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# Debt Covenant Resolution during COVID-19

Ciana R. Curran

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## Abstract

This paper explores the change in the relationships between small and private business borrowers and their lenders during the 2020 COVID pandemic. Nationwide government mandated closures changed consumer patterns as well as the cash flow to small and private businesses. Limited cash flows threatened the access to credit for these businesses and the expected outcome of the resulting covenant violations was catastrophic. After surveying nine high ranking credit officers from lenders of various sizes and geographic locations, it was clear that lenders maintained these small and private businesses' lines of credit through accommodations, mainly payment deferral programs and waived covenants. Results indicated lenders used various thresholds for offering accommodations and associated costs. However, every lender, independent of their size, asset class, and geographical characteristics, was willing to work with their small and private business borrowers to help them survive the challenges of the pandemic.



## Keywords

covenant, breach, lender, asset, COVID-19, payment deferral programs, credit, private borrowers, accommodations, government intervention

## Disciplines

Business Law, Public Responsibility, and Ethics

Debt Covenant Resolution during COVID-19

By

Ciana Curran

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WHARTON RESEARCH SCHOLARS

Faculty Advisor:

Vincent Buccola

Assistant Professor, Legal Studies and Business Ethics

THE WHARTON SCHOOL, UNIVERSITY OF PENNSYLVANIA

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**ABSTRACT**

This paper explores the change in the relationships between small and private business borrowers and their lenders during the 2020 COVID pandemic. Nationwide government mandated closures changed consumer patterns as well as the cash flow to small and private businesses. Limited cash flows threatened the access to credit for these businesses and the expected outcome of the resulting covenant violations was catastrophic. After surveying nine high ranking credit officers from lenders of various sizes and geographic locations, it was clear that lenders maintained these small and private businesses' lines of credit through accommodations, mainly payment deferral programs and waived covenants. Results indicated lenders used various thresholds for offering accommodations and associated costs. However, every lender, independent of their size, asset class, and geographical characteristics, was willing to work with their small and private business borrowers to help them survive the challenges of the pandemic.

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## INTRODUCTION

The COVID pandemic created a unique economic distress situation. Unlike the most recent financial disaster in 2008, the economic shock directly affected the real economy: normal business functions halted, consumption patterns changed, and employment levels plummeted. Following the government mandated closures of businesses around the country, cash flow disappeared for many companies initiating mass panic in the debt and equity markets. Banks and other creditors feared the loss of cash flows for many sectors of the economy would lead to severe losses, excess loan foreclosures, and an influx of bankruptcy filings. Widespread breaches in covenants and consequential loan delinquencies were expected to instigate the anticipated chaos within capital markets and the general economy.

The government and the Federal Reserve had no choice but to intervene and release liquidity in the market to restore confidence to the real economy. Similar to the 2008 financial crisis, the Fed promised to keep interest rates low and buy back appropriate assets to maintain liquidity in the capital markets. However, with the uniqueness of the situation, the government experimented with new tools to place the money directly to businesses in need with Paycheck Protection Program loans. These actions created an opportunity for cooperation between qualifying lenders and borrowers. Instead of foreclosing loans, amendments, deferrals, and waivers were granted to keep businesses afloat.

The novelty of the economic crisis spurred many scholars and experts to explore the changes in the credit market during COVID-19 and the government's interventions to provide relief across the supply chain of credit. Despite the attention to the phenomenon, the small, private business credit market has been relatively ignored creating an important gap in the area of research. When states required companies to close their doors, the most affected group of businesses were small, local, and regional firms. In an article by Forbes released shortly after the start of the pandemic, three in four small businesses reported they were concerned with the economic impact on their businesses and 38% were not confident about their financial future (Hannon). Larger, national firms were also concerned with the impact of COVID; however, many had more access to credit options and could adapt more easily to the changing customer environment (COVID-19). Small businesses were not as fortunate. Overnight, revenue streams plummeted, and small, private businesses did not have the capabilities to combat these losses on their own.

Small businesses produce approximately 50% of the GDP and employment in the United States. With COVID threatening a large portion of these businesses, gaining insight into this market will help to understand the lasting impact of the pandemic. For small businesses, loans are often the only source of capital. The general trend in the private market correlates the self-ownership and risk characterizing small and private businesses with a higher number of covenants (Berger and Udell 2003). There are more restrictions on these businesses' activities lowering the threshold for breaches. These breaches have the potential to completely cut off these businesses' source of credit and force them to close their doors. Ultimately, the consequences could lead to a significant decline in GDP. Studying covenant resolutions and the cooperation within lender and borrower relationships can reveal information that has largely escaped academic commentary.

