

High-Yield Debt

in Portugal

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Update and trends

UNPROCESSED QUESTIONS

All questions

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MARKET OVERVIEW**High-yield debt securities versus bank loans**

Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

One of the key differences between high-yield debt securities and bank loans is the regulatory framework applicable to bank loans. Only duly authorised credit institutions and financial companies can carry out credit transactions (including the granting of loans, guarantees and other commitments) on a professional basis (isolated transactions are excluded). On the contrary, the issue of debt securities does not require regulatory authorisation, thus giving greater flexibility for companies to seek a wider range of investors through high-yield debt securities as opposed to bank loans.

Another key difference is typically found in the covenant package: bank loans have financial maintenance covenants, while high-yield bonds have incurrence-based covenants. Typically, financial maintenance covenants are triggered if the borrower does not meet certain leverage ratios (eg, debt-to-earnings before interest, tax, depreciation, and amortisation (EBITDA)) or a certain limit of interest coverage (eg, EBITDA-to-interest expense) or some other coverage metric set forth in the business model. Nonetheless, loan agreements usually establish exceptions for investments, disposals and liens that are in line with the business model. Cash sweep mechanisms that force the borrower to prepay the loan if there is an excess cash flow are also common. In incurrence-based covenants of high-yield bonds, however, a potential breach of the same may only occur whenever the issuer raises new debt, makes an acquisition, pays a dividend, or undertakes some other relevant corporate action (usually it requires an action from the borrower). From the issuer's perspective, incurrence-based covenants, which are usually tailored to the specific case, are preferable as they give more flexibility and, therefore, constitute an advantage compared to bank loans.

Another consequence of having the covenant package established is that the process for obtaining waivers or consents in a bank loan is easier and more flexible. In this regard, the borrower is able to approach a limited number of lenders and agree with them on waivers or consents within a short period, while in the case of high-yield bonds the issuer has to communicate with a wider range of investors, the threshold for amending key economic terms is higher and the process is more costly and time-consuming.

Finally, another relevant difference is the level of disclosure of information, in particular if there is a public placement of the securities or if they are admitted to trading (see question 6).

Regulation

Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

In recent years bank loans have been subject to stricter regulation, in particular regarding interest rates, the payment of interest, fees and other charges as well as the information disclosed to the borrower.

As to high-yield bonds, investment in these securities is not regulated. However, several laws applicable to securities have been toughened in recent years with a view to providing greater protection and information to investors namely by means of an increasing control over the other parties (mainly intermediaries); high-yield bonds are traded on secondary markets or non-regulated markets where information level requirements are lower, thus being less likely for investors to be provided with an adequate level of information for the risk being taken.

From a regulatory perspective, the second Markets in Financial Instruments Directive (2014/65/EU) (MiFID II) has already been implemented into Portuguese national law by means of Law No. 35/2018, of 20 July 2018. MiFID II aimed at ensuring a fairer, safer and more efficient functioning of the capital markets as well as greater transparency for all

participants.

In this regard, Law No. 35/2018 followed MiFID II and new reporting requirements and tests have been established that consequently increase the level of information available and contribute to reducing the use of less transparent pools and OTC trading. Moreover, the protection of investors has also been strengthened via the creation of new requirements on product governance as well as independent investment advice, among many others (including the provision of rules on the responsibility of management bodies, inducements, information and reporting to clients, cross-selling, remuneration of staff and best execution). Another important change refers to the terminology used in respect of the categories of investors, as the concept of qualified investors has been replaced by that of professional investors, which should not be disregarded, as the markets have been showing that high-yield bonds are usually sought mostly by institutional investors and big players and not retail investors (the non-professional investors).

Current market activity

Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

After a record-breaking year in 2017 for the European high-yield market (including the Portuguese segment), with European high-yield issuances totalling around €114 billion according to DebtWire, 2018 fell short in comparison, as the European high-yield issuance volume amounted to approximately €71 billion. This significant drop in the issuance volume owes much to the second half of 2018 in which, after a strong first half (April being the best month, with issuances above €10 billion), fewer deals than expected were completed, to the point that no European high-yield issuances took place in December. Nonetheless, 2018 also marks the year when the market saw €5 billion-worth deals being postponed or pulled out from the market, as volatility disrupted pricing of new high-yield bonds and, in some cases, the issuers simply could not raise the intended financing.

As to the main underlying factors, both trade tensions (such as the one between China and the US) and political risks (in particular those involving Brexit and the populist rise of European anti-establishment forces) have contributed to an increase of risk aversion as well as to a jump in volatility, thus resulting in an investor pushback. The refinancing activity also contributed decisively to this cooling, with a drop from €70 billion in 2017 to €37 billion in 2018 (however, the M&A related European high-yield issuances rose from €10 billion to €18 billion). As to the average yield to maturity on European unsecured notes, it has increased from around 4.3 per cent in 2017 to 5.0 per cent in 2018.

The trends at the beginning of 2019 are not very positive. According to Moody's, European high-yield volumes have recorded their second lowest January since 2012, with a high-yield bond volume of just €2.3 billion (considerably lower than the €5.9 billion registered in January, 2018). In this context, one must not disregard that the European Central Bank (ECB) had announced that the quantitative easing (QE) would end in 2018. As the ECB is to stop purchasing debt under the QE programme (since 2015 the ECB has purchased not only sovereign bonds but also corporate bonds in the investment-grade market), this may result in higher borrowing costs for high-yield issuers as well as in a slowdown in growth in the market. Not surprisingly, the European high-yield market has registered outflows ranging from 7 to 8 per cent during 2017 and 2018 (showing that investors are repositioning their capitals for the end of QE).

As with the distribution of the high-yield debt activity by the different economic sectors, we have seen issuances in the telecommunications, power and energy, security and alarms, and pharmaceutical sectors among others (namely the financial and basic industry sectors).

As to the activity and trends from a technical standpoint, high-yield bonds are commonly regulated by a New York law governed indenture pursuant to which a trustee and a security agent are appointed to represent and defend the interests of the holders of high-yield bonds. However, with the significant increase in European high-yield bond issuances we have seen in recent deals the indenture being ruled by English law and, in some cases, German law.

Other typical documents in high-yield bond transactions are the purchase agreement pursuant to which the purchasers underwrite the notes issued by the issuer; the intercreditor agreement between the bank lenders, the noteholders and the issuer; and the security agreements pursuant to which the several companies of the issuer's group grant security in case of secured deals. Legal opinions and accountants' comfort letters are also a necessary element of these transactions.

In terms of security, and aside from the classic corporate guarantee granted by Portuguese subsidiaries, share security and certain types of in rem security (eg, pledges over bank accounts, insurance policies and receivables) are taken without affecting the day-to-day business activity of the company.

High-yield bonds are usually exclusively offered to professional investors rather than to retail investors. As such, they usually do not entail a public placement in Portugal for the purposes of the Securities Code and have a nominal unitary value of at least €100,000. Investors in high-yield debt securities are usually mutual funds (eg, corporate bond funds, high-yield funds and income mutual funds), insurance undertakings and pension funds.

