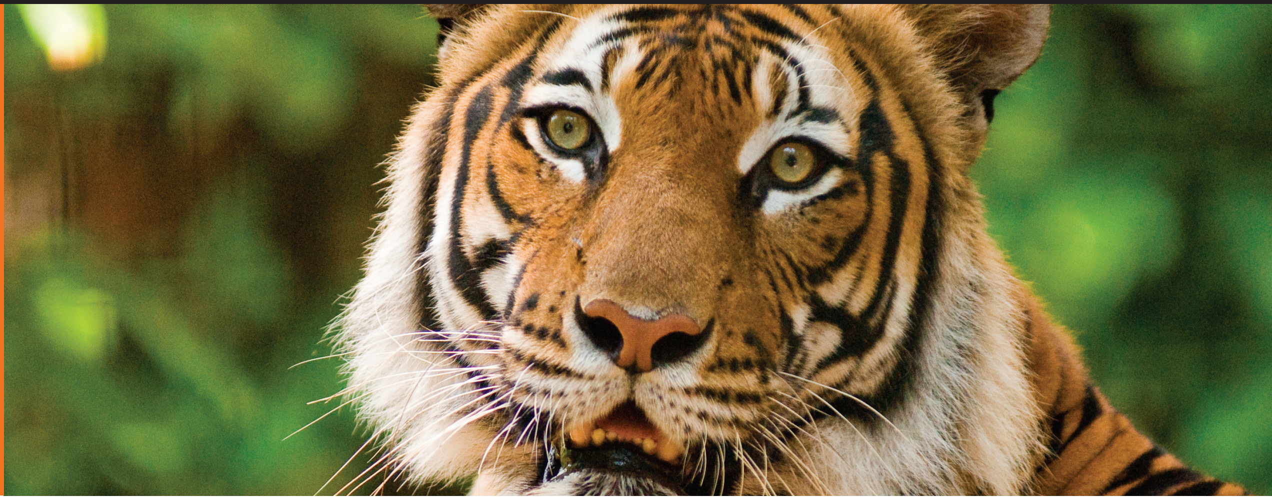

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Debt capital markets in Spain: In search of new financing opportunities

by Antonio Herrera, Javier Redonet and Josep Moreno, Uría Menéndez

Spanish companies have traditionally used bank loans as their primary source of financing. However, the credit crunch, the prevalence of low interest rates supported by the ECB and tighter banking regulations have fuelled Spanish debt capital markets over the last few years, evidencing a trend followed by Spanish companies to diversify their sources of financing and reduce their dependence on banks. In pursuit of that objective, significant steps have been taken such as the creation of a new MTF (MARF) and the enactment of Act 5/2015, aimed to set up a more modern and flexible legal framework for debt issuances.

The Spanish debt capital markets: Economic overview

Markets: Development and debt products

In Spain, the persistence of low interest rates over the last few years has offered a favourable framework for companies accessing the debt capital markets to either raise funds or restructure their liabilities. Gross debt issuances by private companies registered with the Spanish National Securities Market Commission (CNMV) increased consistently from 2013 to 2016 to then show just a slight decline in 2017. The bulk of the issuances (around 95%) comes from financial institutions.

Furthermore, the amount of debt issuances carried out by Spanish companies (especially non-financial companies) through foreign subsidiaries has gradually increased (44.7% in 2017). The international market is particularly active around the issuance of hybrid debt instruments such as structured bonds, synthetic convertible and subordinated bonds.

