



SPAIN

FINANCIAL SECTOR ASSESSMENT PROGRAM

TECHNICAL NOTE—INSOLVENCY AND CREDITOR RIGHTS

November 2017

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October 30, 2017

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Prepared By
**Legal and
Monetary and
Capital Markets
Departments**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Spain. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Please also see the Financial System Stability Assessment at <http://www.imf.org/~media/Files/Publications/CR/2017/cr17321.ashx> Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

EU	European Union
NPLs	Nonperforming Loans
OAP	Agreements on Payments for SMEs
SME	Small- and Medium-Sized Enterprises

EXECUTIVE SUMMARY¹

This technical note analyzes selected issues related to four areas of the legal system for insolvency and creditor rights with a particular relevance for financial stability and the resolution of legacy assets. These are specifically, creditor/debtor rights, corporate workouts/out-of-court regimes, the legal framework for insolvency, and institutional frameworks.

The regime for creditor/debtor rights is largely in line with international best practices. With respect to creditor/debtor rights, the registration of real estate mortgages is efficient, reliable and cost effective; due to nonperforming loans (NPLs), real estate foreclosure has been extensively used in Spain. Real estate collateral plays a critical role in Spain due to the fact that a very large percentage of loans are collateralized with real estate. Stakeholders however reported that the duration of foreclosure has increased to around 24 months recently due to various facts jeopardizing the prompt realization of the collateral. Spain also has a register for security rights over movable assets which is computerized and efficient; due to the focus on financial collateral it is limited to such purpose. The enforcement on movable assets is reportedly somewhat lengthy.

The recently introduced pre-insolvency out-of-court mechanisms, in particular, the homologated refinancing agreements, have been well accepted and used by the market. These have led to an increased use of the system, in particular, with respect to out-of-court pre-insolvency mechanisms facilitating a number of restructurings (including some high-profile cases). In order to enhance out-of-court workouts, public creditors in pre-insolvency out-of-court procedures should also be stayed and affected by those processes. Despite the adoption of a SME specific out-of-court debt restructuring process, the agreements on payment for SMEs (OCAP) have not been used frequently therefore not facilitating sufficiently the restructuring of distressed but viable SMEs. They should be strengthened by facilitating coordination and promoting unified approaches among banks, for instance with respect to viability. The OCAP should also include the possibility to stay and restructure public claims. SMEs form a significant share of businesses in Spain and thus mechanisms benefiting such segment should be fast, government supported, and cost effective.

The revised Spanish insolvency law, which has undergone major changes, is largely in line with international best practices, but can be refined further. The eight reforms since 2009 have substantially improved the regime to restructure viable firms and resolve and liquidate nonviable firms. The reforms have introduced hybrid pre-insolvency restructuring procedures (see above), streamlined the in-court processes, and addressed substantive shortcomings. Nevertheless, stakeholders continue to note the lengthy processes and the limited recovery for creditors due to some remaining obstacles. A modern creditor class voting system (in accordance to economic value/hierarchy of claims) with a cram down mechanism should be introduced in all in-court and out-of-court procedures to ensure creditor equity and the restructuring of only viable firms (those

¹ The author of this note is Wolfgang Bergthaler (IMF), part of the Spain FSAP 2017 team led by Udaibir Das. The analysis has benefitted from discussions with the staff of the Ministry of Economy and Justice, the Spanish Treasury, the Spain FSAP team, and reviewers at the IMF.

whose restructuring value exceeds their liquidation value). The (albeit limited) mandate from Congress to finalize the insolvency reform (which is ongoing), and the need to transpose the EU Insolvency Directive, once adopted, are opportunities to refine Spain's legal insolvency framework.

The institutional framework supporting insolvency and creditor rights has been strengthened but requires further reinforcement and more resources. In particular, commercial courts need more resources in terms of support staff and judges; and electronic justice systems should be fully implemented. The profession of insolvency practitioners needs to be fully developed including their framework for supervision, appointment and remuneration.

Main Recommendations		
Recommendation	Time line	Institution
Enable the stay and involvement of public creditors' claims in all pre-insolvency out-of-court procedures (including the OCAP process).	Short term/Medium term	Ministry of Finance, Economy and Justice, Congress
Fully adopt a class voting system including a cram-down for all in-court and out-of-court processes.	Short term/Medium term	Ministry of Economy and Justice, Congress
Enhance the SME out-of-court agreement on payment (OCAP) by promoting it, giving guidance on viability and facilitating coordination among banks.	Short term	Ministry of Economy and Justice
Strengthen and resource better (including by use of electronic justice) the commercial courts in terms of support staff and more judges.	Short term	Ministry of Justice

INTRODUCTION

1. **This technical note assesses the Spanish system of insolvency and creditor rights against international best practices such as the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes (the “World Bank Principles”) and the UNCITRAL Legislative Guide on Insolvency Law (“UNCITRAL Legislative Guide”).**² In addition, there is an emerging European body of law in this area, such as the 2014 Recommendation on a New Approach to Business Failure³ and the Proposal for a Directive on Preventative Restructuring Frameworks, Second Chances and Measures to Increase the Efficiency of Restructuring, Insolvency, and Discharge Procedures (the “draft EU Directive on Insolvency”).⁴
2. **Spain underwent a severe financial crisis and NPLs continue to be elevated.** The resolution of legacy assets is important for financial stability.
3. **Spanish businesses are largely SMEs.** There are about 3.1 million businesses operating in Spain of which over 50 percent have only a single employee and about 50 percent operate as entrepreneurs/professionals (rather than a legal entity). About 300.000 businesses (of which 61 percent are entrepreneurs/professionals) exit the market annually.⁵

CREDITOR/DEBTOR RIGHTS

A. Description of the System

4. **There is an advanced and largely transparent system in support of debtor/creditor rights in Spain.** Public registers are transparent, reliable and effective. Data in this area is largely of very good quality albeit with some gaps.
5. **The registration of real estate mortgages is efficient, reliable and cost effective.** Real estate mortgages play a critical role in the Spanish financial system as collateral for loans. In order to be validly perfected, such mortgages need to be notarized and registered with the land register. Most loans are secured with real estate collateral. Mortgages are generally full recourse mortgages in Spain meaning that the debtor continues to be liable for any deficiency in case the creditor cannot fully recover the obligation through foreclosure.⁶

² See: <http://www.worldbank.org/en/topic/financialsector/brief/the-world-bank-principles-for-effective-insolvency-and-creditor-rights>. See: http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html.

