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ASSET MANAGEMENT COMPANIES AND THE SAREB

LAW 9/2012, OF NOVEMBER 14, 2012, ON THE RESTRUTURING AND RESOLUTION OF CREDIT INSTITUTION, AND ROYAL DECREE 1559/2012, OF NOVEMBER 15, 2012, ESTABLISHING THE LEGAL REGIME FOR THE ASSET MANAGEMENT COMPANIES

1. INTRODUCTION

This document highlights the main aspects of asset management companies (“AMCs”) and, in particular, of the SAREB (*Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria*), governed by the rules in chapter VI and certain additional provisions of Law 9/2012, of November 14, 2012, on the restructuring and resolution of credit institutions (“**Law 9/2012**”), originating from parliamentary approval of Royal Decree-Law 24/2012, of August 31, 2012, and implemented by Royal Decree 1559/2012, of November 15, 2012, establishing the legal regime of asset management companies (“**Royal Decree 1559/2012**”).

Law 9/2012 approaches the rules on these companies from two angles:

- (i) general rules on AMCs in the long term, applicable to any present or future restructuring or resolution of a credit institution that requires the creation of an AMC; and
- (ii) specific rules on the creation of the SAREB, to which the assets from the ongoing bank restructuring process in Spain will be transferred.

It is important to note that, for the purposes of Royal Decree 1559/2012, the asset management companies regulated in chapter II of Law 8/2012, of October 30, 2012, on the writedown and sale of the financial sector’s real estate assets are not treated as AMCs.

Royal Decree 1559/2012 contains a series of definitions of the terms that are used in this document and that is attached at Schedule.

2. ASSET MANAGEMENT COMPANIES (AMCs)

Law 9/2012 authorizes the Fund for the Orderly Restructuring of the Banking Sector (“**FROB**”) to make a credit institution transfer certain impaired assets, or assets that are considered potentially harmful to the institution if they remain on its balance sheet, to an AMC, to remove those assets from the balance sheet and allow them to be managed separately.

2.1 Objectives of AMCs

AMCs are designed to contribute to allowing the processes for restructuring or resolution of credit institutions to take their proper course, by allowing the objectives of those processes as envisaged in Law 9/2012 to be met.

Thus, AMCs are designed to pursue the following objectives:

- (a) To contribute to financial industry reform, by acquiring the relevant assets so that, when the assets are transferred, the risks associated with those assets are actually transferred with them.
- (b) To minimize public financial support.
- (c) To settle the debts and liabilities they assume in the course of their operations.
- (d) To minimize any possible market distortions arising as a result of their actions.
- (e) To dispose of the assets received, optimizing their value, within the term for which they have been organized.

2.2 Assets qualifying for transfer to an AMC

Royal Decree 1559/2012 establishes a series of criteria and specifications in accordance with which the FROB will define the classes of assets to be transferred:

- General qualitative criteria, based on: the nature of the assets (real estate or personal property, debt claims, instruments representing the capital of other entities or intangible assets); the legal transaction through which they were acquired; and the business to which they relate.
- In all cases, a distinction will be drawn between construction and property development business, industrial activity, commercial activity, lending to financial institutions, public authorities, SMEs and individual traders, mortgage lending, consumer lending and other business.
- Qualitative criteria specifically applicable to debt claims (security; claims rated as normal, subprime, doubtful, etc. in accordance with the Bank of Spain's accounting circulars; and location of real estate collateral).
- Qualitative criteria specifically applicable to real estate (use, condition, classification and location).
- General quantitative criteria (length of time on the balance sheet and value).
- Quantitative criteria specific to debt claims (value of security).

The Bank of Spain is also authorized to expand on or establish a more precise definition of these criteria.

When the obligation to transfer assets arises, the FROB will determine the classes of assets to be transferred in a single list; any doubts as to whether a particular asset belongs to the categories defined will be settled by the Bank of Spain.

Once the transfer value has been set by the Bank of Spain, as indicated below, the FROB will issue a decision establishing the maximum period within which the assets in each category must be transferred to the AMC and the terms of that transfer.

