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Covid – 19 update

IMPACT OF SPANISH COVID19 LEGISLATION ON NPL TRANSACTIONS

1. INTRODUCTION

The Covid-19 pandemic has triggered the development of a profound economic crisis in Spain, the scope and effects of which are still unknown.

According to the speech by the Governor of the Bank of Spain on 18 May 2020[1]:

- The preliminary estimate of the reduction of the GDP in the first quarter of 2020 was 5.2%, even though the confinement affected only the last two weeks of the quarter.
- It is expected that Spanish GDP will fall between 9.5% and 12.4% during 2020.
- The pandemic has triggered a substantial increase in credit risk, in respect of companies and consumers.

According to the Bank of Spain, the Covid-19 crisis however reached Spain with a very different economic landscape as that prevailing during the financial crisis that started in 2008. In particular:

- The quality of the Spanish banks' balance sheets is quite better: The rate of defaulted loans has been reduced in 9% from the peak reached in 2013, reaching 4.8% in the first quarter of 2020.
- Refinanced debt has reduced its weight in 9% as compared to that in 2013.
- The weight of exposures to the real estate sector, which as at 2013 reached 27% was 10% as at the en of the first quarter of 2020.
- The "Tier 1" capital of the Spanish banking system has gone from €158 billion in 2007 to €215 billion as at the end of the first quarter of 2020, providing a very substantial loss absorption capacity for Spanish banks.
- Almost half of the referred "Tier 1" capital, estimated at circa €90 billion, may cover an amount of losses equivalent to two times the actual volume of doubtful credit in the Spanish banking system, currently being at circa 8.2% of the total credit exposures to the Spanish private resident sector.

In a more recent report[2], the European Banking Authority (EBA) has set out that as the Covid-19 crisis develops, banks are likely to face growing non-performing loan (NPL) volumes, which can reach levels similar to those recorded in the aftermath of the sovereign debt crisis. According to EBA a sensitivity analysis based on the 2018 EBA stress test suggests credit risk losses could amount up to 3.8% of RWAs. State-guarantees introduced in many jurisdictions might soften this impact while the EBA Guidelines on loan moratoria will avoid the automatic classification of affected exposures as forborne or defaulted. Nonetheless, EBA recognises that the extent to which banks will be affected by the crisis is

[1] Given to the Commission of Economic Affairs and Digital Transformation of the Spanish Parliament.
[2] COVID-19 is placing unprecedented challenges on EU banks – EBA, 25 May 2020.

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expected to differ widely, depending on how the crisis evolves, the starting capital level of each bank and the magnitude of their exposures to the most affected sectors.

Against the aforementioned backdrop, the Spanish legislator has approved a very substantial number of protective legislative measures for individuals and companies.

This document sets out a summary of the legislative measures implemented and the likely impact that we expect for non-performing loan (NPL) portfolio disposal transactions, both on the consumer and corporate space. In respect of consumer loans, the considerations set out below, particularly the loan repayment moratorium measures, affect both performing and non-performing loans.

2. IMPACT ON CONSUMER/INDIVIDUALS NPLs

The measures taken by the Spanish legislator in order to protect households and individuals include (i) a temporary employment furlough scheme, to avoid termination of employment contracts, (ii) moratorium on loan repayments, (iii) moratorium on residential lease payments, securing basic supplies like gas, water, and electricity, and (iv) the activation of certain direct aid schemes for the most vulnerable citizen groups.

This section focuses on the measures which we deemed most relevant for their impact on consumer NPL transactions. There are other measures of a wider scope (like the suspension of procedural terms) which have also been included in this section given their likely impact on the credit enforcement timings.

2.1 Restrictions on the eviction of vulnerable dwellers

(a) Legislation

Royal Decree-law 6/2020 of 10 March (amends Law 1/2013, of 14 May, of protection of mortgage debtors).

(b) Summary of relevant provisions

(i) Eviction restrictions extended: Extension of the period of application of the rules setting out restrictions on the eviction of individuals classified under special economic vulnerability from adjudicated dwellings. The period of application of the restrictions is extended until 15 May 2024 (11 years since the entering into force of Law 1/2013).

