MADRID
Castellana, 216
28046 Madrid
Tel.: (34) 91 582 91 00

BARCELONA
Diagonal, 640 bis
08017 Barcelona
Tel.: (34) 93 415 74 00

BILBAO
Alameda Recalde, 36
48009 Bilbao
Tel.: (34) 94 415 70 15

MALAGA
Marqués de Larios, 3
29015 Málaga
Tel.: (34) 952 12 00 51

VALENCIA
Gran Vía Marqués
del Turia, 49
46005 Valencia
Tel.: (34) 96 351 38 35

VIGO
Colón, 36
36201 Vigo
Tel.: (34) 986 44 33 80

BRUSSELS
Avenue Louise, 267
1050 Bruselas
Tel.: (322) 231 12 20

LONDON
Five Kings House
1 Queen Street Place
EC 4R 1QS Londres
Tel.: +44 (0) 20 7329 5407

LISBON
Avenida da Liberdade, 131
1250-140 Lisboa
Tel.: (351) 213 408 600

UPDATE ON THE SPANISH FINANCIAL RESTRUCTURING: LEGAL REGIME APPLICABLE TO RESTRUCTURING AND RESOLUTION OF CREDIT INSTITUTIONS (ROYAL DECREE-LAW 24/2012)

Banking and Capital Markets Department, Gómez-Acebo & Pombo SLP, Madrid/London

I. Introduction

On August 31, the Spanish Council of Ministers approved Royal Decree-Law 24/2012, on the orderly restructuring and resolution of credit institutions *("Real Decreto-Ley 24/2012, de 31 de agosto, de reestructuración y resolución de entidades de crédito")* (hereinafter, "**RDL 24/2012**"), which was published and came into force on that same day.

This complex and technical rule contains a structural reform of the Spanish financial system, required by the situation in which it is immersed since the Minister of Economy announced last June the need for a European bail-out of the Spanish banks and, in particular, by the Memorandum of Understanding on Financial-Sector entered into by Kingdom of Spain (hereinafter "**MoU**").

Main purposes of RDL 24/2012:

1. Regulate and introduce alternative procedures to manage difficulties of credit institutions different from those foreseen in previous applicable regulations and the Spanish Insolvency Act.

2. Redesign the functions of the Fund for Orderly Banking Restructuring (hereinafter, "**FROB**"), establishing a new legal regime for the FROB and repeal Royal Decree-Law 9/2009, of 26 June, on banking restructuring and reinforcement of own resources of credit institutions (hereinafter "**RDL 9/2009**").

3. Establish a new legal framework for hybrid instruments in accordance with the requirements envisaged in the MoU.

4. Establish a legal framework for the creation of an Assets Management Company (hereinafter "**AMC**") (also known as "bad bank").

II. Principles governing restructuring and resolution procedures

In accordance with art. 4 of RDL 24/2012, restructuring and resolution of credit institutions shall be based on the following principles:

- Shareholders will be the first to bear any losses.

- Subordinated creditors will bear losses derived from the restructuring or the resolution after shareholders and according to the order of priority established in the Spanish Insolvency Act, with the exceptions set forth in RDL 24/2012.

- Creditors with equal rank will be treated equivalently.

- No creditor will bear any losses above those it would have born if the institution were liquidated in accordance with the Spanish Insolvency Act.

- In case of resolution, directors will be substituted.

- Directors will be made liable for losses and damages caused in proportion to their participation in, and to the seriousness of, the damage, in accordance with insolvency, corporate and criminal regulations.

For the purposes above, in no event shall the FROB be treated as a shareholder or a creditor.

III. New procedures introduced by RDL 24/2012

RDL 24/2012 establishes three groups of procedures: (i) early actions, (ii) restructuring and (iii) orderly resolution. The main features of the referred procedures are the following:

1. **Early action measures** are envisaged for credit institutions that do not (or is reasonable to expect that they will not) comply with solvency, liquidity, organizational structure or internal control requirements, but are capable of returning to compliance by their own means, without prejudice to exceptional and limited public financial aid in the form of instruments convertible into shares (cocos) with a maturity of two years.

