Are refinancing and the ICO's line of guarantees compatible?

Following the release of the second tranche of the Spanish Official Credit Institute's (ICO) line of guarantees approved under Royal Decree-law 8/2020 (RDL 8/2020) in a bid to reduce the economic impact of COVID-19, their compatibility with refinancing and debt restructuring remains a significant talking point.

In particular, questions have been raised in relation to three time-based scenarios:

- **Pre-existing refinancing:** whether it is possible to grant a loan backed by the Ministry of Economic Affairs and Digital Transformation – managed by the ICO – to a company or self-employed individual who has already restructured their debt at an earlier date.

- **Current refinancing:** whether it is possible to grant a loan backed by the ICO's COVID-19 line of guarantees as part of a refinancing operation or alongside it.

- **Subsequent refinancing:** having authorised a transaction backed by said line of guarantees, whether it is possible to refinance or restructure other pre-existing debts of the company or self-employed individual in the future.

While neither the Royal Decree-law nor the Council of Ministers Resolutions published on 25 March and 10 April 2020 approving the components of the first two tranches specifically address this subject, the questions raised on the back of the details on the ICO website and wording of the template master agreement between the ICO and financial institutions explain why there is a fundamental need for clarification.

Let's take a look at the following references and provisions:

- **ICO website:**

    - Purpose of the ICO's COVID-19 line of guarantees: "*The consolidation and restructuring of loans, as well as the cancellation or early repayment of pre-existing debts, are not to be funded by the line of guarantees*".

    - Transactions open to being secured: "*Secured loans are not to be used to cancel or repay pre-existing debts early*".

- **Master agreement:**

    - "*The entity commits and undertakes (…) not to refinance or restructure the transactions concluded with the self-employed individual/customers prior to 17 March 2020*".

- "*The purpose of this agreement is not to consolidate or restructure the self-employed individual/company's debts, rather to provide sufficient liquidity for them to satisfy their cash-related requirements in view of the COVID-19 pandemic, in accordance with the envisaged purpose. Moreover, this facility may not be used to cancel or repay pre-existing debts early.*

  This restriction is understood without prejudice to the possibility of renewing loans and lines of credit for equivalent or significant amounts and/or terms, as well as the payment, as the case may be, of ordinary instalments and other current expenditure forming part of the working capital".

- Maximum guarantee amount: "*For this purpose, the term renewal shall mean a new undertaking of a transaction which provides continuity for a previous transaction that has reached maturity with a payable outstanding balance. Any amendments and/or the restructuring of existing loans which are yet to mature will not be considered as renewal".*

Taking each of the above points separately could lead to conflicting interpretations as to the purpose of this measure. For example, the prohibition set out in the master agreement ("*The entity commits and undertakes (…) not to refinance or restructure the transactions concluded with the self-employed individual/customers prior to 17 March 2020*") would prevent companies or self-employed individuals who receive a loan backed by the ICO's COVID-19 line of guarantees from being able to restructure their pre-existing debt in the future.

The quest to find an interpretation which coincides with the purposes of the measure paves the way for other conclusions. Essentially, the key aim is for these public guarantees – created to help towards obtaining liquidity to alleviate the economic effects of COVID-19 – not to be exploited as a means of refinancing pre-existing debts.

Based on that straightforward notion, sense can be made to clarify the three scenarios mentioned at the beginning of this piece:

- **Pre-existing refinancing:** there is nothing to stop companies or self-employed individuals who have previously refinanced their debt from receiving a loan backed by the ICO's COVID-19 line of guarantees.

Against this backdrop, the only restrictions outlined in the 25 March Resolution is for borrowers not to be listed as delinquent within the files held by the Bank of Spain's Risk Information Office (CIRBE) as at 31 December 2019 and that, as at 17 March 2020, they were not subject to bankruptcy proceedings or declared insolvent. The master agreement goes on to add to the foregoing that they must also not have issued the notification described under Article 5 bis of the Spanish Insolvency Act. However, there is no reference as to whether they have already refinanced their debt or not.

- **Current refinancing:** there are no stumbling blocks under the refinancing of a company's bank debt to agreeing an additional loan backed by the ICO's COVID-19 line of guarantees.

In order for this to be possible, and in accordance with the purpose of the line of guarantees:

  - Liquidity requirements must be related to reducing the effects of the pandemic and not to other needs, hence financial institutions should request that borrowers provide them with a report showing the appropriate justification.

  - The secured loan must be used to "*satisfy financing needs relating to, among others, the payment of salaries, invoices, working capital requirements or other liquidity-related demands, including those stemming from the maturity of financial or tax obligations*".

    As for the latter requirement, it should be pointed out that new loans and other forms or financing such as pre-existing debt renewal can be secured, provided that they were mature. Therefore, a State-backed guarantee cannot be obtained for a loan used to cancel existing transactions which are yet to mature. In other words, they cannot be used to refinance, rather to provide fresh liquidity in a refinancing context and as long as they are used for the means set out under the corresponding regulation and to counter the needs arising from the relevant impact.

- **Subsequent refinancing:** in view of the above, the position in relation to this scenario is also apparent. Under the master agreement, the signatory entities are prohibited from using the secured loans to refinance pre-existing debt, specifically "*not to refinance or restructure the transactions concluded with the self-employed individual/customers prior to 17 March 2020*". Nevertheless, beyond the time of granting – where, as we have seen, it could co-exist with refinancing or restructuring arrangements –, there is nothing to suggest that restrictions are being put in place against other pre-existing debts being refinanced at a later date.

  Unfortunately, it is clear that the economic consequences of the pandemic and lockdown will deal a severe blow to companies and self-employed individuals. What's more, it would not make sense for the liquidity gained from the ICO's COVID-19 lines of guarantee to prevent them from agreeing a more pertinent financing structure with their creditors where necessary in the future.

To conclude, the answers to the questions raised lie within the purpose of the secured transactions (fresh liquidity for specific means, albeit under no circumstances to refinance outstanding debt) and the reasons underpinning the need for such liquidity (based on the economic effects of COVID-19). If both requirements are met, the loans backed by the ICO's COVID-19 line of guarantees will be able to peacefully co-exist with the refinancing and restructuring of prior, simultaneous and future debt.

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