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In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […].		PUBLIC VERSION This document is made available for information purposes only.

Subject: State aid n° SA.36500 (2013/N) – Spain
Recapitalisation and Restructuring of Banco Gallego S.A.

Sir,

1 PROCEDURE

(1) On 28 November 2012, the Commission approved the Restructuring Decision for NovaCaixaGalicia Banco (“**the NCG Decision**”)[1] based on commitments by NovaCaixaGalicia Banco (“**NCG**”) to fully write down its stake in Banco Gallego S.A. ("**Banco Gallego**" or the "**Bank**") by 31 December 2012 and by the Spanish authorities to sell Banco Gallego by 30 April 2013.

(2) The Spanish authorities started an open tender procedure in late February 2013. On 18 April 2013 the tender procedure was finalised. The offer of Banco Sabadell was assessed as the best offer.

[1] SA.[33734] (2012/N), OJ C75 of 14.03.2013, p.1.

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(3) By its bid, Banco Sabadell offered EUR 1 for Banco Gallego and requested several support measures to be granted by the *Fondo de Restructuración Ordenada Bancaria* ("**the FROB**")[2].

(4) On 16 July 2013, Spain notified a restructuring plan for Banco Gallego ("**the Restructuring Plan**").

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

2 DESCRIPTION OF THE MEASURE

2.1 The beneficiary

(6) Banco Gallego, a Spanish commercial bank, operates mainly in the region of Galicia. Banco Gallego was created by the merger of Banco 21 and Banco Gallego in 1998. Subsequently, Caixanova[3] took a stake in its capital by subscribing for a capital increase. At 30 June 2012 NCG held 49.85% of Banco Gallego and accounted for that holding using the full consolidation method. However, as a result of the implementation of the NCG Decision, the FROB became sole owner of NCG, thus holding an indirect ownership of 49.85% of Banco Gallego.

(7) On 29 January 2013, Banco Gallego's shareholders decided to reduce the equity of the Bank to zero by absorbing losses and, simultaneously, NCG increased the capital of Banco Gallego. As a result of that operation, on 18 March 2013, the FROB, indirectly through NCG, held 99.95% of Banco Gallego, the rest remaining in the hands of private shareholders.

(8) Although the Bank was included in the consolidated group of NCG, it had managerial autonomy. NCG did not control the board of directors, but did control the executive committee.

(9) Banco Gallego business model was based on commercial banking, traditionally focused on the small and medium-sized enterprise ("**SME**") and premier banking (personal and private banking) segments. From 2004 onwards the Bank increased its presence in the real-estate development/construction sector. At 31 December 2012, Banco Gallego had 742 employees and 183 branches, of which 117 were located in Galicia. Its market share was [0.2-0.3] % in deposits and [0.1-0.2] % in loans at national level, and [1-5] % and [1-4] % respectively at a regional level. Table 1 provides Banco Gallego's main financial figures.

Table 1: Banco Gallego's main financial figures

[2] The FROB was established, 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 Commission adopted on 28 January 2010 a decision not to raise objections (case N 28/2010, OJ C57, 09.03.2010, p. 2) on FROB as a recapitalisation scheme for fundamentally sound institutions. 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 billion.

[3] Caixanova was a regional Galician saving bank that merged with Caixa Galicia to create NCG.

	31.12.2012	30.06.2010 (peak)
Total assets (billion EUR)	4.3	4.5
Loans to customers (billion EUR)	2.1	3.4
Retail deposits (billion EUR)	3	3
Total wholesale funds - including central banks (billion EUR)	1.2	1.1
Employees Total Group	742	989
Number of branches	183	203
National Market share in deposits	[0.2-0.3]%	[0-0.3]%
Regional Market share in deposits	[1-5]%	
National Market share in loans	[0.1-0.2]%	[0.1-0.2]%
Regional Market share in loans	[1-4]%	

2.2 The buyer

(10) As part of the Restructuring Plan, Banco Gallego will be bought by Banco Sabadell S.A. ("**Banco Sabadell**"). Banco Sabadell is an integrated financial group, with a banking business, insurance, pension and asset management activities incorporated in Sabadell (Barcelona). As a listed bank, it is subject to supervision from the Bank of Spain ("**BoS**") and the National Stock Market Commission.

(11) Banco Sabadell is one of the top-five banking groups in Spain with 1 853 branches, 15 596 employees and a total balance sheet of EUR 161.5 billion with a pre – provision profit of EUR 1.3 billion as of 31 December 2012. Geographically, its presence is particularly strong in Catalonia and the Region of Valencia due to the acquisition of Banco CAM. Its market share is [5-10] % in loans and [5-10] % in deposits at national level.