Finally, we have been seeing in the majority of financings a clear overlap between high-yield debt securities and loan financings, although usually the lion share of the financing arises from high-yield bonds.

Main participants

Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

The main participants (aside from the issuer, guarantors, legal advisers and auditors) in a high-yield debt financing and their roles are as follows:

- Initial purchasers and underwriters: the role of the initial purchasers is to advise the issuer on the structure and timing of the offering and to coordinate and market the transaction. They have a major role in the discussion of the offering memorandum with the legal teams and accountants. They underwrite the securities from the issuer under the purchase agreement and resell them to investors.
- Security agent: given that neither the trusteeship nor parallel debt are recognised legal concepts under Portuguese law, the security agent has a major role in high-yield bond transactions. It is a party to the intercreditor agreement and the security documents and is responsible for monitoring and enforcing the collateral guaranteeing the notes in an enforcement scenario (as usually guarantees and security are granted in its favour, for its benefit and for the benefit of the secured parties).
- Paying agent: the role of the paying agent is to make payments of principal and interest to the noteholders.
- Rating agencies: ratings are issued by two of the largest four rating agencies (eg, DBRS, Fitch, Moody's and Standard & Poor's).

The fees of the initial purchasers are usually calculated as a percentage agreed on an individual basis of the aggregate principal amount of the notes. The other parties referred to above receive market-standard fees (usually flat fees) in connection with their involvement.

New trends

Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

Covenant packages vary considerably depending on the economic and credit cycle. They are more restrictive if there is more risk aversion and interest rates and spreads are higher. If, however, there is less risk aversion and interest rates and spreads are lower, the covenant package is less restrictive.

The first half of 2018 maintained the trend from 2016 and 2017 and therefore covenant packages continued to be very favourable to issuers. By the same token, covenant-lite issuances continued to be adopted, as did soft-cap grower baskets calculated on the higher of a fixed amount or a percentage of assets or EBITDA. In addition, European (including Portuguese) high-yield bonds continue to provide issuers with more flexibility to redeem notes and equity claws are more and more common.

Notwithstanding this, further to the continuation of covenant loosening in the first half of 2018, during the second half of 2018 the market reacted adversely to a handful of covenants due to the tightening of the bond market and an increase in the risk aversion of investors. Several examples illustrate the above-mentioned shift, as is the case of economic terms in respect of which we have seen shortened maturities, the use of floating rate bonds and even the lengthening of the non-call periods. Other examples include changes in restricted payments covenants (the underwriters being more reluctant to employ leverage-based ratios), the inclusion of contribution debt baskets (allowing the incurrence of debt up to 100 per cent of any new equity injection, as opposed to the 200 per cent more easily seen in the US context) and the refusal of portability covenants, very popular in Europe in 2017 (currently, it is more difficult to get investors to accept that a change of control is effected without that triggering put rights).

DOCUMENTATION TERMS

Issuance

How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

Transaction documents are prepared based on recent relevant precedents, including the offering memorandum or prospectus, the purchase agreement and the indenture as well as, if combined with a loan financing, the relevant senior facilities agreement.

Previous issuances by the same issuer will tend to set such a precedent, as will set it issuances by companies in the same industry or sector or with a similar credit risk profile. By the same token, the standard covenant forms of lead banks (and, in sponsored deals, of sponsors) typically also play an important role in negotiating the covenants with the issuer, as both will try to use a covenant package familiar to them.

Maturity and call structure

What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

Typically, high-yield debt securities have maturities that range from five to 10 years.

In relation to redemption or call rights, it is rare to have mandatory redemption provisions requiring an issuer to prepay the outstanding notes prior to their maturity and it is very common for the issuer to have call rights.

Notwithstanding, there are usually non-call periods and declining premium redemptions. In recent years high-yield bonds have provided issuers with more flexibility to redeem notes, namely with shorter non-call periods and the widespread use of the equity claw redemption, although the first few months of 2019 may indicate that this is a trend that may come to an end shortly. See question 5.

Offerings

How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

The launching, pricing and closing of high-yield bonds issued by a Portuguese issuer follow the standard process and steps of a typical high-yield offering. The offering is launched by preparing and distributing the preliminary offering memorandum to investors, which is then followed by a roadshow with several investor meetings, which typically lasts from three days to two weeks.

The roadshow ends with the pricing of the offering, which basically consists of executing the purchase agreement. While the company is on the roadshow, the company counsel will be negotiating the purchase agreement with the banks and the purchasers. The most significant aspect of the purchase agreement, besides the pricing of the notes, is the dramatic and temporary change it entails in the relationship between the company and the initial purchasers.

Prior to executing the purchase agreement, the company and the initial purchasers have an informal arrangement to do a deal if there is one to be done. Either party can walk away at any time with no liability being triggered (without prejudice to the general clauses under civil law for breaches due to fraud and bad faith). Once the purchase agreement is signed, the parties are bound to close, typically within the third business day after pricing (T+3) although sometimes up to as many as nine business days later (T+9).

The closing of a high-yield offering is relatively uneventful. The initial purchasers will initiate a bring-down due diligence call in which they will ask the company whether there have been any material events since the pricing. After that, the transfer of funds and delivery of the notes will take place.

The majority of high-yield bonds have a fixed coupon, although there has been a recent rise in the use of floating rates. The coupon is determined based on investor demand, which in turn depends on several factors, including, among others, the general market development, the financial condition of the issuer, the covenant package and the prospects for the industry in which the issuer is operating. However, as mentioned before, we note that in recent years there has been an increase in floating rate unsecured high-yield bonds.

Covenants

Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

As mentioned above, covenants for high-yield bonds are generally incurrence-based, as opposed to maintenance-based (more common in the banking market). The issuer will not typically be required to maintain any financial ratios, but will be restricted from taking certain actions (including in relation to subsidiaries, except if it is an unrestricted subsidiary), unless it meets an exception to the relevant restrictions. Typical covenants relate to the following:

- fixed-charge coverage ratios;
- credit facility and debt baskets;
- permitted investments;
- change of control or ownership;
- limitations on payments, distributions, liens and asset sales; and
- transactions with affiliates.

Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

As mentioned above, covenant trends in the first half of 2018 were still very favourable to issuers, with covenant-lite issuances and soft-cap grower baskets being frequently used. However, as seen before (see questions 3 and 5), the year of 2018 saw very specific fears from investors, which have contributed to what may be seen as a shift in the covenant package paradigm so far.

On another note, covenant terms are often redrafted and renegotiated between the launching and pricing of an offering as well as during the marketing process, with additional covenants sometimes being added and others removed.

Are there particular covenants that are looser or tighter, based on a particular industry sector?

If the relevant industry sector is characterised by certain customary specifics or requires more investment (eg, telecommunications, energy, etc), the covenants will contain adequate exceptions to reflect these industry specifics and grant more flexibility to the issuer. Coherently, some transactions in other sectors do not have the same elasticity as they are more standardised and, therefore, the underwriters may not be open to these adjustments.

Change of control

Do changes of control, asset sales or similar typically trigger any prepayment requirements?

