High-Yield Debt 2021

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Getting The Deal Through

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Lexology Getting The Deal Through is delighted to publish the sixth edition of *High-Yield Debt*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes a new chapter on Luxembourg.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

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Jaime de la Torre Viscasillas, Miguel Cruz Ropero and Tania Esteban Logroño

Cuatrecasas SLP

MARKET OVERVIEW

High-yield debt securities versus bank loans

1 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 main differences between corporate bank loans and high-yield notes is the control of financial ratios. For corporate bank loans, the borrower is required to maintain certain financial ratios during the term of the loan (maintenance covenants), as well as when it wishes to take a particular action (incurrence covenants), to avoid being in default. Moreover, maintenance covenants are subject to regular controls as they could be breached without a specific concerted action on the part of the borrower or any other company of their group. This is not the case for high-yield structures, for which there are typically fewer covenants, all of which are incurrence covenants that would typically affect the issuer and its restricted subsidiaries. This gives the company more flexibility to perform its business.

High-yield debt securities tend to have longer maturities, from five to 12 years (even though they normally range between seven and 10 years) and bullet repayments. High-yield notes have a non-call period (usually half the term of the notes) when they may not be reimbursed unless the issuer pays a penalty fee. Despite that, the inclusion of an equity claw redemption clause permits the issuer to use the proceeds of public or private equity issuances to redeem a portion of the outstanding notes (traditionally between 35 and 40 per cent), usually paying a small fee. Once the non-call period has elapsed, the early repayment fee is reduced progressively.

On the other hand, bank loans are typically granted for a slightly shorter term (four to six years) and have compulsory repayment schedules (monthly instalments and French amortisation system). Moreover, high-yield notes usually have a fixed interest rate, while bank loans usually have a variable interest rate. Furthermore, high-yield bonds generally offer a greater return to the investor compared to other types of notes (investment grade notes) or the granting of traditional bank financing, as it is an investment product that carries greater risk. In 2020, the return on high-yield notes is between 3 and 5 per cent, while in the long term the return on bank loans for professional investors with a standard security package stands at around 1.5 per cent.

The downsides of high-yield notes are the higher transaction costs, which require a minimum issue amount of not less than €150 million to €200 million to be cost effective, a longer time frame for document preparation, higher interest rates compared to bank financings and a costly and time-consuming process if consent solicitation from investors is required. High-yield notes are also very market dependent, with specific windows for issuing bonds. Regardless of these concerns, the issuance of high-yield notes has the added benefit of increasing the issuer's presence on the international stage through public capital markets, leading to possible further fundraising.

Regulation

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

Spanish high-yield debt issues for foreign investors are normally private placements governed by New York law and admitted to trading on the Irish or Luxembourg alternative stock exchanges.

Moreover, since the marketing of these high-yield notes is done under circumstances that do not constitute a public offer of securities in Spain, they do not fall under the Prospectus Regulation (Regulation (EU) 2017/1129) and are therefore exempt from the requirement to approve and publish a prospectus.

However, on 3 July 2016, a new Market Abuse Regulation scheme came into effect, replacing the existing EU regime on insider trading and market abuse (which only applied to financial instruments admitted to trading on a regulated market) and expanding it to securities traded on a multilateral trading facility. The new regulation also imposes new disclosure and reporting obligations and amends the scope of inside information. Additionally, Spanish issuers should take into consideration the Royal Decree-Law 19/2018 of 23 November on payment services and other urgent financial measures, which has amended the Spanish Securities Market Act (Royal Legislative Decree 4/2015 of 23 October), to adapt it to the new Market Abuse Regulation and complete the required legislative transposition of Implementing Directive (EU) 2015/2392 of 17 December 2015 on Market Abuse Regulation as regards reporting to competent authorities of actual or potential infringements of that regulation.

Therefore, as most high-yield transactions are listed on unregulated markets, such as the Irish Stock Exchange and the Luxembourg Stock Exchange, the market abuse regime that previously was only applicable to regulated markets also applies to them.

Despite the latter, in recent years the Spanish regulations with regard to the gradual easing in the requirements on issuance of tradable securities was possible thanks to the amendment of Spanish Companies Act by means of the Law 5/2015, of 27 April 2015, on Promoting Business Financing and the adoption of the Circular 2/2018, of 4 December, on the admission and removal of securities in the alternative fixed income market (MARF).