³ See: http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf.

⁴ See: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52016PC0723>.

⁵ See: National Institute for Statistics.

⁶ There are exceptions to full recourse mortgages subject to agreements between the creditor and the debtor under Article 140 of the Mortgage Act (*Ley Hipotecaria*). Further, individuals in a situation of vulnerability can avail themselves of the processes set forth in the 2012 [Code of Good Practices](#) which includes the possibility for individuals that meet certain vulnerability criteria to request a bank for a cancellation of the debt by handing over the real estate collateral (“*dación en pago*”).

6. Creditors may foreclose on their real estate collateral through two processes. First, an in-court process through the civil court system. Second, an out-of-court process, if agreed between the parties in advance, by way of a process before a notary public. The latter process is rarely used. The in-court process is separated into the enforcement and the auction process. There is a reserve price of 70 percent of the assessed value for the auction. There is the possibility of acquiring the property by the creditor if the auction fails. Many banks have also used the “*dación en pago*” which is the cancellation of the debt by handing over the real estate and relinquishing the collateral. With respect to consumer residential mortgages, European Court of Justice decisions and the soon to be implemented European Union (EU) directive on credit agreements for consumers relating to residential immovable property (“Mortgage Directive”)⁷ will further strengthen due process and consumer protection possibly at the expense of speed and efficiency.⁸

7. The registry for security rights over movables is well managed and computerized. Most movable assets may be used as collateral (i.e., receivables, vehicles, machines, plant, vessels, aircrafts). The system is document-based, and therefore access to the register follows an analysis and control of the documents by the relevant officers. The system is managed by highly qualified legal specialists (*registradores*), who charge a fee. Litigation concerning the adequacy of the information is very rare. The registry works online and is publicly accessible, although a fee is charged to access the information. The IT is fully operated by the body of registrars (*Colegio de Registradores de la Propiedad y Mercantiles de España*). The regulation of the system of security interests over movables is spread over several laws, of different times and levels of evolution.

B. Use

8. Foreclosure on real estate has been used extensively in Spain (see Figure 1).

9. While the average duration of foreclosure has increased recently (in 2007, it was about 7–9 months),⁹ it lasts around 24 months according to stakeholder information. Data on recovery rates for creditors in foreclosure proceedings is not available.

10. The registry for security rights over movables is not used widely and to its fullest potential. The vast majority of businesses in Spain are SMEs with a high percentage of micro-businesses. Due to a lack of additional (not yet collateralized) real estate, most SMEs and startups may increase their access to finance by providing new forms of collateral through the system of

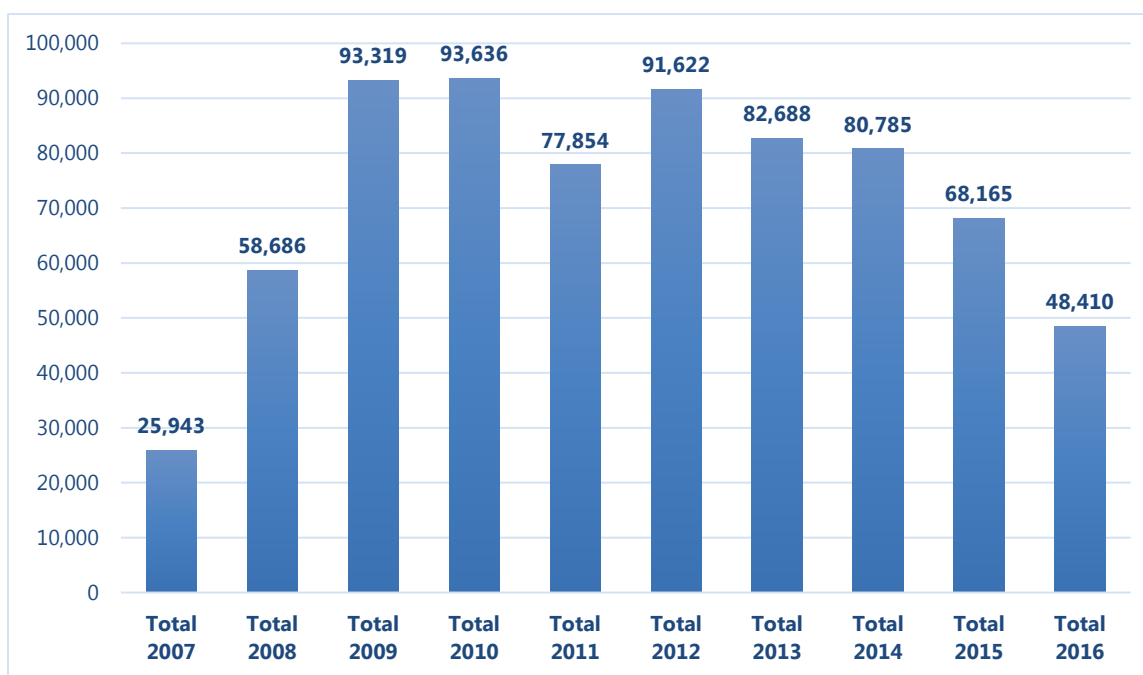
⁷ Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010.

⁸ The implementation of the Mortgage Directive in Spain is expected to increase financial consumer protection, with a corresponding impact on the costs of mortgages and banks’ transaction cost. It is expected that the legislation implementing the Mortgage Directive will provide rules for the acceleration of mortgage loans: until now, banks could accelerate mortgage loans even where the defaults were minor, but the expected legislation will only allow acceleration when the debtor defaults for amounts that represent 3 percent of the loan (for loans of a duration of less than 10 years) or 5 percent (for loans of longer duration). This development, together with ongoing litigation over “floor clauses” in floating rate mortgages, and over clauses that forced the borrower to pay for all the costs of formalizing a mortgage, will probably have the effect of increasing the costs of mortgages for Spanish consumers.

⁹ See: European Mortgage Federation (2007): “Study on the Efficiency of the Mortgage Collateral in the European Union,” EMF Publication, May 2007.

security rights over movable assets. In order to enable this, the system may need to introduce some changes. Stakeholders note the cost as one of the reasons that the register is not more frequently used. Further, it is noted that it is difficult to create security interests over inventory, raw materials, and generally over groups of assets. The micro and small SMEs do not often use their receivables as collateral; the use of receivables as collateral is widespread in the financing of larger entities and for certain type of business projects.

