

Impact of the Coronavirus outbreak on Finance Sector

17 February 2020

On 31 January 2020, the World Health Organization has announced the outbreak of novel coronavirus (2019-nCov), sourced from Wuhan, as a Public Health Emergency of Concern. The impact of the coronavirus outbreak, social distancing measures implemented by the PRC governments and the WHO's declaration of a public health emergency of international concern further extends to the finance sector.

1.1 Lender

A typical situation a lender might be facing is where there is no occurrence of an actual event of default, but due to the coronavirus outbreak, they could smell that a default will occur by lapse of certain time. What can they do?

In the PRC, under a recent government notice (the "**Notice 29**")¹, banks were required not to blindly suspend, terminate or delay distribution of any loan to any borrower which is materially adversely affected by the coronavirus outbreak (e.g. borrower in the wholesale, retail, accommodation, logistics, cultural or tourism industry) or who has a good prospect of growth but is suffering temporary difficulties due to the coronavirus outbreak. Banks are further required to support companies which are materially adversely affected by the coronavirus outbreak by granting extension, reducing interest rate, advancing new facility and/or increasing facility amount to those companies to help them survive this difficult period. This Notice 29 applies to all financial institutions incorporated or registered in the PRC (including for example foreign banks' PRC branch, collectively the "**PRC FIs**"). It seems that for the PRC FIs, and potentially overseas branches of PRC FIs, even if there is a clear cut event of default under a loan agreement, they may not be able to call loans, as under the Notice 29, it is uncertain as to whether the burden lies on the borrower to prove that the borrower is materially affected by the coronavirus outbreak or on the banks to prove otherwise. In any event, almost all companies in the PRC are affected, more or less, by the coronavirus outbreak.

Other pure offshore banks are not bound by this Notice 29. Before the occurrence of a clear event of default (e.g. payment default), some banks may ask whether they could call loan based on a material adverse effect (the "**MAE**") clause, which is quite commonly included in a loan

¹ "Notice on further strengthening financial support in relation to the new coronavirus outbreak" (关于进一步强化金融支持防控新型冠状病毒感染肺炎疫情的通知) issued on 31 January 2020 by the People's Bank of China, Ministry of Finance, the China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission and the State Administration of Foreign Exchange of the People's Republic of China.

agreement. MAE has rarely been used on its own to call loan under common law, since whether a MAE has occurred is a question of fact, with little (if any) legal certainty for the party trying to rely on it. The court has in the past given very little guidance on this point since it is fact specific and the wording of MAE clause varies from one case to another. But in some cases, the court held, among other things, that in order for a change to be material, it needs to affect such company's ability to perform its obligation under the relevant agreement, and a change must not be merely temporary. It is still early at this stage to tell whether a change caused by coronavirus outbreak would be a temporary one. While the threshold for proving a MAE under a loan agreement remains high, it might be easier for banks to walk away from their commitment letter which were made subject documentation, since such commitment was not true commitment anyway. That said, offshore banks should understand the potential reputational risk associated with accelerating loan or cancelling commitment purely relying on MAE. For example, in Hong Kong, the Hong Kong Monetary Authority (the "HKMA") issued a notice to all Hong Kong authorised institutions² (the "HKAI's") on 6 February 2020³ (the "HKMA Notice"), under which HKMA requested the HKAI's to adopt a sympathetic stance in dealing with customers facing financial stress due to the coronavirus break and said that HKAI's should, to the extent prudent risk management principles permit, consider requests from these borrowers for temporary relief arrangement favourably. These are recommended measures issued by HKMA and by no means compulsory, but these measures demonstrated that Hong Kong banks should exercise extra caution when they plan to call loans or cancel commitment at this difficult period of time.

1.2 Borrower

From a borrower's perspective, we would suggest borrower conducting a careful review of the finance documents they have entered into, and analysing the actual and potential default(s) which could be caused by this coronavirus outbreak, in addition to any obvious interest or principal payment default (for example, the debt/interest reserve amount requirement, financial covenants, cessation of business covenant, litigation related provisions, cross default, or PRC filing covenants). Borrowers should understand the impact of Notice 29 on PRC FIs, the recommended measures contained in HKMA Notice which are applicable to HKAI's, and adopt different approaches when asking PRC FIs, HKAI's and other financial institutions for extension or waiver.

Some borrowers may also argue that a default or an event of default is caused by force majeure and therefore they should be released or partially released from the relevant obligations or be permitted with an extension under the finance documents. While force majeure clause is an implied term under PRC law and the PRC courts in the past have held SARS outbreak a force majeure event, for cross border agreements which are not governed by PRC law, borrowers need to be more careful when making this argument by checking whether its finance agreement contains such clause or whether local law recognise force majeure (or equivalent concept) as an implied term of contracts.

For borrowers who are at the commitment stage, we suggest those borrowers reviewing their commitment documents to check whether the commitment is subject to documentation and whether the commitment documents contain a widely drafted MAE clause. Since such commitment is not a true commitment which requires the banks to fund based on commitment documents, and borrowers should understand that banks theoretically may use the MAE clause contained therein to walk away from their commitments.

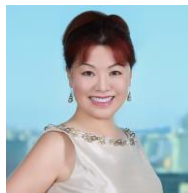
² HKAI means an institution authorized under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) to carry on the business of taking deposits (including banks, restricted licence banks and deposit-taking companies).

³ "Measures to relieve impact of the novel coronavirus" issued by Hong Kong Monetary Authority on 6 February 2020.

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