CONFRONTING THE ECONOMIC IMPACT OF COVID-19 IN SPAIN: THE APPROVAL OF A LINE OF PUBLIC GUARANTEES ON LOANS

Background

Following the Royal Decree 463/2020 (*Real Decreto 463/2020, de 14 de marzo, por el que se declara el estado de alarma para la gestión de la situación de crisis sanitaria ocasionada por el COVID-19*) declaring a State of Emergency in Spain as of 14 March 2020, the Royal Decree-Law 8/2020 of 17 March on urgent and extraordinary measures to confront the economic and social impact of COVID-19 (*Real Decreto-ley 8/2020, de 17 de marzo, de medidas urgentes extraordinarias para hacer frente al impacto económico y social del COVID-19*), which came into force on 18 March 2020 (hereinafter, the "**RDL 8/2020**"), approved a set of extraordinary measures to confront the economic and social impact of COVID-19 in Spain.

Among the specific provisions targeted to ensure liquidity and access to finance by companies and the self-employed to sustain their economic activity, RDL 8/2020 provides a line of public guarantees on financing granted by financial institutions to companies and the self-employed for a maximum amount of EUR 100,000 million (hereinafter, the "**Line of Guarantees**").

The European Commission adopted and published on 19 March 2020 a Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak, establishing the compatibility conditions that it will apply to aid granted by Member States under Article 107(3)(b) of the Treaty of the Functioning of the European Union (TFEU). The aid in the form of guarantees on loans is one of the five types of State aid which the European Commission considers compatible and that can be approved rapidly upon notification by each Member State, provided the relevant requirements established on the Temporary Framework for State aid measures are met.

Spain's Official Gazette has published today the resolution adopted by the Council of Ministers (*Consejo de Ministros*) on 24 March 2020, approving the terms and conditions that will govern the public guarantees issued under the first tranche of the Line of Guarantees.

Amount of the Line of Guarantees

The Council of Ministers has approved an initial tranche of EUR 20,000 million, although the RDL 8/2020 provides the approval of a Line of Guarantees for a maximum amount of EUR 100,000 million.

Up to EUR 10,000 million of the initial tranche will be allocated to guarantee loans granted to small and medium enterprises ('SMEs') and the self-employed, whereas the remaining EUR 10,000 million will be allocated to guarantee loans to large enterprises.

Eligibility criteria

The determination of the loans eligible to be guaranteed is based on the borrower, the type of loan and lender(s) as well as the amount and the maturity of the loan.

Borrower

The guarantees may be issued to secure loans granted to companies (SMEs and large enterprises) and to the self-employed with registered office in Spain affected by the economic impacts of COVID-19 outbreak provided that they were not: (i) on a late/delayed payment situation on 31 December 2019 according to the Bank of Spain's Risk Information Centre (CIRBE) and (ii) subject to insolvency proceedings as of 17 March 2020.

Type of loan and lender(s)

New loans and other financing methods as well as renewals of loans granted by credit entities (*entidades de crédito*), financial credit institutions (*establecimientos financieros de crédito*), electronic money entities (*entidades de dinero electrónico*) and payment entities (*entidades de pagos*), regardless of the source of funding, to companies and to the self-employed after 17 March 2020 to cover their financial needs related, among others, with salary payments, invoices, working capital or other liquidity needs, including those arising from maturities related with financial obligations or taxes, will be eligible to be guaranteed.

Maximum Amount of eligible loans per client

In the case of one or more financing transactions up to EUR 1.5 million, the specific provisions of Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid shall apply.

In the case of loans exceeding EUR 1.5 million, the maximum amounts provided by the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak shall apply, and accordingly:

A) In case of new loans or refinancing with a maturity date beyond 31 December 2020, the amount of the loan principal shall not exceed:

(i) the double of the annual wage bill of the beneficiary (including social charges as well as the cost of personnel working on the undertakings site, but formally in the payroll of subcontractors) for 2019, or for the last year available. In the case of undertakings created on or after 1 January 2019, the maximum loan must not exceed the estimated annual wage bill for the first two years in operation; or

(ii) 25% of total turnover of the beneficiary in 2019; or

(iii) with appropriate justification and based on a self-certification by the beneficiary of its liquidity needs, the amount of the loan may be increased to cover the liquidity needs from the moment of granting for the next eighteen (18) months for SMEs and for the next twelve (12) months for large enterprises.

B) For loans with a maturity until 31 December 2020, the amount of the loan principal may be higher than under paragraph A) with appropriate justification and provided that the proportionality of the aid remains assured.