Figure 1. Number of initiated foreclosures on mortgages (corporate and individuals)



Source: Judicial Council

C. Analysis

11. Stakeholders cannot point to specific reason why length for real estate foreclosure increased to 24 months in the course of the financial crisis. One reason could be the increased workload for civil courts due to the large number of foreclosures that lead to an increase in the duration thereof. With the economic recovery, the number of foreclosures has decreased which should have an impact on the workload of the civil courts and a corresponding impact on shorter foreclosure periods.

12. Although the system of security rights over movable assets has a sufficiently good legal framework and its institutional framework is adequate, changes could be introduced to enhance its use. Searches on the registry for security rights over movables take time and are somewhat costly. Regulations are dispersed and there is legal uncertainty over some types of security. Although some have been updated, consistency has not always been achieved and legal certainty over certain types of security rights (i.e., over receivables—*prenda de créditos*) could be improved. The use of secured transactions may increase—and access to credit growth as a consequence thereof—in case a cheaper, unified registry, with one law and one type of security right over all sorts of movable assets (individually considered and universalities) is introduced.

D. Recommendation

13. It could be considered to enhance the register for security rights over movable assets and reduce the related costs for its use which could have a positive impact for the access of creditor for SMEs. Access to the system could be made easier and cheaper by lowering formal requirements of titles (for some kinds of assets). It should be noted though that stakeholders overwhelmingly did not see such an enhancement as critical.

CORPORATE WORKOUTS/OUT-OF-COURT

A. Description of the System

14. In 2003, Spain adopted a new insolvency law¹⁰—which became effective in 2004—the “Insolvency Law”) which has continuously evolved in particular in the aftermath of the global financial crisis and with special regard to pre-insolvency hybrid out-of-court mechanisms (see Figure 2).¹¹

Figure 2. Out-of-Court/Pre-insolvency/Hybrid/In-court Restructuring Processes in Spain

Out-of-court	Hybrid			in-court		
Purely contractual	Refinancing agreements	Homologated refinancing agreements	Agreements on payments (OCAP) for SMEs	Anticipated insolvency plan	Ordinary insolvency plan	Going concern sale in liquidation
Pre-insolvency				Insolvency		

Source: IMF staff

15. In Spain, out-of-court debt restructuring may be reached through a purely contractual arrangement or by means of three different regulated, hybrid collective proceedings. Debtors and creditors can reach purely contractual arrangement which do not benefit from any protection in case of ex-post failure and only bind participating creditors. Due to the limitations inherent to this solution, the reforms of 2011, 2013 and 2015 incorporated three different out-of-court proceedings which involve a collectivity of creditors and enjoy different levels of protection in case certain conditions are met.¹² These agreements can be reached on a standalone basis or following the

¹⁰ Act on Insolvency of 22/2003, July 9, 2003, as amended effective as of January 1, 2004.

¹¹ Royal Decree-Law 3/2009 of 27 March 2009; Act 38/2011 of 10 October 2011; Royal Decree Law 6/2012 of 9 March 2012; Act 1/2013 of 14 May 2013; Royal Decree Law 14/2013 of 27 September 2013; Royal Decree Law 4/2014 of 7 March 2014; Royal Decree Law 11/2014 of 5 September 2014; or Royal Decree Law 1/2015 of 27 February 2015.

¹² The Spanish system includes a fourth category of regulated, non-collective out of court agreements. These agreements can be reached between the debtor and one or more creditors, but no majorities are envisaged. If the conditions are met, the said agreements will be shielded from future avoidance actions, should the debtor end up in insolvency. There are no known cases recorded to date because the agreements do not need to be published. The conditions are: (i) the proportion between the assets and liabilities must be increased; (ii) following the agreement, the working capital has to be positive; (iii) the value of the security rights created in favor of the participating

(continued)

opening of a negotiation period of three months.¹³ Businesses do not need to be insolvent or imminently insolvent except for the out-of-court agreements on payments (OCAPs). During this negotiation period, enforcement actions against the debtor are stayed—except for public creditors—and creditors may not petition the court for the debtor’s insolvency. If certain conditions are met, and the negotiation period ends in one of the different types of out-of-court agreements, ex post avoidance actions cannot be successfully started (particularly in the case of refinancing agreements). Public creditors do not participate in these mechanisms but have their parallel regime.¹⁴

- Ordinary Refinancing Agreements (*Acuerdo de Refinanciación*). Except for public creditors, any type of creditor and debtor can reach such refinancing agreement. There is no formal institutional involvement (e.g., mediator or insolvency practitioner). These agreements only bind participating creditors. In order to benefit from the protection of ex-post avoidance the following conditions need to be met: (i) The refinancing agreement must in substance consist of a “significant increase in the funds available” or “the rescheduling or writing down of the debts,” and either of those measures that must be linked to a business viability plan that allow for the continuation of the activity over the short and mid-terms.” (ii) 3/5 of the total claims support the agreement (all creditors of a syndicated loan will be deemed to support the agreement if creditors representing 75 percent of the loan have voted for it; and loans provided by companies of the same group are excluded); (iii) an auditor (the one of the company or one appointed ad hoc if there was not one in office) certifies that the required majority has been reached; (iv) the agreement and all necessary documents have been notarized.
- Homologated Refinancing Agreements (*Acuerdo de Refinanciación Homologado*). These are agreements between any debtor (regardless of its size, although it is almost exclusively used by medium and large entities) and its financial creditors thus excluding trade/commercial and public creditors as well as employees. Trade creditors may participate if they voluntarily agree but public creditors cannot take part. There is no formal institutional involvement (e.g., mediator or insolvency practitioner) and limited court involvement (i.e., to commence through a voluntary court notification and to conclude by means of a mandatory court confirmation). These agreements may bind dissenting and non-participating financial creditors. The required majority is 51 percent of claims (with debt to related parties not taken into account) in order to obtain protection from ex post avoidance actions. This type of agreement may be made binding on non-participating/dissenting financial creditors

creditors does not exceed 90 percent of the value of the debt outstanding with the said creditors; (iv) the proportion of security rights to debt held by the participating creditors is not increased as a consequence of the agreement; (v) the interest rate applicable to the debts following the restructuring operation has not increased more than 33 percent of the previous interest rate; and (vi) the agreement, including a justification of the measures adopted, is formalized by public deed before a notary public.