This paper will explore how the COVID-19 pandemic and resulting government intervention has affected the relationship between creditors and small and private business borrowers regarding covenant violations and accommodations. Using survey data from lenders ranging from less than \$5bn to above \$500bn in total assets, the paper will discuss 1) *How did* *lenders address payment defaults and covenant violation accommodation requests?* and, 2) *What were the costs of these accommodations?* The results identified key trends in lender's approach to accommodations as well as differences due to total asset size and asset class. Specifically, the surveys revealed that with the overall regulatory leniency over credit risk, lenders of various sizes, asset classes, and geographical areas were willing to work alongside their borrowers through the pandemic. Small, local, and regional lenders were more likely to freely offer accommodations to their borrower portfolios. Larger national lenders were more likely to look at characteristics of the borrower before making accommodations and leniently adjusted the terms of the loan to better match the credit risk of the company. Lenders that service unique asset classes, specifically short-term cash loans and commodities, used more in-depth due diligence methodologies to determine which borrowers were more likely to survive COVID and therefore required appropriate accommodations. The survey results ultimately highlighted the deviation from the typical treatment of covenant violation seen in normal economic conditions as well as previous economic distress environments.

## LITERATURE REVIEW

Debt covenants are vital in providing creditor's confidence when issuing a loan. They can prohibit or limit activities of a business to maintain an expected level of performance from the debtor. The COVID-19 pandemic has provided a unique economic backdrop to study covenant breach resolution. To fully grasp the contextual landscape of covenants, it is critical to look at the literature focused on their significance in the credit markets and trends during financial distress. Additionally, for the purpose of this study, it is essential to explore the split between loan covenant treatment for large and small businesses in public and private markets. This section will discuss the theories of these three areas to create a foundation necessary to explore the new lender and borrower relationships that emerged during the COVID-19 pandemic.

The protection of the debt covenant arose from the conflict of interest between firm managers, debtholders, and shareholders. By understanding these conflicts, scholars have developed a central theory called the Agency Theory of Covenants (ATC) that justifies the need for covenants in the credit markets.

To understand the theory, it is essential to examine the relationship nature of the conflicts between managers-shareholders and shareholders-debtholders. ATC is grounded in the idea of agency's costs within a firm. This relationship is defined as "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent" (Jenkins and Meckling 1976, 308). In the case of a corporation, the management team has a contract to make decisions on behalf of the shareholders. These relationships come at a cost to align the interests of shareholders with the actions of management.

The added layer of debtholders within the capital structure of the corporation forces management to mitigate the additional conflicting interests between its shareholders and its debtholders. Clifford Smith and Jerold Warner (1979) found that there were four major sources of these conflicts in which management favors the shareholder's interest over the debtholders due to their agency relationship. These sources include dividend payments, claim dilution of debt holders, asset substitutions, and underinvestment in projects that could potentially add value only to the debtholders (Smith et al. 1979). These "conflict[s] results in actions undertaken by managers acting on behalf of shareholders that have a negative impact on the value of the firm's outstanding debt as well as the total value of the firm" (Bradley and Roberts 2015, 2). The ATC states that covenants can help to balance these complex, conflicting interests by restricting management's decision-making abilities to balance debtholder and shareholder needs.

The ATC is based on the costly contracting hypothesis, that by managing the shareholder-debtholder conflict, the value of a firm can increase. The hypothesis asserts that covenants can reduce the opportunity loss when management prioritizes the shareholder over the debtholders and lowers the cost of monitoring management for debtholders (Smith et al. 1979, 121). Bradley and Roberts' (2015) study found covenants reduce agency costs leading to a lower cost of debt. The reduced cost offsets the extra cost of covenants to the firm. "As long as the costs of the constraints imposed by the covenants are less than the increase in the proceeds of the issue, firms will include covenants in their debt contracts" (Bradley et al. 2015, 4). This theory holds true in all markets.

The variance of these effects due to sizes and disclosure requirements of business are regularly explored by scholars. It is uncontested that there is a positive linear correlation between covenants and a businesses' growth rate and risk level. As predicted by the ATC, most scholars have found that high risk businesses benefit the most from covenants. These differences can be found when dividing the credit markets into two dimensions: public and private markets and the size of the business.

With the available information, scholars have found trends in the private market that mirror the ATC predictions. Private businesses have more cost when it comes to the "screening, contracting, and monitoring" necessary for a loan and do not have the agency costs of public businesses as they are self-owned (Berger and Udell 1998). Since there are no agency costs between managers and shareholders, managers are more inclined to offload risk on the lender (Berger and Udell 2003). Covenants offer a more significant decrease in agency costs for the lender and are more prevalent in the private market. A study done in Australia, analyzing the differences between debt covenants in private and public contracts, revealed more restrictive covenants are better suited for private market loans that are more diverse and volatile (Mather and Graham 2006). Another study done by Kahn and Tuckman (1993) revealed private placement covenants were found to "more aggressively control the actions of equity holders…and allow lenders to monitor businesses easier." The distinction between public and private businesses illustrates the different treatments of businesses with different ownership structures. Specifically, lenders benefit from aggressive use of covenants in the private market.

