

Recent Key Developments in the Area of Spanish Financial Regulation

Prepared by the Regulation and Research Department of the Spanish Confederation of Savings Banks (CECA)

Royal Decree-Law on urgent budgeting, tax and financial measures (Royal Decree Law 20/2011, published in the Spanish Official Gazette – Boletín Oficial del Estado – of December 31st, 2011)

This regulation reforms the legal and regulatory regime for institutional protection schemes and for the indirect exercise of savings banks' financial business activities. The main new features are:

A) Reform of the legal and regulatory regime for Savings Banks (“Cajas”)

Spanish savings bank will be transformed into a special character foundation when it ceases to control (individually or collectively) the banking entity (previously the savings bank had to hold at least 50% of the capital of the instrumental bank).

B) Granting of new state guarantees

The maximum amount of state guarantees to be provided during 2012 will be approximately €196bn. From these, €100bn will be directed towards new issuance of bank bonds, €3bn towards asset-backed fixed income securities issued by SPVs and €93bn towards ensuring the economic obligations committed to the European Financial Stability Facility.

C) Introduction of extraordinary tax measures

The aim of these measures is to generate an additional income of €6.2 mn for the reduction of the public deficit. They include:

a) Personal Income Tax

The introduction of a complementary, temporary and progressive taxation

b) Real Estate Value Tax

The tax rate for urban real estate will increase during 2012 and 2013. This measure is temporary and exceptional.

c) Value Added Tax

The application of the reduced VAT rate of 4% to housing is extended until December 31st, 2012.

Order from the Spanish Ministry of Economy and Competitiveness on the requirements to grant state guarantees for new bond issuance (Order ECC 149/2012 published in Spanish Official Gazette – Boletín Oficial del Estado – of February 1st, 2012)

This regulation determines the necessary requirements for provision of Spanish state guarantees for new bond issuance by Spanish credit entities, provided that they carry out significant business activity. The Order also stipulates procedural aspects, guarantee fees, and terms related to the usage of the guarantees granted.

The most important features of the Order are:

- Guarantee application form. State guarantees may be requested, before February 6th, 2012, by credit entities, credit entities' consolidating groups or credit entity groupings, provided that they carry out significant business activity.

- Procedures for the granting of guarantees. Credit entities will need an authorisation from the European Commission and the guarantees have a limited duration (the deadline for completion of guaranteed issuance is June 30th, 2012). This deadline may be extended by the Commission.
- Interest rate. The interest rate on the prospective guaranteed issuance may be fixed or floating.
- Issuance amount. The amount of each issuance should be a minimum of €10bn.
- Fees. A guarantee fee of 0.5% should be payable for the requested amount, which will be discounted from the underwriting fee payable by the issuing institution.
- The guarantee is granted for the requested amount, provided that the maximum guarantee amount for the applying entity is not exceeded.

Royal Decree-Law on the clean up of the financial sector (Royal Decree-Law 2/2012, published in the Spanish Official Gazette – Boletín Oficial del Estado – of February 4th, 2012)

Last February 4th, 2012, the Royal Decree-Law 2/2012 of February 3rd, 2012, on the clean up of the financial sector, entered into force. Its main objective is to clean up the credit entities' balance sheets in order to improve the confidence, reliability and strength of the Spanish financial system. The reform seeks to facilitate the entities access to capital markets and, in short, the regulation envisions the return of credit entities to their fundamental role - to channel savings to the real economy.

The major features are:

D) MANDATORY CLEAN UP

■ **Affected portfolio**

The exposures linked to real estate development up to December 31st, 2011, and the exposures subsequently arising from their refinancing.

■ **Appointment by portfolio**

The estimated impact of the measure is €52bn, as stated by the Spanish Ministry of Economy and Competitiveness. This amount can be disaggregated into: new specific provisions for impaired assets; additional general provisions for performing assets with exposure to real estate development; and an additional capital add-on.

