

Royal Decree-Law 24/2012, dated 24 August, on the restructuring and resolution of financial institutions

On 31 August 2012, Royal Decree-Law 24/2012, dated 31 August, on the restructuring and resolution of financial institutions ("**RDL 24/2012**") was published in Spain's Official State Gazette.

1. Purpose of RDL 24/2012

The purpose of RDL 24/2012 is to regulate the orderly resolution processes of financial institutions and the early intervention and restructuring measures designed to deal with their situations of weakness, and to establish the legal regime of the Fund for Orderly Bank Restructuring ("**FROB**"), as it derives from Spain's aid programme, while fulfilling the obligations imposed by the Eurogroup through the Memorandum of Understanding.

This is due to the requirement that flexible and effective procedures be in place to ensure the stability of the financial system, at the lowest possible cost to society. This need to ensure stability likewise justifies that certain situations involving the temporary non-viability of financial institutions must be overcome by the injection of public funds, while always ensuring that the funds injected can be recovered within a reasonable period, through the profit generated by the financial institutions receiving the support.

Thus, RDL 24/2012 incorporates three types of measures which can be applied (**early intervention, restructuring measures and orderly resolution**), depending on the seriousness of the financial institution's situation, governing each case and the measures and instruments which may be adopted in relation to each. Among these measures and instruments is the possibility of creating a management company to take care of problematic assets in the context of the bank restructuring.

In addition, RDL 24/2012 modifies the FROB's organisational structure so as to avoid conflicts of interest due to the private sector's participation on its Governing Committee, and it strengthens its powers of intervention, especially in restructuring and resolution situations.

Lastly, it establishes another series of measures, including in particular the modification of the capital requirements and its definition, which both the consolidated groups of financial institutions and the entities not forming part of a consolidated group must comply with.

2. Early intervention

This is a procedure applicable to financial institutions which breach the requirements of solvency, liquidity, organisational structure and internal supervision, or when objective elements exist so that it is reasonably foreseeable that they will not be able to fulfil these requirements or any other requirement established by the rules on compliance and conduct, but which are in a position to regain the ability to comply on their own, notwithstanding the public and exceptional financial support established in RDL 24/2012.

In this case, the financial institution in question must immediately inform the Bank of Spain and simultaneously present an action plan indicating what actions it will take to ensure the institution's long-term viability and the foreseen term for its execution, which cannot exceed three months. The Bank of Spain can order the preparation of this action plan, if it becomes aware that a financial institution is in the non-viable situation described. The action plan must be approved

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by the Bank of Spain, and if the financial institution seeks public financial support, it will also require a favourable report from the FROB, which must be issued within ten days.

The Bank of Spain may adopt some or all of the **measures** listed below:

- Require the financial institution's management body to call, or call directly (if the management body fails to do so within the stipulated period) a general meeting of the financial institution's board or general meeting, proposing the agenda and the adoption of certain resolutions.
- Require the removal and substitution of members of the management body or general managers and the like.
- Require the drafting of a programme for the renegotiation or restructuring of its debt with some or all of its creditors.
- Adopt any of the measures established in the rules in force on rules on compliance and conduct.
- Should any of the above measures prove insufficient, decide to provisionally substitute the financial institution's management body.
- As an exception, order a recapitalisation.

3. Restructuring

This procedure applies to financial institutions requiring public financial support to ensure their viability, when objective elements exist which make it reasonably foreseeable that said support will be repaid or recovered within the established periods. In addition, the restructuring of a financial institution may be appropriate without the existence of said objective elements, when the orderly resolution of the financial institution may have seriously harmful effects on the stability of the financial system as a whole.

A restructuring plan will be needed which, following a favourable report from the FROB –which must be issued within ten days- will be subject to approval by the Bank of Spain and may require amendments or additional measures deemed necessary to ensure the financial institution's recovery from its deteriorated situation.

In these cases, the Bank of Spain can adopt any of the early intervention measures and order the implementation of the financial support or asset transfer instruments to an asset management company.

4. Resolution

This is the procedure applicable to a financial institution when the following two circumstances simultaneously affect it:

- The financial institution is non-viable or it is reasonably foreseeable that it will become non-viable in the near future.
- For public interest reasons, it is necessary or advisable to undertake the resolution of the financial institution, without insolvency proceedings allowing the objectives sought by this regulation to be adequately achieved.