Business size also affects lenders use of covenants due to credit availability and general risk of the loan. Larger banks are not as suited to make loans to small businesses; their centralized decision-making structure gives them a disadvantage in the monitoring costs for small businesses (Berger and Kashyap and Scalise 1995). This inherently limits the pool of lenders for these businesses. DeYoung, Goldberg and White (1999) further explored this relationship and found a negative correlation between bank size, age and loans to small businesses. With limited sources of funds, it is unsurprising that these businesses are treated differently when it comes to covenants. Bathala, Bowlin, and Dukes (2006) conducted a study that showed most covenants imposed on small businesses were from banks and tended to be positive covenants, meaning the covenants required these businesses to meet certain performance measures. There is also a positive correlation between covenants and debt levels, cost of borrowing and the security of a bank (DeYoung et al. 1999). With limited access to credit through larger banks, small businesses are at an inherent disadvantage. These businesses are more subjected to less secure loans and higher costs of borrowing. Therefore, they are more likely to have greater exposure to covenant breaches and are at an extreme disadvantage when the financial environment prevents them from meeting their required performance metrics.

Finally, it is important to look at the debt covenant market during times of distress. After banks violate a covenant, businesses adjust their decision-making process due to changes in their debt structure. Acharya, Almeida, Ippolito and Perez found violations of covenants usually lead to raised spreads, shortened maturity, tighter covenants, and reduction of the size of credit. These effects are exaggerated when banks are financially unhealthy and tend to increase after a financial crisis (Acharya et al. 2014). Business activity also changes after credit violations; specifically, changes in agreements affect a business's investment and financing behavior (Roberts and Chava 2008). Investments are expected to decrease, and a company's financing options are expected to contract due to past performance. These companies are more likely to be classified as a "risky" investment. Additionally, Nini, Smith and Sufi (2012) found that after a credit violation there is a decline in capital expenditures, leverage, and shareholder payouts along with an increase in CEO turnover. The study also concluded that there were stronger restrictions on management's decision-making capabilities (Nini et al. 2012). Breaching a covenant has important implications for businesses in the short and long term. The impact can be felt by all shareholders and can permanently affect the growth trajectory of the business.

The ATC theory explains why covenants are often used within the credit market and helps to identify the trends seen in various market structures and financial situations. The COVID pandemic has provided a landscape unlike any seen in the last century. The theories and outcomes of covenant breaches explored by the academic community demonstrates the severity of the current financial crisis. The literature confirms that small, private businesses are at greater risk for covenant breaches and are more likely to have the greatest consequences. However, with the general effects of the pandemic and the interference of the government and the Federal Reserve, these trends related to the ATC theory may not apply.

## RESEARCH AND DATA

I began with a sample of 70 banks and lending platforms as sources of contact to gather data using a questionnaire. Admittedly, the sample offering was not random due to information barriers. The nature of the research and data gathering technique required direct access to members of the private credit lending branch from each bank. This requirement narrowed sample options considerably. To accomplish a well-rounded sample given the research barriers, resources available as a Wharton Undergraduate student were utilized. These sources included contact information found through alumni connections and PitchBook. However, with further analysis of the characteristics of the sample, it is evident the sample provides a diverse population representative of the banks and lending platforms that typically lend to small and private businesses.

Two key characteristics were used to determine the fitness of the sample: the size of the assets and the location of the bank. After searching for providers of small and private businesses, it was evident the population includes very small local lenders, small regional lenders and larger national and multi-regional lenders. The sample represents every aspect of this population as seen in the table below.

**Table 1. Total Sample Population by Asset Class**

| Total Asset Size: | Number of Lenders: |
|---|---|
| Very Small (x >$5 bn) | 20 |
| Small ($5< x <$100 bn) | 34 |
| Medium ($100< x <$500bn) | 8 |
| Large (x >500bn) | 7 |

The sample consisted of a wide range of lender sizes with a high concentration of smaller lenders with total assets below $100 bn. As mentioned, local lenders are better equipped to monitor these higher risk businesses and therefore the concentration of smaller lenders within the sample is justified. The inclusion of large and medium lenders encompasses the representation of these lenders as the large volume providers of small and private business loans. With the distribution of total assets of these lenders, the sample distribution matches the expected population of credit providers.

