

BANKING AND FINANCE ALERT

A BRIEF SUMMARY OF ROYAL DECREE-LAW 24/2012, OF 31 AUGUST, ON RESTRUCTURING AND RESOLUTION OF CREDIT INSTITUTIONS: THE NEW REFORM OF THE SPANISH FINANCIAL SECTOR

On Friday 31 August 2012, the Counsel of Ministries approved the Royal Decree-Law 24/2012, of 31 August, on restructuring and resolution of credit institutions ("**RDL 24/2012**") which entered into force on that very same date after its publication in the Official State Gazette (*Boletín Oficial del Estado*).

This piece of legislation is the latest policy adopted by Spain in compliance with the Memorandum of Understanding on Financial-Sector Policy Conditionality dated 20 July 2012 ("**MOU**"). It also intends to implement the main aspects and guidelines of the future EU Directive dealing with the rescue and resolution of financial entities, a draft of which has already been produced by the Commission.

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1. New Bank Restructuring and Resolution Regime

1.1. Types of management proceedings

RDL 24/2012 sets out a new range of crisis management tools for the Bank of Spain and the Fund for Orderly Bank Restructuring (*Fondo de Reestructuración Ordenada Bancaria*, "**FROB**") to be used when credit institutions suffer vulnerable economic situations. These tools include, where appropriate, early actions, restructuring and even orderly resolution.

These new measures and tools are now the main legal regime for the reorganization of credit institutions (notwithstanding the disciplinary authority of the Bank of Spain) which reinforce the authority of the FROB and the Bank of Spain and limits the involvement of the Deposit Guarantee Scheme (*Fondo de Garantía de Depósitos*, "**FGD**"). The intervention of either the FROB or the Bank of Spain in credit institutions in difficulties shall be conducted in order to minimize the cost to taxpayers and shall be ruled by the principle of burden sharing, by virtue of which shareholders will be obliged to assume losses.

These new tools are the following:

Early actions: the Bank of Spain may make use of early actions with regard to credit institutions which fail to comply, or is foreseeable that will fail to comply, with the relevant solvency, liquidity, internal organization and internal control requisites but it is in a position to comply again through its own means (regardless of the financial aid it may receive according to the paragraph below).

Amongst these early actions the Bank of Spain is entitled to substitute members of the governing body and managers of the credit institution, require it to call a shareholders meeting, require it to renegotiate or restructure its debt and, exceptionally, subscribe or acquire instruments convertible into shares (see section 1.2 below). Consent from the FROB will be sought on this stage only if public financial aid is requested by the credit institution.

Restructuring: restructuring proceedings is for credit institutions that require financial public aid in order to guarantee its viability and being foreseeable that they will be able to pay back such aid within the relevant maximum statutory period (which depends on the type of financial aid granted, as explained in section 1.2 below) as well as for non-viable credit institutions which their orderly resolution would end up producing serious negative effects on the stability of the financial system (systemic).

The restructuring of a credit institution shall be designed on the basis of a restructuring plan and the Bank of Spain and the FROB may put into practice any of the early actions described above, grant public financial aid (see section 1.2 below) and/or transfer assets to an external asset management company (the AMC, see section 3 below).

Orderly resolution: the orderly resolution of a credit institution will take place when the institution is considered (i) non-viable and (ii) for the sake of public interest it is not advisable to open an ordinary insolvency and winding up proceeding. The orderly resolution may also apply if, in addition to requisite (ii) above, a restructuring proceeding is frustrated or it is considered unsuitable.

Once the resolution of a credit institution is agreed by the Bank of Spain the FROB will be appointed as director (contrary to early actions or restructuring proceedings, where, in principle, credit institutions keep their management autonomy) and will produce a resolution plan. At this stage the FROB may decide to:

- Sell the business of the credit institution to a third party: transferring its shares or whole or part of its assets. The sale will be made at a market value through a competitive and transparent procedure and without the need of the prior consent of the shareholders. The shareholders shall bear the losses, if any;
- Transfer its assets and liabilities to a "bridge-bank": the "bridge-bank" will be a credit institution owned (in whole or in part) and managed by the FROB (for a maximum of 5 years). The aim is to sell the "bridge-bank" or its assets and liabilities at a certain point. The shareholders of the "bridge-bank" will be entitled to the proceeds of such sale;
- Transfer its assets and liabilities to an asset management company (see point 3 below); and/or grant public financial aid (see section 1.2 below).

