C/M/S/ Albiñana & Suárez de Lezo

BANKING AND FINANCE ALERT

The final structure of the SAREB (the Spanish "bad bank"): An opportunity for investors in NPLs and REOs?

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1. Introduction

On 15 **November**, the Spanish Government set out the features and structure of the ad hoc asset company that will be incorporated by the Fund for Orderly Bank Restructuring ("FROB", the public entity in charge of managing the financial sector aid funds) in the course of December 2012. This completes the framework that will allow compliance with the requirement of the Memorandum of Understanding on Financial-Sector Policy Conditionality dated 23 July 2012 ("MOU") of segregating problematic assets from the balance sheet of certain credit entities.

This asset company will be known as SAREB and will absorb the problematic assets of the Spanish credit entities needing public financial aid in the course of the current financial crisis, facilitating and achieving a transfer in the risks associated to such assets. The exclusive purpose of the SAREB is to permit the concentration in a single entity of those assets by holding, directly or indirectly managing, and realising the assets acquired from the affected credit entities

SAREB has been designed to be a company owned by a majority of private investors that will have, amongst others, the goal of maximizing benefits and being profitable. For such purposes, SAREB will acquire assets (mainly, foreclosed real estate assets and loans for real estate development) from aided credit entities that will be sold to investors directly or through specific vehicles to be created within SAREB, the so-called Bank Asset Funds (Fondos de Activos Bancarios, "FABs").

In this alert, we briefly describe the SAREB and mainly focus on the main legal and tax aspects of FABs, which may be an investment vehicle of interest for investors aiming to acquire assets transferred to the SAREB, if their price is attractive.

2. SAREB

The SAREB will have a maximum lifetime of 15 years, period during which it shall aim to realise all assets acquired from the entities that undergo a restructuring or resolution proceeding. Initially, these entities are BFA-Bankia, Banco de Valencia, Catalunya Banc and Novagalicia Banco (Group 1 entities) which shall transfer their assets prior to year end. Additionally, Group 2 entities (Liberbank, Ceiss, Caja3 and Banco Mare Nostrum) may be forced to transfer their affected assets to the SAREB before 30 June 2013. Group 3 (Banco Popular e Ibercaja) may also end up being forced if unable to successfully complete their recapitalisation plans. This would make an approximate total of EUR 90 billion of NPLs and REOs acquired by the SAREB.

2.1 Shareholders

If instead of (or in addition to) directly or indirectly acquiring assets from the SAREB, investors are interested in acquiring equity of the SAREB, this is also a possibility. The aim of the Spanish Government is to minimize the public funds used in the restructuring of the financial sector given the need to reduce the current public deficit. For these purposes, the design of SAREB includes a limit to the aggregate participation of the Spanish public institutions, which shall always be below 50% of the share capital of SAREB.

The rest of the share capital of SAREB will then be held by private investors either via shares or subordinated debt, but as the regulation does not restrict it, other alternative products (such as senior debt) may also be possible to articulate investment in the SAREB.

2.2 Assets to SAREB

The following assets of the affected entities will be transferred to SAREB within the calendar mentioned above:

(a) Foreclosed real estate assets or those acquired in payment of debts, as long as they were included in the balance sheets of the credit entities as of 30 June 2012, with a net book value each, after applying value adjustments, higher than EUR 100,000.

(b) The following credit rights, as long as they were included in the balance sheets of the credit entities as of 30 June 2012, with a net book value each, after applying value adjustments, higher than EUR 250,000:

• Loans or credits for the financing of land for real estate developments in Spain, real estate developments and constructions in Spain either on-going or completed, irrespective of their date or risk categorisation.

• Participative loans granted to real state companies or their related entities irrespective of their date or risk categorisation.

• Any other loans or credits granted to the debtors of loans or credits described in the first point above, when the FROB so determines.

(c) Real estate assets and credits rights which comply with the requirements imposed in the above paragraphs (a) and (b) from real estate companies controlled by a credit entity.

