

**Resolution of the Governing Committee of the Fund for Orderly Bank Restructuring setting out the criteria and conditions guiding its actions in the process of strengthening credit institutions' capital pursuant to Articles 9 and 10 of Royal Decree-Law 9/2009, 26 June 2009 on bank restructuring and credit institution equity reinforcement, as amended by Royal Decree-Law 2/2011, 18 February 2011, on the financial system reinforcement.**

#### Preamble

Royal Decree-Law 9/2009, 26 June 2009, on bank restructuring and credit institution equity reinforcement (Royal Decree-Law 9/2009) created the Fund for Orderly Bank Restructuring (FROB), and assigned to it, *inter alia*, the function of helping strengthen institutions' capital during certain integration processes between essentially sound credit institutions so as to enhance their capacity to finance the economy. In order to clarify the mechanisms whereby the FROB will perform this role, on 29 January 2010 the Governing Committee of the FROB approved the terms guiding its activities to strengthen the capital of credit institutions undertaking integration processes in the first half of 2010.

Royal Decree-Law 9/2009 was subsequently amended by the single additional provision of Royal Decree-Law 11/2010, 9 July 2010, on savings banks' governing bodies and other aspects of their legal framework, which authorised the FROB to provide exceptional support to recapitalise fundamentally sound credit institutions that, in the opinion of the Banco de España, require the strengthening of their capital. In line with this amendment to Royal Decree-Law 9/2009, on 27 July 2010, the Governing Committee of the FROB approved the criteria that will govern its activities during the second half of 2010.

These measures, along with others, have helped minimise the impact of the global crisis on both the Spanish financial system and the treasury, and have set in train an intense process of restructuring in the financial sector.

On 1 December 2010 the European Commission published a communication concerning the application, as of 1 January 2011, of rules on state aid to the measures to support the banks in the current financial crisis, establishing parameters for the eligibility of temporary state aid granted to the banks in the context of the crisis as of 1 January 2011. This communication eliminates the difference in treatment between institutions considered fundamentally sound and those that are not, and does not require all credit institutions, in general, receiving state aid as of January 2011 to present a restructuring plan as envisaged in the Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules.

Royal Decree-Law 2/2011, 18 February 2011, on the Spanish financial system reinforcement (Royal Decree-Law 2/2011), represented a further milestone in the regulatory system available with which to address the restructuring of the financial system. As indicated in its preamble, Royal Decree-Law 2/2011 has a dual purpose: firstly, to raise all credit institutions' levels of solvency by establishing demanding requirements for top-quality capital, in order to dispel any doubts about their solvency; and secondly to accelerate the final phase of institutions' restructuring, through the essential framework created by Royal Decree-Law 11/2010.

As regards bolstering solvency, Royal Decree-Law 2/2011 establishes in advance the application of the demanding new international capital standards envisaged in Basel III. Thus, the requirement that financial institutions operating in Spain have a minimum core capital ratio in relation to risk-weighted assets has been brought in with immediate effect, basically bringing forward the regime that will be imposed by Basel III as of 2013.

Anticipating the possibility that not all financial institutions will be able to raise capital on the capital markets by the set deadlines, Royal Decree-Law 2/2011 has amended the FROB's legal framework so that, applying the provisions of Article 9 of Royal Decree-Law 9/2009, it can temporarily purchase the ordinary shares or capital contributions necessary, under market conditions, from institutions that do not meet the required capital level and which apply to the FROB for its support.

Also, Royal Decree-Law 2/2011 has reworded article 10 of Royal Decree-Law 9/2009 to allow the FROB to purchase preference shares convertible into contributions to the share capital of credit cooperatives that apply to the FROB for its support and which, while not in the circumstances envisaged in Article 6 of Royal Decree-Law 9/2009, need to strengthen their capital with the sole aim of enabling them to proceed with integration processes.

Against this backdrop, given the modifications to the instruments used to provide support to financial institutions and the conditions imposed on institutions benefiting from such support, the governing committee of the FROB considers it desirable to set out the terms which will henceforth govern its measures to strengthen credit institutions' capital, aiming in all cases to ensure that the use of public resources is minimised and is appropriate, and that possible competitive distortions are mitigated, in accordance with the guidelines established by the European Commission. To this end, the Governing Committee of the FROB has resolved to approve the following principles of action.

