVID-19 pandemic is having a widespread impact on all market participants and originators are not an exception. While the current economic environment poses challenges for all originators, the nature of these challenges depends on the structure of each transaction and the roles undertaken therein by originators.

### General considerations for originators

In the current environment, certain obligations and undertakings that would not typically be a source of potential concern for originators - such as general corporate covenants - should be carefully monitored, as exceptional circumstances may trigger unexpected breaches.

For instance, as a result of the COVID-19 crisis:

- any delays in the publication and filing of accounts (either as a result of guidance issued by the relevant authorities and/or of the extension of the applicable deadlines) and any issues in relation to the auditing of financial statements may impact compliance with information covenants;
- compliance with covenants restricting corporate reorganisations (in particular if those covenants are broadly drafted) may need to be carefully assessed if certain measures are adopted in relation to the originator's business;
- covenants relating to the suspension of business may need to be closely monitored if temporary restrictions on the activities of originators are envisaged; and

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- certain arrangements with creditors entered into in the current context may be caught under insolvency-related covenants.

In relation to all existing transactions, originators should revisit the content of existing general covenant packages and assess compliance in light of the current situation.

Additionally, originators should continue to observe their obligations under the applicable legislation, including compliance with disclosure obligations under Regulation (EU) 2017/2402 (the "**Securitisation Regulation**"). For further information on this topic, please refer to the briefing entitled 'EU Securitisation Regulation Disclosure in times of COVID-19' (available [here](#)).

## **Originators as sellers**

In securitisation transactions an originator will typically transfer receivables to a special purpose vehicle in exchange for a payment made by the special purpose vehicle (using proceeds of the issuance of notes or another form of financing). For other transactions, the originator will transfer the receivables to a bank or factor who will hold those assets directly on its balance sheet.

### **True sale, perfection events and debtor notification**

If the transaction has been structured to include a "true sale", a transfer of assets should not be subject to challenge upon the insolvency of the seller (other than, in some jurisdictions, possible claw-back). However, it is common practice in some jurisdictions (e.g. in England) for the seller to retain legal title to the assets while the special purpose vehicle acquires beneficial title to such assets often through an equitable (or undisclosed) assignment. In those cases, transaction documentation usually provides that, upon occurrence of certain events in relation to the seller (including rating downgrades, deterioration in financial condition and/or prospects and insolvency), the requirement to transfer legal title from the seller to the special purpose vehicle (or another entity designated to act as legal title holder) is triggered, requiring all underlying borrowers / customers to be notified of such transfer of legal title.

In some other jurisdictions, legal title to assets can be transferred without debtor notification being required, through an undisclosed assignment. Even in such jurisdictions, transaction documentation typically includes certain debtor notification triggers. This ensures that, following notification and transfer of legal title to the relevant legal title holder, such underlying borrowers / customers will only be able to validly discharge their obligations by paying to the legal title holder (or in such manner as the legal title holder may direct).

Originators should consider whether these triggers have been met, what the consequences are under the relevant transaction documentation and whether any waivers or amendments should be sought.

### **Repurchase and other covenants**

Originators acting as sellers under existing transactions may be required to comply with repurchase obligations in relation to certain assets that are not compliant with asset warranties (as set out in the transaction documentation).

Additionally, the requirement to comply with eligibility criteria (often including criteria designed to limit the inclusion of delinquent or defaulted assets as of the date of transfer) and concentration limits on an ongoing basis may cause some originators to be required to substitute assets and replenish the asset pool.

It is important for originators to ensure that appropriate liquidity is in place to be able to comply with these obligations within the time frames set out in the relevant transaction documentation.

### **Private transactions with revolving pools**

In private transactions with revolving pools (usually found in motor finance and consumer credit asset financing and many trade receivables backed transactions), the typical requirement of ongoing compliance with eligibility criteria has prompted a surge in waiver and consent requests aimed at ensuring that assets that have had



payments deferred as a result of a COVID-19 relief measure will continue to be treated within the eligible funding base.

These requests raise a number of issues and have additional implications that need to be considered, such as the need to:

- establish criteria to define and identify the category of assets subject to COVID-19 measures (the "**COVID-19 Affected Assets**") - this category will typically comprise assets that were, until the inception of the COVID-19 crisis, (i) performing/non-delinquent, (ii) not subject to forbearance measures and (iii) which have been specifically identified by the originator / servicer as such in accordance with their documented policies;
- determine whether the COVID-19 Affected Assets need to be carved out from or included in any other tests and/or covenants (for instance, determining whether COVID-19 Affected Assets should still be included when testing portfolio covenants) and whether any different terms should apply to COVID-19 Affected Assets; and
- determine whether the maintenance of COVID-19 Affected Assets in the pool and their inclusion in tests and/or covenants could cause shortfalls and decide how those shortfalls should be addressed.

Additionally, still in the context of transactions involving revolving features, many asset financing arrangements include:

- "stop purchase event" triggers which may suspend arrangements whereby the assets originated are purchased by the special purpose vehicle; and
- "amortisation events" which may terminate revolving periods (and therefore stop the sale of further assets to the special purpose vehicle entirely).