Typically, high-yield bonds documentation establishes that, upon a change of control, the issuer is forced to make a repurchase offer for the notes at a fixed percentage, which is usually 101 to 103 per cent. Portable change of control provisions have become increasingly popular during 2017, however, as stated before, this was one of the many covenants that started to receive considerable investor pushback in marketing during the second half of 2018.

There are also put option rights of the noteholders upon the sale of certain assets to the extent that the cash proceeds of the sale are not reinvested in the business or used to repay debt.

Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

Yes. Some high-yield bonds include a 'double trigger' change of control covenant giving more protection to investors against a deterioration in credit quality as a result of a change of control event of the issuer. Consequently, there is only an obligation to exercise the relevant put (poison pill put) if there is a change of control event of the issuer followed by a ratings downgrade. However, this is not very common.

Crossover covenants

Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

Yes, a 'crossover' covenant package is common for issuers who are on the verge of becoming investment grade. Usually there is no restricted payments' covenant and limitations on indebtedness' covenant might apply to secured

debt only. Another difference is the basket mechanics, which are adjusted in light of the lower credit risk of the issuer.

REGULATION

Disclosure requirements

Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

In the case of a private placement, there are no specific statutory disclosure requirements to be complied with and the typical high-yield debt offering disclosure standards are followed. However, whenever the issuer is a publicly traded company or a company issuing securities traded in the market, private placements shall be subsequently reported to the Portuguese Securities Market Commission (CMVM) for statistical purposes. However, the private placement offering memorandum does not need to be approved by the CMVM.

Contrarily, public offerings of high-yield bonds in Portugal, as well as the listing of debt securities in a Portuguese secondary regulated market, require the filing of a prospectus for approval by the CMVM and the offering itself is subject to prior registration. The CMVM will verify that the prospectus contains all necessary information concerning the issuer and the securities in order for investors to make an informed investment decision and that it complies with the applicable regulations (mainly EU Prospectus Directive regulations).

The prospectus shall contain all information that, according to the particular nature of the issuer and the securities offered to the public or admitted to trading on a regulated market, is deemed necessary to allow investors to make an informed assessment on, primarily, the assets and liabilities, financial position, risk factors, profit and losses, and prospects of the issuer and of any guarantor, as well as on the rights attaching to these securities.

Use of proceeds

Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

There are very few limitations on the use of proceeds by an issuer in the context of an issuance of high-yield securities. The more important limitations are those arising under the financial assistance rules set forth in the Portuguese Companies Code (prohibiting the use of the proceeds to fund the acquisition of own shares or even own notes) and anti-money laundering or similar laws that limit the possible use of proceeds.

Restrictions on investment

On what grounds, if any, could an investor be precluded from investing in high-yield securities?

Any investor can potentially invest in high-yield securities. In fact, a variety of investors participate in the high-yield bonds market either directly or indirectly via investment funds or other entities investing in high-yield securities.

However, if high-yield securities are offered by way of a private placement, the nominal unitary value of the notes must be at least €100,000 (or otherwise that must be the minimum subscription or sale price, per addressee, by each offering) and all actions that could permit a public offering of any of the notes in Portugal or for the offering memorandum to be distributed in Portugal are prohibited, except in circumstances that will not be deemed as a public offering under article 109 of the Securities Code.

Closing mechanics

Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

No, there are no particular closing mechanics in the case of the issuance of high-yield bonds in Portugal.

GUARANTEES AND SECURITY**Guarantees**

Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

In Portugal, a high-yield deal comprises the granting of guarantees by material subsidiaries of the issuer (upstream guarantees) and, in cases where the issuer is not the top holding company, also by its parent company (downstream guarantee), as well as by any material sister companies (cross-stream guarantees). The guarantors are usually the same as the guarantors under the senior facilities agreement (if any).

Pursuant to the Portuguese Companies Code, Portuguese guarantors may only secure third parties' obligations if the company has a justified corporate self-interest in the granting of the guarantees or the security, or both, or if the company is in a group or controlling interest with the entities whose obligations are being secured.

Under the Portuguese Companies Code the definition of 'controlling interest' includes relationships between companies where one company holds, directly or indirectly, the majority of the share capital or the voting rights in another company or otherwise has the right to appoint the majority of the members of its board of directors or supervisory board. A 'group interest' includes relationships between Portuguese companies where one is 100 per cent owned or controlled, directly or indirectly, by the other; or between companies that are bound by a group agreement or a subordination agreement, whereby one company is subject to the instructions or management of the other.

In the absence of a control or group interest, the validity of a guarantee or security interest could be challenged if there is no justified corporate self-interest in its granting, as the interested parties (such as the shareholders of the company) may argue that the granting of said guarantee or security is contrary to the purpose of the company.

In addition, the obligations under the high-yield bonds' guarantees or security granted by the guarantors shall not extend to any use of the proceeds of the notes for the purpose of acquiring shares representing the share capital of the guarantor or shares representing the share capital of the parent guarantor, or refinancing a previous debt incurred for the acquisition of shares representing the share capital of the guarantor or shares representing the share capital of its parent guarantor. This would constitute unlawful financial assistance pursuant to article 322 of the Companies Code.

In this respect, guarantee limitation language is included in such high-yield bonds' guarantees or collateral to ensure that in no case can any high-yield bonds' guarantees or collateral granted by a guarantor secure repayment of the above-mentioned funds.

Finally, we also outline that, for tax reasons (namely in the context of the payment of stamp duty), the obligations under high-yield bonds' guarantees or collateral granted by the guarantors are typically limited to an agreed maximum secured amount (which is commonly established as an aggregate maximum amount should there be multiple guarantees). As a result, the guarantors will not have a direct obligation to repay any amounts once the relevant maximum secured amount has been reached, as applicable.

Collateral package

What is the typical collateral package for high-yield debt securities in your jurisdiction?

In Portugal, the typical collateral package for high-yield debt securities includes pledges over the issued share capital, plant and equipment (this refers to manufacturing plant and machinery, trucks, generating sets, drilling rigs and similar items), bank account pledges, and assignments of receivables by way of security, among others.

The typical collateral package granted by entities in connection with high-yield debt securities depends on the type of assets owned by the issuer and its subsidiaries as well as on the sector of activity. Usually it comprises:

- share security (namely, a financial pledge over the issued share capital and a promissory pledge over any equity that is issued afterwards);
- bank account security (namely, a financial or commercial pledge over the bank accounts);
- assignment of receivables, whether present or future (including intercompany receivables);
- security over fixed movable assets (namely, a pledge over stock, equipment or inventory); and
- assignments of receivables emerging from, or pledges over, insurance policies and, in some cases (although less commonly), intellectual property rights.

In very few issuances, security is taken over real estate (this will usually include mortgages and assignments of income emerging from the relevant real estate).

Limitations

Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

The limitations on the granting of guarantees are those already mentioned above in respect of the granting of upstream, downstream and cross-stream security (see question 19). As to the types of assets that can be pledged, there is a very broad diversity of assets to be considered in this context as, conceptually, a pledge will be created over a certain moveable asset or otherwise a credit or other right, which may not be mortgaged. However, the type of pledge itself will vary according to the pledged asset and other factors. Hence, one may grant financial or commercial pledges, rotary pledges (in which the pledged asset is not always the same), pledges over credit rights, shareholdings, commercial establishments, credit notes, among others.