In Spain, the vast majority of debt securities trade in AIAF

Antonio Herrera

Javier Redonet

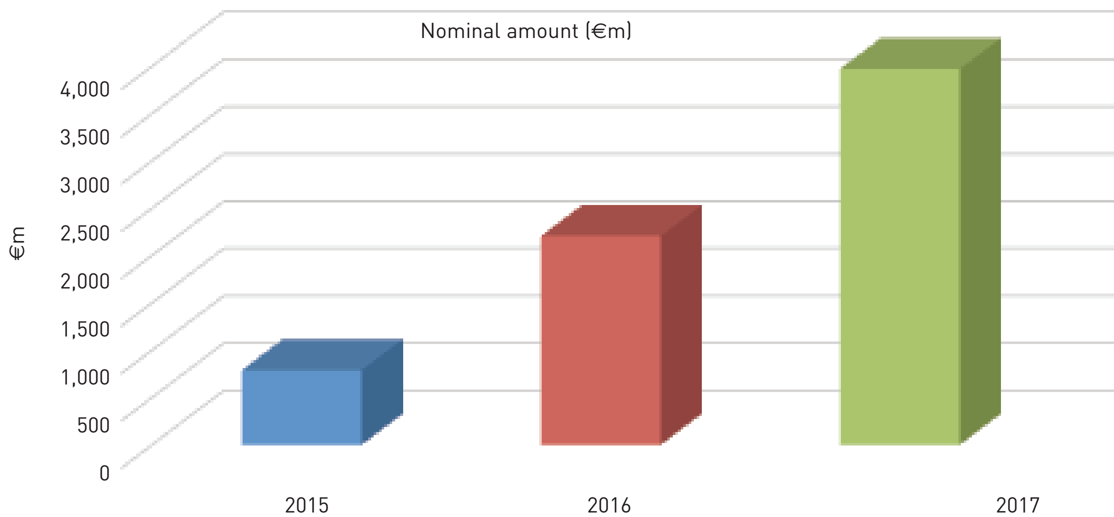
Josep Moreno

Antonio Herrera, Partner
email: antonio.herrera@uria.com

Javier Redonet, Partner
email: javier.redonet@uria.com

Josep Moreno, Trainee
email: josep.moreno@uria.com

Fixed-income trading on MARF	Exhibit 1



Source: Data sourced from the CNMV and graph prepared by the authors

(which operates a multilateral electronic platform called SEND). The aggregate outstanding balance of debt securities admitted to trading on both markets totalled €494.66bn in 2017 (although this amount has been decreasing over the last few years).

Additionally, a multilateral trading facility, MARF, was created in 2013 to provide SMEs with a market in which they can list their debt securities. Only qualified investors may purchase and sell securities in MARF. The aggregate amount of debt securities admitted to trading in MARF totalled almost €4bn in 2017 (from just €2.2bn in 2016).

With regards to products, Spanish companies issue a broad range of debt securities that include principally:

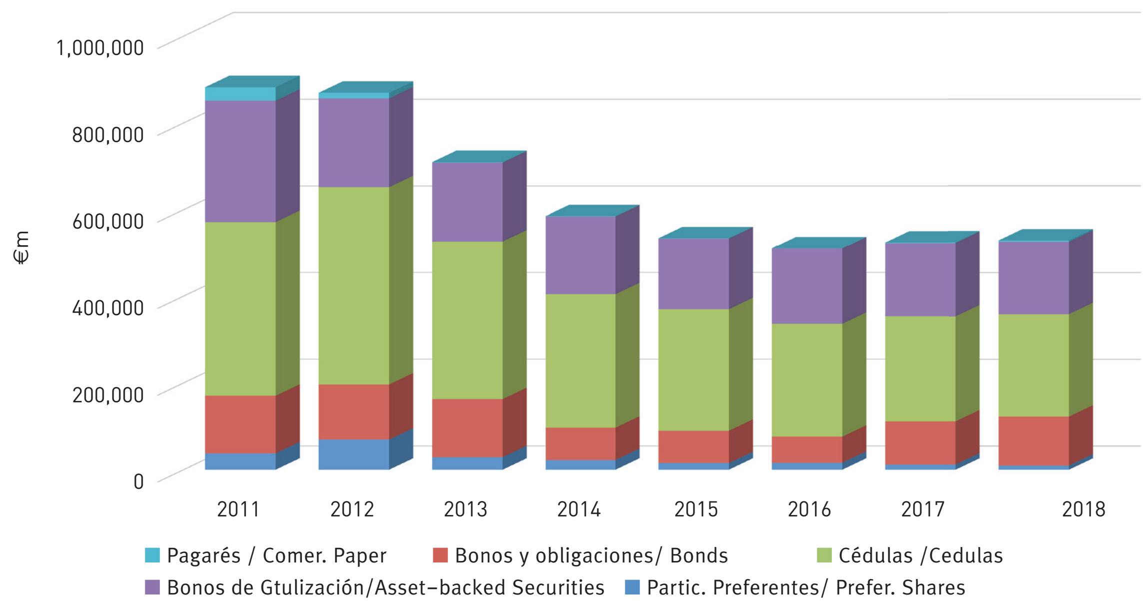
- bonds: debt securities paying fixed or floating interest rates under a variety of forms (ranging from zero coupon to high-yield), secured or unsecured, senior or subordinated, guaranteed or not, as well as social and green bonds;
- structured bonds;
- convertible or exchangeable bonds: debt securities that can be converted into equity, such as contingent convertible bonds;
- asset-backed securities: mainly Spanish covered bonds and mortgage bonds (issued only by financial institutions); and
- commercial paper: short-term debt securities generally issued in the form of zero coupons and at a discount.

