**Ashurst Madrid**
August 2012

# Upcoming Law Reform for Bank Restructurings in Spain

An upcoming law reform is expected to be approved by the Spanish Government by no later than 31 August 2012, in order to implement the agreements reached in the Memorandum of Understanding on Financial Sector Policy Conditionality (the **"MoU"**) entered into between the Kingdom of Spain and the Eurogroup in July 2012.

The MoU provides in sections 18 and 20 that prior to the end of August 2012, the Spanish authorities must have approved the rules ensuring the effectiveness of the so-called "Subordinated Liability Exercises" ("**SLEs**") as well as the upgrade of the legal framework for the resolution of banking entities. This will be done by strengthening the powers of the FROB (Fund for Orderly Bank Restructuring).

The requirements of the MoU in respect of the Spanish legislation changes relating to the efficacy of SLEs, the resolution and liquidation of banking entities and the strengthening of the powers of the FROB will be implemented by means of a Royal Decree-Law (*Real Decreto-ley*) (**"RDL"**) which we expect to be passed by the Spanish Council of Ministers on or around next Friday 31 August 2012. The RDL is also expected to incorporate some of the principles set out in the European legislative proposal adopted by the EU Commission on 6 June 2012 to establish a framework for the recovery and resolution of credit institutions and investment firms and to amend Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010 (the **"EU Legislative Proposal"**). This proposes three key stages in the context of a bank recovery and resolution framework: (i) preparation and prevention, (ii) early intervention and (iii) resolution. The EU Legislative Proposal acknowledges the absence of bank specific resolution tools in many EU jurisdictions, and that the reorganisation of banks under insolvency procedures would most likely be unsuccessful, given that debtors would immediately withdraw funds and insolvency procedures may take years to complete. Therefore, the draft RDL will introduce the concept of "bank resolution" under Spanish law.

The purpose of this client briefing note is to analyse certain provisions of the latest draft of the RDL available to us in order to provide a preview of certain matters that we deem of particular interest, in each case subject to the proviso that our review is based on draft legislation publicly available and not on the definitive legislation in force. Moreover, the draft on the basis of which we have prepared this briefing note, although publicly available, does not seem to have been officially released. Our conclusions will be therefore subject to the actual terms of the RDL finally passed by the Spanish Council of Ministers.

## Legal regime of the FROB

Articles 2 to 11 of the draft RDL deal with the legal regime, applicable to the FROB, which amend the existing FROB legislation by clarifying and updating its legal status, sources of financing, governance and control of the FROB. In this regard, the FROB shall be governed by a governing commission (*Comisión Rectora*) made up of nine members, out of which four shall be designated by the Bank of Spain and the other five shall be high ranking officers of the Spanish Ministries of Finance and Competitiveness and of the Treasury and Public Administrations. The FROB shall have a Chief Executive Officer (*Director General*) which shall be appointed by the Spanish Council of Ministers. The cash and treasury service of the FROB shall be carried out by the Bank of Spain.

## Early intervention of credit entities

Articles 12 to 18 of the draft RDL set out the regime of early intervention rights of the Bank of Spain, which shall apply where a credit entity "fails to comply, or there are objective elements pursuant to which it is reasonably expected that the relevant entity will fail to comply with solvency, liquidity, organisational structure or internal control requirements, or any other requirement set out by the rules governing discipline and control of banking entities, but which is in a situation where it is capable of resuming

compliance with those requirements using its own means".

The draft RDL enables the Bank of Spain to take measures ranging from requiring the directors of the relevant entity to call a shareholders meeting (or the Bank of Spain calling it directly) and proposing resolutions to be passed, requiring the preparation of a debt restructuring plan or even the dismissal and replacement of the directors of the entity, the provisional substitution of the board of directors of the relevant entity or to require the adoption of recapitalisation measures.

Those provisions will reinforce the current powers of the Bank of Spain already set out by Law 26/1988, of 29 July, of Discipline and Intervention of Credit Entities, which enable the Bank of Spain to take intervention measures against banking entities failing to comply with the rules governing discipline and control of credit entities.

It must be noted that the early intervention measures are taken by the Bank of Spain, not by the FROB. However, the draft RDL contemplates that the FROB shall be kept informed of early intervention measures and any action plan submitted by the relevant entity shall be approved by the Bank of Spain with a favourable report by the FROB if the relevant entity is to request public financial support.

