Characteristics of the first tranche of ICO bank guarantees (avales) for companies and the self-employed in order to mitigate the economic effects of COVID-19 and requirements for qualification

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As a general rule, state aid to companies is prohibited when it may affect trade between member States of the European Union (Article 107(1) of the Treaty on the Functioning of the European Union).

Notwithstanding the above, and exceptionally in the context of the current COVID-19 crisis, on 19 March 2020, the European Commission has approved a temporary framework for state aid measures to support the economy (the "**Temporary Framework**"), which defines the conditions under which member States' aid is compatible with the internal market. This state aid can take the form of direct subsidies or tax benefits, bank loan guarantees, loans at reduced interest rates, aid implemented through financial entities and/or short-term export credit insurance.

In this context, one of the measures announced in *Royal Decree-Law 8/2020 of 17 March on urgent extraordinary measures to deal with the economic and social impact of COVID-19*, the Spanish government announced the implementation of a line of bank guarantees (*avales*) by the State for financing granted by financial entities, for an amount of up to 100 billion euros.

The first tranche of this line of bank guarantees, which will be managed by the Spanish Official Institute of Credit (*Instituto de Crédito Oficial)* ("**ICO**", its acronym in Spanish) and amounts to 20 billion euros, was approved by the Spanish Council of Ministers on 24 March 2020 and authorised by the European Commission on the same date as it was in line with the Temporary Framework. According to internal sources at ICO, they are currently working with the financial entities that will collaborate with this line of bank guarantees to finalize the relevant agreements, as well as the specific conditions –the small print– of the bank guarantees. The list of financial entities that will collaborate with this project has not yet been published.

According to the Resolution of the Council of Ministers of 24 March 2020, published in the Spanish Official Gazette on 26 March 2020, the terms and conditions of this first tranche of the line of bank guarantees are as follows:

- **Beneficiaries**

  50% of the first tranche of the line of bank guarantees (10 billion euros) is reserved for the self-employed and SMEs. Self-employed shall have the meaning ascribed to it under Act 20/2007, of 11 July, on the Self-Employed Workers' Statute (in general, natural persons who carry out an economic or professional activity for profit, on a regular, personal, direct and self-employed basis without being managed or organised by another person, full or part-time and whether or not they give employment to other persons). SME shall have the meaning ascribed to it in Annex I of Commission Regulation (EU) 651/2014, of 17 June 2014 (that is, in general terms, those companies with less than 250 employees and an annual turnover not exceeding 50 million euros or whose balance sheet assets do not exceed 43 million euros).

  The remaining 50% of the first tranche of the line of bank guarantees (10 billion euros) is reserved for companies that do not qualify as SMEs ("**Large Companies**").

- **Maximum coverage of the bank guarantees**.

  The bank guarantees granted as part of the first tranche can guarantee up to 80% of new financings and renewals for the self-employed and SMEs, and up to 70% of new financings and up to 60% of renewals for Large Companies.

- **Eligible financing/renewals**

  Transactions must meet the following conditions in order to be eligible for these bank guarantees

  (i) new money financing transactions or renewals;

  (ii) granted by financial entities, financial credit entities, electronic money entities and payment entities;

  (iii) executed after 17 March 2020;

(iv) to meet the financing needs of beneficiaries arising, among others, from the payment of salaries, invoices, working capital requirements or other cash flow needs, including those arising from the maturity of financial or tax obligations.

It seems that these lines of bank guarantees may not be used to guarantee debt refinancing, but they can be used to renew existing credit or working capital lines granted to meet financial or tax obligations and other cash flow needs of the beneficiaries.

Additionally, eligible beneficiaries may not be in a situation of late payment as of 31 December 2019 (that is, they must not be listed as payment-defaulters in the files of the Bank of Spain's Central Risk Information Office (*Central de Información de Riesgos del Banco de España, or CIRBE for its acronym in Spanish*)), or be subject to bankruptcy proceedings or in an insolvency situation that allow its creditors to request the initiation of insolvency proceedings (that is, in any of the circumstances set forth in article 2.4 of *Law 22/2003 of 9 July on Bankruptcy*) as of 17 March 2020.

- **Maximum amount of financing or renewals.**

Below 1.5 million euros, the *de minimis* rules for state aid apply. Above that amount, the general rules laid down by the Temporary Framework apply. Such general rules have the following criteria:

(i) for transactions maturing after 31/12/2020 *a*) double the salaries and social costs (including contractors working on site) of 2019 or *b*) 25% of the 2019 turnover or (iii) to cover necessary and duly justified liquidity for the next 12/18 months.

(ii) for transactions maturing before 31/12/2020, the above limits do not apply and higher amounts can be granted, provided they are duly justified and in accordance with proportionality principles.

- **Term**

The bank guarantees will have a term equal to that of the financing granted, with a maximum of 5 years.

- **Deadline and application procedure**

Applications for these bank guarantees may be submitted up to 30 September 2020, although this deadline may be extended by a Resolution of the Council of Ministers in accordance with European legislation of state aid.

For transactions of up to 50 million euros, a prior risk analysis and study of eligibility conditions will be conducted by the financial entities themselves in accordance with their risk policies, without prejudice to the ICO's subsequent verification of eligibility.

For transactions above 50 million euros, the ICO will analyse whether the applicant meets the conditions for eligibility, in addition to the analysis by the financial entity.

- **Cost of the bank guarantees**

  The cost of the bank guarantees will be assumed by the financial entities that collaborate with the ICO in this aid. The Resolution of the Council of Ministers established a cost ranging between 20 and 120 basic points depending on the amount, the type of beneficiary (self-employed, SME or Large Company), the date of maturity and whether it is a new money financing or renewal of a prior financing. It also established a management fee of 0.05% of the volume of guaranteed transactions.

- **Ranking of the bank guarantees**

  The guarantees will rank *pari passu* with the risk assumed by the financial institutions in the transactions that are formalized. Consequently, any losses arising from such transactions will be borne by the financial institutions and the ICO proportionally to the percentage covered by the guarantee, and the financial institutions must pay the ICO the percentage of the recoveries of unpaid amounts equal to the guaranteed risk.

- **Financing costs**.

  Financial entities must maintain the costs of new financing and renewals guaranteed by the bank guarantees in line with those applicable prior to the start of the COVID-19 crisis, taking into account the bank guarantee provided by the ICO and its coverage cost. In other words, the financing costs must continue to be assumed by the beneficiary, but financial entities may not increase those costs on the basis of a higher level of risk.

The Council of Ministers also decided that financial entities must maintain, at least until 30 September 2020, all customers' caps on financing to cover working capital needs and, in particular, for those customers whose loans are guaranteed by this line of bank guarantees. In our opinion, this means that the measures included in this last paragraph apply to financial entities that adhere to the ICO agreement with respect to all of their customers, and not only those to whom they grant financing or renewals under this line of bank guarantees.