EUROPEAN COMMISSION

Brussels, 28.11.2012
C (2012) 8764 final

Subject: State aid SA.35253 (2012/N) – Spain
Restructuring and Recapitalisation of the BFA Group

Sir,

1 PROCEDURE

(1) On 28 January 2010, the Commission adopted a decision not to raise objections to a recapitalisation scheme[1], set up and managed by the newly established "Fondo de Reestructuración Ordenada Bancaria" ("**the FROB**")[2] in the context of the financial crisis, to provide public support for the consolidation of the Spanish banking sector by, inter alia, strengthening the capital buffers of credit institutions ("**the FROB recapitalisation scheme**").

(2) On 29 June 2010, Spain informed the Commission that the FROB had decided to subscribe convertible preference shares, under the FROB recapitalisation scheme, for EUR 4 465 million in Banco Financiero y de Ahorro, S.A. ("**BFA**").

[1] Case N 28/2010, OJ C 57, 09.03.2010, p. 2.

[2] After the enactment of Royal Decree Law 24/2012, the FROB has been entrusted with the management of the restructuring and resolution proceedings of Spanish credit institutions. For that purpose, it may provide public support to distressed institutions. The FROB funds are contributed by the State Budget. Additionally, the FROB may obtain other funding (via issuance of securities, loans, credits or other debt transactions) up to the limit annually established in the State Budget. The maximum for 2012 amounts to EUR 120 000 million.

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(3) On 19 June 2012, the Spanish authorities notified the Commission that the convertible preference shares subscribed for by the FROB in BFA were to be converted into ordinary shares. Additionally, a liquidity guarantee of up to EUR 19 billion was also to be granted to BFA in the context of that conversion. The Commission approved both measures on 27 June 2012[3] ("**the Conversion Decision**").

(4) On 20 July 2012, the Memorandum of Understanding on Financial Sector Policy Conditionality between the Kingdom of Spain and the Heads of State and Government of the Euro Area was signed ("**the MoU**"). The MoU sets a strict for the recapitalisation and restructuring of the different groups of banks in Spain established on the basis of stress test results published on 28 September 2012[4]. In particular, for credit institutions controlled by the FROB, such as BFA, additional public capital will only be provided once individual restructuring plans have been approved by the Commission. Furthermore, the MoU established that those restructuring plans will incorporate the results of a stress test exercise conducted by independent consultants. Finally, the restructuring plans were to be presented in time to allow the Commission to approve them by the end of November 2012.

(5) On 3 September 2012, the Spanish authorities notified a new aid measure in favour of the BFA group, which includes BFA and its banking subsidiary Bankia ("**the BFA Group**" or "BFA/BANKIA") via a new capital injection of up to EUR 4.5 billion. The Commission approved the measure through a rescue decision on 7 September 2012[5] ("**the Urgent Recapitalisation Decision**").

(6) On 9 November 2012, in accordance with the requirements of the MoU, the Spanish authorities notified a restructuring plan for BFA to the Commission ("**the Restructuring Plan**"). Subsequently, numerous meetings, conference calls and exchanges of information took place between the Spanish authorities and Commission.

(7) On 9 November 2012, Spain communicated the final content of the Restructuring Plan, including the final figures pertaining to the size, composition and valuation of the assets and credit portfolio to be transferred to an Asset Management Company ("**AMC**") in the context of an impaired asset measure. With regard to issues pertaining to the asset valuation methodologies employed in the context of the impaired asset measure, the Commission has drawn on technical assistance provided by independent experts.

(8) Spain exceptionally accepts that the present decision be adopted in the English language.

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[3] Case SA34820, OJ C 220, 25.07.2012, p. 7

[4] On the basis of the stress test results and the recapitalisations plans, banks are categorised as follows: Group 0 - banks for which no capital shortfall is identified and no further action is required; Group 1 - banks already owned by the FROB; Group 2 - banks with capital shortfalls identified by the stress test and unable to meet those capital shortfalls privately without having recourse to State aid; Group 3 - banks with capital shortfalls identified by the stress test with credible recapitalisation plans and which are, in principle, able to meet those shortfalls privately without recourse to State aid. Group 3 banks will be split into: (i) Group 3a - banks planning a significant equity raise (>2% of risk weighted assets ("RWA")) and (ii) Group 3b - banks planning a less significant equity raise (<2% RWA)

[5] Case SA.35369 (Decision not yet published in the OJ)

2 DESCRIPTION OF THE MEASURE

2.1 The creation of the BFA Group

(9) On 14 June 2010, an agreement was signed to integrate seven Spanish savings banks[6] into BFA, a regulatory consolidated group, through a so-called Institutional Protection Scheme ("**IPS**"). The concentration process required the granting of State aid by the FROB under the FROB recapitalisation scheme for a total amount of EUR 4 465 million in the form of interest-bearing convertible preference shares.

(10) On 3 December 2010, BFA, a commercial bank, was set up as the central vehicle of the IPS, which was at the time wholly-owned by the seven founding savings banks as follows:

Caja Madrid	52.06%
Bancaja	37.70%
Caja Insular	2.45%
Caja de Ávila	2.33%

Caja Laietana	2.11%
Caja Segovia	2.01%
Caja Rioja	1.34%

(11) On 18 February 2011, Spain adopted more stringent regulatory capital requirements for the entire banking sector, requiring all credit institutions in Spain to meet by 30 September 2011 at the latest higher minimum regulatory solvency levels, known as "*capital principal*". To that end, minimum regulatory solvency requirements were raised to 10% of capital principal for credit institutions for which: a) wholesale funding exposure was higher than 20% of total funding or b) third party ownership was less than 20% of total ownership. However, a capital principal level of 8% was set for banks meeting those new criteria (i.e. limited reliance on wholesale funding and broad third party ownership).

(12) In accordance with the new solvency requirements, the Bank of Spain ("**BoS**") informed BFA that BFA would require EUR 5.8 billion of additional capital to meet the new 10% capital principal ratio or EUR 1.8 billion if it fulfilled the requirements for an 8% capital principal ratio.

(13) On May 2011, 99% of the assets and liabilities of the seven founding savings banks were transferred to BFA. At the same time, 85% of the assets and liabilities received by BFA were transferred to a new wholly-owned subsidiary called Bankia. Both transactions took place in May 2011 but with an effective date of 1 January 2011.

6 Caja de Ahorros y Monte de Piedad de Madrid (CajaMadrid), Caja de Ahorros de Valencia, Castellón y Alicante (Bancaja), Caja Insular de Ahorros de Canarias (Caja Insular), Caixa D'Estalvis Laietana (Caixa Laietana), Caja de Ahorros Monte de Piedad de Avila (Caja de Avila), Caja de Ahorros y Monte de Piedad de Segovia (Caja Segovia) and Caja de Ahorros de la Rioja (Caja Rioja).

(14) On 20 July 2011, Bankia was listed on the Madrid Stock Exchange through an initial public offering in which private investors bought 47.6% of Bankia shares for EUR 3.09 billion, leaving BFA with the rest[7]. As a result of the listing the minimum regulatory capital for BFA Group was 8% of capital principal.

(15) Bankia is a large universal retail bank, with a presence in all main business segments: namely, mortgage, consumer lending, small and medium-sized enterprises (SMEs) and large corporations, as well as public and private institutions. the BFA Group's main figures are:

	30.06.2010 (peak)	31.12.2011
Total assets (mio, EUR)	344,853	312,343
Loans to customers (mio, EUR)	229,684	198,815
Loans to customers (performing)	n.a.	181,320
Retail deposits (mio, EUR)	113,188	110,961
Total wholesale funds (mio, EUR)	190,919	164,327
Employees	25,244	21,538
Number of branches	3,864	3,291
National Market share in deposits	n.a.	8.9%
Regional Market share in deposits	n.a.	15.8%
National Market share in loans	n.a.	9.2%
Regional Market share in loans	n.a.	15.6%

(16) Taking into account the above description on the creation of BFA and Bankia, two separate levels of beneficiaries can be identified for the purposes of the present decision, namely: a) the seven founding savings banks, that through their merger, established and owned 100% of BFA and b) the BFA Group consisting of BFA and Bankia.

(17) An economic valuation of BFA was subsequently conducted by three independent investment banks that established a negative economic value for BFA. On 25 June 2012, following that valuation process, the FROB, in order to increase the solvency of the bank, resolved to convert all of its convertible preference shares into ordinary equity of BFA. As a result of that conversion, the FROB is now the sole shareholder of BFA leaving the seven founding savings banks with no economic or political rights over the BFA Group.

[7] On 7 November 2012, BFA held a 45.5% equity stake in Bankia

2.2 The events triggering the measure

(18) Following the outbreak of the financial crisis in 2008, the Spanish government laid down via Royal Decree Law 9/2009 the legal foundations for the restructuring of the Spanish banking sector. The savings banks (*cajas de ahorros*[8]), which form a significant part of that sector, had several structural limitations, such as legal restrictions on the raising of regulatory capital and, in some cases, weak corporate governance systems which prevented those institutions from detecting problems at an early stage.

(19) Pursuant to that legislation, in 2010, BFA benefited from a capital injection in 2010 of EUR 4 465 million by the FROB in the form of convertible preference shares purchased by the FROB to support the merger of the seven founding savings banks and partially fund their restructuring costs.

(20) On 8 December 2011, the European Banking Authority ("**EBA**") published its Recommendation on the creation and supervisory oversight of temporary capital buffers to restore market confidence. The recommendation in effect requested that certain institutions build a temporary capital buffer to reach 9% of Core Tier 1 by 30 June 2012, and constitute another additional sovereign buffer to cover potential impairments of debt instruments and loans with the European Economic Area Member States as of 30 September 2011. As a result, the BFA Group's capital shortfall as identified by EBA amounted to EUR 1 329 million[9]. However, following the announcement of the Spanish authorities in May 2012 the BFA Group would go through a deep restructuring process, the BFA Group was not included in the final recapitalisation exercise, and will be monitored separately by the Spanish authorities in conjunction with the Commission and liaising with the European Central Bank ("**ECB**"), the EBA and the International Monetary Fund ("**IMF**").

(21) On 3 February 2012, the Spanish government approved Royal Decree Law 2/2012 increasing the level of provisions and capital buffers for non-performing real estate assets and loans to the real estate developer sector classified as doubtful, substandard and repossessed. The new regime gave rise to additional capital needs for BFA and its subsidiary Bankia of EUR […]* million, according to BFA's provisional estimation[10].

(22) On 11 May 2012, the Spanish authorities approved a new Royal Decree Law 18/2012 on the consolidation and sale of real estate assets in the financial sector, as a result of which BFA/Bankia needed a further EUR 1 452 million of additional provisions for performing loans according to BFA's provisional estimation.

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8 "*Cajas de ahorros*" are credit institutions that have no shareholders, but instead are governed by their stakeholders. Their legal form is a private charity that holds a banking license and is entitled to provide banking services as commercial or cooperative banks do. Profits are partially used to fund the social activities that each Caja carries out through its Obra Benéfico-Social, which are charity programmes funded by the Caja with the profits that are not used to build up reserves. The remainder is used to strengthen their capital

9 EUR 763 million, corresponding to capital needs to reach 9% of Core Tier 1 and EUR 566 million to sovereign exposure buffer

* Business secret

10 The solvency and provisioning requirements is required on a solo (i.e. Bankia and BFA) and consolidated basis (i.e. BFA/Bankia)

(23) On 25 May 2012, the BFA Group's newly appointed management announced that it would request from the FROB an additional EUR 19 billion of capital, of which EUR 12 to 14 billion would be needed for Bankia alone. The BFA Group also published a revised version of its 2011 annual accounts recognising additional losses of EUR 4 952 million. On that same day, Bankia was suspended from trading in the official markets.

(24) In sum, the BFA Group lacked sufficient capital to meet more demanding regulatory requirements approved by the Spanish government throughout 2012 and had acute liquidity problems. The value of the franchise of the BFA Group progressively deteriorated as a result.

(25) The great weakness of the BFA Group became more evident with the public disclosure of financial information for the first half of 2012 on 31 August 2012, revealing losses of EUR 2.8 billion in BFA and EUR 4.5 billion in Bankia, as a result of, among other reasons, the partial recording of higher loan-loss provisions required for real estate and construction sector exposures by Royal Decree Laws 2/2012 and 18/2012. Those losses leave BFA with a negative equity and both entities, BFA and Bankia, with a shortfall of regulatory capital. Furthermore, that regulatory capital deficit could have denied BFA and Bankia access to the liquidity provided by the Eurosystem through its monetary policy operations. Accordingly, an interim capital injection by the FROB amounting to EUR 4.5 billion in BFA was completed on 4 September 2012 leaving the BFA Group with a solvency ratio of 8.2% in anticipation of the submission of the restructuring plan that should lead to its final recapitalisation by the FROB.

(26) In June 2012 S&P downgraded Bankia's covered bonds and subordinated debt to AA- and CCC-, respectively. More recently, in October 2012, following a sector review, S&P took actions on Bankia's long-term rating, downgrading it to BB (15 October 2012) and on Bankia's covered bond programme, rating it at BBB+ (18 October 2012). On 12 June 2012, Fitch downgraded Bankia's senior debt from BBB+ to BBB. Moody's assigned a Ba2 rating to Bankia's long-term rating on 25 June 2012. The agency also reviewed Bankia's subordinated debt, assigning it a B3 rating, which has since been downgraded to C on 8 October 2012. BFA has also been assigned reviewed ratings after making public its recapitalisation needs. Currently S&P rates BFA's long-term debt with a B rating (15 October 2012) and its subordinated debt and preferred instruments with a CC (8 June 2012) and C (12 July 2012) rating. Fitch assigned BFA a BB rating on 12 June 2012 and Moody's rates BFA with a B2 rating for the long-term rating (25 June 2012) and a C rating for its subordinated debt (8 October 2012).

(27) On 28 September 2012, the results[11] of a bottom-up stress test and asset quality review conducted by an independent consultant, Oliver Wyman, in the context of the MoU ("**the MoU Stress Test**") revealed that the BFA Group has a capital shortfall of EUR 24 743 million under the exercise's adverse scenario and EUR 13 230 million under its base case for a three-year period (2012-2014). Under the adverse scenario, the

[11] Ref. Oliver Wyman report, Asset Quality Review and Bottom-up Stress test exercise, 28 September 2012, http://www.bde.es/bde/en/secciones/prensa/infointeres/reestructuracion/

cumulative expected losses for the BFA Group are estimated at EUR 42 756 million, with a loss absorption capacity of EUR 18 012 million.

(28) Operationally, BFA/Bankia faces important challenges stemming mainly from expansion by each of the seven founding savings banks which resulted in high exposure to the real estate sector[12]. As a result, the BFA Group has had an increase in its non-performing loans[13], over-reliance on wholesale funding (with a loan-to-deposit ratio of 185% as of 30 June 2012) and liquidity issues with constrained access to wholesale market because of several downgrades. The BFA Group has also had pressure exerted on its net interest because of the heightened competition for deposits in the Spanish banking sector over recent years.

(29) As stated in the Conversion Decision and the Urgent Recapitalisation Decision[14], the current situation of the BFA Group is characterized by a significant vulnerability in terms of the credit quality of its existing portfolio and the latter's lack of profitability, associated with the lack of sufficient capital to meet the newly established regulatory requirements as well as growing liquidity problems.

2.3 Overview of the aid measures

(30) The BFA Group has benefitted from several aid measures since the group was set up in 2010. Overall the Spanish State has provided or plans to provide the BFA Group capital injections totalling up to EUR 22 424 million, plans to transfer impaired assets and credit to an asset management company ("**AMC**") amounting to a gross book value of EUR […] billion, State guarantees worth EUR 53.9 billion, and averted potential losses linked to credit lines from the BFA Group to Banco de Valencia ("**BdV**"), a bank which was part of the BFA Group prior to the former's rescue with public funds in November 2011. Table 1 provides an overview of the aid measures

Table 1: Summary of the aid measures

Measure	Description	Amount (in million)	Approved	RWA
A	State guarantees on senior unsecured debt: under the Spanish Guarantee Scheme	€34 963	23.12.2008 25.06.2009 9.02.2012	Not applicable.
B	State guarantees on senior unsecured debt	€19 000	27.06.2012	Not applicable

12 The overall exposure of BFA to the real estate sector represented 13% of its balance sheet on June 2012

13 The non-performing loan ratio stood at 11.62% on 30 June 2012.

14 See part 2.3 of the respective decisions.

C	Recapitalisation measure: *FROB I convertible preference shares*	€4 465	30.06.10	[0-5]% [15]
D	Averted losses linked to the FROB intervention in BdV	€1 759	Approved by this Decision	[0-5]% [16]
E	Recapitalisation measures: *Conversion of the FROB I preference shares (measure C) into equity*	€4 465	27.06.2012	[…]
F	Recapitalisation Measure[17]	€4 500	07.09.2012	[0-5]% [18]
G	Recapitalisation measure	€17 959	Approved by this Decision	[5-10]% [19]
H	Impaired asset measure	€12 000[20]	Approved by this Decision	[5-10]% [21]

2.3.1 Measures A and B: Guarantees on liabilities

(31) Since 2009, the BFA Group has received State guarantees worth EUR 34 963 million under the approved Spanish guarantee scheme[22]. Out of the total amount granted, the BFA Group has issued State-guaranteed unsecured debt for a total amount of EUR 34 768 million out of which EUR 24 268 million remain outstanding, as of 30 October 2012.

(32) In addition, the BFA Group benefited from an ad hoc liquidity guarantee granted by the Kingdom of Spain of up to EUR 19 billion approved in the context of the Conversion Decision. To date, none of the guarantees approved under the Conversion Decision have been utilised by the BFA Group.