   When a credit institution is involved in any of the circumstances referred to in the paragraph above it shall notify so immediately to the Bank of Spain and shall file with the Bank of Spain an action plan within fifteen days from such notification.

   In the case that the Bank of Spain acknowledges that the credit institution is involved in such circumstances and the credit institution fails to notify, the Bank of Spain will require to the credit institution to analyze its situation and file an action plan within fifteen days from the requirement.

   Actions and measures to be taken by the credit institution will respond to the action plan that must be approved by the Bank of Spain within a month from its filing.

   In addition, in the case that public financial aid is requested, the action plan will also need a favorable report from the FROB.

   The action plan shall include a business plan setting forth specific objectives and commitments regarding solvency and improvement of efficiency, rationalization of management, improvement of corporate governance, reduction of structural costs and resizing of productive capacity. The implementation period of this plan cannot exceed three months from the date of approval, unless specifically authorized by the Bank of Spain.

   From the moment the Bank of Spain acknowledges that a credit institution is involved in any of the aforementioned situations, it may adopt the following measures:

   a) Call a shareholder meeting to adopt specific resolutions or agreements.

   b) Remove or replace members of the board or general managers.

   c) Require a plan to restructure debt with creditors.

d) Temporarily substitute the board.

e) Require recapitalization measures.

2. **<u>Restructuring procedure</u>** is envisaged for institutions that (i) present transitory weaknesses that can be superseded by injecting public funds to guarantee their viability and it is expected that such aid will be reimbursed or recovered or (ii) may not be resolved without serious damaging effects on the stability of the financial system.

The credit institution involved in any of the circumstances mentioned in the paragraph above will immediately inform the FROB and the Bank of Spain. Within fifteen days from the notification, the credit institution must present a restructuring plan setting forth the measures envisaged to secure the long term viability of the institution.

In the case that the Bank of Spain acknowledges that the credit institution is involved in any of the circumstances mentioned above and such credit institution fails to notify, the Bank of Spain will require to the credit institution to analyze its situation and file an action plan within fifteen days from the requirement.

The period in which the action plan shall be approved by the Bank of Spain and the execution period of such action plan will be the same as the periods envisaged in the early action procedure, but note that before the approval of the restructuring plan by the Bank of Spain:

The FROB will file with the Ministry for the Economy and Competitiveness and the Ministry of Finance and Public Administration an economic report regarding financial impact on public funds, and the Minister of Finance and Public Administration may oppose to it within five days from the filing of such report.

- The FROB may require amendments or additional actions over the restructuring plan.

- The Bank of Spain must request a report from competent authorities of relevant Regional Governments where the saving banks have their registered address.

The instruments to restructure the credit institutions are:

a) Financial aid by FROB through guarantees, loans or credits, acquisition of assets or liabilities or recapitalization measures (shares, capital contributions or convertible instruments to be subscribed/made by FROB and to be repurchased/redeemed/sold in a maximum term of 5 years).

b) Transfer of assets or liabilities to an asset management entity.

3. **The orderly resolution procedure** applies when an institution is non-viable[1] and it is necessary to avoid its liquidation in a bankruptcy procedure due to public interest and financial stability reasons.

   When a credit institution is involved in any of the abovementioned circumstances, the Bank of Spain, at its own initiative or at the FROB's proposal, will declare the immediate opening of the resolution procedure.

   Once the resolution procedure is opened, the Bank of Spain will order the substitution of the credit institution's governing body by the FROB. Within two months from its designation as governing body, the FROB shall prepare a resolution plan for the credit institution in which, among other things, it will establish the period of implementation of such plan.

   In application of this procedure, the business of the non-viable institution will be sold, or its assets or liabilities will be transferred to a bridge bank, or its assets or liabilities will be transferred to an asset management company.

   Nevertheless, previously to the opening of the resolution procedure, when the Bank of Spain considers that the conditions to the resolution are presented, it may adopt certain actions.