2.3 Valuation adjustments prior to transfer

Before the assets are transferred to the AMC, the credit institutions must make valuation adjustments in accordance with the criteria established in Royal Decree 1559/2012, adjustments which cannot be less than the relevant coverage in accordance with the Bank of Spain's accounting legislation, or the coverage under Royal Decree-Law 2/2012, of February 3, 2012, or Law 8/2012, of October 30, 2012. The valuation adjustment criteria established in Royal Decree 1559/2012 are summarized below:

- Assets traded in an active market: their market value as of the valuation date.
- Assets not traded in an active market: generally accepted valuation criteria will be used to estimate their economic value, with the clarifications established in Royal Decree 1559/2012.
- Real estate assets: in general the characteristics that would be considered by a purchaser will be taken into account, with the clarifications established in Royal Decree 1559/2012, relating, for example, to the capacity to generate returns, rental property, property that requires additional investment, establishing in any event that in the case of real estate with a book value of more than €3 million, the economic value must be based on the report of an independent expert with sufficient experience.
- Debt claims: the valuation must reflect the loss expected over their remaining life, and the value of any first-ranking security will be taken into account, in accordance with the criteria for valuing real estate. In the case of doubtful debt claims, the value set will relate only to the part that is secured with first-ranking security, less expenses.
- Equity instruments: a distinction is drawn according to whether or not the instruments are traded in an active market. Assets that are traded in an active market will be valued at their market value as of the valuation date. In the case of assets that are not traded in an active market, if the companies have filed for voluntary insolvency or have been declared insolvent, the value will be zero; in all other cases the value cannot be greater than their book equity, and where the total asset value is more than €10 million and the proportional part represented by the instruments in question is more than €3 million, a specific independent expert valuation will be required.

2.4 Transfer value of assets

Once the above-mentioned adjustments have been made, as appropriate, the transfer value will be determined by the Bank of Spain, on the basis of the estimated economic value, based on valuation reports prepared by one or more independent experts (whose

valuations, save where the assets are valued at more than €20 million, must be based on an analysis of representative samples of the classes of assets to be transferred, and will, in the case of real estate or first-ranking secured debt claims on real estate, be entrusted to independent experts). The estimated economic value may be adjusted in accordance with the criteria established in Royal Decree 1559/2012 (hedging against the risk of unfavorable price performance, the projected management, administration and maintenance expenses, and finance costs, associated with holding the assets to be transferred, and the prospects for divestment of the assets). The transfer value will be expressed, for each class of assets, as a percentage of their book value following the necessary adjustments; these percentages were recently announced by the FROB.

2.5 Asset transfer regime

Law 9/2012 and Royal Decree 1559/2012 establish that the assets may be transferred by any legal means, with the following particular terms:

- No third-party consent will be needed, and there will be no need for the conditions envisaged for structural changes to commercial companies to be met.
- No provisions of bylaws or contractual clauses that restrict the transferability of shares will be enforceable, and no liability or compensation claims of any kind may be filed based on the nonfulfillment of any such provisions or clauses.
- Any asset valuations made will replace the independent expert valuations required by the Corporate Enterprises Law.
- The FROB may demand that, before being transferred to the AMC, the assets are grouped together into a company, or operations of any kind are performed in respect of the assets to facilitate the transfer.
- The transfer may not, under any circumstances, be clawed back under any of the asset clawback actions envisaged in insolvency law.
- Article 1535 of the Civil Code will not apply to the transfer of disputed debt claims.
- The obligation to submit a tender offer will not apply.
- The transfer will not constitute a succession or an extension of liability for tax or social security costs, save as envisaged in article 44 of the Workers' Statute.
- The AMC will not be responsible for any tax liabilities accrued prior to the transfer, in connection with the ownership, use or management of the assets by the transferor.
- In the case of debt claims, the transferor will not be liable for the creditworthiness of the relevant debtors, and if the transfer is made via a spin-off or a carve-out, the joint and several liability of the participating entities established in article 80 of the Law on Structural Changes to Commercial Companies will not apply.
- The costs accrued and expenses incurred in the transfer of the assets will be borne by the transferor (the credit institution), including: any amount accrued or due, and unpaid as of the valuation date, relating to any of the assets (including any tax and legal expenses derived from the execution and registration of public deeds); any

expenses relating to appraisals; any expenses incurred by the AMC after the valuation date as the result of any errors or omissions; and any others that may derive from any legal obligations to write down the assets transferred.

2.6 Penalty regime

Law 9/2012 establishes the specific penalty regime applicable to AMCs and their managers or executives, to be implemented by the Bank of Spain.