(ii) The economic criteria to classify a person as economically vulnerable is modified as follows (see Annex 1 for the full criteria of the economic vulnerability definition):

- The combined income of the members of the household must not exceed three times the annual IPREM index (*Indicador Público de Renta de Efectos Múltiples mensual*) corresponding to fourteen annual payments.
- The limit may be increased to up to five times the IPREM in certain events (for example if the debtor suffers certain medical or physical conditions).
- The limit will also be increased in the following percentages for each descendant living with the household unit as follows:
  - 0.15 times IPREM for single parent family households
  - 0.10 times IPREM for the rest of households

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2.2 Loan repayments moratoria

(a) Legislation

(i) Royal Decree-law 8/2020 of 17 March, of urgent measures to counteract the economic and social impact of the COVID-19 (as amended by Royal Decree-law 11/2020, of 31 March).

(ii) Royal Decree-law 19/2020 of 26 May, of complementary measures to counteract the effects of COVID-19.

(b) Summary of the moratorium regime

Following the enactment of Royal Decree-law 19/2020 of 26 May, the Covid-19 loan repayment moratorium regime sets out three types of moratoria:

(i) The binding loan repayment moratoria legally imposed by Royal Decree-law 8/2020 of 17 March (as amended), which affect certain mortgage secured loans and unsecured consumer loans (the **Legal Moratorium**).

(ii) The loan repayment moratoria agreed between creditors and debtors pursuant to lenders' sector framework agreements entered into between members through the relevant sector associations. These moratoria are entered into between lenders and borrowers on the basis of bilateral negotiations following the guidelines of the relevant sector framework agreements, following the guidelines on loan moratoria of the European Banking Authority (EBA GL 2020/02), which if entered into according to the framework agreements would not lead to a reclassification of the moratoria as a refinancing or restructuring of the relevant loans for regulatory capital purposes.

(iii) Other moratoria entered into between lenders and borrowers on a bilateral basis that where entered into with borrowers in a situation of economic vulnerability, would benefit from the same reduction in notarial and registration fees, as well as stamp duty taxes, applying to the Legal Moratorium.

The moratoria referred to in (ii) and (iii) above are herein referred to as **Conventional Moratoria**.

(c) Legal Moratorium - Mortgage loans: Affected transactions

(i) A Legal Moratorium on mortgage loan payments is set out in respect of the following types of mortgage debt:

(A) debt incurred in the acquisition of the residential dwelling of the borrower;

(B) debt incurred in the acquisition of properties used for the business activity of entrepreneurs and professionals; and

(C) debt incurred in the acquisition of leased residential dwellings other than habitual residential dwelling in respect of which the owner and lessor (being an individual) has ceased to receive rent from the date of the entering into force of the state of alarm[3], or ceases to receive rent until one month after the end of the state of alarm,

in each case as a result of "extraordinary difficulties" to meet payment obligations as a result of the COVID-19 crisis.

[3] 14 March 2020.

(d) Legal Moratorium - Mortgage loans: Scope of beneficiaries

(i) In respect of debt incurred in the acquisition of the habitual residential dwelling:

(A) Individuals which meet the economic vulnerability criteria; and

(B) personal guarantors of the foregoing.

(ii) In respect of debt incurred in the acquisition of leased residential dwellings referred to in paragraph (c)(i)(C) above:

(A) individuals that meet the economic vulnerability criteria; and

(B) personal guarantors of the foregoing.

(iii) In respect of debt incurred in the acquisition of properties used for the business activity of entrepreneurs and professionals:

(A) individuals which pursuant to the VAT law[4] carry out business or commercial activities as defined in that law which meet the economic vulnerability criteria; and

(B) personal guarantors of the foregoing.

(e) Economic vulnerability criteria

In order to benefit from the Legal Moratorium, all debtors must comply with the economic vulnerability criteria, which is set out in detail by article 16 of Royal Decree-law 11/2020, of 31 March. A summary of the requirements is set out in Annex 1.

(f) Implementation of the Legal Moratorium

Debtors falling within the scope of the Legal Moratorium may request from the lender the suspension of their payment obligations until the date that is fifteen calendar days after Royal Decree-law 8/2020 ceases to be in force. Pursuant to its Tenth Final Provision, Royal Decree-law 8/2020 will be in force for one month after the end of the state of alarm.