15 RWA as of 31 December 2009.

16 RWA as of 30 June 2011.

17 That capital injection was completed by the FROB on an interim basis pending approval of Measure G so that The BFA Group would keep its eligibility status for Eurosystem monetary policy operations. The funds disbursed by the FROB pursuant to that measure are to be reimbursed by The BFA Group upon completion of Measure G

18 RWA as of 31 December 2011.

19 RWA as of 31 December 2011.

20 See recital (139).

21 RWA as of 31 December 2011.

22 On 23 December 2008, the Commission approved a scheme for the creation of a debt guarantee scheme (State aid case NN 54b/2008 OJ C 122/2009 of 29.05.2009). On 16 April 2009, the Commission approved changes to that scheme. On 23 April 2009, a corrigendum was published. The Scheme was prolonged five times, for six-month periods each time, and those prolongations were approved by the Commission on 25 June 2009 (State aid case N 336/2009 OJ C 174/2009 of 28.07.2009), 3566/2011, 28 June 2010 (State aid case N 263/2010 OJ C 190/2010 of 14.07.2010), 29 November 2010 (State aid case N 530/2010 OJ C 7/2010 of 12.01.2011) and 1 June 2011 (State aid case SA.32990 2011/N OJ C 206/2011 of 12.07.2011) which expired on 31 December 2011. On 9 February 2012, the Commission approved the introduction of a new debt guarantee scheme (State aid case SA.34224 2012/N OJ C 82/2012 of 21.03.2012) which was then prolonged up to 31 December 2012 by decision on 29 June 2012 (SA.34904 2012/N OJ C 232/2012).

2.3.2 Measure C: FROB convertible preference shares

(33) On 29 June 2010, the FROB decided to support the merger of the seven founding savings banks into BFA by subscribing EUR 4 465 million in newly issued convertible preference shares under the FROB recapitalisation scheme. The aid represented [0-5]% of the BFA Group's RWA as of March 2010. The securities subscribed for by the FROB have an annual yield of 7.75% the first year, with annual step-ups for the following years until redemption. The first coupon paid on the preference shares held by the FROB was paid in December 2011, but the securities were converted into ordinary shares before the second coupon was paid.

2.3.3 Measure D: capital relief through the FROB's intervention in Banco de Valencia

(34) BdV is a Spanish commercial bank which operates mainly in the regions of Valencia and Murcia. As of June 2011, BdV had 427 branches and 2 028 employees. BdV has been listed on the Spanish stock exchange since 1967[23]. At a national level, its market share is 0.93% in deposits and 1.01 % in loans. As of 30 June 2011 the BFA Group had an equity stake of 39.11% in BdV and had provided it with funding of EUR 1 759 million.

(35) On November 2011, following the results of an inspection, the BoS, at the request of BdV, took control over the bank[24]. The BoS appointed the FROB as administrator who decided to inject EUR 1 000 million (or 6.3% of BdV's RWA as of 31 December 2010) in the form of capital and to grant BdV a liquidity line of up to EUR 2 000 million, so as to strengthen its precarious capital position and tackle some liquidity issues mostly related to material deposits outflows on the back of a number of credit downgrades. As a result of the FROB's capital injection completed on 26 June 2012, BFA/Bankia's equity stake in BdV was diluted to 3.52%.

(36) In spite of the fact that the BFA Group was the majority shareholder of BdV and that BdV was consolidated within the BFA Group, the latter did not provide any capital alongside the FROB. According to the Spanish authorities, under Spanish law[25], the consolidation of BdV into the BFA Group is only for accounting purposes. According to the Spanish authorities, BdV and BFA are separate legal entities and the fact that BdV is included in the 'consolidation perimeter' creates no legal obligation for BFA to assist BdV by subscribing newly issued capital or by other means. They claim that as a consequence BFA was not legally bound to assist BdV if the latter failed to meet the required ratios.

(37) Spanish law set outs conditions under which credit lines granted to a company placed under insolvency are to be converted into subordinated debt. In the case of listed companies like BdV, credit lines granted by shareholders holding at least 5% of the capital of the insolvent company are considered subordinated debt, thereby increasing the loss-absorption capacity of those credit lines in the insolvency procedure.

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[23] Listed in the Valencia Stock Exchange since 1940.

[24] Pursuant Article 7 of Royal Decree Law 9/2009 of 26 June 2009.

[25] Articles 92 and 93 of Law 22/2003 of 9th July on Insolvency.

(38) Therefore, by rescuing BdV with State resources, the FROB prevented the conversion of the BFA Group's credit line of EUR 1 759 million to BdV into subordinated debt of BdV.

2.3.4 Measure E: the conversion of the preference shares held by the FROB in BFA

(39) Under the Spanish recapitalisation scheme, State aid beneficiaries committed that they would repurchase the convertible preference shares they had issued to the FROB in 2010 as soon as they were in a position to do so without compromising their viability. Nonetheless, at the end of the fifth year, which coincides with the duration of their viability plans, those securities would have to be bought back or converted into ordinary shares. However, if the BoS were to consider at any point in time, in view of the situation of the beneficiary (or its group), that the buy-back would be unlikely, the FROB would be entitled to convert the preference shares that it acquired into ordinary shares (or equity-like instruments) of the beneficiary.

(40) On 14 May 2012, following a decision of the BoS, by which it considered it improbable that BFA would either redeem or repurchase the convertible preference shares within the prescribed five-year period, the FROB decided to convert its preference shares in BFA into ordinary shares. The number and value of the new ordinary shares to be issued to the FROB in exchange for its preference shares, was determined based on the bank's valuation (EUR -13.6 billion), which was conducted by three independent investment banks.

(41) On 13 June 2012, the Spanish authorities notified the conversion of the preference shares to the Commission. As part of that notification, the Spanish authorities accepted that the conversion measure constitutes State aid[26] and also committed to submit BFA's restructuring plan to the Commission within six months.

(42) Furthermore, BFA asked for a new capital injection measure which the Spanish authorities notified on 3 September 2012. The measure is examined below as Measure F.

(43) On 27 June 2012[27] BFA converted the preference shares held by the FROB. As a result of the conversion the FROB became the sole shareholder of BFA.

2.3.5 Measure F: Recapitalisation of September 2012

(44) On 4 September 2012, the BFA Group benefited from an urgent recapitalisation measure via a new capital injection of EUR 4.5 billion in the form of ordinary shares into BFA. Subsequently, BFA granted a subordinated loan, qualifying as Tier II capital, for the same amount to Bankia. The subordinated loan has an annual interest rate of [5-10]%. Given that the FROB was already the sole shareholder of BFA, no valuation of the BFA Group was needed. The FROB will, in any event, continue to be the sole shareholder of BFA.

[26] See recital 35 of the Conversion Decision.

[27] Date on which the conversion of FROB's BFA's preferred shares into capital became effective.

(45) The losses suffered by BFA as a result of, among other reasons, the partial recording of higher loan-loss provisions required by Royal Decree Laws 2/2012 and 18/2012 left it with a shortfall of regulatory capital. Once the second capital injection by the FROB in BFA was implemented, the BFA Group had a solvency ratio of 8.2%. The urgent recapitalisation measure was carried out in anticipation of the submission of the restructuring plan for the BFA Group that should lead to its final recapitalisation by the FROB. The measure was approved by the Commission pursuant to the Urgent Recapitalisation Decision.

2.3.6 Measure G: Recapitalisation of November 2012

(46) Following the results of the MoU Stress Test and the series of measures proposed by the BFA Group in the Restructuring Plan (including a series of subordinated liabilities exercises and the transfer of some impaired assets and real estate loans to the AMC), a capital injection by the FROB of EUR 17 959 million is still needed for the BFA Group to meet the new regulatory solvency levels in Spain taking into consideration the results of the MoU Stress Test.

(47) In December 2012, the FROB will subscribe EUR 13.5 billion in ordinary shares in BFA. The FROB will contribute bonds issued by the European Stability Mechanism ("**ESM**") for an amount of EUR 17 959 million in consideration for the new shares in BFA and EUR 4.5 billion in Treasury bonds delivered by the FROB in the capital injection approved by the Urgent Recapitalisation Decision. After this new capital injection, the FROB will continue to be the sole shareholder of BFA

(48) Following that capital injection, BFA will transfer the funds injected into it by the FROB to Bankia through the subscription of contingency convertible bonds ("**CoCos**") qualifying as capital principal (or CT1 EBA) in order to allow the BFA Group to comply with the regulatory solvency ratio by 1 January 2013 in accordance with the results of the MoU Stress Test. The CoCos injected by BFA will be converted into ordinary shares of Bankia within the first quarter of 2012 upon the approval of its 2012 audited accounts.

(49) Based on the initial best estimates provided by the Spanish authorities and pending the economic valuation of Bankia, the FROB will hold approximately [60-90]% in the BFA Group as a result of measures G and the conversion of hybrid capital instruments into equity as described below in the burden-sharing section.

(50) As regards timing, Measure G will be executed in the following sequence: As regards BFA, the FROB, as its sole shareholder, and upon completion of an independent economic valuation will approve a capital reduction to offset losses and a subsequent capital increase to be entirely subscribed for by FROB as described in recital (47) above. As regards Bankia, the FROB will use the extraordinary powers conferred upon it by Royal Decree Law 24/2012, to approve -on behalf of the General Shareholders' Meeting -, the issuance of the CoCos to be fully subscribed for by BFA. Consequently, the BFA Group will meet the solvency requirements as of 31.12.2012. Subsequently in the first quarter of 2013, Bankia will convene a General Shareholders' Meeting to approve its 2012 annual audited accounts and, following an independent economic valuation, convert the CoCos subscribed for by BFA into ordinary shares.

2.3.7 Measure H: segregation of impaired assets to the Asset Management Company

a. Objective

(51) The BFA Group will benefit from an impaired asset measure whereby it transfers assets to the AMC. The aim of that measure is to remove uncertainty about the future value of its most problematic asset portfolio and allow the BFA Group to concentrate on the implementation of the Restructuring Plan.

b. AMC: set up and characteristics

(52) Under the MoU, assets related to real estate of banks needing State aid will be transferred to the AMC, for which a blueprint and a legislative framework[28] was prepared by Spain in consultation with the Commission, the ECB, ESM and IMF.

(53) The overall objective of the AMC will be the management and orderly divestment of the portfolio of assets and loans received, maximising their recovery over a maximum of 15 years. In pursuing that activity, the AMC contributes to the restructuring of the financial system, while minimising the use of public funds and avoiding any market distortions as much as possible.

(54) The FROB worked on the design of the AMC (including its legal and financial structure, operational model, and business and divestment plans) in close collaboration with the BoS and the Ministry of Economic Affairs and Competitiveness ("**the MOF**"), as well as with the Commission, the ECB, the ESM and the IMF.

(55) The volume of assets to be transferred to the AMC – taking into account only the portion corresponding to Group 1 banks following the classification pursuant to the MoU Stress Test – is estimated to be around EUR 45 billion. That amount will increase after the assets of the Group 2 banks are transferred. However, the maximum volume of impaired asset and real estate loans that Spanish banks may contribute to the AMC under the MoU will in principle not exceed EUR 90 billion.

(56) The own funds of the AMC, established as a limited liability company, will be approximately 8% of the volume of its total assets. Its capital structure will consist of a non-majority holding of the FROB and a majority holding by private investors. That structure was chosen with the aim of ensuring that the overall debt of the AMC is not consolidated with the debt of the Spanish State.

(57) As part of the AMC's governing bodies, a so-called "Monitoring Committee" was established, consisting of four parties (the MOF, Ministry of Financial Affairs and Public Administration, the BoS and the CNMV[29]), with a mandate to oversee compliance with the general objectives for which the AMC was set up. The committee's functions include the analysis of the business plan and of possible deviations from it, the monitoring of divestment plans and of repayment of the guaranteed debt. The Monitoring Committee will ask the AMC for such periodic information as it considers appropriate for the carrying out of its task.

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[28] Royal Decree Law 24/2012 on credit institution restructuring and resolution specifies the details of the AMC.

[29] The Spanish government agency responsible for regulating the securities market.

c. Scope of the transfer of impaired assets and loans

(58) As envisaged in the MoU, all banks classified in Group 1 such as the BFA Group will transfer the following assets to the AMC as from December 2012: a) impaired assets whose net carrying amount exceeds EUR 100 000, b) loans/credits to real estate developers whose net carrying amount exceeds EUR 250 000, calculated at borrower, rather than transaction, level and c) controlling corporate holdings linked to the real estate sector. Loans or impaired assets that have been fully written down are excluded from transfer.

(59) The overall portfolio[30] to be transferred by the BFA Group to the AMC amounts to EUR […] billion in terms of gross book value. The value of the controlling corporate holdings linked to the real estate sector has been estimated based on the value of the underlying assets (loans) held by those holdings and is included in those figures.

d. Methodology for the calculation of the transfer value

(60) The transfer value has been set on the basis of two components. First, the economic value of the assets was determined, both for impaired assets and loans related to the real estate development sector. Furthermore, for calculating the transfer value, the expected losses in the baseline scenario of the MoU Stress Test for the BFA Group was used as a reference. The methodology of that valuation was endorsed by a dedicated group composed of the Spanish banking supervisory authority which is the BoS, the Commission and the ECB, with the IMF acting as an observer.

(61) Second, the estimation of the economic value was adjusted by applying a discount based on characteristics inherent to the transfer of the assets to the AMC. That adjustment is the result of aspects such as: a) the aggregate acquisition of the assets; b) the consideration of certain expenses previously borne by the bank, which must now be assumed by the AMC, such as asset management and administration costs including financial costs; and c) the negative short-term outlook for divestment of the assets by the AMC.

e. Independent expert advice for the Commission

(62) The Commission has retained independent experts in order to assist it in the assessment of the proposed methodology and transfer price in connection with the real economic value of the transferred assets, as laid down in the Communication from the Commission on the treatment of impaired assets in the Community banking sector ("**the Impaired Asset Communication**")[31], which serves as the reference framework for that State aid measure.

[30] Gross book value of the assets transferred.

[31] Communication from the Commission on the treatment of impaired assets in the Community banking sector, OJ C 72, 26.03.2009, p. 1.

f. Purchase of those assets by the AMC

(63) The AMC will pay the BFA Group the established transfer value by means of State-guaranteed debt securities issued by the AMC ("**the AMC bonds**"). The AMC bonds have a one to three-year maturity, with an average weighted life of 1.95 years. The foreseen yield on the AMC bonds will be the lower of: a) the Spanish government bond yield for the same maturity or b) 12-month Euribor plus 200 basis points (bps).

g. The transfer value

(64) Based on the methodology and discounts described in recitals (60) to (61), the transfer value of the assets and real estate loans of the BFA Group amounts to approximately EUR 27.9 billion, which is equal to approximately 49% of the gross book value. Those figures are an estimate based on the situation of those assets as of 30 June 2012. It is possible that the final numbers could differ from that level as the asset transfer will only take place as from December 2012.The BFA Group will therefore receive EUR 27.9 billion of AMC bonds in consideration for the assets transferred.

(65) On 20 November 2012, the BoS provided a letter certifying the valuation methodology of the asset transfer to the AMC by the BFA Group.

h. Market price

(66) The independent experts assisting the Commission have also estimated the market value of the impaired assets of the BFA Group. Based on their estimate, the market value of the transferred portfolio is about 27.9% of the transferred gross book value, and thus amounts to about EUR 15.9 billion.

3 RESTRUCTURING OF THE BFA GROUP

(67) The Restructuring Plan, in accordance with Royal Decree Law 24/2012, states that , in view of the BFA Group's: a) significant capital shortfall (EUR 24.7 billion), as revealed in the MoU Stress Test[32] b) the considerable amount of State aid received since 2010, which still remains unpaid and c) low probability of being able to fully repay the public funds granted through the various aid measures proposed in the Restructuring Plan, it should be placed under resolution under the auspices of Royal Decree Law 24/2012. However, in view of the systemic nature of BFA/Bankia within the Spanish and European financial sector and in accordance with Royal Decree Law 24/2012, for exceptional reasons the BFA Group is to be restructured. Accordingly, the Spanish authorities will carry out an in-depth restructuring of the BFA Group's activities as set out in the Restructuring Plan.

[32] See recital (29)

3.1 Restoration of viability through refocusing on the core activities of the BFA Group

The table below presents the main financial projections contained in the Restructuring Plan for the BFA Group ("**the Summary Table**"):

P&L	Jun-12		2012		2013		2014		2015		2016		2017		Evolution rate 2012-2017 (%)	
	Core	Total	Core	Total	Core	Total	Core	Total	Core	Total	Core	Total	Core	Total	Core	Total
Profit before tax	[...]	-7,378	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[(-300)-200%]	[(-200)-(100)%]
Cost of Income Ratio	[60-70%]	49.6%	[70-80%]	[50-60%]	[130-140%]	[50-60%]	[80-90%]	[40-50%]	[60-70%]	[40-50%]	[50-60%]	[40-50%]	[40-50%]	[40-50%]	[(-30)-(-20)%]	[(-30)-(-20)%]
FTE		21,538	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[(-30)-(-20)%]	[(-40)-(-30)%]
Branch	[...]	3,291	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[(-30)-(-20)%]	[(-40)-(-30)%]
ROE		187.8%	[(-10)-(-5)%]	[(-120)-(-110)%]	[(-10)-(-5)%]	[10-5%]	[(-5)-(0)%]	[5-10%]	[0-5%]	[10-5%]	[10-5%]	[10-5%]	[10-5%]	[10-5%]		

Balance sheet	Jun-12			2012			2015			2017			Evolution rate 2012-2017 (%)		
Assets	Total	Core	Non-core	Total	Core	Non-core	Total	Core	Non-core	Total	Core	Non-core	Total	Core	Non-core
Loans to clients (net)	180,268	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[(-30)-(-20)%]	[(-10)-(5)%]	[(-80)-(-70)%]
NPLs	24,561	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[(-80)-(-70)%]	[(-60)-(-50)%]	[(-100)-(-90)%]
Total assets	291,878	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[(-80)-(-70)%]	[(-5)-0%]	[(-40)-(-30)%]
RWA				[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[(-20)-(-10)%]	[30-20%]	[(-60)-(-50)%]

Liabilities	Jun-12			2012			2015			2017			Evolution rate 2012-2017 (%)		
	Total	Core	Non-core	Total	Core	Non-core	Total	Core	Non-core	Total	Core	Non-core	Total	Core	Non-core
Central bank	75,474	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[(-70)-(-60)%]	[(-100)-(-90)%]	[(-70)-(-60)%]
Liabilities to clients (deposits)	121,527	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[(-20)-(-10)%]	[10-5%]	[(-60)-(-50)%]
Total Liabilities	291,455	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[(-40)-(-30)%]	[(-10)-(-5)%]	[(-50)-(-40)%]
LTD	168.0%			[170-160%]	[130-140%]		[130-140%]	[120-110%]		[130-120%]	[110-100%]		[(-20)-(-10)%]	[(-20)-(-10)%]	
EBA CT1	4.3%			[10-5%]	[20-10%]	[10-5%]	[20-10%]	[20-10%]	[30-20%]	[20-10%]	[20-10%]	[40-30%]			
Basel III CET1	4.1%			[20-10%]	[20-10%]	[10-5%]	[20-10%]	[20-10%]	[20-10%]	[20-10%]	[20-10%]	[10-5%]			

(68) The measures recorded in the Restructuring Plan to achieve the intended deep structural change include splitting BFA/Bankia's activities into two separate parts: namely, a core and a legacy unit ("**the Steady Bank Unit**" and "**the Legacy Unit**", respectively). The Steady Bank Unit and the Legacy Unit will remain within the same legal entity but will be managed differently.

