

Client Alert

Latham & Watkins
Corporate Department

Royal Decree Law 24/2012 Addresses Restructuring and Termination of Spanish Credit Entities

The Spanish Council of Ministers has approved the Royal Decree Law 24/2012 (the RDL 24/2012), for the restructuring and termination of Spanish credit entities. This RDL entered into force on 31 August 2012.

The approval of the RDL 24/2012 is the result of implementing the recapitalization plan of the Spanish financial system, which the Spanish government agreed to in its Memorandum of Understanding with the Eurozone (the Memorandum of Understanding). With this law, it also anticipated that Spain has implemented the major requirements of the EU Crisis Management Directive regarding the recovery and resolution of credit institutions.

Potential Measures On Distressed Financial Entities

The new legislative framework introduced by the RDL 24/2012 aims to preserve the financial stability of Spanish credit institutions, protect depositors and the public in the event of a banking crisis and put in place certain burden sharing mechanisms in financial crisis. The law also provides for the establishment of asset management companies to strengthen the Spanish financial system.

The RDL 24/2012 outlines three types of measures for credit entities, based on its level of impairment as determined by the Bank of Spain:

a) Early Action Measures

Early action measures shall be put in place if a credit entity fails or is likely to fail to meet its solvency, liquidity, organizational structure or internal control requirements, provided that it is likely that the financial entity may overcome this situation by its own means (although, under extraordinary circumstances, such entities could receive public financial support). In such a scenario, the entity must put forward an action plan to the Bank of Spain for approval that clarifies long term viability without public financial support.

The Bank of Spain, as supervisor of these "early action" measures, may, among other things, require the temporary resignation or replacement of the members of the management body of the financial entity. It may also, under exceptional circumstances, require the financial institution to undergo recapitalization measures by issuing convertible instruments into shares, where the period of reconversion or repurchase may not exceed two years.

"New corporate and managing powers are granted to the fund for the orderly restructuring of the banking (FROB)."

b) Restructuring Measures

The restructuring measures can be implemented on a financial entity when public financial support is required to guarantee its viability and there are objective elements that indicate that the entity has the capacity to repay that public support within the expected time limits. In addition, when the termination of the entity may cause serious damaging effects to the stability of the financial system as a whole, the restructuring of a credit institution may be carried out without taking the objective elements into consideration.

The entities under such circumstances have to inform the Bank of Spain and the FROB (*Fondo de Reestructuración Ordenada Bancaria*), and must submit a restructuring plan detailing the measures planned to ensure the long-term viability of the institution. The restructuring measures may include: (i) public financial support from the FROB and (ii) the transfer of assets and financial liabilities to an asset management company.

c) Termination Measures

The termination of a credit entity must take place when the following two circumstances are simultaneously fulfilled: (i) the entity is no longer viable or will not be viable in the foreseeable future and (ii) termination is preferable to an ordinary insolvency.

The concept of viability is defined in the RDL 24/2012. An entity is no longer viable when: (a) it is either: (i) not in compliance with the its applicable solvency ratio; (ii) its liabilities are higher than its assets or (iii) it cannot or may not be able to meet its outstanding payment obligations and (b) the credit entity is not in a position to resolve the situation on its own in the foreseeable future.

It is the Bank of Spain, at its own initiative or at the request of the FROB, that will establish the commencement of the termination process. After the commencement of the termination process, the Bank of Spain will replace the governing body of the entity and appoint the FROB as provisional manager. The FROB then must submit a termination plan to the Bank of Spain or determine the opening of an insolvency procedure.

