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## New Royal Decree-Law for the rationalization of the Spanish financial system.

### A NEW ROYAL DECREE-LAW FOR THE RATIONALIZATION OF THE SPANISH FINANCIAL SYSTEM HAS BEEN APPROVED

Following the approval in February 2012 of Royal Decree-law 2/2012 ("**RDL 2/2012**"), the Spanish Council of Ministers has approved a new Royal Decree-law 18/2012 ("**RDL 18/2012**"), which came into force on 12 May.

Through RDL 2/2012, Spanish financial institutions were required to set aside new provisions in connection with real estate loans (the "**Loans**") as well as plots of land and real estate assets on their books received as a consequence of the foreclosure of mortgages or arrangements with the underlying debtor (jointly, the "**Real Estate Assets**").

RDL 18/2012's aims are to dispel the uncertainties surrounding the Spanish financial system and complete its reforms. For such purposes, it (i) sets forth new provisioning requirements for the Loans held by Spanish financial institutions classified as "normal" ("*riesgo normal*") (RDL 2/2012 had focused mainly on provisioning requirements for Loans classified as "doubtful" ("*riesgo dudoso*") and "sub-standard" ("*riesgo subestándar*") and for Real Estate Assets) and (ii) forces Spanish financial institutions to contribute their Real Estate Assets to newly incorporated S.A. companies, which will be in charge of managing and selling them in the market.

#### NEW PROVISIONING REQUIREMENTS

- Financial institutions are generally required to comply with the following provisioning requirements for Loans classified as "normal" ("*riesgo normal*") before 31 December 2012. These provisions will be additional to those demanded by RDL 2/2012.
- The new provisioning requirements (conceived in all cases as "one-off" generic provisions) are as follows (the relevant percentages apply to the outstanding nominal amount as calculated on 31 December 2011):
  - For Loans secured by plots of land, a provision of 45%.

- For Loans secured by real estate assets whose building work is on-going, a provision of 22%.
- For Loans secured by real estate assets already completed, a provision of 7%.
- For unsecured Loans, a provision of 45%.
- Financial institutions will have to present a plan (the “**Plan**”) to the Bank of Spain by 11 June 2012:
  - The Plan will detail the measures that they pretend to implement in order to comply with these provisioning requirements, including a programme of divestment of risky real estate assets and a schedule for its execution.
  - In the event that the Plan provides that, once the new provisions are made, the relevant financial institution may have a shortfall in core capital (“*capital principal*”) or equity (“*recursos propios computables*”), it will also need to detail the measures to be adopted to avoid such shortfall (which must be implemented in no more than 5 months).
  - The Plan will have to be approved by the Bank of Spain within 15 business days of submission. The Bank of Spain will be entitled to request the inclusion in the Plan of amendments or additional measures (including the need to request financial support from the Fund for the orderly restructuring of the Spanish financial system (the “**FROB**”) via the subscription by the FROB of shares or financial instruments convertible into shares of the financial institution).
  - The serious infringement of any of the provisions of the Plan which may endanger the fulfilment of its objectives may lead the Bank of Spain to agree the restructuring of the relevant financial institution (and the appointment of the FROB as its provisional director), pursuant to article 7 of Royal Decree-law 9/2009.
- However, those financial institutions participating in integration processes during 2012 are granted an extension to comply with the provisioning requirements described above:
  - Therefore, such financial institutions will need to comply with such requirements within 12 months after the integration process has been authorized.
  - In order to benefit from this extra time, the integration process needs to comply with the following features:
    - The integration process needs to be carried out pursuant to a corporate restructuring (e.g. through a merger, spin-off, global assignment of assets and liabilities, etc.) or the sale by the FROB of its stake in

the share capital of a financial institution majority-owned by it or where it has been appointed as its provisional director.

- The institutions participating in the process will need to improve their corporate governance rules.
- The integration project will detail how the integration process will increase the credit available for Spanish families and small and medium sized enterprises and will need to include a plan for divestment of risky real estate assets.
- Those institutions having issued preferred securities (“*participaciones preferentes*”) or mandatory convertible bonds prior to the entry into force of RDL 18/2012 will be allowed to include in their Plan the request to defer payment of the relevant remuneration / interest for no more than 12 months in the event that, as a consequence of their compliance with the provisioning requirements described above, they no longer have enough distributable profits or reserves to satisfy the relevant remuneration or there is an equity shortfall in the issuing institution or in its parent company. In any case, payment of the deferred remuneration can only be made, once the relevant period has elapsed, if the financial institution has sufficient distributable profits or reserves and such equity shortfall no longer exists.

#### **CONTRIBUTION BY SPANISH FINANCIAL INSTITUTIONS OF THEIR REAL ESTATE ASSETS TO NEWLY INCORPORATED S.A. COMPANIES**

- RDL 18/2012 forces Spanish financial institutions to contribute their Real Estate Assets to newly incorporated S.A. companies (the “**Real Estate Managing Companies**”), which will be in charge of managing and selling them in the market (whether directly or indirectly).
- For financial institutions majority owned by the FROB or where it has been appointed as its provisional director, the FROB will decide whether the relevant financial institution needs to incorporate a Real Estate Managing Company or not.
- The Real Estate Assets will need to be contributed to the Real Estate Managing Companies before the end of the provisioning period described above and in RDL 2/2012 (i.e. generally before 31 December 2012 and if the relevant institution is participating in an integration process, within 12 months after the integration process has been authorized).

- The contributed Real Estate Assets will be valued based on their fair value ("*valor razonable*")<sup>1</sup>. If no fair value can be determined or it is difficult to determine, they will be valued based on their book value ("*valor en libros*"), which will be determined taking into account the provisions that need to be made in respect of those Real Estate Assets following RDL 2/2012 and RDL 18/2012.
- In the event that, when the Real Estate Assets are contributed, no such respective provisions are made, they will have to be created by the relevant Real Estate Managing Company on the terms established by RDL 2/2012 and RDL 18/2012.
- The Real Estate Managing Companies of financial institutions which receive financial support from the FROB on the terms described above will be obliged to sell annually at least 5% of their Real Estate Assets to a third party different to the contributing financial institution or an institution from its group. In addition, in 3 years these contributing financial institutions will need to hold a stake of no more than 20% in the relevant Real Estate Managing Company.
- Contribution of the Real Estate Assets will benefit from certain tax exemptions<sup>2</sup>, as well as from reductions in notarial and registration fees.

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

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<sup>1</sup> It could be the case that this fair value was determined by the two independent experts appointed by the Spanish Ministry of Economy and Competitiveness (Oliver Wyman and Roland Berger) in order to prepare two valuation reports in relation to Spanish financial institutions' assets.

<sup>2</sup> Special tax regime set forth in Chapter VIII of Title VII of the Spanish Corporate Income Tax Act (approved by Royal Legislative Decree 4/2004) ("tax neutrality" regime).

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