2.7 Supervisory regime

The Bank of Spain will be responsible for supervision of the AMCs, having to oversee: that their exclusive purpose is met, so as to detect any possible departures from that purpose that may jeopardize the achievement of the general objectives established in law for the AMCs; that the specific requisites for the assets and liabilities to be transferred are met; and that the rules on transparency, on the formation and composition of their governing and controlling bodies, and on the commercial and professional integrity of the members of their boards of directors are met.

Law 9/2012 sets out the powers of the Bank of Spain relating to the supervision of the AMCs.

3. SAREB

The SAREB will be the AMC to which the assets of the institutions in which the FROB has a majority holding, or of those which, in the view of the Bank of Spain, in the current framework, may need to open a restructuring or resolution process, will be transferred.

3.1 Purpose and duration

The SAREB will be organized as a corporation which, for all purposes, will be an AMC, with the specific characteristics derived from its unique corporate purpose and the fact that its activity lies in the realm of the public interest.

The SAREB will be formed with a maximum term of 15 years and its sole corporate purpose is determined by the transfer of assets that is needed to carry out the process of restructuring and reorganization of the banking industry, within the framework of the memorandum of understanding for financial assistance signed between the Spanish and European authorities on July 23, 2012.

3.2 Size

The transfer value of the assets to be transferred to the SAREB cannot exceed €90,000 million, although the government anticipates that the transfer value will not exceed €2,000 million.

3.3 Capital and shareholders

The FROB will set the amount of the initial capital stock and additional paid-in capital of the SAREB, according to the envisaged volume of activity.

The range of possible shareholders of the SAREB is quite broad, including the FROB, credit institutions, insurance companies, investment services firms, collective investment vehicles, pension funds, securitization fund managers, private equity firms, mutual guarantee societies, foreign entities similar to the latter, or other entrepreneurs who may be considered professional investors pursuant to the terms of article 78 bis.3.c) of the Securities Market Law.

In all cases, there is a limit on direct or indirect public ownership, which must be lower than 50% of the SAREB's capital.

3.4 Governing bodies

The following provisions apply in relation to the SAREB's governing bodies:

- The board of directors must have between 5 and 15 members, at least a third of whom must be independent directors.
- All the directors and the general manager must have recognized commercial and professional integrity and the appropriate knowledge and experience.
- The position of director of the SAREB is incompatible with any elected political office or similar position, and with the existence of an employment, commercial or professional relationship with companies engaged in similar activities to the SAREB or that hold, directly or indirectly, significant interests in those companies.
- The board of directors must set up an audit committee and an appointments and remunerations committee whose composition and functions are regulated in Royal Decree 1559/2012.
- Royal Decree 1559/2012 likewise regulates the formation by the SAREB of various board support committees, such as management, risk, investor, and asset and liability committees.

3.5 Transparency

In addition to complying with the general obligations of corporate enterprises in terms of financial statements, the SAREB must act in a manner that is transparent and coherent with the purposes for which it is created, in particular:

- It must have a website.
- It must include in its financial statements a breakdown of the volume of lending to third parties, drawing a distinction between the loans transferred to it by the institutions and those granted by the SAREB, and also recording separately any refinancing and loan restructurings that may have been made in either case.
- It must produce a half-yearly business report including essential information on its activities, the degree of achievement of the objectives set in its business plan and the reasons for any possible departure from those objectives, a report that will be sent to the Bank of Spain and to the Monitoring Committee and made available to the public on the SAREB website.

- An independent expert must prepare an annual independent performance report that will be sent to the Monitoring Committee and to the Bank of Spain and will assess the extent to which the activities and strategies of the SAREB conform to its general objectives.

3.6 Monitoring Committee

A Monitoring Committee will be set up to oversee that the general objectives of the SAREB are met. This committee will analyze the business plan and the degree of fulfillment of the SAREB's general objectives, along with the plans for divestment and repayment of the guaranteed debt. The committee will have four members: one appointed by the Ministry for the Economy and Competitiveness, who will chair the committee and have the casting vote, and one each appointed by the Ministry of Finance and Public Administration, the Bank of Spain, and the National Securities Market Commission ("CNMV"). The committee may also decide on the inclusion of permanent observers.

The committee must send a half-yearly report to parliament on the progress made at the asset management company and, in particular, on the key points of its economic-financial situation.