Current market activity

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

Spain does not have specific consolidated industries that are more active than others in the high-yield market. In the past, Spanish issuers belonging to a wide range of industry sectors – including the automotive,

transportation, pharmaceutical, construction, hotel, energy and gaming sectors – have participated in high-yield debt issues. To date, there have been very few private equity transactions, most of which involved only Spanish entities acting as guarantors of European issuers. Moreover, many high-yield issues launched in the last couple of years were undertaken to refinance previous issues, taking advantage of lower interest rates.

In terms of the main features of Spanish high-yield deals, Law 5/2015 of 27 April 2015 on promoting business financing significantly changed the legal regime for the issuance of notes through several amendments to the Spanish Companies Act and the Spanish Securities Market Act. The aim of these changes was to make the Spanish bond market more flexible and to lessen Spanish companies' traditional dependence on bank financing, which is particularly critical among small and medium-sized companies.

Briefly, the main changes introduced are as follows:

- Private limited liability companies may now issue and guarantee bonds and other securities that create or recognise debt, except for convertible instruments. Previously, only public limited liability companies could issue debt or guarantee bonds and were subject to a limit. This limit now applies to issues of twice their own funds by private limited liability companies, unless the issue is secured by a mortgage, a pledge of securities, a public guarantee or a joint and several guarantee from a credit institution.
- The requirement to publish an announcement with details of the issue in the Official Gazette of the Commercial Registry has been eliminated.
- On the requirement to execute a public deed of issuance, when the issuer is a Spanish company, there are doubts as to whether it is necessary. However, it is no longer necessary for the deed to be registered at the Commercial Registry before the notes can be released into circulation. Moreover, a deed is not necessary if the securities are to be listed on a regulated market that requires the preparation of a prospectus, or on a multilateral trading system established in Spain.
- A new regime for the incorporation of a syndicate of holders and a commissioner have been introduced.
- Furthermore, the additional provision 1 of Law 10/2014 on the organisation, supervision and solvency of credit institutions provides for a special tax regime for bond offerings. This consists of an interest withholding tax exemption, subject to certain requirements – mainly that the bonds are admitted to trading on regulated exchanges, multilateral trading systems and other organised exchanges; certain tax-related information is supplied to the paying agent; and the net proceeds are placed within an entity belonging to the same consolidated group or subgroup of companies.

In the past, only financial institutions or listed companies, or wholly owned subsidiary special purpose vehicles (SPVs) of these entities, could benefit from this tax regime. Now Spanish-resident companies (and therefore privately held companies), wholly owned subsidiary SPVs of Spanish-resident companies that are resident within the EU and public entities in corporate form can benefit from this special tax regime.

These changes facilitate the direct issue of bonds by Spanish companies, eliminating the need to create foreign vehicles.

With respect to collateral, the majority of Spanish high-yield issues are secured, although there are some exceptions that have been guaranteed only by certain subsidiaries of the issuer.

Investors in high-yield bonds are typically investment banks, pension funds, hedge funds, mutual funds, insurance companies and private wealth management accounts, while loan financing is almost exclusively granted by the traditional banking sector in Spain. Direct lending by other players, such as investment managers and hedge funds, is still to be developed.

Main participants

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

The main participants in Spanish high-yield bond issues do not differ much from those in other European jurisdictions, as to our knowledge all Spanish issues in this market are governed by New York law and tend to follow American standard procedures.

The investment banks leading the transactions normally act as initial purchasers of the bonds, and will resell them to the final investors, receiving a commission. The fees will vary from deal to deal and may be directly included in the purchase agreement and deducted from the purchase price or documented in separate fee letters.

A paying agent and a registrar and transfer agent are also appointed. The former will be in charge of making all payments, including principal, premium, if any, and interest on the notes; while the latter will maintain a register reflecting ownership of the definitive registered notes outstanding from time to time.

Additionally, a listing agent is appointed to help the issuer with the listing of the notes on the relevant stock exchange if they are to be admitted to trading.