(d) Equity instruments of real estate companies or other related entities which, directly or indirectly, allow the credit entity (or any other entity of its group) to hold a controlling interest in these companies, when the FROB so determines.

Notwithstanding the above, the FROB may also order the mandatory transfer of consumer credits or loans, credit or loans to small and medium-sized companies, credits or loans guaranteed with residential mortgages or any other assets not listed above, provided that such assets are particularly damaged or their on-going inclusion in the balance sheets is considered prejudicial to the viability of the entity. Prior report of the Bank of Spain shall be required in these cases.

2.3 Transfer price

The specific price at which assets will be transferred to SAREB has not yet been specified, only general valuation principles have been indicated.

The Bank of Spain will set the final transfer price of the assets listed above by no later than 23 November on the basis of the economic value of the assets and the valuation reports produced by independent experts (Oliver Wyman), applying a haircut to each specific type of asset. Final acquisition prices will be the result of deducting from the book value the provisions, any potential additional value adjustment and the haircut.

So far, according to the information published by the FROB, the average transfer price for real estate foreclosed assets will represent an approximate discount of 63% to the book value (this includes provisions and haircut). The breakdown of this average by types of foreclosed assets is: 79.5% in the case of land; 63.2% for non-finished assets; and 54.2 for finished assets. In the case of credits to promoters, the average discount will sum up to 45.6%, including 32.4% discounts for finished assets and 53.6% for credits related to urban land.

2.4 Tax

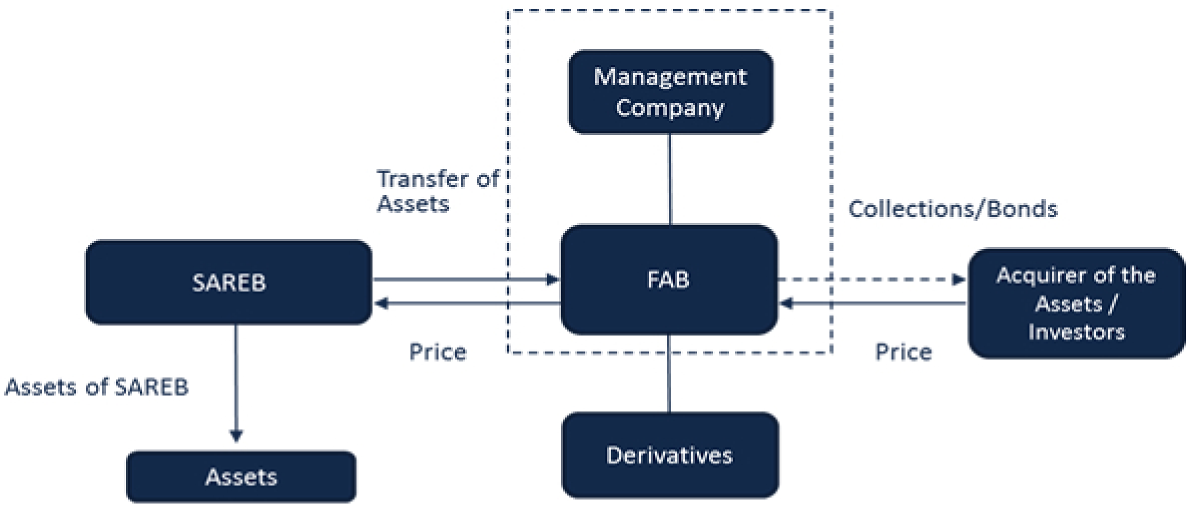
In general terms, the SAREB benefits from several new tax provisions which purpose is focused at ensuring tax neutrality upon the transfer of real estate assets and loans by aided banks to the SAREB, the reorganization of such assets by the SAREB for their direct sale to third parties or their assignment to FABs as well as a preferential tax treatment for the taxation of FABs and income derived by foreign investors from their investment in the same.

