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Liquid Spirit

Following our articles on emergency liquidity for businesses adversely affected by the economic impact of the COVID-19 Pandemic and overview of Standstill Agreements as the first item out of the financial first aid kit, we examine Ireland's public sector lifeboat for small and medium size enterprises (**SMEs**); the Strategic Banking Corporation of Ireland (**SBCI**)'s Covid-19 Working Capital Loan Scheme (the **Irish Liquidity Scheme**). Details, including how SMEs can apply, are available from the SBCI's web page for the Scheme: https://sbci.gov.ie/schemes/covid-19-loan-application/ and latest updates at https://sbci.gov.ie/.

Cask aged

The Liquidity Scheme is neither new to Europe nor to Ireland. For good reason, it is similar in concept to the British Business Bank (**BBB**)'s Coronavirus Business Interruption Loan Scheme (the **British Liquidity Scheme**). The British Liquidity Scheme itself borrowed heavily from techniques employed by the United States Small Business Administration (**SBA**), a body originally established to provide debt capital to smaller businesses in the wake of the Great Depression of the 1930's. Both public bodies, BBB and the SBA do not lend to businesses directly. Rather, they provide a government guarantee of loans to small businesses for the benefit of their lenders. Importantly, the small business remains liable to repay the money it has borrowed – if it fails to pay, the lending bank may claim under its government guarantee, but BBB or the SBA remains indemnified by the borrower for all and any sums that the authority has paid out to the bank. Both institutions will pursue borrowers to recoup amounts claimed by lenders. The benefit to SME borrowers is purely that they are given access to loan capital when they would otherwise be refused and on terms that reflect the ability of the government to pay under the guarantee, rather than their own credit risk.

In a similar vein, the Irish Liquidity Scheme very largely replicates the

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SBCI's older Brexit Loan Scheme. Similarly, the Department of Business, Enterprise and Innovation (the **Department**) describes the Irish Liquidity Scheme as an extension of the existing SME Credit Guarantee Scheme. Both are loan guarantee rather than 'soft loan' or grant facilities. However, as currently presented and although restrictive EC rules on illegal state aid are set to be lifted in both jurisdictions, the Irish Liquidity Scheme is far less generous and much narrower in scope than the British Liquidity Scheme. In this article, we touch on the limitations and restrictions of the Irish Liquidity Scheme as those areas ripe for updating in the face of the COVID-19 financial crisis. We also discuss how to combine a Scheme loan with other relief from creditors of SMEs. We conclude by considering management of Irish Liquidity Scheme loans in a lender's balance sheet and looking further forward, how securitisation might ultimately provide regulatory capital relief for credit institutions.

Still comes with a hangover

The first thing to note about the Irish Liquidity Scheme is that assistance comes in the form of a loan and not a grant. And unlike the British Liquidity Scheme, where interest costs are borne not by the borrower, but HM Treasury for the first 12 months, loans under the Irish Liquidity Scheme are neither interest free nor completely repayment deferred. In fact, the Department is keen to point out that SME's should first look for scope to lower variable costs (other than employee costs supported by the COVID-19 Wage Subsidy Scheme), delay discretionary spend, extend their payables, expedite their receivables and explore supply chain financing options, before considering a working capital loan. The Department also urges SMEs to talk to their bank. See: https://www.dilloneustace.com/legal-updates/running-to-standstill

A number of business leaders have commented that now is not the time for SMEs to be increasing their indebtedness and that many, particularly those engaged in the service sector, operate with relatively low levels of capital. Accordingly, they argue, the Irish Liquidity Scheme requires significant development if it is to work for most businesses. Certainly, if the cost of additional borrowing, at least initially, is met directly or indirectly by the taxpayer, that would be a game changer. In our initial article, https://www.dilloneustace.com/legal-updates/the-abc-and-de-of-emergency-liquidity-solutions, we suggested that this might be achieved by giving tax breaks to banks lending interest free under rescue schemes. We are still waiting for news on that front and the SBCI has promised updates on further developments for its scheme.

We note that microenterprises in Ireland can access COVID-19 loans of up to €50,000 from MicroFinance Ireland. The terms include a six months interest free and a repayment moratorium, with the loan to then be repaid over the remaining 30 months of the 36-month loan period. Loans are available at an interest rate of between 6.8% and 7.8%. Businesses can apply through their Local Enterprise Office or directly at microfinanceireland.ie. Eligibility criteria apply and our attention here is directed at supported loans to larger borrowers, which under the terms of the Irish Liquidity Scheme must be obtained from the private sector.

