

**Royal Decree-Law 24/2012, of 31 August, on restructuring
and resolution of credit entities**



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1. INTRODUCTION

Last 31 August, the Spanish Council of Ministers passed the Royal Decree-law 24/2012, on restructuring and resolution of credit entities (the "**RDL 24/2012**") which entered into force on such date immediately following its publication in the Spanish Official Gazette (*Boletín Oficial del Estado*). This rule is the third reform of the financial sector carried out in 2012, after the Royal Decree-law 2/2012, of 11 February, on reorganization of the financial sector and the Royal Decree-law 18/2012, of 11 May, on reorganization and sale of real estate assets of the financial sector.

The main purposes of the RDL 24/2012 may be summarized as follows:

- (a) Establishing a legal framework for the management of crisis situations in credit entities, as further detailed in section 2 below.
- (b) Establishing a new legal framework for the Spanish fund for the orderly restructuring of the Spanish financial system (the "**FROB**"), as well as vesting new powers in the FROB, as further detailed in section 5 below.
- (c) Complying with certain commitments assumed by Spain pursuant to the memorandum of understanding on financial sector policy conditionality dated 20 July 2012 (the "**MoU**"). In particular, RDL 24/2012
 - (i) approves the regulation that, according to the MOU, should have been implemented by the end of August 2012 (i.e., (a) hybrid capital and subordinated debt instruments related regulation; (b) rules aimed at strengthening the powers granted to the FROB; and (c) regulation governing the incorporation of an asset management company -the so called "bad bank"-); and
 - (ii) implements other regulations contained in the MoU, such as the amendment of the core capital requirements for credit entities, the removal of the representatives of the private financial sector in the FROB's management body or the protection of retail investors who acquire complex financial products which are not covered by the Deposit Guarantee Fund of Credit Entities (the "**DGFCE**").

2. CREDIT ENTITIES CRISIS

The RDL 24/2012 establishes a framework for the management of crisis situations affecting credit entities in line with the proposal made last 6 June 2012 by the European Commission 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.

2.1 Procedures

RDL 24/2012 contemplates three different procedures depending on the nature and materiality of the crisis affecting the relevant credit entity. Such procedures are aimed at (i) ensuring the continuity of the essential functions of the affected entities; (ii) ensuring their long term viability; and (iii) preserving the stability of the financial sector.

(a) Early intervention

The early intervention is the procedure applicable to a credit entity that:

- (i) fails to comply (or it is reasonably likely that will fail to comply) with its solvency, liquidity, structure or internal control requirements; and
- (ii) it is, however, in a situation where the entity is able to comply again with the aforementioned requirements using its own resources, without prejudice to the public exceptional and limited financial support that could be requested.

Among the measures that may be taken by the Bank of Spain in the context of an early intervention procedure, it is worth pointing out the following:

- (i) the dismissal and replacement of the members of the Board of Directors or general managers, including the possibility of provisional substitution of the managing body as a whole, becoming in the latter case the management entrusted to the FROB;
- (ii) request the drafting of a plan for the renegotiation or restructuring of its debt with all or some of its creditors; and
- (iii) exceptionally, and if so supported by the FROB, recapitalization measures.

The abovementioned recapitalization measures are limited to the subscription or acquisition by the FROB of instruments convertible either in ordinary shares or in share capital contributions in the relevant entity. In any event the repurchase or amortization date of such instruments shall not go beyond two years.

The rest of the recapitalization measures are only available within the scope of restructuring or resolution procedures.

(b) **Restructuring**

Restructuring is the procedure applicable to a credit entity that:

- (i) requires public financial support in order to ensure its viability, provided that it is reasonably likely that such financial support will be reimbursed or recovered; or
- (ii) its resolution could not be carried out without substantial adverse effects on the stability of the financial sector.

Entities in such scenario shall submit a restructuring plan to the FROB. The FROB can request amendments to the plan or additional measures before submitting the plan to the Bank of Spain for its approval. This plan shall include, among others, (i) the analysis justifying the entity's capacity to reimburse the requested public financial support or, alternatively, the analysis of the substantial adverse effects on the stability of the financial sector that would arise from the entity's resolution; and (ii) the measures which shall be implemented for minimizing the use of public resources and, in particular, the management actions regarding hybrid capital and subordinated debt instruments.

The restructuring instruments contemplated in the RDL 24/2012 in this scenario are:

- (i) financial support measures, in the terms detailed in section 2.2 below; and
- (ii) the transfer of assets or liabilities to an asset management company in the terms further detailed in section 3 below.

(c) **Resolution**

The resolution is the procedure applicable to a credit entity that:

- (i) is not viable¹ or it is not reasonably likely that it will be viable in the near future; and
- (ii) for public interest reasons and financial stability it is required to avoid its winding up in the context of an insolvency proceeding.