The state of alarm has been extended a number of times and as at the date hereof it has been extended until 7 June 2020. It is likely that the Spanish Government requests another extension from the Parliament until the end of June. If such extension request is granted, the relevant debtors could potentially request the Legal Moratorium until mid-August 2020.

Once the Legal Moratorium is requested and the required evidentiary documentation delivered, the creditor shall be obliged to implement the Legal Moratorium within fifteen days of request.

The Legal Mratorium must be implemented by way of the execution of a public deed of amendment of the original mortgage loan agreement and shall be registered in the relevant Land Registry. As the moratorium will require the extension of the original maturity date of the loan, it is required to amend the mortgage loan deed in order implement the Legal Moratorium.

(g) Implementation costs of the Legal Moratorium

The costs of implementation of the Legal Moratorium shall be payable by the lender, but the costs are subject to the following reductions:

[4] Law 37/1992 of 28 December of VAT.

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(i) Notarial fees: Reduction of 50%, with a maximum fee of € 75 per deed.

(ii) Registrars' fees: Reduction of 50% with a maximum fee of € 50 per deed.

In addition, the amendment deeds granted in order to implement the Legal Moratorium as per the foregoing are declared exempt from stamp taxes.

(h) Duration and scope of the Legal Moratorium

The Legal Moratorium shall be granted for a period of **tree months**. It must be noted that most Spanish banks have adhered to the AEB Framework Agreement Covid-19 (as further described below). As a result, most Spanish banks are offering longer Conventional Moratoria to their clients on a case by case basis.

The Legal Moratorium covers principal and interest: Interest shall not accrue during the moratorium period. Therefore, failure to pay any of the suspended instalments or interest payments during the moratorium shall not be regarded as a breach of payment obligations.

This brings another important consequence of the Legal Moratorium: **The number of unpaid instalments in order to accelerate the mortgage loans (12 or 15 instalments, as applicable[5]) will start to count from the first instalment payable after the moratorium (in the absence of not previously defaulted instalments)**.

(i) Conventional Moratoria entered into pursuant to sector framework agreements

Royal Decree-law 19/2020 of 26 May governs the requirements of this type of Conventional Moratoria and its main features are the following:

(i) The moratoria are agreed on a case by case basis following the guidelines set out by the sector framework agreements to which the relevant lender has acceded.

(ii) The scope of loans is much wider than that of the Legal Moratorium, as they cover any type of loans or facilities.

(iii) The moratoria may include a redistribution of repayment instalments without extension of the maturity date or the extension of the maturity date to accommodate the moratorium.

(iv) The moratoria may not amend the contractual interest rate, require payment of fees or expenses (except in certain cases), impose the obligation to enter into other financial products or require additional guarantees or security.

If the agreed Conventional Moratorium complies with the requirements set out above, the lender will benefit from the same reduction in costs and taxes set out for Legal Moratoria (described in section (g) above).

(j) Duration and scope of Conventional Moratoria entered into pursuant to sector framework agreements

The scope of debtors and the duration of the Conventional Moratoria entered into pursuant to a sector framework agreement is as set out in the relevant framework agreement. In respect of Spanish banks, the Spanish Bankers Association (AEB) has published the Framework Agreement on the Financing Transactions Moratorium Applying to Clients Affected by the Coronavirus Crisis, dated 16 April 2020 (**AEB Framework Agreement Covid-19**). Most of the banks of the Spanish banking sector have already

[5] As set out in Law 5/2019 of 21 February, of real estate credit.

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acceded as parties to the AEB Framework Agreement Covid-19, which provides for the following scope and terms:

(i) Qualifying debtors: Individuals affected by the Covid-19 crisis which did not have defaulted transactions as at 14 March 2020.

(ii) Transactions: Mortgage secured loans over dwellings or over real estate assets attached to a professional activity and unsecured loans payable by way of periodic instalments.

(iii) Moratorium terms: Maximum twelve month deferral for mortgage loans and six months for unsecured loans.

(iv) Effect of the moratorium: Deferral of repayment of principal instalments. Interest has to be paid as per the original contractual terms during the moratorium period.

(v) Availability: Moratoria can be requested until 29 June 2020 (unless extended following applicable EBA guidelines).

(vi) Interest rate: Same as per the original contract.

(vii) Security and guarantees: Same as per the original contract.