## **- Chapter I - General Criteria**

### **Rule one. Purpose and scope of this resolution**

The purpose of this resolution is to establish the conditions and requirements under which the FROB shall subscribe ordinary shares or contributions to the share capital of credit institutions pursuant to article 9 of Royal Decree-Law 9/2009.

Likewise, this resolution shall govern, by reference, the rules applicable to the purchase of preference shares convertible into contributions to the share capital of credit cooperatives, pursuant to Article 10 of Royal Decree-Law 9/2009.

### **Rule two. Action of the FROB to strengthen credit institutions by means of the procedure laid down in Article 9 of Royal Decree-Law 9/2009**

1. In accordance with the provisions of Article 9 of Royal Decree-Law 9/2009, the FROB may take measures to provide financial support to institutions that, while not in the circumstances set out in Article 6 of Royal Decree-Law 9/2009, need to strengthen their capital, and that apply to the FROB for its support.

2. The need to strengthen an institution's capital will be determined by its being unable to achieve the core capital ratio set for it, pursuant to paragraphs 1 and 2 of Article 1 of Royal Decree-Law 2/2011, or the ratio required of it by the Banco de España if the institution in question does not reach the minimum capital level required of it under the most adverse scenario during a stress test on the system as a whole, and shall be up to the limit of that requirement.

3. The granting of state aid through the FROB to applicant institutions shall be subject to their compliance with the provisions of Royal Decree-Law 2/2011 and other applicable

regulations, together with their compliance with the conditions and requirements set out in this resolution.

#### - Chapter II -

**Conditions under which the FROB may purchase ordinary shares representing the share capital or contributions to the share capital of credit institutions envisaged in Article 9 of Royal Decree-Law 9/2009**

#### **Rule three. Prerequisites for FROB support**

1. Any request for financial support from the FROB must be accompanied by a recapitalisation plan formulated in accordance with the terms set out in Chapter II of Title II of Royal Decree-Law 9/2009 and expanded upon in Chapter 4 of this resolution.

The FROB may only provide financial support to applicant credit institutions following approval of the aforementioned plan by the Banco de España.

Also, share subscriptions by the FROB shall require the prior "no objection" of the Minister of Economy and Finance, to whom an economic report shall be submitted detailing the financial impact of this purchase on the funds provided against the General State Budget, under the terms of Article 9.3 of Royal Decree-Law 9/2009.

2. The effectiveness of the financial support provided by the FROB shall be subject to its approval by the European Commission in accordance with community rules controlling state aid.

#### **Rule four. Valuation of the securities to be subscribed by the FROB**

1. Securities subscribed by the FROB are to be purchased under market conditions and in accordance with the economic value of the credit institution in question. This value shall be obtained based on a valuation, applying commonly accepted practices, as determined by the Governing Committee, by three independent experts appointed by the FROB.

The experts' fees and other costs of the evaluation shall be borne by the FROB.

2. Once the experts' evaluations have been received, the FROB will determine the economic value of the institution in the following way:

- a) If the difference between the upper and lower valuations and the central valuation is less than 15% in both cases, the arithmetic mean of three values shall be taken as the economic value of the institution.
- b) If just one of the valuations differs from the central valuation by more than 15%, the average of the two closest valuations shall be used.
- c) If the upper and lower valuations vary from the central valuation by more than 15%, the latter shall be used.

3. If, during the five months prior to the FROB's subscription, a significant percentage of the institution's capital (greater than the percentage of capital purchased by the FROB) has been subscribed by third-party investors unrelated to the institution, the subscription price shall be the same as that at which this capital was placed. Any shareholding of more than 10% of the institution's capital shall be considered significant for these purposes.

If the placement made during the previous five months consisted of a significant percentage of capital, but one smaller than that being subscribed by the FROB, the price paid for the aforementioned placement shall be taken as a reference for the subscription price, such that it shall be considered, for the purposes of determining the subscription value, to be equivalent to an expert valuation. Therefore, the FROB shall obtain a valuation from two independent experts, and it shall apply the rules set out in paragraph 2 above using the valuations of the two experts appointed by it together with the price paid in the placement of the aforementioned significant percentage of capital.

