



Spanish Executive Resolution Authority

**ANNUAL REPORT**  
**2016**

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## ABBREVIATIONS AND ACRONYMS

APS: Asset Protection Scheme  
BMN: Banco Mare Nostrum  
CBCM: Cross-border Crisis Management (groups), under the auspices of the FSB  
CMG: Crisis Management Group  
CNMV: Comisión Nacional del Mercado de Valores (Spanish Securities Market Regulator)  
CoCos: Contingent Convertible Bonds  
ECB: European Central Bank  
ESM: European Stability Mechanism  
EU: European Union  
FGDEC: Fondo de Garantía de Depósitos de Entidades de Crédito (Deposit Guarantee Fund of Credit Institutions)  
FMI: Financial Market Infrastructures  
FSAP: Financial Sector Assessment Process  
FSB: Financial Stability Board  
G-20: Group of 20 (industrialised and emerging countries)  
GSIB: Global Systemically Important Bank  
IF: Investment Firm  
IMF: International Monetary Fund  
IRT: Internal Resolution Team  
MREL: Minimum Requirement of Eligible Liabilities  
NRF: National Resolution Fund  
ResCo: Resolution Committee of the EBA  
ReSG: Resolution Steering Group of the FSB  
Sareb: Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria (Asset Management Company for Assets Arising from the Banking Sector Reorganisation).  
SRB: Single Resolution Board  
SRF: Single Resolution Fund  
SRM: Single Resolution Mechanism  
SSM: Single Supervisory Mechanism  
TLAC: Total Loss Absorbing Capacity

## 1. CHAIRMAN'S STATEMENT

*The Act on the recovery and resolution of credit institutions and investment firms was approved in June 2015, pursuant to which the FROB was granted its current status of executive resolution authority. It is my pleasure to introduce this activities report for the first full year of activity under this new regulatory framework. Adapting to this regulatory framework has entailed a significant effort for the FROB, not only because it introduces substantial developments in the measures to be taken in the case of failing financial entities, but also because it transposes into our legal system the common regulatory structure of the European Union.*

*Since it was incorporated in 2009, the FROB has played a key role in the Spanish banking sector as an agent that is staunchly committed to guaranteeing and maintaining the stability of the financial system. Following this period of intense and decisive activity, the organisation is currently working on two fronts: First, to successfully complete the restructuring processes currently in progress, especially by monitoring its investees; and second, to strive to bring the Banking Union project to fruition, with the ultimate goal of ensuring a level playing field for the banking activity, and therefore for the individuals, businesses and public entities accessing financial services, across the eurozone, and in doing so, creating a true, efficient internal market governed by the same rules and authorities. The FROB's membership of the Single Resolution Mechanism, led by the Single Resolution Board, has been a major milestone in this regard.*

*2016 was a key year for strengthening the FROB's position as a leading resolution authority both at home and on the international stage. To achieve this, the organisation has had to adopt new functional arrangements, with internal recapitalisation instruments predominating and preventive planning playing a pivotal role. A new institutional structure has also been established in which cooperation between authorities is essential – at a domestic level with the preventive resolution authorities (the Bank of Spain and the CNMV) and across Europe through membership of the aforesaid Single Resolution Mechanism.*

*These challenges have been reflected in the FROB's transformation since the end of 2015. The key aims of this process have been to achieve operating excellence, organisational flexibility to respond to the various action scenarios, integrity and professionalism in decision-making processes and the commitment to institutional cooperation, and transparency.*

*Indeed, it was precisely to ensure the FROB conducts its ordinary activity in a transparent manner that a decision was taken to publish an activities report this year for the first time. The report sets out the functions performed by the various areas of the organisation (thereby offering a better understanding of the context in which the FROB operates) and the measures taken by these areas during the year. The Single Resolution Board recently carried out a similar process<sup>1</sup>.*

*2016 has therefore been a transitional year in which the FROB has become fully established as Spain's resolution authority. Despite the many hurdles faced, it has been a positive year. A significant part of the fruits of the previous year's efforts have been reaped in the first half of 2017, off the back of both progress made in the restructuring of several banks (most noteworthy, the current merger of Bankia and BMN to maximise the possibility of recovering state bailouts), and the fine-tuning of the institution as a well-prepared and mature executive resolution authority which will contribute to ensuring the Single Resolution Mechanism is effective and credible (resolution of Banco Popular).*

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<sup>1</sup> The Single Resolution Board published its Annual Report on 11 June. <https://srb.europa.eu/en/node/360>

*With regard to the latter point, which justifies the existence of an institution such as the FROB, whose sole aim is to protect public funds and financial system stability (particularly depositors), undoubted progress has been made in 2016. It is clear that the banking sector is far more robust than even just a few years ago. It is also evident that the FROB has continued to make strides in equipping Spain with the best tools to complete the restructuring of the financial sector in the best of conditions, while simultaneously and in partnership with the Single Resolution Board, providing our country with a public authority that is extremely specialised and effective at managing critical scenarios involving failing financial entities.*

*Lastly, I would like to highlight that all this has only been possible thanks to the hard work of the institution's staff, who are unwaveringly professional and dedicated. I would not want to end without expressing my gratitude to all of them for their commitment and willingness to serve, both key to being able to continue to rise to the challenges faced by the FROB and to be in a position to tackle any tests moving forward.*

Jaime Ponce Huerta

Chairman

## 2. EXECUTIVE SUMMARY

Pursuant to Act 11/2015, the FROB is the Spanish executive resolution and contact authority in matters concerning the European Bank Recovery and Resolution Directive. The Act also grants the FROB powers to collect contributions to the National Resolution Fund and Single Resolution Fund. It also establishes that the FROB must analyse entities' recovery plans to detect any potential obstacles to their resolution if the need arises, and report on the resolution plans that the preventive authorities (the Bank of Spain and the CNMV) may draw up, prior to their approval.

In order to efficiently perform these functions, which also enhance the FROB's ability to act in the execution phase, it must work closely with the preventive resolution authorities and the supervisors. In this regard, the FROB has worked with the Bank of Spain, the CNMV and the SRB on resolution planning, by analysing the practical application of the plans of six investment firms and 10 significant Spanish credit institutions<sup>2</sup>.

Further, in the case of Spanish entities with operations in other countries or foreign entities operating in Spain, the FROB has been involved in the Resolution Colleges and Crisis Management Groups that take decisions jointly. Thus, in 2016, the FROB participated as a member or observer in 10 Resolution Colleges and 3 Crisis Management Groups.

Vis-à-vis the resolution funds, during 2016 the FROB collected contributions to the Single Resolution Fund from 106 credit institutions and 10 investment firms, and contributions to the National Resolution Fund from 28 investment firms.

The FROB's work in resolution and restructuring processes prior to the entry into force of Act 11/2015 focused on: monitoring the financial position and fulfilment of the resolution and restructuring plans of entities; participating in the governing bodies and general meetings of its investee credit institutions and of Sareb; overseeing legal disputes deriving from resolution measures taken; managing guarantees granted during the divestment of entities receiving bailouts; and divesting entities in which the FROB continued to hold stakes.

Here, the main developments in 2016 were: the recovery of part of the contingent convertible bonds (CoCos) in Caja3 (now Ibercaja); the amendment to the restructuring plan for Banco CEISS (Unicaja Group), delaying its flotation in exchange for the assumption of certain additional commitments; early collection of part of the deferred payment for the sale of NGC Banco; and lastly, the start of analysis on the appropriateness of merging Bankia and BMN as an optimal sales strategy.

On this point, of particular note was the approval of Royal Decree-Law 4/2016 of 2 December, adding a further two years to the time limit for the FROB to exit its investees and also amending the Sareb's accounting regime.

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<sup>2</sup> The plans of less significant credit institutions started to be submitted in 2017.

### 3. FROB INSTITUTIONAL FRAMEWORK

#### 3.1. NATURE AND OBJECTIVES

***The FROB is dedicated to executing the resolution of failed entities that is more efficient in terms of public interest, protecting the stability of the financial system, and avoiding disturbances in the real economy and minimising the use of public funds.***

1. The FROB is the Spanish executive resolution authority subject to the provisions of Act 11/2015 of 18 June on the recovery and resolution of credit institutions and investment firms. Its purpose is to manage the resolution of failed entities to fulfil prevailing resolution objectives and principles, using the relevant powers conferred on it through domestic law and European Union legislation.

2. Since the Banking Union and, especially, the Single Resolution Mechanism came into force (Regulation (EU) No 806/2014), the FROB performs its duties as a national authority within the framework led by the European Single Resolution Board.

3. The FROB is governed and managed by a Governing Committee of 11 members: a Chairman appointed by the Council of Ministers after appearing before the Congress of Deputies' Economy and Competitiveness Commission, subject to certain termination clauses and for a non-extendible term of five years; a Vice-Chairman who is the Deputy Governor of the Bank of Spain, and three other members of this organisation; the Vice-Chairman of the CNMV; three representatives of the Ministry of the Economy, Industry and Competitiveness; and two representatives of the Ministry of Finance and Civil Service. Decisions affecting the General State Budgets are made by a governing body solely comprising these last five members and the Chairman.