■ **Proceedings**

The new provisions (both general and specific) should be accounted for by the income statement; while the capital add-on may come from eligible items, such as capital.

■ **Deadline**

December 31st, 2012. (For banks that opt for consolidation/merger, the time frame to have these provisions in place will be extended until the end of 2013.)

B) CONSOLIDATION PROCESSES

The credit entities that enter new consolidation processes (or have done so after September 1st, 2011), will benefit from the following incentives:

- They will have an extended deadline to meet new provisioning requirements, until the end of 2013.
- They will have access to the Spanish Fund of Orderly Bank Restructuring (FROB) support, through the issuance of convertible instruments – which would constitute basic equity or “capital principal”.

However, in order to benefit from these incentives, some requirements must be met:

- Upon the completion of the consolidation process, the resulting entity must reflect an increase of, at least, 20% relative to the balance sheet of the largest entity participating in the consolidation process.
- The consolidation process must entail an operation leading to a structural modification (merger, takeover, etc.); or

the purchase of entities owned mainly by the FROB.

- The entity must submit an application for authorisation, including a compliance plan, before December 31st, 2012.
 - A plan of real estate divestments during the three years following the consolidation must be presented.
 - The entity must make the commitment of reaching a measureable objective of increasing credit to households and SMEs during the three years following the consolidation.
 - The entity must adopt corporate governance measures as well as a Board of Directors and senior managers compensation plan.
- The savings bank will be transformed into a foundation when it ceases to hold at least 25% of the voting rights in the entity through which the savings bank performs the activities of a credit institution.
 - The savings bank's General Assembly will approve, together with the arrangement of transformation into a foundation, its statutes and the composition of its Board of Trustees.
 - The government will supervise and control all such foundations whose main scope exceeds a single autonomous community in Spain (measured based on the scope of the instrumental bank activities).

C) SPANISH SAVINGS BANKS' CORPORATE GOVERNANCE

Modifications in the Royal Decree-Law 11/2010 of July 9th, 2010, published in the Spanish Official Gazette – Boletín Oficial del Estado – of July 13th, 2010, on the governing bodies and legal and regulatory regime of the savings banks are as follows:

- **Spanish savings banks' indirect exercise of financial business activities**
 - The governing bodies will be the General Assembly, Board of Directors and, optionally, the Control Committee. The number of members in the governing bodies and the frequency of their meetings will be established in the Caja's statutes (with the aim of reduction in frequency).
 - A savings bank under an indirect exercise agreement must not dedicate more than 10% of its unrestricted profits to cover operating expenses.
 - A savings banks under an indirect exercise agreement will also be exempt from certain obligations (mainly organizational and reporting), as most of the requirements are expected to be covered by the new banking entity.

■ Conditions for entities in a institutional protection scheme

When the ownership of assets and liabilities is transferred to the central entity of an institutional protection scheme, the savings banks participating in the process will be understood to be under the regime for indirect performance in virtue of the Royal Decree-Law 11/2010.

D) REMUNERATION OF SENIOR MANAGERS AND DIRECTORS IN ENTITIES SUPPORTED BY THE SPANISH FUND OF ORDERLY BANK RESTRUCTURING (FROB)

This regulation establishes limitations to both fixed and variable remunerations of the Board of Directors and senior managers within entities supported by the FROB, differentiating FROB 1 (based on the issuance of preference shares) and FROB 2 (based on the issuance of common shares).

Royal Decree-Law on urgent measures to reform the labour market (Royal Decree-Law 3/2012, published in the Spanish Official Gazette – Boletín Oficial del Estado – of February 11th, 2012)

Together with the concrete measures related to the labour market, this Royal Decree-law includes a specific regime which limits the termination

benefits for senior managers and the Board of Directors of credit entities, applicable to entities that are primarily owned by the FROB.

Additionally, several rules are established regarding the termination and suspension of the contract of managers and directors when the termination or suspension is due to (1) sanctions, (2) suspension, or (3) certain situations of provisional substitution.