In high-yield secured issues, a security agent is appointed to hold any collateral on behalf of the trustee and the noteholders, and to initiate any enforcement procedure if required. Spanish law does not contemplate the concept of a security agent, and, although this by itself does not prohibit this agent from being appointed, the fact that there is a lack of regulation on the matter results in uncertainty as to how a Spanish court would recognise the actions of a security agent in an enforcement situation.

A bank or trust company will also be designated to act as trustee on behalf of the noteholders.

Prior to the entry into force of Law 5/2015, there were some risks related to the interplay between certain provisions of US and Spanish law. In Spain, issuers of debt securities such as high-yield notes were generally required to have a syndicate of holders represented by a commissioner. However, because the indentures of the relevant issues contained mandatory provisions relating to the appointment of a trustee, neither a syndicate of holders nor a commissioner was designated, which led to potential issues and challenges under Spanish law. In some cases, a syndicate of holders and a commissioner were appointed in addition to the trustee, leading to a potential conflict of their roles.

It has now been clarified that Spanish issuers are only obliged to create a syndicate of holders and appoint a commissioner if:

- the terms and conditions of the notes are governed by Spanish law or by the law of a state that is not a member of the EU or the OECD; and
- there is an initial public offering of the notes in Spain, or they are listed on a Spanish regulated market or a multilateral trading system established in Spain.

In all other cases, the law to which the issuance is subject will determine the collective organisation of noteholders.

Typically, two of the main three rating agencies (Fitch, Moody's or Standard & Poor's) will be appointed to assign credit ratings to the bonds, and therefore provide a risk assessment for the investors.

New trends

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

The current Spanish legal regime for issuance of high-yield notes provides more flexibility than before, providing companies with an alternative funding option to the traditional banking system.

Since the creation of the MARF in 2013, a multilateral trading facility similar to those in some other European countries such as Germany, Ireland and Luxembourg, there have been several companies that have used this alternative market to issue bonds or commercial paper. The terms of the existing issues in the MARF are governed by Spanish law and, in some cases, by English law. Some of the bonds admitted to trading in this market may not be strictly considered as high-yield notes, but are proving to be a good alternative for medium-sized companies, which, owing to the size of the volume of issuance, do not have access to the international high-yield market.

The adoption of the Circular 2/2018, of 4 December, on the admission and removal of securities in the MARF, has reduced the formal requirements, documentation and procedures for admission and removal of securities in the MARF.

In particular, without limitation, the following apply:

- both the incorporation and validity of the issuer and the content of its by-laws and the deposit of accounts must be accredited, although not necessarily by the issuer. This work may also be carried out directly by the MARF if telematic access to the corresponding registers is possible;
- the requirement that the issuer's annual accounts do not contain qualifications disappears;
- there is no need to provide the corporate resolutions authorising the issue; and
- a credit assessment or solvency report will be provided only if its preparation has been required by the issuer or investors.

DOCUMENTATION TERMS

Issuance

6 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?

Spanish high-yield bonds are typically issued either directly by a Spanish company (currently, private limited liability companies and public limited liability companies can issue bonds) or through foreign special purpose vehicles, normally incorporated in Luxembourg or Ireland, but governed by New York law.

As high-yield bonds were originally developed in the US and US investors tend to be a key target when marketing the bonds, most high-yield bond issuances in Spain have been governed by New York law.

If the issuer is a Spanish company, in addition to the documents required by New York law, it is advisable to execute a public deed of issuance and file with the Commercial Registry.

The structure of the offering memorandum is similar in all transactions. Some sections, such as general risk factors or limitations on the validity and enforceability of civil liabilities, are standard, while the remaining sections are bespoke for each company. The description of the notes contained in the offering memorandum is a summary of the terms of the indenture.

The indenture is the legal contract containing the key terms of the notes, such as the maturity, interest rate, representations, covenants, guarantees and events of default. It is entered into by the issuer, the guarantors, if any, and the trustee of the notes.

In issues where a senior credit facility is also entered into, it is normally governed by English law and follows the standard format of the Loan Market Association.

Maturity and call structure

7 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.

The typical maturity of most Spanish high-yield bonds is seven years, although they may be issued with shorter (three years) or longer maturities (12 years). While normally issued at par, in some cases, the bonds could be issued at a discount. Although fixed interest is more common, there are a few cases of issues with floating interest.