4. When the FROB subscribes securities through an issue in which a third-party investor unrelated to the institution subscribing at least 30% of the placement takes part under the same conditions and in accordance with the provisions of paragraph 21 of the Commission Communication on the recapitalisation of financial institutions, the FROB may waive the requirement for the commitments and safeguards established in rule eight.

5. The FROB shall send a report to the General State Comptroller describing the procedure followed to calculate the purchase or subscription price of the shares representing institutions' share capital for the purposes envisaged in the final paragraph of Article 9.5 of Royal Decree-Law 9/2009.

**Rule five. Rights inherent in the subscription by the FROB of securities representing institutions' share capital**

1. In addition to any rights which, pursuant to applicable company law, may accrue to the FROB as a shareholder of institutions to which it provides aid, its taking a stake in the institution's share capital shall, in all cases, automatically result, without the need for any further acts or resolutions by any corporate governing body, in its being included on the governing body of the issuing institution so as to guarantee adequate compliance with the recapitalisation plan. The FROB shall also promote the adoption of measures to facilitate its subsequent divestment, in order to ensure the most efficient use of public resources.

2. The FROB shall appoint one or more natural persons to represent it for this purpose, and shall have as many votes on the governing body as it is entitled to by virtue of its proportion of the institution's capital.

3. The FROB shall appoint three people to represent it on the institution's governing body, unless circumstances arise which make a different number appropriate.

If the FROB is represented on the governing body by three persons, its representation shall be exercised jointly by at least two of its representatives. The FROB shall present motions for resolutions and shall exercise its voting rights on the governing body of the institution by the agreement of at least two of its representatives. For these purposes, each representative of the FROB on the governing body may only grant a proxy to one of the other two. This proxy may be general or specific to each meeting of the governing body.

4. The FROB shall exercise its right to receive the compensation corresponding to it in its capacity as a member of the board of the institution, including attendance fees or other remuneration of any kind.

**Rule six. Temporary nature of the subscription**

1. The FROB shall divest the shares or capital contributions that it subscribes in the exercise of its powers within a maximum of five years from the subscription date.

2. Notwithstanding the foregoing, in its decision to subscribe securities the FROB may establish the terms under which, within a maximum period of one year from the subscription date, it shall resell these securities to the issuing institution or third-party investors proposed by the latter.

Alternatively, this period may be of two years from the subscription date, in which case the FROB may require additional commitments from the applicant institution as well as those envisaged in Article 12.1 of Royal Decree-Law 9/2009.

The terms which the FROB agrees for the divestment shall follow the guidelines outlined by the European Commission regarding compliance with the rules on state aid and avoidance of distortions of competition.

#### **Rule seven. Divestments of subscribed shares**

1. In general, in order to ensure the most efficient use of public resources, the divestments by the FROB of securities subscribed within the framework of its competencies shall take place within the periods stated in rule six. Divestments shall take place under market conditions, for which procedures ensuring competition, such as, inter alia, the auction system, shall be used.

Notwithstanding the foregoing, the FROB may also reach an agreement with one or more of the other partners or shareholders of the credit institution in question regarding the possible sale of securities, under the same terms as the latter may arrange. In this case, the FROB shall consider it positive that the sale take place under market conditions and that it ensure that more efficient use of public resources, bearing in mind, where applicable, the premium that may be applied to the transfer of a controlling interest. As a general rule, these circumstances may be construed to obtain when the other partners or shareholders make securities amounting to at least 10% of the institution's capital available for sale to unrelated third parties.

2. The FROB shall send the General State Comptroller a report describing the procedure followed in the disposal of shares for the purposes envisaged in the second paragraph of article 9.9 of Royal Decree-Law 9/2009.

### **- Chapter III - Safeguards against distortion of competition**

#### **Rule eight. Imposing of safeguards on institutions receiving state aid.**

1. For as long as they continue to receive support from the FROB, and without prejudice to the commitments of beneficiary institutions pursuant to Article 12.1 of Royal Decree-Law 9/2009, the FROB shall also impose the following safeguards:

- a) Institutions may not implement expansion plans involving the acquisition of other institutions;
- b) They may not use the fact that they have received support from the FROB for commercial or advertising purposes, nor may they conduct aggressive marketing policies;

- c) They must ensure their remuneration policies comply with the provisions of Chapter XIII of Title I of Royal Decree 216/2008, 15 February 2008, on financial institutions' capital and the criteria outlined in the applicable European Union regulations.
  - d) They shall not remunerate hybrid instruments representing the institution's equity except in fulfilment of a legal obligation or contractual commitment.
2. The FROB may also require the beneficiary institution to adopt a dividend policy that ensures that the support provided remains compatible with community legislation.