(12) Banco Sabadell has proven in the current context its capacity to maintain high profitability, solvency, efficiency and productivity ratios throughout the crisis. The limitation of its exposure to the troublesome real estate sector (15.5%) has contributed to ensure its resilience, both in absolute and in relative terms.

Table 2: Banco Sabadell's main figures (as of 31/12/2012)

	Financial indicator	*Banco Sabadell*
Profitability	ROA[4]	0.07%
	ROE[5]	1.01%
Solvency	Coverage ratio	64.62%
	EBA[6] Core Tier 1	9.2
	Basel II CET1[7]	10.4
Efficiency	Efficiency ratio	51%
Productivity	Deposits per employee (EUR million)	5.2
Risks	% loans to developers / total loans	15.5%

4 Return on Assets
5 Return on Equity
6 European Banking Authority
7 Common Equity Tier 1

(13) Banco Sabadell has a long and positive track record in acquiring and integrating retail banking entities and achieving synergies[8]. In particular the acquisition of Banco CAM allowed Banco Sabadell to diversify its business towards the retail segment, as well as to diversify geographically into the Valencia region.

(14) Banco Sabadell has a strong liquidity position with approximately EUR [...] billion available liquidity and manageable future debt maturities. Its loan-to-deposits ratio stands at 126% as of 31 December 2012.

(15) The results[9] of the bottom-up stress test and asset quality review ("**MoU Stress Test**") conducted by an independent consultant, Oliver Wyman, in the context of 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 ("**MoU**") identified a capital excess of EUR 0.9 billion (1.4% of the estimated risk weighted assets in 2014) in the adverse scenario for Banco Sabadell, confirming that it is among the most resilient Spanish institutions, with 9.2% EBA Core Tier 1. Total expected loss rates of 12.2% and 63.1% were estimated for the current credit book and foreclosed assets, respectively. Those figures compare favourably to loss rates for the system (14.6% for current credit book and 63.4% for foreclosed assets), confirming Banco Sabadell's high credit quality.

2.3 The events triggering the measures for Banco Gallego

(16) Following the outbreak of the financial crisis in 2008, the Spanish authorities laid down via Royal Decree Law 9/2009 the legal foundations for the restructuring of the Spanish banking sector. Some of the banks present in the market had several structural limitations, such as weak corporate governance systems which prevented those institutions from detecting problems at an early stage.

(17) On 18 February 2011, the Spanish authorities adopted more stringent regulatory capital requirements for the entire banking sector, which, *inter alia*, obliged all credit institutions operating in Spain to meet, by 30 September 2011 at the latest, higher minimum regulatory solvency levels, known as "*capital principal*"[10].

(18) Additionally, on 3 February 2012, the Spanish authorities approved Royal Decree-Law 2/2012 setting up a new capital and provisioning requirements framework[11] increasing the level of provisions and capital buffers for non-performing real estate assets (mainly loans to real estate developers) classified as doubtful, substandard and repossessed. The new rules implied additional capital needs for Banco Gallego of EUR 31.2 million and additional provisions of EUR 124.8 million.

(19) Moreover, on 11 May 2012, the Spanish authorities approved a new Royal Decree-Law 18/2012 on consolidation and sale of real estate assets in the financial sector, as

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8 In the last decade, Banco Sabadell has acquired and successfully integrated the following banks: a) Caixa Penedes (2013), Banco CAM (2012), c) Lydian Private Bank (2011), d) Banco Guipuzcuano (2010), e) Mellon United National Bank (2010), f) Transatlantic Bank (2007), g) Banco Urquijo (2006), h) Banco Atlantico (2004) and i) Banco Herrero (2000).

9 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/

10 See Royal Decree Law 2/2011 of 18 February 2011: "Real Decreto-ley 2/2011, de 18 febrero para el reforzamiento del sistema financiero". The new legal framework established that by 30 September 2011 any credit institution without private investors holding at least 20% of its equity or with wholesale funding exceeding 20% of its financing needs had to meet a solvency level (defined as "capital principal"), set at 10% of its RWA. The new rule applies at consolidated and solo level.

11 The solvency and provisioning requirements is required on a solo and consolidated basis.

a result of which, Banco Gallego needed EUR 142.7 million of additional provisions, for performing loans.