When the conditions for the early intervention are no longer continuing the Bank of Spain shall declare the end of the early intervention measures. However, if the financial condition of the relevant entity cannot be resolved, the Bank of Spain may proceed with a restructuring or orderly winding up of the entity, if the required circumstances prompting a restructuring or orderly winding up apply.

## Restructuring of credit entities

Chapter II of Section III of the draft RDL deals with the restructuring of credit entities, setting out that the restructuring of a credit entity shall apply when (i) the relevant entity requires public financial support in order to ensure its viability, and (ii) there exist objective elements pursuant to which it is reasonably expected that the financial support to be granted shall be recovered in the period set out in the relevant instruments. The restructuring of credit entities may also apply even if the condition set out in (ii) above is not complied with if the orderly winding up of the relevant entity would produce substantial negative effects on the stability of the financial system as a whole. This circumstance shall be determined by the Bank of Spain.

Entities to be restructured shall submit a restructuring plan to be approved by the Bank of Spain with the favourable report from the FROB.

When the conditions that led to a restructuring are no longer continuing, the Bank of Spain shall declare the end of the restructuring process.

## Orderly resolution of credit entities

Chapter III of Section III of the draft RDL introduces the concept of the "orderly winding up" of credit entities. This is a requirement set out in section 20 of the MoU, in which it was agreed that the Spanish authorities would modify the bank resolution framework in order to grant ample resolution powers to the FROB as well as provisions overriding shareholders' rights in the resolution processes and to ensure consistency with the provisions of the EU Legislative Proposal which aims to provide a bank liquidation tool in insolvency procedures by non-judicial authorities.

The concept and application of an orderly winding up of a credit entity raises a number of questions, which we will analyse below:

- Is an "orderly resolution procedure" an insolvency procedure?

  According to the draft RDL, the measures taken in the context of an orderly resolution procedure as well as the SLEs shall be classified as reorganisation and winding-up measures of credit entities for the purposes of Law 6/2005 of 22 April, of reorganisation and winding-up of credit entities, which implemented in Spain Directive 2001/24/EC of Parliament and of the Council of 4 April 2001, on the reorganisation and winding up of credit institutions. Law 6/2005 of 22 April, of reorganisation and winding-up of credit entities, sets out that current measures of reorganisation and winding up of credit entities in Spain consist of the initiation of an insolvency and winding up procedure within the context of insolvency, in each case as governed by Law 22/2003 of 9 July on Insolvency (the **"Spanish Insolvency Act"**). However, the orderly resolution procedure set out in the draft RDL is not set out as an insolvency procedure for the following reasons:

  - It does not require the initiation of a formal insolvency procedure and is therefore not governed by the Spanish Insolvency Act.

  - It is consistent with the resolution framework set out by the EU Legislative Proposal, which will require EU Member States to implement banking entities resolution tools that can be

applied outside of judicial insolvency proceedings.

- Article 28 of the draft RD expressly sets out as one of the events prompting the initiation of an orderly resolution procedure when, for reasons of public interest, it is necessary or convenient to take that measure given that the winding-up of the relevant credit entity in the context of an insolvency procedure would not reasonably achieve the RDL's objectives to safeguard the stability of the financial system.

- Article 32 of the draft RD sets out that within two months from its designation as the relevant credit entity administrator, the FROB shall prepare a resolution plan for the relevant entity or, otherwise, it shall resolve to initiate insolvency proceedings, which clearly shows that the resolution procedure is an alternative procedure to an insolvency proceeding.

In addition, the Fifth Additional Provision of the RDL expressly sets out that:

- The obligation to file for insolvency set out by the Spanish Insolvency Act shall not apply to any credit entity which is the subject of an orderly resolution procedure.

- The FROB, once appointed to run the relevant credit entity, shall be the only entity with powers to file for the insolvency of the relevant credit entity, but it shall not be under the obligation to do so.

- The measures implemented in the context of an orderly resolution procedure pursuant to the powers set out in the draft RDL shall not be regarded as an insolvency procedure for the purposes of certain legislation (Law 41/1999, of 12 November, which implemented in Spain Directive 98/26/EC of 19 May (the Settlement Finality Directive)).

In our view, an orderly resolution procedure can be regarded as a special administrative liquidation procedure, an alternative to the formal initiation of an insolvency liquidation procedure, which is expected to qualify as a winding-up procedure of credit entities, as per the provisions of Directive 2001/24/EC of Parliament and of the Council of 4 April 2001 (which for these purposes shall be amended once the EU legislation proposed under the EU Legislative Proposal is approved), in addition to the procedures contemplated by the Spanish Insolvency Act.