#### 3.2. THE FROB WITHIN THE FRAMEWORK OF THE SINGLE RESOLUTION MECHANISM

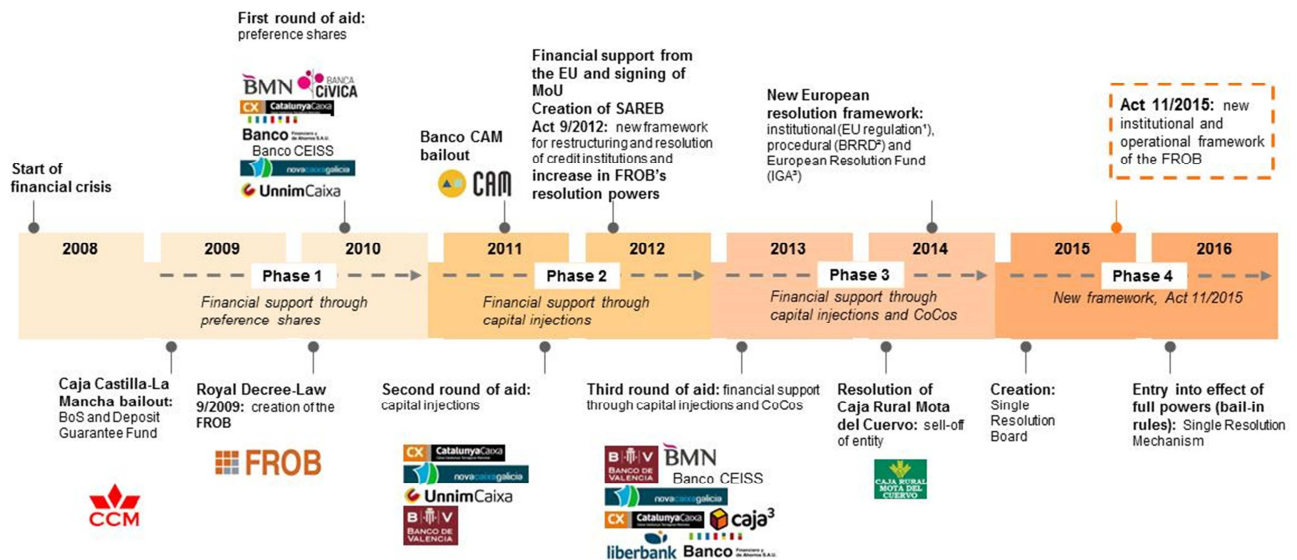
4. The FROB, established in 2009 to manage the restructuring of credit institutions and contribute to bolstering the own funds thereof, adopted as its objective the management of several resolution processes in 2012 (linked with bailouts in the eurozone), as approved in Act 9/2012 of 14 November on the restructuring and resolution of credit institutions.

5. Since the approval of said Act 9/2012 (formally preceded by Royal Decree-Law 24/2012 of 31 August), Spain was a pioneer in transposing into its legal system the key features of what later became Directive 2014/59/EU<sup>3</sup> (hereinafter, "the European Bank Recovery and Resolution Directive"). National legislation granted the FROB the resolution tools and powers that other EU Member States were subsequently incorporating into their legal systems. This resulted in the FROB being one of the first resolution authorities in the European Union and even worldwide, on being granted said powers and ultimately implementing some of the resolution measures agreed by the G-20 under the auspices of the Financial Stability Board (Key Attributes of Effective Resolution Regimes for Financial Institutions).

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<sup>3</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the restructuring and resolution of credit institutions and investment firms, and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulation (EU) No 1093/2010 and Regulation (EU) No 648/2012 of the European Parliament and of the Council

**Chart 1. FROB's development over time**



6. The FROB's current position as a resolution authority must be considered in the context of two essential elements. First, the national design of the assignment of powers in Act 11/2015 of 18 June on the recovery and resolution of credit institutions and investment firms. And, second, the configuration of the Banking Union project at the European level.

7. In effect, both the approval of the European Bank Recovery and Resolution Directive and, above all, the creation of the Banking Union with its three pillars – the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the future creation of a European Deposit Guarantee Scheme (still being negotiated) – resulted in the configuration of a completely new institutional framework for the FROB.

8. In particular, Regulation (EU) No 806/2014<sup>4</sup> establishes a single resolution framework and a Single Resolution Fund directly applicable to the entities of countries that are members of the Banking Union<sup>5</sup>. The Regulation establishes a Single Resolution Mechanism (SRM) in which the Single Resolution Board (SRB) is appointed as the single resolution authority directly responsible for all significant credit institutions<sup>6</sup> supervised by the Single Resolution Mechanism (SRM), and any others that, while not significant due to their size, operate in two or more countries in the Banking Union.

<sup>4</sup> Regulation (EU) No 806/2014 of the European Union and of the Council of 15 July 2014 establishing standard rules and a standard procedure for the resolution of credit institutions and certain investment firms within the framework of a Single Resolution Mechanism and a Single Resolution Fund.

<sup>5</sup> While only eurozone members are currently included in the Banking Union, other countries from the European Economic Area may also apply to join.

<sup>6</sup> Pursuant to the Single Supervisory Mechanism Framework Regulation (Regulation (EU) no 468/2014 of the European Central Bank of 16 April 2014), significant institutions are those which: have assets exceeding EUR 30 billion; have assets that as a percentage of the GDP of the country in which they are established exceed 20% (except where said assets are less than EUR 5 billion); are one of the three largest entities in a Member State; have subsidiaries in more than one member country of the Banking Union whose assets or liabilities represent over 20% of its total assets or liabilities; or which have received or requested direct bailouts from the European Stability Mechanism or the European Financial Stability Facility.



**Chart 2. List of entities under the SRB’s jurisdiction<sup>7</sup>**

Country	Number of entities
Germany	24
Austria	10
Belgium	8
Cyprus	5
Slovakia	3
Slovenia	3
<b>Spain</b>	<b>14</b>
Estonia	2
Finland	4
France	14
Greece	4
Netherlands	8
Ireland	5
Italy	16
Latvia	4
Lithuania	3
Luxembourg	6
Malta	3
Portugal	5
<b>Total</b>	<b>141</b>

Source: Single Resolution Board 2016 Annual Report (figures at 31/12/2016)

9. In addition to the SRB, the regulation establishes a Single Resolution Fund (SRF) which all significant and less significant credit institutions in the Banking Union must pay into. This fund is managed by the SRB.

10. The Single Resolution Mechanism is also made up of the National Resolution Authorities of each member state, which are responsible for the credit institutions outside the scope of the SRB’s jurisdiction and investment firms not included in banking groups.

### 3.3. RESOLUTION AUTHORITIES IN SPAIN

11. The European Bank Recovery and Resolution Directive establishes as normal practice the creation of resolution authorities that are independent from the supervisory authorities. This is the model applied in the actual architecture of the Banking Union, separating the supervisory functions of the SSM from the resolution functions of the SRM. This consideration is based, as per the wording of the preamble of Act 11/2015, on “*the necessary separation of supervisory and resolution functions with the declared intention of eliminating any conflicts of interest that may affect the supervisory authority if it were to simultaneously perform resolution functions*”.

12. Notwithstanding the above, the European directive also offers Member States the option of adopting a different organisational approach of assigning the resolution function to central banks or supervisors, provided that full independence is guaranteed. It also allows for a system with more than one resolution authority, as long as a single authority is designated as the contact authority.

<sup>7</sup> In Spain, these are: Santander, BBVA, Popular, La Caixa, Sabadell, Ibercaja, Liberbank, Unicaja, Cajamar, Bankinter, Kutxabank, Abanca, BMN and BFA-Bankia.

This latter option was adopted in Spain, where resolution functions were split between three authorities:

- An executive resolution authority, the FROB, which is also the contact authority and is responsible for coordination at an international level. The FROB is responsible for executing the resolution decisions taken by the SRB for significant institutions and directly exercising these powers, within the framework of the European Single Resolution Mechanism, for other types of entity. The FROB also represents the resolution authorities on the Single Resolution Board (and in dealings with the other international bodies involved in resolution).
- Two preventive resolution authorities: the Bank of Spain and the CNMV (with the pertinent separation of functions and structures from those of supervision) responsible for drafting the resolution plans of credit institutions and investment firms, respectively, in close collaboration with the SRB in the case of significant institutions, and with full powers in the case of less significant ones.

### Chart 3. Different configurations of SRB meetings

#### The format of the Board's meetings can be two-fold:

- Executive session: to decide on resolution-related matters. So-called restricted executive sessions are attended by the Board (Chairman, Vice-Chairman and four permanent members) and a member of the European Commission and of the European Central Bank as permanent observers. If decisions to be taken concern a resolution plan, the resolution scheme or use of the resolution fund for a specific entity, representatives of the national resolution authorities (NRAs) of the countries of the bank affected by the decision (extended executive session) may join the members of the Board at executive sessions. If an entity has significant subsidiaries or branches in countries not in the Banking Union, the NRAs of these countries may attend meetings as observers. Pursuant to the regulation on resolution, decisions taken in executive sessions of the SRB must be reached by consensus. If a consensus is not reached, only the members of the Board (Chairman and directors) may vote.
- Plenary session: plenary sessions are held at least every six months. They are attended by the Board (Chairman, Vice-Chairman, four permanent members), the NRAs, a member of the European Commission and a member of the European Central Bank. Matters discussed during these sessions concern resolutions but are not connected with a specific entity. They basically cover administrative issues and two key matters: (a) decisions on specific resolutions when the resolutions entail drawing down more than EUR 5 billion from the Single Resolution Fund; and (b) decisions on SRF borrowings. The rules of procedure of SRB plenary sessions state that at least two meetings must be held annually. In 2016, the plenary session met on seven occasions, although there was a total of 65 additional written procedures.

In the case of Spain, the FROB represents the Spanish resolution authorities on the SRB, in both extended executive sessions and plenary sessions. As the preventive resolution authority, the Bank of Spain attends both sessions as an observer, with a voice but no vote.

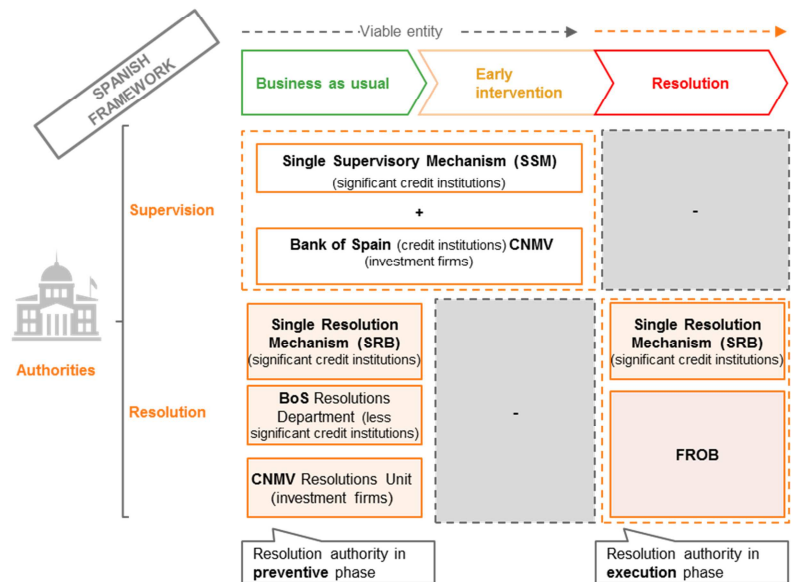
13. Lastly, the FROB collects SRF contributions from all Spanish entities and manages the National Resolution Fund, which is made up of contributions from investment firms (and is only used in resolutions of this type of entity).