The location of the bank was also essential in determining the suitability of the sample. Due to the pattern of the closures throughout the country, the sample population needed to represent a diverse geographical population to capture the various effects of COVID throughout the country. When closures began, one of the most impacted areas was the East Coast while the South had limited closures and less exposure to the crisis impact. To ensure the representation of the various economic scenarios, the sample needed to include lenders from various regions to capture the total impact of COVID on credit relationships. The table below accounts for the number of lenders that cater to each region with some lenders catering to more than one region.

**Table 2. Total Sample Population by Geographical Region**

| Regions: | Number of Lenders: |
|---|---:|
| East Coast | 42 |
| West Coast | 25 |
| Mid-West | 28 |
| South | 25 |

As shown in the table, the sample population has a relatively equal representation amongst the various regions of the United States. Insight into the various treatment of borrowers throughout the country is instrumental in identifying the impact of COVID on the small and private business credit industry. The sample, therefore, encompasses the appropriate access to information to identify overall trends in changes in behavior in credit relationships.

Using this sample of banks and lending platforms, surveys were sent to each lender's highest ranking credit officer. The survey was conducted through email or phone interviews. These surveys focused on three main topics including: the overall impression of lenders in the changing relationship between lenders and borrowers and subsequently the government, the characteristics of businesses that were given accommodations, and the types of accommodations with the resulting costs. Due to the sensitive nature of numeric data from these sources, many of the questions were phased to extract tangible and comparable answers through a yes/no structure as seen in the table below.

**Figure 1. Survey Questions**

| |
|---|
| *Was there a cohesive leniency throughout the supply chain of capital?* |
| *Did the industry matter?* |
| *Did the size of the company matter? Size of the loan?* |
| *Did the size of the revenue shock to the industry matter?* |
| *Did the location/regionality matter?* |
| *Did the fact they received PPP make a difference?* |
| *Compared to normal times, were accommodation for covenant renegotiation needed or sought after more frequently?* |
| *Were accommodations granted?* |
| *Was a fee included in these accommodations?* |

These questions helped identify several tangible trends from responses regarding the general characteristics of changing behaviors between lenders and borrowers. In addition to these questions, the survey included several open-ended questions for credit experts to explain their overall impression of these changes within the industry during COVID, how they compare to normal times and other financial crises, and the potential expiration date of these changes.

After sending out the surveys, a conservative response rate of 10-15% was expected from the initial sample due to the nature of the requested data. Many companies would most likely be unwilling to divulge sensitive information on their relationships with their borrowers. Consistent with expectations, there was a 12.9% response rate from the original sample.

Using the same two criteria, geographical regions and size of the lender, to determine the soundness of the data ensured properly drawn conclusions from these responses. As shown in the table below which accounts for the location each lender, the responding lenders were almost evenly spread across the nation.

**Table 3. Respondent Population by Asset Class**

| Regions: | Number of Lenders: |
|---|---|
| East Coast | 5 |
| West Coast | 5 |
| Mid-West | 6 |
| South | 4 |

The equal representation ensures the reported results of the survey had limited location bias and captured a population exposed to the various degrees of COVID effects throughout the nation. The responding population allows identified trends concerning the changing behavior between lenders and borrowers to be applied on a national level.

Additionally, the distribution of bank size of the respondents mirrored the overall population of participants originally identified. A higher concentration of the responders fell into the “small and very small” lender categories and several responders fell into the “large and medium” lender categories.

**Table 4. Respondent Population by Geographical Region**

| Total Asset Size: | Number of Lenders: |
|---|---|
| Very Small (x >$5 bn) | 2 |
| Small ($5< x <$100 bn) | 5 |
| Medium ($100< x <$500bn) | 1 |
| Large (x >$500bn) | 1 |

With the available data and means of collecting my sample populations, biases were unavoidable. First, as expected with survey driven data, the sample contains non-response bias as the respondents were willing participants. With this type of information, there was a greater likelihood that lenders with successful systems of accommodating their borrower portfolios were more likely to respond to the survey. Lenders that struggled with their borrower relationships and ended up with higher levels of defaulted loans would be less likely to respond to the survey. Additionally, due to the sensitivity of the overall data and information it may have been difficult for the company’s legal team to approve any commentary further limiting the pool of willing participants. These biases were expected and therefore need to be taken into account in the results.