(k) Coordination of Legal Moratoria with Conventional Moratoria entered into pursuant to sector framework agreements

Conventional Moratoria are compatible with the Legal Moratorium. Therefore, where a Conventional Moratorium has been agreed with a debtor that also qualifies to benefit from a Legal Moratorium, the terms of the Legal Moratorium shall prevail over the terms of the Conventional Moratorium. As a result, the terms of the Conventional Moratorium would enter into force after the termination of the Legal Moratorium. **It is likely that NPL portfolios originating after March 2020 may include consumer loans (secured and unsecured) subject to Conventional Moratoria (whether or not a Legal Moratoria was also obtained in respect of the same loans). As the Conventional Moratoria may be granted for as long as twelve months in respect of mortgage secured loans, as mentioned above, the status of loans subject to moratoria must be carefully analysed, and adequate representations and warranties must be obtained as regards the number of loans under moratoria and their duration.**

2.3 Special protections for personal guarantors and third party mortgagors

Guarantors and third party mortgagors meeting the economic vulnerability criteria are also protected by the Legal Moratorium rules. Before enforcement of the guarantee or third party mortgage, the creditor must first exhaust the assets of the debtor (without prejudice to the application to the debtor of the benefits set out above or in the current Code of Good Practices [6]). This benefit shall apply even if the guarantor or third party mortgagor waved the right to first claim against the principal debtor (as is customarily the case in the commercial practice). **This has the effect of transforming first demand or joint and several guarantees into subsidiary guarantees, making enforcement against the guarantors and third party mortgagors more difficult**.

2.4 Protections for debtors under non-secured loans

A Legal Moratorium has also been provided for in respect of unsecured loans, financial leasing contracts and outstanding credit facilities as at the date of entering into force of Royal Decree-law 11/2020, where

[6] The Code of Good Practices was set out by Royal Decree-law 6/2012 of 9 March and currently all Spanish banks have subscribed to this code.

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the debtors are individuals meeting the economic vulnerability criteria (in the same manner as set out for mortgage secured loan debtors).

The protections afforded for personal guarantors of debtors under mortgage secured loans (as described in section 2.3 above) apply to guarantors of these unsecured loans, credit facilities and financial leasing contracts.

2.5 Suspension of judicial proceedings

(a) Legislation

(i) Royal Decree 463/2020, of 14 March, declaring the state of alarm as a result of the health crisis caused by COVID-19.

(ii) Royal Decree-law 16/2020, of 28 April, of procedural and organisational measures to deal with COVID-19 in the Justice Administration.

(b) Summary of relevant measures

Royal Decree 463/2020 declaring the state of alarm in Spain, set out various measures including the suspension of procedural terms in respect of all judicial proceedings (with the exception of certain proceedings not relevant for the purposes of this note).

Procedural terms were suspended for as long as the state of alarm is in force. During the state of alarm all mortgage and debt enforcement proceedings in general have been suspended, as well as insolvency proceedings. To this end, Royal Decree-law 16/2020 has set out that procedural terms will be restarted *ab initio* (i.e. without discounting the time period lapsed until the date of declaration of the state of alarm) from the first business day following the last day of the state of alarm (or the last day in which the relevant proceeding is suspended).

Royal Decree 463/2020 also suspended the legal terms to exercise any actions or rights during the state of alarm, therefore deferring the time barring of enforcement actions.

Royal Decree 537/2020 of 22 May, which approved the latest extension of the state of alarm in Spain until 7 June, has approved the gradual reactivation of judicial activity. In particular, the suspended procedural terms will be restarted on 4 June 2020. Also, the suspension of the statute of limitations and of the legal time periods for the exercise of actions and rights will also be lifted on that same date.

(c) Consequences

(i) All ongoing judicial recovery and enforcement proceedings have been suspended and will not be resumed until 4 June 2020.

(ii) Procedural terms will be restarted from the beginning without discount of the time period lapsed until the date of declaration of the state of alarm, therefore substantially delaying all judicial proceedings.

(iii) In the case of judicial decisions notified during the state of alarm or during the period of twenty business days after the lifting of the suspension, the terms available for the appeal against the relevant decisions will also be restarted.