**Chart 4. Institutional and operational framework of the FROB**

**New resolution framework**

- Institutional framework**
  - **European level:** Single Resolution Mechanism
  - **Spanish level:** three authorities:
    - FROB as resolution authority in execution phase and coordinator of international action
    - BoS and CNMV as resolution authorities in preventive phase
- Functional framework**
  - **Operational level:** maximum involvement between bail-in resolution instruments and strategic role of resolution planning
  - Creation of the **Single Resolution Fund**

**Organisational chart of the resolution system in Spain<sup>1</sup>**



1. Further to the provisions of Act 11/2015 on the recovery and resolution of credit institutions and investment firms, Royal Decree 1012/2015 implementing Act 11/2015 and Regulation (EU) No 806/2014 on the recovery and resolution of credit institutions and investment firms.

## 4. RESOLUTION PLANNING

14. The European resolution framework places considerable emphasis on both preventing and planning the resolution of credit institutions and investment firms. In this regard, Act 11/2015 allows for early intervention of a bank when it is still possible to return it to viability and thus to avoid entering the resolution phase. Without prejudice to the fact that these preventive powers are primarily exercised by the supervisors (the Bank of Spain and the CNMV) and their respective preventive resolution departments, the FROB has certain legal powers, which were exercised in 2016 as described hereon.

### 4.1. EARLY INTERVENTION AND RECOVERY

15. With regard to early intervention, Act 11/2015 requires all entities to prepare recovery plans that must be approved by the supervisor. Such plans must set out the measures that may be taken by the entity to restore its financial position in the event of a significant deterioration in its capital, liquidity or profitability or any other event that could jeopardise its viability.

16. In 2016, FROB analysed the recovery plans of 54 less significant institutions submitted by Bank of Spain, and of 10 recovery plans of investment firms received from the CNMV. The aim of the FROB's review of these plans is to evaluate whether the content thereof could negatively affect an entity's *resolvability*.

## 4.2. RESOLUTION PLANNING

### Content of resolution plans

17. Resolution plans are drawn up by the preventive resolution authority and have several parts:

- A description of the entity and of the material legal entities<sup>8</sup> comprising it, its core business lines<sup>9</sup>, interconnectedness and the critical functions or services it provides.
- The preferred resolution strategy, i.e. a description of the tools and measures that would be applied in each case.
- The plan must also contain an analysis of the entity's *resolvability*. In other words, an assessment of whether it is feasible and credible that an entity can be resolved either through liquidation in normal insolvency proceedings or by way of the proposed resolution strategy, without affecting financial sector stability or the taxpayer, and guaranteeing the continuity of the critical functions it performs. The resolution plan identifies existing impediments to potential resolution, such that the resolution authority may require the affected entity to take appropriate steps to eliminate such impediments.
- Lastly, the plan must set the MREL. As explained in the previous section, the MREL is intended to ensure that, if a resolution tool is used, there are sufficient liabilities with loss absorbing capacity and that could enable the entity to be recapitalised.

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<sup>8</sup> The European Banking Authority (EBA) defines "material legal entities" as those entities fulfilling the following conditions:

- They contribute substantially to the profit of the entity (or its group, where applicable), to their funding, or hold an important share of its assets, liabilities or capital;
- They perform key commercial activities or carry out key economic functions;
- They provide critical services;
- They bear substantial risks that could, in a worst-case scenario, jeopardise the viability of the entity (or group);
- They could not be "liquidated" without having a significant impact on the entity (or group);
- They are systemic in the financial system in which they operate.

<sup>9</sup> A business line is a structured group of activities, processes and operations performed by an entity to achieve the organisation's objectives.

## Chart 5. Resolution tools

### Resolution tools

The rules allow resolution authorities to use four tools to resolve an entity:

- i. **Sale of business tool:** Enables resolution authorities to force the sale of certain assets, liabilities or shares of an entity to a buyer selected through a competitive process (unless this is not possible due to the need for urgency), without requiring consent of the shareholders or other owners.
- ii. **Bridge institution tool:** This tool is similar to the previous one, although here the assets and liabilities that are transferred are those performing the entity's critical functions. These assets and liabilities are transferred to a bridge institution, i.e. a company whose purpose is to perform all or part of the activities of the entity under resolution, and will remain in said institution for up to two years. In practice, two entities are involved: the bridge institution itself, which must be sold within this time frame, and an entity holding the remaining assets, that must be liquidated.
- iii. **Asset separation tool:** This involves transferring an entity's troubled assets to an asset management vehicle (AMV). The AMV will manage the assets to maximise their value and minimise the impact that their direct sale on the market could have on a specific sector or the economy as a whole. This tool must always be used in conjunction with a bail-in.
- iv. **Bail-in tool:** This tool enables the claims of shareholders and/or creditors to be written down or converted to equity in order to absorb losses and, where applicable, recapitalise the entity under resolution (or the bridge institution) to enable normal operations to continue.

### Less significant institutions and investment firms

18. Act 11/2015 establishes that the preventive resolution authority will prepare resolution plans and review them annually. Once a resolution plan has been drawn up, it will be sent to the supervisor, the FROB and the SRB. These will analyse the plan to determine if there are any further impediments that could arise on executing the plan.

In 2016, the FROB reviewed and issued reports on the resolution plans of six investment firms prepared by the CNMV<sup>10</sup>.

<sup>10</sup> The resolution plans of less significant credit institutions started to be submitted after year-end.

## Significant credit institutions

19. Resolution plans for significant credit institutions are drawn up by the SRB. To this end, the SRB has established arrangements for collaboration between it and the national authorities through mixed working groups known as Internal Resolution Teams (IRTs)<sup>11</sup>. SRB employees – one of whom acts as lead – and staff from the various national authorities responsible for an entity participate in these teams. An IRT may be responsible for the planning work of one or a number of credit institutions. The FROB collaborates with the planning work of the IRTs coordinated nationally by the Bank of Spain as the preventive resolution authority.

20. When an entity operates in other EU countries that are not members of the Banking Union, its joint negotiation plan must be negotiated in a Resolution College<sup>12</sup>. In the case of Global Systemically Important Banks (GSIBs), certain agreements are also reached with the resolution authorities of non-EU countries in Crisis Management Groups (CMGs)<sup>13</sup>.

21. In 2016, the FROB participated in six IRTs, responsible for 14 significant Spanish institutions. The FROB's work as a member of the IRTs involved reviewing and analysing the draft plans for 10 entities, sharing its conclusions with the other IRT members. It should be noted that a specific MREL has not been included in these first plans, as the SRB has still not established a definitive methodology for calculating said requirement.

22. The SRB defined two types of entity for the plans of significant credit institutions for 2016:

- ***Priority entities:*** Groups with significant entities in Banking Union countries and in any other EU Member State that is not in the Banking Union (or outside the European Union).  
In the case of entities in the Banking Union (including Spanish ones), the FROB participates as an observer in the colleges and CMGs of those entities with significant branches or subsidiaries in Spain.

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<sup>11</sup> The IRTs are working groups for cooperation between the SRB and the national authorities (NRAs) when performing tasks related with the resolution and resolution planning of entities for which the SRB is responsible. Their functions include:

- Examining recovery plans and preparing resolution plans;
- Assessing resolvability and defining measures to eliminate impediments;
- Defining the MREL for individual entities and groups;
- Preparing for the SRB's involvement in Resolution Colleges;
- Preparing resolution schemes and monitoring the execution thereof;
- Providing advice to the executive session of the SRB;
- Coordinating/supporting inspections in situ; and
- Working with the supervisory/resolution authorities.

<sup>12</sup> Their functions include planning, assessing resolvability, determining MREL and ensuring cooperation and coordination with third countries (outside the European Union). Their decisions are binding if an agreement is reached, otherwise the European Banking Authority (EBA) will step in as mediator. They are chaired by the pertinent NRA, while the national resolution authorities, supervisors, government ministries and deposit guarantee funds (DGFs) of all Member States in which the group has significant branches or subsidiaries may take part. The authorities of third countries where the group has significant branches/subsidiaries may attend as observers.

<sup>13</sup> The Financial Stability Board (FSB) provides for the creation of CMGs, for all Global Systemically Important Banks (G-SIBs), for the prevention and coordination of bank resolutions. This is an FSB recommendation, but not a mandatory obligation, in contrast to the case of resolutions colleges. Each CMG will be led by the home (resolution or supervisory) authority, while the relevant home and host authorities – supervisor, central bank, finance ministry, and deposit guarantee fund – may participate. This is an advisory body, whose decisions are not binding, in which resolution planning and the most effective execution thereof will be agreed.

For entities in the European Union but outside the Banking Union, the FROB participates as a member in the colleges and CMGs of those entities with significant branches or subsidiaries in Spain.

In 2016, the FROB participated in 10 Resolution Colleges (7 corresponding to non-Spanish entities) and in 3 Crisis Management Groups. Pursuant to the aforementioned criterion, the FROB has only participated as a member of one Resolution College (attending the rest as an observer, as it did in the case of the CMGs, with the SRB being the member thereof).

- *Other non-priority significant entities:* Those groups without significant branches or subsidiaries outside the Banking Union. The extended executive session of the SRB is responsible for approving their resolution plans and schemes (i.e. based on the vote of the representatives of the countries involved – the FROB, in the case of Spain). In this particular instance, as it concerns matters specifically related with the preventive phase of the resolution of credit institutions, the FROB determines the position of the Spanish representation through prior dialogue with the Bank of Spain, as preventive resolution authority, taking its opinion into consideration.

