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SPAIN'S NEW STATE FUND TO PROVIDE LIQUIDITY TO ITS AILING AUTONOMOUS REGIONS (ROYAL DECREE LAW 21/2012)

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Spain has taken exceptional new measures for the State funding of its ailing autonomous regions, which are suffering acute cashflow problems, with the announcement of new legislation: Royal Decree Law 21/2012 of July 13, "Liquidity measures for public administrations and the financial sector" published in the Official Gazette of July 14.

It is not, as intended by some Autonomous Communities, that the State guarantees the issuing of regional debt by the "hispanobond" formula but to fund them in order to address the outstanding maturities and avoid a much-feared default. In other words, this is a full-blown "bailout", in which the State provides credit to those Autonomous Regions that need it, in exchange for them undergoing a strict budget plan supervised and controlled by central government. Last resort enforcement measures for compliance are available under Article 155 of the Spanish Constitution.

The proposed system is similar to the suppliers' payment plan¹ created at the beginning of the year, although the goals of the funding

are different. Both are exceptional measures approved by the Central Government to assist those Administrations with liquidity problems. This created a legal framework set out in the first additional provision of that Act, to regulate the "additional mechanisms for the financing of the Autonomous Communities and Municipalities".

The main elements of the finance mechanism offered under the latest Royal Decree Law are as follows:

1. The Autonomous Communities that wish to subscribe to this system will have to apply to the Ministry of Finance and Public Administration before 31 December 2012. Once the request is filed, the Governing body of the Autonomous Region has to adopt an agreement promising to fulfill the requirements set out in the Royal Decree Law and in the corresponding provisions and agreements implementing the same.
2. The State will execute the appropriate credit operations with each of the Autonomous

¹ The suppliers' payment plan, set up by Royal Decrees 4/2012 and 7/2012, was provided with €35 bn by the creation of a Fund with separate legal personality, financed by a syndicated loans. Municipalities and Autonomous Communities have been able to use this Fund in order to pay off their debts with suppliers, in exchange for promising to fulfill a budget adjustment plan accepted by the Ministry of Finance and Public Administration. This plan has created a massive liquidity boost for the business sector and has also ameliorated the local employment situation.

Communities that join the mechanism for an amount not exceeding the debt at its maturity date. The presumably preferential financial terms applicable to these credit operations will be fixed by the Government's Delegate Commission on Economic Affairs whilst the Official Credit Institute will administer and manage the operations (article 16).

3. The credit operations will be charged to a special Treasury Ministry Fund (viz. the Regional Liquidity Fund, RLF) without separate legal personality created by the Royal Decree Law and will be managed by the Official Credit Institute². The RLF will be provided with an €18bn extraordinary credit against the current budget. The RLF will foreseeably remain operational for some time and will be provided with funds in the coming years; the rescue mechanism is by its very nature a temporary measure, but nevertheless one of undefined duration. According to the Royal Decree Law, the Regional Liquidity Fund *"will meet the financial needs defined in article 1 as long as the Autonomous Communities continue to have difficulties accessing the financial markets, subject to the assessment and annual review by the Delegate Commission on Economic Affairs"*.
4. The exceptional credit provided to the RLF, will in turn be financed by Sovereign debt; however, ministers have ensured that the

Treasury will not have to modify its existing issuing schedule as a result.

5. The liquidity granted by the financing system will be specifically targeted at the Autonomous Communities' "public debt" which, according to Article 4.2 of Royal Decree is defined exclusively as being the following:
 - a) The settlement on maturity of previously issued securities;
 - b) The settlement on maturity of loans granted by European Institutions of which Spain is a member;
 - c) Those operations³ that cannot be refinanced or novated by the Autonomous Communities, in order to respect the principle of financial good governance defined by the Resolution of the Secretary of the Treasury and Financial Policy;
 - d) The requirements of financing the public deficit.

Article 14 refers again to the applicable limits for the conclusion of these credit operations, stating that the amount "can not exceed the resources needed to meet the financial debt maturities for the Autonomous Community and its subsidiaries that are classified within the Public

² The Royal Decree Law, article 13.1 related to the "Regional Liquidity Fund Management" states: "The Official Credit Institute will be in charge of the management of the Fund. The Official Credit Institute, among other functions will formalise, on behalf of the Spanish Government and on the Central Government's account, the loan policies to subscribe with the Autonomous Communities, by virtue of the Government's Delegate Commission on Economic Affairs mandatory instructions, at the proposal of the Minister of the Treasury and Public Administrations. Likewise, it will render technical implementation services, accounting, cash, paying agent, monitoring and, in general, each of the financial services related to the authorised operations against the Regional Liquidity Fund, without prejudice to the control competences established by the General Budgetary Act 47/2003 and the rest of legislation in force."

³ Even though it is not specifically said, it is understood that the Royal Decree Law is in this case referring to "credit operations".

Administrations sector, according to the definition and delimitation of the European Accounts System, as well as the amounts needed to finance the indebtedness permitted by the budgetary stability regulation, *within the limits fixed by the Government's Commission for Economic Affairs.*"

As explained, this financing system excludes the payment of commercial obligations, or the payment of capital costs (eg. investments) that have been contracted directly with suppliers. Nevertheless as the financing of the Autonomous Communities frees them from using their own budgets to pay debt maturities, there is some scope to meet payments that were not covered by the suppliers' payment plan. It is expected, moreover, that the remaining resources from suppliers' payment plan, amounting to more than €7bn, are intended to provide a new phase of the system, directed to paying bills that were not eligible for the plan, such as those resulting from the outstanding debts of local bodies, for example those undertaken by associations or consortia.