(20) Nevertheless, as a consequence of the transfer of assets and a credit portfolio by Banco Gallego to the Asset Management Company ("**SAREB**") the amount of required additional provisions and capital decreased to EUR [...] million and EUR [...] million respectively.

(21) On 28 November 2012, based on the Commitments in the NCG Decision, NCG and the Spanish authorities committed that NCG would fully write down its stake in Banco Gallego and sell Banco Gallego by 30 April 2013.

2.4 The sale of Banco Gallego through an open and competitive tender

(22) At the beginning of 2013, the Spanish authorities initiated a sales process by starting an open, transparent and competitive tender procedure organised with the assistance of the investment bank Mediobanca ("**the Tender Procedure**").

(23) On 23 January 2013, the FROB launched the first phase of the Tender Procedure. About 19 potential buyers were contacted out of which six[12] submitted indications of interest by 4 March 2013.

(24) On 8 March 2013, the second phase of the Tender Procedure started with the six potential buyers. The interested buyers had: (i) access to ad hoc due financial, legal, tax diligence reports prepared by Ernst&Young; (ii) access to a memo prepared by Mediobanca; (iii) access to a virtual data room; (iv) the opportunity to meet with Banco Gallego's management and the teams responsible for preparing those reports; and (v) access to Banco Gallego's credit files. On 5 April 2013, three of the potential banks submitted binding offers.

(25) [...] submitted an offer for the full perimeter of [...], requesting EUR [500-550] million of capital injection, other support measures amounting to approximately EUR [50-100] million and a series of other conditions.

(26) [...] submitted an offer for a reduced perimeter (approximately EUR [4 200-4 300] million of assets). The offer was conditional on an upfront capital injection in the amount of EUR [600-630] million, other support measures amounting to approximately EUR [120-130] million and a series of other conditions.

(27) [...] submitted an offer for the full perimeter of Banco Gallego, requesting from the Spanish authorities an upfront capital injection of EUR 245 million in Banco Gallego, a series of contingent grants amounting up to EUR 340 million and other guarantees.

2.5 The alternative to a sale: orderly winding up scenario

(28) In order to compare the costs of the sale of Banco Gallego as a whole with the costs of an orderly winding up of the bank, the Spanish authorities have evaluated and quantified the costs of an orderly winding up of Banco Gallego. The initial winding

[12] [...]

up scenario was developed based on the assumption of the sale of all the assets and part of the liabilities. The main assumption used for that initial scenario was based on the sale of the loan portfolio and real estate assets to private investors, using specific haircuts for each asset class with a liquidation prior to 30 June 2015.

(29) The long-term economic costs of the orderly winding up of Banco Gallego were estimated to be around EUR 1.04 billion whereas the upfront capital needs for Spain would amount to approximately EUR 2.6 billion.

(30) The Spanish authorities assessed the alternative resolution scenario of Banco Gallego through a judicial insolvency procedure. However, as it implied a non-orderly resolution of the entity, it was disregarded on the grounds of threatening the stability of the Spanish financial system.

2.6 Overview of the aid measures

(31) Banco Gallego has benefitted or will benefit from several aid measures. As envisaged in the MoU, the Spanish authorities have transferred assets amounting to EUR 1 026 million gross (estimated EUR 610 million transfer price) to SAREB.

(32) In the context of the sale of Banco Gallego to Banco Sabadell, the Spanish authorities intend to grant or have granted a series of capital injections, or equivalent measures, amounting up to EUR 866.9 million and guarantees amounting up to EUR 806 million. Table 3 provides an overview of the aid measures.

Table 3: Overview of the aid measures

Measure	**Description**	**Amount (EUR million)**	**Approved by the Commission**	**RWA**[13]
A	Recapitalisation measure (upfront recapitalisation)	245	Approved by this Decision	12.3%
B	Contingent grant of Deferred Tax Assets ("**DTAs**")	Up to 127	Approved by this Decision	6.4%
C	Contingent grant of other tax advantages	Up to 163	Approved by this Decision	8.2%
D	Contingent grant on badwill	Up to 50	Approved by this Decision	2.5%
E	Second loss guarantee linked to the asset transfer to the AMC	Up to 24.3	Approved by this Decision	1.2 %

13 Risk Weighted Assets ("**RWA**") as of 31 December 2012 equal to EUR 1 996 million.

F	Impaired asset measure	257.6	Approved by NCG decision of 28.11.2012	12.9%
G	Guarantee on [...]	Up to 6	Approved by this Decision	Not applicable
H	Guarantee on liquidity	Up to 800	Approved by this Decision	Not applicable

2.6.1 Measure A: Recapitalisation measure

(33) Banco Sabadell's offer for the full perimeter of Banco Gallego is conditional on the injection of EUR 245 million of upfront capital in Banco Gallego. Accordingly the FROB will subscribe for EUR 245 million in ordinary shares issued by Banco Gallego.