## 5. RESOLUTION PHASE

23. The resolution of a credit institution or investment firm entails an extraordinary administrative procedure to manage its failure without having to resort to liquidation in normal insolvency proceedings. Its extraordinary nature means that three conditions must be fulfilled simultaneously for resolution to take place:

- The entity is failing;
- There is a lack of private sector alternatives that could prevent failure; and
- Resolution action is in the public interest.

24. A resolution authority will only take the decision to open a resolution process if these three circumstances apply. Such a process will begin with a valuation of the entity and drafting of a resolution scheme setting out the measures to be adopted.

25. The FROB did not carry out any resolutions in 2016. The only action over the period was to determine that public interest was not affected by the winding up of a minor investment firm, reported by the CNMV, (due to its small size and the lack of any detrimental effects on the few investors still holding stakes in the entity).

26. Furthermore, in 2016, the FROB continued to work hard on readying itself for possible future resolution processes, developing the in-house capabilities needed to ensure it will be able to manage them efficiently and in a well-coordinated manner with all the authorities involved, especially with the SRB.

### European resolution of Banco Popular, 2017

In the afternoon of 6 June 2017, the Single Supervisory Mechanism informed the SRB of the failure of this entity, due to it being imminently unable to settle its payments in the near term.

As a result, during the night of 6 to 7 June 2017, the SRB approved the first resolution scheme of the Banking Union. The European Commission, meanwhile, was charged with formally rubber-stamping the SRB's decision.

In particular, the SRB agreed the following measures: redemption of all the bank's outstanding shares; conversion of Additional Tier 1 capital instruments into shares and redemption of the latter; conversion of all the Tier 2 capital instruments into newly issued shares in the bank; and lastly, sale of all these new shares at EUR 1.

The SRB's resolution scheme was reported to the FROB's Governing Committee which, as per applicable Banking Union rules, proceeded to execute it immediately.

Public information on this case is available:

From the SRB: <https://srb.europa.eu/en/node/315>

From the FROB:

[http://www.frob.es/es/Lists/Contenidos/Attachments/518/170607\\_NP\\_Popular\\_Santander.pdf](http://www.frob.es/es/Lists/Contenidos/Attachments/518/170607_NP_Popular_Santander.pdf)

[http://www.frob.es/es/Lists/Contenidos/Attachments/520/ProyectedeAcuerdoreducido\\_EN\\_v1.pdf](http://www.frob.es/es/Lists/Contenidos/Attachments/520/ProyectedeAcuerdoreducido_EN_v1.pdf)

<http://www.frob.es/es/Lists/Contenidos/Attachments/522/QA14062017v13web.pdf>

*As an exception, this case is included in the 2016 report, as it was the first resolution scheme of the Banking Union.*

## 6. SINGLE RESOLUTION FUND AND NATIONAL RESOLUTION FUND

27. One of the pillars of the new resolution framework is the creation of resolution funds as funding tools that resolution authorities can use in certain circumstances to effectively carry out the various resolution measures put in place.

28. The funds comprise contributions of credit institutions and investment firms established in Spain (as well as the contributions of credit institutions of the other member countries of the Banking Union, in the case of the Single Resolution Fund). The target volume of funds for 31 December 2024 is equivalent to 1% of covered deposits.

29. Spanish investment firms not in a banking group are required to contribute to the National Resolution Fund, while credit institutions and investment firms that are subsidiaries of credit institutions make contributions that are collected by the FROB and are transferred in full to the Single Resolution Fund. Using information provided by the affected entities, said fund is responsible for calculating each entity's contribution.

30. Each entity's total liabilities excluding own funds less covered deposits as a percentage of the total for all entities are taken into consideration to calculate contributions. This result is then



adjusted based on each entity's risk profile. Details of the calculation method are provided in Commission Delegated Regulation (EU) 2015/63 of 21 October 2014.

31. The FROB is responsible for collecting the contributions to both funds, on the one hand, and for calculating contributions to the National Resolution Fund, on the other. In this respect, the FROB's activity in 2016 primarily focused on announcing and carrying out the steps needed to effectively collect contributions and, specifically to:

- Act as the first port of call for any queries or requests from entities required to make contributions. In this regard, the FROB held information sessions with the industry to set out the purpose of and method for calculating contributions;
- Obtain from entities the data needed to calculate the contributions for each entity; and
- Collect the contributions of Spanish credit institutions and investment firms that are subsidiaries of such entities, and transfer the contributions to the Single Resolution Fund.

**Chart 6. Contributions of Spanish entities to the NRF and the SRF**

EX-ANTE CONTRIBUTIONS	2016				2015			
	SRF		NRF	Total	SRF		NRF	Total
	CI (*)	IF	IF		CI (*)	IF	IF	
Number of entities	106	10	28	144	109	10	29	148
Contribution (EUR thousand)	726,295	64	1,790	728,149	690,208	73	890	691,171

(\*) Commission Delegated Regulation (EU) 2015/63 establishes that in the case of entities affiliated to a central body and exempted from prudential requirements in national law, contributions should only apply to the central body. Pursuant to information provided by the supervisor, there are two entities considered to be central bodies, in which a total of 24 affiliated entities are included.

32. According to information provided by the Bank of Spain and the CNMV, in 2016 144 entities were required to contribute, 106 of which were credit institutions and 38 investment firms (2015: 148 entities, of which 109 were credit institutions and 39 investment firms).

33. In 2016, the FROB collected total contributions of EUR 728 million (EUR 726.35 million for the Single Resolution Fund and EUR 1.79 million for the National Resolution Fund).

34. Furthermore, at the start of November, work began to gather information for calculating 2017 contributions. Entities had to furnish the FROB with this information by 31 January 2017.

35. Following payment of the 2017 contribution at the end of June 2017, the Single Resolution Fund has a balance of EUR 17.4 billion provided by approximately 3,500 European entities. EUR 2.1 billion of this amount was contributed by Spanish entities<sup>14</sup>.

36. The 2017 contribution by Spanish entities totalled EUR 677 million<sup>15</sup>.

<sup>14</sup> <https://srb.europa.eu/en/node/362>

<sup>15</sup> <http://www.frob.es/es/Lists/Contenidos/Attachments/526/Notadeprensarecaudacion2017final.pdf>

## 7. INTERNATIONAL ACTIVITY

37. One of the FROB's major areas of work concerns its active involvement in international discussion forums that are drawing up resolution rules, to ensure they are applied consistently. It is also party to discussions regarding amendments or new regulatory projects related with resolution.

### 7.1. SINGLE RESOLUTION BOARD

38. The FROB's Chairman represents the Spanish resolution authorities in SRB plenary sessions (and in any extended executive sessions involving Spain). The Bank of Spain, meanwhile, attends as an observer. The FROB and the Bank of Spain participate in the various sub-committees and working groups created under the auspices of the plenary to push forward with building a common vision in the Banking Union regarding resolution planning and execution.

39. Three committees were established in 2016, all reporting to the plenary session:

- i. The Resolution Committee, responsible for resolution planning and execution matters, and for the monitoring performed by the SRB of the activity of the national resolution authorities concerning entities in their countries;
- ii. The Administrative and Budget Committee; and
- iii. The Committee dedicated to the Single Resolution Fund.

40. The aim of these committees is to support the SRB, facilitating decision-making by providing prior technical guidance and analysis on matters to be discussed in the plenary. A number of technical working groups also report to each committee. These comprise personnel from the national resolution authorities and the SRB who prepare and put forward specific technical proposals on the various matters at hand.

41. In 2016, the SRB's plenary session focused on continuing to improve preparations for resolution, further developing the configuration and collection of Single Resolution Fund contributions, developing resolution regulations, and continuing to build its internal organisational structure. Most noteworthy has been the work on identifying critical functions, preparing the resolution plans for the largest banking groups, and enhancing the operating manuals and guides on resolution planning and crisis management. Throughout the year, the FROB has been involved in seven SRB plenary session meetings, and in all the written procedures circulated, always with the aim of contributing the institution's experience vis-à-vis the construction of the SRM, as well as continuing to adopt a proactive and collaborative approach regarding organisational matters and resolution policy issues.

### 7.2. OTHER INTERNATIONAL FORUMS

42. The FROB also participates in other discussion forums within the European Union and around the world.

43. First, the FROB is a member of the Resolution Committee (ResCo) of the European Banking Authority (EBA). This committee develops technical rules, guides and reports on the Bank Recovery and Resolution Directive. Some of these rules are subsequently enacted as level two EU law. Also notable is this committee's role in the analytical work being carried out to issue recommendations on amendments of certain aspects of the aforesaid directive and the development of technical rules regulating how assets and liabilities are measured in resolution processes.

44. The FROB is also a member of the Resolution Steering Group (ResG) of the Financial Stability Board (FSB), which not only debates the resolution of banks but also analyses the possible resolution of financial market infrastructure and insurance firms.

45. The FROB participates in the Cross Border Crisis Management Group for banks (CBCM) and the Cross Border Crisis Management Group for financial market infrastructures (fmiCBCM), as well as their respective sub-groups. The CBCM's work has primarily revolved around:

- Practical execution of internal recapitalisation;
- Funding for entities placed into resolution;
- Maintaining business continuity;
- Access to financial market infrastructures for entities placed into resolution; and
- Total Loss Absorbing Capacity (TLAC): similar to MREL, but with differences in the way it is calculated and applied.

46. The fmiCBCM is involved in analysing the possible resolution of central counterparties. However, less progress has been made with this group's work than that of the CBCM.

47. During 2016, the FROB also provided advice to the Spanish representation led by the General Secretariat of the Treasury and Financial Policy in meetings hosted by the European Commission and the Council of the European Union concerning resolution matters. Also of note was the review of the Resolution Directive and of the SRB Regulation, the main developments of which are the introduction of Total Loss Absorbing Capacity (TLAC) in the EU and harmonisation between Member States of creditor hierarchy in resolution processes and insolvency proceedings. The FROB provided technical advice on the proposals included in the new package of regulations and will continue to do so as they are negotiated.