## RESULTS

With the limited sample size, it is necessary to note some concern on the reliability of statistically significant conclusions for the population. However, with the resulting data, several important trends can be identified with respect to the process of granting accommodations for covenant violations and the resulting costs. Through the information received, general patterns were identified with yes/no responses from survey participants concerning tangible characteristics of what accommodations were given as well as which borrowers were most likely to receive this cooperation. Trends were also identified using key population characteristics described in the methodology. With the additional information provided by the surveys, the paper discusses the behavior between lenders and their borrowers within various asset classes. Finally, the impact of the government intervention on the cooperation between lenders and borrowers and how it compares to the 2008 crisis will be addressed.

**Expectations and Typical Borrower Treatment**

In the typical situation, the covenant breach is a trigger to discuss waivers and new terms if the borrower's distress situation is temporary. However, if the situation was not temporary or there is a payment default, the lender is unlikely to waive covenants and negotiate for new terms with the violating business. Still, it is difficult to foreclose a loan without payment defaults and non-performing status. The insight from the survey was consistent with previous literature on covenants and covenant violations within the small and private business credit industry. Violations usually lead to waivers that included fees, increased interest rates, and higher collateral requirements to account for the added risk the lender takes on with these accommodations.  Consequently, the businesses that are given accommodations have larger burdens through increased fees and payments to account for their covenant violations.

According to these 'normal times' practices and the previous literature regarding covenant violations and consequences, the expectations for the COVID crisis were catastrophic. With business closures, almost all failing businesses that requested accommodations were unable to make principal and even interest payments during the first few months of the crisis. These payment defaults should have been met with foreclosed loans and tighter liquidity terms due to the added risks to the lenders. However, as one response indicated 'accelerating the loan might be the worst thing you can do- as long as it's not bad business judgement'. The general results from the survey suggest that lenders did not take the expected actions characterizing typical covenant breaches and payment defaults. Instead, lenders worked with the borrowers to provide them non-consequential relief through payment deferral plans and covenant waivers.

**Survey Results**

***Figure 2. Survey Responses***

| Question | YES | NO |
|---|---|---|
| *Was there a cohesive leniency throughout the supply chain of capital?* | 9 | 0 |
| *Did the industry matter?* | 5 | 4 |
| *Did the size of the company matter? Size of the loan?* | 5 | 4 |
| *Did the size of the revenue shock to the industry matter?* | 5 | 4 |
| *Did the location/regionality matter?* | 4 | 5 |
| *Did the fact they received PPP make a difference?* | 6 | 3 |
| *Compared to normal times, were accommodation for covenant renegotiation needed or sought after more frequently?* | 8 | 1 |
| *Were accommodations granted?* | 9 | 0 |
| *Was a fee included in these accommodations?* | 3 | 6 |

As expected, almost every response indicated that the frequency of accommodations needed from borrowers increased during the COVID crisis. With the exception of one lender, all the responding lenders found that a greater portion of their loan portfolios required waivers and deferrals to survive due to rapidly decreasing cash flows to small and private businesses. For two of these lenders, almost half of their portfolios filed requests for accommodations. Other lenders had smaller portions of their portfolios exposed to the risks of COVID, while the only response that indicated no change in this frequency was in the commodities business. This exception within the sample implies that the industry and asset class of the typical borrower of the lender did affect the overall need for accommodations. These effects will be discussed in a later section.

The most consistent answer among the responding lenders was that COVID created the opportunity for leniency throughout the supply chain of capital. From the survey results, the government's behavior was characterized as a general shift towards forgiveness and leniency while monitoring the credit risk of loans to businesses. Small and private businesses affected by COVID were likely to drop in their credit ratings; they were not able to make payments without any cash flow. In normal times, lenders, specifically monitored banks, would be required to label these non-performing loans as TDRs or a troubled debt restriction. This indication requires the bank to mark the loan down to its collateral value and report the losses on its regulatory filings. However, in general, regulators allowed banks to defer clients up to six months without transferring these loans to TDRs on their balance sheet. This leniency from regulators was the turning point in the general trend towards broader cooperation between lenders and their borrowers. Banks were able to maintain their required capital and risk ratios instead of foreclosing on loans that were only considered nonperforming due to extraneous circumstances. This maintained the balance needed for banks to continue lending and addressing the needs of the small and private business without a liquidity freeze from regulatory scrutiny.

As a direct result from this leniency, overall, the characteristics of businesses receiving accommodations was determined by their needs and in some cases, industry and location. From the five responses that suggested that business characteristics, the industry and region of the business, did not matter, the needs of their borrower base tended to span a wider breath of the portfolio and therefore, did not require attention to these items. These accommodations were given more liberally due to the changes made to the overall structure of the lenders. Responders who reported these business characteristics were unimportant, were able to step up new structural systems to quickly service accommodations and monitor the risk of these accommodations smoothly. For the four lenders in which the characteristics of the businesses did matter, accommodations were only given on a case-by-case basis. Respondents consistently claimed that accommodations requested and given were only to businesses within industries that were greatly affected by COVID. Typically, these lender's responses indicated that a small portion of their portfolios were affected by COVID and therefore did not adopt the 'open' accommodation policies of more affected lenders when assisting their borrowers.