One of the various yield protections included in the documentation is having a non-call period during which the issuer is restricted from redeeming the notes. This period is normally halfway through their tenor. After this, the notes can be redeemed at a premium that typically begins at 50 per cent of the coupon and then decreases rateably to par in the following years. If the notes are redeemed prior to the first call date, the issuer must pay 100 per cent of the principal amount of the notes redeemed plus a make-whole premium, plus accrued and unpaid interest and additional amounts, if any, to the date of redemption. Another protection is having an optional redemption for taxation reasons by virtue of which, if there is any change in the law or treaties affecting taxation, then the issuer may redeem the notes at 100 per cent of the principal amount together with the accrued and unpaid interest. In that case, the issuer will pay any additional amounts as may be necessary so that the net amounts received by each noteholder after the withholding will not be less than the amounts that would have been received in respect of such payments in the absence of such withholding.

An additional protection is the change of control covenant, which requires the issuer to offer to purchase at a tender offer all outstanding notes at a price equal to 101 per cent of their principal amount and purchase all bonds that are tendered.

Equity clawbacks further limit the right of the issuer to use proceeds from equity offerings (initial public offerings) to redeem the outstanding notes. This feature normally allows the issuer to redeem 35 per cent to 40 per cent of the outstanding bonds with the initial public offering proceeds.

Offerings

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

Spanish high-yield debt issues are normally private placements admitted to trading on the Irish or Luxembourg alternative stock exchanges and are therefore exempt from the requirement to approve and publish a prospectus with the relevant authority under the Prospectus Regulation.

Before the launch, the issuer, the arrangers and the underwriters will have prepared the preliminary offering memorandum, which will contain a description of the risks related to an investment in the bonds, a description of the issuer's business and the industry and markets in which it operates, management information, historical financial statements, a description of the notes, a description of the material agreement and any other key information, and certain legal and tax matters. The description of the notes section of the offering memorandum is one of the most negotiated parts because it includes the main covenants.

Following the launch of the offering, the issuer and the underwriters will go on an investor roadshow. Once the roadshow is completed

(typically in a few days to two weeks), the price of the bonds will be fixed (including the final amount of the issue, maturity and coupon), and a bring-down due diligence call will take place.

After the launch, the issuer, the initial purchasers and the guarantors, if any, will sign the purchase agreement, and prepare the final offering memorandum and the rest of the transaction documents, such as the indenture, intercreditor agreement and facility agreements, as the case may be. Comfort letters, legal opinions and other related closing documents are also delivered at this stage.

Coupons are determined during the roadshow depending on the investors' demand, market conditions, risk assessment of the issuer and its business and other factors.

Most Spanish high-yield issues have fixed interest rates.

Covenants

9 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?

The standard covenant package for non-investment grade high-yield bonds typically restricts the ability of the issuer and its restricted subsidiaries to:

- incur or guarantee additional debt and issue preferred stock;
- make certain payments, including dividends or other distributions;
- make certain investments or acquisitions, including participating in joint ventures;
- prepay or redeem subordinated debt;
- engage in certain transactions with affiliates;
- create unrestricted subsidiaries;
- sell assets or consolidate or merge with or into other companies;
- sell or transfer all or substantially all of the issuer's assets or those of its subsidiaries on a consolidated basis;
- issue or sell share capital of certain subsidiaries; and
- create or incur certain liens.

The aim of these covenants is to restrict the issuer and its restricted subsidiaries from engaging in acts that could compromise its ability to meet its obligations under the bonds. However, there are a series of exemptions to the standard covenant package. These include specific baskets, depending on the business of the issuer and the flexibility that it might need.

In general terms, high-yield bond covenants impose fewer restrictions and obligations on the issuer than bank loans. The fact that they are also incurrence covenants as opposed to maintenance covenants gives the issuer more flexibility to operate its business.

10 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?

In the current market situation, where, in general terms, there are fewer high-yield issuances than in previous years, covenant packages in Spain seem to show more flexibility than in previous deals. This is in line with what other European jurisdictions are experiencing.

The covenants are negotiated between the issuer and the arranger and the initial purchasers prior to the launch of the notes, and in our experience they do not normally change much during the roadshow and prior to pricing.