   In addition, financial aid (guarantees, loans or credits, acquisition of assets or liabilities or recapitalization measures) may be provided to business purchasers, bridge bank or asset management company, if required to facilitate implementation and minimize use of public funds.

IV. FROB's new regulation

The FROB is a public entity with legal personality and with public and private capacity for the development of its purposes.

In line with the MoU and for the purposes of addressing the difficulties in which the Spanish financial system is immersed, RDL 24/2012 amends the existing legal regime for the FROB, clarifies the function of the Spanish Deposits Guarantee Fund and establishes a clear separation between the functions attributed to the Bank of Spain and the Ministry for Economy and Competitiveness regarding authorization and sanction of credit institutions, allocating to the Bank of Spain some functions that before were allocated to the Ministry for Economy and Competitiveness.

RDL 24/2012 reinforces the FROB's authorities, becoming, together with the Bank of Spain, the public institution responsible for the restructuring and resolution of credit institutions.

It will be funded from the General State Budget and may raise funds from third parties with a limit for 2012 of €120 billion.

1 For purposes of RDL 24/2012 Law, a non viable institution is an institution that (i) significantly infringes or it is reasonably expected that it will significantly infringe in a near future its solvency requirements; or its outstanding liabilities exceed or it is reasonably expected that they will exceed in a near future its assets; or the institution cannot or it is reasonably expected that in a near future it will not be able to punctually fulfill its outstanding obligations and (ii) it is not reasonably expected that the institution can redirect the situation in a reasonable amount of time by its own means (art 20 RDL 24/2012).

It will have a Management Committee composed by representatives of the Ministry of Economy and Competitiveness, the Ministry of Finance and Public Administration and the Bank of Spain and will count with a general director with full executive functions.

The RDL 24/2012 establishes that the adoption of an early action, restructuring or resolution measure will not, on its own, constitute a breach nor will allow to declare an event of default or the early termination of any transaction or agreement or start enforcement or set off of rights or obligations arising from such transaction or agreement. Clauses establishing the aforementioned must be deemed as not included.

It is important to point out that the FROB may, as an administrative act:

- Suspend any payment or delivery obligation arising from any agreement signed by the credit institution within a maximum period that starts with the publication of the exercise of this power up to 5 p.m. of the following business day.

- Prevent or limit the execution of guarantees over any of the assets of the institution for a limited period of time that the FROB considers necessary to achieve the goals of the resolution procedure.

- Suspend the right of the counterparties to declare an event of default or early termination or enforcement or set off of any rights or obligation arising from financial collateral arrangement and netting agreements as a result of the adoption of any resolution or restructuring or early termination action for a maximum period that starts with the publication of the exercise of this power up to 5 p.m. of the following business day. On the completion of this period, if the assets or liabilities mentioned in the financial collateral arrangement and netting agreements have been transferred to a third party, the counterparty may not declare an event of default or the early termination or enforce or set off the rights or obligation arising from this transaction and agreements if the assets and liabilities have been transferred in accordance with the resolution instruments.

  Notwithstanding the aforementioned, the counterparty of a credit institution may declare an event of default or early termination of the guarantee or contractual compensation agreements or the correspondent operations and demand the enforcement or set off of any rights or obligations related with such agreements or operations as a consequence of an alleged –previous or subsequent to the transmission- breach, and not related with it.

In addition, RDL 9/2009, which created the FROB, is expressly repealed. Therefore, any references made to RDL 9/2009 shall be deemed made to RDL 24/2012.

V. Management of hybrid instruments

Taking into account to what is established in the MoU and the impact of the hybrid capital instruments and subordinated debt in the Spanish financial system, RDL 24/2012 establishes a special regime for the management of this type of instruments that is merely summarized below.

Restructuring and resolution plans must include actions regarding management of subordinated debt instruments and

hybrid capital instruments issued by the institutions, in order to secure an equitable distribution of restructuring or resolution costs, in compliance with EU State aid rules and with the objectives and principles established in RDL 24/2012 and, particularly, to protect financial stability and minimize the use of public funds.