3. FABs

SAREB, in addition to managing and selling assets directly, can also create special funds (FABs) where its assets may be transferred to achieve off balance sheet treatment. FABs are a completely new investment vehicle under Spanish law, being a hybrid between Spanish securitization funds and collective investment funds and which lack separate legal personality (they are a pool of assets and liabilities. In fact, the legal regime applicable to securitisation funds and collective investment funds is subsidiary to the regime of FABs contained in the new regulation.

Investors interested in the assets of SAREB can invest to acquire indirect control over such assets. SAREB, upon transfer to a FAB will no longer have control over management/servicing of such assets. When creating a FAB, a Spanish regulated management company of securitisation funds (similar to trustees) must be appointed to manage the pool of assets of such FAB and legally represent it. The management company of the FAB must act in the best interest of the investors.

For instance, just like in securitisation structures, if an investor is interested in acquiring a specific portfolio of NPLs from SAREB, it can do so directly or by setting up an ad hoc FAB, being the investor the holder of the securities issued by such FAB and thus entitled to the proceeds of the underlying portfolio that has been transferred to the FAB.



3.1 Assets and liabilities of FABs

FABs' assets may comprise any of the assets transferred to the SAREB.

The transfer of these assets to a SAREB shall meet the following requirements:

- The transfer of assets must be full and unconditioned until maturity, where appropriate.
- The transferor (SAREB) must not grant any guarantee to the transferee (FAB), nor may it assure

the good outcome of the transaction. So, full risk transfer.

FABs' liabilities may comprise (i) any of the liabilities transferred by SAREB or assumed by the SAREB; (ii) issued securities of any type; (iii) loans or credits of any nature; and (iv) contributions by institutional investors who will have a right to any surplus in the fund.

3.2 Investors

The regulation does not, a priori, impose a minimum number of investors in a FAB, so one single investor could create (or ask SAREB to create) its own. FABs' deed of incorporation shall regulate all aspects of the operation of the FAB, including the ability of acquiring assets on an on-going basis or issuing securities also periodically to finance such acquisitions. In case of various investors, the FAB may foresee the creation of a syndicate of holders of securities.

Issuance of securities by a FAB shall be subject to the relevant Spanish Stock Market laws, may be admitted to trading on an official secondary market and may only be subscribed by professional investors. The minimum par unitary value of any such securities shall be EUR 100,000.

3.3 Sub-funds

FABs' assets may be segregated into independent sub-funds. Securities may be issued or obligations may be assumed against a specific sub-fund. Creditors of a given sub-fund may only enforce their credits against the assets of said sub-fund.

3.4 Termination and winding-up

FABs shall be wound up upon expiry of the term for which it was created, as well as for any other cause established in the deed of incorporation.

3.5 Tax

In particular, FABs have been introduced as Corporate Income Tax (CIT) payers in the same terms as Spanish investment funds. They are therefore subject to tax at a 1% rate and they are entitled to recover Spanish withholding taxes, but no to apply any tax credits.

Although as commented above reorganization of assets into FABs is generally tax free, it must be noted that, as opposed to SAREB, no tax exemption has been introduced to the stamp duty (1%) applicable to the notarial transfer of mortgage loan portfolios and other security to FABs.

As a special tax incentive to foreign investors, it has been established that all income obtained by foreign investors from the participation in FABs is tax free, even if the investor is resident in a tax haven jurisdiction for Spanish tax purposes (i.e. in the same terms as Spanish public debt).

It must be noted that all of the abovementioned tax benefits are temporary and are directly linked to the period during which the SAREB exists (i.e. a maximum period of 15 years). However, as a transitory measure, after such period FABs should be able to prorate taxation of capital gains on a lineal basis according to the applicable tax rate within the holding period and foreign investors should be entitled to apply the tax free regime in the same terms as before.

Royal Decree 1559/2012, of 15 November, which develops Law 9/2012, of 14 November, on restructuring and resolution of credit entities (formerly, Royal Decree-Law 24/2012, of 31 August, on restructuring and resolution of credit entities as ratified and amended by the Spanish Parliament - for further information on RDL 24/2012 see the alerts in these links, 1, 2).

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