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# ICO-backed debt refinancing

## Flexibility measures and practical aspects

Legal flash

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Since the health crisis began, many companies have received financing guaranteed by the state through guarantee facilities managed by the Spanish State Finance Agency (*Instituto Oficial de Crédito* or "ICO"). Some companies are likely to experience difficulties in meeting payments for these financial transactions at the end of the grace periods.

In this context, measures approved by the Spanish government enabling the potential renegotiation of these transactions while maintaining the public guarantee take on special significance, including in particular the approval of a Code of Best Practices, which many financial institutions have adhered to voluntarily.

This document outlines these measures and addresses the issues arising in respect of the possibility of refinancing transactions backed by these public guarantees, or restructuring the financial debt of companies carrying out a transaction within the framework of these facilities.

## ICO guarantee facilities

The Spanish government has approved state guarantees managed by ICO granted within the scope of the two guarantee facilities: a facility for a maximum amount of €100 billion, aimed at covering liquidity needs, and another for a maximum amount of €40 billion, the main purpose of which is to finance investments (the "**Guarantee Facilities**").

The guarantees are granted by the state (the Ministry for Economic Affairs and Digital Transformation) and managed by ICO with the collaboration of financial institutions that adhere to them by entering into a framework collaboration agreements with ICO (the "**Framework Agreements**").

The Guarantee Facilities are regulated under several laws approved by the government, which have undergone numerous amendments and extensions in line with the *Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak* (the "**Temporary Framework**"), and by resolutions adopted by the Council of Ministers implementing these regulations.

## Capillarity of Guarantee Facilities and restructuring scenarios

Since they were launched, the Guarantee Facilities have been well received and many companies of all sizes currently have in their pool of financial debt transactions that have benefited from state guarantees within the scope of these facilities (guarantees have been granted for an amount exceeding €103 billion).

There is no doubt that the Guarantee Facilities made a decisive contribution to ensuring ongoing access to credit and liquidity, thus mitigating the economic impact of the COVID-19 health crisis.

However, the crisis is greatly affecting contractual credit relationships, and many companies foresee or are already facing liquidity pressure to meet the payments of their financial transactions, including ICO-backed financings. In some cases, these transactions are worth significant amounts or make up a considerable part of the companies' financial debt.

This situation has given rise to a number of issues concerning the possibility of refinancing transactions guaranteed by the state within the scope of the Guarantee Facilities and, generally speaking, of restructuring the financial debt of companies carrying out a transaction guaranteed within the scope of these facilities.

## Impact of flexibility measures on renegotiating guaranteed transactions

Under Royal Decree-Law 5/2021, of March 12, implemented by the Council of Ministers' resolutions, the Spanish government gave far greater flexibility to restructuring the debt of companies granted financing with a public guarantee between March 17, 2020, and March 13, 2021. This regulation also adopts a set of additional measures on how guarantees must be structured and managed.

Specifically, Royal Decree-Law 5/2021 establishes a set of actions to restructure the guaranteed debt. It also includes a Code of Best Practices, which financial institutions can adhere to voluntarily, facilitating and encouraging the coordination between institutions in the context of these restructuring transactions (the "**Code of Best Practices**"). The main points are summarized below:

- Financial institutions that adhere to the code will take on certain commitments to facilitate negotiations and they must make every effort to include the unguaranteed debt arising between March 17, 2020, and March 13, 2021.

- For the measures to be applied, the debtor must make a request covering one or several measures, whether all at once or in stages.

- If several lending entities are involved in the same renegotiation process, the Code of Best Practices lays down rules on coordination (to be overseen by the entity in the strongest position as regards a public guarantee) and a majority system binding dissenting creditors. The rules vary according to the levels of action requested and the size of the debtor. The coordination rules do not include guaranteed transactions covered by security in rem.

- A list naming the institutions that have adhered and those that have not adhered to the code is published.

Guaranteed transactions can be renegotiated maintaining the guarantee as long as the renegotiation is conducted in accordance with these regulations. Outside of this scope, renegotiating the debt could result in the guarantee becoming ineffective.

## Renegotiation of guaranteed transactions

Renegotiating transactions financed by Guarantee Facilities encompasses three levels of action to restructure the financing guaranteed by the state:

- **First level: Extension of the maturity date** up to 10 years (or up to eight years for debtors exceeding the state aid threshold set out in the Temporary Framework, generally established at €2.3 million for debtors that are not active in the fishery and aquaculture sectors, or in the primary production of agricultural products). Agreements can be reached to extend the grace periods of transactions, giving notification to ICO before June 1, 2022.[1]

- **Second level**: Non-convertible **participatory loans** can be converted into capital.

- **Third level**: As an exceptional measure of last resort, **debt relief** can be applied by using the funds transferred by the state to reduce the amount of the guaranteed principal through a facility funded with up to €3 billion. On carrying out this action, financial institutions must assume the reductions they apply to the outstanding principal of the loan not covered by the guarantee.

  To apply this third-level action, the lending entity and the debtor must reach a renegotiation agreement for the whole debt—both guaranteed and unguaranteed—the parties owe, as long as it was incurred between March 17, 2020, and May 11, 2021.

  Generally speaking, transfers cannot exceed 50% of the outstanding guaranteed principal of each transaction contemplated in the renegotiation agreement. The transfer may amount to up to 75% of that amount in cases where the turnover in 2020 dropped by over 70% compared to 2019.