¹³ The Spanish Insolvency Law incorporates a duty to file for insolvency within two months from the moment the debtor (i.e., its directors) know or should have known that the business was insolvent. The negotiation period of three months suspends this two-month period. Once the three months have been exhausted, the debtor/directors have one month to file for insolvency in case the negotiations have failed and the business continues to be insolvent.

¹⁴ This regime permits public creditors to extend maturities but no haircuts (see Articles 65, 75, 82 of the General Tax Law (*Ley General Tributaria*)).

(even secured creditors) if certain majority thresholds are met. The thresholds vary depending on the content of the agreement ranging from 60 percent to 80 percent of the total amount of claims bound by the agreement.

- Out-of-court Agreements on Payments (*Acuerdo Extrajudicial de Pagos* or “OCAP”). This mechanism is designed for SMEs with debts up to EUR 5 Million, involving legal entities as well as individual entrepreneurs and all their creditors except for public creditors. Applications are subject to a debtor initiated, streamlined procedure and are channeled through the commercial register or the chamber of commerce¹⁵ with the intervention of a mediator (*mediador concursal*) and limited court involvement (court notification to commence). The majorities necessary depend on the level debt restructuring but are slightly higher than those needed to approve a plan within formal insolvency proceedings.¹⁶

B. Use

16. Banks seem to use purely contractual arrangement as well as ordinary refinancing agreements to restructure NPLs. No data seems to be available on the number and amounts of debt restructured under those agreements. Out-of-court processes have generally been well accepted by the market. The use of pre-insolvency processes compared to in-court processes has increased significantly to about 92.7 percent in 2016 (Figure 3). There is only reliable data for homologated refinancing agreements with more than 90 in 2015 and 2016 (Figure 4). While these numbers seem small, these agreements have been used by a number of high profile medium to large size (group of) companies in Spain with significant economic value. SME agreements on payments have been very few (about 978 in 2016)¹⁷, with limited debts, and commenced at a very late stage. These processes seem to have (about 1/3) been used by entrepreneurs (very few legal entities) and ultimately by natural persons with the intent to receive a discharge.

Figure 3. Pre-insolvency Processes (Including Attempts) to In-court Insolvency Proceedings

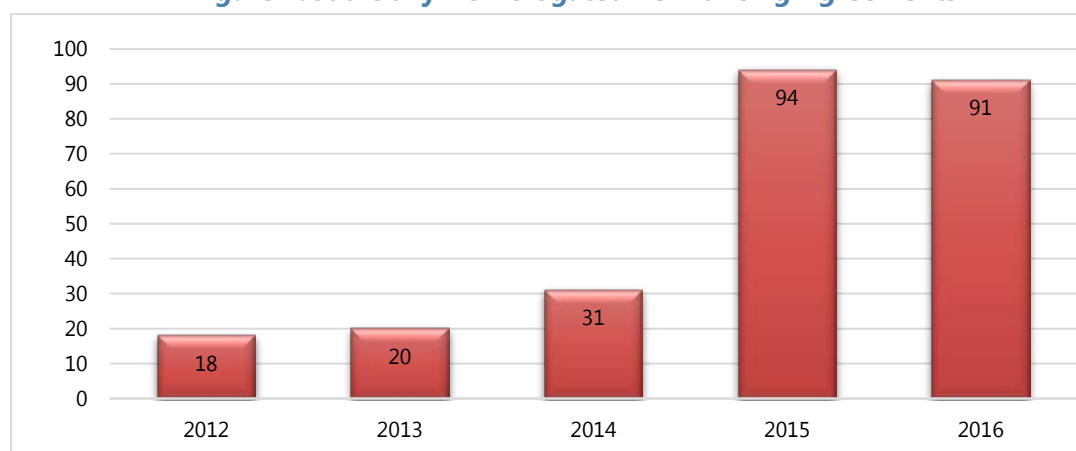
Year	Communications of the negotiation of pre-insolvency processes (number)	Pre-insolvency processes compared to in-court insolvency procedures (percent of total)
2010	1,266	25.4
2011	3,124	52.9
2012	5,644	69.7
2013	5,437	59.5
2014	4,621	70.4
2015	4,256	83.5
2016	4,754	89.1

Source: General Council of the Judiciary

¹⁵ This mechanism is also used as a precondition to get a discharge for individual debtors (consumers). If the petitioner is a consumer, the public notaries play an institutional role instead of the commercial register and the chamber of commerce.

¹⁶ 60 percent of the value of the claims for plans including write-downs of up to 25 percent or rescheduling of less than 5 years; 75 percent necessary to pass a plan with higher write-downs and reschedulings (with a cap of 10 years). Secured creditors may also be bound by the plan (for the amount covered by the collateral) as long as 65 percent or 80 percent vote in favor of the agreement, depending on the extent of the write downs/rescheduling.

¹⁷ This is provisional data.

Figure 4. Judicially Homologated Refinancing Agreements

Source: Yearbook of Insolvency Statistics

C. Analysis

17. Pre-insolvency out-of-court mechanisms have increasingly played a facilitating role for debt restructuring and have generally been well accepted by stakeholders except for the SME focused agreements on payments (OCAP). There are a number of issues to be considered:

- Public creditors. The standard provides that public interests generally should not be given precedence over private rights.¹⁸ In Spain, neither the content of any out-of-court agreement nor the stay during the negotiation period may affect public claims. Public creditors have their own parallel process which enables them to agree to extensions of maturities but no haircuts (outside formal insolvency proceedings).¹⁹ In other words, public claims receive a procedural privilege and are hence in a better situation out-of-court than in-court. Public creditors point out that the nature of their claims on the debtor is different than commercial/financial debt and they have constitutional constraints to freely negotiate a debt restructuring. While there is no notification of public creditors in most pre-insolvency processes, public creditors are informed of the beginning of the negotiations of agreements under the OCAP through the communication of the acceptance of the mediator which may give public creditors an advance warning. If the public debt is large enough, this may significantly diminish the debtor's chances for an out-of-court restructuring.
- SMEs. The standard provides that workouts function better when creditors and debtors are enabled to use informal techniques.²⁰ The issue of public creditors is particularly pronounced for the SME out-of-court mechanism since typically a proportionally larger portion of debt is owed to the State than in the case of larger business. Many times, SMEs come to the process too late meaning that their financial situation is already badly impaired. The agreements on payments (OCAP) have a relatively low threshold of up to EUR 5 million of debts which may open a gap for larger SMEs for which the financing agreements are too

¹⁸ See Principle C12.3 of the World Bank Principles. See also context of the draft EU directive on insolvency, page 12.