- When does an orderly resolution of a credit entity apply and who makes the decision for this process to apply?

  The draft RD sets out that an orderly resolution shall apply when the relevant credit entity or its group falls, simultaneously, under the following circumstances: (i) it is not viable or is reasonably expected that it will not be viable in the near future; (ii) there is no expectation that the entity will become viable within a reasonable period of time by taking only early intervention or restructuring measures, and (iii) when for reasons of public interest it is necessary or convenient to take that measure given that the winding-up of the credit entity in the context of an insolvency procedure would not reasonably achieve the objective of the RDL to safeguard the stability of the financial system.

  An orderly resolution shall also apply when a credit entity under a restructuring process fails to deliver a restructuring plan; the plan delivered is not accepted by the Bank of Spain or the relevant entity does not accept the amendments proposed by the Bank of Spain to the relevant restructuring plan; the relevant plan, if accepted is not complied with; or where the relevant credit entity acknowledges to the Bank of Spain that it is impossible to find a viable solution.

  The concept of a non-viable entity is also described in broad terms by the draft RDL although it will be further detailed in subsequent development regulation.

  The Bank of Spain shall make the decision to initiate the orderly resolution process of a credit entity when the required criteria is met.

- Who runs the administration of a credit entity subject to an orderly resolution process?

  To the extent the FROB does not already control the relevant entity, further to the initiation of the orderly resolution process, the Bank of Spain shall replace the board of directors of the relevant entity and shall designate the FROB as the administrator of the credit entity, which in turn shall appoint directors to run the credit entity.

- The methods available to carry out the resolution of the credit entity

  The draft RDL sets out that the methods available to the FROB in the resolution of the credit entity are (i) the sale of the business of the credit entity; (ii) the transfer of its assets and liabilities to a "bridge banking entity", (iii) the transfer of its

assets and liabilities to a managing entity; and (iv) financial support to the entities acquiring the aforementioned businesses or assets.

The FROB may provide financial support measures to achieve the orderly resolution procedure, including the granting of guarantees, loans or other facilities, the acquisition by the FROB of assets and liabilities, which the FROB may manage or transfer the management to third parties, or the recapitalisation of the relevant credit entity. Financial support measures may be granted to the relevant credit entity or to the entities or bridge banking entity acquiring the assets or business of the relevant credit entity.

It is important to note that it is expressly provided that the granting of financial support by the FROB shall not operate to reduce the losses which shareholders and holders of hybrid and subordinated instruments in the troubled entity must bear in accordance with the principles set out in the draft RDL.

The sale by the FROB of the business or assets or liabilities of the relevant credit entity shall be made by way of a competitive process and the principles of transparency. There must be no discrimination against potential bidders and best price must be achieved. However, it must be noted that the draft RDL expressly provides for an option to waive any of those requirements if the objectives of ensuring the financial system stability or the effectiveness of the transaction may be put a risk or be jeopardised. In that case the selection of bidders may be made without compliance with all of the aforementioned requirements.

It is also expressly contemplated that the FROB may transfer the assets and liabilities of the relevant credit entity to a management entity in which it participates, which will be in charge of selling and managing the relevant assets and liabilities.

- What happens to the credit entity subject to an orderly resolution procedure once the sale of its assets or business has been executed?

  If there are still assets and liabilities remaining (as a result of a partial transfer of assets and liabilities), the credit entity shall be liquidated in the context of an insolvency procedure. Note that if no further assets and liabilities remain, the entity may just be wound-up without the need to open an insolvency procedure.

## Powers of the FROB in implementing reorganisation and resolution measures

Chapter V of Section III of the draft RDL sets out the powers of the FROB in order to implement the reorganisation and resolution measures and instruments. The FROB shall enjoy the following powers:

- Immediate enforceability of instruments and actions

  Without prejudice to formal documentary or registration and disclosure requirements, the enforceability of the actions to implement the instruments available to the FROB under the draft RDL shall not be subject to approvals, consents, notices or ratifications by any shareholders, bondholders, creditors, debtors, counterparties or any other third parties or authorities, being enforceable immediately from the outset, whether the relevant consent, requirement or authorisation was imposed by law or by contract.