Transactions carried out pursuant to actions of the FROB in a resolution proceeding may not be set aside or rescinded pursuant to clawback provisions contained in the Spanish insolvency law.

1.2. Financial public aid: terms and conditions

Financial public aid may be granted by the FROB to credit institutions involved in early actions, restructuring and orderly resolution proceedings. The aid may comprise granting of security, loans and credit facilities, acquisition of assets and liabilities (to be managed by the FROB or to be transferred to a third party) and/or recapitalization. The financial aid provided by the FROB will not diminish the losses of the shareholders of the credit institution and the credit rights of the FROB will rank as privileged.

The recapitalization of a credit institution may imply the FROB subscribing or acquiring ordinary shares (or other capital instruments) and/or instruments convertible into shares (or convertible into other capital instruments). The acquisition or subscription will be at the economic value with the discount applicable by EU legislation on state aid.

In case of recapitalization, the FROB will have a maximum 5 year period to sell the shares and the convertible instruments it may have subscribed (this term may be extended for additional 2 years in case of an exceptional difficult economic situation). In case the recapitalization aid is granted in an early action proceeding, the maximum conversion period will be 2 years.

2. Restatement of the FROB

2.1. Main features of the “new” FROB

The legal regime of the FROB has been modified in order to provide it with more suitable tools in the current financial situation and in compliance with the MOU conditionality.

The FROB will have now corporate powers in aided credit institutions (e.g. including capability of executing increases and reductions of share capital and issuing and redeeming bonds) and wider administrative faculties.

RDL 24/2012 has set a EUR 120 billion limit of capital that the FROB can borrow during the financial year 2012.

Apart from the restatement of the FROB, the functions of the FGD will now be limited to guarantee the deposits and securities held by credit institutions and to finance and guarantee support measures in orderly resolution proceedings.

2.2. Procedural regime

RDL 24/2012 also provides with the procedural regime for any appeal against the FROB’s decisions in case they are *contra legem* decisions. The action against directors will not be available in the framework of restructurings or orderly resolutions carried out by the FROB.

Moreover, the Bank of Spain and the FROB may be jointly (and again directly before the courts and not before any administrative or governmental institution) sued in case of early actions, restructurings or orderly resolutions, but each of the said institutions will only be liable for the damages or prejudices caused on the basis of its own competences.

Finally, the Bank of Spain and the FROB will be able to allege material impossibility to enforce judicial judgements declaring their administrative actions or decisions unlawful, taking into account (among other criteria) the difficulty to proceed with the enforcement and the eventual damages to the financial system, to the specific credit institution or to third parties.

3. The Spanish “Bad Bank”

RDL 24/2012 foresees that the FROB may force credit institutions to transfer specially impaired, problematic or prejudicial assets to an asset management company created *ad hoc* for this purpose. This asset management company will be a Spanish public company (*Sociedad Anónima*), so-called “*Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A.*” (“**AMC**”), which will benefit from certain conditions and prerogatives to ease the transfer and management of the problematic assets it will hold.

Only the main aspects of the AMC are regulated in the RDL 24/2012 in line with the parameters contained in the MOU and further regulations still need to be approved to complete the mandate imposed by the MOU in this respect: (i) problematic assets of aided credit institutions should be quickly removed from their balance sheets and (ii) the AMC will manage the assets with the goal of realising their long-term value.

3.1. Creation and features of the AMC

The AMC will be governed by the rules contained in the RDL 24/2012, the regulations developing it and, subsidiarily, by the Spanish Companies Act and the rest of applicable rules.