Likewise, the resolution of the entity will occur when, together with the condition set out in paragraph (ii) above, any of the following circumstances occurs:

- (i) the credit entity does not submit the restructuring plan or it informs the Bank of Spain about the impossibility of finding a viable solution;
- (ii) the restructuring plan proves to be inadequate in the opinion of the Bank of Spain;
- (iii) the amendments or additional measures requested by the FROB are not accepted by the relevant entity; or
- (iv) the entity fails to comply with the implementation term or with any of the measures contained in the restructuring plan, risking the achievement of the restructuring objectives.

The Bank of Spain has the authority to initiate the resolution procedure. Once initiated, the Bank of Spain will decide the substitution of the management body of the relevant credit entity (unless the FROB controls such management body). The FROB will make a resolution plan for such entity or, as the case may be, will determine the appropriateness of the opening of an insolvency proceeding. The resolution plan will be subject to the Bank of Spain approval.

Certain preliminary measures may be taken by the Bank of Spain in advance to the initiation of the resolution procedure, such as (i) the subscription of services agreements to ensure the effectiveness of the critical services; (ii) the limitation of the entity's exposure (on and individual or on a consolidated basis); and (iii) the request of changes in the legal or operational structure of the entity.

The resolution instruments provided in RDL 24/2012 are:

¹ A credit entity will be considered non viable provided that the following two requirements are met: (a) the relevant credit entity is under any of the following circumstances (i) fails to comply with its solvency ratios; (ii) its demanded liabilities are higher than its assets; or (iii) it will not be able to perform the demanded obligations; and (b) it is not reasonably likely that it will be able to change the situation by its own means.

- (i) the sale of the business of the relevant credit entity.
- (ii) the transfer of the assets and liabilities to a "bridge bank" (*banco puente*) (the bridge bank shall be a credit entity -including, as the case may be, the affected credit entity itself-, participated by the FROB, which corporate purpose is the development of all or part of the activities of the affected credit entity and the management of all or part of its assets). Such bridge bank will be managed with the purpose of being sold (or its assets and liabilities), once the market conditions are improved and, in any case, within five years from its incorporation or acquisition by the FROB.
- (iii) the transfer of assets and liabilities to an asset management company, as detailed in section 3 below.
- (iv) the financial support to the business acquirers, the bridge bank or the asset management company, when it is deemed necessary to ease the implementation of the abovementioned instruments and to minimize the use of public resources.

The transactions by virtue of which the resolution measures are implemented will not be subject to claw-back actions in case of insolvency.

(d) **Common conditions to early intervention, restructuring and resolution procedures**

The adoption of early intervention, restructuring or resolution measures will not constitute by itself an event of default and will neither allow any counterparty to declare the early termination of any transaction or agreement nor the set-off of any right or obligation arising from such transaction or agreement. Any provisions agreed between the relevant parties to the contrary shall be deemed null and void.

2.2 Financial support instruments

The FROB's financial support instruments for credit entities in a restructuring or resolution process may involve, among others, one or several of the following measures:

- (a) Granting guarantees.
- (b) Granting loans or credits.
- (c) The acquisition of assets and liabilities.
- (d) The acquisition or subscription of recapitalization instruments, which may consist in:
 - (i) Ordinary shares or share capital contributions.

The divestment by the FROB of the ordinary shares or share capital contributions will be carried out within 5 years from the date of their acquisition or subscription.

- (ii) Instruments convertible in ordinary shares or in share capital contributions.

Notwithstanding what it is stated in section 2.1.a) above for the early intervention scenario, the credit entity shall commit itself to purchase or redeem such instruments as soon as it is able to do so and, in any event, within a five year term (period which may be extended for an additional term of two years in the event that the financial and economic situation or the market conditions prevent the compliance of the relevant plan).

The payment of the price for the acquisition or subscription of such capitalization instruments could be made (i) in cash, (ii) delivering public debt securities, securities issued by the European Facility for the Financial Reorganization (*Facilidad Europea de Estabilización Financiera*), by the European Reorganization Mechanism (*Mecanismo Europeo de Estabilidad*) or by the FROB; or (iii) setting-off the credits held by the FROB against the affected entities.

3. ASSET MANAGEMENT COMPANY

One of the main novelties of RDL 24/2012 is the authority vested in the FROB to oblige a credit entity to transfer to an asset management company certain categories of assets specially damaged or which permanence in the balance sheet of the credit entity is considered to have a negative impact in its viability, in order to clean up the affected credit entity's balance sheet and allow the independent management of the referred asset.

The abovementioned transfer of assets will not require any third parties' consent or the fulfillment of the requirements applicable for structural changes and it will not be subject to insolvency claw-back actions. Further, such credits will not

be considered as a litigious credit for the purposes of article 1,535 of the Spanish Civil Code and will not be considered as a transfer as an on going concern for tax and Social Security liability purposes. Likewise, the acquirer company will not be obliged to submit a tender offer (*Oferta Pública de Adquisición*) and will not be responsible for the tax obligations accrued before such transfer arising from the ownership or management of the assets by the transferor.