- Events of default and early termination provisions not enforceable

  The draft RDL sets out, in a similar fashion as set out in article 61 of the Spanish Insolvency Act, that the entering into any action of early intervention, restructuring or orderly resolution shall not be regarded *per se* as an event of default or termination event, and shall not entitle any counterparty to terminate the relevant contract or take enforcement action, and the relevant provision shall be regarded as unenforceable. It is however expressly provided that counterparties shall not be prevented from enforcing termination rights as a result of other events of default under the relevant contracts, either arising before or after the implementation of the relevant measure.

  This provision obviously raises a number of issues where the law of the relevant contract is other than Spanish law, since under the law of the relevant contract the counterparty may still be able to claim early termination on the grounds set out above. It is expected that the EU Legislative Proposal will introduce harmonisation rules in this regard, although obviously the scope will be limited to EU Member States. In any case, if the relevant terminated contract is to be enforced against the debtor in Spain, Spanish courts may refuse to recognise such enforcement (in the event of litigation or court enforcement actions in Spain) if such termination was made against the provisions of the RDL.

- Transactions subject to Royal Decree Law 5/2005 ("RDL 5/2005"), master netting agreements of financial transactions and financial collateral

  The FROB may suspend the right of counterparties to terminate early and close-out master netting agreements and carry any right of set-off in respect of transactions and master netting agreements entered into under RDL 5/2005 as a consequence of the entering into any action of early intervention, restructuring or orderly resolution, for a maximum period which, under the current draft RDL, runs from the date of the publication of the exercise of the suspension right until 17:00 of the next business day. If within that period, the relevant assets and liabilities subject to the relevant financial transactions and/or master agreements have been transferred to a third party in accordance with the relevant instruments, the relevant counterparties may not exercise their termination and close-out rights thereunder (it is however expressly provided that counterparties shall not be prevented from enforcing termination rights as a result of other events of default under the relevant transactions or master agreements, either arising before or after the implementation of the relevant measure).

  This particular provision overrides to a certain extent the existing protections set out by RDL 5/2005 as regards the strength of close-out rights of master netting agreements where the counterparty is a Spanish credit entity subject to measures taken by the FROB under the draft RDL (article 16.1 of RDL 5/2005 sets out that "*the declaration of an early termination, termination, enforcement of equivalent effect of financial transactions entered into in the context of a master netting agreement or in relation thereto may not be limited, restricted or affected in any way by the opening of an insolvency procedure or an administrative liquidation procedure")*. The effective application of the close-out suspension powers shall be problematic where the relevant contracts are governed by other than Spanish law although it is expected that the EU Legislative Proposal will introduce harmonisation rules in this regard, although obviously the scope will be limited to EU Member States. In addition, the current drafting is quite imprecise as regards the particular event that gives rise to the suspension. In our view, it focuses on particular asset and liability transfer transactions rather than the formal initiation of the intervention, restructuring or resolution procedure. In any case, the proposed provisions are a departure from the existing close-out protection regime so far applicable to master netting agreements of financial transactions under RDL 5/2005, although for a limited period.

  In addition, the Fifth Additional Provision of the draft RDL provides that the measures implemented by the FROB or the Bank of Spain pursuant to the powers set out in the draft RDL shall not be regarded *per se* as an enforcement event as set out by article 11 of RDL 5/2005. Article 11.1 of RDL 5/2005 sets out that "*The following shall be deemed an enforcement event: any breach of obligations or any other event agreed between the parties which, if taking place, shall entitle the beneficiary of the collateral arrangement, pursuant to the collateral agreement or to the law, to enforce or appropriate the collateral assets, or that produces the operation of a close-out provision if that provision was set out in the relevant contract*". The Fifth Additional Provision of the draft RDL is not clearly drafted, but as per the current draft it its attempting to mandatorily exclude the measures that can be taken under the draft RDL from being included as early termination, close-out or enforcement events in master netting agreements and collateral arrangements covered by RDL 5/2005. As said before, unless the EU legislation that implements EU Legislative Proposal introduces rules in this regard, this provision will be, in practice, difficult to apply to contracts governed by laws other than Spanish laws or where the collateral assets are located outside Spain.

- Suspension of contracts and enforcement of security

  Article 54 of the draft RDL sets out the power of the FROB to suspend payment or delivery obligations under existing contracts entered into by the relevant credit entity for a maximum period which, under the current draft RDL, runs from the date of the publication of the exercise of the suspension right until 17:00 of the next business day. This does not apply to cash deposits generally.