If the assets of the Portuguese issuer or guarantor are covered by the immunities legally set forth - which include, but are not limited to, assets that are part of the public domain of Portugal or allocated to public service purposes - the relevant issuer or guarantor will be entitled to claim for itself immunity from suit, attachment or other legal process in respect of its obligations under said guarantees.

We also note that, as a general rule, under law, any guarantee, pledge or mortgage must guarantee or secure another obligation to which it is ancillary, which must be identified in the security agreements. Therefore, the guarantee or security follows the underlying obligation in such a way that the invalidity of the underlying obligation entails the invalidity of the guarantee or security and the termination of the underlying obligation entails the termination of the guarantee or security.

Collateral structure

Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

There is no typical collateral structure in Portugal, as this structure will primarily depend on the issuer and its guarantors as well as on their credit profile risk, capital and financial structure.

Crossing lien structures (where lenders benefit from first ranking security and noteholders benefit from second ranking security) are not very common but we have seen them being used. This concept can be implemented in practice, although it can be more complex in relation to certain types of assets, such as real estate.

It is also common to regulate this type of issue (ranking and priority of debt and security) in the intercreditor agreement through waterfall provisions.

Finally, we have also seen structures where there is a mixed issuance of senior secured notes and senior unsecured notes.

Legal expenses

Who typically bears the costs of legal expenses related to security interests?

In Portugal, the issuer usually bears the costs of legal expenses related to the transaction, including the fees to be paid by the initial purchasers to their legal counsel. It is also common for the issuer to bear any expenses related to the security interests, including the payment of stamp duty and any registration costs.

Security interests

How are security interests recorded? Is there a public register?

Bank account pledges are subject to registration with the bank with whom the account is held, while share security is subject to registration with the issuer, a depositary or a bank in the case of registered, deposited or dematerialised shares. Mortgages over real estate or registrable movable assets (eg, vehicles, ships and aircraft), assignments of real estate income, as well as pledges over quotas, are recorded in the competent land or commercial registry office, whose register is in both cases public.

How are security interests typically enforced in the high-yield context?

Portuguese law does not recognise the concept of parallel debt or trusteeship. The indenture will thus provide (along with the intercreditor agreement) that only the security agent may enforce the security documents in its capacity as agent and joint and several creditor, and that usually the holders of the notes will not have direct security interests. Therefore, the holders will not be entitled to take enforcement action in respect of the guarantees or collateral securing the high-yield bonds, except through the trustee, who will provide instructions to the security agent in respect of the notes' guarantee or collateral, or both.

The security interests are thus enforced by the security agent, if necessary, and following an instruction by the noteholders or lenders in accordance with the provisions of the indenture, the intercreditor agreement and the relevant security agreement. Depending on the type of security, the ways of enforcing can be very different. Financial pledges over financial instruments and bank accounts allow for an appropriation of the asset by the pledgor and allow for an

extrajudicial sale of the asset to the extent that said appropriation right as well as the rules for the evaluation of the asset have been established in the contract. Nonetheless, the pledgor is subject to the obligation of paying the difference between the value of the relevant asset and the amount of the secured obligations to the pledgee. The enforcement of a mortgage, however, requires a judicial enforcement proceeding, whereas the assignment of receivables only requires a notification to the debtor or client of the issuer to make payments directly to the secured parties (said notification being an enforceability requirement rather than a validity one).

Finally, it is very common for the guarantors to grant power of attorney in favour of the security agent allowing it to enforce the security and to sell the assets upon the occurrence of an event of default, as well as to carry out any other necessary actions in respect of the enforcement of the security or otherwise its perfection.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Ranking of high-yield debt

How does high-yield debt rank in relation to other creditor interests?

The majority of high-yield bonds are senior unsecured notes, which means that they rank equally in right of payment with all existing and future non-subordinated obligations of the issuer and rank senior to any existing or future subordinated indebtedness. If collateral is granted (which is often the case), the notes will, in practice, rank senior to any existing or future unsecured obligations to the extent that the proceeds of the enforcement of the collateral satisfy with priority the obligations of the issuer under the high-yield debt securities.

However, certain guaranteed credits - namely, special statutory liens (eg, real estate special statutory liens such as state credits related with real estate property tax) and movable assets special statutory liens (eg, credits resulting from legal expenses incurred in the interest of the creditors) - may rank above the security of high-yield debt.

If there are privileged credits, which are credits secured by general statutory liens over assets integrated in the insolvency estate (labour, tax and social security debts), they rank as higher priority than common credits up to the amount corresponding to the value of the assets granted in guarantee or the general statutory liens, which means that they rank above senior unsecured high-yield bonds.

Regulation of voting and control

Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

The terms of the intercreditor agreement governing control of enforcement proceedings depend on the collateral structure and the ranking of high-yield debt in relation to bank debt. Structures involving super senior bank debt with lenders controlling the enforcement are less common and deals with pari passu structures provide for a right of the noteholders to participate in the control of enforcement proceedings by voting as a class (the vote of said class is usually achieved by the majority rule by reference to the capital held).

TAX CONSIDERATIONS

Offsetting of interest payments

May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

Issuers of securities, including high-yield bonds, may generally set off their interest payments against their tax liability.

However, there is a general annual limitation to tax deduction for corporate income tax purposes of financial expenses in excess of the highest of €1 million or 30 per cent of EBITDA (as adjusted for tax purposes). Non-deductible financial expenses can be carried forward to the five subsequent years. In the event that net financial expenses of a tax year are below the 30 per cent EBITDA threshold, the difference may be used as an extra deduction on top of the 30 per cent of EBITDA during the five subsequent years.

Tax rulings

Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

No, it is uncommon for issuers to obtain any tax rulings in connection with the issuance of securities, including high-yield bonds.

UPDATE AND TRENDS

Recent developments

Are there any emerging trends or hot topics regarding high-yield debt in your jurisdiction?

MARKET OVERVIEW

High-yield debt securities versus bank loans

Discuss the major differences between high-yield debt securities and bank loans in your jurisdiction. What are some of the critical advantages and disadvantages?

One of the key differences between high-yield debt securities and bank loans is the regulatory framework applicable to bank loans. Only duly authorised credit institutions and financial companies can carry out credit transactions (including the granting of loans, guarantees and other commitments) on a professional basis (isolated transactions are excluded). On the contrary, the issue of debt securities does not require regulatory authorisation, thus giving greater flexibility for companies to seek a wider range of investors through high-yield debt securities as opposed to bank loans.

Another key difference is typically found in the covenant package: bank loans have financial maintenance covenants, while high-yield bonds have incurrence-based covenants. Typically, financial maintenance covenants are triggered if the borrower does not meet certain leverage ratios (eg, debt-to-earnings before interest, tax, depreciation, and amortisation (EBITDA)) or a certain limit of interest coverage (eg, EBITDA-to-interest expense) or some other coverage metric set forth in the business model. Nonetheless, loan agreements usually establish exceptions for investments, disposals and liens that are in line with the business model. Cash sweep mechanisms that force the borrower to prepay the loan if there is an excess cash flow are also common. In incurrence-based covenants of high-yield bonds, however, a potential breach of the same may only occur whenever the issuer raises new debt, makes an acquisition, pays a dividend, or undertakes some other relevant corporate action (usually it requires an action from the borrower). From the issuer's perspective, incurrence-based covenants, which are usually tailored to the specific case, are preferable as they give more flexibility and, therefore, constitute an advantage compared to bank loans.