(69) The Steady Bank Unit will form the basis of a sound and viable bank. It will include the existing retail, SME and public sector banking businesses of the BFA Group that are located in its so-called core areas, […], as well as those of a limited number of branches in selected main economic centres of other Spanish regions. The detailed description of the assets and liabilities within the Steady Bank Unit is set out in the Annex to this Decision, which sets out a separate document entitled: "Term sheet of the Spanish authorities' commitments for the approval of the Restructuring Plan of the BFA Group by the European Commission" ("**the Term Sheet**" annexed to this decision)[33].

(70) The Legacy Unit will include the businesses, assets and liabilities that will be discontinued and will be sold, closed or held to maturity as set out in the Annex. The Legacy Unit includes the banking business not in the Steady Bank Unit, the non-core subsidiaries and equity stakes to be divested, the financial assets and other assets and liabilities set out in the Term Sheet[34].

(71) As set out in the Summary Table, the total balance sheet of the BFA Group will be reduced from EUR […] billion at end 2011 to EUR […] billion at 31 December 2017, which is the end of the restructuring period. That reduction will mainly be due to a decrease in the loans portfolio, a reduction in Eurosystem funding and a decline in deposits.

(72) The BFA Group, as explained in more detail in recitals (51) to (66), will transfer some impaired assets and loan to the AMC with a gross value of EUR […] billion, which implies a reduction in its RWA of EUR […] billion.

(73) The BFA Group will cease any new business in loans in a number of restricted activities as set out in the Term Sheet[35], refocusing on retail banking activities and SME business banking services. Furthermore, there will be additional branch and staff adjustments in its branch network and central services. Those measures involve a reduction between 2012 and 2017 of [30-40]% in branches and [30-40]% in staff, which, if added to the previous restructuring effort (2010-12), represents a total [40-50]% closure of branches and [40-50]% reduction in staff.

(74) Furthermore, besides those measures[36,] the total balance sheet of the BFA Group will be reduced as a result of divesting the portfolio of industrial stakes and the sale of the entire trading/treasury portfolio of fixed-income securities[37].

(75) Accordingly, the volume of RWA in the BFA Group falls by [10-20]%, which, if

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[33] See Annex I: Term-sheet recital 5.1.1
[34] See Annex I: Term-sheet recital 5.2.1
[35] See Annex I: Term Sheet recital 42
[36] See recitals (71), (72) and (73)
[37] See Annex I: Term Sheet 5.2.3

added to reductions achieved in the previous restructuring period, will represent a net reduction of [50-60]% from 31 December 2010.

(76) Following the deep restructuring, the BFA Group projects to post profits before tax in 2017 of EUR […] million, a cost/income ratio of [40-50]%, which represents an improvement of [20-30]% compared to the cost/income ratio of 2012, and solvency ratios according to EBA Core Tier 1 ("**CT1**") and to Basel III common equity Tier 1 ("**CET1**")[38] of [10-20]% and [10-20]% respectively.

3.1.1 Steady Bank Unit

(77) As part of the restructuring, the BFA Group will refocus in the core areas and activities which will lead to additional branch and staff adjustments in its branch network and central services in the Steady Bank Unit. Those measures involve the reduction between […] and […] of [20-30]% in branches and [20-30]% in staff in the Steady Bank Unit.

(78) Accordingly, at the end of the restructuring period, the Steady Bank Unit in which the BFA Group will carry on its retail banking activities will be much smaller, with a core balance sheet of EUR […] billion and RWA of EUR […] billion. Compared to the peak period of 2010, that decline represents a net reduction of [70-80]% of total assets and a reduction of [70-80]% of RWA.

(79) That comprehensive rebalancing in the structure of the BFA Group's balance sheet brings the Steady Bank Unit's business loan-to-deposits ratio to [100-120]% in 2017. After deducting the ICO loans portfolio[39], which is a credit risk free and back-to-back funded portfolio, from the denominator, the loan-to-deposit ratio will fall to [100-120]%.

(80) The restructuring plan projects a net margin of the Steady Bank Unit of EUR [..] million in 2017, which represents an increase of [150-160]% between end 2012 and end 2017.This is mainly due to an increase in the margins for the new production. In this respect, the average loan-to-client net margin above Euribor for the existing portfolio at 1 January 2013 is […] bps whereas the new production is being priced at […] bps. More specifically, the BFA Group projects an increase in the new production of the net margin over Euribor of […] bps in SMEs and of […] bps in residential mortgages over the restructuring period.

(81) The deep restructuring enables the Steady Bank Unit to reach a profit before tax in 2017 of EUR […] million, a cost/income ratio of [40-50]% and solvency ratios according to EBA CT1 ratio and Basel III CET1 of [10-20]%.

[38] On 20 July 2011, the Commission adopted a legislative package (the CRDIV package) to replace the current Capital Requirements Directives (2006/48 and 2006/49) with a Directive and a Regulation implementing the globally developed and agreed elements of bank capital and liquidity standards known as Basel III.

[39] These loans are credit risk-free and back-to-back funded to the BFA Group by the "*Instituto Oficial de Crédito*" or ICO.

3.1.2 Legacy Unit

(82) The assets in the Legacy Unit will be managed so that they are divested, liquidated or wound down, in an orderly manner minimizing the cost for taxpayers. Any remaining assets at the end of the restructuring period should be wound down in an orderly manner once the assets mature. As a general rule, assets assigned to the Legacy Unit will be sold as quickly as possible so long as the sale does not lead to booking a loss[40].

(83) The size of the balance sheet of the Legacy Unit will be reduced by [30-40]% between 2012 and 2017, to stand at a maximum level of EUR […] billion (EUR […] billion RWA) in 2017[41].

(84) The BFA Group will gradually reduce the size of its corporate banking loan book to a marginal size by […][42].

(85) Non-core subsidiaries and equity stakes to be divested in the Legacy Unit amount to a total gross book value of EUR […] billion. The BFA Group will sell its listed and unlisted equity holding/subsidiaries in line with the principles and the timetable recorded in the Term Sheet.

(86) The Legacy Unit structure will be reduced to no branches by […] and to […] employees at […], and will not increase thereafter[43]. The employees remaining in the Legacy Unit will be dedicated to the working out of the assets transferred to the AMC ([…] full-time effective positions ("**FTE**") and to the working out of the legacy assets remaining on the Legacy Unit ([…] FTE). That remaining headcount of the Legacy Unit will be reduced as soon as the assets under management are amortised or have been disposed of.

(87) As a general rule, there will be no new production in the Legacy Unit branches except in the cases set out in the Annex, based on strict limitations on new lending, on new deposits, on transactional products and on the management of the existing assets[44].

3.2 Contribution to the restructuring cost of the BFA Group

(88) In accordance with the MoU[45] and Royal Decree Law 24/2012, prior to benefiting from State aid, aided banks shall conduct burden-sharing exercises on existing shareholders, and on holders of hybrid and subordinated (both perpetual and dated) debt instruments so as to, inter alia, maximise the loss-absorption capacity of the aided bank and at the same time minimise the cost for the tax payer.

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[40] See Term-sheet recital 45
[41] See Term-sheet recital 5.2.2.
[42] Namely Syndicated Loans, Project Finance and Large Corporate loans. See footnote 41
[43] See Term-sheet recital 44
[44] See Term-sheet recital 5.2.3
[45] See recitals 17, 18, 19 and 20 of the MoU

3.2.1 Burden-sharing on existing shareholders of the BFA Group

(89) In light of the results of the MoU Stress Test, the BFA Group presents a capital shortfall of EUR 24 743 million under the adverse scenario for it to reach a regulatory solvency level of 6% of its RWA by 31 December 2014.

(90) A significant portion of those losses have already been incurred in the course of 2012 (the first year covered by the MoU Stress Test). The BFA Group posted material losses for half-year[46] and third quarter results[47] in 2012. It is worth noting that much of the losses stem from the need to comply with the regulatory framework approved in Spain in 2012, requiring all credit institutions to substantially increase the level of provision for those assets and loans related to the real estate development sector. Furthermore, the transfer of impaired assets and loans to the AMC will also contribute to further losses for the end of 2012.

(91) In June 2012, as a result of the restated annual accounts for 2011 of the BFA Group, which resulted in losses of EUR 4 952 million and the impossibility of BFA to buy back the convertible preference shares issued to the FROB in 2010 and after an economic valuation of BFA that resulted in a negative value of EUR 13.6 billion, the FROB resolved to convert all of its preference shares (EUR 4.4 billion) into ordinary shares of BFA. As a result of that conversion, as of June 2012 the FROB owned 100% of the ordinary shares in BFA. Accordingly, the previous equity holders (the seven founding savings banks) lost all economic and political rights over the BFA Group.

(92) On 3 September 2012, as a result of the losses posted on 31 August 2012 by the BFA Group for the 2012 half-year accounts, the FROB resolved to make a limited capital injection in BFA of EUR 4.5 billion in order for the BFA Group to comply with the minimum regulatory capital requirements and maintain its eligibility as an Eurosystem counterpart for monetary policy operations. After that new capital injection FROB kept its [90-100]% stake in BFA. As the proceeds of the capital injection were lent to Bankia by BFA, the [40-50]% stake that BFA had in Bankia remained unaltered.

(93) The current existing shareholder structure prior to the implementation of the recapitalisation and burden-sharing measures envisaged in the Restructuring Plan is as follows: BFA is [90-100]% owned by the FROB, while Bankia is [40-50]% owned through BFA by the FROB with the outstanding part of Bankia's shares being held by private shareholders who had invested in Bankia through its initial public offering in 2011 and by other holders of hybrid instruments that were converted into ordinary shares in 2012.

(94) With the implementation of the Restructuring Plan, all existing shareholder will be asked to bear losses in proportion to their stakes prior to any new capital injection under the MoU.

[46] EUR -5.1 billion
[47] EUR -7.7 billion

3.2.2 Subordinated liability exercise in the BFA Group

(95) In view of the significant losses posted by the BFA Group to date[48] and forecast for the full year 2012, as described in recital (27), and in the context of the MoU holders of preference shares (EUR 3 246 million) and perpetual (EUR 394 million) dated-subordinated debt instruments (EUR 3 270 million[49]) will contribute to the adequate recapitalisation of the BFA Group in two different ways:

(i) First, the securities will be bought back by the BFA Group at their net present value calculated in accordance with the methodology set out in recitals (60) and (61), which implies deep discounts from the nominal value of the instruments (EUR […] billion). That action will generate immediate capital gains for the BFA Group estimated[50] at EUR […] billion that will reduce significantly its needs to raise new capital; and

(ii) Second, the proceeds of the buy-back will be automatically intake the form of ordinary shares of Bankia with the sole exception of dated subordinated debt, whose holders will also be offered the opportunity to convert into more senior debt instruments as described in recital (105) in addition to the possibility to also convert into ordinary shares or other equity-equivalent instruments. The conversion into core capital will further reduce the needs of the BFA Group to raise new capital by approximately EUR […] billion, while, at the same time providing holders of those securities with a listed security and the potential upside in value of that security that should materialise upon the implementation of the Restructuring Plan.

(96) Conversion of the proceeds of the buy-back of those hybrid and subordinated debt securities into ordinary shares of Bankia will be completed following an independent economic valuation of the bank which shall be completed upon the approval of Bankia's 2012 full year audited accounts and after all remaining losses have been taken by the existing shareholders in Bankia/BFA and by the FROB.

(97) The rights of the new shares in the BFA Group will be allocated, following an independent economic valuation of both BFA and Bankia in proportion to the capital contribution of each of the new shareholders. As a result, it is expected that following the new recapitalisation by the FROB and the equity conversion of the holders of hybrid and subordinated debt instruments, the FROB will continue to hold a 100% equity stake in BFA while the equity structure of Bankia will be split between the FROB and private shareholders stemming from the conversion of the latter's hybrid and subordinated debt instruments into equity.

[48] The BFA Group posted losses for the BFA Group up to 3Q12 amount to EUR -7.7 billion.
[49] Out of which EUR 2 719 million mature after 31 December 2015 and EUR 150 million before 31 December 2015.
[50] Assuming that 100% of the holders of those securities accept the tender offer by the BFA Group.

(98) For holders of preference shares and perpetual subordinated debt, burden-sharing will be implemented through conversion of those securities into equity or equity equivalent instruments. As regards the holders of dated subordinated debt they will be given the choice between conversion into equity or into a senior debt instrument.

(99) Calculation of the fair value of the different financial instruments subject to burden-sharing will be based on the net present value ("**NPV**") of the instruments according to the methodology set out below.

(100) Consequently, as a result of the burden-sharing there will be no cash outflow from the BFA Group to the holders of those securities with the sole exception of the holders of dated subordinated debt instruments who decide to convert into new debt securities whose principal will be paid upon maturity.

Methodology for the conversion into capital

(101) For each financial instrument the NPV will be calculated by way of discounting the cash flows of the instrument ("**DCM**") according to the terms and conditions upon which the instrument was issued, including coupon suspension, deferrals, etc.

(102) The discount factors to be applied in order to establish the DCM will be: a) [20-30]% for preference shares and other instruments of the same rank; b) [10-20]% for perpetual subordinated instruments; and c) [10-20]% for dated subordinated instruments.

(103) For coupon payments that are discretionary or linked to the profitability of the issuing bank, it will be assumed for the purpose of the NPV calculation, that no coupon payment will take place for the years during which the bank is not profit-making, in line with the Restructuring Plan. The NPV will be augmented by a take-up premium of [10-20]% and a further [20-30]% premium for those securities for which conversion into equity or equity-like instruments of the issuing bank is envisaged.

(104) The conversion rate will be a maximum of [90-100]% of the face value.

Specific provision for dated subordinated debt

(105) The holders of dated subordinated debt will be offered the choice between:

(i) Conversion into a new senior debt instrument with a maturity matching that of the subordinated debt being exchanged. The conversion rate will be equal to the nominal value of the subordinated debt instrument, minus a haircut that will be equal to [0-5]% multiplied by the number of months to maturity. The starting date for the calculation of the number of months will be 1 December 2012. The new senior debt instrument will have a zero-coupon until maturity; and

(ii) Conversion into core capital of the issuing bank. The conversion rate to be applied will be the higher of: i) the amount resulting from the methodology for the conversion into core capital described in recitals (60) and (61); and ii) the amount resulting from the calculation in point i) above.

d) Equity stake for the holders of securities subject to burden-sharing

(106) The holders of securities subject to burden-sharing will receive an equity stake in Bankia in the form of ordinary shares which shall be proportional to value of Bankia, as determined by a due diligence and three economic valuations carried out in accordance with Royal Decree Law 24/2012 and the methodology put forward by the FROB in liaison with the Commission.

4 POSITION OF THE SPANISH AUTHORITIES

4.1 Position of the Spanish authorities on the Restructuring Plan

(107) The Spanish authorities accept that some of the proposed measures, in particular the new recapitalisation of the BFA Group and the segregation to the AMC constitute State aid and request the Commission to verify if those measures together with the rescue measures (including the FROB's intervention in BdV) already taken in favour of the BFA Group (together referred to as "**the State aid measures**") are compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union ("**the TFEU**"), as they are necessary to remedy a serious disturbance in the Spanish economy.

(108) The Spanish authorities accept the market price estimate of the assets which are transferred to the AMC provided to them by the Commission, which is based on the assessment of the independent experts assisting the Commission

(109) The Spanish authorities submit that the State aid measures are: (i) appropriate and well-targeted; (ii) necessary and limited to the minimum amount necessary; and (iii) proportionate as designed to minimize negative spill-over effects on competitors.

(i) *Appropriate and well-targeted*. The Spanish authorities submit that the BFA Group, being the fifth-biggest credit institution in Spain, is systemically important within the Spanish financial system, especially in its geographical operating area[51].

(ii) *Necessary and limited to the minimum amount*. The Spanish authorities submit that the State aid measures are necessary to bring the BFA Group's solvency position in line with the new solvency requirements in Spain after the MoU. In addition, they are limited in size to ensure that the BFA Group meets a solvency ratio of 9% Core Tier 1 of its RWA required by the Spanish banking rules[52] and of 6% Core Tier 1 under an adverse scenario as determined in the Stress Test. Finally, the Spanish authorities observe that the State aid measures are limited in time since they will form part of the Restructuring Plan that should led to the selling of the bank and/or its orderly resolution. The Restructuring Plan was approved by the BoS and notified to the Commission thereafter.

[51] Bankia's market share in deposits in the region where it operates is [10-20]%.

[52] See footnote 9.

(iii) *Proportionate*. The Spanish authorities submit that the terms and conditions of the State aid measures together with the terms and conditions imposed on the BFA Group in the Restructuring Plan contain a sufficiently extensive range of safeguards against possible abuses and distortions of competition.

4.2 Commitments of the Spanish authorities

(110) The Spanish authorities have undertaken a number of commitments related to the implementation of the Restructuring Plan. The commitments by the Spanish authorities have been presented in the Term Sheet. The Spanish authorities commit to comply with the commitments listed in the Term Sheet, if necessary by ensuring that the BFA Group complies with said commitments.

(111) Furthermore, in order to ensure that the various commitments are duly implemented during the implementation of the Restructuring Plan, the Spanish authorities commit to the appointment of a monitoring trustee in charge of monitoring all the commitments undertaken by the Spanish authorities and the BFA Group towards the Commission ("**the Monitoring Trustee**"). The Monitoring Trustee will be appointed by the BFA Group and must be endorsed by the Commission. The Monitoring Trustee must be independent of the BFA Group and be remunerated by the BFA Group. The Monitoring Trustee will report to the Commission.