Resolution is also appropriate when: the financial institution fails to present the required restructuring plan in time or it informs the Bank of Spain of the impossibility of finding a viable solution for its situation, or if the plan presented were not appropriate, in the opinion of the Bank of Spain, or the required additional measures or modifications were not accepted by the financial institution, or if the financial institution fails to comply with the implementation time table or any other specific measures contained in the restructuring plan, such that it jeopardises the achievement of the restructuring objectives.

Prior to beginning the resolution process, the **Bank of Spain** may adopt the following measures:

- Require the subscription of service agreements to ensure the provision of critical services, whether with group entities or with third parties.
- Require the restriction of the financial institution's exposure, on an individual and an aggregate level.
- Impose additional specific or regular information requirements.
- Require the divestment of specific assets.
- Require the restriction or cessation of certain activities the financial institution has been carrying out or which it

planned to carry out in the future.

- Restrict or prevent the development or sale of new lines of business or products.
- Require changes to the legal or operating structure of the financial institution, consolidated group or subgroup, reducing its complexity so that the critical services may be legally and financially separate from other services through the adoption of resolution measures.

Once the resolution process has begun, the management body will be substituted and the FROB will be appointed as administrator, which will prepare a resolution plan which must contain the conditions, resolution instruments, financial support measures and the financial assessment of the entity or of its corresponding assets and liabilities.

The resolution instruments, which may be adopted by the FROB individually or jointly, are as follows:

- The sale of the financial institution's business: The FROB may order and execute the transfer to an acquirer of the shares, participations or share capital contributions or, in general, instruments representing the financial institution's capital or equivalent or which may be converted into these (regardless of their holders) or all or part of the financial institution's assets and liabilities.
- The transfer of all or part of the assets and liabilities to a "bridge bank", which is a financial institution (including, as the case may be, the financial institution in resolution itself) in which the FROB has a stake, whose purpose is to carry out some or all of the financial institution's activities and manage some or all of its assets or liabilities during a five-year term.
- The transfer of assets or liabilities to an asset management company in order to maximise their price.
- Financial support for the acquirers of the business, the bridge bank or the asset management company, when necessary, to facilitate the implementation of the above instruments and to minimise the use of public funds.

5. Financial support instruments

Financial support from the FROB may take one or more of the following forms, among others:

- The granting of guarantees.
- The granting of loans or credits.
- The acquisition of assets and liabilities, maintaining its management or entrusting it to a third party.
- Recapitalisation, subscribing or acquiring ordinary shares or share capital contributions, or instruments which may be converted into these.

Depending on whether it involves restructuring or resolution processes, the financial support measures mentioned above may be adopted with regard to the financial institution, the entities of its group, the acquirer, a bridge bank or an asset management company.

In this regard, please note that, for the purposes of Spanish Insolvency Law 22/2003, of 9 July, the FROB's credits will be considered credits having a general privilege.

6. Creation of a management company for assets deriving from bank restructurings

Within three months of 31 August 2012, the FROB must incorporate, under the name Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A., an asset management company whose purpose is to acquire assets from those financial institutions determined by the FROB, for the exclusive purpose of possessing, directly or indirectly managing and administering, acquiring and disposing of the assets transferred to it by financial institutions, as well as any assets it may acquire in the future.

In this regard, according to the provisions of RDL 24/2012, the FROB may oblige a financial institution to transfer to an asset management company certain types of especially problematic assets or those assets which, if they were to remain on the financial institution's balance sheet, would be considered detrimental to its viability. The purpose of this would be to remove such assets from the balance sheet and to allow this to be managed separately.

The regulations will determine which assets are to be transferred by those financial institutions in which, at 31 August 2012, the FROB holds a majority stake, or which, in the opinion of the Bank of Spain and in view of an independent

assessment of their capital needs and asset quality underway when this Royal Decree-Law entered into force, must undergo a restructuring or resolution process.

Asset transfers will not require third-party consent. Prior to a transfer, value adjustments will be made according to the criteria established in the regulations, the Bank of Spain will determine the value of the assets and the FROB may require that they be grouped in any company or that any kind of operation be conducted on them, so as to facilitate their transfer.