It will be able to issue bonds and other similar debt securities without any limitation of debt to equity ratio. In accordance with the MOU, any bonds issued by the AMC will be structured in such a manner that they will meet the conditions set out in the ECB’s “Guideline on monetary policy instruments and procedures of the Eurosystem” but so far nothing is said in the Spanish regulations in this respect.

The AMC will need to be created on or prior to the end of November 2012 with the exclusive purpose of holding, directly or indirectly managing and administering, acquiring and selling the assets of the credit institutions that the FROB determines. The AMC will be created for a limited period of time (likely to be between 10 to 15 years).

The AMC may have the following entities as shareholders, provided always that the aggregate direct or indirect holdings of any public companies shall always be less than 50% of the share capital of the AMC:

(i) the FROB; (ii) the FGD; (iii) Credit Institutions; (iv) Investment Services Companies; (v) Insurance Companies; (vi) Collective Investment Institutions and their Management Companies; (vii) Pension Funds and their Management Companies; (viii) Securitisation Funds and their Management Companies; (ix) Venture Capital Companies or Funds and their Management Companies; (x) Holding Companies of shares in Financial Entities; (xi) any other Institutional Investors; and (xii) any other entities so determined by the developing regulations.

As the case may be, the RDL 24/2012 allows the FROB to create, if it deems it convenient in order to ensure an orderly management of the assets, a management company so that the assets would sit in the AMC and the management of such assets and the representation of the AMC would correspond to the management company.

The FROB will at all times be devoted to the supervision of the operations of the AMC and the management company and their compliance with the rules contained in the RDL 24/2012. For this purpose, both the AMC and the management company shall provide the FROB with any information it requires.

The AMC will be able to segregate assets into different and separate portfolios which will take the form of venture capital funds or securitisation funds.

3.2. Assets transferable to the AMC

The criteria to determine the categories of assets that will be transferred to the AMC will be set forth by the developing regulations which are yet to be enacted, on the basis of the activity to which the assets are linked, the period of time they have been on the balance of the credit institutions and their accounting treatment. Once the categories are determined, the Bank of Spain will precise which assets of each of the credit institutions are transferable to the AMC (including any liabilities that may be required to transfer with the assets).

The assets able of being transferred will include the shares of the management companies that the banks may have created *ad hoc* for the purpose of transferring certain real estate assets as imposed by the last financial sector reform back in May 2012.

3.3. Method of transfer

The transfer of the assets to the AMC can be done by any legal means and without the need of obtaining any third party consents or complying with the requisites for corporate reorganizations, that otherwise would be legally required.

Prior to the transfer, the relevant credit institutions shall adjust the valuation of the assets to be transferred in the manner and with the criteria that will be set forth by the developing regulations, and the Bank of Spain will determine the valuation of any such assets on the basis of the reports issued by one more independent experts. The methods for valuation have been briefly described by the RDL 24/2012 but very widely.

In order to ease the transfers, the FROB can force that the assets are grouped in one or more companies.

The transfer of the assets will be subject to, among others, the following main special conditions and prerogatives:

- (a) the transfer may not be set aside or rescinded pursuant to clawback provisions contained in the Spanish insolvency law;
- (b) the acquiring company is not bound by the takeover bid regulations; and
- (c) no labour or tax liabilities will be transferred with the assets.

3.4. Entities obliged to transfer to the AMC:

The entities obliged to transfer assets to the AMC shall be those which are controlled by the FROB or that in the opinion of the Bank of Spain will require to be restructured or resolved in the manner prescribed by the RDL 24/2012.

4. New Regulation on Hybrid and Subordinated Instruments

4.1. Management actions regarding hybrid and subordinated instruments

Restructuring and resolution plans shall include, inter alia, hybrid and subordinated instruments management actions (liability management). These measures shall be designed according to the "burden sharing" principle.

The measures provided for in RDL 24/2012 are divided into two main groups:

(i) Voluntary management measures:

These voluntary management measures shall be included in the restructuring and resolution plans of each credit institution and do not need the FROB's approval. They may involve equity swaps, buy-back of securities, reduction of nominal value and early repayment. In all cases the (prior) voluntary agreement of the holders is required.

