

BANKING AND FINANCE ALERT

FROB's ability to restrict netting agreements and enforcement of collateral

Spanish Law 9/2012 (Law 9/2012) was approved on 14 November 2012 (former Royal Decree-Law 24/2012) and confers on the Spanish FROB (Fondo de Reestructuración Ordenada Bancaria / the Fund for Orderly Bank Restructuring of the Spanish Financial System) wide powers to restrict and/or suspend contracts (predominantly netting agreements) and enforcement of collateral arrangements. The rules are enacted in the context of bank resolution/restructuring/early action situations and as a result are considered to be special rules.

The majority of these restrictive and exceptional rules are inspired by and tend to anticipate the provisions set out in the European Commission Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010. The recitals to Law 9/2012 make clear that its intention is to implement in Spain the future legislative changes that will be necessary with the implementation of the forthcoming directive, prior to such directive entering into force. However, the final text of the directive may differ from the current draft and therefore the Spanish regulations may need to be adapted accordingly. It also worth noting that Law 9/2012 may be further developed and thus additional rules and clarification may be enacted regarding these exceptional rules.

Consequently, until then, we can only summarise what we anticipate may be the impact that these rules have on contracts entered into by the affected credit institutions and their counterparties. As financial derivatives and related collateral arrangements between credit institutions are generally governed by ISDA documentation, we are addressing this alert to you so that you may consider whether your transactions with Spanish credit institutions under ISDA Master Agreements, may be affected. The Spanish credit institutions that are undergoing or are likely to undergo a restructuring or resolution proceeding include Bankia, Banco de Valencia, NCG Banco, Catalunya Banc, Liberbank, Caja3, CEISS and BMN.

We summarise below the main aspects of the powers and measures under Law 9/2012:

- Judges cannot admit petitions for the insolvency (concurso) of credit institutions that are or will be in a restructuring or resolution process.
- The implementation by the FROB or by the Bank of Spain of the measures and powers provided for in Law 9/2012 will not be regarded as an insolvency proceeding for the purposes of:
 - (a) Law 41/1999, on securities payment and settlement systems;
 - (b) enforcement of collateral arrangements, for the purposes of the provisions of Section 3 of Chapter II (on the legal regime of netting

and financial collateral agreements) of Royal Decree-Law 5/2005 (the Financial Collateral Regulation); or

(c) the operation of the Spanish payment, netting and settlement systems in general. It will neither affect exercise of netting nor enforcement of the collateral provided to the Bank of Spain, the European Central Bank or any EU national central bank.

- Credit institutions controlled by the FROB are not affected by the following provisions of the Spanish Corporate Law:
 - (a) mandatory dissolution by reason of losses;
 - (b) capital reduction by reason of losses; and,
 - (c) in general, any legal requirements or events foreseen in the by-laws regarding dissolution.
- The FROB has the power to stay contracts and enforcement of collateral arrangements. In particular, it may stay any payment or delivery obligation deriving from any contract entered into by the credit institution for a maximum period that runs from the publication of exercise of such power to 5 p.m. on the following business day (although this power does not affect deposits with such credit institution).
- The FROB may also prevent or restrict the enforcement of collateral over any of the institution's assets for the limited period of time that the FROB considers necessary to achieve the resolution objectives (i.e. only in respect of resolved entities).
- In respect of financial collateral only, the FROB may stay the right of counterparties to declare the early acceleration or termination, or to seek the enforcement or netting, of any rights or obligations by virtue of the financial transactions and contractual netting agreements entered into under Royal Decree-Law 5/2005 (the Financial Collateral Regulation), due to the adoption of any restructuring, resolution or early action measure, for a maximum period that runs from the publication date to 5 p.m. of the following business day.
- Regarding management of hybrid and subordinated instruments (such as preferred shares or subordinated debt) as a result of action taken by the FROB, such action cannot be deemed an event of default or an early acceleration trigger of any of the credit institution's obligations vis à vis third parties. These measures will neither modify, stay nor extinguish the relationships between the credit institution and any third parties, nor grant any new rights or impose new obligations on the credit institution vis à vis such third parties. Additionally, any action taken in order to comply with the FROB may not be alleged by third parties to be an event modifying the ranking of debt of the relevant entity.
- In respect of restructuring and resolution processes, the measures taken by the FROB will be immediately effective, without the need of any corporate approvals or formalities or any requirements imposed by current legislation or contractually. In addition, the FROB's measures are protected against clawback in case of insolvency of the credit institution. Regarding resolution only, the opening of a resolution process or any measures adopted in the course of a resolution process cannot be deemed an event of default or an early acceleration trigger or an enforcement or netting event of any of the credit institution's obligations vis à vis third parties under agreements entered into by virtue of Royal Decree-Law 5/2005 (the Financial Collateral Regulation), save if the relevant agreement or transaction is not finally transferred to a third party or a bridge bank.

Please note that so far there is no conflict of laws rule approved for the application of any of the above measures to transactions entered into under ISDA Master Agreements or subject to any laws other than Spanish law. We understand that the Government shall clarify this sooner rather than later and, according to our understanding, the above rules may be applicable to agreements subject to foreign laws such as ISDA agreements.

If you need any more information please contact:

Beltrán Gómez de Zayas - beltran.gomezdezayas@cms-asl.com

Pablo Ruiz de Assín - pablo.ruiz@cms-asl.com

Will Dibble - will.dibble@cms-cmck.com

Nigel Dickinson - nigel.dickinson@cms-cmck.com

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CMS Albiñana & Suárez de Lezo

Génova, 27

28004 Madrid

Spain

T: (34) 91 451 93 00

F: (34) 91 442 60 45

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