(iv) Royal Decree-law 16/2020 has taken measures to speed up proceedings (such as declaring as business days for procedural purposes the period between 11 and 31 August, which are statutory non-business days for judicial proceedings or assigning certain courts to deal exclusively with COVID-19 related claims). However, it is expected that the number of accumulated suspended

proceedings plus the new claims arising from the COVID-19 crisis in all fronts will have a **substantial saturation effect on the Spanish judicial system**, therefore increasing the recovery timelines used in the assumptions built in NPL investors' models, which will have to be revised.

3. IMPACT ON SMEs NPLs

No loan or credit facilities payment moratoriums have been set out by law for corporates, even if classified as SMEs. On this regard, the Spanish Government measures for the protection of businesses in the COVID-19 crisis can be classified in the following groups:

- Corporate: Measures relating to relaxation of formal corporate law requirements, foreign investment restrictions in strategic sectors and anti-trust measures (relaxation of state aid rules in order to permit the enactment of the Governmental guarantee scheme and other state rescue measures).
- Financing: Governmental guarantee scheme.
- Insolvency: Measures relating to relaxation of certain requirements under insolvency proceedings, deferral of insolvency filing obligations and exceptions relating to the application of equitable subordination rules.
- Procedural: Measures relating to suspension of proceedings and other measures affecting enforcement proceedings.
- Real estate: Measures relating to the deferral of lease payments.
- Tax: Tax measures taken to defer certain tax payments obligations.
- Employment: Measures relating to temporary lay-offs and other employment protection rules.
- From an NPL investor point of view, we should focus on the consequences of two groups of measures: The governmental guarantee scheme and insolvency related measures. However, investors must bear in mind that the suspension of judicial proceedings described in section 2.5 above will also impact enforcement proceedings against corporate debtors.

3.1 Governmental guarantee scheme

(a) Legislation

Royal Decree-law 8/2020, of 17 March, which approved a state guarantee facility for up to €100 billion, to be distributed through banks for companies and professionals to fund their liquidity needs arising from COVID-19 impact on their businesses.

(b) Characteristics of the scheme

(i) The guarantee scheme is managed by the Instituto de Crédito Oficial (**ICO**), which has entered into certain master agreements with Spanish distributor banks and other regulated lenders, which will provide the guaranteed facilities to qualifying borrowers through their branch office networks. It is important to note that ICO will not have any contractual relationship with borrowers.

(ii) The guarantees are provided by ICO on a *pari passu* basis. The risk is shared between ICO and the lenders in accordance with the proportion guaranteed by ICO but otherwise on a *pari passu* basis (i.e. on an 80% guaranteed loan, of any €100 lost, ICO assumes €80 and the lender assumes €20).

(iii) The purpose of the guaranteed financing is to fund working capital needs of the borrowers (payment of suppliers, wages, due and payable financial and tax payment and other working capital financing needs). The Resolutios of the Cabinet approving the final terms of each tranche

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expressly clarified, by way of example, that the guaranteed financings may not be used to fund payments of dividends to shareholders.

(iv) As at the date hereof four tranches of €20 billion each[7] have been released. The characteristics of each tranche are as follows:

(A) First tranche (released by Resolution of 25 March 2020, setting out the Agreement of the Cabinet of 24 March 2020) – €20 billion

I. Borrower elegibility:

- Beneficiaries: Professionals, SMEs[8] and larger companies (€ 10Bln for professionals and SMEs and € 10Bln for larger companies).
- Domiciled in Spain.
- Their operations must have been affected by the COVID-19 crisis.
- Borrowers must have not been in default and therefore not registered in CIRBE[9] as a defaulting lender as at 31 December 2019.
- Borrowers must not be insolvent as at 17 March 2020.
- Borrowers must not qualify as an "undertaking in difficulty [10]".

II. Size:

- Transactions of up to € 50 million must be approved by the distributor bank as per its own risk policies.
- Transactions over € 50 million must be subject to secondary approval by ICO.

III. Maximum percentage guaranteed: 80% (professionals and SMEs) and 70% for large companies (for new transactions) and 60% for refinancing for existing transactions.

IV. Maximum term: 5 years

V. Pricing: The pricing scheme has been set out as follows.

For loans of up to € 1.5 million: 20 bps p.a. calculated over the guaranteed amount.