## 8. RESTRUCTURING AND RESOLUTION PROCESSES

### 8.1. ENTITIES SUBJECT TO RESTRUCTURING OR RESOLUTION

#### 8.1.1. Credit institutions in which the FROB holds a stake

##### **BFA-Bankia**

48. At 31 December 2016, BFA (and therefore, indirectly, the FROB) held 65.904% of Bankia's shares<sup>16</sup>.

49. The deadline for the FROB's full exit was pushed back in December 2016 on approval of Royal Decree-Law 4/2016, and is now December 2019. In September 2016, work started to analyse which of the available divestment options for the FROB regarding the credit institutions in which it holds a stake would be the most appropriate in terms of maximising recovery of the state bailouts. This process was completed in March 2017 and the fundamental conclusion was that the best option to achieve the aforesaid objective was to divest FROB's two investees (Bankia and BMN) as one entity after their merger.

50. Regarding this entity's performance in 2016, the Bankia Group (which includes the banking arm) posted a profit of EUR 804 million. Bankia distributed dividends for the third year running. Dividends paid out against 2016 profit totalled EUR 317 million, EUR 211 million of which was paid to BFA for its stake in the entity. Dividends collected by BFA to date for its stake in Bankia total EUR 534 million.

51. At the 2016 close, the BFA Group (which includes Bankia) posted attributable profit of EUR 65 million, negatively affected by the additional provisions of EUR 621 million recognised to cover the legal contingency associated with the annulment petitions filed in relation to the mis-selling of hybrid instruments.

52. The BFA-Bankia Group's restructuring plan will be completed by 31 December 2017. At 31 December 2016, the group had fulfilled all the commitments assumed under the plan.

##### ***Legal contingencies***

- **Minority shareholder tranche in the entity's stock market flotation:** As a result of the Supreme Court Judgement of 27 January 2016, the entity agreed an out-of-court settlement to reimburse its minority shareholders. At year-end 2016, this settlement entailed pay-outs of approximately EUR 700 million for 135,000 claims.
- **Floor clauses:** On 21 December 2016, the European Court of Justice ruled that when floor clauses in mortgage loan agreements are rendered null and void due to a lack of transparency of said clauses, any amounts unfairly charged should be calculated retrospectively from the moment the aforesaid clauses were applied.

In Bankia's case, only 3% of the mortgage loans granted were subject to a floor clause during the loan term. In September 2015, the entity also decided to no longer apply these

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<sup>16</sup> At the date of preparing this report, this stake stood at 66.973% (as a result of the enforcement of the final court judgements concerning the mis-selling of hybrid instruments, which has led to the bank having to buy back the instruments converted into shares).

floor clauses in all these operations. Subsequent to year-end, a Royal Decree-Law was enacted in January 2017 establishing the measures entities must take to reimburse the unduly charged amounts. Bankia has already taken action to quickly refund these amounts since the first quarter of 2017.

## BMN

53. The FROB holds a 65% stake in BMN, with the remaining shares primarily held by the foundations of the former savings banks and the holders of hybrid instruments.

54. As mentioned beforehand, the deadline for the FROB's full exit was pushed back in December 2016 on approval of Royal Decree-Law 4/2016, and is now March 2020. In September 2016, work started to analyse which of the available divestment options for the FROB regarding institutions in which it holds a stake would be the most appropriate in terms of maximising recovery of the state bailouts. This process was completed in March 2017 and the fundamental conclusion was that the best option to achieve the aforesaid objective was to divest FROB's two investees (Bankia and BMN) as one entity after their merger.

55. Turning to the entity's performance in 2016, BMN posted a loss of EUR 39 million during the year, principally due to the major provisions recognised.

56. The FROB has monitored the progress of BMN's recapitalisation plan, which ends on 31 December 2017. At 31 December 2016, the objectives regarding the size of the entity's balance sheet, deleveraging, number of branches and staff were easily exceeded. As a result, all the structural commitments assumed under the restructuring plan have been met or are on track for fulfilment in 2017.

### 8.1.2. Credit institutions in which the FROB holds CoCos

57. At year-end 2016, the FROB held CoCos of Caja3 (merged with Ibercaja) and of CEISS (Unicaja Group) on its balance sheet. Nevertheless, at the date of publication of this report, the Ibercaja CoCos had been bought back in full ahead of the deadline stipulated in the initial schedule. It therefore only retains the CoCos of CEISS on its books.

#### Banco Caja 3 (taken over by Ibercaja Banco)

58. In March 2013, Caja3 received a total of EUR 407 million through the subscription of contingent convertible bonds (CoCos), issued to bolster the entity's required capital. While the CoCos have been on the FROB's balance sheet, they have generated interest of EUR 143 million, fully paid out by the entity.

**Chart 7. Redemption schedule for Caja3 contingent convertible bonds**

(EUR thousand)

	% redemption	Amount	Planned date	Actual date
1	5%	20,350	31/03/2016	31/03/2016
2	40%	162,800	31/03/2017	29/12/2016
3	55%	223,850	31/12/2017	24/03/2017

59. The entity's restructuring plan is scheduled for completion by 31 December 2017. At the 2016 close, Ibercaja had fulfilled all the commitments assumed under the restructuring plan.

### **Banco CEISS (taken over by the Unicaja Banco Group)**

60. CEISS received a bailout in the form of capital instruments totalling EUR 1.129 billion, EUR 525 million of which was injected as preference shares convertible into capital in 2010. These securities were converted and redeemed by way of a capital reduction to zero in 2013. The remaining EUR 604 million was injected in the form of CoCos subscribed by the FROB in April 2013, which are pending redemption.

61. The entity has paid out interest accrued on the CoCos (amounting to EUR 219 million). The next payment of EUR 15 million will be made on 30 July 2017.

62. The FROB and the Bank of Spain approved on 20 and 22 December 2016, respectively, the third amendment to Banco CEISS' resolution plan. Meanwhile, on 27 January 2017 the European Commission adopted the decision to amend the plan. The amendment included extending the deadline for Unicaja Banco's flotation, an additional reduction in the number of CEISS staff and branches, and a new undertaking for the accelerated redemption of the CoCos.

63. At the 2016 close, and after the third amendment of the resolution plan, the entity had fulfilled all the undertakings assumed under the plan.

64. It is worth mentioning that on 30 June 2017, Unicaja Banco fulfilled the commitment to be floated on the stock market, and was listed on the four Spanish stock exchanges. According to the prospectus on the public offering and admission to trading of ordinary shares, the entity initially issued 625 million new shares (not including any issued following the execution of a greenshoe option). The funds obtained through the share issue are for:

- Fully redeeming the CoCos held by the FROB (EUR 604 million);
- Funding the acquisition of the FROB's temporary stake in CEISS as a result of the compensation mechanism (EUR 62 million); and
- General corporate purposes.

### **8.1.3. Other restructuring and resolution plans**

#### **NCG Banco**

65. Approval of the sale of NCG Banco to Banco Etcheverría-Grupo Banesco was given on 18 December 2013. The FROB and the Deposit Guarantee Fund sold their stake for EUR 1.003 billion, EUR 403 million of which was settled when the sale was formalised. The remainder will be paid in instalments until June 2018. Nonetheless, the contract allows for early repayment – a right that the buyer has exercised. At the date publication of this report, the buyer has settled the agreed price in full, having made an early repayment of EUR 300 million in May 2016 and another for the outstanding balance (a further EUR 300 million) at February 2017.

66. Concerning progress with the entity's resolution plan, the entity has fulfilled all its commitments, resulting in completion of the restructuring on 31 December 2016.

#### **Catalunya Banc (taken over by BBVA)**

67. The entity was sold to BBVA in July 2014 for EUR 1.165 billion. Work on achieving the commitments set out in the resolution plan is progressing as envisaged, with completion of the plan

expected at the end of 2017. These commitments basically involve achieving a certain number of branches and staff.

### **Liberbank**

68. Liberbank 's restructuring plan is scheduled for completion by 31 December 2017. To date, the entity has fulfilled all the commitments established in its resolution plan.

## **8.2. MONITORING OF GUARANTEES GIVEN IN DIVESTMENT PROCESSES**

69. As part of the credit institutions' sale and resolution processes, the FROB granted a series of guarantees securing certain contingencies, with a view to avoiding full haircuts resulting from a number of legal disputes involving the entities. The aim is to maximise sales prices and minimise the use of public funds. Some of these guarantees merely cover the volume of losses to be assumed by the buyer with regard to certain loan books. Others are intended to hold the buyer harmless (or assume jointly with the buyer) of the cost of certain lawsuits or future events associated with this type of entity<sup>17</sup>.

70. The FROB constantly monitors the status of these guarantees, confirming that the claimed disbursements are justified and within the parameters agreed with the buyer.

71. The main guarantees and the status thereof in 2016 are set out hereon:

### **8.2.1. Asset protection scheme arranged in the sale of Banco Valencia**

72. On 27 November 2012, the FROB arranged an APS for the buyer of Banco Valencia (CaixaBank), maturing on 30 September 2022, covering 72.5% of any losses on a closed loan book, which initially totalled EUR 6.424 billion, with a first-loss threshold of EUR 402 million. As a result of two writedowns and a correction of scope in April and August 2013 and October 2016, respectively, these amounts were reduced to EUR 5.192 billion and EUR 212 million, respectively.

73. To date, the FROB has made no payments to CaixaBank under the APS, as the first-loss threshold (EUR 212 million) is higher than the net losses incurred to 31 December 2016 (EUR 175 million). On the other hand, to date, the FROB has collected a total of EUR 1.5 million for the annual APS commission.

### **8.2.2. Other guarantees**

74. With regard to the other guarantees, in order to ensure they are used as effectively as possible, beneficiaries must submit formal compensation claim requests to the FROB. These requests must provide individual and detailed information on the case for which compensation is being requested, and the amounts thereof. Each request is exhaustively reviewed by the FROB in order to fulfil the provisions in the corresponding contracts including the guarantees.