Another consequence of having the covenant package established is that the process for obtaining waivers or consents in a bank loan is easier and more flexible. In this regard, the borrower is able to approach a limited number of lenders and agree with them on waivers or consents within a short period, while in the case of high-yield bonds the issuer has to communicate with a wider range of investors, the threshold for amending key economic terms is higher and the process is more costly and time-consuming.

Finally, another relevant difference is the level of disclosure of information, in particular if there is a public placement of the securities or if they are admitted to trading (see question 6).

Regulation

Are you seeing increased regulation regarding either high-yield debt securities or bank loans in your jurisdiction?

In recent years bank loans have been subject to stricter regulation, in particular regarding interest rates, the payment of interest, fees and other charges as well as the information disclosed to the borrower.

As to high-yield bonds, investment in these securities is not regulated. However, several laws applicable to securities have been toughened in recent years with a view to providing greater protection and information to investors namely by means of an increasing control over the other parties (mainly intermediaries); high-yield bonds are traded on secondary markets or non-regulated markets where information level requirements are lower, thus being less likely for investors to be provided with an adequate level of information for the risk being taken.

From a regulatory perspective, the second Markets in Financial Instruments Directive (2014/65/EU) (MiFID II) has already been implemented into Portuguese national law by means of Law No. 35/2018, of 20 July 2018. MiFID II aimed at ensuring a fairer, safer and more efficient functioning of the capital markets as well as greater transparency for all participants.

In this regard, Law No. 35/2018 followed MiFID II and new reporting requirements and tests have been established that consequently increase the level of information available and contribute to reducing the use of less transparent pools and OTC trading. Moreover, the protection of investors has also been strengthened via the creation of new requirements on product governance as well as independent investment advice, among many others (including the provision of rules on the responsibility of management bodies, inducements, information and reporting to clients, cross-selling, remuneration of staff and best execution). Another important change refers to the terminology used in respect of the categories of investors, as the concept of qualified investors has been replaced by that of professional investors, which should not be disregarded, as the markets have been showing that high-yield bonds are usually sought mostly by institutional investors and big players and not retail investors (the non-professional investors).

Current market activity

Describe the current market activity and trends in your jurisdiction relating to high-yield debt securities financings.

After a record-breaking year in 2017 for the European high-yield market (including the Portuguese segment), with European high-yield issuances totalling around €114 billion according to DebtWire, 2018 fell short in comparison, as the European high-yield issuance volume amounted to approximately €71 billion. This significant drop in the issuance volume owes much to the second half of 2018 in which, after a strong first half (April being the best month, with issuances above €10 billion), fewer deals than expected were completed, to the point that no European high-yield issuances took place in December. Nonetheless, 2018 also marks the year when the market saw €5 billion-worth deals being postponed or pulled out from the market, as volatility disrupted pricing of new high-yield bonds and, in some cases, the issuers simply could not raise the intended financing.

As to the main underlying factors, both trade tensions (such as the one between China and the US) and political risks (in particular those involving Brexit and the populist rise of European anti-establishment forces) have contributed to an increase of risk aversion as well as to a jump in volatility, thus resulting in an investor pushback. The refinancing activity also contributed decisively to this cooling, with a drop from €70 billion in 2017 to €37 billion in 2018 (however,

the M&A related European high-yield issuances rose from €10 billion to €18 billion). As to the average yield to maturity on European unsecured notes, it has increased from around 4.3 per cent in 2017 to 5.0 per cent in 2018.

The trends at the beginning of 2019 are not very positive. According to Moody's, European high-yield volumes have recorded their second lowest January since 2012, with a high-yield bond volume of just €2.3 billion (considerably lower than the €5.9 billion registered in January, 2018). In this context, one must not disregard that the European Central Bank (ECB) had announced that the quantitative easing (QE) would end in 2018. As the ECB is to stop purchasing debt under the QE programme (since 2015 the ECB has purchased not only sovereign bonds but also corporate bonds in the investment-grade market), this may result in higher borrowing costs for high-yield issuers as well as in a slowdown in growth in the market. Not surprisingly, the European high-yield market has registered outflows ranging from 7 to 8 per cent during 2017 and 2018 (showing that investors are repositioning their capitals for the end of QE).

As with the distribution of the high-yield debt activity by the different economic sectors, we have seen issuances in the telecommunications, power and energy, security and alarms, and pharmaceutical sectors among others (namely the financial and basic industry sectors).

As to the activity and trends from a technical standpoint, high-yield bonds are commonly regulated by a New York law governed indenture pursuant to which a trustee and a security agent are appointed to represent and defend the interests of the holders of high-yield bonds. However, with the significant increase in European high-yield bond issuances we have seen in recent deals the indenture being ruled by English law and, in some cases, German law.

Other typical documents in high-yield bond transactions are the purchase agreement pursuant to which the purchasers underwrite the notes issued by the issuer; the intercreditor agreement between the bank lenders, the noteholders and the issuer; and the security agreements pursuant to which the several companies of the issuer's group grant security in case of secured deals. Legal opinions and accountants' comfort letters are also a necessary element of these transactions.

In terms of security, and aside from the classic corporate guarantee granted by Portuguese subsidiaries, share security and certain types of in rem security (eg, pledges over bank accounts, insurance policies and receivables) are taken without affecting the day-to-day business activity of the company.

High-yield bonds are usually exclusively offered to professional investors rather than to retail investors. As such, they usually do not entail a public placement in Portugal for the purposes of the Securities Code and have a nominal unitary value of at least €100,000. Investors in high-yield debt securities are usually mutual funds (eg, corporate bond funds, high-yield funds and income mutual funds), insurance undertakings and pension funds.

Finally, we have been seeing in the majority of financings a clear overlap between high-yield debt securities and loan financings, although usually the lion share of the financing arises from high-yield bonds.

Main participants

Identify the main participants in a high-yield debt financing in your jurisdiction and outline their roles and fees.

The main participants (aside from the issuer, guarantors, legal advisers and auditors) in a high-yield debt financing and their roles are as follows:

- Initial purchasers and underwriters: the role of the initial purchasers is to advise the issuer on the structure and timing of the offering and to coordinate and market the transaction. They have a major role in the discussion of the offering memorandum with the legal teams and accountants. They underwrite the securities from the issuer under the purchase agreement and resell them to investors.

- Security agent: given that neither the trusteeship nor parallel debt are recognised legal concepts under Portuguese law, the security agent has a major role in high-yield bond transactions. It is a party to the intercreditor agreement and the security documents and is responsible for monitoring and enforcing the collateral guaranteeing the notes in an enforcement scenario (as usually guarantees and security are granted in its favour, for its benefit and for the benefit of the secured parties).
- Paying agent: the role of the paying agent is to make payments of principal and interest to the noteholders.
- Rating agencies: ratings are issued by two of the largest four rating agencies (eg, DBRS, Fitch, Moody's and Standard & Poor's).

