



## **NEW FRAMEWORK FOR THE RESTRUCTURING AND RESOLUTION OF FINANCIAL INSTITUTIONS**

The Spanish government has approved on August 31, 2012 a Royal Decree-Law on a new framework for the restructuring and resolution of financial institutions, which will become an essential tool in the crisis management in financial institutions. To this end, the available instruments, the role of public institutions and the procedures are reinforced. The ultimate objective is to safeguard the stability of the entire financial system, beyond the problems of a particular entity. This Royal Decree Law enters immediately into force and has to be ratified by the Parliament.

With this Royal Decree-Law the Government fulfils the commitments acquired within the program of financial assistance to Spain for the recapitalization of the banking sector, agreed upon by the Eurogroup on 20 July and included in the Memorandum of Understanding. In fact, it includes not only the commitments to be implemented before August 31 but also others which were to be implemented in the following months, such as the strengthening of the Fund for Orderly Bank Restructuring (FROB), the strengthening of the protection of retail investors and the transfer of responsibilities for sanctioning and licensing of new banks from the Ministry of Economy and Competitiveness to the Bank of Spain.

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The Royal Decree Law includes measures on six fields:

1. A new and strengthened framework for crisis management of financial institutions that allows for effective restructuring and orderly resolution if necessary.
2. Reinforcement of the FROB's intervention tools at all stages of crisis management.
3. Strengthening of the protection of retail investors.
4. Establishment of an Asset Management Company (AMC).
5. Burden sharing between the public and private sector of the cost of restructuring resulting from the restructuring of entities.
6. Other aspects such as the strengthening of capital requirements, new limits on executive compensation and transfer of competences to the Bank of Spain.

### **Crisis management framework**

The Royal Decree-Law sets up a comprehensive framework to deal with financial institutions in stressed situations. This Royal Decree-Law incorporates in advance some of the provisions foreseen in the future European Directive on crisis management. Depending on the financial entity's situation, three types of measures can be applied: early intervention (for mild difficulties) restructuring measures (for temporary troubles, able to be coped with by means of public financial support) and orderly resolution (for non-viable institutions).



- Early intervention measures are envisaged to deal with viable institutions which may require an exceptional and temporary support (no longer than two years) through the use of contingent capital instruments (CoCos).
- Restructuring provisions are aimed at institutions presenting temporary weaknesses that can be overcome through the injection of public funds. In this regard, the troubled institution will be able to obtain guarantees, loans, recapitalization through shares or CoCos, etc.
- The orderly resolution of an institution might take the form of partial business sales or an asset and liability sale to a bridge-bank or to an asset management company. The FROB should dispose of its capital shares in 5 years. As far as CoCos are concerned the FROB can convert them into capital in the 6 months following the fifth year of their subscription. The six months deadline can be increased to 2 years depending on the entity's situation.

### **FROB reinforcement**

The Royal Decree-Law also deals with the strengthening of the FROB's powers, placing it, together with the Bank of Spain, as the public institution in charge of the restructuring and resolution of financial institutions. The FROB will be funded by the State Budget and could leverage up to a certain limit (120 billion for 2012). It will be ruled by a board formed by representatives of the Bank of Spain and the Ministries of Economy, Public Administrations and Finance, and it will also have a General Director with full executive powers.

### **Restructuring of entities**

The Royal Decree Law establishes the burden sharing regime between the public sector and the private stakeholders, defining the mechanism by means of which the owners of hybrid capital instruments could be forced to bear part of the losses of a troubled institution. The objective is to reduce, to the maximum extent possible, the cost for taxpayers of restructuring, according to the European rules of state aids. Following this regulation, if the FROB considers that the loss absorption by private owners is not enough, it will be able to impose them specific exchange exercises.

These exercises could consist of exchanges into capital instruments, direct or conditioned cash repurchases, or reduction and anticipated amortization of the nominal value of the instrument. All these actions will take into account market values, applying a haircut as established in the European rules.

### **Strengthening of the protection of retail investors**

At the same time, certain restrictions to the future sale of these hybrid products are adopted, in order to protect retail customers and enhance transparency. From now on, each of these issuances will have a minimum wholesale tranche of 50% and a threshold for retail investments of € 25.000 and 100.000€, respectively for listed and non-listed companies. Supervision powers of the National Securities Commission (CNMV) are reinforced in this



sense and non-suitable retail customers will be requested to handwrite a statement saying they were warned about their non-suitability to buy that product.

### **Asset Management Company**

The role of the Asset Management Company is shaped in the Royal Decree Law, and will be subject to a further detailed regulatory development. The AMC may adopt the form of a limited company or of a trust fund. This instrument will allow the removal from the balance sheet of state aided banks of certain problematic assets in order to ease their viability. This AMC has a temporary role. The FROB is entitled to commit the entities receiving state aids to transfer those problematic assets.

### **Capital requirements**

The Royal Decree-law sets a new minimum Common Equity Tier 1 ratio requirement that the entities and groups of credit institutions must comply with. Specifically, the current requirements of 8% and 10% (8% as a general rule and 10% for entities with difficult access to capital markets and for those for which wholesale funding is predominant) become a single requirement of 9% that all the entities must comply with as from 1 January 2013. The new regulation does not only modify the capital requirements but also its definition in order to adapt it to the one established in the European Banking Authority recapitalisation exercise recently carried out. This change does not imply, de facto, a significant change of the requirements already applied.

### **Bank of Spain**

The Royal Decree-Law also contributes to make a clear separation of the functions assigned to the Bank of Spain and to the Ministry of Economy and Competitiveness regarding the authorization and sanctioning of financial institutions. Sanctioning of very serious infringements and licencing powers are entrusted to the Bank of Spain.

### **Executives' compensations**

Finally, a new reduced cap is established for the fixed retributions of the Chairman, Board members and executives of State aided entities for which the FROB has not the majority control. This cap is reduced from the current 600,000 € to 500,000.