For loans exceeding € 1.5 million:

Professionals and SMEs:

- 20 bps p.a. for transactions up to 1 year
- 30 bps p.a. for transactions between 1 and 3 years
- 80 bps p.a. for transactions between 3 and 5 years

For larger companies (new money)

- 30 bps p.a. for transactions up to 1 year
- 60 bps p.a. for transactions between 1 and 3 years
- 120 bps p.a. for transactions between 3 and 5 years

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7 In addition, €4 billion have been released to guarantee, under certain conditions, commercial paper listed in the Spanish debt regulated market (AIAF) and in the Spanish debt MTF (MARF) and another € 500 million to guarantee transactions subscribed with the Spanish Counterguarantee Company (CERSA).

8 Please, note that the concept of SME for these purposes is as defined in the Commission Regulation (EU) No 651/2014 of 17 June 2014: Companies with less than 250 employees and an annual turnover not exceeding € 50 million or whose annual balance sheet does not exceed € 43 million.

9 *Central de Información de Riesgos del Banco de España* (Risk Information Database of the Bank of Spain).

10 As defined by article 2 (18) of Regulation (EU) 651/2014 of 17 June 2014. This requirement is not clearly set out in the Resolution of 25 March 2020. Our understanding is that ICO requires that this condition must be assessed as at 31 December 2019.

Larger companies (refinancing)

- 25 bps p.a. for transactions up to 1 year
- 50 bps p.a. for transactions between 1 and 3 years
- 100 bps p.a. for transactions between 3 and 5 years

(B) Second tranche (released by Resolution of 10 April 2020, setting out the Agreement of the Cabinet of 10 April 2020) – €20 billion

This tranche was limited to professionals and SMEs only. Rest of the conditions are as set out for the first tranche.

(C) Third tranche (released by Resolution of 6 May 2020, setting out the Agreement of the Cabinet of 5 May 2020) – €20 billion

The third tranche provides up to €10 billion for professionals and SMEs and up to €10 billion for larger companies. Rest of the conditions as set out for the first tranche. Available until 30 September 2020.

(D) Fourth tranche (released by Resolution of 19 May 2020, setting out the Agreement of the Cabinet of 19 May 2020) – €20 billion

This tranche is limited to professionals and SMEs only. Rest of the conditions are as set out for the first tranche. Available until 30 September 2020.

(c) Status of the programme

According to the Bank of Spain, the COVID-19 crisis has triggered an annual 50% increase in lending provided to Spanish corporates as compared to 2019. As at 13 May 2020 the total amount of lending transactions entered into under the governmental guarantee scheme are 371,070 out of which 98% have been granted to SMEs and professionals. The total amount of ICO guarantees requested was €36,291 million and the amounts made available were €47,751 million, with an average ICO guarantee coverage of 76%. According to more recent data from the Ministry for Economic Affairs and Digital Transformation released as at 25 May 2020, the total amount of lending transactions entered into under the governmental guarantee scheme are 462,614 for a total guaranteed amount of €44,096 million.

(d) Consequences

The most important consequences of the ICO guarantee scheme are the following:

(i) As ICO and the lenders will support losses *pari passu*, banking lenders will require less capital allocated to guaranteed loans and therefore defaulted guaranteed loans will be less prone to be sold in NPL portfolios. Conversely, non-guaranteed defaulted loans with same borrowers will be sold, meaning that it will be more difficult to request that all competing claims against the same borrower are included in NPL portfolios, where borrowers have ICO guaranteed loans and non-guaranteed loans.

(ii) Master agreements entered with ICO customarily restrict transferability of ICO supported loans, and ICO guaranteed loans are no exception. In the past it has been customary to exclude ICO supported loans[11] from NPL portfolios for this same reason. Given the size of the ICO guarantee programme, it is likely that the amount of defaulted ICO guaranteed loans in the Spanish banking

[11] ICO has supported lending under certain specific programmes in the past to incentivise development of certain sectors or areas.

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system will be much higher. The need of lenders to dispose of defaulted loans may require a wider use of sub-participation or similar arrangements.

(iii) As the terms of the ICO guarantee programme allows for the refinancing of existing debt facilities, it is likely that a substantial amount of existing exposures are refinanced with ICO guaranteed facilities.