The fees of the initial purchasers are usually calculated as a percentage agreed on an individual basis of the aggregate principal amount of the notes. The other parties referred to above receive market-standard fees (usually flat fees) in connection with their involvement.

New trends

Please describe any new trends as they relate to the covenant package, structure, regulatory review or other aspects of high-yield debt securities.

Covenant packages vary considerably depending on the economic and credit cycle. They are more restrictive if there is more risk aversion and interest rates and spreads are higher. If, however, there is less risk aversion and interest rates and spreads are lower, the covenant package is less restrictive.

The first half of 2018 maintained the trend from 2016 and 2017 and therefore covenant packages continued to be very favourable to issuers. By the same token, covenant-lite issuances continued to be adopted, as did soft-cap grower baskets calculated on the higher of a fixed amount or a percentage of assets or EBITDA. In addition, European (including Portuguese) high-yield bonds continue to provide issuers with more flexibility to redeem notes and equity claws are more and more common.

Notwithstanding this, further to the continuation of covenant loosening in the first half of 2018, during the second half of 2018 the market reacted adversely to a handful of covenants due to the tightening of the bond market and an increase in the risk aversion of investors. Several examples illustrate the above-mentioned shift, as is the case of economic terms in respect of which we have seen shortened maturities, the use of floating rate bonds and even the lengthening of the non-call periods. Other examples include changes in restricted payments covenants (the underwriters being more reluctant to employ leverage-based ratios), the inclusion of contribution debt baskets (allowing the incurrence of debt up to 100 per cent of any new equity injection, as opposed to the 200 per cent more easily seen in the US context) and the refusal of portability covenants, very popular in Europe in 2017 (currently, it is more difficult to get investors to accept that a change of control is effected without that triggering put rights).

DOCUMENTATION TERMS

Issuance

How are high-yield debt securities issued in your jurisdiction? Are there particular precedents or models that companies and investors tend to review prior to issuing the securities?

Transaction documents are prepared based on recent relevant precedents, including the offering memorandum or prospectus, the purchase agreement and the indenture as well as, if combined with a loan financing, the relevant senior facilities agreement.

Previous issuances by the same issuer will tend to set such a precedent, as will set it issuances by companies in the

same industry or sector or with a similar credit risk profile. By the same token, the standard covenant forms of lead banks (and, in sponsored deals, of sponsors) typically also play an important role in negotiating the covenants with the issuer, as both will try to use a covenant package familiar to them.

Maturity and call structure

What is the typical maturity and call structure of a high-yield debt security? Are high-yield securities frequently issued with original issue discount? Describe any yield protection provisions typically included in the high-yield debt securities documentation.

Typically, high-yield debt securities have maturities that range from five to 10 years.

In relation to redemption or call rights, it is rare to have mandatory redemption provisions requiring an issuer to prepay the outstanding notes prior to their maturity and it is very common for the issuer to have call rights.

Notwithstanding, there are usually non-call periods and declining premium redemptions. In recent years high-yield bonds have provided issuers with more flexibility to redeem notes, namely with shorter non-call periods and the widespread use of the equity claw redemption, although the first few months of 2019 may indicate that this is a trend that may come to an end shortly. See question 5.

Offerings

How are high-yield debt securities offerings launched, priced and closed? How are coupons determined? Do you typically see fixed or floating rates?

The launching, pricing and closing of high-yield bonds issued by a Portuguese issuer follow the standard process and steps of a typical high-yield offering. The offering is launched by preparing and distributing the preliminary offering memorandum to investors, which is then followed by a roadshow with several investor meetings, which typically lasts from three days to two weeks.

The roadshow ends with the pricing of the offering, which basically consists of executing the purchase agreement. While the company is on the roadshow, the company counsel will be negotiating the purchase agreement with the banks and the purchasers. The most significant aspect of the purchase agreement, besides the pricing of the notes, is the dramatic and temporary change it entails in the relationship between the company and the initial purchasers.

Prior to executing the purchase agreement, the company and the initial purchasers have an informal arrangement to do a deal if there is one to be done. Either party can walk away at any time with no liability being triggered (without prejudice to the general clauses under civil law for breaches due to fraud and bad faith). Once the purchase agreement is signed, the parties are bound to close, typically within the third business day after pricing (T+3) although sometimes up to as many as nine business days later (T+9).

The closing of a high-yield offering is relatively uneventful. The initial purchasers will initiate a bring-down due diligence call in which they will ask the company whether there have been any material events since the pricing. After that, the transfer of funds and delivery of the notes will take place.

The majority of high-yield bonds have a fixed coupon, although there has been a recent rise in the use of floating rates. The coupon is determined based on investor demand, which in turn depends on several factors, including, among others, the general market development, the financial condition of the issuer, the covenant package and the prospects for the industry in which the issuer is operating. However, as mentioned before, we note that in recent years there has been an increase in floating rate unsecured high-yield bonds.

Covenants

Describe the main covenants restricting the operation of the debtor's business in a typical high-yield debt securities transaction. Have you been seeing a convergence of covenants between the high-yield and bank markets?

As mentioned above, covenants for high-yield bonds are generally incurrence-based, as opposed to maintenance-based (more common in the banking market). The issuer will not typically be required to maintain any financial ratios, but will be restricted from taking certain actions (including in relation to subsidiaries, except if it is an unrestricted subsidiary), unless it meets an exception to the relevant restrictions. Typical covenants relate to the following:

- fixed-charge coverage ratios;
- credit facility and debt baskets;
- permitted investments;
- change of control or ownership;
- limitations on payments, distributions, liens and asset sales; and
- transactions with affiliates.

Are you seeing any tightening of covenants or are you seeing investor protections being eroded? Are terms of covenants often changed between the launch and pricing of an offering?

As mentioned above, covenant trends in the first half of 2018 were still very favourable to issuers, with covenant-lite issuances and soft-cap grower baskets being frequently used. However, as seen before (see questions 3 and 5), the year of 2018 saw very specific fears from investors, which have contributed to what may be seen as a shift in the covenant package paradigm so far.

On another note, covenant terms are often redrafted and renegotiated between the launching and pricing of an offering as well as during the marketing process, with additional covenants sometimes being added and others removed.

Are there particular covenants that are looser or tighter, based on a particular industry sector?

If the relevant industry sector is characterised by certain customary specifics or requires more investment (eg, telecommunications, energy, etc), the covenants will contain adequate exceptions to reflect these industry specifics and grant more flexibility to the issuer. Coherently, some transactions in other sectors do not have the same elasticity as they are more standardised and, therefore, the underwriters may not be open to these adjustments.

Change of control

Do changes of control, asset sales or similar typically trigger any prepayment requirements?

Typically, high-yield bonds documentation establishes that, upon a change of control, the issuer is forced to make a repurchase offer for the notes at a fixed percentage, which is usually 101 to 103 per cent. Portable change of control provisions have become increasingly popular during 2017, however, as stated before, this was one of the many covenants that started to receive considerable investor pushback in marketing during the second half of 2018.