5 ASSESSMENT

5.1 Existence of State Aid

(112) The Commission has already concluded[53] that the aid measure already approved by it as part of the Spanish guarantee scheme (measure A) and the aid measures approved temporarily by it as rescue aid to the BFA Group in the Conversion Decision and the Urgent Recapitalisation Decision (measures B, C, E and F), constituted State aid in favour of the seven founding savings banks and of the BFA Group. As a consequence, it is not necessary to reassess whether they constitute State aid under the present decision.

(113) The measures which need to be assessed for State aid under this decision are those described in sections 2.3.3, 2.3.6 and 2.3.7 respectively (namely, measures D, G and H).

(114) The Commission has to examine those measures in the light of Article 107(1) TFEU. According to that provision, State aid is any aid granted by a Member State or through State resources in any form whatsoever which distorts, or threatens to distort, competition by favouring certain undertakings, in so far as it affects trade between Member States.

[53] See footnotes 3 and 5

(115) The qualification of a measure as State aid within the meaning of that provision therefore requires the following cumulative conditions to be met: (i) the measure must be imputable to the State and financed through State resources; (ii) it must confer an advantage on its recipient; (iii) that advantage must be selective; and (iv) the measure must distort or threaten to distort competition and have the potential to affect trade between Member States

5.1.1.1 Capital relief measure through the FROB's intervention in Banco de Valencia (measure D)

State resources and imputability

(116) The FROB's intervention in BdV involved State resources, as Spain itself has recognised[54].

Advantage and Selectivity

(117) The capital relief measure provided through the FROB's intervention in BdV in November 2011 conferred an economic advantage to the BFA Group as it averted losses that the BFA Group would probably have incurred in the event of BdV's insolvency, which would have occurred without the FROB's capital injection. The advantage is selective since it benefits the BFA Group alone, whose EUR 1 759 million credit line in favour of BdV would have been considered subordinated debt under Spanish insolvency law if BdV had becomes insolvent. As subordinated debt, the EUR 1 759 million claim would have been wiped out in the insolvency procedure, thus, generating a corresponding loss for the BFA Group. That feature is unique to the BFA Group since that mechanism of the Spanish insolvency law only applies between related entities and BdV was consolidated within the BFA Group prior to the State's intervention.

Distortion of competition and effect on trade between Member States

(118) The capital relief measure provided through the FROB's intervention in BdV distorts competition as it strengthens the position of the BFA Group vis-à-vis its competitors in Spain and in other Member States, thus also affecting trade between Member States.

5.1.1.2 The recapitalisation measure of December 2012 (measure G)

State resources

(119) The Commission observes that the FROB, through which the recapitalisation measure will be taken in December 2012, is directly and totally financed through State resources following its latest reform.

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[54] See recital 19 of Decision SA. 33917 (2011/N) of 21 November 2011

Advantage

(120) The proposed recapitalisation by the FROB confers an advantage to the BFA Group. In particular, the measure provides additional core capital to it, allowing it to restore its regulatory solvency ratio and to, inter alia, avoid technical insolvency.

(121) The Commission furthermore notes that the amount of capital requested by the BFA Group would not have been provided by a market economy investor expecting a reasonable return on its investment particularly in light of the considerable size (EUR 17 959 million) of the investment and the low profitability of the banking business. By contrast, since the seven founding savings banks have seen their equity stake into the BFA Group reduced to zero as a consequence of measure E in July 2012, the recapitalisation in December 2012 will provide no advantage to them.

Selectivity

(122) The recapitalisation measure to be undertaken in December 2012 will confer an economic advantage to the BFA Group as it strengthens its solvency position vis-à-vis its competitors in Spain and in other Member States. The advantage is selective since it benefits only the banks receiving State aid in Spain such as the BFA Group.

Distortion of competition and effect on trade between Member States

(123) The recapitalisation to take place in December 2012 will distort competition as it allows the BFA Group to obtain the capital necessary to avoid its orderly liquidation and exit from the market.

(124) The Commission finds that recapitalisation is also likely to affect trade between Member States. The BFA Group has a material market share in the Spanish market, where it competes on retail, mortgage lending and commercial lending markets, and in all those markets some of its competitors are subsidiaries and branches of foreign banks.

5.1.1.3 The impaired asset measure (Measure H)

State resources and imputability

(125) As regards the transfer of assets to the AMC (measure H), while the capital structure of the AMC will consist of a majority holding by private investors, the Commission nevertheless considers the impaired asset measure to involve State resources. First, the AMC was set up for a public policy objective, namely to help troubled Spanish banks by transferring their most risky assets off their balance sheet and thus by helping them implement their restructuring plans. That genesis in public policy consideration is also underlined by the fact that the AMC was set-up between the Spanish authorities and its international partners as a result of the MoU and the special legal setting implemented by the Spanish authorities for the AMC. Second,

the FROB will be the single largest investor in the AMC and the bonds issued by the AMC will be guaranteed by the State. Without that State guarantee, the measure could not be financed. Indeed, the amount of own funds invested by private investors is very small when compared to the amount of State guaranteed bonds. Third, the Spanish public authorities will keep a high of oversight over the AMC's decisions and overall management issues. Therefore, the AMC's shareholding structure does not contradict the fact that measure F is imputable to the State and constitutes State resources.

Advantage

(126) As regards the impaired asset measure, measure H, the BFA Group receives a clear advantage in that its most risky portfolio is transferred off its balance sheet, thus avoiding foreseeable adverse consequences (i.e. additional provisions, management of the assets, etc.) of potential future losses on those assets. Furthermore, the transfer also significantly reduces the RWA of the BFA Group and thus its capital needs. In the case of the BFA Group transferred problematic assets amount to EUR […] billion and the reduction of risk weighted assets EUR […] billion.

(127) It should also be noted that the AMC cannot be considered as a market investor. The fact that private investors take part in the equity of the AMC does not alter that conclusion. Current market circumstances are such that purchases of such a large amount of assets under market conditions can only happen if the purchaser receives vendor financing, i.e. that the purchase price is financed by the selling entity. In the present instance, the BFA Group will not however, be providing vendor financing. Furthermore, private investors are purchasing such assets only at very low prices (i.e. fire-sale conditions), given the uncertainty surrounding their value. Those low prices are due to liquidity constraints affecting the European financial system, particularly prevalent in Spain at the moment.

(128) In fact, the transfer price of the assets, while conservative and below their real economic value, is still above the market price that a private investor would have been willing to pay for those assets. It can therefore be excluded that a market economy investor would have purchased the proposed assets out of private funds on a comparable scale and on similar terms.

(129) As the seven founding savings banks had their equity stake into the BFA Group reduced to zero as a consequence of measure E in June 2012, the impaired asset measure granted in December 2012 will provide no advantage to them

Selectivity

(130) The advantage conferred on the BFA Group by the impaired asset measure is selective since it benefits only banks in Spain which will transfer assets to the AMC such as the BFA Group.

Distortion of competition and effect on trade between Member States

(131) The impaired asset measure strengthens the position of the BFA Group vis-à-vis its competitors in Spain and in other Member States. As a result, that measure distorts competition and affects trade between Member States.

5.1.2 Conclusion

(132) On the basis of the foregoing, the Commission recalls that the aid measures temporarily granted to the BFA Group pursuant to the Conversion Decision and the Urgent Recapitalisation Decision have already been definitively found to constitute aid and finds that the State aid measures fulfil the conditions laid down in Article 107(1) TFEU and, therefore, they qualify as State aid.

(133) The Commission in that context observes that the Spanish authorities do not dispute that the State aid measures constitutes State aid.

5.2 Amount of aid

5.2.1 State guarantees

(134) Since the Spanish authorities approved the Spanish Guarantee Scheme in 2008, the BFA Group has been granted a total of EUR 34.9 billion in State guarantees for unsecured senior debt, of which the BFA Group has issued a total amount of EUR 34.7 billion. Of the issued amount, EUR 24.2 billion of State-guaranteed debt issued by the BFA Group remains outstanding. The Spanish Guarantee Scheme will be in force until 31 December 2012 at least.

(135) On 27 June 2012, in the context of the conversion by the FROB of the preference shares that it has subscribed for in BFA in 2010, BFA was also granted as a rescue measure the possibility to issue up to EUR 19 billion of State-guaranteed senior debt. However, to date, BFA has not taken advantage of any of those guarantees.

5.2.2 Recapitalisation measures

(136) As set out above, the BFA Group has in total received recapitalisations of EUR 22 424 million. The Commission considers the aid element in recapitalisation to be up to 100% of the nominal amount, and hence concludes that the recapitalisation measures entail aid of an amount up to EUR 22 424 million ([10-20]% RWA[55]).

5.2.3 Capital relief from the FROB's intervention in Banco de Valencia

(137) As set out above in recital (117), the BFA Group in total received a capital relief measure of up to EUR 1 759 million corresponding to its credit exposure to BdV at the time of its rescue by the FROB in November 2011. The Commission considers the aid element in the capital relief measure to be up to 100% of the nominal amount, and hence concludes that the measures entail aid of an amount up to EUR 1 759 million.

[55] RWA as of 31 December 2011.

5.2.4 Impaired asset measure

(138) Point 15 of the Impaired Assets Communication explains that asset relief measures are considered State aid if impaired assets are transferred at a value above market prices and that the amount of aid is the difference between those two values.

(139) As described in recital (64), the transfer price of the assets transferred by the BFA Group to the AMC will be about EUR […] billion, which is greater than the current market value of about EUR […] billion estimated by the experts advising the Commission, with which the Spanish authorities agree. Consequently, the resulting State aid from the transfer amounts to EUR […] billion ([5-10]% RWA[56]).

5.2.5 Conclusion

(140) On the basis of the foregoing, it should be concluded that the BFA Group has received State aid in form of direct capital injections, capital relief and impaired asset measures amounting to up to EUR 36.2 billion (or 22% of its RWA as of 31 December 2011), in addition to the State guarantees on senior unsecured debt for a total amount of EUR 53.9 billion.

5.3 Legality of the aid

(141) The Commission notes that Spain notified measures A, B, C, D, E, F, G and H to the Commission for its approval prior to putting them into effect and, thus, complied with its obligations under Article 108(3) TFEU. As regards measure D, the Commission noted in recital (34) of its Decision on the Recapitalisation and Liquidity support for Banco de Valencia[57] that, at the time of the decision, it was not in a position to ascertain the existence of a selective advantage in the aid measures to BdV to the BFA Group. The present Decision completes the assessment of this aid measure for the BFA Group.

6 COMPATIBILITY OF THE AID WITH THE INTERNAL MARKET

(142) As regards the compatibility of the aid provided to the BFA Group, the Commission must determine, first, whether the aid can be assessed under Article 107(3)(b) TFEU, i.e. whether the aid remedies a serious disturbance in the economy of Spain. Subsequently, the Commission, using that legal basis, must assess whether the aid is compatible with the internal market.

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[56] RWA as of 31 December 2011.

[57] See SA. 33917 (2011/N) of 21.11.2011

6.1 Legal basis for the compatibility of the aid

(143) Article 107(3)(b) TFEU empowers the Commission to find that aid is compatible with the internal market if it is intended "*to remedy a serious disturbance in the economy of a Member State*". The Commission has acknowledged that the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks are apt to remedy that disturbance[58]. The Commission confirmed that view by adopting the 2011 Prolongation[59].

(144) In respect of the Spanish economy, that assessment was confirmed in the Commission's approvals of the various measures undertaken by the Spanish authorities to combat the financial crisis[60]. Therefore, the legal basis for the assessment of measures A through H should be Article 107(3)(b) TFEU.

6.2 Compatibility assessment

(145) The BFA Group has already benefited and will continue to benefit from several State aid measures whose compatibility has not previously been assessed by the Commission, namely measures D, G and H. Moreover, the BFA Group has previously benefited from State aid measures that the Commission found temporarily compatible with the internal market as rescue aid, namely, measures E and F referred to in sections 2.3.4 and 2.3.5 above. Finally, the approval of the measures A, B and C was granted under the approved Spanish Guarantee and Recapitalisation Schemes.

(146) Measures A through H have been provided in the context of the restructuring of the BFA Group. The Commission will therefore examine the Restructuring Plan under the Restructuring Communication, which sets out the rules applicable to the granting of restructuring aid to financial institutions in the current crisis. Accordingly, it will have to be determined whether measures D, G and H as well as measures E and F are compatible as restructuring aid, in particular, based on the Restructuring Plan, while taking account of the effects of measures A, B and C in that context.

(147) However, prior to that examination, it will have to be examined whether measures D and G are compatible with the Recapitalisation Communication and whether measure H is compatible with the Impaired Assets Communication.

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[58] That view has been confirmed in the Banking Communication, the Recapitalisation Communication (Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.1.2009, p. 2), the Impaired Asset Communication (Communication from the Commission on the treatment of impaired assets in the Community banking sector, OJ C 72, 26.3.2009 p. 1) and the Restructuring Communication (Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9).

[59] Communication on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis OJ C 356, 6.12.2011, p. 7.

[60] See Decision on the Reintroduction of the Spanish Guarantee Scheme SA 34224 (2012/N), OJ C82/2012 of 21.03.2012

The position of the seven founding savings banks as beneficiaries of State aid

(148) The position of the seven founding savings banks as beneficiaries of State aid has evolved significantly since the first recapitalisation by the FROB was granted in 2010. While initially the savings banks maintained full ownership and structural links with the banking activities of the BFA Group, successive legal and corporate changes increasingly broke those links. Indeed, with measure C, the conversion of FROB's convertible preference shares into equity in BFA in June 2012, any pre-existing link between the seven founding savings banks and the BFA Group was severed, in terms of ownership, control and operational involvement.

(149) The founding savings banks have thereafter completely ceased their involvement in banking activities. Their activities are currently limited to charitable activities. In terms of burden-sharing, they have relinquished any ownership rights in the BFA Group, and will not recover them in the future. All the assets and resources they have maintained stem from and are directed to the exercise of their charitable activities. As they have lost any control over the BFA Group and completely ceased banking activities, the distortion of competition caused by the aid measures benefitting them has been minimised.

(150) The remainder of this Decision will therefore focus on the compatibility of the measures regarding the BFA Group, which will continue to carry out banking activities

6.3 Compatibility of measures D and G with the Recapitalisation Communication: Appropriateness, necessity, proportionality

(151) As recalled in the Banking Communication, in order for an aid measure to be compatible under Article 107(3)(b) TFEU it must comply with general criteria for compatibility under Article 107(3) TFEU, which imply compliance with the following conditions :

(i) *Appropriateness*: The aid must be well-targeted to be able to effectively achieve the objective of remedying a serious disturbance in the economy.

(ii) *Necessity*: The aid measure must, in its amount and form, be necessary to achieve the objective. Thus it must be of the minimum amount necessary to reach the objective, and take the most appropriate form to remedy the disturbance.

(iii) *Proportionality*: The positive effects of the measure must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measure's objectives.

6.3.1 The capital relief measures through the intervention of the FROB in Banco de Valencia (measure D)

(152) The intervention in BdV by the FROB had the effect of a capital relief measures for the BFA Group. In the absence of that measure, the latter's credit exposure to BdV at the time of the intervention would have been converted into a subordinated liability pursuant to the Spanish insolvency law. Had such a subordinated liability arisen, it would, in the light of the financial situation of BdV, have been fully written-off thereby generating losses of up to EUR 1 759 million for the BFA Group.

(153) That capital relief measure did not carry any remuneration obligation by the BFA Group. Spain did not provide elements to demonstrate that the measure was appropriate, necessary and proportional.

(154) In that respect, it should be noted that, had that particular measure not been granted in favour of the BFA Group, its capital needs would have increased accordingly as a result of the Stress Test. Such an increased need for capital would have in all likelihood resulted in a higher recapitalisation in December 2012 under measure G.

(155) For that reason, the compatibility of measure D needs to be assessed taking into account the overall restructuring of the BFA Group so as to compensate for the lack of remuneration on that aid measure. In that regard, the Commission considers that the far-reaching restructuring of the bank can be sufficient to compensate for the lack of remuneration of the capital relief obtained by the BFA Group as a result of the FROB intervention in BdV.

6.3.2 The recapitalisation measure of December 2012 (measure G)

a. Appropriateness of the measure

(156) As for measure G, the proposed recapitalisation in December 2012, the Stress Test revealed - under the stressed scenario - a capital deficit of EUR 24.7 billion, which will be reduced by EUR […] billion through the transfer of assets to the AMC (estimated at EUR 191 million) and the burden-sharing exercise on hybrid and subordinated debt instruments (estimated at EUR […] billion), as well as by the capital injection of EUR 4.5 billion of September 2012.

(157) Owing to the lack of confidence of the markets in the BFA Group and the general uncertainty regarding the economic situation of Spain overall, it is virtually impossible for the BFA Group to raise the capital necessary to cover that capital deficit from private investors. Accordingly, the Commission is of the view that the additional capital injection from the FROB is appropriate in that it fills the remaining capital deficit.

b. Necessity – limitation of the aid to the minimum

(158) According to the Banking Communication, the aid measure must be, in its amount and form, necessary to achieve its objective. That requirement implies that the aid measure must be of the minimum amount necessary to reach the objective. With the additional capital provided through measure G, the BFA Group will meet the new regulatory capital ratios in Spain and, thus, the aid amount is limited to the minimum.

(159) In addition, adequate remuneration of any State intervention contributes to ensuring that the aid is limited to the minimum necessary. As regards the required remuneration for recapitalisation in the form of ordinary shares, the 2011 Prolongation Communication lays down that new shares should be subscribed for at a discount to the market price prevailing at the time of the announcement of the proposed subscription. However, such a discount is not necessary in the case of BFA as the FROB is currently its sole shareholder.

(160) In spite of the fact that the Restructuring Communication considers that adequate remuneration of any State intervention is one of the most appropriate limitations of distortions of competition, in the present case the Commission notes that an adequate remuneration of the proposed recapitalisation in December 2012 is unlikely, given the current troubled state of the BFA Group and the large amounts of aid it has received. Therefore, given that adequate remuneration is not guaranteed, further restructuring is required.