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

Spain does not have specific consolidated industries in the high-yield market. Therefore, the tightness or looseness of covenants depends more on the company, the nature of its business, its financial strength and the particularities of the transaction than on the industry sector.

Change of control

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

A change of control triggers the right of each noteholder to require the issuer to repurchase all or any part of that holder's notes in an amount equal to 101 per cent of the aggregate principal amount of notes repurchased, plus accrued and unpaid interest, if any, on the notes repurchased, to the date of purchase.

Similarly, any net cash proceeds from asset sales that are not applied or invested within a certain time frame, and that exceed a specified threshold amount, normally constitute excess proceeds, which must be used by the issuer to make an offer to repurchase the notes at a price equal to 100 per cent of the principal amount plus accrued and unpaid interest to the date of purchase and other pari passu indebtedness with similar provisions.

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

No. Spanish high-yield issues tend to include the traditional single-trigger change of control provision, whereby ultimate shareholders directly or indirectly have the power to cast or control the casting of at least 50.01 per cent of the eligible votes in the company's general meeting, and appoint or remove all or the majority of the directors; or hold beneficially at least 50.01 per cent of the issued share capital of the company with voting rights.

Double-trigger provisions are seen more in European high-yield issuances for private equity transactions where portability could be important for the private equity sponsors, but not often in Spanish deals, where bonds are normally issued by corporate-owned issuers.

Crossover covenants

14 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?

The suspension of certain covenants typically occurs when the notes are rated investment grade but not before. Once the notes are rated Baa3 or better by Moody's, BBB– or better by Standard and Poor's or BBB– or better by Fitch, covenants such as restricted payments, limitations on sale of assets, incurrence of indebtedness, dividend restrictions and others cease to be effective and are not applicable to the issuer and its restricted subsidiaries. Therefore, the crossover covenant package is not something customary in Spain.

REGULATION

Disclosure requirements

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

The offering memorandum contains detailed disclosure information about the issuer, including its business, its industry sector, any guarantees and security, its financial statements and the terms of the notes, to enable investors to make an educated investment assessment.

Spanish high-yield bond issuances are normally governed by New York law and admitted to trading on the nonregulated markets of Ireland or Luxembourg. Therefore, the law to which the issuance is subject is that governing the rights of the noteholders concerning the issuer, their forms of collective organisation and the regime for repayment and redemption of the securities; while Spanish law determines the capacity, the competent body and the conditions for adoption of the resolutions approving the issuance.

Furthermore, if the bonds are admitted to trading on the non-regulated market of Ireland, Luxembourg or any other alternative market, they are subject to the listing conditions and disclosure requirements required by these markets.

If high-yield debt notes are offered, sold or distributed to the public in Spain, except in circumstances that do not constitute a public offer of securities in Spain according to the Spanish Securities Market Act, or listed on the Spanish regulated market, the issuer must register a prospectus with the Spanish Securities Market Commission to comply with the minimum disclosure requirements of the Prospectus Regulation.

Should the high-yield notes be admitted to trading on the alternative fixed income market (MARF), an information memorandum is required and must be approved by the MARF pursuant to Circular 2/2018, and a private issuance document with the main terms and conditions of the issuance must be registered with the Spanish Securities Market Commission. The disclosure requirements are similar to those contained in European offering memoranda.

Use of proceeds

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

There are no limitations in Spanish law on the use of proceeds of a high-yield debt issuance by an issuer. However, if those proceeds are used to finance or refinance the acquisition of its shares or its parent (or, in some cases, of companies within the same group), these obligations cannot be secured or guaranteed by a Spanish guarantor, as it would breach the financial assistance prohibition. Therefore, these limitations would restrict the ability of Spanish guarantors to grant guarantees or provide security for financing used for this acquisition.

Restrictions on investment

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

There is no specific provision that precludes Spanish investors from investing in high-yield securities. Notwithstanding this, there are a number of rules aimed at protecting retail investors that might make it very difficult to sell these products to them.