**- Chapter IV -  
Provisions concerning the recapitalisation plan**

**Rule nine. Content of the recapitalisation plan**

1. In accordance with Article 9.2 of Royal Decree-Law 9/2009, the granting of public support by the FROB shall be subject to the submission of a recapitalisation plan by the applicant institution, which must receive the prior approval of the Banco de España.

Also, the effective provision of state aid through the FROB shall be subject to approval by the European Commission of the aforementioned plan, pursuant to articles 4.2 or 7.2 of Council Regulation (EEC) No. 659/1999, if the intervention of the FROB envisaged therein does not constitute state aid, or pursuant to articles 4.3, 7.30 7.4 of Council regulation (EEC) No. 659/1999, if it constitutes state aid compatible with the common market.

2. The recapitalisation plan, which shall include a business plan setting targets for efficiency, profitability, leverage levels and liquidity, and the milestones and actions to be fulfilled in order to ensure the viability and long-term solvency of the institution, must comply with the content of Annex I of the European Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, 23 July 2009. In particular, the plan must cover the following points, in accordance with the aforementioned Commission communication:

- a) A detailed description of the institution, its structure and current economic situation, based on the most recent economic information available;
- b) A description of the situation of the institution in the various markets or segments of the financial sector in which it is present (including activities outside Spain), stating market share when possible;
- c) An analysis of the reasons why the institution needs to apply for public aid through the FROB and, if the applicant institution has failed the stress tests to which it has been subjected, a detailed explanation of the reasons for this outcome;
- d) An explanation of the amount of aid requested from the FROB, the contribution made by the institution itself, and where appropriate, the proposed timetable and conditions for divestment.

3. Additionally, applicant institutions shall make the following undertakings:

- a) The commitment, if so requested by the FROB, to reduce total overheads at the time securities are subscribed by the FROB;

- b) Adoption of measures to enhance corporate governance. In general, institutions shall adapt themselves to comply with the provisions of the standards of good corporate governance and, in particular, they must comply with standards in force under Article 13 of Royal Decree-Law 9/2009;
- c) A commitment to increase lending to small and medium-sized enterprises, in terms compatible with the objectives established in its business plan;
- d) Any other commitments required by the FROB to ensure that efficient use is made of public resources and that the aid provided to the institution in question is compatible with the common market;
- e) Any other commitments to provide regular information required by the FROB to meet its obligations to supply information to the competent European Union authorities.

4. In the case of institutions that have already received state aid through the FROB and which are complying with a viability plan approved by the Banco de España, the new recapitalisation plan will take into account the restructuring efforts the institution has already made.

#### - Chapter V -

#### Monitoring, information disclosure and breach of obligations

##### **Rule ten. Quarterly reports from institutions to the FROB**

In accordance with the provisions of Article 9.9 of Royal Decree-Law 9/2009, institutions receiving support from the FROB in the form of a subscription of ordinary shares or capital contributions, shall send quarterly reports to the FROB on the degree of compliance with the planned measures and the commitments made and the milestones and actions envisaged in the approved recapitalisation plan. In the light of the content of this report and without prejudice to the powers that the Banco de España or other institutions may have, the FROB, may require that further actions be adopted if necessary to ensure that the plan is implemented in full.

##### **Rule eleven. Six-monthly reports to the European Commission**

The FROB shall send six-monthly reports to the European Commission on the financial support it has provided to financial institutions under the provisions of Article 9 of Royal Decree-Law 9/2009 in the terms set out in paragraph 46 of its communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules.

#### - Chapter VI -

#### Process of integration of credit cooperatives

##### **Rule twelve. Purchase of convertible preference shares**

The purchase by the FROB of preference shares convertible into contributions to the share capital of credit cooperatives within the framework of the process of integration envisaged in Article 10 of Royal Decree-Law 9/2009 shall be governed, *mutatis mutandis*, by the criteria and conditions approved by the Governing Committee of the FROB on 27 July 2010.