2.6.2 Measure B: Contingent grant of DTAs

(34) Banco Sabadell requested in its bid a guarantee of the deferred tax assets ("**DTAs**") active in the balance sheet of Banco Gallego as of 31 December 2012 (amounting up to EUR 127 million) in order to ensure that they will not be lost as a consequence of the sale or of the merger of Banco Gallego with Banco Sabadell.

2.6.3 Measure C: Contingent grant of other tax advantages

(35) The FROB guarantees that Banco Sabadell will be entitled to benefit from other tax advantages (temporary differences, tax deductions, fiscal credits deriving from impairments before the closing date, etc.) totaling up to EUR 163 million.

(36) According to the Spanish authorities, the tax rules are such that there should be no problems for Banco Sabadell to benefit from those fiscal credits. Thus, no public resources will be disbursed.

2.6.4 Measure D: Contingent grant on the badwill

(37) The FROB will compensate Banco Sabadell for the tax expenses due to the hypothetical income to be received arising from the difference between the share purchase price and the reasonable value of assets and liabilities, with a limit of up to EUR 50 million.

(38) The Spanish authorities claim that in the worst case scenario in which, despite the principle of tax neutrality of mergers, the Spanish fiscal authority would call upon taxes over that badwill, the cost of such a measure would be limited to EUR 6 million (30% of EUR 20 million).

2.6.5 Measure E: Second loss guarantee on adjustments linked to the assets transfer to SAREB

(39) The FROB will guarantee adjustments over EUR 1 million on the price of transfer of credits and assets (or adjustments of the perimeter to be transferred) to SAREB. Such adjustments will be verified by an independent expert. Positive and negative adjustments will be compensated.

(40) The *Due Dilligence* which SAREB is carrying out is not finalised yet. Thus at the current stage the FROB cannot provide the exact amount regarding the adjustments of the assets.

(41) The Spanish authorities have provided information which shows that in the most adverse scenario the impact to the FROB resulting from the second loss guarantee will be at most EUR 24.3 million. However, FROB argues that it is an unlikely scenario.

2.6.6 Measure F: The transfer of impaired assets to SAREB

(42) NCG transferred loans and foreclosed assets to SAREB with a gross book value of EUR [...] million, of which EUR [...] million came from Banco Gallego.

(43) The transfer price of the assets transferred from Banco Gallego amounted to EUR [...] million, which is equal to [...] % of the gross book value of those assets.

(44) As a result of the asset transfer, the RWA of Banco Gallego were reduced by EUR [...] million.

(45) That aid measure has already been approved in the Restructuring Decision of NCG of 28 November 2012.

2.6.7 Measure G: Guarantee on the reimbursement of the funding granted to [...]

(46) The FROB will compensate for any amount that [...] (a real estate subsidiary of Banco Gallego) must pay its creditors (except Banco Gallego itself), inasmuch as [...] assets are not sufficient to face such a liability.

(47) After the transfer of assets to SAREB, Banco Gallego has recorded provisions for its exposure to [...]. Therefore, the loss of its credit against [...] will have no impact in Banco Gallego’s accounts.

(48) In case of a liquidation of [...] the maximum risk to which Banco Gallego would be exposed would be limited to around EUR 6 million, resulting from the difference between the market value of the bonds received from SAREB (EUR 21.9 million) and the total amount of liabilities from other creditors (EUR 27.8 million).

2.6.8 Measure H: Guarantee on liquidity

(49) The FROB guarantees a liquidity line to Banco Gallego amounting to up to EUR 800 million during the interim period of two months from the closing of the agreement should Banco Gallego not be eligible for ECB operations during that period.

3 THE RESTRUCTURING OF BANCO GALLEGO

(50) In accordance with Law 9/2012 and in view of: a) its significant capital shortfall; b) the considerable amount of State aid received; and c) the impossibility to restore Banco Gallego's stand-alone viability, Banco Gallego will be placed under resolution within the meaning of that Law.

(51) Accordingly, the Spanish authorities will carry out an in-depth restructuring of Banco Gallego’s activities as set out in the Restructuring Plan through the sale of Banco Gallego to Banco Sabadell.

(52) The commitments by the Spanish authorities have been presented in a separate document entitled: *"Term Sheet of* Banco Gallego*"* (hereinafter referred to as "**the Term Sheet**", annexed to the present decision)[14].