PPP loans also played an important role in the process of granting accommodations and saving small and private businesses from loan foreclosures. All the responding lenders agreed that PPP loans increased the confidence of the lender in the borrower's ability to overcome the challenges of COVID. Six out of the nine lenders indicated that these PPP loans increased the probably of receiving accommodations. These lenders were typically more stringent with their handouts. The three respondents who indicated the PPP loans were not essential for receiving additional assistance were the lenders who were very lenient in giving out accommodations. Overall, the impression of PPP was positive among all responders. Lenders perceived these loans as another instrumental government program that helped small and private businesses overcome the COVID crisis. It provided them with extra cash to make payments and increase lender confidence in their future recovery.

Accommodations varied between the responses. The most consistent changes to contracts reported were deferrals of both interest and principal payments on preexisting loans. Typically, these missed payments were added onto the final months of payments or the payments were added to the end of the term contract extending the maturity to match the deferral period. These maturity extensions were more common with the "small and very small" lenders that served more local populations. The larger lenders did offer accommodations and deferrals; however, they were less willing to extend the overall maturity of the loan to accommodate the missed payments. Instead, payments were spread out over the last few months of payment on the loans.

The cost of these accommodations also varied across responses. Although every lender explicitly stated that they did not take advantage of the larger inflex of accommodations requests to charge fees or penalties, three lenders did have costs associated with these changes made. These additional costs consisted of a small increase in interest rates to account for the added risk of the loan. The remaining six responses specified that no costs were associated with these accommodations for the duration of the pandemic's effects on the business. From all responses, it was clear that, compared to typical times, costs and fees were significantly more lenient. A typical covenant violation ensures penalty fees, requires fees to renegotiate the contract, and likely leads to an increase the interest rates charged due to the added risk of the borrower. From the results, it seems most lenders were more concerned with allowing these businesses to overcome the challenges of COVID without any added stress of the typical penalties.

Overall, the relationship between the lenders and their borrowers, despite the characteristics of the lenders, was more lenient and cooperative. The government leniency towards these accommodations and new standards during COIVD made these changing relationships possible.

**Geographical and Size Analysis**

As indicated in the methodology, the geographical location and the size of the bank helped to determine the overall reliability of the sample population. With a respondent sample size of nine lenders, it is difficult to make any conclusions with certainty on the overall trends within each region and lender size. However, some conclusions described in the previous section can be linked to these various sample population characteristics.

Looking at these characteristics, the lenders were split into two sub sections to identify patterns. The first group included five regional lenders all had assets qualified as "small to very small" lenders. These lenders located in the Mid-West, South, and the West were relatively liberal with their thresholds for receiving extra accommodations; they all choose to accommodate any borrower that was in need due to COVID and did not discriminate based on the business characteristics. The only small lender in the east coast region that exclusively lent to commodity businesses did not follow the same pattern. This lender was less affected by COVID and therefore does not accurately depict a conclusive pattern for the region. Apart from the commodities lender, none of these lenders charged borrowers for the accommodations. Overall, it was difficult to pinpoint geographical trends, however, using the category of size, it was clear that smaller lenders were more likely to offer accommodations freely and without extra costs.

The second group of lenders were comprised of four national lenders that fell into the "medium and large" lenders for their total asset sizes. Typically, these national lenders provided their businesses with accommodation but took a more case-by-case approach for each of their borrowers. Two out of the three lenders in this category charged small fees for these accommodations. All lenders considered characteristics of the borrower when deciding the accommodations plan going forward. These consistent trends in response indicated lenders consistently treated their borrower different than the small regional lenders.

The responses indicated that, overall, lenders of all sizes that serviced various regions of the country consistently focused on creating an environment of accommodations based on the various needs of their portfolio. Smaller, regional, and local lenders tend to focus on meeting every need and providing these accommodations without fees. Larger lenders were focused on meeting the needs of businesses severely affected by COVID and were more likely to adjust for the added risk of taking on these deferred loans.

**Asset Class Analysis**

The collection of responses highlighted key trends throughout different asset classes and industries. Some of the responding lenders lent to a broad range of small and private businesses with typical commercial loan structures while other lenders specialized in short term loans and commodities. The range of response explored the nuances in treatments across lenders and assets during the COVID crisis.