3.7 Assets to be transferred to the SAREB

The assets to be transferred to the SAREB by the institutions concerned will be as follows:

- (a) Real estate assets foreclosed or acquired in payment of debts that appear on the individual or consolidated balance sheets of the credit institutions as of June 30, 2012, with a net book value, after the valuation adjustments, of more than €100,000.
- (b) The following debt claims that appear on the individual or consolidated balance sheets of the credit institutions as of June 30, 2012, or that come from subsequent refinancing thereof, with a net book value, after the valuation adjustments, of more than €250,000:
 - (i) Loans funding land for property development in Spain, or funding construction or property development in Spain, whether in progress or completed, irrespective of how they are classified and how long they have been on the balance sheet, except for any such loans that have been written off.
 - (ii) Participating loans granted to real estate industry companies, or to their related companies, irrespective of how they are classified and how long they have been on the balance sheet.
 - (iii) Other loans granted to holders of the loans included in point (i) above, where the FROB deems their transfer appropriate in order to allow the SAREB to manage the transferred assets appropriately.

- (c) Real estate assets and debt claims that meet the requirements described in the preceding paragraphs coming from real estate industry companies, or their related companies, over which the credit institution exercises control within the meaning of article 42 of the Commercial Code.
- (d) Instruments representing the capital of real estate industry companies, or their related companies, which directly or indirectly allow the credit institution, or any other entity of its group, to exercise joint control or a significant influence over such companies, where the FROB deems the transfer appropriate either because they have a very substantial volume of the loans that fall under point (i) above or because they effectively serve as a channel for the institution to pursue construction or property development activities in Spain.
- (e) The FROB may also require that consumer loans or loans to small and medium-sized enterprises, loans secured with residential mortgages and any other loans not included in the above paragraphs be transferred, if those loans are severely impaired or if their remaining on the balance sheet may be considered harmful to the viability of the institution. The existence of such circumstances will require a prior report by the Bank of Spain.

The legislation establishes the obligation on the credit institutions to transfer, along with the above-mentioned loans, databases with the information necessary for their management, in accordance with the conditions established by the Bank of Spain.

The transfer value of the assets indicated will be set by the Bank of Spain, within a period of seven days from the date of entry into force of Royal Decree 1559/2012 (November 17, 2012).

4. BANK ASSET FUNDS

It has been established that the SAREB can set up separate sets of assets called bank asset funds (*Fondos de Activos Bancarios*), to which the SAREB would contribute certain assets and, liabilities, if any, and there are very detailed rules on, among other things:

- How the bank asset funds are to be managed and represented, which must be entrusted, on an exclusive and reserved basis, to a securitization fund manager that had been adapted to the new requirements that are envisaged.
- The requirements for organizing bank asset funds and the contents of their formation deeds.
- The registration of bank asset funds in a register organized by the CNMV.
- The composition of the assets and liabilities of bank asset funds.
- The rules on transfers of assets and liabilities by the SAREB to a bank asset fund, which must be made by registering a document with the CNMV, executed by the SAREB and the bank asset fund.
- The issue of securities by bank asset funds and the potential creation of a pool of holders of those securities.

- The acquisition by bank asset funds of derivative financial instruments and other risk management instruments.
- The creation of compartments within each bank asset fund.
- The merger of or spin-off from a bank asset fund.
- The extinguishment or dissolution of bank asset funds.
- The disclosure obligations of bank asset funds, including their half-yearly and yearly reports, financial statements and audit obligations.
- The rules on bank asset fund managers, including the requirements applying to them, of which their minimum capital stock deserves a special mention as it must be equal to the minimum capital stock of securitization fund managers, plus 0.02% of the sum of the book value of the assets of the bank asset funds under their management, provided it is in excess of €250 million; the requirement for the procedure to determine its remuneration is consistent with the investment and risk management policy of each bank asset fund, avoiding the appearance of incentives to management that are contrary to the objectives set in those policies.
- The tax rules for bank asset funds and their investors, notably:
 - Bank asset funds will be liable for corporate income tax at 1% and will be eligible for the special rules on collective investment vehicles in article 57 of the Revised Corporate Income Tax Law.
 - Those of their investors who are nonresident income taxpayers with a permanent establishment in Spain or personal income taxpayers will apply the tax rules provided for the shareholders or investors in collective investment vehicles under Law 35/2003, that is, article 94 of the Personal Income Tax Law and article 58 of the Revised Corporate Income Tax Law. This basically entails taxation upon the transfer or repayment of the shares or, if it is envisaged and occurs, on the distribution of earnings (which would not give entitlement to the double taxation corporate income tax credit or the €1,500 personal income tax exemption).

