

Legal and tax considerations of secondary loan transfers in Spain

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1. Introduction

Economic conditions have substantially improved since the financial crisis hit the Spanish financial system. Although the economy is still facing challenges, Spain GDP increased by 3.1% in 2017 and Spain has one of the highest growth rates among the biggest economies of the European Union.

Secondary debt trading remains a buoyant business. Financial institutions, which are still focused on improving their balance sheets, are the most active sellers of non-performing loans. The “bad bank” SAREB is still carrying out a disinvestment process and continues selling distressed portfolios, including real estate baked debt.

The Spanish market for non-performing loans has matured and the presence of UK and US funds and asset managers in the economy has become normal. Due to the maturity of the market, it is expected that some funds that acquired position in previous years, start exiting those positions.

There are important Spanish legal and tax implications in any secondary loan transaction that involves Spanish borrowers or guarantors, loans or guarantees governed by Spanish law and/or any Spanish security. Getting them right is key to acquire valid and enforceable title over debt claims and security. For such reason, it is recommendable to seek advice from Spanish local counsel in such cases.

This purpose of this document is to provide a summary overview of some Spanish law issues that may be relevant to a purchaser or seller of single name debt and loan portfolios in the secondary loan market.

The document only refers to Spanish law. This document does not intend to be comprehensive. Legal advice should be obtained on a case by case basis.

2. Methods, conditions and formalities

2.1. Transfer by assignment

Most transfers of debt in Spain are made by way of assignment, pursuant to an assignment agreement typically governed by Spanish law by which a lender assigns its claims (totally or partially) against a borrower under a loan or credit facility to the assignee.

If there are amounts still pending to be draw-down under the facility, the assignment agreement shall regulate whether the purchaser only assumes the claim; or it also assumes the whole contractual position of the seller (including future draw-down obligations). The later option will likely require the consent from the borrower in order to release the seller from such obligation.

A claim assignment transfers the legal and beneficial ownership over the claim and the assignee will hold a direct claim against the borrower. In Spain there is no such thing as an “equitable assignment” (typical under English law).

Unless otherwise agreed in the assignment documents, under Spanish law an assignee will have no recourse to the seller of the claim except in connection with the existence and legitimacy of the claim, but not with respect to the solvency of the borrower. Also, the seller’s liability is generally limited to the purchase price, plus expenses and other legitimate payments made as a consequence of the transfer of the claim.

2.2. Other methods of transfer

Participation (or sub-participation) agreements are also valid in Spain, but in this case the grantor would remain the lender of record and the participant will not hold directly enforceable rights against the borrower.

In recent years LMA transfers have become popular. Typically, the transfer conditions are established under a LMA Trade and thereafter an assignment agreement is formalized (which cross refers to the LMA Trade Confirmation) in order to comply with any requirements established under the loan.

English law transfers by way of novation are hardly used in connection with Spanish claims, as there is a risk of release of any existing security or guarantees granted in favour of the transferor.

2.3. *Conditions to the transfer*

In Spain claims are generally freely transferrable and assignable. Unless the facility documentation contractually requires otherwise, neither consent from the debtor nor notification to the debtor are legally required.

However, until a claim transfer or assignment is notified to the borrower, the debtor may be released from its payment obligations by paying the transferor. Therefore, if the parties have no reason to keep the transfer private, it is advisable to notify the borrower of the transfer. In case of joint debtors each of them shall be notified and in case of joint and several debtors notification to one of them is sufficient.

Despite the above, facility documents (mainly in syndicated facility) usually establish certain conditions to transfers or assignments of claims, the most common being: (i) notice to the agent and the debtor, (ii) no increased costs for the debtor (which may typically be in the form of gross-up for withholding taxes), (iii) minimum nominal amount transferred, and (iv) transfer on particular dates (usually at the end of an interest period).

It is also not uncommon that the loan document itself includes a form of transfer or assignment document that needs to be used to document any transfer or assignment.

Facility documents may impose additional restrictions on certain forms of transfers (such as sub participation agreements) or on transfers to certain players (such as hedge funds and certain distressed debt investors). It is also typically the case that such restrictions fall apart once the loan is in default.

2.4. *Transfer of security*

In Spain, security (and guarantees) are ancillary rights to the principal obligation (the loan or credit facility). Therefore, upon the transfer of a secured claim, security will generally be transferred as well and the transferee will become the beneficiary of existing security interests over the claim.

Spanish security is generally granted in favour of all lenders (and not the agent or the security trustee), which may require the lenders' appearance before a Spanish public notary to accept the security. Consequently, it is usually advisable that transfer of a secured claim is also made before a Spanish public notary.

Also, certain types of security (fundamentally, mortgages and pledges without displacement) require registration in a public registry in order to be valid and enforceable. Transfers of claims secured by such types of security will also need to be registered (triggering stamp duty if a public deed is used) in order for the transferee to be able to enforce the security.

Additionally, only financial institutions can be beneficiaries of floating mortgages and, therefore, a purchaser of claims secured by this type of mortgage may lose the benefit of this security if it is not a financial institution. The definition of financial institution is subject to interpretation.