There are also put option rights of the noteholders upon the sale of certain assets to the extent that the cash proceeds of the sale are not reinvested in the business or used to repay debt.

Do you see the inclusion of 'double trigger' change of control provisions tied to a ratings downgrade?

Yes. Some high-yield bonds include a 'double trigger' change of control covenant giving more protection to investors against a deterioration in credit quality as a result of a change of control event of the issuer. Consequently, there is only an obligation to exercise the relevant put (poison pill put) if there is a change of control event of the issuer followed by a ratings downgrade. However, this is not very common.

Crossover covenants

Is there the concept of a 'crossover' covenant package in your jurisdiction for issuers who are on the verge of being investment grade? And if so, what are some of the key covenant differences?

Yes, a 'crossover' covenant package is common for issuers who are on the verge of becoming investment grade. Usually there is no restricted payments' covenant and limitations on indebtedness' covenant might apply to secured debt only. Another difference is the basket mechanics, which are adjusted in light of the lower credit risk of the issuer.

REGULATION

Disclosure requirements

Describe the disclosure requirements applicable to high-yield debt securities financings. Is there a particular regulatory body that reviews or approves such disclosure requirements?

In the case of a private placement, there are no specific statutory disclosure requirements to be complied with and the typical high-yield debt offering disclosure standards are followed. However, whenever the issuer is a publicly traded company or a company issuing securities traded in the market, private placements shall be subsequently reported to the Portuguese Securities Market Commission (CMVM) for statistical purposes. However, the private placement offering memorandum does not need to be approved by the CMVM.

Contrarily, public offerings of high-yield bonds in Portugal, as well as the listing of debt securities in a Portuguese secondary regulated market, require the filing of a prospectus for approval by the CMVM and the offering itself is subject to prior registration. The CMVM will verify that the prospectus contains all necessary information concerning the issuer and the securities in order for investors to make an informed investment decision and that it complies with the applicable regulations (mainly EU Prospectus Directive regulations).

The prospectus shall contain all information that, according to the particular nature of the issuer and the securities offered to the public or admitted to trading on a regulated market, is deemed necessary to allow investors to make an informed assessment on, primarily, the assets and liabilities, financial position, risk factors, profit and losses, and prospects of the issuer and of any guarantor, as well as on the rights attaching to these securities.

Use of proceeds

Are there any limitations on the use of proceeds from an issuance of high-yield securities by an issuer?

There are very few limitations on the use of proceeds by an issuer in the context of an issuance of high-yield securities. The more important limitations are those arising under the financial assistance rules set forth in the Portuguese Companies Code (prohibiting the use of the proceeds to fund the acquisition of own shares or even own notes) and anti-money laundering or similar laws that limit the possible use of proceeds.

Restrictions on investment

On what grounds, if any, could an investor be precluded from investing in high-yield securities?

Any investor can potentially invest in high-yield securities. In fact, a variety of investors participate in the high-yield bonds market either directly or indirectly via investment funds or other entities investing in high-yield securities.

However, if high-yield securities are offered by way of a private placement, the nominal unitary value of the notes must be at least €100,000 (or otherwise that must be the minimum subscription or sale price, per addressee, by each offering) and all actions that could permit a public offering of any of the notes in Portugal or for the offering memorandum to be distributed in Portugal are prohibited, except in circumstances that will not be deemed as a public offering under article 109 of the Securities Code.

Closing mechanics

Are there any particular closing mechanics in your jurisdiction that an issuer of high-yield debt securities should be aware of?

No, there are no particular closing mechanics in the case of the issuance of high-yield bonds in Portugal.

GUARANTEES AND SECURITY

Guarantees

Outline how guarantees among companies in a group typically operate in a high-yield deal in your jurisdiction. Are there limitations on guarantees?

In Portugal, a high-yield deal comprises the granting of guarantees by material subsidiaries of the issuer (upstream guarantees) and, in cases where the issuer is not the top holding company, also by its parent company (downstream guarantee), as well as by any material sister companies (cross-stream guarantees). The guarantors are usually the same as the guarantors under the senior facilities agreement (if any).

Pursuant to the Portuguese Companies Code, Portuguese guarantors may only secure third parties' obligations if the company has a justified corporate self-interest in the granting of the guarantees or the security, or both, or if the company is in a group or controlling interest with the entities whose obligations are being secured.

Under the Portuguese Companies Code the definition of 'controlling interest' includes relationships between companies where one company holds, directly or indirectly, the majority of the share capital or the voting rights in another company or otherwise has the right to appoint the majority of the members of its board of directors or supervisory board. A 'group interest' includes relationships between Portuguese companies where one is 100 per cent

owned or controlled, directly or indirectly, by the other; or between companies that are bound by a group agreement or a subordination agreement, whereby one company is subject to the instructions or management of the other.

In the absence of a control or group interest, the validity of a guarantee or security interest could be challenged if there is no justified corporate self-interest in its granting, as the interested parties (such as the shareholders of the company) may argue that the granting of said guarantee or security is contrary to the purpose of the company.

In addition, the obligations under the high-yield bonds' guarantees or security granted by the guarantors shall not extend to any use of the proceeds of the notes for the purpose of acquiring shares representing the share capital of the guarantor or shares representing the share capital of the parent guarantor, or refinancing a previous debt incurred for the acquisition of shares representing the share capital of the guarantor or shares representing the share capital of its parent guarantor. This would constitute unlawful financial assistance pursuant to article 322 of the Companies Code.

In this respect, guarantee limitation language is included in such high-yield bonds' guarantees or collateral to ensure that in no case can any high-yield bonds' guarantees or collateral granted by a guarantor secure repayment of the above-mentioned funds.

Finally, we also outline that, for tax reasons (namely in the context of the payment of stamp duty), the obligations under high-yield bonds' guarantees or collateral granted by the guarantors are typically limited to an agreed maximum secured amount (which is commonly established as an aggregate maximum amount should there be multiple guarantees). As a result, the guarantors will not have a direct obligation to repay any amounts once the relevant maximum secured amount has been reached, as applicable.

Collateral package

What is the typical collateral package for high-yield debt securities in your jurisdiction?

In Portugal, the typical collateral package for high-yield debt securities includes pledges over the issued share capital, plant and equipment (this refers to manufacturing plant and machinery, trucks, generating sets, drilling rigs and similar items), bank account pledges, and assignments of receivables by way of security, among others.

The typical collateral package granted by entities in connection with high-yield debt securities depends on the type of assets owned by the issuer and its subsidiaries as well as on the sector of activity. Usually it comprises:

- share security (namely, a financial pledge over the issued share capital and a promissory pledge over any equity that is issued afterwards);
- bank account security (namely, a financial or commercial pledge over the bank accounts);
- assignment of receivables, whether present or future (including intercompany receivables);
- security over fixed movable assets (namely, a pledge over stock, equipment or inventory); and
- assignments of receivables emerging from, or pledges over, insurance policies and, in some cases (although less commonly), intellectual property rights.

In very few issuances, security is taken over real estate (this will usually include mortgages and assignments of income emerging from the relevant real estate).