For personal income taxpayers, however, the transfers rules (deferral of capital gains) in paragraph two of article 94.1.a) of the Personal Income Tax Law will not apply.

The income obtained by non Spanish-resident investors without a permanent establishment will be exempt from nonresident income tax on the same terms as income from public debt.

- These tax rules will apply while the FROB retains exposure to these funds, which is established in relation to the period of time for which the SAREB is set up. After the end of that period:
 - ◆ A tax period for the bank asset funds will end, and they will start to be taxed at the standard corporate income tax rate. The income obtained from transfers of assets and liabilities existing at that time but performed later will

be taxed with a distinction between the gains generated in periods under the special and standard rules and the rates and provisions in each set of rules will apply to each portion.

- ◆ Any income for the investors from periods in which the bank asset fund was subject to the 1% rate will be subject to the rules described above.

5. TAX IMPLICATIONS OF ASSET AND LIABILITY TRANSFERS IN WHICH THE SAREB OR THE BANK ASSET FUNDS TAKE PART

Final Provision Fifteen of Law 9/2012 contains new exemptions in article 45.1.B) of the Revised Transfer and Stamp Tax Law in relation to (i) transfers of assets and liabilities and the provision of guarantees where the taxpayer is the SAREB, (ii) transfers of assets and liabilities performed by the SAREB to its affiliates in which it owns directly or indirectly at least 50% of their capital, equity, earnings or voting rights, (iii) transfers of assets and liabilities by the SAREB, or by entities organized by it to fulfill its corporate purpose, to the bank asset funds, and (iv) transfers of assets and liabilities by the bank asset funds to other bank asset funds.

Moreover, an exemption is provided for transactions for a capital reduction at and the dissolution of the SAREB, of its affiliates which are at least 50% owned on the terms mentioned above, and transactions to reduce the assets of or dissolve the bank asset funds.

The special tax treatment applicable to transactions between the bank asset funds is restricted to the period in which the FROB is exposed to these funds.

Final Provision Sixteen of Law 9/2012 similarly defers the liability for the tax on the increase in value of urban land in respect of the transactions mentioned above, although, because it is a deferral rather than an exemption, in the next following transfer it will be deemed that the number of years over which the increase in value of the land has taken place has not been interrupted by reason of the transfer under those transactions.

It must be noted that there is no mention of the corporate income tax or VAT implications of the transfers made to the SAREB or by the SAREB to the bank asset funds or others, and therefore the standard rules will apply.

6. AMENDMENT TO LAW 2/2012, ON THE GENERAL STATE BUDGET FOR 2012

Final Provision Ten of Law 9/2012 amends the Law on the General State Budget for 2012, by raising the upper limit on the guarantees to be provided by the State in fiscal year 2012 to €13,278,560 thousand, and increasing the figure by €5,000,000 thousand to secure the obligations of the securities issues made by the SAREB. It says that the guarantee will secure “the principal of the issue of ordinary interest”, although we believe this should say that it will secure the principal and the ordinary interest.

Schedule**Some definitions contained in Royal Decree 1559/2012**

- **Valuation date:** the date coinciding with the date of the transfer agreement for the assets to the asset management company. For the transfer of personal property, or real estate, however, the valuation date can be earlier than the date of the transfer agreement by not more than three months, provided the valuation parameters are not likely to undergo significant changes between one date and the other.
- **Active market:** a market determined as such under the accounting legislation applicable to credit institutions.
- **Real estate industry company:** a company engaged primarily in urbanism, property development, the construction of buildings, the sale and purchase of real estate for their own account, the lease of real estate for their own account, real estate activities for third parties, asset management related to any of the foregoing activities, or simply holding rights in real estate assets.
- **Market value:** the amount in cash or a cash equivalent, that would be obtained on the sale of an asset in an orderly transaction between participants in the reference market for the asset concerned which, acting in accordance with mutual independence, are basically informed on the nature and characteristics of the traded asset.
- **Economic value:** is an estimate of the present value of an asset that the institution would obtain in a voluntary sale, making maximum use of relevant observable market value and minimum use of non observable data.

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