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New developments regarding ICO-backed debt refinancing

Recent flexibility measures and practical aspects

Legal flash
May 2021

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”). For some companies, the lasting effects of the pandemic has led to difficulties in meeting payments for financial transactions.

In this scenario, the Spanish government has recently approved a set of measures enabling the potential renegotiation of these transactions while maintaining the public guarantee, as provided under Royal Decree-Law 34/2020, Royal Decree-Law 5/2021, and the Council of Ministers resolutions of May 11, 2021, approving a Code of Best Practices, which financial institutions can adhere 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

To date, the Spanish government has approved state guarantees managed by ICO granted within the scope of the two guarantee facilities: the facility provided under *article 29 of Royal Decree-Law 8/2020*, for a maximum amount of €100 billion, and the facility provided under *article 1 of Royal Decree-Law RDL 25/2020*, for a maximum amount of €40 billion, the main purpose of which is to finance investments (the **"Guarantee Facilities**").

The Guarantee Facilities are granted by the General State Administration (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 agreement negotiated between the financial institutions and ICO for each of the Guarantee Facilities (the "**Framework Agreements**").

The Guarantee Facilities have been further regulated (owing to the release of the amounts) under resolutions adopted by the Council of Ministers and by amendments of the Framework Agreements. Also, as explained below, these regulations have been completed by *Royal Decree-Law 34/2020, of November 17, on urgent measures to support business solvency and the energy sector, and on tax-related measures* ("**RDL 34/2020"**) and *Royal Decree-Law 5/2021, of March 12, on urgent measures to support business solvency in response to the COVID-19 pandemic* ("**RDL 5/2021**"), implemented under the Council of Ministers resolutions of May 11, 2021 (the "**May 11 Resolutions**") available *here* and *here*.

Capillarity of guarantee facilities and restructuring scenarios

Since they were launched, the Guarantee Facilities have been well received and many companies of all sizes have in their pool of financial debt transactions that have benefited from state guarantees within the scope of these facilities (totaling over €95 billion). Spanish financial institutions have also actively granted this type of financing.

There is no doubt that the Guarantee Facilities have 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.

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.

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Impact of recent flexibility measures on renegotiating guaranteed transactions

To provide the flexibility required by transactions financed by a Guarantee Facility, the Spanish government has approved the following fundamental regulations:

- **RDL 34/2020**, which regulates, among other aspects, the extension, at the debtor's request, of the maturity date and grace period of previously guaranteed transactions within the scope of the Guarantee Facilities and brings the maturity date of financing transactions backed by either ICO facility into line, up to a term of eight years. For more details, see our *Legal Flash on Royal Decree-Law 34/2020: main legal consequences for businesses.*

- **RDL 5/2021**, which gives far greater flexibility to restructuring the debt of companies granted financing with a public guarantee between March 17, 2020, and March 13, 2021, or that have a second guarantee granted by the Spanish Refinancing Company (CERSA). This Royal Decree-Law also adopts a set of additional measures on how guarantees must be structured and managed. For more details, see our *Legal Flash on Royal Decree-Law 5/2021: main legal consequences for businesses*.

- The **May 11 Resolutions**, which implement the precepts of RDL 5/2021 and establish a set of potential actions to restructure the guaranteed debt. Also, they include 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 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 will be published. Also, a Code of Best Practices steering committee will be set up, comprising representatives of, among others, the Spanish Banking

Association (AEB), ICO and the Ministry for Economic Affairs and Digital Transformation, in charge of analyzing the data from the Bank of Spain.

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 under RDL 5/2021 and the May 11 Resolutions

Renegotiating transactions financed by a Guarantee Facility under RDL 5/2021 and the May 11 Resolutions 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 for State aid measures to support the economy in the current COVID-19 outbreak*, generally established at €1.8 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 December 1, 2021.
- **Second level**: Conversion into **participative loans** *(préstamos participativos)* that cannot 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, under the "Facility for the restructuring of COVID financial debt," 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 set out in the May 11 Resolutions. 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.

Debtors have until October 15, 2021, to submit their requests.

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. Also, as a general requirement, the turnover in 2020 must have dropped at least 30% compared to 2019. Also, to request second- and third-level actions (conversion into participatory loan and reduction of the principal), the debtor's profit and loss account corresponding to financial year 2020 must show a negative balance after tax.

On granting any of these measures, lending entities cannot increase the cost of a guaranteed financing transaction by an amount exceeding the increase (if applicable) in the cost of the public guarantee. Generally speaking, the remuneration of the guarantee should not vary either.

Finally, adhering institutions granting any of the above measures to debtors must also keep the working capital facilities open to them until December 31, 2022.

Refinancing existing debts

Any impediments preventing voluntary early repayment and the refinancing of unguaranteed transactions (particularly those conducted before March 17, 2020) provided in the Framework Agreements must be taken into account when the debt is refinanced through financial institutions benefiting from one of the Guarantee Facilities securing a financing transaction with the financed company in question (even if the guaranteed transaction is not refinanced), and when the financed company has entered into other financing transactions within the scope of the Guarantee Facilities.

Thus, the Framework Agreements are likely to be amended to introduce the recent flexibility measures applicable to the Guarantee Facilities explained above.

Whether financial institutions adhere to the Code of Best Practices will also affect these transactions.

Claiming repayment of the amount resulting from enforcing the guarantee

Under RDL 5/2021, financial institutions are assigned court and out-of-court claims for the repayment of the amounts of appropriation by the tax authorities resulting from enforcing these 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 prior authorization from the collections department of the Spanish tax authorities.

On implementing this regime, the May 11 Resolutions include a general authorization so that, before taking court action, financial institutions can grant deferrals and installments for up to 12 months and on the basis of payments being made in monthly installments. Also, once court action has been taken and, if applicable, the notices of attachment have been issued, the financial institution can set up an agreement or system to repay the payable guaranteed principal, establishing the term and frequency of payments laid down and in compliance with applicable law.

Pre-insolvency and insolvency proceedings

In pre-insolvency refinancing proceedings, financing transactions granted a guarantee within the scope of the Guarantee Facilities and credits 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.

Once the credit granted through a guarantee has been enforced, it will be considered an ordinary credit in the insolvency proceedings of the guaranteed debtor. In this regard, the May 11 Resolutions provide that 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.

The May 11 Resolutions also establish that declaration of insolvency will lead to the subrogation of the state (the Ministry for Economic Affairs and Digital Transformation) in financing transactions granted a guarantee within the scope of the Guarantee Facilities, regardless of whether their enforcement has begun. Notwithstanding this subrogation, the May 11 Resolutions set out rules on the coordination required between the institutions and the authorities for action in these proceedings based on the *pari passu* clause.

For additional information, please contact Cuatrecasas.

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