  In addition, the FROB may suspend or limit the enforcement of security over the assets of the relevant entity "for the limited period of time that the FROB deems necessary to comply with the objectives of the resolution" (as an exception, these suspension rights shall not apply to collateral granted to EU central banks or to the ECB).

  It is not clear how this will apply to security assets held outside Spain under foreign law collateral arrangements (as mentioned above, it is expected that the EU Legislative Proposal will introduce harmonisation rules in this regard applying to EU

Member States), and whether this would capture financial collateral governed by RDL 5/2005. It must be noted that there is no specific time limitation for the suspension of the security enforcement, which provides the FROB with discretionary powers in this regard that may raise uncertainty in respect of secured transactions with Spanish banking entities, particularly where the collateral is subject to volatility.

The FROB may also request the suspension of any judicial actions or any other proceeding involving the relevant credit entity.

## Safeguards

Chapter VI of Section III of the draft RDL provides for certain safeguards in respect of the overriding powers of the FROB where there are partial transfers of assets and liabilities, which we believe will be of complex practical application as per the current drafting:

- In respect of shareholders and creditors

  Where in the context of an orderly resolution, only part of the assets and liabilities are transferred, shareholders and creditors of the entity whose claims have not been transferred, shall have the right to receive those payments and proceeds up to the limit that they would have received if the entity was liquidated in a hypothetical insolvency process taking place immediately before the transfer date. For these purposes the FROB shall make the relevant valuation on the basis of one or more independent experts' reports.

- In respect of counterparties under financial collateral transactions and master netting agreements covered by RDL 5/2005, as well as under structured financial transactions

  Where in the context of an orderly resolution, only part of the assets and liabilities are transferred, the FROB shall (i) avoid the novation, termination or transfer of only part of the assets or liabilities that are the subject of a master netting agreement covered by RDL 5/2005; (ii) ensure that secured obligations and the assets securing such obligations are transferred together or otherwise remain in the same entity; and (iii) avoid the termination or novation of financial pledge arrangements if that would render the loss of the relevant security. As regards structured financing arrangements, the FROB shall avoid the termination, novation or transfer of only part of the assets or liabilities covered by the arrangement, unless if only assets or liabilities related to the cash deposits of the entity are affected.

- Mortgage backed bonds (*cédulas hipotecarias*):

  Nothing is mentioned in the draft RDL about mortgage backed bonds (*cédulas hipotecarias*) and their treatment in the context of an orderly resolution, even if the issuance of *cédulas hipotecarias* has been one of the principal avenues for the wholesale financing of Spanish banking institutions. Pursuant to Law 2/1981 of 25 March, of the Mortgage Market, Spanish banking and certain credit entities may issue the so-called *cedulas hipotecarias*, being securities in which the principal and interest is secured by a legal mortgage over all of the real estate mortgage secured loans granted by the issuer and complying with certain minimum requirements, to the extent not already securing the so-called mortgage secured bonds (*bonos hipotecarios*). Holders of *cédulas hipotecarias* shall be regarded as specially privileged creditors of the issuer in the event of the insolvency of the issuer and shall therefore enjoy a special privilege to be repaid with priority over other creditors with the proceeds of all of the portfolio of the relevant mortgage secured loans held by the issuer, ranking equally among them (regardless of the date of issuance) and only ranking below mortgage secured bonds (*bonos hipotecarios*) in respect of the proceeds of the mortgage secured loans securing mortgage secured bonds.

  Concerns have been raised as to whether the FROB may, under the powers conferred by the draft RDL, transfer parts of the mortgage loan portfolios securing issuances of *cédulas hipotecarias* but without the transfer of all or part of the corresponding liabilities, so that the pool of assets securing *cédulas hipotecarias* issued by the relevant credit entity is diminished or impaired as a result of the FROB actions.

