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Client Alert
News Flash

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COVID-19 in Germany: Immediate Measures to Gain State Aid Financing (KfW Credit et al)

The German government announced that it will expand the KfW financing programme.

Due to the already existing and upcoming multiple business challenges caused by COVID-19, there will be a strong demand for additional financing throughout the German and European economy. The German government announced on 13 March 2020 that "unlimited funds" will be provided and "all weapons" will be put on the table to support and stabilise the economy. A key measure of the announced government programme is an expansion of the already existing KfW financing programme. However, there are still substantial challenges to obtain respective state aid financing.

Suspension of Obligation to File for Insolvency

The German Federal Ministry of Justice and Consumer Protection announced that it is preparing a legal regulation to suspend the obligation to file for insolvency until 30 September 2020 for companies affected by the coronavirus. As of today, companies that are illiquid[1] or over-indebted without positive going-concern prognosis[2] have to file for insolvency within three weeks at the latest.[3] The suspension of the filing obligation will enable companies to organise a restructuring solution and/or gain additional financing together with their respective relationship banks at a time when institutions operationally impaired by COVID-19 are facing a substantial demand for additional financing. The suspension is linked to the condition that there are well-founded prospects of recovery following its application for public aid or ongoing serious financing or restructuring negotiations.

The suspension of the insolvency filing obligation is a necessary and unavoidable step in the current situation. However, the proposal as announced in a 16 March 2020 press release still contains avoidable uncertainties. We as members of the Turnaround Management Association (TMA) and by way of all other expert and lobbying channels work with the Federal Ministry of Justice in order to overcome the practical deficiencies of the current proposal.

KfW Programmes and Federal Support Programmes

As one of the key measures of the relief programme, already existing programmes provided by the KfW through the companies' relationship banks will be expanded with regard to their personal and factual scope to address the current challenges. To date, the details of the conditions regarding interest, repayment, etc., appear to be unaltered. However, those conditions likely will have to be adjusted in the near future. Therefore, we are talking about moving targets.

As of today, loans shall be provided in line with the already existing categories of size, business experience and financial health:

Companies in existence for more than five years will be eligible for

- **The KfW-Unternehmerkredit ("corporate loan")**. Conditions will be loosened by raising the level of risk assumptions (indemnity) for operating loans and extending these instruments to large enterprises with a turnover of up to €2 billion (previously, the limit was €500 million). Higher risk assumptions of up to 80% for operating loans of up to €200 million are meant to increase banks' willingness to extend credit.

- **The KfW Wachstumskredit ("loan for growth")**. The programme aimed at larger companies, will be adjusted by raising the current turnover threshold of €2 billion to €5 billion. In the future, these loans may take the form of syndicated loans, and the restriction specific fields of development will be lifted (in the past, only innovation and digitalisation projects were eligible). The risk assumption by KfW will be increased to up to 70% (from 50%).

- For companies with a turnover of more than €5 billion, support will continue to be provided on a case-by-case basis.

For companies with less than five years of existence:

- **The ERP-Gründerkredit-Universell ("founder loan")**. Conditions will be amended in parallel to the adjustments regarding the KfW-Unternehmerkredit as laid out above — *i.e.*, the limit for the turnover of the eligible companies will be raised to €2 billion, and higher risk assumptions of up to 80% for operating loans of up to €200 million are planned as well.

The application process for companies and the provision of financing occurs in two steps:

1. Companies need to apply for loans via their relationship banks and relationship banks provide financing to the companies.

2. The relationship banks need to apply for a partial — up to 80% or up to 70% (only) — refinancing or coverage from KfW without KfW entering into direct relations to the company. The KfW loans are administered by PwC as the competent mandatary of the Federal Republic of Germany.

In other words, relationship banks will have to take additional risks in order to provide respective KfW aided financing to companies. In addition, KfW claims a preferential access to collateral. This requires a respective credit diligence and approval process not only on the level of KfW, but also on the level of the financing banks. There is a substantial risk that — despite the current political goodwill with respect to state aid financing — sufficient financing will not be provided in practice.

Besides the KfW programmes, the German federal states offer a variety of subsidised loans via their so-called support banks (Förderbanken) for **smaller and midsize companies**, in particular companies with a turnover of up to €500 million. Similar challenges as for the KfW financing apply under these programmes.

Currently, companies that were in a crisis situation prior to COVID-19 generally do not have access to the KfW and governmental financing programmes. Additional programmes for already **distressed**

companies are likely to be announced shortly. The key question is which companies will qualify as being in a crisis. These companies face the most daring challenges.

We use our contacts to overcome deficiencies in the current legislation processes and to facilitate the best possible financing support. In any case, banks and companies should now enter into intensive discussions in order to use available measures to the extent necessary and possible to avoid further harm for the companies, the banks with their existing and future exposures and all other stakeholders involved.

Federal and State Guarantee Programmes

In addition to the above loan programmes, there is the option of obtaining federal and state guarantees. Also these guarantees need to be applied for via the relationship bank and require risk-taking on the part of the relationship banks. Currently, these programmes are only accessible to companies that had viable business models before COVID-19.

The respective provider of such federal and state guarantees depends on the amount of the applied guarantee. The guarantee banks (Bürgschaftsbanken) are responsible for guarantee limits of up to €2.5 million. For higher limits, the states will be in charge. If the guarantee limit exceeds €20 million in structural weaker regions or €50 million elsewhere, the federal government will be in charge. Under special state aided programmes, guarantees of up to €100 million may be applied for. It is under discussion to increase these programmes to an amount of up to €250 million. Generally, and as of today, guarantees under these programmes will be limited to a maximum of 80% of the overall credit risk. Twenty percent will have to be borne by the relationship banks as “gate keepers”.

Export Credit Guarantee Programmes

According to the German Federal Ministry for Economic Affairs and Energy, the Federal Republic will continue to provide Export Credit Guarantee Programmes via Euler Hermes. As of today this will also comprise deliveries into high-risk areas such as China.

Shareholder Financing

Another measure to increase the availability of alternative sources of liquidity could be the enhancement of conditions for shareholder financing. Under German law, shareholder loans are deeply subordinated.[4] Also, there are specific clawback risks.[5] Aside from structuring options with respect to shareholder loans, a suspension of the subordination for shareholder loans could unlock additional financing resources. However, this step has not been addressed by the legislator as of today.

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Endnotes

[1] § 17 of the German Insolvency Code, InsO.

[2] § 19 InsO.

[3] § 15a InsO.

[4] § 39 par. 1 no. 5 InsO.

[5] § 135 InsO.