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<sup>17</sup> Main guarantees given: Asset Protection Scheme (APS) to cover any losses on a certain asset portfolio (only in Banco de Valencia process); Sareb guarantee covering a number of potential contingencies deriving from the transfer of the entities' to Sareb; tax credits, through which the FROB will ensure these credits can be used by the entities in the future; mis-selling, in light of possible liabilities that could arise from lawsuits for mis-selling of hybrid instruments, floor clauses or interest-rate hedge agreements; legal/damages, holding the entity harmless of any damages stemming from final legal rulings; equity stakes, compensation for amounts due for price of stake or any possible future claims concerning the early cancellation of significant contracts, based on a change in control of the acquired entity, to finance certain payment obligations of entities.

### 8.3. SAREB

75. The Asset Management Company for Assets Arising from the Banking Sector Reorganisation (Sareb) was incorporated on 28 November 2012 as a limited company for a finite period to November 2027. Its original own funds totalled EUR 4.8 billion, EUR 1.2 billion of which was capital and EUR 3.6 billion, deriving from two issues of unsecured subordinated debt contingently convertible into shares subscribed by shareholders.

76. The FROB subscribed 45% of the shares and 45.9% of the subordinated debt (EUR 540 million and EUR 1.652 billion, respectively).

77. The total value of the assets transferred to Sareb was EUR 50.781 billion. Payment for the transfer was effected through the delivery of six senior debt issues by Sareb with an irrevocable state guarantee, signed by the aid recipients. The bonds received as payment are non-transferable and may be redeemed on expiration in cash or through the delivery of newly issued bonds, as Sareb so decides.

78. As a result of the losses deriving from the measurement of Sareb's assets on applying Bank of Spain Circular 5/2015 of 30 September, setting out the specific accounting principles for Sareb, the company's own funds were negative at 31 December 2015. In order to redress this situation, EUR 2.170 billion of subordinated debt was converted into capital: an operation authorised by the General Shareholders' Meeting on 5 May 2016. Following the conversion and reduction of capital, Sareb's own funds<sup>18</sup> totalled EUR 2.380 billion, which comprised 5% of total outstanding assets at 31 December 2016.

79. Subsequently, Royal Decree-Law 4/2016 of 2 December was published in December setting out urgent financial measures, which involved an amendment to clause 10.c) of additional provision seven of Act 9/2012, changing the scheme for recognising potential capital losses deriving from the application of the Bank of Spain's accounting circular. Rather than being taken to profit or loss, these capital losses were recognised directly in equity, and as the new criterion was applied retroactively, the company increased its reserves for the accumulated losses, net of the tax effect.

80. Consequently, Sareb's own funds at year-end 2016 totalled EUR 2,620 billion, comprising EUR 304 million of capital and EUR 2.979 billion of reserves, and losses of EUR 663 million (for 2016). EUR 1.430 billion of outstanding subordinated debt needs to be added to this amount, taking total own funds to EUR 4.050 billion.

81. The shareholder structure remains practically unchanged from the original situation, except for minor, immaterial differences in the percentages. The FROB currently holds 45.9% of capital and outstanding subordinated debt.

**Chart 8. Key financials of Sareb at year-end 2016 (EUR million)**

Results	2016
Total income	3,923
Gross income from financial assets	515
Gross income from real estate assets	149

<sup>18</sup> Comprising capital, reserves and subordinated debt.



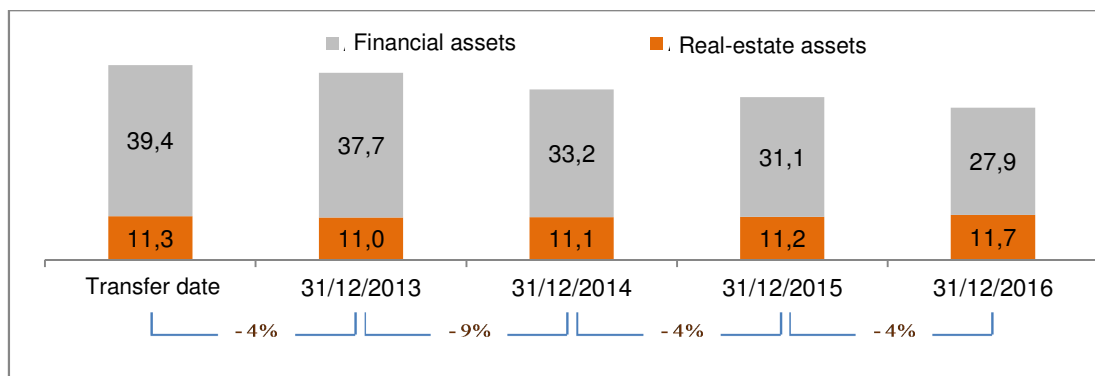
Total gross income	664
Operating expenses	(683)
Amortisation and depreciation charges and others	(85)
Finance costs	(558)
<b>Loss for the year</b>	<b>(663)</b>

82. The net result for 2016 was a loss of EUR 663 million. At year-end 2016, own funds totalled EUR 2.620 billion, while equity was a negative EUR 2.657 billion, given the marking to market of interest-rate hedging derivatives and the impairment of financial assets.

83. The remaining senior debt amounted to EUR 41.597 billion (80% of the initial total), following repayment of EUR 1.879 billion in 2016. Consequently, a total of EUR 9.184 billion of the senior debt has been repaid since the start. Savings in the finance costs of senior debt issues are noteworthy, as such costs are 20% lower than those incurred in 2015.

84. The remaining balance of assets transferred at their carrying amount (taking accumulated depreciation and amortisation and impairment into account) totalled EUR 36.564 billion, 67% of which are financial assets and 33% real-estate assets. Changes in the carrying amounts of the financial and real-estate assets on Sareb's balance sheet (excluding the EUR 3.389 billion of estimated impairment losses on Sareb's 2016 annual accounts) were as follows:

**Chart 9. Changes in the financial and real-estate assets on Sareb's balance sheet (EUR thousand million)**



85. In keeping with its social objectives, Sareb conducts a number of social responsibility campaigns, primarily focusing on:

- Improving the lives of groups at risk of social exclusion, granting financial aid for social housing and emergency funds, distributed through agreements with local councils and regional governments;
- Providing alternative accessible rented accommodation, with a view to offering especially vulnerable groups alternatives to asset repossession processes; and
- Providing support to entrepreneurs, in partnership with local councils, to tackle unemployment.

86. Sareb has put a stock of 4,000 homes at the disposal of these institutions through these programmes, which can be ceded for social use, subsequent to signing an agreement. In 2016, the

company signed agreements with the autonomous community governments of Cantabria, Navarra, Andalusia, Extremadura and Murcia; and with the local councils of Barcelona, Madrid, Malaga, Seville, Valladolid, Hospitalet, Móstoles and San Sebastián de los Reyes.

87. As a result, at year-end, Sareb had assigned around 2,500 homes under agreements that have been signed or are very close to being signed, and it is in talks with other regional governments and local councils to assign further dwellings.

#### **8.4. LEGAL AFFAIRS**

88. The FROB actively participates in and monitors legal proceedings related with restructuring and resolution processes and any action associated therewith. The FROB's activity can, in this regard, be classified in the four major blocks of law comprising Spanish legislation:

- a) Criminal law;
- b) Administrative appeals;
- c) Civil-commercial law; and lastly
- d) Company law.

##### **8.4.1. Criminal law**

89. In criminal law, the FROB has been heavily involved in detecting and analysing transactions at credit institutions receiving public bailouts that could comprise criminal activities, and in taking legal action to prosecute for any irregular conduct detected.

90. The FROB has pushed for exhaustive internal audits of the various entities receiving public bailouts, covering transactions related with real-estate deals and the internal remuneration practices of the entities themselves.

91. Where irregularities in transactions have been detected, a far more in-depth analysis has been performed with the preparation of forensic reports by consultancy firms that are expert in such matters. The objective of this work is to pass on to the Special Prosecutor for Corruption and Organised Crime any transactions that could be subject to criminal sanction, along with any information collated and related documentation, so that they can be investigated if the prosecutor determines that there is evidence of criminal activity.

92. At year-end 2016, the FROB had reviewed a total of 90 transactions, 47 of which were passed on to the Special Prosecutor for Corruption and Organised Crime<sup>19</sup>. Also at that date, the FROB was involved in a total of 24 criminal cases, 20 filed by the entity itself, either directly with the prosecutor or through the entities involved, during the period in which they were administrated by the FROB.

##### **8.4.2. Administrative appeals**

93. The legal action in this area in which the FROB has been involved has derived from the FROB's administrative activity in its capacity as a resolution authority, with the powers granted to it as per article 64 of Act 9/2012 of 4 November on the restructuring and resolution of credit institutions (now repealed and replaced by the same article of Act 11/2015 currently in force). In

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<sup>19</sup> At the time of writing this report, 57 forensic reports on irregular transactions had been sent to the Special Prosecutor for Corruption and Organised Crime.

particular, the administrative appeals concluded during 2016 derived from the administration's state liability, and appeals against rulings passed by the FROB.

94. The majority of the cases filed contesting action performed during restructuring and resolution processes relate to FROB rulings to take steps to manage hybrid instruments, increase or decrease capital without preferential subscription rights, or transfer assets to Sareb. All legal rulings to date have upheld the legality and compliance of the administrative actions of the FROB.

#### **8.4.3. Civil-commercial law**

95. In this area, the lawsuits involving the FROB have been in connection with the FROB's actions under the powers bestowed upon it in article 63 of Act 9/2012 (now repealed and replaced by the same article of Act 11/2015 currently in force). These include cases in which petitions were filed to annual agreements to buy and sell the shares of entities subject to restructuring or resolution to a third party.

96. Another area of civil legal action in 2016 concerned the implementation of the so-called "Review Mechanism" in the resolution of Banco CEISS, since a number of this entity's customers who disputed this mechanism decided to submit their case to the courts. The courts rejected their claims.

#### **8.4.4. Corporate law**

97. Lastly, alongside its work to prosecute irregular conduct detected in the entities receiving state aid, the FROB has also analysed any cases that could involve irregularities in the remuneration practices of said entities, submitting them to the courts.