¹⁹ Generally, such creditors require new or increased collateral or guarantees.

²⁰ See Principle B4 of the World Bank Principles.

expensive. In addition, the majorities to approve the plan are larger than in the in-court processes further discouraging its use. Thus, for SMEs the OCAP does in many instances not provide the needed procedure since the debtor's main creditor (i.e., the public creditor) remains outside the process.

- Class voting in homologated refinancing agreements. According to the standard, classes of creditors may be provided with voting rights weighted according to the amount of a creditor's claim. Further, opposing creditors should be offered a dividend equal to or greater than they would receive in liquidation ("best interest test").²¹ In Spain, the current class voting system for homologated refinancing agreements envisages only two types of classes: secured and unsecured creditors. It does not necessarily ensure that economically similar claims are treated the same way. There is also a lack of clarity concerning the treatment of shareholders. Even in cases of actual balance sheet insolvency, "out-of-the-money" shareholders cannot be bound by a debt-for-equity agreement (i.e., an agreement in which creditors become shareholders and dilute current shareholders), unless they consent. The system corrects this problem indirectly, by including a provision according to which the debtor, directors, or shareholders may be made personally liable in case they unreasonably withhold their agreement to a dilution of their rights if the agreement later fails. This—somewhat unique—solution is complex. A proper functioning absolute priority rule would better serve to ensure inter-creditor equity. Stakeholders also assert that the current system does not prevent a collusion of shareholders with secured creditors at the expense of ordinary creditors. The process also does not ensure that the so called "best interest test" is applied.
- Judicial review. The current level of judicial review of the homologated refinancing agreements seems to focus on process rather than substance. The Insolvency Law provides that the judge, in addition to checking the majorities and other formal requirements, should also review that the agreement foresees a significant increase in funds available or allows for a continuation of the activity in the short to medium term (i.e., the requirements set forth in Article 71 bis 1 of the Insolvency Law). Stakeholders mention that they are not aware of agreements not being approved by the judge, and there seems to be no ex ante control of the content. In addition, the only challenge for an appeal is the concept of "disproportionate sacrifice." Due to the lack of a legally recognized "best interest test", it is unclear if a creditor who is to be paid less than in liquidation should be deemed to have been imposed a "disproportionate sacrifice". Some clarity in this regard, and generally on the concept, would be welcome. Appeals are about 20 percent and anecdotal evidence suggests that appeals are lengthy (up to 19 months in one high profile case).

D. Recommendation

18. The following amendments to the pre-insolvency out-of-court mechanisms should be considered:

- Public creditors. In order to enhance the effectiveness of out-of-court debt restructuring, public creditors should participate in and be affected by the restructuring and be subject to

²¹ See Principle C14.3 of the World Bank Principles.

the stay during the negotiation period. The latter could be achieved by either changing the law or issuing detailed guidelines of the terms under which public creditors can participate in out-of-court debt restructuring. In addition, the parallel rules currently existing for public creditors could be made more flexible to enable public creditors to be affected and involved similarly to commercial/financial creditors.

- SMEs. In order to enhance out-of-court workouts, the agreement on payments (OCAP) should be further enhanced, and include the following changes: (i) involving and affecting public creditors (see above); (ii) lowering the majorities, to equate them with those in formal insolvency proceedings (since now they are considerably higher, the debtor will have no incentive to use the system); and (iii) the mechanism should be better promoted to enhance SMEs' awareness. The bankers' association should refine the existing OCAP templates and develop unified assessments to ascertain viability.²²

19. Enhancements to the refinancing agreements.²³ The class voting system should be enhanced to ensure inter-creditor equity and the absolute priority rule should be fully adopted to ensure the hierarchy of creditors is fully respected. The "best interest test" should be introduced. The scope of judicial review for financing agreements could be reviewed to ensure adequate judicial supervision.

LEGAL FRAMEWORK FOR INSOLVENCY

A. Description of the system

20. The Spanish insolvency law is a unitary law with a single point of entry. It has a common stage which is followed by either the reorganization stage or the liquidation stage. Dependent on the debtors' size or the amount of debt, the insolvency law distinguishes between abbreviated and ordinary proceedings.

21. The insolvency law provides for a fresh start for individual entrepreneur subject to certain conditions. It combines a liquidation process with a good faith payment process for up to five years.²⁴

22. The Insolvency Law provides for a number of techniques to restructure a viable business. The rescue of a business may be achieved through an insolvency plan (ordinary or anticipated) or through the sale of the business as a going concern in liquidation (see Figure 2 above). The majorities required to approve a plan vary depending on the content of the agreement (ranging from the simple majority of 50 percent to 65 percent of ordinary creditors), and include

²² See a link to the template: <https://www.boe.es/boe/dias/2015/12/29/pdfs/BOE-A-2015-14225.pdf>; Bergthaler/Liu/Monaghan/Kang, Tackling Small and Medium Sized Enterprise Loans in Europe, SDN/15/4, IMF, Washington DC, 2015 at <https://www.imf.org/external/pubs/cat/longres.aspx?sk=42614.0>.

²³ See: Article 11 of the draft EU Directive on insolvency.

²⁴ International Monetary Fund (IMF), 2015, Spain—Selected Issues, IMF Country Report No. 15/233 (Washington DC) at <https://www.imf.org/external/pubs/cat/longres.aspx?sk=43192.0>.

special thresholds for privileged creditors.²⁵ Concerning the different types of exits, the following could be highlighted:

- Anticipated insolvency plan. Any debtor may use such procedure which is conducted in court upon a debtor's filing supported by 10 percent of the claims (20 percent if the proposal is filed after the petition). Negotiations are expected to have taken place before filing.
- Ordinary insolvency plan/composition. The debtor proposes a reorganization plan that is subject to creditors' voting under the class voting system. There is no supervision of the implementation stage unless agreed otherwise in the plan. Failure to comply with the plan leads to the opening of the liquidation stage.
- Going concern sale. The business may be sold even in the common stage. Contracts (as well as, in principle, licenses and permits) are automatically assigned with the transferred business.²⁶ With the business transfer, liabilities can be shed except labor and social security claims which can only be shed subject to a judge's decision.

23. If a going concern sale fails, the liquidation stage completes with a piece-meal liquidation of the business. Stakeholders continue to note that liquidation is lengthy with little payout to creditors.

