How the World's Largest Economies Are Addressing Insolvency in Wake of the Pandemic

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The financial fallout from the COVID-19 pandemic has shaken the global economy to its core. Millions of jobs have been lost (either temporarily or permanently) and insolvency has become a growing issue for companies of all sizes. Governments across the globe are introducing new laws and amending others in an attempt to provide relief, and organizations must be aware of the resources available in order to best survive the crisis and position themselves for the long-term.

So far, relief packages in the form of massive loans, suspension periods, and exemptions have been instituted country-by-country with varying levels of success. Efforts have been predominantly focused on helping small and medium-sized businesses, but we have seen larger corporations struggle too—particularly, those in highly impacted industries such as commercial real estate, travel, retail, etc. Several global brands have already filed for bankruptcy and more are expected to do the same in Q4. For the businesses that do survive, questions remain regarding repayments, future audits, supply chains effects, and much more.

As some of the world's largest economies continue to respond to the COVID-19 pandemic, here are steps organizations can take to remain solvent and avoid bankruptcy.

France

In March, France announced that organizations unable to make payments will be protected from filing for bankruptcy for the period of the "health emergency," plus an additional three months—as opposed to the normal 45-day period.[1] The measure also protects representatives of distressed companies from legal proceedings and personal sanctions for not declaring insolvency during this time period.

Further, if a company was not deemed to be in cessation of payments on March 12, 2020, it will be protected from filing for bankruptcy at least until August 24, 2020. For practical purposes, a company in "cessation of payments" after March 12, 2020 will therefore be able to use every pre-insolvency and insolvency proceeding provided for under French law, depending on their needs and the circumstances.

France later increased its initial economic support plan from €45 billion to €110 billion, in an effort to provide additional relief to struggling companies. At the time, Finance Minister Bruno Le Maire proclaimed, "the deployment of state-guaranteed loans is now a reality for French companies, regardless of their size."[2] Businesses have until December 31, 2020 to ask their bank for a loan guaranteed by the state.

Fnac Darty was the first large company in France to utilize a state aid scheme. The consumer electronics retailer secured a €500 million government-guaranteed loan to help overcome deficits created by the coronavirus. This trend may continue for the nation's bigger and more profitable companies, which have Le Maire's support. The Finance Minister added: "I won't hesitate to use all means available to protect big French companies," when speaking with journalists.[2]

While no plans for audits have been announced just yet, loan recipients in France should be aware this is a possibility down the line and prepare accordingly. This means maintaining accurate documentation and assessing all risks involved to withstand any regulatory scrutiny.

It is also important to note that if a company with operations in France continues to struggle amidst the pandemic, the business may voluntarily seek bankruptcy protection and initiate restructuring or liquidation proceedings.

Germany

Even a country like Germany, known for its historically balanced budget and conservative approach, has launched a €750 billion aid package to protect the economy from the worst effects of the coronavirus outbreak. Similar to France, the country has also enacted a suspension period for bankruptcy filings.

The Federal Ministry of Justice and Consumer Protection (BMJV) announced that a company is no longer obligated to declare bankruptcy within three weeks after becoming insolvent during the "suspension period," ranging from March 1, 2020 until September 30, 2020. The suspension period may be extended by a statutory order until March 31, 2021. Additionally, repayments on loans granted during the suspension period, as well as the secured collateral for such loans, cannot be challenged until September 30, 2023.[3]

Germany's Kurzarbeit program—which helped in stabilizing the country's labor market during the 2008 financial crisis—was recently updated in response to the current economic climate. In short, businesses facing a temporary and unavoidable shortfall of orders due to the crisis can apply for the government to subsidize workers' salaries while activity is reduced or put on hold.[4]

Almost half a million companies in Germany are taking advantage of the program, including some of the country's most prominent brands such as BMW, Volkswagen and Daimler.[5] Any Germany-based companies struggling to pay workers' salaries and stay afloat would be wise to explore this option.

Finally, the country has created the Economic Stabilization Fund (WSF) to provide companies (non-financial firms only) with liquidity support. Thus far, the WSF has designated €400 billion for public guarantees to secure credits issued by local banks. Companies are only eligible to draw from the WSF if there are no other funds/financing options to overcome the difficulties brought on by the pandemic. So, the WSF essentially serves as a last resort for businesses before declaring bankruptcy.

Just recently, Luthansa—Europe's leading global airline—received a €9 billion loan through the WSF.[6] While there are no mandatory audits attached to withdrawing from the WSF, one of the "expected conditions" for Luthansa is that two seats on the company's supervisory board will be filled in agreement with the German government, one of which is to become a member of the Audit Committee.[7] Similar agreements may be reached should more Germany-based companies accept bailouts from the government.

United Kingdom

The U.K. government has made a calculated effort to assist smaller companies dealing with the devastating financial effects of the pandemic. In March, the country announced an emergency £330 billion credit scheme, including loans of up to £5 million for small and medium-sized companies, with state guarantees of 80% through accredited lenders.[8]

Also, new bounce back loan schemes allow eligible companies to borrow between £2,000 and up to 25% of their turnover, while the maximum loan available is £50,000.[9] Most notably, the government guarantees 100% of the loan and there will not be any fees or interest to pay for the first 12 months.[9] British Finance Minister Rishi Sunak initially opposed this measure, but later changed course as the economic effects of the pandemic worsened.