(161) Finally, to ensure that the BFA Group is not overcapitalised should the adverse scenario assumed under the Stress Test not materialise, Spain has committed that, as from 1 January 2015, the BFA Group shall distribute in the form of dividends any capital surplus above the regulatory minimum level plus a buffer of 100 bps ("**the Capital Repayment Mechanism**")[61].

c. Proportionality – measures limiting negative spill-over effects

(162) The Commission considers that in principle the proportionality of the proposed recapitalisation in December 2012 has to be assessed in the light of the depth of the restructuring planned for the BFA Group and, in particular, taking into account the measures ensuring burden-sharing and limiting distortions of competition. It therefore refers to its assessment of the measure under the Restructuring Communication below. It is worth noting that in view of the significant degree of burden-sharing imposed and the Capital Repayment Mechanism, the measure seems *prima facie* proportionate.

Conclusion

The Commission concludes that the measure is appropriate, necessary and, in the light of the deep restructuring foreseen, proportional.

[61] For further information on the capital repayment mechanism see recital 86, 87 and 88 of the Term Sheet.

6.4 Compatibility of measure H with the Impaired Asset Communication

(163) Before examining the compatibility of all the measures with the Restructuring Communication, it is necessary to assess the compatibility of measure H – the transfer of impaired assets to the AMC on the basis of the Impaired Assets Communication. The Impaired Assets Communication defines impaired asset relief as any measure which "*free[s] the beneficiary bank from (or compensate[s] for) the need to register either a loss or a reserve for a possible loss on its impaired assets and/or free regulatory capital for other uses*" and sets out criteria for the compatibility of such measures with the internal market. Those criteria comprise: (i) the eligibility of the assets; (ii) transparency and disclosure of impairments; (iii) the management of the assets; (iv) the correct and consistent approach to valuation; and (v) the appropriateness of the remuneration and burden-sharing.

Eligibility of assets

(164) As regards the eligibility of the assets, section 5.4 of the Impaired Assets Communication indicates that asset relief requires a clear identification of impaired assets and that certain limits apply in relation to eligibility to ensure compatibility.

(165) The Impaired Assets Communication however further sets out that a balance needs to be found between meeting the objective of immediate financial stability and the need to ensure the return to normal market functioning, which would plead in favour of flexibility when identifying classes of assets. In particular, whilst the IAC cites as eligible assets those that have triggered the financial crisis (the IAC explicitly refers to US mortgage-backed securities), it also allows for the possibility to "extend eligibility to well-defined categories of assets corresponding to a systemic threat upon due justification, without quantitative restrictions". In this context the IAC specifically mentions as one of those systemic threats, the burst of a bubble in the domestic real estate market

(166) As mentioned in recitals (51) to (66), measure H targets a specific type of assets, namely (i) all impaired real estate related assets and (ii) all real estate development loans.

(167) The Commission recognises that the Spanish financial system and domestic economy has been affected by the burst of a real estate bubble and agrees that as a consequence loans to the real estate development sector are at the source of the principal uncertainties in relation to asset quality in the Spanish financial system.

(168) On the basis of the above Spain has developed a proportionate approach within the meaning of point 34 of the Impaired Assets Communication and the scope of assets to be included in the asset transfer to the AMC is in line with the eligibility requirements of the IAC.

Transparency and disclosure

(169) As regards transparency and disclosure, section 5.1 of Impaired Assets Communication requires full ex-ante transparency and disclosure of impairments by eligible banks on the assets which will be covered by the relief measures, based on an adequate valuation, certified by recognised independent experts and validated by the relevant supervisory authority. In other words the Impaired Assets Communication requires that disclosure and valuation should take place prior to government intervention.

(170) As regards measure H, the Commission notes that independent experts have been engaged to value the assets and that the valuation methodology has been endorsed by the Spanish supervisory authority and also by a group including international institutions.

(171) However, while it is accurate that the definitive number of the impaired assets falling under measure H are not yet available due to accounting and other changes which may occur between the date of this decision and the final date of the asset transfers, the asset classes to be transferred have been clearly identified and the transfer will only occur on the basis of the approved methodology. The Commission therefore considers that the Member State has provided full disclosure on the entirety of impaired assets on the balance sheet of the BFA Group.

(172) The requirement for transparency and disclosure are thus met.

Management of the assets

(173) As regards the management of assets, section 5.6 of the Impaired Assets Communication stipulates the necessity of ensuring a clear functional and organisational separation between the beneficiary bank and its assets, notably as to their management, staff and clientele. The Communication provides in that respect that such arrangements should allow the bank to focus on the restoration of viability and to prevent possible conflicts of interest.

(174) As regards measure H, the Commission notes that the assets are managed by the AMC, which is fully independent from the BFA Group. The Commission therefore concludes that the arrangements for the condition of separate asset management is thus in line with the Impaired Assets Communication.

Valuation

(175) Section 5.5 of the Impaired Assets Communication notes that a correct and consistent approach to valuation is of key importance to prevent undue distortions of competition. The main aim of valuation is to establish the real economic value of the assets. That value constitutes the benchmark level in so far as a transfer of impaired assets at that value indicates the compatibility of aid – it creates a relief effect because it is in excess of the current market value.

(176) Spain appointed Oliver Wyman to assess the portfolio and has applied a number of haircuts in order to arrive at the transfer value. In addition, Spain has provided a letter from the head of the supervisory authority, the BoS, certifying the detailed results of the asset transfer to the AMC.

(177) The Commission has scrutinized the valuation and in particular the underlying general methodology in order to ensure a consistent approach at Union level. For that purpose the Commission has called on the technical assistance of external experts. In particular, the Commission has contracted external experts in order to scrutinize the valuation prepared by Oliver Wyman.

(178) The valuation process is therefore in line with the Impaired Asset Communication.

Burden-sharing and remuneration

(179) As regards burden-sharing, section 5.2 of the Impaired Assets Communication repeats the general principle that banks ought to bear the losses associated with impaired assets to the maximum extent so as to ensure equivalent shareholder responsibility and burden-sharing. Thus, the assets should be transferred at a price that matches or remains below their real economic value.

(180) Furthermore, the Impaired Assets Communication explains that burden-sharing is achieved through an adequate remuneration of the aid. In section II of Annex IV to the Impaired Assets Communication the Commission explains that the pricing of the impaired asset measure must include remuneration for the State that adequately takes account of the risks of future losses exceeding those that are projected in the determination of the real economic value. Such remuneration may also be provided by setting the transfer price of assets well below the real economic value to a sufficient extent so as to provide for adequate compensation for the risk in the form of a commensurate upside.

(181) As regards measure H, the transfer value is well below the real economic value as determined by the Commission's experts. The Commission notes in that regards that the assets have been fully written down to their transfer value. The transfer price is, on a relative basis, about [5-10]% lower as compared to the REV, with the latter being certified by the independent experts retained by the Commission. That difference between the REV and the transfer price corresponds thus to a remuneration of about EUR […] billion.

(182) Additionally, it must be noted that the BFA Group receives one-, two-, and three-year bonds as opposed to cash, in exchange for its assets. The yield on those bonds is set at the lowest between the rate of the corresponding maturity government bond and 12-month Euribor plus 200 bps. It is very likely that the bonds will be rolled over several times as the request of the AMC, as eventual redemption will depend on the sales of the assets transferred during the next 15 years. As a result of the form of the payment which it receives, the BFA Group forgoes revenue which it might otherwise generate if it had had cash available which it could lend on at a higher yield or invest in higher yielding risk-free bonds.

(183) Therefore, adequate compensation for the risk of the State is embedded in the low transfer price and in the payment through bonds. The BFA Group consequently provides adequate compensation and even the possibility that the valuation of the assets can recover over time which would additionally benefit the State.

(184) Thus, the requirements in the Impaired Assets Communication for burden-sharing have been met.

Conclusion

(185) In light of the above, the Commission considers measure H – the asset relief measure – to fulfil the conditions on eligibility of assets, asset management arrangement, transparency and disclosure, valuation and burden-sharing and is thus to be in line with the Impaired Assets Communication.

6.5 Compatibility of all aid measures (A–H) with the Restructuring Communication

(186) According to the Restructuring Communication, in order to be compatible with the internal market under Article 107(3)(b) TFEU, the restructuring of a financial institution in the context of the current financial crisis must (i) lead to a restoration of the viability of the bank, or to the orderly winding-up thereof; (ii) ensure that the aid is limited to the minimum necessary and include sufficient own contribution by the beneficiary (burden-sharing); and (iii) contain sufficient measures limiting the distortion of competition.

6.5.1 Restoration of viability

(187) As the Commission has indicated in its Restructuring Communication' the Member State needs to provide a comprehensive restructuring plan which shows how the long-term viability of the entity will be restored without State aid within a reasonable period of time and within a maximum of five years. Long-term viability is achieved when a bank is able to compete in the marketplace for capital on its own merits in compliance with the relevant regulatory requirements. For a bank to do so, it must be able to cover all its costs and provide an appropriate return on equity, taking into account the risk profile of the bank. The return to viability should mainly derive from internal measures and be based on a credible restructuring plan.

(188) The Spanish authorities have submitted a plan for the BFA Group with a five-year time-span going up to 2017, showing a return to viability at the end of the restructuring period.

(189) First, point 10 of the Restructuring Communication requires that the proposed restructuring measures remedy to the entity's weaknesses. In that regard, the Restructuring Plan adequately addresses the causes of failures of the BFA Group described in recital (191). First, segregation and transfer of the assets and loans related to the real estate development sector to the AMC (measure H) is an adequate response

to the high concentration of entity's balance sheet on the real estate development sector and level of non-performing assets[62], and its past expansion outside its core retail banking business and historical core regions. That transfer will allow the BFA Group to benefit from a RWA relief of EUR […] billion, and facilitate new production in core retail business such as residential mortgages and SME loans.

(190) Second, since the change of management in May 2012 and the listing of Bankia in July 2011, a significant overhaul of strategy has been undertaken to strengthen the corporate governance management of the BFA Group, most notably on risk management practices and controls. The BFA Group had a cost/income ratio of 60.1% in 2011, one of the highest ratios[63] among its publicly quoted Spanish peers. The BFA Group plans to reduce that ratio by significant reductions in the branch network and personnel. The plan projects a new cost/income ratio of [40-50]% at group level and [40-50]% at the Steady Bank level in 2017.

(191) Third, the Restructuring Plan foresees in a fundamental change to the BFA Group's business profile as it intends to concentrate on its core strengths and to wind down non-core activities and more risky activities. The BFA Group will also cease all activities regarding the capital markets (wholesale activities) as well as specialised financing. The plan includes a split between its core and non-core business and geographical activities, which will allow the BFA Group to focus on pure retail banking activities.

(192) The BFA Group will use the Legacy Unit as a run-off vehicle to maximise the value of non-core assets through ordered disposals and winding down. Thus, the Legacy Unit will be used to divest the BFA Group's equity stakes and fixed income portfolios as well as non-core loans. […] international branches and representatives branches will also be included in the Legacy Unit and closed.

(193) In terms of the viability of the Steady Bank Unit, the Commission notes that the Restructuring Plan uses conservative assumptions in terms of market shares evolution in the core areas, net margins on pricing new productions of loans and cost of funding. The business plan foresees that the BFA Group will strengthen its position in its core historical regions and selected economic centres in Spain and in business segments where it has a good client base. In particular it plans to focus in the SME segment where growth rates are higher and where the BFA Group has had one of the lowest financial margins compared to its peers. In addition, it plans to increase cross-selling activities to its customer base. Overall, the re-pricing of new production (which has already been put in effect as of mid-June 2012) and the cross-selling strategy will improve the profitability of the Steady Bank Unit, and should compensate for the large long-term mortgage legacy portfolio. Hence the BFA Group will gradually become smaller and the Steady Bank Unit will be a more balanced unit with total loans to clients of EUR […] billion by […] (and a non-core part from the Legacy Unit of EUR […] billion). Those arrangements will ensure a clean-up of the core business in terms of lending book allowing the BFA Group to focus on its strong base amongst retail and SME clients. At the end of the restructuring period, the Steady Bank Unit will be able

[62] 19% of its balance sheet in 2011 and 7% of impaired assets - Source: Oliver Wyman analysis.
[63] 60.1% - Source: The BFA Group responses to Commission questions, electronic mail from the BoS of 29 August 2012.

to cover all its costs and provide an appropriate return on equity of 9%, taking into account an adequate cost of risk in view of its new risk profile

(194) Fourth, according to point 13 of the Restructuring Communication, the restructuring plan should address the requirements emerging from a stress test exercise and ensure that the entity is sufficiently and adequately capitalised. At group level, the BFA Group undertook the MoU Stress Test detailed in recital (27). This exercise was well designed for assessing the current challenges of the Spanish banking system, with conservative assumptions and a robust execution under the close monitoring of the international partners. It included a comprehensive asset quality review as well as an identification of the capital needs over three years (2012-2014).

(195) The BFA Group plans to clean its balance sheet by taking accounting losses to a level of loan-loss provisions of EUR […] billion in […] and deducting the estimated increase in own funds of EUR […] million from the burden-sharing exercise and the estimated benefit from the transfer to the AMC of EUR […] million. It plans to be recapitalised to a level that will allow it to reach a CTE ratio of [5-10]% and CT1 ratio of [10-20]% at […], and [10-20]% and [10-20]% respectively at […], which is the end of the restructuring period.

(196) Finally, the Restructuring Plan provides information on the future funding profile of the BFA Group. As described in recital (25), the funding and liquidity profile of the BFA Group remains weak with deposits outflows amounting to a reduction of approximately EUR […] billion from 31 December 2011 to 30 October 2012, and with over-reliance over Spanish government-guaranteed debt issuance as well as on central bank funding.

(197) The Restructuring Plan factors in conservative assumptions in terms of deposits evolution and wholesale and central bank reliance. At the end of the restructuring period the Steady Bank Unit will have a loan-to-deposit ratio of [100-120]% and at group level reliance on the central bank funding will have reduced from EUR […] billion in 2012 to EUR […] billion (and to […] for the Steady Bank Unit) at the end of the restructuring period.

(198) The Commission therefore considers that the implementation of the Restructuring Plan which involves a significant reduction of the balance sheet, and hence funding needs, as well as its loan-to-deposit ratio target of [100-120]% and exit from central bank reliance for the Steady Bank Unit, will ensure that the BFA Group has a conservative funding profile with a greater alignment of assets and liabilities.

6.5.2 *Own contribution and burden-sharing*

(199) The Restructuring Communication indicates that an appropriate contribution by the beneficiary is necessary in order to limit the aid to a minimum and to address distortions of competition and moral hazard. To that end, it provides that (i) both the restructuring costs and the amount of aid should be limited and (ii) a significant own contribution is necessary.

(200) The Restructuring Plan does not contain any elements that suggest that the proposed aid measures exceed the means required to cover the costs resulting from the restoration of viability of the BFA Group.

(201) Moreover, the measures committed to by Spain in the Restructuring Plan ensure that own-resources are indeed used and that shareholders and private investors holding hybrid and subordinated debt instruments contribute as much as possible to the envisaged restructuring of the BFA Group. The measures that are relevant assessing whether the aid is limited to the minimum necessary and whether the criteria of own contribution and burden-sharing are fulfilled are recalled below:

(i) The Commission notes positively that the commitments regarding burden-sharing of hybrid and subordinated debt instruments are in line with the MoU but go beyond the prerequisites of the Restructuring Communication. As described above in recital (39), all hybrids and subordinated debt instruments[64] will be converted into equity following a haircut on their nominal prices, further decreasing the BFA Group's capital shortfall. As the Commission would consider a cash buyback of hybrids securities at market price plus a 10% premium to fulfil the requirements of the Restructuring Communication, it welcomes the commitment by Spain[65], which results in greater burden-sharing and consequently a decrease in the public funds that are needed to restore viability.

(ii) Regarding previous and existing shareholders of the BFA Group and in accordance with the Restructuring Plan, the FROB will acquire a significant stake in the BFA Group as a result of which previous owners will be either fully wiped out as in the case of BFA or materially diluted as in the case of Bankia.

(iii) As the proposed capital injection by the FROB will be made in the form of ordinary shares in the BFA Group the remuneration of those securities is by definition uncertain and subject to the existence of distributable profits. However, in view of the Restructuring Plan it is expected that the FROB will receive a large portion of future profits and revenue from the envisaged sale of the BFA Group in the future. That expected return is in line with the Restructuring Communication, which provides that an adequate remuneration of the State capital is also a means of achieving burden-sharing.

(iv) To ensure that the BFA Group is not overcapitalised, if the adverse scenario used for the purpose of the MoU Stress Test does not materialise, Spain has committed that the BFA Group shall distribute any capital in excess of the regulatory minimum in accordance with the Capital Repayment Mechanism.

(v) As regards covering part of the restructuring costs stemming from the Restructuring Plan through internal measures, the Commission notes that the BFA Group has carried out and will continue to implement significant cost-cutting measures, resulting in a reduction of operational costs by EUR […] million (or 30%) between December 2012 (or a reduction of 46.5% when taking the peak period in December 2010) and December 2017, which is the end of the restructuring period. Furthermore, the restructuring costs are also partly borne by the future proceeds from the proposed divestments of subsidiaries and equity stakes in non-core entities set out in the Term Sheet.

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[64] With the sole exception of dated subordinated debt instrument, which will also be offered the possibility to convert these instruments into a more senior non-remunerated debt instruments.

[65] In line with the MoU and recently enacted legislation, namely Royal Decree Law 24/2012.

(202) Therefore, burden-sharing on equity, hybrid and subordinated debt holders, cost-reductions, divestments and adequate remuneration for the aid represent sufficient own contribution by the BFA Group to the costs of its restructuring. For those reasons the Commission concludes that the Restructuring Plan provides for an appropriate own contribution and burden-sharing.

6.5.3 Limiting distortion of competition

(203) Finally, section 4 of the Restructuring Communication requires that the Restructuring Plan contains measures limiting distortions of competition which may be caused through the aid granted. Such measures should be tailor-made to address distortions on the markets where the BFA Group operates post-restructuring. The nature and form of such measures depend on two criteria mainly: a) the amount of the aid and the conditions and circumstances under which it was granted and b) the characteristics of the markets on which the beneficiary will operate. Furthermore, the Commission must also take into account for that analysis the degree of the BFA Group's own contribution and burden-sharing over the restructuring period.

(204) The Commission recalls that the BFA Group has received State aid in the form of capital injections, capital relief and impaired asset measures totalling EUR 36.2 billion. In addition the State has granted guarantees over senior unsecured debt issued by the BFA Group for an amount of EUR 53.9 billion.