The RDL 24/2012 sets forth a list of termination instruments that the FROB can use:

- Sale of the credit entity's business to a third party, either through the sale of shares or the sale of its assets and liabilities. The sale neither requires the consent of the shareholders or any third parties, nor the fulfillment of the procedural requirements established by Spanish corporate law pursuant to the law on structural modifications of commercial companies (*Ley de Modificaciones Estructurales*).
- Transfer of the assets and liabilities of the entity to a "bridge bank", which is a credit entity held by the FROB the purpose of which is to oversee the development of all the activities of the entity in termination and the management of all or part of its assets and liabilities. The "bridge bank" will be managed with the goal that it, or its assets and liabilities, can be sold within a 5-year period.
- Transfer of the assets and liabilities to an asset management company in which the FROB retains a stake to maximize the price.
- The FROB may also adopt instruments of financial support. These instruments of financial support may include: (a) granting guarantees; (b) the provision of financing; (c) the acquisition of assets and liabilities or (d) recapitalization measures. Recapitalization measures may be provided in the form of subscription by the FROB of equity instruments, or convertible obligations that can be exchanged into equity instruments that the credit entity will have to redeem or repurchase within a 5-year period.

The Joint Management of the Impaired Assets of the System: Creation of an Asset Management Company

In compliance with the commitments assumed under the Memorandum of Understanding, RDL 24/2012 establishes that credit entities that are held by the FROB, in whole or in part, are obliged to transfer their "impaired" assets to the referred asset management company. The entities that, as a consequence of due diligence exercises established by the FROB, must undergo a restructuring or termination process are also obliged to transfer their "impaired" assets.

The type of assets to be transferred and the framework of action and legal regime of the asset management company are subject to regulatory development which is expected to be passed before the year end. Such companies will be organised as a public limited company and operate under the name "Asset of the Bank Restructuring Management Company, S.A. (*Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A.*)."

a) Management Measures on hybrid instruments

The RDL 24/2012 also foresees two types of measures to manage hybrid instruments: (i) voluntary management measures and (ii) management measures imposed by the FROB.

Voluntary management measures may include:

- (a) Exchange offers for equity instruments; (b) pure repurchase offers or reinvestment offers in equity instruments or other bank products; (c) reductions of securities nominal value and (d) early repayment under par. The measures provided in sections c) and d) above require the previous consent of the applicable investors for the amendment of its terms.

Management measures imposed by the FROB can be count on any of the following:

- The deferment, suspension, termination or amendment of certain rights, obligations, terms and conditions of all or some of the debt issuances of such credit entity;
- The obligation of the entity to repurchase the affected securities for the price determined by the FROB; and
- Any other management measure that the entity may adopt voluntarily.

b) Clarification of the Role of the Bank Deposit Guarantee Fund

Following the guidelines from the IMF, RDL 24/2012 has clarified that the role of the Bank Deposit Guarantee Fund is to act as the guarantor of deposits, although in exceptional circumstances it may participate in the termination processes by providing financial support.

New Powers of The Fund for the Orderly Restructuring of Banking (FROB)

One of the main aspects of the RDL 24/2012 is the reform of the FROB. The Memorandum of Understanding, calls for the untying of the FROB from credit entities to avoid the appearance of a conflict of interest.

The FROB will exercise the necessary powers for the application of any measures provided in the RDL 24/2012. In this respect the FROB has the following new corporate and administrative powers:

- **Corporate powers:** Besides exercising the powers granted in the corporate legislation to the management body (when it takes over control of the financial entity) or any shareholders (if holding a stake in a financial entity) the FROB may exercise the powers that correspond to a general shareholders meeting or to the general assembly when the restructuring or termination is happened or when necessary resulting from emergency reasons.
- **Administrative powers:** Among the administrative powers given to the FROB, the most important are: (i) the ability to order the transfer of equity or convertible instruments, no matter their holders, as well as the assets and liabilities of the entity; (ii) the ability to make capital increases and decreases, and issue and redeem liabilities, being entitled to determine the exclusion of the preemptive subscription rights or (iii) the ability to transfer the securities held in another entity by submitting previously a report to the Spanish Securities Exchange Commission (CNMV).

Other Important Points

Core Capital: The capital ratio changes to 9 percent for all the entities. The definition of core capital is modified to align it with the definition given by the European Banking Authority.

Ongoing restructuring processes: The entities that received financial support from the FROB in accordance with the RDL 9/2009, will be subject to a restructuring process.

In any event, the Bank of Spain may decide, at any time, to commence the termination process for any credit entity that has received financial support from the FROB in accordance with RDL 9/2009, if the requirements established in the RDL 24/2012 are met.

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