These are all viable options for companies needing to restructure their finances due to the coronavirus, particularly for smaller organizations that need cash fast. The government revealed plans to pay firms within 24 hours of a successful application.[8] Still, there have been setbacks worth noting.

Servers have been overloaded due to an influx of loan applications and, despite the government's efforts, some businesses have voiced complaints over delayed payments.[10] As criticism mounted, lenders have been pressured to expedite the process, only "touching" on anti-money laundering and fraud checks for applicants, as opposed to conducting full due diligence.

As a result, there could be future audits related to bounce back loan schemes. Specifically, the

“government will retain the right to retrospectively audit all aspects of the scheme with scope to claw back fraudulent or erroneous claims.”[11]

The U.K. is not the only country that has had difficulty distributing loans efficiently. In the U.S., it was reported that deficiencies in the federal government’s loan-entry portal were causing delays as banks attempted to pay out loans to hundreds of thousands of small businesses.[12] Fortunately, both countries have since made improvements to their processes, but the issue could resurface if there is a future surge in loan applications.

Finally, to further encourage businesses to take advantage of financial aid, the U.K. is temporarily suspending wrongful trading provisions. This removes the threat of directors incurring personal liability during the COVID-19 period. The government also amended the Insolvency Act to prevent a supplier from terminating goods or services to a company that has entered into an insolvency process.[13]

Even with the resources available, some companies still may not survive the current economic crisis. Insolvent U.K.-based companies can obtain a 20 business-day moratorium period, which allows additional time to restructure or seek new investment free from creditor action.[14] The moratorium can then be extended to 40 days subject to the approval of the board of directors (and further extended to up to a year, but requires consent from the company’s creditors).[15]

United States

On March 27, the U.S. passed the Coronavirus Aid, Relief, and Economic Security Act (better known as the CARES Act) focused on providing economic assistance to American workers and families, as well as small businesses.[16] The CARES Act includes the Paycheck Protection Program (PPP), which allows small businesses to borrow from SBA authorized lenders to help maintain payroll, hire back employees who may have been laid off, and cover applicable overhead.[17]

A PPP Loan can be made by any existing U.S. Small Business Administration lender or by any participating federally insured depository institution, federally insured credit union, farm credit system institution, and select FinTech lenders who are approved by the U.S. Small Business Administration as a 7a lender. All loans are 100% guaranteed by the SBA.

Since being instituted, the law has received criticism from some and praise from others. PPP loans were originally intended for small businesses in need of relief, available only to companies with fewer than 500 employees.[18] Initially, this included several large-scale companies with sufficient funds to hold them over for several months. As more and more of these companies received PPP loans, public outcry ensued.

For example, when news broke that Shake Shack (worth $1.6 billion) had received a maximum $10 million loan, the company returned the money within 48 hours after significant media backlash. By April 27, two waves of PPP loans worth a combined $530 billion provided relief to U.S. businesses. At the end of May, further revisions were made to the PPP, resulting in the PPP Flexibility Act.

Despite these issues, there is evidence that PPP loans have helped to decrease unemployment

and enable companies to stay in business during the pandemic. Reports in early June showed U.S. unemployment dropped to 13.3% instead of surging to 20% as many economists had predicted, which could be attributed to the PPP.[19]

For U.S. businesses that received a PPP loan over $2 million, audits are coming. Eligible borrowers should not be frightened, but instead use this time to prepare. Organizations need to take steps now to reap the full benefits of the PPP, while remaining compliant with its uncertain requirements. Those that are successful should be able to avoid insolvency as well as any scrutiny from regulators.

Growing Threat of Insolvency

As companies are faced with difficult decisions about whether they can withstand the economic downturn, they need to evaluate if the available relief programs will truly help them survive or just postpone the inevitable. Besides cash flow management and projections, some may decide, based on their debt leverage and business models, that they are better off seeking bankruptcy protection.

In the U.S. alone, Chapter 11 bankruptcy filings in the commercial sector were up 48% in May 2020 compared to May 2019. Between April and May 2020, American bankruptcy filings were up 30% with 165 new filing petitions.[20] The COVID-19 pandemic has hit the restaurant, hospitality, and leisure industries hardest; for many, the Chapter 11 process will help them to restructure and continue to operate. For others, the losses will be too great and they will have to close their doors permanently.

Private equity firms are in a similar position; they must assess their portfolios and consider the future. Again, the decision to cut losses or double down on investments becomes critical. Cash needs to be invested somehow, meaning many are looking at distressed investments. Cutting costs when little revenue is flowing in—at a time when clients are pushing payments out and stretching payables—can only go so far. There are many options that businesses need to consider when formulating their short and long-term strategies.

Looking Ahead

The economic impact of the COVID-19 pandemic will likely be felt for some quite some time. Well-known brands such as Brooks Brothers, Frontier Communications, Intelsat, J. Crew, JCPenney, Neiman Marcus, and Virgin Australia have all declared bankruptcy due to financial issues stemming from the coronavirus crisis.

The right leadership, clear vision and understanding of the financial packages/schemes available can enable an organization to feasibly overcome the challenges that lie ahead. Businesses must be ready to navigate the new normal and determine which available resources can meet their needs. As conditions change over the coming months and provisions are repealed or amended, companies must stay nimble and strategic in their approach. This will be a pivotal factor in determining how they will emerge from the current crisis.

Jack Aerni, a consultant at StoneTurn, contributed to this article.

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