(205) The aid amount granted is equivalent to [20-30]% of the BFA Group's RWA as of 31 December 2011. As the relative amount of aid to the beneficiary is very large, significant measures are necessary in order to limit potential distortions of competition.

(206) The main measures that should limit distortions of competition are the downsizing of the banking activities in terms of: a) total assets, b) RWA, c) geographical footprint through the reduction of its branch network, d) exiting some business segments, e) reducing staff and d) the split into the Steady Bank and a Legacy Unit.

(207) The BFA Group will become a much smaller bank. As indicated in the Summary Table, its total balance sheet will shrink from EUR 291.8 billion on 31 December 2011 to EUR […] billion by […]. Its total RWA will be reduced from EUR […] billion to EUR […] billion over the same period. In parallel to the deleveraging of assets, the BFA Group will also shrink in terms of branches and headcount, as illustrated by the table referred to in recital (15) above.

(208) Furthermore, the BFA Group will divest (by tranches) before […] its entire portfolio of unlisted subsidiaries[66]. That portfolio amounts to an adjusted book value of EUR […] million and includes, amongst others, its subsidiaries in […] and its leasing corporation[67]. However, if a sale of those subsidiaries does not take place as scheduled (taking into account the [10-20]% buffer foreseen in the Term Sheet in terms of number of companies to be achieved each year), any remaining difference will have to

[66] The BFA Group will keep […]core subsidiaries which are part of the core banking business of the Steady Bank Unit and which for legal or historical reasons having developed under a subsidiary (e.g. […], etc.). Those subsidiaries are considered necessary for the Steady Bank Unit to continue providing core banking services.

[67] See Term Sheet, Appendix 6

be sold at no minimum price, i.e. even if the price is lower than the book value.

(209) The BFA Group will also sell its entire listed portfolio[68] amounting to an adjusted book value[69] of EUR […] billion before […].

(210) Altogether, the Commission considers the reduction of the BFA Group's total balance sheet of more than [40-50]% from its peak (or [70-80]% if only the Steady Bank is considered) to be appropriate, as compared to the distortions of competition stemming from the large amount of aid it received.

(211) Furthermore, the Commission recalls that in principle, subject to limited exemptions recorded in the Term Sheet, only the Steady Bank Unit is authorised to engage in new business. The Steady Bank Unit will be smaller than the total bank's balance sheet, reaching EUR […] billion and its total RWA EUR [...] billion by [...].

(212) In addition, the Steady Bank Unit will focus exclusively on retail, SME, corporate and public sector banking in its core regions, as well in selected capitals in non-core regions. It will exit the market in all other banking segments (real estate development and wholesale banking in particular) and strongly reduced its presence or exit in the other regions […] as well as in […].

(213) Moreover, the Steady Bank Unit will decrease its existing geographical footprint and the business segments in which it is active at the moment. It will also reduce its presence in the traditional regions where arguably the distortions of competition post-restructuring caused by the aid are most significant. The Commission considers that the projected decrease of the BFA Group's market share in terms of loan from [10-20]% to [5-10]% and from [10-20]% to [10-20]% in terms of deposits in its traditional regions[70] addresses that distortion in an appropriate manner.

(214) As for the distortions of competition stemming from the residual business allocated to the Legacy Unit before it is fully resolved, the Commission is of the view that they will be minor. The Legacy Unit will not enter into new activities and will stop the collection of deposits, while its lending activities will be strictly limited to the normal management and work-out of the loan book allocated to the Legacy Unit as of December 2012[71].

(215) In addition to those far-reaching structural measures, Spain also committed to several additional behavioural constraints up to December 2017, which is the end of the restructuring period (except for the coupon ban which will cease to apply as from the date on which the burden-sharing exercise referred to in section 3.2.1. above is completed), namely, that the BFA Group will:

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[68] See. Term Sheet, Appendix X b.

[69] The adjusted book value refers to the market value of 30 September 2012.

[70] In […].

[71] See Case C 11/2010 and No SA.32504, Anglo Irish Bank and Irish Nationwide Building Society, OJ L 139, 26.5.2012, p. 18, recital 174 et seq.

(i) verify the incentives and appropriateness of its remuneration system of bodies, employees and essential agents and, in particular, undertaking to ensure that it meets the applicable legislation[72] in all salary and compensation matters, especially regulation related to remuneration limits applicable to credit institutions, as well as those restrictions that may arise from being an entity and/or group controlled by the government. Likewise, it commits to ensure that the BFA Group complies scrupulously with the conditions specifically imposed by the Commission in that subject, within the Union framework for State aid.

The government also undertakes to ensure the most efficient use of public resources, regarding compensation and salaries issues, as inspiring principle of Royal Decree Law 24/2012. Therefore, it will oversee that the restructuring process is very demanding, seeking that severance pays approach to the legal minimum, but with some flexibility to avoid delaying the process; it will also assess, if appropriate, to propose general and personnel expenses reductions if the evolution of the income statement is unfavourable.

(ii) implement a ban on coupon payment until the burden-sharing measures on hybrid and subordinated debt have been implemented;

(iii) implement a ban on advertising State support preventing the BFA Group from using the aid granted for anti-competitive market conduct;

(iv) implement a ban on commercial aggressive practises, which ensure that the BFA Group will not compete in terms of pricing of its products in an aggressive way;

(v) implement an acquisition ban, which ensures that State aid will not be used to take over competitors, but to restore the BFA Group's viability; and

(vi) put in place a capital repayment mechanism to ensure that any extra capital not needed for prudential reason is repaid to the shareholders of the BFA Group at the moment of the repayment.

(216) Taking into account that mix of diverse measures and in view of the assessment that the levels of own contribution and burden-sharing are appropriate and, in some cases, go beyond what the Commission would normally require, the Commission considers that there are sufficient safeguards to limit potential distortions of competition despite the high amount of State aid the BFA Group has and will receive.

6.5.4 Conclusion on compatibility with the internal market

(217) The Commission concludes that the aid measures notified (Measures G and H), namely, the capital injection in the form of ordinary shares in the BFA Group, and the segregation of impaired assets to the AMC in favour of the BFA Group, constitute State aid pursuant to Article 107(1) TFEU. Furthermore, the capital relief provided to BFA by the FROB's intervention in BdV in 2011 also constitutes State aid pursuant to Article 107(1) TFEU.

[72] Primarily regulated by Spanish law through Royal Decrees Law 2-2012 of 3 February and 3-2012 of 11 February; RD 771/2011 of 3 June; Order ECC/1762/2012 of 3 August and BoS Circular 4/2011 of 30 November.

(218) The Commission finds that the restructuring aid in favour of the BFA Group (Measures A to H) is compatible with the internal market for reasons of financial stability on the basis of Article 107(3)(b) TFEU, in light of the commitments made under the Term Sheet.

7 Monitoring

(219) Pursuant to section 5 of the Restructuring Communication, regular reports are required to allow the Commission to verify that the restructuring plan is being implemented properly The Restructuring Plan will need to be properly implemented throughout its duration. In order to ensure its proper implementation, the Spanish authorities will ensure that the BFA Group complies with the commitments listed in the Term Sheet attached to this Decision.

8 Conclusion

The Commission has accordingly decided:

- to consider the aid to be compatible with the Treaty on the Functioning of the European Union.

The Commission notes that Spain exceptionally accepts that the adoption of the present Decision be in the English language.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

http://ec.europa.eu/competition/elojade/isef/index.cfm

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
Rue Joseph II 70
B-1049 Brussels
Fax No: (+32)-2-296.12.42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President

ANNEX

TERM SHEET (CASE SA.35253 RESTRUCTURING OF BFA/BANKIA)

1. BACKGROUND

(1) This document (the "**term sheet**") sets out the terms (the "**commitment**s") for the recapitalisation and restructuring of BFA Group/BANKIA S.A. ("**BFA/BANKIA**"), which the kingdom of Spain and BFA/BANKIA have committed to implement.

(2) Whenever appropriate, in response to a request from the Kingdom of Spain showing good cause, the Commission will make changes when justified on the merits either to (i) grant an extension of the time period of the Commitments or (ii) waive, modify or substitute one or more of the aspects of any Commitment hereunder.

2. DEFINITIONS

(3) "**AMC (Asset Management Company**)" is an independent commercial entity established by the Spanish Law 8/2012. The Spanish Government decision to set up AMC was introduced on 31 August 2012 through the Royal Decree 24/2012 with a view to addressing in a comprehensive way the problem of the real state exposure in the Spanish banking system. Assets will be transferred from banks to AMC to strengthen the bank's balance sheets and ensure that uncertainty over real state exposure is reduced.

(4) "**Steady Bank Unit**" refers to those assets, liabilities and structure related to the activities detailed in clause 5.1.1.

(5) "**Legacy Unit**" refers to those assets, liabilities and structure related to the activities detailed in clause 5.2.1.

(6) "**Monitoring trustee**" has the meaning as set out in clause 8 and in Appendix IX.

(7) "**Divestment**" means, without limitation, all or part of (i) the disposal of non-core commercial activities; (ii) shrinkage of the BFA/ BANKIA balance sheet through cessation of business, customer redemption, repayments by clients/customers, sales of assets or interests to other syndicate or consortium members, and refinancing by other lenders; (iii) transfer of assets to the AMC; (iv) loan portfolio deleveraging; (v) shrinkage of the portfolio through further impairments; (vii) presentation of an

insolvency situation according to the article 5.bis of the Law 22/2003 in a subsidiary and (vi) any other means of transferring substantial risks and benefits related to the assets to third parties.

(8) “**Retail activities**” and “SMEs banking business” means the offering to clients and SMEs of deposit, lending, current account, other money transmission services, installment credit and leasing business, credit card operations, bancassurance products, wealth management, private banking and investment services, commercial finance/factoring, the domestic and foreign exchange operations (foreign currency notes and travelers' cheques and foreign currency-related products and services), and the direct telephone and online banking services.

(9) “**Restricted Activities**” are those detailed in clause 5.1.2

(10) “**Corporate business**” means those products related to the business lines detailed in Appendix VI.

(11) “**FTE**” means full time equivalent employee.

(12) “**Loan to deposit ratio**” means a ratio calculated with the numerator equal to the net credit loan portfolio (chapter 5.2 of the Bank of Spain’s public format balance sheet) and the denominator equal to the customer deposits and debt instruments sold to retail customers net of repo transactions and wholesale funding.

(13) “**New Businesses**” and “**New Production**” are those related to an on-going basis and consequently do not include those actions performed in order to minimize the probability of credit default of the assets so as to minimize capital losses.

(14) “**Decision**” means the decision by which the European Commission approves the restructuring and the State Aid measures for BFA/BANKIA and in the context of which these commitments are undertaken.

(15) “**Financial statements**” refers to the Bank of Spain’s public format balance sheet and profit and loss account submitted by BFA/BANKIA to the Financial Regulator of Spain.

(16) **"RWA"** means risk weighted assets that shall be calculated on a consolidated basis in accordance with Circular 3/2008 and with the IRB models approved by Bank of Spain as of 30 June 2012.

(17) "**Remedial actions**" shall mean action(s) that will allow BFA/BANKIA to meet the identified target(s). The remedial actions need to be submitted within one month by BFA/BANKIA to the monitoring trustee. The Monitoring Trustee will analyse the remedial actions proposed and will report to the Commission on their adequacy to meet the targets in the Restructuring Plan.

(18) "**Core regions**" are those defined in Appendix I. Otherwise, "**non-core regions**" are those national areas were currently BFA/BANKIA conduct it activities different of those included in Appendix I.

(19) "**ALCO related portfolio**" means those Assets, Liabilities and Derivatives that are used by the Group to manage, hedge and cover all market risks of its present and future balance sheet, short and long term liquidity risks and all present and future regulatory requirements including but not limited to: market risk, interest rates and liquidity. The instruments to manage the ALCO include but are not limited to Fixed Income Securities, Derivatives positions on the Securities and on the Assets and Liabilities of the Group, and its necessary funding instruments.

(20) "**SMEs**" are those clients that are Spanish companies that do not have investment grade rating or active capital markets issuances.

(21) "**Cut off date**" is referred to 30 June 2012, except of the balances in the branches included in Appendix XIII that are referred to 31 July 2012.

(22) "**Restructuring Period**" is referred to 31 December 2017. All commitments in the term sheet apply throughout the restructuring period unless specified otherwise.

(23) "**Adjusted Book value**" refers to 30 September 2012 fair value of the equity on subsidiaries.

3. GENERAL

(24) Spain is to ensure that the Restructuring Plan ("**the Restructuring Plan**") for BFA/BANKIA submitted on 15 November 2012 is correctly and fully implemented.

(25) Spain is to ensure that the commitments listed below ("**Commitments**") are fully observed during the Restructuring Period.

(26) The restructuring period will end on 31 December 2017. The Commitments apply during the Restructuring Period, unless otherwise provided.

4. ADJUSTMENTS TO THE CURRENT PERIMETER OF THE BANK

(27) The Restructuring Plan includes the execution of the following adjustments to the current perimeter of BFA/BANKIA:

The transfer and/or contribution to the AMC of BFA/BANKIA real estate exposure at the cut off date falling within the following parameters:

(i) all the loans to developers exceeding a net book value of €250 000;

(ii) the foreclosed real estate assets exceeding a net book value of €100 000 and

(iii) the equity interests in controlled real estate companies;

(iv) the equity interest in joint controlled and associates subsidiaries when the FROB appreciate the convenience of the transfer under volume and opportunity criteria.

(jointly, the "**Real Estate Business**").

(28) At the date of the signing of this Term Sheet, the estimated transfer net value at the cut off date of these assets at BFA/ BANKIA is situated between EUR […] and EUR […] billion equivalent to the face value of the bonds to be received by BFA/BANKIA.

(29) The above mentioned figures on the impact of the assets transferred to the Asset Management Company (SAREB), are an estimate based on the situation of those assets as of 30 June 2012. Although this estimate can be considered as rather accurate, the final impact could differ from this as it could be affected by the events happening during the interim period from 30 June 2012 to the date when the assets transfer will become effective, such as changes in accounting classification and assets inflows and outflows, as well as the final definition of the perimeter to be transferred.

(30) BFA Group shall adopt any of the following measures by […]:

(i) Be merged into one single parent company;

(ii) Simplify BFA as a holding company without banking license.

5. RESTRUCTURING OF BFA/BANKIA: SPLIT INTO STEADY BANK UNIT AND LEGACY UNIT

(31) BFA/BANKIA commits executing an analytical separation of core commercial activities in core regions ("**Steady Bank Unit**") from what are considered non-core commercial activities and activities in non-core regions ("**Legacy Unit**") as follows.

5.1 Steady Bank Unit

5.1.1 Description of Steady Bank Unit

(32) BFA/BANKIA commits that the core commercial activities of the Steady Bank Unit are retail banking activities and SME Business Banking Services carried out in Spain through the Core Retail Branch network and SME Business Network as set out in Appendix I.

(33) The following assets/activities are analytically allocated to the Steady Bank Unit at the cut off date[73]:

(i) Assets and liabilities of the Steady Bank Unit as described in Appendix II;

(ii) Core Subsidiaries as set out in Appendix III;

(iii) On the liability side the assets of the Steady Bank Unit are financed by the Deposits and Equity;

(iv) The […] Retail branches in the Core Regions and […] branches in selected locations/cities in other parts of the country as set out in Appendix IV;

(v) […] SME Branches as set out in Appendix V;

[73] The first analytical report to be submitted to the Monitoring Trustee will be referred to 30 June 2013.

(vi) The headquarter in Madrid and Central Services Structure necessary to support the Steady Bank Unit and where appropriate for efficiency and economies of scale purposes the Legacy Unit Assets and Activities (i.e IT, HHRR, etc).

5.1.2 Restricted Activities

(34) BFA/BANKIA commits that any Retail Banking Activity is restricted to Steady Bank Unit Branches of Appendix IV, as well as Legacy Branches according to the principles as set out in section 5.2.1. Consequently, BFA/ BANKIA shall not engage in any new business during the Restructuring Period in the following areas:

(i) Loans outside the core regions and outside the branches in selected presence in other parts of the country;

(ii) Real estate development;

(iii) Wholesale activities as set out in detail in Appendix VI;

(iv) Financing companies outside Spain;

(v) All Banking and Financing activities not related to short term working capital financing and commercial and transactional Banking services with those corporates with access to the capital Markets.

5.1.3 Steady Bank Unit restructuring

- *Balance sheet size*

(35) By […], the net loan portfolio size of the Steady Bank Unit will not be higher than EUR […] billion. By […], the net loan portfolio size of the Steady Bank Unit will not be higher than EUR […]. If the loan portfolio targets are not met, BFA/BANKIA will not engage in new production in terms of loans to clients as long as the targets defined above are not reached.

On top of this, the Group will be allowed to grant any back to back funded loans that have no risk for the Group (i.e. ICO no risk loans).

(36) The RWAs will not be higher than EUR […] billion by […]and not higher than EUR […] billion by […]. If these targets are not met, BFA/BANKIA shall present remedial actions.

(37) The total balance sheet size of the Steady Bank Unit will not be higher than EUR […]billion by […]and not higher than EUR […] billion by […]. If these targets are not met, BFA/BANKIA shall present remedial actions.

- *Balanced Financing Structure*

(38) BFA/BANKIA commits that the target for the loan-to-deposit ratio (hereinafter "LDR") of the Steady Bank Unit will not be higher than [100-120]% by […], and [100-120]% by the […]. If the LDR targets are not met, BFA/BANKIA shall present remedial actions.

- *Reduction of Branches and FTEs*

(39) The Steady Bank Unit will reduce its retail branch structure from […] to […]branches before the end of […] and from […]to […]employees (FTE) before the end of […] according to the detailed calendar as set out in Appendix VII.

(40) The SME branch structure will consist of […] branches by the end of […].

(41) After the year 2015 the number of branches and employees will not increase.