98. Several major corporate law cases have been filed against directors and senior executives who, due to irregular remuneration practices, may have been responsible for a decline in their entities' financial positions and, in short, aggravated the circumstance leading to the entity requiring a public bailout.

99. On the other hand, other corporate law cases have arisen as a result of workforce measures taken by entities receiving bailouts, which have been contested in the courts by the affected employees. Nonetheless, as proven by the various court rulings, the FROB is not liable as it has no employment relationship with these parties.

### **8.5. DIVESTMENT OF INVESTEE CREDIT INSTITUTIONS**

100. The FROB's strategy for exiting its investees is primarily aimed at maximising recovery of the bailouts to minimise the cost of resolution to the taxpayer.

101. No divestments were performed in 2016, although the FROB's Governing Committee, in its reduced format, agreed on 28 September 2016 to take the necessary steps to analyse reorganising its investee credit institutions. A month later at the 18<sup>th</sup> October meeting, having informed Bankia and BMN of its decision, the FROB Governing Committee voted to start a process to appoint advisors. Six companies submitted bids, with AFI Consultores de las Administraciones Públicas being awarded the contract.

102. Simultaneously, an independent expert was hired to evaluate market interest in BMN. This appointment was authorised by the FROB's Governing Committee at its meeting of 27 December. Bids were received and Société Générale awarded the contract in January 2017.

103. A few days earlier, Royal Decree-Law 4/2016 was enacted, pushing back the divestment deadlines stipulated in Act 9/2012 by two years, as “*the divestment of these entities within said deadlines would severely hinder fulfilment of one of the principal objectives of the resolution: to ensure the most efficient use of public funds, as it would have to be performed quickly and not under market conditions*”. In light of the aforesaid, as well as amending the divestment deadlines – December 2019 for Bankia and March 2020 for BMN – the Council of Ministers was authorised to approve new postponements, if necessary and provided they are duly justified.

## Chart 10. Reorganisation of the FROB’s investments

### Bankia-BMN merger balance sheet

At the date of preparing this report, the results of the work performed by Afi and Société Générale have been obtained. They conclude that the merger of Bankia and Banco Mare Nostrum (BMN) is the best strategy for maximising the capacity to recover the public bailouts in the event of future divestment. At its meeting on 14 March 2017, the FROB Governing Committee took note of these findings and resolved to start the work needed to fulfil its mandate of optimising the capacity to recover the public bailouts in the event of future divestment.

The FROB also informed the entities of the agreement so that they could begin work within the management remit and powers of their governing bodies and in strict compliance with prevailing domestic and European Union law.

Along with the press release published by the FROB on 15 March 2017, the entities also published significant event notices announcing the start of the work needed to analyse the transaction, always with a view to protecting the interests of all their shareholders and in full compliance with the law and following the required procedural steps.

They also clarified that no resolution had yet been passed and that the merger required approval by the two entities’ boards of directors and general shareholders’ meetings.

Subsequently, the entities notified their boards of the FROB’s decision and agreed to hire several firms to provide advice on the main aspects of the merger. The entities also agreed to establish as part of their governance framework, committees of independent directors whose basic remit is to monitor and oversee the entire merger during both the investigation and analysis phase of the transaction and, when the time comes, fulfilment of all established legal requirements. These committees are responsible for keeping the boards of directors abreast of progress with all the work. They also look after the interests of all the entity’s shareholders, to ensure autonomous and independent decision-making.

On 27 June 2017, the boards of directors of BMN and Bankia both published significant event notices announcing the approval, on 26 June, of the joint project to merge Bankia (as acquirer) and BMN (as acquiree). Given potential conflict of interests, the FROB chose to abstain from attending the relevant BNM board meeting during which the merger was approved by the independent directors. The merger entails exchanging one Bankia share for 7.82987 BMN shares which, at the reference exchange date, put BMN’s value at EUR 825 million. From a corporate governance perspective, the project involves including a BMN director on the board of the entity resulting from the merger.

The merger requires the approval of the general shareholders’ meetings of the entities, called for 14 September 2017 by virtue of a two-thirds majority vote, and the pertinent legal authorisations.

*As an exception, this case is included in the 2016 report, due to its materiality with regard to the divestment of investees*

## 9. ORGANISATION OF THE FROB

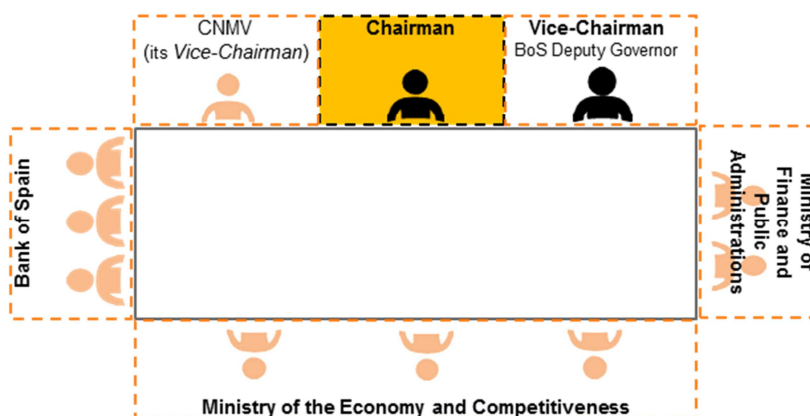
### 9.1. CONTROL AND GOVERNANCE BODIES

#### 9.1.1. Governing Committee

104. The FROB is governed and managed by a Governing Committee of 11 members:

- a. Chairman of the Governing Committee: FROB Chairman;
- b. Vice-Chairman: Deputy Governor of the Bank of Spain, standing in for the Chairman in the event of the latter's absence or illness or if the chairmanship becomes vacant;
- c. Three members of the Bank of Spain, appointed by the Bank of Spain's Executive Committee. These positions are currently held by the Director General of Banking Supervision, Director General of Financial Stability and Resolution, and the General Secretary of the Bank of Spain;
- d. Vice-Chairman of the CNMV;
- e. Three representatives of the Ministry of the Economy, Industry and Competitiveness, appointed by the ministry. These representatives are currently the Deputy Secretary of the ministry, The General Secretary of the Treasury and Financial Policy, and the Chairman of the Spanish Institute of Accountants and Auditors (ICAC); and
- f. Two representatives of the Ministry of Finance and Civil Service, appointed by the ministry. These representatives are currently the ministry's Deputy Secretary and the Director General for Budgeting.

**Chart 11. FROB Governing Committee**



105. Sessions of the Governing Committee are also attended by a representative of the Comptroller General of the State (IGAE) and another of the Attorney General – Director of the State Legal Service, who have a voice but no vote.

106. Irrespective of the aforesaid, decisions affecting the General State Budgets are made by a reduced number of members of the Governing Committee:

- Chairman;
- Three representatives of the Ministry of the Economy, Industry and Competitiveness; and

- Two representatives of the Ministry of Finance and Civil Service.

107. The plenary session of the Governing Committee met on 20 occasions, while two meetings were held in its reduced format.

108. An Audit Committee has been set up under the auspices of the Governing Committee comprising three members of the Governing Committee: the Bank of Spain’s Director General of Banking Supervision, the Director General for Budgeting, and the representative appointed by the Auditor General.

## 9.2. ORGANISATION

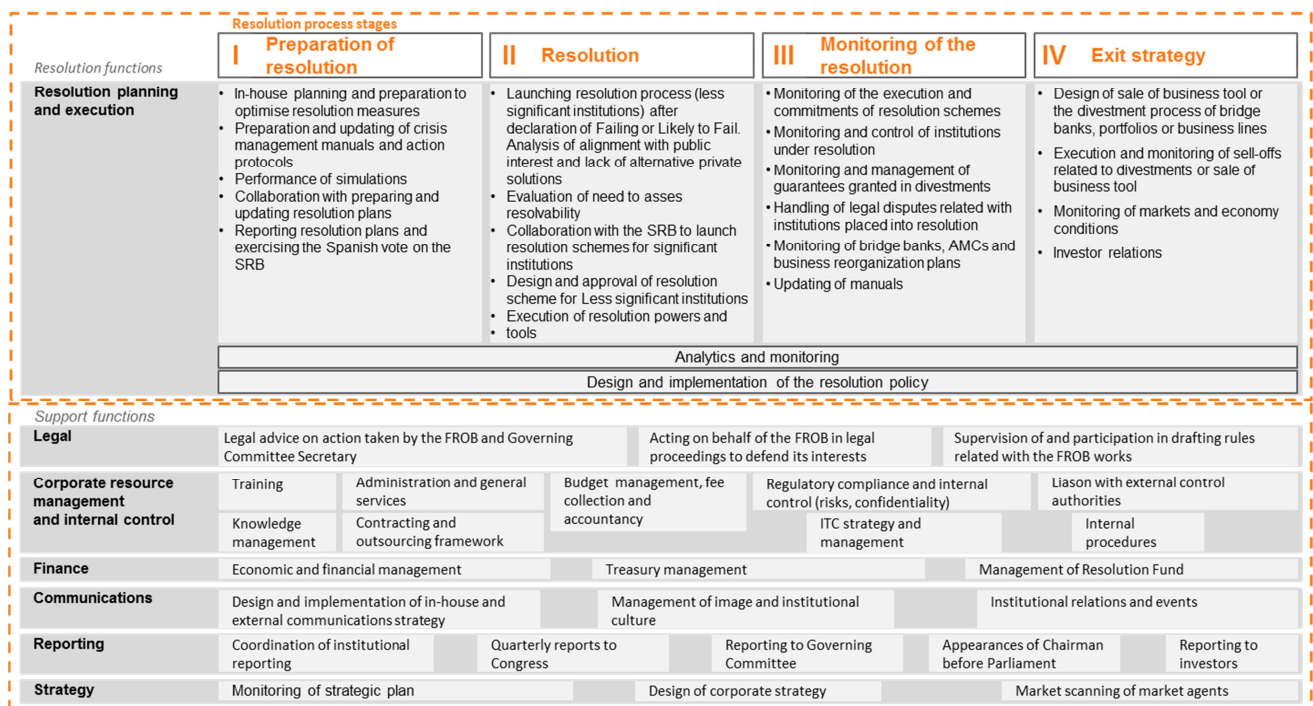
109. The FROB has four divisions led by its Chairman:

- Administration and Control;
- Finance and Investees;
- Legal Affairs; and
- Resolution and Strategy.