  As mentioned, there are no specific rules set out by the draft RDL dealing with securing *cédulas hipotecarias*. However, the safeguards described in Chapter VI of Section III of the draft RDL provide that where in the context of an orderly resolution, only part of the assets and liabilities are transferred, creditors of the entity whose claims have not been transferred, shall have the right to receive those payments and proceeds up to the limit that they would have received if the entity were liquidated in a hypothetical insolvency process taking place immediately before the transfer date. Even though the practical application of this provision will be complex, in our view it is clear that in the contemplated scenario of a partial transfer of assets and liabilities, creditors under

*cédulas hipotecarias* issued by the relevant credit entity would be entitled to receive the amount that they would have received had the relevant entity being liquidated in an insolvency process immediately before the transfer, which would then need to take into account the value of the pool of mortgage loans securing the relevant *cédulas hipotecarias* and the priority rights of the holders in an insolvency wind-up scenario governed by the Spanish Insolvency Act. In any case, given the relevance of *cédulas hipotecarias* as a financing tool of Spanish credit entities, we are of the view that their specific treatment should have been taken into account in the RDL.

## Management of hybrid capital and subordinated debt instruments

Section IV of the draft RDL sets out the powers of the FROB in respect of actions to be taken to manage and restructure hybrid capital and subordinated debt instruments (hereinafter, **"HCSDs"**). Sections 17 to 20 of the MoU set out the guidelines of burden sharing among the various investors and creditors of the relevant credit entities under HCSDs. The underlying principle is to minimise the cost of bank restructurings to tax payers and therefore, the losses shall be allocated first to equity holders and thereafter to holders of HCSDs by the implementation of SLEs.

- Voluntary and mandatory SLEs (Subordinated Liability Exercises)

  SLEs may affect all or part of the issuances of HCSDs but shall take into account the different ranking order that such issuances have among them.

  The contemplated actions to implement SLEs are the following: (i) offers for the exchange for shares or other capital instruments; (ii) offers for the repurchase of the relevant HCSDs in consideration for cash or for other financial assets; (iii) direct reduction of outstanding principal; or (iv) early redemption with a discount and other amendments of the terms and conditions of the relevant HCSDs.

  The actions set out above may be taken by the relevant credit entities. In such case the HSCDs holders shall voluntarily accept the actions and any valuation shall be made on the basis of the market value of the relevant HSCDs.

  Notwithstanding the foregoing, the FROB may also take actions to implement SLEs in respect of the relevant credit entities, in order to ensure an adequate distribution of the restructuring or resolution costs and losses or to preserve or reinstate the financial position of credit entities supported by the FROB.

  In such case, the actions to implement SLEs agreed by the FROB shall be of **mandatory application** for both the credit entities and for the holders of the HSCDs (except for issuances of HSCDs held by the FROB, regardless of when the FROB subscribed to them).

  In this regard, the FROB shall have the power to determine which issuances of HSCDs shall be subject to an SLE although it must respect the different ranking order between the affected issuances. No losses may be attributed to holders of HSCDs with better ranking than others that have not yet absorbed any losses or in situations in which holders of share capital or equivalent instruments have not absorbed losses to the extent possible.

  In carrying out SLEs the FROB may undertake any action such as the amendment of the terms and conditions of the HSCDs (including the deferral, suspension or any other amendment affecting payments of principal, interest, maturity date or any other term and condition), the obligation of the credit entity to repurchase affected HSCDs at the price set out by the FROB, the design of the repurchase process, whether the repurchase shall be for cash or other assets as consideration or any other action that the affected credit entity could have carried out in respect of the relevant HSCDs.

  Proposals to implement an SLE shall be delivered to the Bank of Spain for its approval.

- Price and valuation criteria for the execution of SLEs and the case of HSCDs held by Spanish retail investors

  The draft RDL expressly sets out, both for voluntary and mandatory SLEs, that the actions to implement the relevant SLEs shall be carried out on the basis of the market value of the relevant HSCDs. Furthermore, in respect of mandatory SLEs carried out by the FROB, it is expressly set out that in the case of repurchase, the repurchase price shall not exceed the market value of the affected HSCDs "having regard to premiums or discounts which are in compliance with the rules of the EU on State aid". It is also expressly set out that investors shall receive an amount which is not less than the amount that they would have received if the relevant credit entity was wound-up in the context of an insolvency proceeding.

  Article 64 of the draft RDL sets out the valuation criteria to be taken into account by the FROB in

designing and executing actions to implement SLEs, which include parameters such as the proportion of HSCDs on the total assets of the credit entity, the public financial assistance received by the entity, the entity's capacity to obtain capital in the market, the amount that holders of HSCDs would receive if the relevant credit entity was wound-up, the market value of the affected HSCDs and the likelihood of a voluntary acceptance of the measures to implement an SLE by holders of the relevant HSCDs (among others).