Legal framework: General regime for debt securities offerings

The Companies Act (as amended by Act 5/2015) contains the rules governing the issuance of debt securities by Spanish companies.

The Securities Market Act (which was also partially amended by Act 5/2015) contains the principles governing both the primary and secondary markets for all sorts of securities in Spain. The Securities Market Act implements most of the EU directives on securities, so this regulation is substantially in line with the equivalent legislation in other EU countries.

AIAF outstanding balance **Exhibit 2**



Source: Database of BME (Bolsas y Mercados de España)

The CNMV, as the main regulatory body, is the agency in charge of supervising and inspecting the Spanish capital markets and the activities of all the participants in those markets.

General requirements for offerings of debt securities

Generally, under the Companies Act, a Spanish company issuing debt securities must grant a public deed that shall contain specific information about the debt issuance (including, in particular, the terms and conditions of the securities). This public deed must be granted by the issuer and the commissioner (a representative of the bondholders) before a Spanish notary public and it must be filed and registered with the Commercial Registry.

There are, however, exceptions to this general rule. First, it is only mandatory to constitute a syndicate of bondholders and appoint a commissioner if the following three requirements are met (cumulatively):

- when the debt issuance qualifies as a public offering for subscription;
- when the terms and conditions of the issuance are governed by Spanish law or by the law of a state other than an EU member state or an OECD country; and
- when the issuance takes place within the Spanish territory or the securities are admitted to trading on an official Spanish secondary market (such as AIAF) or a multilateral trading facility established in Spain.

Second, the obligation to grant a public deed with respect to the debt issuance does not apply when:

- the securities are to be admitted to trading on Spanish official secondary markets or are subject to a public offering that requires a prospectus to be approved by and registered with the CNMV; or
- the securities are to be admitted to trading on a Spanish multilateral trading facility.

To sum up, the obligation to grant a public deed in connection with the debt issuance, and to have it filed and registered with the Commercial Registry, only applies in practice to issuances carried out by Spanish companies in the international markets provided the securities are not subject to a public offering in Spain and are not admitted to trading on an official secondary market or multilateral trading facility in Spain. Likewise, it is not necessary to set up a syndicate of bondholders and to appoint a commissioner when, for example, the debt issuance is not subject to a public offering and the securities are governed to the laws of an OCDE country (typically, English or New York law).

Finally, please note that issuances of bonds exchangeable or convertible into shares of the issuer may not benefit from the exceptions to the obligation to grant the public deed.

Offering process and documentation

Corporate approval of the issuance

Following the enactment of Act 5/2015, unless otherwise stated in the issuer's articles of association, its management body (typically a board) is authorised to approve the issuance and admission to trading of standard debt securities that do not yield a share of the profits of the issuer, as well as to grant guarantees or security interests in favour of holders of standard debt securities issued by other companies. However, the general shareholders' meeting retains the power to issue bonds convertible into shares and securities that yield a share of the profits of the issuer.

The corporate resolution whereby the securities are issued will reflect their terms and conditions, which will also be contained in the public deed (if it has to be granted), in the prospectus, if required, or, in the case of a private offering, in the offering document.

Prospectus

A prospectus will be required in Spain if either of the following circumstances applies:

- the securities are the subject of a public offering in Spain; or
- the securities are to be listed on a secondary official market in Spain.