The actions included in restructuring and resolution plans can affect hybrid instruments, such as preferred shares or convertible bonds, bonds and subordinated bonds or any other type of subordinated debt, with or without a maturity date, obtained by the credit institution, either directly or through a fully owned subsidiary.

Such management actions of subordinated debt instruments and hybrid capital instruments can affect all or some of the issues or financings referred above, but they must take into account the different order of priority that they may have among themselves.

In essence, for the allocation of restructuring costs, a mechanism is established by which holders of hybrid capital instruments may be obliged to assume part of the losses of an institution in crisis.

The actions to manage hybrid capital instruments and subordinated debt may involve, among others:

- Exchange offers for capital instruments.
- Repurchase through direct payment in cash or conditional to the subscription of capital instruments or any other banking product.
- Reduction of the debt's par value.
- Early redemption at a value different than par.

These actions must take into account the market value of the hybrid capital instrument or the subordinated debt instrument, applying a discount to the par value according to European rules. To the effects of determining the market value a report from an external expert is needed.

Management actions of hybrid capital instruments and subordinated debt agreed by the FROB, as well as the actions of the credit institution to comply with them, cannot be considered as an event of default or early termination of the obligations of the credit institution with third parties. In particular, such management actions as well as credit institutions' actions to complete and perform them, may not be claimed by third parties as an alteration to the ranking of the payment of the institutions' debt where invoked in litigation. As a result, management actions of hybrid capital instruments and subordinated debt shall not modify, suspend or extinguish credit institutions´ third party relations, and shall not give rise to new rights or impose new obligations on the credit institution towards third parties.

In addition, to avoid the problems derived from miss selling of this type of securities, the Spanish Securities Market Law *("Ley del Mercado de Valores")* has been amended by RDL 24/2012 introducing certain restrictions to the commercialization of hybrid capital instruments and subordinated debt going forward to guarantee the protection of retail investors and increase transparency in the commercialization of these products. From now on, a minimum placement of 50% among institutional investors is required and a minimum investment of €100.000 for non-listed entities and €25.000 for

listed entities. To these effects, the competences of the Spanish Securities & Exchange Commission (CNMV) are reinforced and non-suitable retail investors are required to hand write that they have been warned that the product is not suitable for them.

Moreover, and to protect investor's interests, RDL 24/2012 introduces other amendments to the Spanish Securities Market Law, regarding the prospectus information, the thresholds for offers that are exempt from the obligation to publish a prospectus and the information obligation.

VI. Asset Management Company (AMC)

In accordance with the MoU and notwithstanding what has been previously regulated, RDL 24/2012 announces the creation of an asset management company, merely drafting its role and that shall be further developed through implementing regulations.

Within 3 months from the date RDL 24/2012 entered into force, the FROB will incorporate such asset management company, to be named Sociedad de Gestión de Activos Procedentes de la Restructuración Bancaria, S.A., that will acquire the assets of those credit institutions determined by the FROB.

It will have the form of a corporation (*sociedad anónima*) and will be subsidiarily subject to the Spanish Corporations Act ("*Ley de Sociedades de Capital")* (hereinafter "**SCA**"). It will be entitled to issue bonds and other securities that recognize or create a debt without being subject to the limitation set forth in art. 405 SCA (i.e. the total outstanding amount of AMC's issued debt securities may exceed the subscribed capital plus reserves).

This mechanism will facilitate the removal of problematic assets from the balance sheet of credit institutions receiving public aid to ease their reorganization and viability. Therefore, it has a temporary nature. The FROB may cause the credit institutions receiving public aid to transfer to AMC their problematic assets, which will be determined in further regulation. The first assets to be transferred to AMC will be those of credit institutions in which the FROB now owns a majority of its shares and those institutions that, in the Bank of Spain's opinion after due assessment, will require a restructuring or resolution procedure.

Additionally, it will be possible to create groups of assets and liabilities of an asset management company that will be deemed as separate estates without legal personality, but which may be holders of rights and obligations as provided in RDL 24/2012. The legal regime of these entities shall conform to RDL 24/2012 and, subsidiarily, to the regulations applicable to venture capital funds and companies, securitization funds and mortgage securitization funds, as applicable, except they shall not be subject to the rules regarding portfolio quantitative and qualitative composition.