2.5. Formalities

Transfers of lenders' claims in Spain are often formalized in a public notarial document, which provides legal certainty to the transfer and the ownership of the claim by the assignee. However, transfer or assignments may also be documented in private documents.

As explained in section 2.4 above (*Transfer of Security*), if a claim is secured with any registered security (fundamentally a mortgage or a pledge without displacement), a public document will be required for the registration of the transfer in the applicable registry and the enforceability of the security by the transferee.

Spanish public documents are divided into (i) commercial policies (*polizas mercantiles*); and (ii) public deeds (*escrituras públicas*). Public deeds (*escrituras públicas*) are required if the transfer shall be registered with the land registry (fundamentally mortgages). As explained below in section 5 (*Tax duties and fees*), execution of public deeds may trigger the obligation to pay stamp duty taxes.

3. Insolvency and claims in litigation

3.1. Claw-back

Special care needs to be taken when acquiring debt from a distressed seller, as when an entity is declared insolvent actions carried out within the two years before such declaration may be rescinded if considered detrimental to the insolvency estate. Detriment is assumed, without admitting proof to the contrary, in case of disposals of non-matured claims for no consideration or payment. Detriment is also assumed (unless proven to the contrary) when security is created over a pre-existing obligation.

3.2. Subordination

If a claim is purchased from a related party to the borrower, such claims will be deemed subordinated in an insolvency of the borrower. Related parties include, subject to certain

requirements, shareholders, directors (legal or de facto) and companies of the same group. As an exception, claims acquired from SAREB will not be deemed subordinated even if SAREB is also a shareholder of the borrower, and even if SAREB acquired the claim from an insider of the borrower. This non-subordination exception will not apply if the assignee of SAREB is considered a party specially related to the debtor.

3.3. *Restriction to the petition of insolvency*

The Spanish Insolvency Act allows any creditor to request the insolvency of a debtor if it can evidence the insolvency situation and comply with certain requirements. However, a creditor that has acquired a matured claim will be prevented from requesting the insolvency of the borrower during a period of 6 months after the acquisition of the claim. This should be taken into account by purchasers of distressed debt.

3.4. *Claims in litigation*

If a litigious claim is sold to a third party, the debtor may cancel such credit within nine days as from the date in which the transferee claims the debtor payment of such credit, provided that it pays the purchase price, plus any litigation costs, plus any interest on the price accrued as from the payment date. A claim is in litigation when its existence is at dispute in Court.

4. **Taxes, duties and fees**

4.1. *Withholding tax*

As a general rule, payment of interests to tax residents of a European Union Member State will be exempt from withholding tax and payments of interest to residents outside the EU will be subject to a withholding tax of 19% (unless a double taxation treaty applies).

It is common practice that non-EU investors acquire debt through an EU based vehicle, in order to mitigate potential adverse tax consequences and, in many cases, be an eligible transferee (since, as explained above, many syndicate financings require no more costs to the debtor through the gross-up clause as a condition to a transfer).

In connection with transfers made at a discount, income taxes may be applicable for the difference between the purchase price and the principal repaid (which shall be treated as interest or financial income for taxation purposes).

4.2. *VAT, stamp duty and registration fees*

Transfer of debt is typically subject to VAT but exempt (except when transfer is made between individuals).

Although transfer of debt is generally not subject to stamp duty, if such transfer is formalized in a public deed that may be subject to registration in a public registry, stamp duty will accrue at a tax rate that ranges, depending on the region, between 0.5% and 1.5%.

In case of registrable security (fundamentally mortgages or a pledge without displacements) the possibility to execute a commercial policy (which does not trigger stamp duty) rather than a public deed, shall be carefully analysed. Generally speaking, a pledge without displacement may be formalized in a commercial policy and a mortgage shall be formalized in a public deed.

In such cases, registration fees should also be considered, particularly when security over multiple assets is being transferred, as they may be quite significant in amount.

5. Conclusions

Secondary trading remains an important business in Spain. Financial institutions seeking to clean their balance sheets are the most common sellers of non-performing loans, while SAREB still is a key player on the sale of real estate backed portfolios.

Under Spanish law, debt claims are in principle freely transferrable, but often certain conditions, requirements and restrictions may apply in some cases, which needs to be analysed on a case by case basis. It is common, for example, that syndicate financings documents include conditions and requirements to the transfer or assignment of claims.

In terms of formalities, transfers or assignments of claims can be formalized both in private and public documents, but it is advisable to use the latter, which may be required when credits being transferred are secured with registrable security.

Security is typically transferred with the credit, although some formalities may need to be complied with.

Tax costs shall be taken into account when purchasing debt, in particular: (i) stamp duty, if a registrable document is to be executed; (ii) withholding, in case the lenders in non-EU resident; and (iii) price arbitration.

Purchasers shall assess certain risk when acquiring debt of debtors under financial distress, including subordination of the credit and claw-back of security interests.