Risk covered by the guarantees issued

The amount guaranteed by the public guarantees issued will be limited, depending on the type of borrower:

(i) In the case of new loans and refinancing granted in favour of SMEs and the self-employed, the guarantee will cover 80% of the loan principal (the losses being sustained proportionally and under the same conditions, by the credit institution and the State); and

(ii) In the case of new loans granted in favour of large enterprises, the guarantee will cover 70% of the loan principal (the losses being sustained proportionally and under the same conditions, by the credit institution and the State), and in case of refinancing of large enterprises, the guarantee will cover 60% of the loan principal (again, the losses being sustained proportionally).

Application process

The new Line of Guarantees will be managed by the *Instituto de Crédito Oficial* (ICO), a state-owned bank, in collaboration with the financial institutions.

Accordingly, companies (SMEs and large enterprises) and the self-employed will be able to apply until 30 September 2020 for the issuance of guarantees to secure their financings entered after 17 March 2020, by addressing any of the financial institutions that have entered into the relevant collaboration agreements with ICO.

The guarantees issued shall have retroactive effects and its term will match that of the loan being guaranteed being limited to maximum five years.

Costs related to the issuance of the public guarantees

The cost of each public guarantee will be borne by financial institution(s) and is set at the following levels:

In the case of guarantees on new loans and refinancing up to EUR 1.5 million: 20 bps.

In the case of guarantees on loans exceeding EUR 1.5 million:

Type of borrower	Type of financing	Credit risk margin for a 1-year maturity loan	Credit risk margin for a 2-3 years maturity loan	Credit risk margin for a 4-5 years maturity loan
SMEs and self-employed	New loans and refinancing	20 bps	30 bps	80 bps

Large enterprises	New loans	30 bps	60 bps	120 bps
	Refinancing	25 bps	50 bps	100 bps

Other relevant conditions

Each financial institution will decide on the granting of the financing or refinancing to the client in accordance with its internal credit risk policy and procedures.

Loans approved accordingly up to EUR 50 million approved accordingly will be guaranteed, without prejudice to subsequent eligibility verifications. Loans exceeding EUR 50 million will be only guaranteed upon ICO verifying compliance with the eligibility conditions, in addition to the financial institution risk analysis.

Financial institutions are required to maintain the cost of the new loans and refinancing benefiting from public guarantees at the level prevailing prior to the beginning of the COVID-19 crisis, taking into account the public guarantee and its cost.

In addition, financial institutions are required to maintain, at least until 30 September 2020, the limits of working capital credit lines granted to all clients, in particular those of clients whose new loans or refinancing are guaranteed.

Further considerations

Conditions and requirements might change

The resolution adopted by the Council of Ministers and published today in Spain's Official Gazette establishes the terms and conditions applicable to the initial tranche of up to EUR 20,000 million, i.e. 20% of the total amount of the Line of Guarantees approved by the RDL 8/2020.

The purpose of launching an initial tranche is the proper monitoring of the functioning and development of the measure, and to be able to adjust the conditions and requirements based on demand or market conditions. Accordingly, we would recommend that the conditions and requirements in force from time to time are analysed on a case-by-case basis.

Non-Spanish lenders

The wording of the resolution published in Spain's Official Gazette refers only to credit entities (*entidades de crédito*), financial credit institutions (*establecimientos financieros de crédito*), electronic money entities (*entidades de dinero electrónico*) and payment entities (*entidades de pagos*).

In accordance with the principle of single authorization, any financial institution incorporated in the European Economic Area (EEA) and authorized by the competent authorities of the home Member State can, subject to complying with the passporting procedure, provide the services or perform the activities for which it has been authorized throughout the Single Market, either through the establishment of a branch or by the free provision of services.

It would be advisable for non-Spanish lenders to assess if they meet the relevant criteria, in order for them to benefit from the partial coverage of their risk exposures arising from new loans or refinancing granted after 18 March 2020 pursuant to the Line of Guarantees. Careful consideration must be given to coordination and communication with other lenders for the purposes of assessing potential asymmetries that may arise and exploring alternatives to facilitate the participation of non-Spanish lenders in the financings covered by the Line of Guarantees.

Additional security or guarantees

Given the absence of specific provisions to the contrary in the RDL 8/2020 and the resolution published in Spain's Official Gazette, the potential issuance of public guarantees under the Line of Guarantees, in our view, should not limit, the granting of additional security interests and, in general, any personal or *in rem* guarantees, in favour of the concerned lenders.

Notwithstanding the above, it would be advisable to carry out a careful case-by-case analysis of the proposed security package, bearing in mind, most notably, the borrower's insolvency and potential infringement of *pari passu* and/or negative pledge undertakings.

Currency

It is not specified in the abovementioned rules whether the public guarantees will be issued in EUR only. In the past, there have been facilities granted by ICO which have been funded in both EUR and USD.

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Our Banking & Finance practice group will be pleased to provide further information or specific legal advice upon request. Please contact:

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