3.2 Insolvency law measures

(a) Legislation

Royal Decree-law 16/2020 of 28 April, of procedural and organisational measures to deal with COVID-19 in the Justice Administration.

(b) Summary of measures

Royal Decree-law 16/2020 has implemented a number of important temporary insolvency legal measures to deal with the effects of the COVID-19 crisis.

The most relevant measures are the following:

(i) Amendments of creditors voluntary arrangements (**CVAs**)

Existing CVAs may be amended at the request of the debtor, to the extent not in breach as at 14 March 2020[12]:

- When: The amendment request can be filed within one year from 14 March 2020.
- Required creditor majorities: Same as those required for the approval of the original CVA[13]. Secured creditors are not affected unless supporting the amendment.

(ii) Breaches of CVAs

The judicial processing of creditors' requests to declare the breach of a CVA will be delayed.

- Affected requests: Requests filed within the period of six months from 14 March 2020 (period ending on 14 September 2020).
- Processing delay: Requests will not be conducted until a period of three months have lapsed since 14 September 2020 (i.e. 14 December 2020). During that period the debtor may file a proposal for the amendment of the CVA and if so, the debtor's request will be given procedural priority over any request to declare the breach.

(iii) Postponement of the obligation to file for insolvency

The two-month period since the debtor knew or ought to have known it was insolvent set out for debtors' mandatory obligation to file for insolvency has been temporarily extended.

- When: From 14 March 2020 until 31 December 2020.
- Effects on creditors' filing for mandatory insolvency: During the the rest of the calendar year 2020 courts will not process any mandatory insolvency filings requested by any creditor. If the debtor files a request for its voluntary insolvency after a creditors' request has been filed during that period, the courts will process the voluntary request with preference over the creditors' requests.

[12] Date of declaration of the state of alarm.

[13] Generally: (i) where the CVA provided for write-offs of less than 50% or deferrals of up to 5 years, 50% of the senior unsecured claims; and (ii) where the CVA provided for write-offs greater than 50% or deferrals of more than 5 but less than 10 years, 65% of the senior unsecured claims.

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(iv) Postponement of the obligation to file for liquidation

The statutory obligation of a debtor under a CVA to file for liquidation when the debtor becomes aware that it will not be able to fulfil the CVA has been postponed.

- Postponement period: One year from 14 March 2020.
- Requirements: The filing and admission for processing of a proposal to amend the CVA within that period. During that period courts will not open the liquidation stage of the debtor, even if a creditor provides evidence of any of the triggers for the opening of the liquidation stage for debtors which are clearly unable to comply with the terms of a CVA.

(v) Preferential claims upon breach of an amended CVA

In the event of breach of a CVA approved or amended within the period set out below, certain claims shall be regarded as estate claims (i.e. superprivileged) and shall be preferential in respect of all other claims except secured claims (for up to the value of the security).

- Qualifying CVAs: CVAs approved or amended within the period of two years from 14 March 2020.
- Claims benefiting: Claims arising from fresh money injections by means of loans or other financing facilities granted to the debtor in the context of the CVA or its amendment, even those provided by specially related persons.

(vi) Preferential processing of insolvency actions and disputes

During the period set out below, certain insolvency actions and disputes will be processed by courts on a preferential basis.

- When: Actions or disputes filed during the period of one year from 14 March 2020.
- Actions and disputes: Among others, the following:
- disposals of productive units or global disposals of assets of the insolvent debtors;
- CVAs or their amendments, as well as disputes relating to their approval;
- claw-back actions;
- admission of refinancing agreements in the context of homologation requests; and
- others that courts may deem relevant for the maintenance of the insolvent debtors' assets.
- In addition, the approval of liquidation plans filed within the state of alarm must also be processed by courts on an urgent basis.

(vii) Measures relating to the disposal of insolvent debtors' assets

The auction of the insolvent debtors' assets shall be made out-of-court in respect of certain insolvency proceedings, regardless of the provisions set out in the relevant liquidation plan, even if already approved by the court.

- What insolvency proceedings: Those declared within one year from 14 March 2020 and those outstanding as at 14 March 2020.
- Exceptions: The disposal of the debtor's business as a whole or of productive units can be made by judicial auction or by any other means if expressly authorised by the court on those terms. Also, in respect of security assets, these can be sold by direct sale or by deed in lieu if so authorised by the court.