Closing mechanics

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

The approval of Law 5/2015 significantly simplified the closing mechanics in Spain. The main requirement, if the issuer is a Spanish company, and assuming that the terms of the notes are governed by a foreign law and the notes are not admitted to trading in a regulated or alternative market in Spain, is the execution of a public deed of issuance. Additionally, if the issue is guaranteed, the relevant guarantors must also appear before a notary public when the deed of the issue is granted.

GUARANTEES AND SECURITY

Guarantees

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

It is customary that in high-yield structures the parent company and certain subsidiaries guarantee jointly and severally the obligations of the issuer under the bonds on the issue date. Additionally, the parent company shall cause any subsidiary considered as a restricted subsidiary after the issue date to become a guarantor.

Under Spanish law, unlike in other EU jurisdictions, there is no specific obligation for companies to justify that they are acting for the company's benefit when granting a guarantee or security, although it is advisable to do so according to the characteristics of a specific transaction or to uphold the effectiveness of the security or guarantee if the grantor becomes insolvent.

The Spanish law prohibiting financial assistance generally prevents both public and private limited liability companies from advancing funds, granting loans, supplying guarantees or providing any sort of financial assistance aimed at allowing a third party to acquire a company's own shares; or the units or shares of its parent company, in the case of public limited liability companies, or the units or shares of any company belonging to its corporate group, in the case of private limited liability companies. There are two limited exceptions for public limited liability companies: ordinary operations carried out by banks and credit entities, and financing for employees.

The guarantee is normally regulated under the indenture and subject to New York law. The indenture is sometimes notarised in Spain to have access to a more expeditious enforcement process against the assets of a Spanish guarantor if the guarantee is to be enforced directly in Spain.

Furthermore, in those cases where it is necessary to execute a public deed of issuance and the issue is guaranteed, the relevant guarantor must also appear before the notary public when the deed of the issue is granted.

Collateral package

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

The typical security package for secured high-yield bond issues involves pledges over the shares of the issuer, the parent company and certain of its subsidiaries, as well as over material assets, such as bank accounts, receivables and insurance policies.

Other securities, such as non-possessory pledges over movable assets or real estate mortgages, are less common, mainly because of associated registration fees and stamp duty.

Generally, a security interest can only secure one main obligation and its ancillary obligations. If two different main obligations need to be secured, two different guarantees must be created. Spanish law does not provide for a 'universal guarantee' over all the debtor's assets, although there are exceptions – for instance, mortgages; nor does it provide for the creation of a floating or adjustable lien or encumbrance.

Guarantees subject to Spanish law or security documents must be granted before a notary public to benefit from an executive proceeding in Spain.

Limitations

21 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?

Any type of security in Spain can secure high-yield bonds if the relevant formalities for each type of security are met.

Real estate assets can only be secured by a mortgage, which covers:

- the plot of land and the buildings built on it;
- the proceeds from the insurance policies insuring the property; and
- the improvement works carried out on the property and natural accretions.

Mortgage agreements must be drafted in Spanish and executed before a notary public in a deed of record. The law requires the mortgage deed to be filed and registered at the relevant land registry.

Pledges over shares and credit rights (such as bank accounts, receivables and insurance policies) are the most common type of security.

Under Spanish law, receivables can be attached to three different types of security interests:

- possessory pledges;
- non-possessory pledges; and
- subject to certain limitations, financial collaterals.

Perfection of possessory pledges requires that the pledgor transfer the possession of the receivable to the pledgee or to a third party (as appointed by the pledgor and pledgee (eg, a security agent)). Spanish law is unclear on how this transfer of possession should be made in connection with a receivable, as in general Spanish security interest rules only foresee the transfer of tangible assets. In practice, it is generally accepted that notarisation of the pledge, plus giving notice to the obligor, is sufficient to perfect a possessory pledge. When the parties prefer not to give notice for commercial (eg, confidential or reputational) reasons, alternative means of transferring the possession of the receivable may be available.

Non-possessory pledges must be registered with the relevant movable assets registry. Non-possessory pledges are signed before a Spanish notary public and are notarised in the form of a public document.

Non-possessory pledges are also granted over movable assets that cannot be the object of a chattel mortgage because their specific identity cannot be registered; or of a possessory pledge, given the legal or financial impossibility of transfer to the creditor or to a third party.