110. The divisions are split into departments for the purpose of exercising the powers and conducting the activities assigned to each of them.

111. There is also a unit reporting to the Chairman’s Office that is headed up by a director and is responsible for legal relations with investees.

**Chart 12. Map of the FROB’s functions**



112. At 31 December 2016, the FROB had 40 members of staff, including the Chairman and directors. The following tables show the distribution of the workforce by professional category and gender:

**Chart 13. Distribution of personnel by professional category**

Category	Headcount
Senior Management <sup>20</sup>	5
Group II	20
Group III	10
Group IV	3
Group V	2
<b>Total</b>	<b>40</b>

*Of the 40 employees, 19 are women and 21 men.*

113. During 2016, the FROB continued to build up the resources needed to ensure it can meet the challenges arising from the new resolution framework in the European Union and as a result of the launch of the Single Resolution Mechanism.

114. Moreover, in December 2016 and after the necessary authorisations had been obtained from the Ministry of Finance and Public Administrations, six new selection processes were conducted to fill eight full-time vacancies. These selection processes were solely aimed at civil servants or permanent staff working in state agencies or departments, pursuant to article 20.3 of Act 48/2015 of 29 October on General State Budgets for 2016.

115. These vacancies were filled in early 2017.

## 10. FINANCIAL MANAGEMENT

### 10.1. CASH MANAGEMENT

116. The FROB's Finance and Investees Division manages the entity's funds as per the requirement to invest in highly liquid, low risk assets. This means holding deposit and current accounts and acquiring short-term treasury bonds and bills.

117. At 31 December 2016, the FROB's cash reserves not subject to short-term commitments totalled EUR 1.177 billion; sufficient to redeem the bond expiring in the near term (April 2017) and to cover expected cash outlays.

118. Payments made and collections received by the FROB in 2016 included:

- Redemption on 31 March 2016, as per the established schedule, of EUR 20.4 million of the Caja3 CoCos (5% of the total). Further, on 29 December, Caja3 CoCos of EUR 163 million were redeemed early (40% of the total).

<sup>20</sup> As defined in Royal Decree 451/2012 of 5 March, regulating the remuneration of senior executives and directors in state-owned companies and other entities.

- On 6 May 2016, the FROB received part of the deferred payments for the sale of NGC totalling EUR 300 million.
- On 12 July 2016, the FROB's third bond issue was redeemed on maturity for an amount of EUR 2.505 billion.
- Also, the FROB received over the course of the year, payments corresponding to the coupons and interest on CoCos, remunerative current accounts and public debt portfolio, totalling around EUR 160 million.

119. Turning to the FROB's funding, details of the only bond issued by the FROB that was outstanding at 31 December 2016 but has since been redeemed at the date of this report, are as follows:

**Chart 14. Outstanding issue at year-end 2016**

ISIN	COUPON	EXPIRATION DATE	NOMINAL (EUR million)	AVERAGE COST
ES0302761046	0.218%	30/04/2017	520	0.218%

## 10.2. FROB OPERATING FEE

120. Article 53.4 of Act 11/2015 introduces the so-called “fee for activities performed by the FROB in its capacity as a resolution authority”. This fee is intended to cover the entity’s operating costs and is charged to the entities required to contribute to either the Single Resolution Fund or the National Resolution Fund. This is an important development regarding the sources of funds available to the FROB to perform its activities, as before said Act 11/2015 came into force, the legal regime applicable to the FROB established that this entity would avail of the funds allocated to it through the General State Budgets and obtained through borrowings.

121. This funding system is in line with that established for the Single Resolution Board, the administrative expenses of which are also covered by the entities through the pertinent annual payments.

**Chart 15. Main features of the fee collected by the FROB**

- Chargeable event.** Performance of supervisory and reporting functions and application of resolution tools during the preventive and execution phases of resolutions.
- Accrual.** The fee is accrued on 1 January each year, except for the incorporation of entities, in which case it is accrued from the incorporation date.
- Fee payers.** Credit institutions and investment firms established in Spain.
- Calculation base.** The ordinary annual contributions payable by each entity to the National Resolution Fund or, where applicable, the Single Resolution Fund.
- Tax liability.** Result of applying a rate of 2.5% to the taxable fee.

122. As per Royal Decree 1012/2015, the FROB's Governing Committee approved in its 19 April 2016 meeting, the proposed fee breakdown for activities performed by the FROB as resolution authority in 2016, and delivery of the corresponding payment form to fee payers.



123. All fee payers paid the fee within the stipulated deadline, with a total of EUR 18.206 million collected.

### 10.3. STATE LOAN FOR FINANCIAL SECTOR RECAPITALISATION

124. On 3 December 2012, the State granted the FROB a loan to execute the European financial assistance programme for the restructuring of Spain's financial system. This loan acted as a vehicle through which funds from the European Stability Mechanism (ESM) could be channelled to the Kingdom of Spain and subsequently, through the FROB, to Spanish credit institutions.

125. The loan was paid out in two tranches, the first at the end of 2012 (EUR 39.468 billion) and the second in early 2013 (EUR 1.865 billion), through the contribution of financial instruments (bills and bonds) issued by the ESM.

126. Key milestones since the loan was received are as follows:

- Following the ESM's approval, part of the loan from the Spanish State was converted on 9 December 2013 into a contribution to FROB's capital of EUR 27.170 billion.
- In 2014, unused funds held by Sareb of EUR 307.54 million were returned. EUR 1.304 billion of the loan was also repaid voluntarily, EUR 399 million of which was provided by the FROB.
- Two voluntary repayments were made by the Treasury in 2015.
- A further voluntary repayment was made in 2016.

127. At 31 December 2016, the outstanding balance on the loan awarded to the FROB by the Spanish State totalled EUR 13.456 billion: EUR 11.591 billion corresponding to the first pay-out and EUR 1.865 billion to the second. Another part of the loan from the Spanish State was recently converted into a contribution to FROB's capital of EUR 3.000 billion, corresponding to the first tranche. The first repayment of the remaining loan principal corresponding to the first tranche will be on 11 December 2022, and annually thereafter until it matures in 2027. The second tranche will fall due in two equal parts on 11 December 2024 and 2025, respectively.

128. In 2016, EUR 148 million was paid on this loan for interest and other associated costs, representing 1.10% of the finance cost in 2016.

#### 10.4. 2016 ANNUAL ACCOUNTS

129. On 29 June 2017, the FROB Governing Committee approved the entity's annual accounts for 2016, previously authorised for issue by the Chairman, in fulfilment of article 54.5 c) and 55.4 c) of Act 11/2015 on the recovery and resolution of credit institutions and investment firms.

130. The FROB's 2016 annual accounts show assets of EUR 14.354 billion, liabilities of EUR 15.963 billion and negative equity of EUR 1.609 billion, including the loss for the year of EUR 1.693 billion. This primarily derives from the discounting of the FROB's equity investments in BFA, BMN and Sareb, and the negative impacts of guarantees given by the FROB in the various sell-offs.

131. After applying the 2016 result, the endowment fund (*fondo patrimonial*) totals a negative EUR 1.615 billion, as legislation establishes that any losses must be taken to the institution's endowment fund. In order to redress the FROB's equity position, a further EUR 3 billion of the Spanish State loan was converted into a contribution to FROB's capital, as per article 53.4 of Act 11/2015 and as stipulated in the corresponding loan agreement, following approval by the ESM (given on 30 May 2017). Subsequent to this conversion, the FROB's endowment fund has a positive balance of EUR 1.385 billion

132. The FROB's annual accounts are audited by an independent auditor. The auditor stipulated in its audit report on the 2016 annual accounts that, in its opinion, the FROB's annual accounts give, in all material respects, a true and fair view of the assets and liabilities and financial position of the FROB at 31 December 2016.

**ANNEX**
**Record of FROB aid at 31 December 2016 (EUR million)**

Entities involved	APS and guarantees	Shares, preference securities or CoCos	Recoveries (FROB)
<b>Catalunya Banc</b> Catalunya, Tarragona, Manresa	559	12,052	782
<b>CEISS</b> Caja España-Duero	430	1,129	-
<b>Nova CaixaGalicia</b> Galicia, Caixanova	379	9,052	783
*Banco Gallego (spun off from NCG)	95	245	-
<b>BFA-Bankia</b> Madrid, Bancaja, Laietana, Insular, Rioja, Ávila, Segovia	-	22,424	-
<b>Banco Mare Nostrum</b> Murcia, Penedés, Sa Nostra, Granada	-	1,645	-
<b>Banca Cívica</b> Navarra, Cajasol-Guadalajara, General de Canarias, Municipal de Burgos	-	977	977
<b>Banco de Valencia</b>	656	5,498	-
<b>Liberbank</b> G. Cajastur, C. Extremadura, C. Cantabria	-	124	124
<b>Caja3</b> CAI, C. Círculo, C. Badajoz	-	407	183
<b>Caja Sur</b>	392	800	800
<b>Interest collected through coupons and others</b>	-	-	<b>1,377</b>
<b>FROB injection</b>	<b>2,511</b>	<b>54,353</b>	-
<b>Sareb</b>	-	<b>2,192</b>	-
<b>Total</b>	<b>2,511</b>	<b>56,545</b>	<b>5,026</b>

(\*) Final aid recovered will depend on the performance and financial divestment of the FROB's investees (BFA/Bankia, BMN and Sareb) and the final redemption and interest payment of the outstanding CoCos (CEISS and Cajas3-Ibercaja). This column does not include EUR 1.304 billion from the sale of 7.5% of Bankia in January 2014, or EUR 321 million in dividends paid out by Bankia, as in both cases, the amounts received are retained in BFA. From 31 December 2016 to the date of this report, BFA received EUR 211 million in dividends from Bankia, while the full outstanding amount of the Caja3 CoCos of EUR 224 million has been collected.