5.2 The Legacy Unit

5.2.1 Description of the Legacy Unit

(42) The following assets/activities are allocated to the Legacy Unit (cut-off date 30 June 2012):

(i) Staff Related to the former activities and to support the Wind Down and Divestiture Process;

(ii) Legacy Branches, including their assets and liabilities, as set in Appendix VIII;

(iii) Assets and liabilities of the Legacy Unit as described in Appendix IX;

(iv) Non Core Subsidiaries and Equity Stakes to be divested amounting […]MM €as set in Appendix X;

(v) Restricted Activities and its related loan portfolios, as set out in section 5.1.2 until assets are orderly closed/transferred sold or liquidated;

(vi) Financial Assets to be held until sold or matured: Non ALCO fixed income portfolio allocated in the Legacy Unit will be held to maturity Maturity Calendar is stated in Appendix XI. This portfolio could be sold, totally or partially, before maturity only if the sale generates a positive impact in the profit and loss account or in the economic value of the entity, or avoids a material potential risk for the entity;

(vii) ALCO portfolio will be held with the objective of managing structural risks such as -but not limited to- interest rate risk or liquidity risk. This portfolio will be managed by the Assets & Liabilities Committee, under the risk policies and procedures approved by the Board. Management of the ALCO portfolio may include buying, selling, swapping, hedging, collateralizing or funding operations or any other financial transaction that may be needed for managing the structural risks of the entity. The ALCO fixed income portfolio is set at EUR […] billion maximum;

(viii) An estimated amount between EUR […]billion and EUR […] corresponding to loans to developers below €[…], foreclosed real estate assets below €[…]and non-controlled real state subsidiaries as set out in clause (27);

(ix) Non-real estate troubled assets originated outside the Core Region;

(x) Real Estate assets that are not commercially used by the group, in particular, those properties related to closed branches both in the Steady State Unit and the Legacy Unit;

(xi) All operating branches or offices located abroad as set out in Appendix XII.

5.2.2 Legacy Unit restrictions and reduction

- *Balance Sheet Size*

(43) By […], the balance sheet size of the Legacy Unit will not be higher than EUR […] billion. By […], the balance sheet size of the Legacy Unit will not be higher than EUR […] billion. If these targets are not met, BFA/BANKIA shall present remedial actions.

- *Branches and FTEs*

(44) The Legacy Unit will reduce its current structure from […] to […] branches (see Appendix XIII) before the […]and from […]to […] employees (FTE) before […]. After the year […] the number of branches and employees will not increase

5.2.3 Active winding up of the assets in the Legacy Unit and Divestment Process

(45) The assets in the legacy unit will be managed with the objective of being completely divested, liquidated or wound down, in an orderly manner minimising the cost for taxpayers. Any remaining assets at the end of the restructuring period should be wound down in an orderly manner once the assets mature. No new activities will be undertaken, unless explicitly mentioned in the term-sheet.

A. Wind Down Branches Process and principles

(46) All Wind Down Branches will be closed before […]. The Closing Calendar of branches is stated in Appendix XIII.

(47) Until three months before the date of closure of the wind down branches, the following principles shall apply:

- **Limitation on new lending**

(48) Contractually committed but not yet paid-out amounts to be limited to the strict minimum (definition of cap); No additional financing to existing customers which is not contractually committed with the exception if it is (a) strictly necessary to preserve the value of the loan collateral or (b) otherwise related to minimising capital losses and/or enhancing the expected recovery value of a loan;

(49) No additional financing to new customers which is not contractually committed with the exception if the balance of the loan exceeds the value of the property, the bank may facilitate the loan's redemption through selling off the property by the way of providing additional finance to a vendor enabling the repayment of the outstanding balance and it complies with “management of existing assets” point below.

- **Management of existing assets**

(50) The branches will manage existing assets in a way that maximises Net Present Value of the assets. Specifically, if a client cannot respect the terms of his loan, the entity will only restructure the lending terms (deferral or partial waiver of repayments, conversion of (part of) the claim in capital, etc.) if such a restructuring would lead to enhancing the present value of the loan. In particular the bank will be allowed to restructure its mortgage assets via the following variations to the terms of existing mortgages a) a change of deal (e.g. by offering a new fixed rate); b) transferring existing mortgages to new properties; and c) transferring equity (e.g. adding a borrower to the mortgage or removing one).

- **Limitation on new deposit**

(51) […]

- **Limitation on transactional products**

(52) […]

- **5% Buffer**

(53) Possibility to exchange up to 5% of branches between Legacy Unit and Steady Bank unit as long as it does not change the geographical distribution as set out in Appendix VII.

- **Closing procedure**

(54) 3 months before closing all commercial activity will cease, and the branch will start the closing procedure, which consists of informing the clients, personally and by mail, of the closure of the branch and offering the possibility of transferring their business to the nearest core branch, if applicable.

B. Non core Subsidiaries Portolio Divestment

B.1 Non real estate subsidiaries

(55) BFA/BANKIA shall manage the portfolio of 238 subsidiaries of BFA/BANKIA in such a way as to run off the portfolio in an orderly way and maximise the capital value and liquidity of the Group. For this purpose BFA/BANKIA will execute the following strategies with respect to the portfolio:

- *Listed Portfolio*

(56) BFA/BANKIA commits to sell the entire portfolio of Listed Companies before […] (Appendix X).

(57) BFA/BANKIA shall not sell Listed Subsidiaries at a price lower than the adjusted book value plus disposal costs and appropriate discounts.

(58) BFA/BANKIA will accelerate the divestment of the Listed Subsidiaries in the event:

(i) There is enough liquidity in the market to acquire the stake and,

(ii) For the previous 30 business days the average market price exceeds 15% book value.

(59) If a divestment of any such Listed Subsidiary has not taken place by […] and on the basis of a sufficiently reasoned request by BFA/BANKIA the divestment period may be extended. Such extension may be granted in particular when the divestment of the Listed Subsidiaries will not be implemented by the proposed dates through no fault of BFA/BANKIA. If no such extension is granted by the European Commission then Group will have a 3 month period to execute the divestment.

(60) Adjusted book Value will be updated to the current Market Value before 31 December 2012.

• *Portfolio of Unlisted subsidiaries (Private Companies)*

(61) BFA/BANKIA commits to sell the entire portfolio of unlisted subsidiaries before […]. In particular, BFA/BANKIA will sell the Unlisted Subsidiaries of Appendix X amounting an adjusted book value of […] MM € adjusted as of the fair value of 30 September 2012, under the following minimum cumulative divestment calendar from 2013-2016.

YEAR	Minimum Number of companies (a)	Target Number of companies	Minimum Market Value 30/09/2012 [Adjusted Book Value (b)]	Target Market Value 30/09/2012 [Book Value]	% of cumulative companies to be sold	% of book cumulative book value to be divested
2013	[...]	[...]	[...]	[...]	[...]	[...]
2014	[...]	[...]	[...]	[...]	[...]	[...]
2015	[...]	[...]	[...]	[...]	[...]	[...]
2016	[...]	[...]	[...]	[...]	[...]	[...]
TOTAL	[...]	[...]	[500 - 1 000]	[500 - 1 000]	100%	100%

(62) BFA/BANKIA commits to execute the divestments within the targets established for number of companies and […]% of remaining adjusted book value. Nevertheless, BFA/BANKIA will have a [10-20]% buffer in terms of number of companies (a) and initial adjusted book value (b) to be achieved each year, as long as BFA/BANKIA meets the difference in the following year.

(63) As a general rule, BFA/BANKIA shall not sell Unlisted Subsidiaries at a price lower than book value on a cumulative basis. For those Unlisted Subsidiaries in which BFA/BANKIA holds a majority stake divestment will consist primarily on an orderly sell. If a divestment cannot be achieved the relevant subsidiary will be properly liquidated according to the proposed divestment calendar.

(64) If BFA/BANKIA does not comply with the minimum number of companies or with the minimum % of book value any given year, then BFA/BANKIA will send in the first quarter of the following year an updated divestment report including (a) the justification for that deviations, and (b) a strict impairment test agreed with the statutory auditor of the Group that reflects the potential further deterioration to be registered (c) a commitment to sell the remaining difference (in terms of numbers of companies and investment amount) at no minimum price.

(65) BFA/BANKIA commits to actively decrease the total risk exposure (equity, loans and guarantees) of the Non Core Subsidiaries from the date of their assignment to the Legacy Unit until the equity stakes are divested. Risk exposure includes equity, guarantees and loans to subsidiaries.

B.2 Real estate subsidiaries

(66) BFA/BANKIA commits to divest or write down the equity stakes of those real estate subsidiaries not transferred to the AMC as set out in section 4 above by […]

6. BURDEN SHARING MEASURES ON SUBORDINATED DEBT AND PREFERENCE SHARES HOLDERS

6.1 Key principles

(67) For holders of preference shares and perpetual subordinated debt, burden sharing will be implemented through conversion of these securities into equity or equity equivalent instruments. As regards the holders of dated subordinated debt they will be given the choice between conversion into equity or into a senior debt instrument.

(68) Calculation of the fair value of the different financial instruments subject to burden sharing will be based on the net present value ("**npv**") of the instruments according to the methodology set out below.

(69) Consequently, as a result of the burden sharing there will be no cash outflow from BFA/BANKIA to the holders of these securities with the sole exception of the holders of dated subordinated debt instrument who decide to convert into new debt securities with the maturity matching that of the subordinated debt being exchanged.

(70) A list of all outstanding preference shares and subordinated debt instruments is set out in Appendix XIV.

6.2 Methodology for the conversion into capital

(71) For each financial instrument the npv will be calculated by way of discounting the cash flows of the instrument ("**dcm**") according to the terms and conditions upon which the instrument was issued, including coupon suspension, deferrals, etc.

(72) The discount factors to be applied to the dcm will be: a) [20-30]% for preference shares and other instruments of the same rank, b) [10-20]% for perpetual subordinated instruments and c) [10-20]% for dated subordinated instruments.

(73) Should coupon payments be discretionary or linked to the profitability of the BFA/BANKIA, it will be assumed, for the purpose of the npv calculation, that no coupon payment will take place for the years that BFA/BANKIA is not profit-making, according to the restructuring plan submitted by the Spanish authorities in the context of the Decision.

(74) The npv will be augmented by a take-up premium of 10% and a further 20% premium for those securities for which conversion into equity or equity-like instruments of the issuing institution is envisaged.

(75) The conversion rate will be maximum 90% of the face value.

6.3 Specific provision for dated subordinated debt

(76) The holders of this type of security will be offered the choice between:

(i) Conversion into a new senior debt instrument with a maturity matching that of the subordinated debt being exchanged. The conversion rate will be equal to the nominal value of the subordinated debt instrument, minus a haircut that will be equal to [0-5]% multiplied by the number of months to maturity. The starting date for the calculation of the number of months will be 1 December 2012. The new senior debt instrument will have a zero-coupon until maturity; and

(ii) Conversion into core capital of BFA/BANKIA. The conversion rate to be applied will be the higher of: i) the amount resulting from the methodology for the conversion into core capital as described in section 6.2 above and ii) the amount resulting from the calculation in point i) above.

6.4 Equity stake for the holders of securities subject to burden sharing

(77) The holders of securities subject to burden sharing will receive an equity stake in BFA/BANKIA in the form of new ordinary shares or equity-equivalent instruments which shall be proportional to value of BFA/BANKIA resulting from the restructuring plans, as determined by a due diligence and three economic valuations carried out in accordance with RDL 24/2012 and the methodology put forward by the FROB in liaison with the Commission.

7. BEHAVIOURAL MEASURES AND CORPORATE GOVERNANCE

7.1 Ban on acquisitions

(78) BFA/BANKIA will not acquire any stake in any undertaking. This covers both undertaking which have the legal form of a company and package of assets which form a business.

(79) That commitment will apply for a period of […] starting from the date of the cut off date.

(80) Acquisitions that take place in the ordinary course of the banking business in the management of existing claims towards ailing firms do not fall under the ban on acquisition.

(81) BFA/BANKIA may acquire stakes in undertakings provided that the purchase price paid by BFA/BANKIA for any acquisition is less than 0.01% of the balance sheet size of the BFA/BANKIA at the cut off date and that the cumulative purchase prices paid by BFA/BANKIA for all such acquisitions over the whole restructuring period is less than 0.025% of the balance sheet size of BFA/BANKIA at the date of the cut off date.

7.2 Ban on Coupon

(82) Until the burden sharing measures provided for in section 6 of this Term Sheet will have been implemented, BFA/BANKIA will not make any payments to holders of preference shares and subordinated debt instruments, in so far as those payments are not owed on the basis of a contract or the law.

7.3 Advertising

(83) BFA/BANKIA must not use the granting of the aid measures or any advantages arising therefrom for advertising purposes.

7.4 Remuneration of bodies, employees and essential agents

(84) The Spanish Government undertakes to ensure that BFA/Bankia meets the legislation applicable at the time in all salary and compensation matters, especially regulation related to remuneration limits applicable to credit institutions (primarily currently regulated by Spanish law through Royal Decrees Law 2-2012 of February 3rd and 3-2012 of February 11th; RD 771/2011 of June 3rd; Orden ECC/1762/2012 of August 3rd and Bank of Spain Circular 4/2011 of November 30th) as well as those restrictions that may arise from being an entity and/or group controlled by the Government. Likewise, it commits to ensure that the bank complies scrupulously with the conditions specifically imposed by the European Commission in this subject, within the Community framework for State aid.

(85) The Government also undertakes to ensure the most efficient use of public resources, regarding compensation and salaries issues, as inspiring principle of RDL 24/2012 of August 31st, on restructuring and resolution of banks. Therefore, it will oversee that the restructuring process is very demanding, seeking that severance pays approach to the legal minimum, but with some flexibility to avoid delaying the process; it will also assess, if appropriate, to propose general and personnel expenses reductions in the Group if: the actual net margin at the end of each year is 20% below the projected target; or the actual pre-provision profit at the end of each year is 25% below the projected target; and always when losses are reported in the income statements at the end of each year or the entity do not comply with minimum solvency regulatory requirements on the same date. The former will apply to the Group BFA/Bankia's consolidated financial statements.

7.5 Capital repayment Mechanism

(86) Based on the audited year end accounts BFA/Bankia will pay in form of dividend disbursement the following amounts to its shareholders:

(i) For the fiscal year […]: [40-50]% of the excess capital above the applicable minimum capital requirement under European and Spanish law (including pillar 1 and 2) plus a capital buffer of […] basis points.

(ii) For the fiscal years […]: [90-100]% of the excess capital above the applicable minimum capital requirement under European and Spanish law (including pillars 1 and 2) plus a capital buffer of […] basis points.

(87) Without prejudice to the competences of Bank of Spain as banking supervisor of BFA/Bankia, the dividend disbursement shall be, totally or partially, suspended if, on the basis of a reasoned request by BFA/Bankia endorsed by the Monitoring Trustee, it is considered that it would endanger the solvency position of the bank in the following years.

(88) Until […], no dividend will be paid.

7.6 Ban on commercial aggressive practices

(89) BFA/BANKIA shall avoid engaging in aggressive commercial practices throughout the duration of the restructuring period. To that end, BFA/BANKIA shall make sure that the nominal interest rate offered to clients on its products must be less attractive than the average of the most competitive real rates offered on analogous products by the five main non-aided competitors within the geographical area where BFA/BANKIA operates in the core regions. To this end, BFA/BANKIA will operate in conformity with the restrictions approved by the board of the FROB on 22 December 2010. The monitoring trustee will verify compliance with such restrictions

8. THE MONITORING TRUSTEE

(90) Spain is to ensure that the full and correct implementation of the Restructuring Plan and the full and correct implementation of all Commitments within this Term Sheet are continuously monitored by an independent, sufficiently qualified monitoring trustee (who is obliged to maintain confidentiality).

(91) The appointment, duties, obligations and discharge of the monitoring trustee must follow the procedures set out in the "Monitoring Trustee" Appendix XV.

(92) Spain and BFA/BANKIA are to ensure that, during the implementation of the Decision, the Commission or the Monitoring Trustee have unrestricted access to all information needed to monitor the implementation of this Decision. The Commission or the trustee may ask BFA/BANKIA for explanations and clarifications. Spain and BFA/BANKIA are to cooperate fully with the Commission and the monitoring trustee with regard to all enquiries associated with monitoring of the implementation of this Decision.

(93) BFA/BANKIA will report annually to the Commission on the evolution of the Legacy Unit after the dismissal of the monitoring trustee at the end of the restructuring period.

Appendix I – Definition of Core Regions

Province: […]

Appendix II – Steady Bank Unit Assets and Liabilities

STEADY BANK UNIT BALANCE SHEET	Jun-12
Interbank accounts & Central bank	[...]
Fixed Income	[...]
Loans to clients (net)	**[...]**
Gross Loans	[...]
(Gross) Developers and construction	[...]
(Gross) Residential mortgages	[...]
(Gross) SMEs	[...]
(Gross) Consumer loans	[...]
(Gross) Public sector	[...]
(Gross) Other	[...]
(Gross) NPLs	[...]
Provisions	[...]
Investments	[...]
Property and equipment (Own assets)	[...]
Foreclosed assets	[...]
Other Assets	[...]
TOTAL ASSETS	**[120-130]**
Non Deposit Funding Needs	[...]
Liabilities from financial institutions	[...]
Liabilities to clients	**[...]**
Deposits	**[...]**
Repo	[...]
Covered bonds (TDAs)	[...]
Bonds and other marketable debt	[...]
Subordinated debt	[...]
Valuation Adjustments	[...]
Other liabilities	[...]
TOTAL LIABILITIES	**[120-130]**
Equity	**[...]**
TOTAL LIABILITIES AND EQUITY	**[120-130]**
FTEs	[...]
BRANCHES	[...]

Appendix III – Core Subsidiaries

SUBSIDIARY	PARTICIPATION (%)	NUMBER OF COMPANIES	BUSINESS
[…]	[…]	[…]	Mutual funds assets management
[…]	[…]	[…]	Pension funds assets management
[…]	[…]	[…]	Insurance factory
[…]	[…]	[…]	Insurance factory
[…]	[…]	[…]	Insurance factory
[…]	[…]	[…]	Insurance distributor
[…]	[…]	[…]	Private Banking
[…]	[…]	[…]	Private Banking Asset Management
[…]	[…]	[…]	Payment Services and ATM
TOTAL		[10-20]	

Appendix IV –Steady Bank Retail Branches as of June 2012

[…]

[…]

Appendix V –Steady Bank SME Branches
[…]

Appendix VI –Business assigned to the Legacy Unit [...]