Certain types of receivables could also be attached to financial collateral pursuant to Royal Decree Law 5/2005, which provides that financial collateral must be in written form and no additional formality is required to perfect financial collateral. Royal Decree Law 5/2005 also provides that the delivery by a pledgor to the pledgee of a list of receivables in writing is sufficient to consider the receivables transferred to the pledgee.

In practice, it is customary to perform the same perfection requirements required for possessory pledges when creating financial collateral (ie, notarial document and notice to the obligor).

For the pledge to be enforceable against third parties (also in the event of the pledgor's insolvency), a notarised agreement or, as the case may be, a deed, must be created, as these public documents verify the date and terms and conditions of the pledge. Thus, a pledge created under a law other than Spanish law will be valid, although to enforce the pledge in Spain it will be necessary to execute a document equivalent to a Spanish notarised agreement or deed, as a document that only legalises the grantor signature will not be sufficient.

When Law 5/2015 came into force, the prior limitations on which entities could provide security or guarantee bonds were removed. Private limited liability companies may now issue and guarantee bonds and other securities that create or recognise debt, except for convertible instruments. Previously, only public limited liability companies could issue debt or guarantee bonds. In addition, the general issue limit preventing public limited liability companies and limited partnerships by shares issuing notes in excess of their own funds has been removed.

Collateral structure

22 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?

Spanish law is based, inter alia, on the principle of integrity, by virtue of which a security interest can secure only one main obligation and its ancillary obligations, such as interest and costs. Except for floating mortgages, where the law expressly contemplates it, there are uncertainties as to the possibility of using a single pledge to secure different obligations with different creditors and different terms.

In many Spanish high-yield notes deals, a senior facility agreement is also entered into. The same collateral will typically secure both the senior facility and the secured notes in pari passu ranking.

There are various alternatives to achieve pari passu ranking, such as:

- a single pledge securing the senior facilities agreement and the secured notes;
- various pledges, each over a percentage of the collateral to secure each obligation;
- multiple concurrent pledges with the same ranking, each securing 100 per cent of the obligations arising from the senior facilities agreement and the secured notes; or
- subsequent ranking pledges.

Each alternative has its advantages and disadvantages to be analysed case by case. Regardless of the option chosen, it is customary to enter into an intercreditor agreement to regulate the majorities required for enforcing the security and the sharing provisions for the proceeds of enforcement of each pledge.

Legal expenses

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

The issuer normally pays all legal expenses, such as notarial costs, registration fees and stamp duty, if any, arising from the granting of the security, which are paid with the proceeds of the issue.

Security interests

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

The only security interests that need to be recorded are mortgages and non-possessory pledges.

In the case of real estate mortgages, they must be filed and registered at the relevant land registry, while chattel mortgages or

non-possessory pledges over movable assets are subject to registration with the chattel registry. Failure to do so will render these security interests void and not binding against third parties.

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

Security interests are normally granted in favour of the security agent on behalf of the secured creditors, which will, in the event of default, enforce the security interest on their behalf. However, Spanish law expressly recognises neither the concept of security agent nor the concept of trustee, and the security agency or security trustee structure may not be recognised by Spanish courts. Therefore, where an entity acts as security agent of the actual beneficiaries of the security interest or a guarantee (ie, the creditors of the secured obligations), it must be duly empowered at the time it acts as security agent.

If a default takes place resulting in the acceleration of notes, the security agent may, as instructed by the trustee and on behalf of the secured creditors, choose any of the proceedings available under Spanish law to enforce the security.

In the case of a pledge over shares, these proceedings would include a declaratory court judgment, enforcement proceedings under the Code of Civil Procedure or the extrajudicial procedure in article 1872 of the Civil Code and in the Notaries Act of 28 May 1862; or, if applicable, the procedure established in Royal Decree Law 5/2005 of 11 March on urgent reforms to promote productivity and improve government contracting.

Depending on the nature of the collateral (eg, pledge over bank accounts or receivables), the security agent could, instead of initiating the above-mentioned proceedings, enforce the pledge by means of setting off the balances of the bank accounts or the amounts owed by the debtors against the amounts due and payable under the secured obligations, with the sole requirement of prior notification to the pledgor.