RDL 24/2012 establishes that the voluntary management measures shall take into account the market value of the debt securities affected by the restructuring and resolution plans and therefore, each credit institution must request at least a report done by an independent expert.

Finally, in order to protect the investors there is an obligation to publish as a relevant fact the voluntary management measures adopted on the website of the credit institution and, if applicable, in the Listing Bulletin.

(ii) Management measures imposed by the FROB:

The management measures imposed by the FROB are compulsory for the credit institutions and for the securities holders. The FROB decides what hybrid capital instruments and subordinated debts are eligible and what measures are required.

RDL 24/2012 sets forth the unilateral imposition of losses to creditors and establishes that measures imposed by the FROB and their implementation cannot be considered a cause of non-compliance or early termination of any other obligations that the implementing entity has with any third parties.

These measures shall be published as a relevant fact, on the website of the relevant credit institution, in the Official State Gazette and, if applicable, in the Listing Bulletin.

4.2. Procedural regime

RDL 24/2012 also provides with a list of the individuals and entities entitled to appeal the FROB's administrative actions and decisions regarding the management of hybrid subordinated debt and equity instruments. Among others, the holders of securities within the scope of the said management actions or shareholders with at least 5% of the issuing entity's share capital would be entitled to appeal against these FROB's administrative actions and decisions.

Management measures over hybrid instruments and subordinated debt securities may not be set aside or rescinded pursuant to clawback provisions contained in the Spanish insolvency law.

4.3. Other legislative changes affecting hybrids and other securities offers

For the purpose of protecting retail investors, and in accordance with the MOU, RDL 24/2012 sets out new requirements concerning the marketing of hybrid instruments such as privileged shares (acciones preferentes) or convertible debt securities. Therefore, from now onwards (i) it will be strictly necessary that 50% of the total amount of the offering of these instruments is addressed to professional investors and (ii), in the case of privileged shares or convertibles bonds issued by non-listed companies, the minimum unitary nominal value of such instruments shall be EUR 100,000.

Also, in order to further protect retail investors the Securities Market Act has been amended to introduce new conditions for private placements of securities (e.g. increasing up to 150 the maximum number of investors to which the private offer may be addressed; increasing up to EUR 100,000 the minimum amount each investor may subscribe) and to increase the information requirements under MiFID (e.g. the CNMV may require that specific warnings are included in the advertising of financial products; when marketing investment products, other than shares issued by credit institutions, the information to be delivered to investors shall include an explanation of the differences between such investment products and bank deposits).

5. Tax Benefits

In order to ease the indirect taxation burden applicable to the purchaser upon the transfer of securities representing the equity of Spanish real estate vehicles (i.e. those where at least 50% of the assets of the vehicle [including subsidiaries] is real estate located in Spain) owned by aided banks, the RDL 24/2012 introduces an exemption over Real Estate Transfer Tax applicable in the case of change in the control (i.e. an interest which represents more than 50% in the equity) of these kind of real estate asset vehicles when the FROB has supervised the transfer.

From the wording of the provision, and subject to further developments and administrative interpretation, it seems to be inferred that the exemption would only apply to the transfers supervised by the FROB from the aided bank to either a "bridge-bank", the AMC or a third party, but would not apply to subsequent transfers of the control over the Spanish real estate vehicles.

This measure represents a relevant cost reduction to the acquisition of Spanish real estate, although it must be noted that it does not apply to the transfer of isolated Spanish real estate assets.

It must be noted that no tax incentive has been introduced to the indirect taxation (stamp duty) applicable to the notarial transfer of mortgage loan portfolios.

6. Capital Requirements

As a result of the continuing situation of general lack of confidence in the Spanish financial system and with the aim of reinforcing it, RDL 24/2012 has again modified the core capital requirements of credit institutions. Consequently, as from 1 January 2013 capital requirements for all credit institutions will be set at 9%.

The definition of which elements are considered as capital has been also modified in line with recent recommendations of the European Banking Authority. In particular, the applicable deductions to capital have been increased pursuant to Basel III guidelines.

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