Lastly, the transfer of assets will be subject to the following special conditions:

- The transfer cannot, under any circumstance, be the object of rescission by application of the clawback actions established in insolvency legislation.
- Article 1535 of the Spanish Civil Code will not apply to the transfer of credits which are considered litigious.
- The acquiring company will not be obliged to launch a take-over bid in accordance with securities market regulations.
- The transfer of assets will not constitute a case of succession or extension of tax or Social Security liabilities, except as established in Article 44 of the Revised Text of the Spanish Workers' Statute (*Ley del Estatuto de los Trabajadores*), approved by Royal Legislative Decree 1/1995, dated 24 March.
- In the event the transfer takes place, the asset management company will not be liable for the tax obligations incurred prior to said transfer and deriving from the ownership, exploitation or management of the assets by the transferring entity.

7. Management actions in relation to hybrid capital instruments and subordinated debt

These include: preferred stock, convertible bonds, subordinated bonds and obligations or any other subordinated financing.

These actions may be classified as either:

- Voluntary acceptance actions

RDL 24/2012 obliges the affected financial institutions to include, within any resolution or restructuring plan, actions for managing said hybrid capital instruments and subordinated debt, the implementation of which requires the consent of the affected parties. These actions may be:

- a) Exchange offers for capital instruments.
- b) Repurchase offers.
- c) Decreases in the face value.
- d) Early repayment at a value other than face value.

or

- Binding actions

These are actions adopted by the FROB with regard to those financial institutions for which a restructuring or resolution plan has been prepared. These actions are administrative in nature and may consist of:

- a) The deferral, suspension, elimination or modification of their terms and conditions.
- b) The obligation of the affected financial institution to repurchase the securities at a price determined by the FROB.
- c) Any other action.

The affected owners will not be able to claim from the affected financial institution or the FROB any type of financial compensation for any damages caused to them, notwithstanding the exercise of their rights under Articles 69 and 71 of RDL 24/2012.

Said actions cannot be alleged by third parties vis-à-vis the affected financial institution in the context of cross-default or similar clauses.

8. New framework governing the FROB

Royal Decree-Law 9/2009, dated 26 June, on bank restructuring and reinforcement of the equity of financial institutions, which contained the previous FROB regulations, has now been repealed, and a new framework for the FROB has been created under RDL 24/2012. In general terms, it follows the lines of the repealed Royal Decree-Law, although it includes certain new features, such as government supervision and co-operation and co-ordination with the various competent authorities on a national and international level. One of the most important measures is the modification of the composition of the FROB's governing body, eliminating the stake held by the financial institutions in it under the previous regulation, to avoid conflict of interest situations.

The new RDL 24/2012 gives the FROB a series of both commercial and administrative powers.

- In the case of financial institutions which have required financial support or the injection of public funds, the FROB will exercise the powers conferred on a general basis under **commercial** legislation:
 - a) To the management body of the institution, if the FROB acquires such status.
 - b) To the shareholders or holders of any securities or financial instruments, if the FROB has subscribed or acquired such securities or instruments.
 - c) To the board or general meeting, in those cases where the meeting hinders or rejects the adoption of the resolutions required to implement the restructuring or resolution measures, as well as cases where, due to special urgency, it is not possible to meet the requirements established by current regulations for the valid constitution and adoption of resolutions by the board or general meeting. In such cases, it will be understood that the FROB may exercise all the powers which, by law or pursuant to the by-laws, may correspond to the board or general meeting of the financial institution and which are necessary for the performance of its duties relating to the restructuring and resolution of financial institutions.
- Likewise, the FROB will be able to exercise, *inter alia*, the following **administrative** powers:
 - a) Determining the financial value of the institution or its corresponding assets and liabilities, in order to apply the measures and instruments established in RDL 24/2012.
 - b) Requesting any individuals or legal entities to provide any information necessary to prepare and adopt or apply a restructuring or resolution measure or instrument.
 - c) Ordering the transfer of shares, participations or capital contributions or, in general, instruments representing the financial institution's capital or equivalent or which may be converted into these (regardless of their holders), as well as the transfer of the institution's assets and liabilities.
 - d) Carrying out share capital increases or decreases.
 - e) Performing management actions in relation to hybrid capital instruments and subordinated debt.
 - f) Determining the instruments on which the restructuring or resolution measures are based.
 - g) Arranging immediately, pursuant to a report by the Spanish Securities Market Commission, the transfer of securities deposited at the financial institution, to another institution authorised to carry out the same activity.
 - h) In relation to the transfer of the institution's securities, financial instruments, assets or liabilities, the FROB may require the entity and the purchaser to provide the necessary information.
- Lastly, the FROB will be able to exercise the following **administrative** powers in relation to the suspension of agreements and guarantees:
 - a) Suspending any payment or delivery obligations deriving from any agreement entered into by the financial institution, for a maximum period commencing upon the announcement of the exercise of such power, up to 5 pm on the following business day, which will not apply to any current deposits with the institution.
 - b) Preventing or limiting the enforcement of guarantees over any of the financial institution's assets, for a limited period of time, as deemed appropriate by the FROB to achieve the resolution objectives.
 - c) Suspending the right of the counterparties to declare early maturity or termination or to request the enforcement or compensation of any rights or obligations related to the financial operations and contractual