On licensed premises only

Not only are applications by borrowers under the Irish Liquidity Scheme limited to banking institutions, currently Bank of Ireland, AIB and Ulster Bank. There is a strong contrast here with the

British Liquidity Scheme, which gives UK-based SME's access to supported loans from 40+ accredited lenders, including a number of challenger or neobanks. Again, this is perhaps a surprising approach, given that a number of alternative lenders in Ireland could themselves struggle without the option of adding Irish Liquidity Scheme loans to their respective asset portfolios during the slowdown.

As in other countries, the scheme is not available to larger firms, but to SME's only. For these purposes, the SBCI applies the Standard EU definition [Commission Regulation 2003/361/EC]:

An SME is an enterprise that:

- has fewer than 250 employees;
- has a turnover of €50 million or less (or €43 million or less on its balance sheet);
- is independent and autonomous i.e. not part of a wider group of enterprises;
- has less than 25% of their capital held by public bodies; and
- is established and operating in the Republic of Ireland.

The Department has also intimated that the Irish Liquidity Scheme may also be available to Small Mid-Cap businesses, that are not SMEs, but have fewer than 500 employees. Although not expressly stated, we would expect that Small Mid-Caps must also meet the requirement that they are established and operated in the Irish State. The independence and non-public ownership requirements may also apply.

You're not on the list and you're not coming in

There are however a number of categories of SMEs and Small Mid-Cap enterprises that are ruled ineligible for the Irish Liquidity Scheme:

An SME or Small Mid-Cap may not apply for a liquidity facility if:

- it is involved in the primary agriculture and/or aquaculture sector;
- it is in financial difficulty (excluding cashflow pressures caused by COVID19 virus impact);
- it is bankrupt or being wound up or having its affairs administered by the courts;
- in the last 5 years it has entered in to an arrangement with creditors, in the context of being bankrupt or wound-up or having its affairs administered by the courts; or
- broadly, the firm or one of its officers has been convicted of a corporate offence detrimental to the European Union's financial interests.

Moreover, Bank of Ireland, AIB and Ulster Bank may only entertain applications if two basic tests are met. First, the borrower meets the Covid-19 Criterion that its turnover or profitability is being negatively impacted by the virus to the tune of at least 15%. Second, that one of 11 Innovation

Criteria is met. Unfortunately, there is no space to go into the Innovation Criteria here, but suffice it to say, more mature businesses may well struggle to meet any of them.

What's the damage John?

Irish Liquidity Scheme Loans are available in amounts of between €25,000 and €1.5m per eligible enterprise, with a maturity of between one and three years. They are to bear a fixed rate of interest negotiated with the lending bank, subject to a maximum of 4% per annum. For loans of up to €500,000 no security will be required, but larger loans will require collateral to be posted. The SBCI has stated that an interest-only option may be available for the initial period of the loan. However, it is not clear under what circumstances and for how long repayments may be deferred.

Nominally, borrowing under the Irish Liquidity Scheme is subject to the *de minimis* limits under the European Commission's Directorate General for Competition's rules limiting state aid. In order to measure state aid against the three year, €200,000 threshold, one needs to calculate the difference over the life of the loan between the maximum 4% Department supported interest rate and that which the borrower might expect to pay for the same loan in the open market. Not only is that an increasingly difficult calculation to make, but the effects of the Irish Liquidity Scheme on competition between EU Member States is possibly a minor consideration for the Director General at present.

What do we tell them back home?

If the borrower already has one of Bank of Ireland, AIB or Ulster Bank as its main lender, then it would obviously make most sense for it to apply to the same institution as accredited lender under the Irish Liquidity Scheme. By the same token, one would expect the accredited lender to be understanding not only in granting the new facility as working capital to keep its client moving forward, but also by accommodating further indebtedness alongside existing facilities.

Conversely, if the applicant has significant extraneous creditors, particularly those seeking protection from the borrower extending itself further, then considerable negotiation and possibly a standstill agreement might be necessary, as we have discussed previously. We can also see that many businesses could be left out of the Irish Liquidity Scheme and even those eligible at first sight declined or offered less than favourable terms. It would be very unwise to see the scheme as a silver bullet and borrowers are best advised to maintain a continuous dialogue with all of their respective creditors, taxation authorities, suppliers and customers to maximise cash flow in these challenging conditions.

Making for the exit

Borrowers will not be the only ones looking for an end to their troubles and paying off supported loans is likely to be a drag on their profitability. Irish Liquidity Scheme loans could end up as low-yielding, unloved assets on an accredited lender's balance sheet. In the United States, eligible loans are packaged up by accredited lenders as SBA Guaranteed Loan Pool Certificates, constituting a significant portion of the U.S. asset-backed securities market. In designing features of the Irish Liquidity Scheme, the Department and accredited lenders would be sensible to consider how the resulting loans can be optimised for securitisation. And ultimately, the purchase of Irish Liquidity Scheme loan pool securities could form part of quantitative easing by the Irish Central Bank and / or the European Central Bank.

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