(53) The Restructuring Plan was prepared by the Spanish authorities with Banco Sabadell and was submitted to the Commission on 16 July 2013. It covers the period 2012 – 2015 and includes the following measures.

3.1 Restoration of viability through the sale of Banco Gallego to Banco Sabadell

(54) There will be a complete integration of Banco Gallego into Banco Sabadell through the migration of Banco Gallego's operational IT platform. As a result all central services will be transferred to Banco Sabadell's headquarters in Barcelona. The integration of Banco Gallego into Banco Sabadell ("**the combined entity**") will be implemented as described in recitals (106) to (122).

(55) Between the signature of the sale contract and the actual acquisition of control of Banco Gallego by Banco Sabadell, a Steering Committee will be set up. The main task of that committee will be to prepare and monitor the transition of the control of Banco Gallego’s business into Banco Sabadell. Futhermore, a Risk Committee will also be set up in order to supervise the risk operations of Banco Gallego on a weekly basis.

(56) As a result of the integration of Banco Gallego into Banco Sabadell and the restructuring of its network, at least [10-20] % of the former's [150-200] branches as of 31 December 2012 will be closed by the end of [...] at the latest. Likewise, at least [10-20] % of Banco Gallego's 737 employees as of 31 December 2012 will be made redundant.

(57) After the integration of Banco Gallego into Banco Sabadell, the combined entity will have the following financial characteristics.

Table 4: Pro-forma financial figures of the combined entity[15]

Main figures	**Banco Sabadell - Banco Gallego**
Total Assets (EUR billion)	165.69
Loans to clients (EUR billion)	117.45
Deposits (EUR billion)	83.6
Total capital (EUR billion)	9.6
Clients funds off balance (EUR billion)	21.6
National market share in Deposits	[5-10]%

Main ratios 2013e	**Banco Sabadell - Banco Gallego**
Core Tier 1Capital ratio	10.4%

14 See the Annex.

15 Table 4 is based on a pro-forma balance sheet of 12.2012, reflecting the transfer of assets to the AMC, the capital injection and SLEs.

3.2 Contribution to the restructuring costs of Banco Gallego

(58) In accordance with the Law 9/2012, prior to benefiting from State aid, aided banks must conduct burden-sharing exercises on existing shareholders, and on holders of preference shares and subordinated (both perpetual and dated) debt instruments so as to, inter alia, maximise the loss-absorption capacity of the aided bank.

3.2.1 Burden-sharing on existing shareholders of Banco Gallego

(59) As described in recital (7) the existing private shareholders were nearly fully diluted as a result of a capital increase conducted by NCG on 18 March 2013.

3.2.2 Subordinated Liability Exercise in Banco Gallego

(60) In view of the significant losses posted and forecasted by Banco Gallego for 2011 and 2012 and pursuant to the Law 9/2012, holders of preference shares and perpetual/dated subordinated debt instruments will contribute to the adequate recapitalisation of Banco Gallego in two different ways:

(i) First, the securities shall be bought back by Banco Gallego or Banco Sabadell at their net present value, calculated in accordance with the methodology set out in the Term Sheet, which implies deep discounts from the nominal value of the instruments.

(ii) Second, the proceeds of the buy-back will automatically take the form of ordinary shares (or other equity-equivalent instruments) of Banco Sabadell or a more senior debt instrument of Banco Gallego, as described in the Term Sheet[16].

(61) Consequently, as a result of the burden-sharing exercise, there will be no cash outflow from Banco Gallego to the holders of those securities with the sole exception of the holders of hybrid and dated subordinated debt instrument who decide to convert their securities into new senior debt securities of Banco Gallego of the same maturity.

4 POSITION OF THE SPANISH AUTHORITIES

4.1 Position of the Spanish authorities on the Restructuring Plan

(62) The Spanish authorities accept that the proposed measures constitute State aid and request the Commission to verify if they 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.

(63) In particular, the Spanish authorities submit that the 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.

[16] See Term Sheet section 6

i. *Appropriate and well-targeted*. The Spanish authorities submit that Banco Gallego is systemically important within the Spanish financial system, especially in its geographical operating area[17].

ii. *Necessary and limited to the minimum amount*. The Spanish authorities submit that the measures proposed are the least costly option to avoid a disorderly liquidation of Banco Gallego.

iii. *Proportionate*. The Spanish authorities submit that the terms and conditions imposed on Banco Gallego and the integration into Banco Sabadell contains sufficient safeguards against possible abuses and distortions of competition.