B. Use

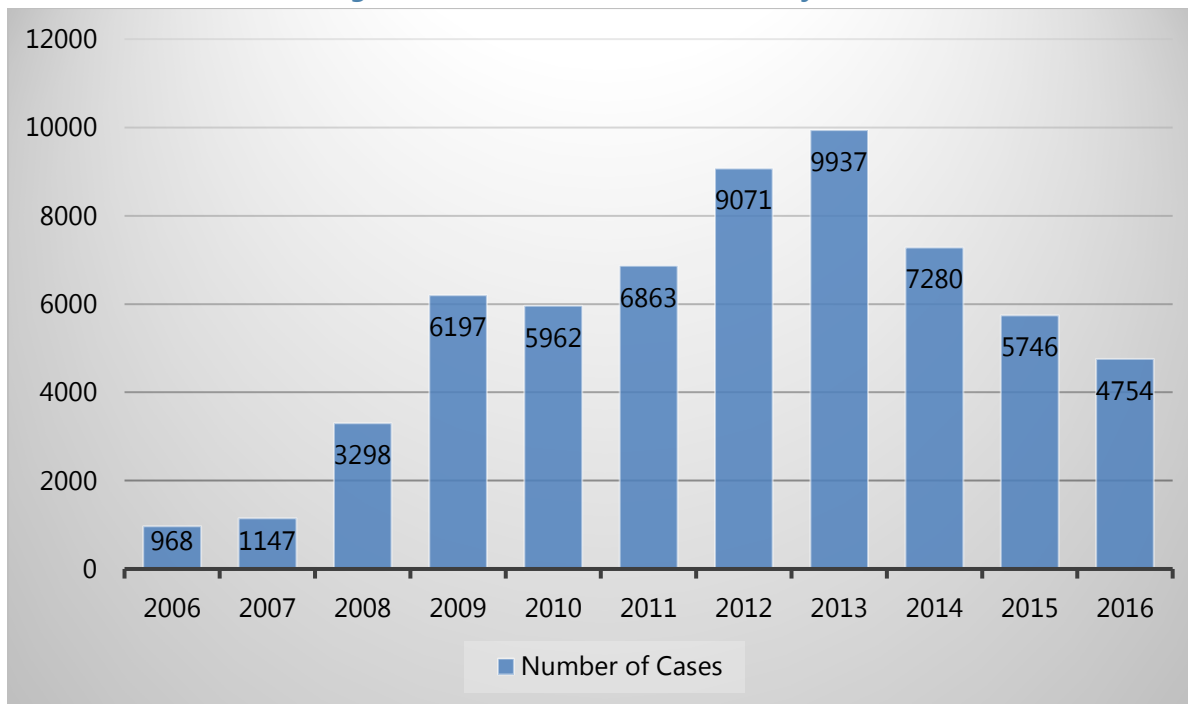
24. While the recent reforms have considerably improved the insolvency regime, data suggests that the current regime continues to be lengthy and anecdotal evidence suggests that it provides only a moderate recovery rate for creditors. The total number of cases are less than during the crisis (see Figure 5). Liquidations account for about 90 percent of all insolvency proceedings (Figure 6). The large majority of proceedings (88.5 percent in 2015) are abbreviated proceedings. The average duration of processes in which an agreement is reached for abbreviated proceeding is 15 months and for ordinary proceedings is 21 months (Figures 7 and 8). While the creditor recovery rate for unsecured creditors in reorganization plan is relatively high (50.56 percent in 2014 and 51.68 percent in 2015),²⁷ there is no data available for liquidations.

²⁵ To bind all privileged creditors within a class, the following thresholds must be met: (a) creditors holding 60 percent of the total value of the claims if the plan includes write downs of less than 50 percent and rescheduling of up to 5 years or (b) creditors holding 75 percent of the total value of the claims if the plan includes higher write-downs and longer rescheduling (with a cap of 10 years).

²⁶ Public contracts can be transferred but only if there is compliance with the special law on public contracts. This basically gives the power to the public administration to continue the contract and to authorize the transfer to a third party.

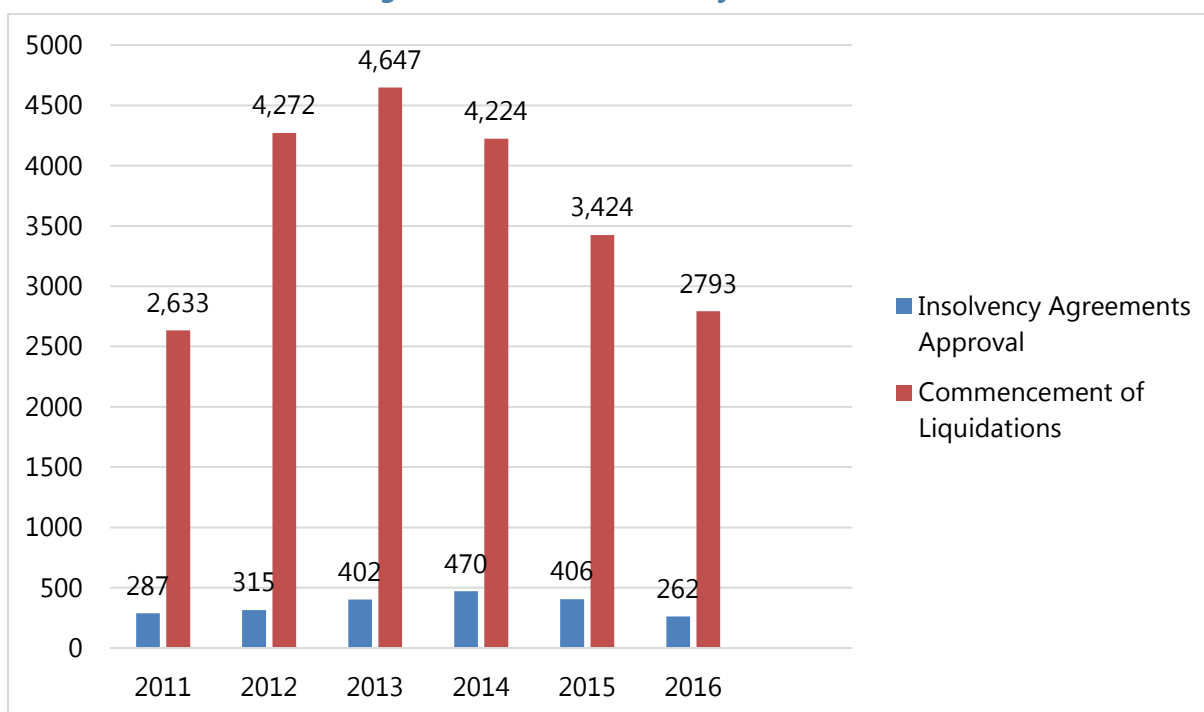
²⁷ See: Annual Yearbook for 2014 and 2015. It should be noted that until 2015, ordinary insolvency plans could only include a write down of 50 percent. In addition, the number refers to nominal write down and does not take into account the NPV value; maturities could only be stretched out to 5 years until 2015 and 10 years now.