The FROB shall incorporate with the corporate name of "*Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A.*", a public limited liability company (*sociedad anónima*), with the exclusive corporate purpose of acquiring the assets from credit entities which at the time the RDL 24/2012 enters into force are majority participated by the FROB or which may require the opening of a restructuring or resolution procedure. The public participation in such asset management company will be in any case less than 50%. Not only the FROB, but also the DGFCE, the credit entities, other institutional investors and the entities so authorised by coming regulations may become shareholders of the asset management company.

Likewise, pursuant to the Eighth Additional Provision of RDL 24/2012, the contribution of the relevant assets to such asset management company shall involve the fulfillment of the obligations contemplated in Royal Decree-law 18/2012 in relation to the contribution of assets received as payment of debts to *ad hoc* companies incorporated by credit entities under the terms of such Royal Decree-law 18/2012. RDL 24/2012 further provides for the possibility of transferring to the asset management company the shares in the abovementioned *ad hoc* companies, provided that, at the moment of the transfer, the relevant assets have already been contributed to such companies.

4. HYBRID CAPITAL AND SUBORDINATED DEBT INSTRUMENTS

4.1 Actions regarding hybrid capital and subordinated debt instruments

One of the guiding principles of RDL 24/2012 is that subordinated debt creditors must bear part of the losses arising from the restructuring or the resolution of the credit entity, in an amount not higher than those that would arise in case that the affected entity was wound-up in an insolvency proceeding.

The restructuring and resolution plans shall include actions regarding the hybrid capital and subordinated debt instruments which have been issued by credit entities. Such actions may affect the issuances of hybrid capital instruments (as preferred stock or convertible bonds) as well as any bond or subordinated obligation, and may involve, among other measures:

- (a) Offers for the exchange of the relevant instruments for capital instruments of the credit entity, whether shares or other kinds of capital contributions.
- (b) Offers for the repurchase of securities.
- (c) Decrease of the nominal value of the debt.
- (d) Early redemption at a value other than par value.

These measures will not be mandatory for the investors unless otherwise imposed by the FROB if deemed necessary to (i) ensure an adequate distribution of the credit entity's restructuring or resolution costs, according to the regulation on State aids from the European Union, trying to minimize the use of public resources; or (ii) preserve or restore the financial condition of the credit entities that are supported by the FROB.

Should the measures be binding for the investors, such measures will most likely result in:

- (a) The deferment, suspension, deletion or amendment of certain rights, obligations, terms and conditions of all or some of the entity's hybrid capital and subordinated debt instruments.
- (b) The repurchase by the affected entity of the relevant securities at a price determined by the FROB.

4.2 Commercialization to retail investors of preferred stock, convertible bonds and subordinated financing treat as equity

The RDL 24/2012 introduces amendments to the rules governing the commercialization to retail investors of preferred stock, convertible bonds and subordinated debt regarded as equity. In particular, pursuant to RDL24/2012 (i) any offers for such products must include a tranche for professional investors; (ii) minimum amounts for the subscription of such products are established; and (iii) other measures aimed at ensuring that the retail investor are fully aware of the risks associated to the relevant investment are implemented.

5. OTHER AMENDMENTS

5.1 Powers of the Bank of Spain

With effects on 1 January 2012, the powers to (i) authorize the incorporation of credit entities, as well as the establishment in Spain of branches of credit entities not authorized in any EU Member State; and (ii) impose severe sanctions to credit entities, shall be vested in the Bank of Spain.

Currently, the aforementioned powers are conferred to the Ministry of Economy and Competitiveness, save as for the sanction to revoke the banking license, which is currently imposed by the Council of Ministers.

5.2 Core capital of credit entities

(a) Strengthening of the solvency

The RDL 24/2012 amends the credit entities core capital requirements. As from 1 January 2012, the only requirement will be to have a 9% over their total exposures weighted by risk, calculated in accordance with the regulations dealing with equity of credit entities.

Currently, the percentage is established at 8% as a general rule, and at 10% for credit entities with difficulties in accessing to the capital markets.

(b) Concept of core capital

The RDL 24/2012 amends the definition of core capital in order to adapt it to the definition provided by the European Banking Authority.

5.3 Limitation of the remuneration of directors and officers

For credit entities not majority participated by the FROB, the RDL 24/2012 establishes a maximum threshold of €500,000 for the fixed remuneration of the executive chairmen, the CEOs and the managers of Spanish banks which have been supported by the FROB.

5.4 Provisional Regime

The regime established in RDL 24/2012 with regards to the restructuring procedures will be also applicable to restructuring procedures of credit entities already in progress (but not yet completed) on 31 August 2012 pursuant to Section II Title I of Royal Decree-law 9/2009.

Likewise, for the purposes of RDL 24/2012, it will be considered that the entities that had received financial support from the FROB according to Title II of Royal Decree-law 9/2009 are deemed to be in a restructuring procedure and those entities subject to a restructuring procedure according to article 7 of Royal Decree-law 9/2009 shall be deemed involved in a resolution procedure.

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