These can be triggered upon the impairment of the creditworthiness or performance of the originator (as seller and/or servicer) or based on the performance of the portfolio.

Originators should factor in the possible suspension of purchase arrangements in their contingency planning and consider alternative sources of asset funding that can be accessed to absorb excess asset supply (including central bank liquidity schemes). Where possible, many originators are constructively discussing with bank funders and arranging banks temporary changes to documentation to allow purchases to continue.

### **Origination platforms and warehouse funding lines**

Mortgage and online lending platforms have emerged in the past few years as important tools for asset financing. Such platforms often involve an undertaking by the relevant originator to issue pre-defined volumes of assets to be purchased by a special purpose vehicle that will be the recipient of some form of finance. In an economically depressed environment, the maintenance of minimum origination volumes may prove challenging for some originators.

Originators should carefully identify any impact of a significant or abrupt drop of new origination volumes on existing covenants as well as any potential causes for suspension or termination of the agreed purchase arrangements, as this will enable originators to address them proactively.

### **Originators as servicers**

Originators often retain a role in securitisation transactions as servicers of the securitised assets.

In their role as servicers, the challenges posed by the current economic climate may include, among others:

- an impact on the standard of servicing agreed under the transaction documentation due to a marked increase of requests and higher frequency of delinquency and defaults (and resulting impact on collections);



- liquidity constraints caused by heightened demand of further advances, in case the servicer is required to make advances under the transaction documentation;
- limited ability of the servicers to take enforcement action due to moratoria and practical constraints;
- limited ability of the servicers to vary the underlying agreements outside the scope of permitted variations allowed in the transaction documentation; and
- impairment of the credit rating of the servicer, potentially triggering its termination and/or replacement under the relevant transaction documentation.

It should be noted that the replacement of a counterparty or the adoption of mitigation measures might prove difficult in the current context. Waivers and consents may be sought in relation to these matters.

### **Contingency plans and liquidity arrangements**

Originators should consider implementing contingency plans and/or potentially seeking waivers or the relaxation of some covenants and undertakings. Review and assessment of liquidity resources and arrangements may also prove fundamental at this stage.

### **Back-up servicing arrangements**

Where back-up servicing arrangements are in place and will be actioned, emphasis should be placed on coordination with the incoming entity to ensure a smooth transition that is in full compliance with the requirements set out in the transaction documentation.

### **Originators as subordinated lenders and holders of the equity piece**

#### **Subordinated funding**

Originators are often involved in transactions as providers of subordinated funding. One of the key aspects for originators at this stage is to quantify the potential additional demand for subordinated funding under the transaction documentation and identify potential sources of funding available to them.

#### **Junior tranches**

When originators are holders of the most junior tranche or equity piece in the transaction, careful consideration must be given to the potential risk associated with these exposures and their impact on the originator's business. If the most junior tranche in a securitisation is the risk retention piece, it should be noted that there are important restrictions to the transfer and hedging of such retained interest under the applicable legislation.

### **Specific issues for originators of securitised trade receivables**

Most of the general considerations applicable to originators are also applicable to trade receivables securitisations. However, the current economic climate poses some additional challenges in this area for trade receivables originators.

### **Asset supply**

In addition to the above mentioned considerations in relation to transactions including revolving features, due to the predominantly short-dated nature of trade receivables, trade receivables securitisation transactions tend to be impacted by interruptions to the ability of originators to ensure a steady supply of trade receivables. This issue is magnified in transactions where notes or commercial paper issued are backed by a pool of trade receivables that is revolving and is supposed to be continually replenished. In contrast, in transactions that contemplate issuances of series or tranches notes or commercial paper backed by specific receivables this risk is mitigated.



## **Eligibility Criteria**

In addition to some of the above-mentioned criteria there are some criteria that are more prevalent in trade receivables transactions that should be carefully considered. For example, a common eligibility criterion is that the seller is in compliance with its underlying contract. In the current climate where many companies' supply chains are disrupted and some services may not be provided, this criterion may not be met. Similarly, in the context of longstanding customer relationships, care should be taking to ensure that extending payment terms on some invoices would not preclude those invoices - and possibly all others issued to that customer - from eligibility.

## **Dilution and collection risks**

During this period, delays in the collection of receivables from the underlying debtors may be experienced, in particular in light of the COVID-19 relief measures introduced by various countries. Additionally, dilution ratio covenants may be triggered whenever a collection shortfall arises. Although in a typical non-recourse structure the risk of non-payment and dilution are typically borne by the securitisation structure, there may be transactions in which such risk is shared with the originator.

## **Complexity in multi-jurisdictional transactions**

In multi-jurisdictional transactions, the variety of COVID-19 relief measures introduced by various countries will introduce additional complexity when determining the regime applicable to each set of trade receivables. The lifting of such measures may also occur at different stages, creating further uncertainty in relation to collection forecasts and cashflow expectations. In addition, some jurisdictions have limits on the length of payment terms that will need to be complied with.

Please contact us if you would like to discuss any particular issues in more detail.