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(c) Consequences

(i) By granting additional time to amend CVAs, to delay the processing of any creditors' request to declare the breach of a CVA and to process with preference any amendment requests over any request by creditors to declare the breach of a CVA, debtors have acquired a substantial power to deactivate breaches of CVAs during the relevant period, being able to renegotiate CVAs even if they are already in breach or are likely to be in breach. This also has the effect of reducing the chances that debtors under a CVA have to file for liquidation. This basically puts the borrower temporarily in control of the fulfilment of a CVA. In our view this would not be disadvantageous for holders of claims under a CVA, as it would avoid entering into lengthy liquidation proceedings. However, there are circumstances in which the amendment of the CVA would be not feasible; in those situations, we do not rule out the possibility of debtors not trying to initiate the process of amending the CVA in order to delay the liquidation process until the first quarter of 2021. On this regard, it must be borne in mind that whilst a CVA is still in force, the debtor is not under the control of the court or the insolvency administrator for the disposal of assets, although these actions will be reviewed after the opening of the liquidation, if the CVA is breached and the debtor is liquidated.

(ii) The extension of the period for the filing for voluntary insolvency, together with the temporary suspension in the processing of mandatory insolvency requests by creditors takes away an important element of pressure on debtors to file for insolvency, and gives debtors temporary control of the insolvency filing. The purpose of these measures is to enable debtors to renegotiate their debts out of an insolvency proceeding. In our view this would be an advantage for NPL investors to reach out-of-court negotiations or settlements. On the other hand, if there is a risk of a creditor starting an enforcement proceding, the debtor will most likely file a preinsolvency notice, which will suspend enforcement over necessary assets and hence freeze the enforcement action until 31 December 2020.

(iii) The preferential processing of disposals of productive units or global disposals of assets of the insolvent debtors, together with the additional flexibility provided in the auction process is expected to prompt more transfers of businesses or productive units from insolvent borrowers, and therefore facilitate recoveries, particularly for secured creditors. This is should have a beneficial effect in dealing with the recovery of claims from borrowers in liquidation which have viable productive units.

(iv) It is expected that the above measures reduce the potential avalanche of insolvency filings reaching Spanish courts after the state of alarm is lifted, although it remains to be seen whether the above measures are effective. On this regard, the plan of Madrid Insolvency Courts is to speed up the current liquidation processes, between June and September. From September onwards to deal with amendments of CVAs and restructurings; and from January 2021, to start dealing with the new insolvency proceedings that will inevitably be declared once the relevant deadlines have elapsed.

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ANNEX 1

ECONOMIC VULNERABILITY CRITERIA

(a) The beneficiary[14] becomes unemployed or, in the case of professionals, suffers a substantial loss of revenues or a reduction of its billings of at least 40%.

(b) The aggregate of the household income does not exceed three times IPREM (*Indicador Público de Renta de Efectos Múltiples mensual*) [15] in the month immediately preceding the moratorium request, provided that:

(i) the above amount shall be increased by 0.1 times IPREM for each descendant in the household and by 0.15 times IPREM where the household is a single parent family; and

(ii) the above amount shall be increased by 0.1 times IPREM for each household member of 65 years or older.

(c) If any household member has a disability greater than 33% or a medical condition preventing that member from carrying out any employment activity on a permanent basis, the limit set out in (a) above shall be four times IPREM (adjusted by (i) and/or (ii) above, as applicable).

(d) If the mortgage debtor has a brain condition or mental disability equal to or greater tan 33%, or a physical disability of equal to or greater than 65%, as well as in cases of serious medical condition preventing him/her or his/her carer to carry out an employment activity, the limit set out in (a) above shall be five times IPREM.

(e) The aggregate of (1) the mortgage instalments due, and (2) expenses and basic supplies (electricity, gas, heating fuel, water, telecoms and property service charges) of the household dwelling, is equal to or greater than 35% of the net household income.

(f) As a result of the COVID-19 emergency the household has suffered a material adverse change of its economic circumstances in terms of dwelling financing effort (meaning that the ratio of mortgage repayments over the household income has increased by 1.3 times).

[14] Being the debtor under the mortgage loan.
[15] €537.84 for 2020 (www.iprem.com.es).

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