Confidential

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Proposal on a Facility for the Recapitalisation of Financial Institutions for the Kingdom of Spain

According to the EFSF Framework Agreement and the Guidelines on Recapitalisation of Financial Institutions via loans to non-programme countries, the EFSF is obliged to make a proposal to the Eurogroup if such a facility is requested.

On 25 June 2012, the Spanish Government requested external financial assistance under the terms of the Financial Assistance for the Recapitalisation of Financial Institutions by the EFSF. The European Commission in liaison with the ECB, the European Banking Authority (EBA) and the International Monetary Fund (IMF) conducted an independent assessment of the eligibility of Spain's request for such assistance. This assessment concluded that Spain fulfils the eligibility conditions.

For the approval of such loans for bank recapitalisation, according to the Guidelines, conditions attached must include institution-specific (without prejudice to the state-aid decision(s) and appropriate reference to its (their) content) and country-specific horizontal elements. The Memorandum of Understanding (MoU) prepared by the Commission, in liaison with the ECB as well as the IMF and EBA provides for such conditions.

When Spain informed the Eurogroup about its intention to apply for financial assistance, the Eurogroup stated on 9 June 2012 that it would respond favourably to a formal request by the Spanish authorities. The aggregate capital shortfall of the Spanish financial system would be determined following the on-going external evaluation process. It was mentioned that the loan amount must cover estimated capital requirements and an additional safety margin. Both elements combined are estimated to amount to EUR 100 billion in total.

According to the external evaluation exercise and further stress tests, the requirements for bank recapitalistation amount to EUR 50-61 billion. Against that background and the information provided in the eligibility report as well as in the MoU, it is suggested that the Financial Assistance Facility Agreement (FFA) to be adopted should amount to up to EUR 100 billion.

The current draft MoU for the Spanish financial-sector programme foresees the following payment schedule for the EFSF:

- <u>Contingency buffer</u>: At the start of the programme (i.e. later in July 2012), a contingency facility is expected to be put in place. This will consist of an amount of EUR 30 billion to be provided by the EFSF in order to allow rapid disbursements in case of urgent needs arising in the Spanish banking sector. The contingency buffer includes an estimated longer-term safety cushion of about EUR 10 billion.

The use of any amount of the contingency buffer before the adoption of restructuring decisions by the European Commission will require a reasoned and quantified request from the Banco de España and approval thereafter by the European Commission in liaison with the ECB.

- Subsequent draw-downs from the EFSF pursuant to the roadmap outlined in the MoU should take place shortly, ahead of the planned recapitalisation dates. The specific amount drawn at each date should cover the estimated recapitalisation needs for the next wave of recapitalisation.
  - First drawdown: After the capital needs of individual banks are sufficiently well established following the bottom-up stress test, the corresponding required amount is expected to be drawn in early October. The capital injections for viable banks and resolution of non-viable banks already owned by the FROB (Group 1) is expected to take place from mid-October onwards. This drawdown is expected to constitute around 60% of total recapitalisation needs of the Spanish banking sector.
  - Second drawdown: The second drawdown, envisaged for late December, will cover the capital injection for viable banks and resolution of non-viable banks with capital shortfalls identified by the stress test and not able to raise private equity without state aid (Group 2), as well as the injection of CoCos into banks with capital shortfalls and fewer problems to raise private capital (Group 3).
  - Third drawdown: The third drawdown according to the MoU is expected to take place before mid-2013. It should cover the capital injection for Group 3 banks that did not succeed in raising equity as planned.

Based on current estimates, the first drawdown could amount to EUR 45 billion, and the subsequent drawdowns to EUR 15 billion each. All disbursements to Spain, and subsequently to private banks would be subject to an EWG or EG decision. EFSF disbursements are expected to be provided in the form of EFSF bonds.

Problematic assets of aided banks should be removed from the bank's balance shees and transfered into a separate asset management company (AMC). The FROB may contribute cash or high quality securities to the AMC which could be kept by the AMC or paid to banks for the assets received. The amounts needed to complement the assets put into an Asset Management Company are not specified at this stage. The AMC would have to draw on the remaining amounts and the schedule would have to be modified accordingly.

The loans to be extended under the FFA should have an average maturity of up to [7.5] years. This reflects the particular nature of the bank recapitalisation facility and the financial position of Spain which will continue to have access to the market.

The final agreement on the loan is subject to the successful conclusion of the FFA incorporating terms and conditions in line with the EFSF guidelines and Master Facility Agreements for Member States.

For the duration of the EFSF programme, the Spanish authorities are committed to take all the necessary measures to ensure compliance with the conditionality specified in the MoU. Disbursements under the FFA will be contingent on such compliance.

The Heads of State or Government concluded at the Summit on 29 June that the financial assistance will be provided by the EFSF until the ESM becomes available, and that it will then be transferred to the ESM, without gaining seniority status. Moreover, ESM could, following a regular decision, have the possibility to recapitalize banks directly after an effective single supervisory mechanism is established, involving the ECB. This would rely on appropriate conditionality, including compliance with state aid rules, which should be institution specific, sector-specific or economy-wide and would be formalised in a Memorandum of Understanding.

<u>Table: Overview of planned disbursements</u>

End-July 2012	Contingency buffer	EUR 30bn
Early October 2012	First disbursement	estimated EUR 45 bn (of which up to EUR 20 bn would be withdrawn from the contingency buffer)
Late December 2012	Second disbursement	estimated EUR 15 bn
Mid- 2013	Third disbursement	estimated EUR 15 bn (of which EUR 10 bn would be withdrawn from the contingency buffer)
	Asset management company (AMC)	To be specified