VII. Other aspects

1. RDL 24/2012 modifies the core capital requirements to be complied by credit institutions and consolidated groups, which were established in Royal Decree-Law 2/2011, of February 18th, for the reinforcement of the financial system (hereinafter "**RDL 2/2011**"). Specifically, the current requirement of 8%, in general, and 10% for institutions with difficult access to capital markets and for those in which wholesale financing predominates, will become a single

requirement of a 9% that must be fulfilled by every institution as from January 1, 2013.

RDL 24/2012 also modifies the definition of core capital to adapt it to the one used by the European Banking Authority in its recent recapitalizing exercise and Basel III. This amendment does not result a material alteration of the current requirements, except that now financial participations and certain securitization exposures will be penalized.

2. RDL 24/2012 Decree-Law establishes a lower limit to the fixed compensation for all concepts to be perceived by executive presidents, managing directors and directors of the credit institutions that, even when the FROB does not hold a majority share in their capital, receive financial aid. That maximum limit is lowered from the current 600,000 Euros to 500,000 Euros, but will not be applied to directors and board members who where appointed after the initiation of the integration process.

Schedule I

Executive Resume

	Factual situation	Relevant stages	Instruments	Recapitalization measures
Early action mesures	Credit institutions that do not comply with or there are objective reason for believing that they will not be able to comply with the solvency, liquidity, organizational structure or internal control requirements but is in a position to return to compliance by their own means, without prejudice to exceptional and limited public financial support.	1. Presentation of the plan of action to the Bank of Spain. 2. Approval by the Bank of Spain of the plan of Action. The approval of such plan will require a favorable report from the FROB, when the institution requires public financial aid. 3. Monitoring of the plan and report to the FROB	The Bank of Spain may adopt the following measures: a) require to call the shareholder meeting or directly call it to adopt specific resolutions or agreements. b) require the removal and replacement of members of the board or general manager, etc. c) agree the temporally replacement of the board of directors. d) adopt any measures established by the rules applying to organization and discipline of the credit institutions.	On an exceptional basis, the Bank of Spain may require recapitalization measures. The FROB may acquire ordinary shares or subscribe share capital contributions or convertible instrument, in which the period for repurchasing or redeeming into shares dos not exceed two years.

Restructuring	Credit institutions that (i) require financial support to guarantee their viability an it is expected that such support will be reimbursed or recovered, or (ii) where the resolution implies seriously damaging effect on the financial system's stability.	1. Presentation of the restructuring plan to the FROB and to the Bank of Spain. 2. The FROB may require a modification in the plan, before transferring it to the Bank of Spain. 3. Requirement of a report to the competent organisms of the Spanish Comunidades Autónomas where the credit institutions have their registered address. 4. Transfer from the FROB to the Ministry of Finance and Public Administration and the Ministry for the Economy and Competitiveness of an economic report detailing the economic impact of the plan. 5. Approval of the restructuring plan by the Bank of Spain.	a) Financial support: i) Issue of guarantees ii) Granting of loans or credits iii) Acquisition of assets o liabilities iv) Recapitalization measures b) Transfer of assets or liabilities to an asset management entity (bad bank).	The FROB may acquire ordinary shares or subscribe share capital contributions or convertible instrument, in which the period for repurchasing or redeeming into shares dos not exceed five years.

Resolution	Credit institutions that are unviable or is expected to become so in the near future, and for reason of public interest and financial stability it is necessary to avoid winding it up in accordance with the Spanish Insolvency Act.	1. Aperture of the resolution procedure. 2. Substitution of the governing body. 3. Enacting of the resolution plan by the Bank of Spain. 4. Enacting preliminary measures.	a) Sale of the entity's business. b) Transfer of assets and liabilities to a bridge bank. c) Transfer of assets and liabilities to an asset management entity. d) Financial support for the purchasers of the business, the bridge bank or the asset management company, when necessary to facilitate implementation and to minimize the use of public measures.	