6. The Autonomous Communities subscribing to this funding system will be restricted from contracting other loan operations. The Royal Decree provides that "Foreign securities or credit operations shall not be carried out without the prior permission of the General Secretariat of Treasury and Finance Policy notwithstanding the approval of the Council of Ministers, according to Article 14 of Organic Law 8/1980 of 22 September, of Autonomous Communities Financing". In addition, the financial terms of all credit transactions of the Autonomous Community subscribed under the system, both short and long term, that are not legally subject to authorisation, shall be communicated to the General Secretariat of the Treasury

and Financial Policy, accompanied by a certificate from the supervisory body of the Autonomous Community certifying the fulfilment of the financial obligations (art. 4, numbers 3 and 4).

7. In exchange for receiving the funding, the Autonomous Regions that voluntarily sign up to the system are subject to strict fiscal and financial conditions.

It should be born in mind that *compliance with these measures is a condition of the granting of the credit*. This follows from the provisions of Article 14.4 of the Royal Decree Law: "the provisions of the Regional Liquidity Fund for the Autonomous Communities subscribed to the mechanism in order to meet their additional financial needs, shall follow a schedule of phases. The release of each phase will be subject to the fulfilment of tax and financial obligations and subject to a report from the Ministry of Finance and Public Administrations".

The onerous obligations imposed on the Autonomous Regions that sign up to the funding system include the following:

- (i) Submission and implementation of a budget adjustment plan

The Autonomous Community has to submit and agree a budget adjustment plan with the Ministry of Finance and Public Administration in order to ensure compliance with the stability and public debt objectives, as well as the repayment of the amounts released by the Regional Liquidity Fund. If the Autonomous Community has already adopted a budget adjustment plan for the suppliers' payment plan, then the necessary modifications will be introduced in order to comply with the new commitments. The budget adjustment plan must include a

treasury schedule and the details of ongoing debt transactions which will allow the Ministry of Finance to monitor liquidity.

The budget adjustment plan is set dynamically, with annual reviews to allow for the Autonomous Community's budget requirements.

Non-compliance or the unfavourable evaluation of the budget adjustment plan will lead to the rejection of the application made to the mechanism. Furthermore, the Budgetary Stability and Financial Sustainability Act provides coercive measures including, as a measure of last resort, the enforcement of unfulfilled obligations under Article 155 of the Spanish Constitution. Such action would not itself be a government "intervention" of the Autonomous Community, as has been suggested, since their governing bodies are not being suspended or dissolved and the State's enforcement measures are in any event limited to ensure compliance with its obligations and to protect Spain's general interest.

(ii) Reporting obligations.

The Royal Decree sets out various periodic reporting obligations for the transfer of economic, financial, budgetary and treasury information in connection with the fulfilment of the budget adjustment plan, to enable the Ministry of Finance and Public Administration to monitor its implementation at all times (sections 5.2 and 6.1). The Autonomous Community's internal regulator must submit this information on a monthly basis. The internal regulator is also responsible for

ensuring the proper implementation of the budget adjustment plan, and must report to the Ministry of Finance and Public Administration notifying where appropriate of any breaches or non-compliance.

8. Monitoring

The monitoring of the compliance with the adjustment plans must be carried out by the Ministry of Finance and Public Administration, based on the information received from the Autonomous Community as set out above.

If the Ministry detects any default risks or breach of the conditions of the budget adjustment plan, it will propose appropriate amendments by the adoption of new measures or by altering the implementation timetable; it can also request that the Comptroller General of the State Administration carry out a "monitoring mission" if it considers this appropriate. In any event, non-compliance with the measures may affect the granting of further stages of the loan.

If the Comptroller General of the State Administration authorises a monitoring mission, it will aim to finalise the diagnosis of the financial situation of the Autonomous Community in the framework of the commitments made in the adjustment plan, applying the techniques and monitoring methodologies as deemed appropriate. The Comptroller General of the State Administration must issue a report on the financial adequacy of the provisions contained in the current budget adjustment defaults or the default risks within one month from the commencement of the monitoring mission. Non-compliance may be sanctioned by the measures set out

in Articles 25 and 26 of the Organic Law 2/2012 of Budgetary Stability and Financial Sustainability.

9. Guarantees

As previously used in the suppliers' payment plan regulation, a final guarantee is the retention of the finance resources of the Autonomous Regions subjected to the Common Regime - which excludes Navarra and the Basque Country.. It should be noted that the Basque Country and Navarra's self-governing regional communities' adherence to this mechanism is nevertheless possible. In order to achieve this however they would have to execute an agreement with the State to offer resources guaranteeing the credit transaction (first additional provision).

Other interesting provisions in the Royal Decree Law include the following:

- (i) The second additional provision, that regulates the extension of the finance mechanism for the suppliers' payment mechanism of local bodies in the Autonomous Communities of the Basque Country and Navarra (which had been excluded from the system by the Royal decree Law 7/2012), provided that the local authorities are included in the model of participation in State taxes
- (ii) The fifth additional provision, which introduces a number of measures fundamental to allow the commencement of the process of European financial assistance for the recapitalisation of certain Spanish financial institutions.
- (iii) And the first final provision, which introduces a modification to the General State Budget for 2012 (Law 2/2012). This is in order to regulate the guaranteeing of financial obligations derived from the emission of bonds and obligations of the financial institutions, and the requirements for their granting and the associated commissions to the above guarantees. As stated in the preamble to the Royal Decree Law, this modification "makes possible the re-initiation and immediate grant of these guarantees, once the extension of its regime is authorised by the European Commission's Decision on 29 June 2012, facilitating the financial institutions access to the liquidity and financing they need as long as they can obtain the above European financial assistance".