Only financial institutions that adhere to the Code of Best Practices are obliged to process and respond to requests to implement the measures submitted by debtors in the framework of the above levels of action, as long as they meet the eligibility requirements. In this regard, it is established that adhering institutions are obliged to extend the maturity date (first-level action). In contrast, any measures relating to the second and third levels of action must be implemented in the framework of a debt renegotiation agreement between the debtor and the lending entity.

The financial institution must notify ICO of the application of the agreed measures no later than June 1, 2022, if the maturity dates are extended and the debt is converted into a participating loan agreement, and no later than June 1, 2023, in the case of measures for debt reduction or write-downs.

The eligibility requirements to be able to benefit from these measures mainly refer to solvency ratios, the fulfillment of financial obligations and obligations with the state, and of regulations on state aid.

Finally, adhering institutions granting any of the above measures to debtors must also

[1] The regulations make no specific reference to the possibility of extending the grace periods of guaranteed transactions, although it appears that under the European Commission's decisions concerning the temporary framework for aid measures in Spain, it is not possible to extend these periods beyond 24 months.

keep the working capital facilities open to them until June 30, 2023.

## Refinancing existing debts

The large number of financial institutions adhering to the Code of Best Practices highlights the financial sector's interest and willingness to support the more flexible debt-restructuring measures mentioned above.

In addition to general aspects concerning refinancing transactions, three particular issues about the Guarantee Facilities should be addressed to safeguard the public guarantee (i) on structuring debt refinancing through financial institutions benefiting from the Guarantee Facilities securing a financing transaction with the financed company in question (even if the guaranteed transaction is not refinanced), or (ii) when the financed company has entered into other financing transactions within the scope of the Guarantee Facilities:

- impediments preventing voluntary early repayment and the refinancing of unguaranteed transactions provided in the Framework Agreements;
- the *pari passu* condition of the guaranteed debt under the Guarantee Facility with regard to the unguaranteed debt; and
- the state's foreseeable determination to prevent to the extent possible the guarantee from being subordinated with regard to the borrower's other financing transactions.

The above could specifically affect the guarantee and security package of new financing transactions for debtors that have state-backed debt within their capital structure, as well as guarantees and security that can be accepted by financial institutions as collateral for potential debt refinancing. Likewise, it could restrict the room for maneuver of financial institutions that have guaranteed and unguaranteed transactions with the same debtor when approving refinancing of existing debt (even if the guaranteed debt is not being refinanced).

These matters require a case-by-case analysis and consideration of specific circumstances, such as the amount of the guaranteed debt under the Guarantee Facilities compared with the total debt amount, the availability of working capital instruments, the existence (or lack) of a commitment to grant new money, and the existence of assets free of charges or guarantors outside the perimeter of the guaranteed debt, among others.

However, financial institutions are likely to allow the use of additional guarantees only in new transactions or refinancing transactions for unguaranteed debt if it can be proved that the guaranteed transactions under the Guarantee Facilities are adequately covered

and at least at the same level as the unguaranteed transactions.

These same matters will be considered in debt restructurings that include financing transactions involving funds aiding solvency and recapitalization made available by the Spanish state to companies affected by the health crisis, although these transactions are likely to be implemented more easily.

## Recovery and collection regime

Financial institutions have been assigned court and out-of-court claims for the repayment of the amounts of appropriation resulting from enforcing the guarantees in the name and on behalf of the Spanish state, applying the same legal regime used for recovery and collection corresponding to the part of the financing not guaranteed by the state. However, financial institutions cannot grant deferrals, installments or write-downs of the amounts claimed on behalf of the state without its prior authorization.

On implementing this regime, financial institutions are authorized, before taking court action, to grant deferrals and installments for up to 12 months and on the basis of payments being made in monthly installments.

## Pre-insolvency and insolvency scenario

Given that they are public-law credits, those arising from enforcing the guarantees will be included on the list of creditors in favor of the state.

However, it is established that in pre-insolvency refinancing proceedings, financing transactions granted a guarantee within the scope of the Guarantee Facilities and claims arising from enforcing the guarantee will both be treated as a financial liability and, therefore, will be taken into account when calculating the percentage of financial liability required to request court approval of the refinancing agreement.

Thus, the credit deriving from the enforced guarantee will be considered an ordinary credit in the insolvency proceedings of the guaranteed debtor (unless it is covered by security in rem, in which case it will be considered a special preferential credit owing to the amount covered by the guarantee value).

Moreover, credits granted by the state will have at least the same rank in the order of precedence as the rights corresponding to the part of the principal that is not guaranteed.

Declaration of insolvency will lead to the subrogation of the state in the guaranteed financing within the scope of the Guarantee Facilities, regardless of whether their enforcement has begun. Notwithstanding this subrogation, rules are provided on the coordination required between the financial institutions and the public authorities for

action in these proceedings based on the *pari passu* clause.

The state legal service will be in charge of representing and defending the credit arising from the guarantee. Along these same lines, in January 2022, the state legal service issued a set of guidelines explaining the rules and criteria applicable to the collection of debt benefiting from the Guarantee Facilities in an insolvency scenario, including procedural and formal rules.

For additional information, please contact our *Knowledge and Innovation Group* lawyers or your regular contact person at Cuatrecasas.

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