In this regard, a public offering consists of any communication to persons in any form and by any means that provides sufficient information on the terms of the offering and the securities offered to allow an investor to decide whether to acquire or subscribe to said securities. This notwithstanding, each of the following is not considered a public offering by the Securities Market Act and does not require a prospectus:

- an offering of securities exclusively directed to qualified investors;
- an offering of securities directed to less than 150 natural or legal persons per member state, without including qualified investors;
- an offering of securities addressed to investors who acquire securities for a total consideration of at least €100,000 each, per offering;
- an offering of securities whose unit nominal value amounts to at least €100,000;
- an offering of securities amounting to a total of less than €5m, which limit shall be calculated over a period of 12 months. This threshold will be automatically reduced to €1m by virtue of the partial entry into force of Regulation (EU) No. 2017/1129 on July 21, 2018 unless the Securities Market Act is amended to increase it, which it may do up to €8m.

The prospectus must contain all the information needed to enable investors to evaluate the assets and liabilities, the financial situation, profits and losses and prospects of the issuer and, if applicable, the guarantors of the securities. Obviously, this document must comply with the standards on content and format imposed by the Prospectus Directive and by Regulation (EU) No. 2017/1129 and its implementing and delegated regulations after July 21, 2019.

In any case, the prospectus must be approved by the CNMV before it is made available to the investors (if it is an offering prospectus) or before admission of the securities to listing (if it is a listing prospectus).

Regarding the legal timeline, the CNMV has a maximum period of 10 business days from the day the prospectus is submitted by the issuer to approve it. If the issuer does not have any other securities admitted to trading in a regulated market within the EU and has not issued

securities to the public before, such period will be extended to 20 business days. The CNMV may request additional information, which it generally does, and suspend these terms so that, in practice, the process takes longer. Once the CNMV has approved the prospectus it will have to be published and made available by the issuer to the public at its expense.

Private vs public offerings

Since public offerings of debt securities entail a longer process including the preparation, filing and approval of a prospectus by the CNMV, which can take from four to eight weeks before the transaction can be launched and marketed to investors, they are relatively unusual in the Spanish business practice.

Alternatively, private placements do not require the registration of a prospectus with the CNMV. Nevertheless, it is also common to produce an offering memorandum, which is submitted to the CNMV or MARF for informal approval before distribution to investors. Consequently, they benefit from greater flexibility, a significant reduction of the time period required to implement the transaction and lower costs.

Clearing, settlement and registry

The Spanish clearance and settlement procedures went through a major process of adjustments that began in April 2016 and finished on September 18, 2017. The changes have aligned Spanish procedures with the efficient practices and standards of most European markets. Furthermore, Iberclear, the Spanish central securities depository in charge of both the register of securities held in book-entry form and the clearing and settlement of all trades in AIAF and MARF, is now connected to the TARGET2 Securities (T2S) technical platform. The settlement and registration of both equity and debt instruments is now carried out through a single platform named ARCO.

The book-entry register structure of Iberclear and the Iberclear participants is divided as follows:

- the Spanish Central Registry, managed by Iberclear, that reflects the aggregate balance of the securities held by each of the Iberclear participants (segregated into the Iberclear participants' own account and accounts held on behalf of third parties); and
- an itemised individual register managed by each of the Iberclear participants, in which securities are listed under the security owner's name.

Special rules for international issuance of debt securities

The Companies Act expressly establishes that Spanish companies can issue debt securities abroad and it regulates which law applies to the different aspects of the debt issuance:

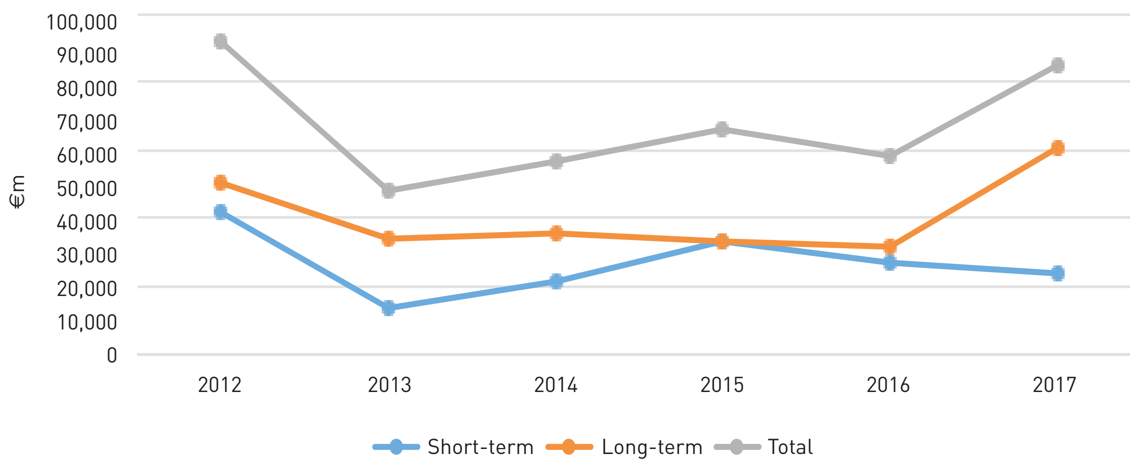
- the Spanish law will determine the power, the competent body and the conditions for approval of the resolution through which the securities are issued; and
- the foreign law to which the issuance is subject will determine the rights of the bondholders against the issuer, the forms of collective organisation of the bondholders and the securities' redemption and cancellation regime, that is to say, the contractual matters of the issuance.

Regarding foreign issuers, the CNMV may approve a prospectus drafted in accordance with international standards (for instance, those of the IOSCO) and provided that the information requirements laid down by such foreign legislation are equivalent to those of the Spanish legislation. Notwithstanding, Iberclear requires additional information for the trading of foreign securities. Additionally, a prospectus approved by the competent authority of another EU member state will be valid in Spain benefiting from the European passport regime set forth by the Prospectus Directive.

Tax regime

There are no stamp or other issuance, registration or transfer taxes on the issue or transfer of debt securities

Gross private fixed-income issued by Spanish issuers in foreign markets **Exhibit 3**



Source: CNMV database and graph prepared by the authors

issued by a Spanish tax-resident issuer and no value-added tax is triggered either.

Additionally, provided that the requirements stated in Act 10/2014, which sets out the tax regime applicable to virtually all issuances of debt securities by private issuers, together with the formalities prescribed by Spanish tax rules are met:

- payments under the debt securities shall not be subject to Spanish withholding tax;
- income derived from the securities would be exempt from Spanish non-resident income tax for non-Spanish resident investors and be fully subject to taxation in the case of Spanish residents; and
- interest paid by the issuer on the securities will be fully deductible for Spanish income tax purposes without limitation.

Conclusion: Update and trends

Over recent years, there has been increasing debt capital market activity supported by the ECB's monetary policy involving quantitative easing and private debt purchase programmes and the market resilience to political headlines. However, the volume of issuances registered with the CNMV or listed on AIAF or MARF remains low as many Spanish issuers continue to issue and list their debt securities abroad.

In this context, the CNMV announced on December 1, 2017 a number of measures designed to streamline its procedures for the registration of debt issuances, targeting qualified investors only with the aim of making the Spanish debt capital markets more attractive. The measures are already in force as they do not require changes in legislation and encompass the reduction of the timeline for providing comments on the offering documents and to approve the admission to trading of the securities, the decision not to review certain final terms of the offering prior to the placement if the issuance is carried out in the framework of a programme and the confirmation that the CNMV will not request going forward statistical information from the issuer regarding the distribution of the securities.

About the authors:

Antonio Herrera joined Uría Menéndez in 1998 in Madrid and became a partner in 2007. He is currently the managing partner of Uría Menéndez's Barcelona office. His practice focuses on mergers and acquisitions, corporate governance, banking and securities law.

Javier Redonet is a partner based in the Madrid office of Uría Menéndez. He joined the firm in 1997 and became a partner in 2008. Javier heads the Capital Markets Practice Area of the firm and specialises in company, finance and securities law.

Josep Moreno Vallés joined Uría Menéndez in 2017 and is a trainee of the firm's Barcelona office where he has completed a seat with the corporate group.

Contact us:

Uría Menéndez

Diagonal, 514, 08006 Barcelona

Spain

tel: +34 93 416 51 00

web: www.uria.com