Appendix VII - Steady Bank FTE and Branch evolution

	2012	2013	2014	2015	2016	2017
	Forecast	Plan	Plan	Plan	Plan	Plan
FTE	**[20000-10000**	**[20000-10000**	**[20000-10000**	**[20000-10000**	**[20000-10000**	**[20000-10000**
BRANCHES	**[3000-2000]**	**[3000-2000]**	**[3000-2000]**	**[2000-1000]**	**[2000-1000]**	**[2000-1000]**
Retail	**[3000-2000]**	**[3000-2000]**	**[2000-1000]**	**[2000-1000]**	**[2000-1000]**	**[2000-1000]**
SMEs	[70-80]	[60-70]	[60-70]	[60-70]	[60-70]	[60-70]
Others	[10-20]	[0-5]	[0-5]	[0-5]	[0-5]	[0-5]

Retail Footprint as of 2017

1.888

[...]

Appendix VIII - Legacy Branches List

[…]

Appendix IX – Assets and Liabilities Legacy Unit

	Jun-12
	[..]
Interbank accounts & Central bank	[..]
Fixed Income	[..]
Loans to clients (net)	**[..]**
Gross Loans	**[..]**
(Gross) Developers and construction	[..]
(Gross) Residential mortgages	[..]
(Gross) SMEs	[..]
(Gross) Consumer loans	[..]
(Gross) Public sector	[..]
(Gross) Other	[..]
(Gross) NPLs	[..]
Provisions	[..]
Investments	[..]
Property and equipment (Own assets)	[..]
Foreclosed assets	[..]
Other Assets	[..]
TOTAL ASSETS	**[150000-200000]**
Non Deposit Funding Needs*	[..]
Liabilities from financial institutions	[..]
Liabilities to clients	**[..]**
Deposits	**[..]**
Repo	[..]
Covered bonds (TDAs)	[..]
Bonds and other marketable debt	[..]
Subordinated debt	[..]
Valuation Adjustments	[..]
Other liabilities	[..]
TOTAL LIABILITIES	**[150000-200000]**
Equity	**[..]**
TOTAL LIABILITIES AND EQUITY	**[150000-200000]**

Appendix X – Non Core Subsidiaries

Listed subsidiaries

Subsidiaries	Equity Stake (%)	Book Value 06/30/12		Market Value 09/30/12
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
[...]	[...]	[...]	[...]	[...]
Total listed (14 companies)		[5000-6000]		[3000-4000]

Apendix X b- Non Core Subsidiaries
Unlisted subsidiaries

Volumes in MM Eur

Subsidiaries	Equity			Credit Exposure		
	Equity Stake (%)	Book Value 06/30/12	Market Value 09/30/12	Gross Loans	Provisions	Net Loans
[...]	[...]	[...]	[...]	[...]	[...]	[...]
Other ([200-300] companies)	-					
TOTAL UNLISTED ([200-300]Companies)		**[2000-3000**	**[800-900]**	**[6000-7000**	**[600-700]**	**[5000-6000]**

Appendix XI – Existing Fixed Income Maturity Profile -

Fixed income portfolio including ALCO

BFA Group	Dec-11 Actual	Jun-12 Actual	Dec-12 Forecast	Dec-13 Forecast	Dec-14 Forecast	Dec-15 Forecast	Dec-16 Forecast	Dec-17 Forecast
Existing Fixed Income	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
HfT	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
AfS	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
HtM	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]

Appendix XII – Branches Abroad List

[…]

Appendix XIII – Branches and FTE evolution in Legacy Unit – 2012 – 2017
[...]

Appendix XIV – OUTSTANDING PREFERENCE SHARES AND SUBORDINATED DEBT INSTRUMENTS – TABLA PREFERENTES

ORIGINAL INSTITUTION	NATURE	ISIN	Start	CALL	YEAR	Maturity	Outstanding Balance (€m)
Bancaja/BancajaCapital	Inst. Preferred	XS0214965450	23/03/2005	23/03/2015	Perp	Perp	20
Caja Segovia	Inst. Preferred	ES0114959028	27/06/2008	27/06/2018	2018	Perp	15
Caja Insular/CanariaPreferentes	Inst. Preferred	ES0156844047	21/12/2007	21/12/2017	Perp	Perp	50
Caja Avila Preferentes	Inst. Preferred	ES0122707021	27/06/2008	28/06/2018	2018	Perp	35
Caixa Laietana	Inst. Preferred	ES0113251005	27/10/2006	27/10/2016	2016	Perp	3
							123
Caja Madrid	Inst. Subordinated Debt	CMSUB10.09.2013	10/09/1998	10/09/2013	2013	10/09/2013	30
Caja Madrid	Inst. Subordinated Debt	ES0214950125	15/07/2004	15/07/2009	2014	15/07/2014	48
Caja Insular	Inst. Subordinated Debt	ES0214983118	31/03/2005	31/03/2010	2015	31/03/2015	38
Caja Madrid	Inst. Subordinated Debt	ES0214950067	16/06/2000	16/06/2015	2015	16/06/2015	50
Caja Madrid	Inst. Subordinated Debt	ES0214950216	15/07/2009	15/07/2015	2015	15/07/2015	143
Caja Segovia	Inst. Subordinated Debt	ES0214959068	28/07/2006	28/07/2011	2016	28/07/2016	20
Caja Madrid	Inst. Subordinated Debt	ES0214950166	17/10/2006	17/10/2012	2016	17/10/2016	372
Caja Insular	Inst. Subordinated Debt	INSAyTD.SUB1	17/11/2006	17/11/2012	2016	08/11/2016	20
Caja Madrid	Inst. Subordinated Debt	ES0AYTSUBI14	17/11/2006	17/11/2012	2016	17/11/2016	10
Caja Segovia	Inst. Subordinated Debt	ES0214959076	20/06/2007	20/06/2012	2017	20/06/2017	28
Caja Madrid	Inst. Subordinated Debt	ES0214950141	01/03/2006	01/03/2013	2018	01/03/2018	191
Caja Avila	Inst. Subordinated Debt	ES0214910004	24/10/2008	24/10/2013	2018	24/10/2018	30
Caja Avila	Inst. Subordinated Debt	ES0214910012	29/10/2008	29/10/2013	2018	29/10/2018	15
Caja Avila	Inst. Subordinated Debt	ES0214910020	26/11/2008	26/11/2013	2018	26/11/2018	40
Bancaja	Inst. Subordinated Debt	ES0214977078	03/02/2005	29/11/2013	2018	29/11/2018	140
Caja Insular	Inst. Subordinated Debt	ES0214983142	02/09/2009	02/09/2014	2019	02/09/2019	21
Caja Rioja	Inst. Subordinated Debt	ES0215530074	03/12/2009	03/12/2014	2019	03/12/2019	30
Caja Insular	Inst. Subordinated Debt	ES0214983100	02/12/2004	31/12/2009	2019	31/12/2019	10
Caja Madrid	Inst. Subordinated Debt	ES0214950182	26/02/2008	26/02/2023	2028	26/02/2028	100
							1.335
Bancaja	Inst. Subordinated Debt (UT II)	ES0214977102	03/03/2006	03/03/2016	Perp	Perp	56
Caja Madrid	Inst. Subordinated Debt (UT II)	ES0214950018	12/12/1990	12/12/2010	Perp	Perp	36
Caja Insular	Inst. Subordinated Debt (UT II)	ES0214983134	24/05/2007	24/05/2017	Perp	Perp	1
							93
Bancaja/EuroCapital	Retail Preferred	KYG0727Q1073	03/03/1999	03/03/2004	Perp	Perp	6
Bancaja/EuroCapital	Retail Preferred	KYG0727Q1156	01/06/2000	03/03/2005	Perp	Perp	8
Caja Rioja Preferentes	Retail Preferred	ES0113698007	15/11/2004	15/11/2009	Perp	Perp	2
Caja Avila Preferentes	Retail Preferred	ES0122707005	29/12/2004	29/12/2009	Perp	Perp	0
Caja Segovia	Retail Preferred	ES0114959002	29/12/2006	29/01/2012	Perp	Perp	42
Caja Madrid/Finance Prefered	Retail Preferred	ES0115373005	16/12/2004	07/07/2009	Perp	Perp	2
Caixa Laietana/SocietatPreferents	Retail Preferred	KYG1754W1087	28/12/2002	28/12/2007	Perp	Perp	2
Caja Insular/CanariaPreferentes	Retail Preferred	ES0156844005	23/12/2004	30/03/2010	Perp	Perp	4
Caja Madrid/Finance Prefered	Retail Preferred	ES0115373021	07/07/2009	07/07/2014	Perp	Perp	3.000
Caja Insular/CanariaPreferentes	Retail Preferred	ES0156844054	30/06/2009	30/09/2014	Perp	Perp	30
Caixa Laietana/SocietatPreferents	Retail Preferred	ES0113251021	19/10/2009	19/10/2014	Perp	Perp	27
							3.123
Caixa Laietana	Retail Subordinated Debt	ES0214846059	15/03/2005	15/03/2010	2035	15/03/2035	1
Bancaja	Retail Subordinated Debt	ES0214977052	04/08/2002	04/07/2007	2022	04/07/2022	33
Caixa Laietana	Retail Subordinated Debt	ES0214846042	12/10/2001	10/10/2006	2021	10/10/2021	2
Caja Madrid	Retail Subordinated Debt	ES0214950224	07/06/2010	07/06/2015	2020	07/06/2020	800
Bancaja	Retail Subordinated Debt	ES0214977169	06/05/2009	06/07/2014	2019	06/07/2019	1.000
Caja Segovia	Retail Subordinated Debt	ES0214959050	27/07/2005	27/07/2010	2015	27/07/2015	20
Caja Segovia	Retail Subordinated Debt	ES0214959043	16/08/2004	16/08/2009	2014	16/08/2014	30
Caja Insular	Retail Subordinated Debt	ES0214983092	11/11/2003	01/11/2013	2013	01/11/2013	30
Caja Segovia	Retail Subordinated Debt	ES0214959035	10/06/2003	10/06/2008	2013	10/06/2013	20
							1.936
Caixa Laietana	Retail Subordinated Debt (UT II)	ES0214846026	01/12/1994	Perp	Perp	Perp	0
Caixa Laietana	Retail Subordinated Debt (UT II)	ES0214846034	23/11/1998	Perp	Perp	Perp	0
Caixa Laietana	Retail Subordinated Debt (UT II)	ES0214846018	26/05/1988	26/05/2008	Perp	Perp	0
Bancaja	Retail Subordinated Debt (UT II)	ES0214977037	15/12/1988	15/12/2008	Perp	Perp	1
Caja Insular	Retail Subordinated Debt (UT II)	ES0214983019	10/06/1990	31/03/2011	Perp	Perp	0
Caja Insular	Retail Subordinated Debt (UT II)	ES0214983035	05/12/1991	05/12/2011	Perp	Perp	0
Bancaja	Retail Subordinated Debt (UT II)	ES0215307036	30/06/1992	30/06/2012	Perp	Perp	0
Bancaja	Retail Subordinated Debt (UT II)	ES0215307028	30/06/1989	30/06/2019	Perp	Perp	0
							3
Bankia, S.A.	Inst. Subordinated Debt (UT II)	XS0205497778	16/11/2004	16/11/2014	Perp	Perp	298
							298
							6.911

Appendix XV – The Monitoring Trustee

A Appointment of the monitoring trustee

(i) Spain undertakes to ensure that BFA/BANKIA appoints a monitoring trustee to carry out the duties of a monitoring trustee ("**Trustee**") as set out in paragraph C(x) of this Annex. The mandate applies to the entire duration of the Restructuring Plan; as defined in clause 3. At the end of the mandate, the Trustee must submit a final report.

The Trustee must be independent of BFA/BANKIA. The Trustee must possess, for example as an investment bank, consultant or auditor, the specialised knowledge that is required in order to carry out its mandate, and must at no time be exposed to any conflict of interest. The Trustee is to be remunerated by BFA/BANKIA in a way that must not impede the independent and effective fulfilment of its mandate.

Spain undertakes to ensure that BFA/BANKIA submits the names of two or more persons or institutions to the Commission for approval as monitoring Trustee no later than four weeks after notification of the Decision.

These proposals must contain sufficient information about those persons to enable the Commission to verify whether the proposed Trustee fulfils the requirements set out in paragraph A(ii), and must in particular include the following:

a) the full terms of the proposed mandate with all the provisions which are necessary to enable the Trustee to fulfil its duties;

b) the draft of a work plan describing how the Trustee intends to carry out its assigned duties.

The Commission has the discretion to approve or reject the proposed Trustees and to approve the proposed mandate subject to any modifications that it deems necessary in order to enable the Trustee to fulfil its obligations. If only one name is approved, BFA/BANKIA will appoint the person or institution concerned as Trustee or cause that person or institution to be appointed, in accordance with the mandate approved by the Commission. If more than one name is approved, BFA/BANKIA is free to decide which of the approved persons should be appointed as Trustee. The Trustee will be appointed within one week of the Commission's approval, in accordance with the mandate approved by the Commission.

If all the proposed Trustees are rejected, Spain undertakes to ensure that BFA/BANKIA submits the names of at least two further persons or institutions within two weeks of being informed of the rejection, in accordance with the requirements and procedure set out in paragraphs A(i) and A(iv).

If all further proposed Trustees are also rejected by the Commission, the Commission will nominate a Trustee which BFA/BANKIA will appoint or cause to be appointed, in accordance with a Trustee mandate approved by the Commission.

B General duties and obligations

The Trustee is to assist the Commission to ensure BFA/BANKIA's compliance with the Commitments and to assume the duties of a monitoring Trustee specified in the Commitments document. The Trustee is to carry out the duties under this mandate in accordance with the work plan, as well as revisions of the work plan that have been approved by the Commission. The Commission may, on its own initiative or at the request of the Trustee or BFA/BANKIA, issue orders or instructions to the Trustee in order to ensure compliance with the Commitments. BFA/BANKIA is not entitled to issue instructions to the Trustee.

C Duties and obligations of the Trustee

(ii) The duty of the Trustee is to guarantee full and correct compliance with the obligations set out in the Commitments, and full and correct implementation of BFA/BANKIA's Restructuring Plan. The Commission may, on its own initiative or at the request of the Trustee, issue any orders or instructions to the Trustee or BFA/BANKIA in order to ensure compliance with the Commitments attached to the Decision.

(iii) The Trustee

a) is to propose to the Commission in its first report a detailed work plan describing how it intends to monitor compliance with the Commitments attached to the Decision;

b) is to monitor the full and correct implementation of BFA/BANKIA's Restructuring Plan,

c) is to monitor compliance with all other Commitments,

d) is to assume the other functions assigned to the Trustee in the Commitments attached to the Decision;

e) is to propose measures to BFA/BANKIA that it considers necessary to ensure that BFA/BANKIA fulfils the Commitments attached to the Decision;

f) is to take into account any regulatory changes on solvency and liquidity when verifying the evolution of the actuals financials with respect to the projections made in the Restructuring Plan;

g) is to take into account the definitive impact of the uncertainties set out in clause 4.1 below and of the burden sharing set out in clause 6;

h) BFA/BANKIA will give access to the six month information to the Monitoring Trustee 30 working days after the conclusion of the period. The Monitoring Trustee is to submit a draft written report to the Commission, Spain and BFA/BANKIA within thirty days after receiving the information. The Commission, Spain and BFA/BANKIA can submit comments on the draft within

five working days. Within five working days of receipt of the comments, the Trustee is to prepare a final report, incorporating the comments as far as possible and at its discretion, and submit it to the Commission. Only afterwards the Trustee is also to send a copy of the final report to Spain and BFA/BANKIA. If the draft report or the final report contains any information that may not be disclosed to BFA/BANKIA, only a non-confidential version of the draft report or the final report is to be sent to BFA/BANKIA. Under no circumstances is the Trustee to submit any version of the report to Spain and/or BFA/BANKIA before submitting it to the Commission.

i) The report is to focus on the duties set out in the mandate by the Trustee and compliance with the obligations by BFA/BANKIA, thus enabling the Commission to assess whether BFA/BANKIA is being managed in accordance with the obligations. If necessary, the Commission may specify the scope of the report in more detail. In addition to these reports, the Trustee is to report promptly in writing to the Commission if it has reasons to suppose that BFA/BANKIA is failing to comply with these obligations, sending a non-confidential version to BFA/BANKIA at the same time.

D Duties and obligations of BFA/BANKIA

(iv) BFA/BANKIA is to provide and to require its advisors to provide the Trustee with all such cooperation, assistance and information as the Trustee may reasonably require to perform its tasks under this mandate. The Trustee is to have unrestricted access to any books, records, documents, management or other personnel, facilities, sites and technical information of BFA/BANKIA or of the business to be sold that are necessary to fulfil its duties under the mandate. BFA/BANKIA is to make available to the Trustee one or more offices at its business premises and all employees of BFA/BANKIA are to be available for meetings with the Trustee in order to provide it with all the information it needs to perform its duties.

(v) Subject to BFA/BANKIA's approval (this approval may not to be unreasonably withheld or delayed) and at its expense, the Trustee may appoint advisors (in particular for corporate finance or legal advice), if the Trustee considers the appointment of such advisors necessary or appropriate for the performance of its duties and obligations under the mandate, provided that any costs and other expenses incurred by the Trustee are reasonable. Should BFA/BANKIA refuse to approve the advisors proposed by the Trustee, the Commission may approve their appointment instead, after hearing BFA/BANKIA's reasons. Only the Trustee is entitled to issue instructions to the advisors.

E Replacement, discharge and reappointment of the Trustee

(vi) If the Trustee terminates its functions under the Commitments or if there are any other significant grounds, such as a conflict of interest on the part of the Trustee,

a) the Commission can, after hearing the Trustee, require BFA/BANKIA to replace it, or

b) BFA/BANKIA, with the approval of the Commission, can replace the Trustee.

If the Trustee is removed in accordance with paragraph E(xiii), it may be required to continue in its function until a new Trustee is in place to whom the Trustee has effected a full handover of all relevant information. The new Trustee is to be appointed in accordance with the procedure referred to in paragraphs A(i) to A(vi).

(vii) Besides removal in accordance with paragraph E(xiii), the Trustee is to cease its activities only after the Commission has discharged it from its duties. This discharge is to take place when all the obligations with which the Trustee has been entrusted have been implemented. However, the Commission may at any time require the reappointment of the Trustee if it is subsequently found that the relevant remedies have not been fully and properly implemented.

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