Limitations

Are there any limitations on security that can be granted to secure high-yield securities in your jurisdiction? Are there any limitations on types of assets that can be pledged as collateral? Are there any limitations on which entities can provide security?

The limitations on the granting of guarantees are those already mentioned above in respect of the granting of upstream, downstream and cross-stream security (see question 19). As to the types of assets that can be pledged, there is a very broad diversity of assets to be considered in this context as, conceptually, a pledge will be created over a certain moveable asset or otherwise a credit or other right, which may not be mortgaged. However, the type of pledge itself will vary according to the pledged asset and other factors. Hence, one may grant financial or commercial pledges, rotary pledges (in which the pledged asset is not always the same), pledges over credit rights, shareholdings, commercial establishments, credit notes, among others.

If the assets of the Portuguese issuer or guarantor are covered by the immunities legally set forth - which include, but are not limited to, assets that are part of the public domain of Portugal or allocated to public service purposes - the relevant issuer or guarantor will be entitled to claim for itself immunity from suit, attachment or other legal process in respect of its obligations under said guarantees.

We also note that, as a general rule, under law, any guarantee, pledge or mortgage must guarantee or secure another obligation to which it is ancillary, which must be identified in the security agreements. Therefore, the guarantee or security follows the underlying obligation in such a way that the invalidity of the underlying obligation entails the invalidity of the guarantee or security and the termination of the underlying obligation entails the termination of the guarantee or security.

Collateral structure

Describe the typical collateral structure in your jurisdiction. For example, is it common to see crossing lien deals between high-yield debt securities and bank agreements?

There is no typical collateral structure in Portugal, as this structure will primarily depend on the issuer and its guarantors as well as on their credit profile risk, capital and financial structure.

Crossing lien structures (where lenders benefit from first ranking security and noteholders benefit from second ranking security) are not very common but we have seen them being used. This concept can be implemented in practice, although it can be more complex in relation to certain types of assets, such as real estate.

It is also common to regulate this type of issue (ranking and priority of debt and security) in the intercreditor agreement through waterfall provisions.

Finally, we have also seen structures where there is a mixed issuance of senior secured notes and senior unsecured notes.

Legal expenses

Who typically bears the costs of legal expenses related to security interests?

In Portugal, the issuer usually bears the costs of legal expenses related to the transaction, including the fees to be paid by the initial purchasers to their legal counsel. It is also common for the issuer to bear any expenses related to the security interests, including the payment of stamp duty and any registration costs.

Security interests

How are security interests recorded? Is there a public register?

Bank account pledges are subject to registration with the bank with whom the account is held, while share security is subject to registration with the issuer, a depositary or a bank in the case of registered, deposited or dematerialised

shares. Mortgages over real estate or registrable movable assets (eg, vehicles, ships and aircraft), assignments of real estate income, as well as pledges over quotas, are recorded in the competent land or commercial registry office, whose register is in both cases public.

How are security interests typically enforced in the high-yield context?

Portuguese law does not recognise the concept of parallel debt or trusteeship. The indenture will thus provide (along with the intercreditor agreement) that only the security agent may enforce the security documents in its capacity as agent and joint and several creditor, and that usually the holders of the notes will not have direct security interests. Therefore, the holders will not be entitled to take enforcement action in respect of the guarantees or collateral securing the high-yield bonds, except through the trustee, who will provide instructions to the security agent in respect of the notes' guarantee or collateral, or both.

The security interests are thus enforced by the security agent, if necessary, and following an instruction by the noteholders or lenders in accordance with the provisions of the indenture, the intercreditor agreement and the relevant security agreement. Depending on the type of security, the ways of enforcing can be very different. Financial pledges over financial instruments and bank accounts allow for an appropriation of the asset by the pledgor and allow for an extrajudicial sale of the asset to the extent that said appropriation right as well as the rules for the evaluation of the asset have been established in the contract. Nonetheless, the pledgor is subject to the obligation of paying the difference between the value of the relevant asset and the amount of the secured obligations to the pledgee. The enforcement of a mortgage, however, requires a judicial enforcement proceeding, whereas the assignment of receivables only requires a notification to the debtor or client of the issuer to make payments directly to the secured parties (said notification being an enforceability requirement rather than a validity one).

Finally, it is very common for the guarantors to grant power of attorney in favour of the security agent allowing it to enforce the security and to sell the assets upon the occurrence of an event of default, as well as to carry out any other necessary actions in respect of the enforcement of the security or otherwise its perfection.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Ranking of high-yield debt

How does high-yield debt rank in relation to other creditor interests?

The majority of high-yield bonds are senior unsecured notes, which means that they rank equally in right of payment with all existing and future non-subordinated obligations of the issuer and rank senior to any existing or future subordinated indebtedness. If collateral is granted (which is often the case), the notes will, in practice, rank senior to any existing or future unsecured obligations to the extent that the proceeds of the enforcement of the collateral satisfy with priority the obligations of the issuer under the high-yield debt securities.

However, certain guaranteed credits - namely, special statutory liens (eg, real estate special statutory liens such as state credits related with real estate property tax) and movable assets special statutory liens (eg, credits resulting from legal expenses incurred in the interest of the creditors) - may rank above the security of high-yield debt.

If there are privileged credits, which are credits secured by general statutory liens over assets integrated in the insolvency estate (labour, tax and social security debts), they rank as higher priority than common credits up to the amount corresponding to the value of the assets granted in guarantee or the general statutory liens, which means that they rank above senior unsecured high-yield bonds.

Regulation of voting and control

Describe how intercreditor arrangements entered into by companies in your jurisdiction typically regulate voting and control between holders of high-yield debt securities and bank lenders?

The terms of the intercreditor agreement governing control of enforcement proceedings depend on the collateral structure and the ranking of high-yield debt in relation to bank debt. Structures involving super senior bank debt with lenders controlling the enforcement are less common and deals with pari passu structures provide for a right of the noteholders to participate in the control of enforcement proceedings by voting as a class (the vote of said class is usually achieved by the majority rule by reference to the capital held).

TAX CONSIDERATIONS**Offsetting of interest payments**

May issuers set off interest payments on their securities against their tax liability? Are there any special considerations for the high-yield market?

Issuers of securities, including high-yield bonds, may generally set off their interest payments against their tax liability. However, there is a general annual limitation to tax deduction for corporate income tax purposes of financial expenses in excess of the highest of €1 million or 30 per cent of EBITDA (as adjusted for tax purposes). Non-deductible financial expenses can be carried forward to the five subsequent years. In the event that net financial expenses of a tax year are below the 30 per cent EBITDA threshold, the difference may be used as an extra deduction on top of the 30 per cent of EBITDA during the five subsequent years.

Tax rulings

Is it common for issuers to obtain a tax ruling from the competent authority in your jurisdiction in connection with the issuance of high-yield bonds?

No, it is uncommon for issuers to obtain any tax rulings in connection with the issuance of securities, including high-yield bonds.

UPDATE AND TRENDS**Update and trends**

Are there any emerging trends or hot topics regarding high-yield debt in your jurisdiction?

UNPROCESSED QUESTIONS**All questions**

Updates and trends

No updates at this time.