Figure 5. Total Number of Insolvency Cases

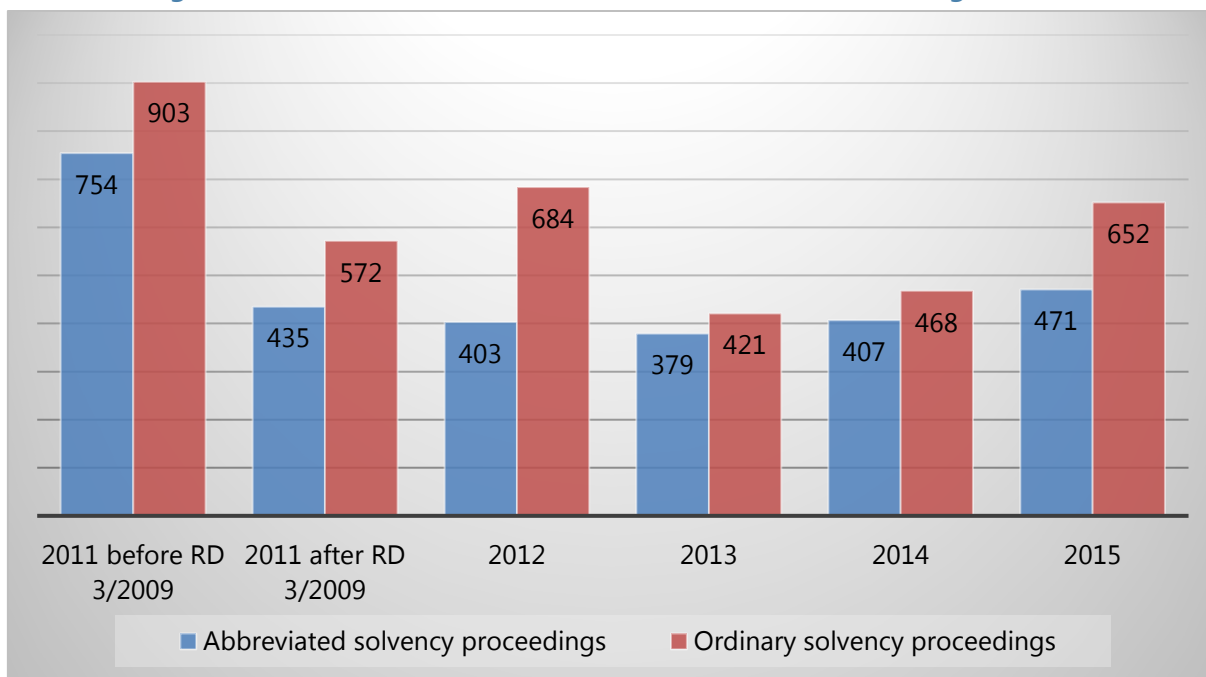


Source: National Institute for Statistics

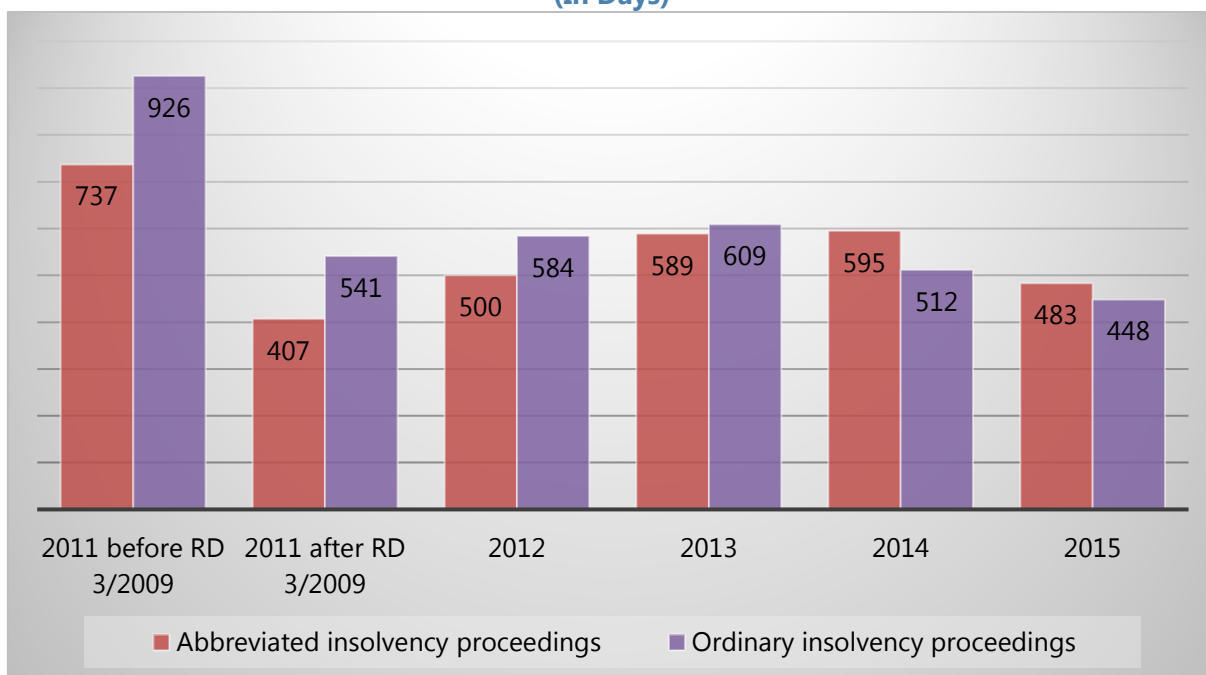
Figure 6. In-court Insolvency Processes



Source: Yearbook of Insolvency Statistics

Figure 7. Duration of The Court Processes that End with An Agreement

Source: Yearbook of Insolvency Statistics

Figure 8. Time to Complete Insolvency Proceeding from the Start of the Liquidation Phase (In Days)

