

Spanish Insolvency Act Amendment Offers Comfort to Parties in Sareb Transactions

Market participants welcome a clarification extending equitable subordination exemptions granted Sareb to those subsequently purchasing debt from Sareb.

On November 30, 2013, the Spanish legislator approved a recent amendment to Spanish insolvency law, introduced in March 2013, to clarify that a claim transferred to Spanish “bad bank” Sareb, and subsequently sold by Sareb to a third party, will also be exempt from equitable subordination risk.

Background

Equitable subordination in general terms essentially allows courts to re-classify the contractual payment priorities by lowering the rank of all or a part of a creditor’s claim below the claims of other creditors.

According to the Law 22/2003 of July 2 on Insolvency Proceedings (the Spanish Insolvency Act), acquiring a credit from a “specially related party” of the debtor can lead to equitable subordination on the debtor’s insolvency. In particular, credits (e.g. credit facility loans) held by an entity or person holding more than 10 percent of a private company’s share capital, or those with more than 5 percent equity in a listed company, may be subordinated in an insolvency scenario.

Additionally, any person or entity acquiring a credit that has previously been held by a “specially related party” of the debtor, will also be considered an “specially related party” if the acquisition has been completed within the two years preceding the insolvency declaration.

Notably, loan-to-own investors who have acquired equity through a debt-for-equity swap have always been excluded, as the rule only applies to those who already own equity at the time of buying into debt or providing the debtor with additional facilities.

In order to allow and accelerate balance sheet cleansing of Spanish credit entities, and to facilitate Sareb’s many future transactions, the March amendment stipulates that loans transferred to Sareb will not be subordinated on the debtor’s insolvency, regardless of the original creditor qualification.

Although the March amendment was welcomed by market participants, great uncertainty remained regarding the potential equitable subordination of any credits acquired from Sareb in the scenario where Sareb had previously acquired the credits from an “specially related party”.

Clarification of the existing regime

With the approval of this new amendment to the Spanish Insolvency Act, the legislator has clarified that in an insolvency context, the protection against equitable subordination granted to Sareb will extend to any third party acquiring a credit from Sareb, avoiding different interpretations.

Notwithstanding the foregoing, the amendment states that the subordination risk exemption will not apply if the transferee/assignee (*i.e.* the 'end buyer') was originally a person or entity specially related to the debtor.

Conclusion

The new amendment of the Spanish Insolvency Act has certainly shed much-needed light on the uncertainty around equitable subordination risk in transactions involving Sareb. Such risk would have clearly impacted the price at which Sareb could have sold the loans on its balance sheet and in light of the multitude of transactions in Sareb's pipeline, and more generally in the context of the many reorganizations affecting Spanish companies to date, this is a welcome development.

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