In an insolvency, credits whose collateral consists of specific property or rights (eg, mortgage or pledges) are considered privileged credits with special privilege. Privileged credits are generally paid first. Once privileged credits have been paid, the rest of the assets are divided among the ordinary creditors in proportion to the amount of their debt. Once the ordinary credits have been paid, the remaining assets, if any, are used for paying subordinated credits.

One of the effects of the declaration of insolvency is that acts or transactions involving the attachment of the debtor's property required for the continuity of its professional or business activity, including mortgages and pledges, are suspended or cannot be executed until:

- the plan of reorganisation is approved;
- liquidation starts; or
- one year has elapsed from the date of declaration of insolvency.

Clawback can apply to any act or transaction performed within the two years before the debtor's declaration of insolvency that is deemed to damage the debtor's estate. Fraud is not required under Spanish insolvency law for the avoidance of transactions.

DEBT SENIORITY AND INTERCREDITOR ARRANGEMENTS

Ranking of high-yield debt

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

In Spanish deals, it is typical for high-yield bonds to rank equally in right of payment with the senior facility that might be entered into. If the notes are secured, the security interests will normally be shared on a pro-rata basis with the senior facility.

The bonds are normally considered as general senior obligations of the issuer, ranking equally in right of payment with all existing and future senior indebtedness of the issuer and ranking senior in right of payment to any future obligations of the issuer subordinated in right of payment to the notes.

Unless the notes are secured, they will be effectively subordinated to all obligations of the issuer that are secured by assets, to the extent of the value of the property or assets securing these obligations. The notes will be structurally subordinated to any existing and future indebtedness of the subsidiaries of the issuer that do not guarantee the notes.

An intercreditor agreement is normally entered into to regulate the relationship between the senior noteholders, the senior lenders and any other noteholder, lender or swap provider. Among senior secured noteholders and senior secured lenders or senior noteholders and senior lenders, the proceeds of enforcement of guarantees or security interests is shared pari passu and on a pro-rata basis among each group.

Regulation of voting and control

27 | 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?

In a high-yield context, the intercreditor agreement tends to follow the Loan Market Association template, which is governed by English law.

Usually, neither the senior noteholders nor the senior lenders may take any enforcement action without the prior written consent of the majority (more than 50 per cent of the relevant participations). This action will be carried out by the security agent on behalf of the secured parties, which shall not have any independent power to enforce the security except through the security agent.

TAX CONSIDERATIONS

Offsetting of interest payments

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

In general, interest payments are deductible for the issuer's corporate tax purposes, provided that they have been recorded in the accounts of the entity according to the accounting standards on their accrual. However, taking into account the international trends (base erosion and profit shifting), Spanish legislation foresees a general limit per tax year on the corporate income tax deduction of any kind of financial expenses (interest-capping rule).

In this regard, it establishes that net financial expenses exceeding 30 per cent of the taxpayer's operating profit (ie, EBITDA with some adjustments) will not be deductible for corporate income tax purposes. However, net financing expenses not exceeding €1 million per company will be tax-deductible in any case. Financial expenses disallowed under the interest-capping rule can be carried forward without any temporary limitation in subsequent years subject to the aforementioned limits. In parallel, in those cases in which financial expenses are below the 30 per cent limit, the difference between the aforesaid expenses and the limit can be added to that limit until the difference has been deducted (within a maximum of five years).

Tax rulings

29 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.

UPDATE AND TRENDS

Recent developments

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

There have been no such developments in the past year.

Coronavirus

31 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

No specific regulations or initiatives in relation to corporate debt markets have been approved by the Spanish Government to address the pandemic.

However, invertors should take into consideration that, as a consequence of the covid-19 outbreak, the Spanish government has passed Royal Decree Law 34/2020 which has stayed the debtors' obligation to file for insolvency until 14 March 2021. Until this date, the courts will not process applications for mandatory insolvency submitted from 14 March 2020.

In addition, as regards the obligation to wind up due to qualifying losses pursuant to the Spanish Companies Act, losses corresponding to 2020 will not be taken into account to ascertain whether the company has grounds for dissolution in accordance with Royal Decree Law 16/2020. Moreover, the assessment of the grounds for dissolution due to qualifying losses can only be carried out on determining the financial result of 2021.

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