compensation agreements referred to in section 2 of chapter II, title I of Royal Decree-Law 5/2005, dated 11 March, as a result of the adoption of any resolution, restructuring or early intervention measures, for a maximum period commencing upon the announcement of the exercise of such power, up to 5 pm on the following business day.

The counterparties cannot exercise their termination rights on the basis of the transfer of the aforementioned assets, if this is carried out within the period indicated above. After the transfer, the counterparties will be entitled to exercise their rights in accordance with the terms of their respective agreements, although the transfer itself will remain "protected" with respect to such termination rights.

- The administrative acts ordered by the FROB will be enforceable without being subject to any approval, ratification, consent, non-opposition or any other procedures or prerequisites.

9. Procedural regime

- The decisions and resolutions adopted by the FROB in the exercise of its commercial powers may only be challenged according to the regulations and procedures established for the challenge of corporate resolutions of Spanish companies (*sociedades de capital*) in the event such resolutions do not comply with the law.
- The approval by the Bank of Spain of the early intervention, restructuring and resolution measures will replace former administrative actions and can be appealed before the Contentious-Administrative Division of the Spanish Court *Audiencia Nacional*. Opposition against the approval of such measures can be filed jointly against the Bank of Spain and the FROB.
- The acts and decisions of the FROB issued in the context of early intervention, restructuring and resolution measures will replace former administrative actions and can be appealed before the Contentious-Administrative Division of the Spanish Court *Audiencia Nacional*.
- Once restructuring or resolution processes have begun, judges cannot admit any applications for insolvency from the financial institution; such actions will be deemed void *ab initio*.

10. Other significant modifications

- RDL 24/2012 modifies the capital requirements which must be met by the consolidated groups of financial institutions, as well as the institutions that do not form part of a consolidated group, established in Royal Decree-Law 2/2011, dated 18 February, in order to reinforce the financial system. Specifically, the current requirements of 8% as a general rule and 10% for entities with difficult access to capital markets and for those for which wholesale funding is predominant, become a single requirement of 9% that all financial institutions must comply with as from 1 January 2013. The new RDL 24/2012 also modifies the definition of capital requirements, with respect to both the computable elements and deductions, in order to adapt it to the definition established in the recent European Banking Authority recapitalisation exercise.
- The event of obligatory resolution due to losses resulting in a decrease in equity to an amount that is less than half the capital, established in paragraph e) of Article 363.1 of the Restated Spanish Companies Act, will not apply to financial institutions which are controlled by the FROB or whose management body is controlled by the FROB, and neither will the regime established in section 2 of chapter I, title X of the said Act apply to such institutions or their administrators.
- Likewise, the provisions of Article 327 of the Restated Spanish Companies Act, referring to the obligation to decrease capital on account of losses which reduce the equity to below two-thirds of the capital figure, will not apply to these financial institutions.
- RDL 24/2012 modifies Law 2/2012, dated 29 June, on General State Budget for the year 2012, establishing: a cap of 120,000 million euros on external financing obtained by the FROB during the 2012 budget period, that the maximum amount of guarantees to be granted by the State during 2012 cannot exceed 258,278,560,000 euros, and that, of such amount, 96,235,000,000 euros are reserved for the granting of guarantees to secure financial commitments derived from bonds and obligations issued by financial institutions resident in Spain which are very active in the national credit market, of which 55,000,000,000 euros are reserved for those guarantees granted

after the entry into force of the said Law on General State Budget for the year 2012.

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