Source: Yearbook of Insolvency Statistics

C. Analysis

25. While the insolvency law is largely in line with international best practices, it should be brought fully in line with the standard:

- Class voting and cram down/absolute priority rule.²⁸ The standard provides that classes of creditors may be provided with voting rights weighted according to the amount of a creditor's claim. Further, opposing creditors should be offered a dividend equal to or greater than they would receive in liquidation ("best interest test").²⁹ In Spain's formal insolvency proceedings, classes are set by the nature of the debt (financial, labor, public, other creditors), not by economic value and there is no cross class cram down mechanism. Given the occasional breaches of the absolute priority rule,³⁰ shareholders are able to block adoption of restructuring plans even though they are "out of the money." There are further breaches to the absolute priority rule. So, for example, according to the Insolvency Law, in case a plan is approved, subordinated creditors will be subject to the same write downs and rescheduling as unsecured creditors, although they will not start receiving payment until all unsecured creditors have been paid the restructured amount. The application of the absolute priority rule would imply that, should unsecured creditors suffer a write down, subordinated debt should not receive anything. This creates a disincentive to approve plans, since unsecured creditors would not have to share the burden with subordinated creditors in liquidation.
- Executory contracts. Inconsistent with the standard,³¹ the damage awarded to the counterparty in disclaimed executory contracts is treated as an administrative claim, rather than as an ordinary claim. This regulation deprives the disclaimer of contracts of any use, since, by definition, onerous executory contracts are terminated because they are burdensome to the insolvency estate. If the counterparty gets full damages, the debtor will be placed in the same situation as if the contract had been executed (when the point was, precisely, to liberate the business from such burden). In other words, a regulation deprives the debtor/insolvency administrator of a very important restructuring tool.
- Labor claims. The acquirer of a business in liquidation needs to assume all labor and social security claims (deducting those paid by FOGASA if so decided by the judge). This

²⁸ The draft EU Directive on Insolvency defines 'cram down' and 'cross-class cram down' as follows: 'cram-down of dissenting creditors' means the confirmation by a judicial or administrative authority of a restructuring plan that has the support of a majority in value of creditors or a majority in value in each and every class of creditors over the dissent of a minority of creditors or the dissent of a minority of creditors within each class. 'a cross-class cram-down' means the confirmation by a judicial or administrative authority of a restructuring plan over the dissent of one or several affected classes of creditors.

²⁹ See Principle C14.3 of the World Bank Principles. See also Article 11 of the draft EU Directive on Insolvency.

³⁰ The draft EU Directive on Insolvency defines the absolute priority rule as "that a dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution or keep any interest under the restructuring plan."

³¹ See Principle C9 of the World Bank Principles and the UNCITRAL Legislative Guide.

diminishes the chance of acquisitions by third parties, or, in the best of cases, reduces the price of acquisition, creating a de facto super-priority on all past labor debts as a consequence there of.

- Creditor control.³² Creditors have no control over certain aspects of the process such as appointment of insolvency administrators. Consideration could be given to enabling the establishment of creditor committees to better facilitate creditor influence over the process. At the very least, it would be recommendable to have minimum rules for the conduct and voting process of creditor committees in the insolvency law.

D. Recommendation

26. The Spanish authorities should finalize the reforms of the insolvency regime. The Law Commission has received the instructions from Congress to prepare a *texto refundido* which is a unified version of the law the work on which is ongoing. Eventually, Spain will need to bring the insolvency regime into line with the draft EU Directive on Insolvency once adopted.

27. In this regard, the following changes should be made:

- Class voting and absolute priority rule. The class voting mechanism should be updated and enhanced including a mechanism to adopt plans in cases not all classes vote in favor of such plan (cram down). Fully implement the absolute priority rule to ensure that shareholders can no longer block agreements and inter-creditor equity, in accordance with the hierarchy of creditors set forth in the law, is observed. In addition, a mechanism should be adopted to protect dissenting creditors (“best interest test”).
- Executory contracts. Bring in line with the standard the treatment of claims derived from the extinction of executory contracts as an ordinary claim.
- Labor claims. Limit the liability for the acquirer of labor and social security claims in cases of a sale of the business as a going concern.

IMPLEMENTATION: INSTITUTIONAL FRAMEWORK

A. Description of the System and Use

28. The Spanish institutional system for insolvency consists of the insolvency administrators (*administradores concursales*) and the commercial courts (*juzgados de lo mercantil*):

- Commercial judges. There are about 75 specialized commercial judges in 55 commercial courts around Spain.
- Insolvency administrators. Insolvency administrators play a critical role in the administration of the insolvency law. There are about 9000 administrators in Spain which are listed in the list of insolvency administrators from which the court appoints an administrator. They can be

³² See Principle C7 of the World Bank Principles on Insolvency and Creditor Rights.

either lawyers, economists or accountants. There is only a law that rudimentarily regulates the accreditation, supervision and monitoring of the administrators which needs to be specified through government regulation which has not yet been adopted.

B. Analysis

29. Stakeholders note that while most commercial judges have a very high technical expertise and competence, there continues to be too few and there is no adequate support in terms of clerks and infrastructure for these judges. Anecdotal evidence suggests that at times commercial judges need to deal with three times the cases load as planned. The commercial courts are also not fully computerized and lack fully implemented e-justice.

30. The lack of a proper regulation of accreditation, supervision and monitoring of the administrators as a profession results in an incomplete framework for the profession. The international standard recommends that criteria as to who may be an insolvency representative should be objective, clearly established, and publicly available.³³ The authorities propose to move the system of appointment from court appointed to randomly appointed from the list except for large cases (where the judge would continue to appoint). Most recently, the fee structure for administrators was capped to EUR 1.5 Million or 4 percent of the value of the estate.

C. Recommendation

31. Commercial courts should be resourced adequately in terms of number of judges and support. More commercial judges should be appointed. The commercial courts should also be fully integrated into the system of electronic justice.

32. The profession of insolvency administrators should be fully developed and a regulation for their accreditation and supervision should be issued. The system of appointment and the fee structure for the administrators should be again reviewed to ensure the most efficient profession that facilitates a high recovery value for creditors. The regulation setting out the supervision, accreditation and the appointment of insolvency administrators should be adopted expeditiously.

³³ See Principle D8 of the World Bank Principles on Insolvency and Creditor Rights.