The typical term and revolver loans made to small and private businesses around the country were treated differently across lenders. As discussed in the previous section, the overall responses of the lenders were synchronized in allowing their borrowers the best opportunities to make it through COVID challenges. However, after speaking with several different lenders, it was clear that everyone had their own system and strategies to offer help to their borrowers in need. Several lenders completely changed the structure of their workflow to accompany the growing needs for accommodations and PPP loans.

One responding lender became a twenty-four-hour service for accommodations and PPP loans to their local borrower populations. The lender was able to create a system of due diligence and approvals for each business that was possible to complete within four to six hours of receiving the request for the accommodation. These approvals allowed for case-by-case deferrals for 60-to-90-day periods depending on the needs of the business. The system was only possible due to the government's leniency in risk monitoring for these deferrals. The responder indicated that the typical time for due diligence without the government intervention was three to five days. Expediting the timeline allowed the lender to quickly get the companies in their portfolio the relief they needed. In addition to this system, the lender was also able to create a system for PPP loan approvals. In a few hours, a company could easily qualify and receive the cash loan from the program. With the efficiency dynamic at the lender, borrower's needs were met quickly and easily and allowed the bank to successfully get these borrowers the relief they needed in a timely manner.

Another responder took a more long-term approach. First, their process required them to make decisions about borrowers who could and could not make it through their expected 12-month recovery period. Loans that did not have any tangible assets or collateral were sold off. Then, the lender split the business into twelve distinct risk groups based on the industry and the size of the business to handle requests for accommodations. These accommodations were made on a six-to-twelve-month basis as a payment plan. The payment contract was negotiated based on the risk group to meet the needs of each business and maintain the appropriate risk taken by the lender. Participating companies were typically backed by sponsors allowing them to provide cash collateral to the negotiations to allow for the more long-term flexibility. Through this twelve-month period, the business had to provide a strategy focused on cutting costs to manage the liquidity they planned to burn through in the first few months of the pandemic. Every month the company and its industry were monitored; once a company or the industry returned to normalcy, the borrower was taken off the list of "payment plans". If the borrower was unable to return to normal operational performance at the same time as the industry, they were labeled a non-performing loan. Finally, after being taken off the "payment plan list", their payment contract covenants were viewed from that month on instead of a twelve-month rolling period. This allowed the monitoring system to skip over the period of covenant non-compliance and rebuild a twelve-month period of compliance.

Finally, one responder had an overwhelming focus on getting their borrower portfolio PPP loans by working directly with the SBA. It was clear that these PPP loans were meant to help relieve any issues with borrowers' ability to pay debt payments during the pandemic. The lender itself restructured to meet its high level of demand for these PPP loans. In return, the high outflow of these loans helped hard hit businesses significantly and reduced the severity of accommodations required to make it through the pandemic. In addition to these loans, the responder worked closely with their borrowers to make other accommodations or offer other products in the market. Similar to other lenders mainly servicing small businesses, these accommodations included waived or reversed fees and/or interest payment increases, deferred payments and even emergency credit lines.

The most unique situation reported was in the FinTech industry, specifically short-term cash loans. These loans were unique as they require daily or weekly payments from businesses that are extremely reliant on daily cash from their customers. The most common customers of these loans are restaurants and other small cash businesses highly reliant on customer foot traffic. Unlike the other responses I received, these lending platforms had various ranges of successes due to their supply chain of credit. Many of these companies received lending from banks. Lending platforms without diverse customers were immediately cut off from their sources of credit. They instantly cut off their customers from cash and liquidate the available assets of their borrowers. These lenders were forced to mark down almost all their loans and their remaining business was sold off to third parties. These lending platforms were high risk and not necessarily protected by the regulatory leniency granted to other responding lenders. If the lending platform did not have diversified and permanent capital, then they ended up failing and cutting off their loans to their small and private business borrowers.

However, some lending platforms with access to the permanent capital necessary to continue lending were able to survive. These lenders utilized their access to data and algorithms to choose the companies they supported through the pandemic. The characteristics of a business were essential in making any accommodations; the lenders utilized their data on credit card receipts and regional news to see how long the shock to revenues would last and how the business was fairing during closures. Unlike the other lender responses, one of the most important factors in making these decisions were previous relationships. Having a prior relationship with consistently successful payment logs helped the lender confidently choose which businesses would most likely recover from the closures and COVID effects. PPP loans were also essential in making decisions to waive payments. Businesses that received the capital injection were more likely to have the cash to cover expense and survive closures and cash flow losses; therefore, the lender’s confidence in the loan and the borrower increased.