An issue that has raised a heated political debate in Spain is the substantial distribution among Spanish retail investors of preference shares by many savings banks which are now in difficulties. Common features of those HSCDs issuances are (i) distribution to retail investors only with no or minimal institutional tranches; (ii) distribution by the issuer through its own branch network and therefore to its own clients; (iii) low minimum denominations and therefore a wide base of retail investors; and (iv) very low or almost nil market values at present and therefore substantial losses for investors.

The above features of those retail distributed HSCDs issuances, together with accusations of dubious selling practices by their issuers, have raised substantial protests by affected investors and this has put political pressure on the Spanish Government to find a solution to mitigate losses for retail investors in respect of HSCDs issuances. This raises the issue of whether there can be a solution for retail investors which may differ from the criteria set out in the draft RDL (and the MoU) for the implementation of SLEs under which holders of HSCDs must absorb in the first place (but after shareholders) the losses and costs of restructuring and/or resolution of the affected credit entities.

No specific rule or exception is set out in the draft RDL in this regard, which only contemplates that SLEs shall be carried out on the basis of the market price of the relevant HSCDs. We are of the view however, that the fact that the draft RDL sets out that the repurchase price of HSCDs shall not exceed the market value of the affected HSCDs, the wording "having regard to premiums or discounts which are in compliance with the rules of the EU on State aid" leaves room for the Spanish Government to negotiate with the EU Commission SLEs with premiums above market price for the contentious HSCDs issuances. In fact, it has been announced in the press that the Spanish Government is actually negotiating a solution with the EU authorities for those HSCDs. This means that some of the retail distributed HSCDs issued by certain savings banks may be repurchased at above market price or an alternative solution to mitigate retail investors' losses may be implemented for certain issuances. Obviously, any advantage given to those investors by the issuer of the HSCDs would be at the expense of more senior creditors of the issuer or could be potentially discriminatory as compared with other issuances of HSCDs. There is also the difficulty of discriminating among retail and institutional holders in the same issuance of HSCDs, which may lead to institutional investors benefiting from advantageous treatment intended to mitigate losses for retail investors. No specific measures have been announced in this regard as at the date of this document and negotiations are still ongoing in relation to this particular issue.

The draft RDL amends Law 13/1985 of 25 May as well as Law 24/1988 of 28 July in order to restrict the placement of preference shares and other HSCDs among retail investors in the future. In this regard, it shall be required that any public offering of preference shares must have at least 50% of the offering addressed to professional investors and those investors must be at least 50, so that retail investors benefit from the more accurate pricing and conditions required to place HSCDs among professional investors. In respect of issuances of preference shares made by non-listed companies, the minimum denominations shall be 100,000 euros. Law 24/1988 of 28 July will also be amended to substantially increase the information and risk disclosure requirements for the distribution of HSCDs.

- Investors and third party rights

The draft RDL sets out that holders of HSCDs may not claim for any losses or any other compensation arising as a result of the implementation of an SLE agreed by the FROB, and may not file for the mandatory insolvency of the issuer, even on grounds of breach of the terms and conditions of the HSCDs, if those terms and conditions have been affected by the SLE, to the extent the issuer complies with the terms of the SLE.

In addition, it is set out that the approval of an SLE by the FROB and any action for the implementation of an SLE may not be regarded as an event of default under other contracts that the issuer may have with third parties. This tries to avoid the situation where the implementation of an SLE triggers cross-default provisions in other financial contracts with third parties. This again raises the issue of whether a foreign court would regard the

provisions of the RDL as overriding cross-default provisions under contracts subject to laws other than Spanish law, a matter that we expect to be dealt with within the EU by the EU legislation implementing the EU Legislative Proposal.

## Ongoing restructuring processes and other amendments

The provisions relating to restructuring and orderly resolution of banking entities set out in the draft RDL shall apply to any restructuring process which is ongoing as at the date of approval of the RDL.

The draft RDL also contains a number of amendments to other laws affecting the solvency and capital requirements of Spanish credit entities, reinforcing the intervention and disciplinary powers of the Bank of Spain and other amendments. The RDL sets out a legislation framework which shall however require detailed regulatory development in various matters.

Once again, we would like to note that the draft RDL is still working progress and the finally approved version will most likely include changes or additions. However, we don't expect fundamental changes and have therefore deemed it to beof interest to our clients to have this briefing as a heads-up of the coming legislation.

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