The accommodations made for these chosen companies varied on a case-by-case basis. Most of these changes included a payment plan with close monitoring of credit card receipts. These payment plans were negotiated with the borrower to determine the best plan for payments on past loans and new loans to cover costs during the crisis. The payment plans included extended maturities to original loans and reduced present payment requirements. The rates of these loans remained relatively low due to government intervention in interest rates; the companies with new payment plans received these lower rates despite the extra COVID risk and deferred payments of their pre-existing loans.

The other atypical asset class was commodities. This asset was unique due to the nature of the limited exposure it had to COVID complications. According to the respondent, the number of accommodations needed for these businesses was limited and not necessarily an atypical amount compared to their typical requests. For this reason, the accommodations were treated with high scrutiny and required significant due diligence to ensure the needs of the business were exclusively from COVID factors. The lender was more concerned with investigating poorly managed businesses and only allowed accommodations to specifically COVID affected borrowers. These loans were unique as they had similarly small maturity times as the fintech loans described above. These loans typically matured in 60 to 90 days and acted as more of a line of credit than a typical term loan. They are often renewed after every period based on the needs of the borrower. For the COVID affected borrowers, deferrals were offered without penalties and fees, however, as mentioned they were not given out lightly due to the nature of the effect of COVID on the asset class. Often, these accommodations did require the bank to add a small increase in the interest rate to adjust for the added risk of the loan changes. This increase in interest rate was considered lenient compared to normal adjustments if covenant violations or payment defaults occur.

Overall, the exploration of tactics used from lender to lender and among various assets demonstrated that the best system and solutions for borrowers during COVID was not uniform. Lenders were able to take the needs of their borrower base and meet them in a way that was necessary for the cooperation required for the loan portfolios.

**Comparison to 2008**

It was common for the responder to compare the COVID situation to the 2008 financial crisis. Although these two financial crises have extremely different origins, the comparison can bring context to the changed behavior between lenders and borrowers.

During the 2008 crisis, the closest comparison to the current PPP program was the TARP program. Through the Emergency Economic Stabilization Act of 2008, the TARP program was meant to improve the stabilities of the market, banks, and the auto industry. The funds purchased the equity of distress business and issued loans. TARP created thirteen programs that allowed the government to use these funds in various areas of the market (CITE). The money was injected into the banks and large businesses directly. The hope was to free up the movement of money in the market and allow banks to continue to lend to everyday people and small businesses. The PPP program of 2020 took a very different approach to freeing up lending in the overall market. Instead of focusing on getting money to small businesses through the banks and the markets, the government took a more direct approach with this program. They brought the lending relief to these businesses to ensure the money would get where it was needed the most.

In addition to the method of injecting cash into the economy, the overall policies of both the banks and the government changed from the 2008 crisis to the COVID crisis. According to the responses, the 2008 crisis was not a time of government leniency and forgiveness. This lack of leniency waterfalled through the supply chain of capital causing banks to restrict their lending capabilities and cut of non-preforming loans. When businesses could not pay their debt due to the overall effects of the housing crisis, many banks tightened up their processes of approving accommodations. Several respondents indicated they forced many of these loans into non-performing status and increase the penalties and costs associated with any changes made to debt contracts. In some cases, the loan was quickly liquidated to get some value back into the bank. Based on previous literature, these changes made to contracts had longer term effects on smaller businesses abilities to engage in investments for growth in their companies. In contrast, the COVID crisis took a different approach to credit. As described above, the government and lenders took on a policy of leniency with credit risk and loan mark downs allowing the evasion of TDR status for many of these non-performing loans. Instead of restricting accommodations and further lending capabilities, lenders helped businesses manage their distressed situation by offering relief with deferral plans and sometimes additional loans. Businesses were able to sustain their basic costs and make it through the crisis with this cooperation returning to some normalcy as various industries recovered. It is clear the government and lenders' change in tactics helped to create an environment for struggling businesses to succeed in making through the crisis.

## CONCLUSION

National COVID closures created mass panic for small and private businesses around the country. Without cash flows, many owners feared they would be cut off from their credit source and forced to close. However, after interviewing nine different executive credit officers from lenders of various sizes around the country, it was clear that the small, private business credit market was able to adapt to the situation and prevent what could have been a massive hit to the United States overall GDP and employment. Lenders and borrowers worked together to create payment plan deferrals to account for the lack of cash flow that prevented many companies from servicing their debt in the short term. Through various systems and structural changes, lenders assisted their borrowers directly affected by COVID efficiently and effectively, giving many businesses the tools and resource to survive. The number of loan losses were significantly less than expected and almost all industries were able to recover from the initial shock of COVID. With the support of the government, banks and lending platforms were able to provide relatively cost-free accommodations to their borrowers in need. Overall, the changing behavior towards cooperation between these lenders and their borrower was seen as positive and helpful in preventing lasting damage to the economy.

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