4.2 Commitments of the Spanish authorities

(64) 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, by ensuring that Banco Gallego and Banco Sabadell comply with those commitments.

(65) In particular, the Spanish authorities commit to a six-month reporting on the execution of their commitments. Those reports will start from the date of the present Decision and will be provided until the end of the restructuring period.

5 ASSESSMENT

5.1 Existence of State Aid

5.1.1 Beneficiaries of the aid measures

(66) With regards to Banco Sabadell, the Commission needs to assess whether any of the aid measures benefit it as the purchaser of the Banco Gallego's banking business. According to point 49 of the Banking Communication, in order to ensure that no aid is granted to the buyer of a financial institution sold by the State, it is important that certain requirements are met, and in particular that i) the sale process is open, transparent, non-discriminatory and unconditional; ii) the sale takes place on market terms; and iii) the State maximises the sale price for the assets and liabilities involved.

(67) The Commission notes that the FROB considered an alternative resolution scenario built on different assumptions as described in section 2.5. In that context, the Commission notes that the Spanish authorities estimated the long-term economic costs of the orderly winding up of Banco Gallego to be of EUR 1.04 billion, whereas the upfront capital needs for Spain would amount to approximately EUR 2.6 billion, which remains significantly higher than the restructuring aid involved in the sale (up to EUR 866.9 million)[18].

[17] Banco Gallego's market share in deposits in the region where it operates is [1-3] %.

[18] The sum of measures A through F.

(68) On the basis of the information provided by Spain, the Commission considers that the Tender Procedure described in section 2.4 was open and non-discriminatory and resulted in the best bid winning the tender. No other participant made an offer requesting less public support. The fact that Banco Sabadell did not offer a positive price for Banco Gallego does not preclude that that sale price reflects the market value of the business since the net equity of Banco Gallego was clearly negative. Therefore, the transaction seems to be aligned with market practice and Banco Sabadell has not received any undue advantage.

(69) With regards to Banco Gallego, the Commission notes that, after the merger with Banco Sabadell, Banco Gallego will disappear as an independent legal and economic entity, and that its economic activities will be transferred to Banco Sabadell. Therefore, while Banco Gallego has benefitted from the aid measures granted until the adoption of the present decision, it will no longer benefit from the aid measures granted prior to that decision. The Commission therefore concludes that the legal person Banco Gallego is not the beneficiary under the present decision.

(70) Finally, with regards to the transferred business ("**the legacy business**"), the Commission notes that it comprises all of Banco Gallego's banking activities. After the merger, some of Banco Gallego's branches will continue to operate in Banco Sabadell's network, while Banco Gallego will cease to exist as an independent legal entity. The legacy business will therefore be allowed to continue providing the same range of banking and financial services to its customers as Banco Gallego did before the sale and will clearly continue to carry out an economic activity within the combined entity.

(71) The Commission therefore considers the legacy business may be a beneficiary of the measures described in section 2.6. For the sake of simplicity, it will refer to that business in the remainder of this decision as "Banco Gallego", as it comprises all its activities.

5.1.2 The Measures

(72) With regard to the measure approved by the Commission in the NCG decision of 28 November 2012 (namely measure F, the transfer of impaired assets to SAREB), the Commission has already concluded that the measure constitutes State aid in favour of NCG. As a consequence, it is not necessary to reassess whether the measure constitutes State aid in this decision. The Commission will quantify the extent to which that measure benefits Banco Gallego when establishing the volume of aid received by the latter.

(73) The measures that need to be assessed in this decision in order to determine whether they constitute State aid within the meaning of Article 107(1) TFEU are measures A, B, C, D, E, G and H as described in section 2.6.

(74) According to Article 107(1) TFEU 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. The Commission observes that the Spanish authorities do not dispute that measures A through H constitute State aid.

(75) The qualification of a measure as State aid within the meaning of this 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.

5.1.3 State resources and imputability

(76) As regards the recapitalisation measure (measure A), the three contingent grants (measures B, C and D), the second loss guarantee (measure E) and the two guarantees (measures G and H), the Commission recalls that the FROB, the intervening authority providing the measures, is directly financed through State resources and its decisions are directly imputable to the State. The FROB essentially acts as the prolonged arm of the State.

(77) The Commission therefore considers that measures A through H are financed by State resources and are imputable to the State.

5.1.4 Advantage

(78) As regards the recapitalisation measure (measure A), the three contingent grants (measures B, C and D), the second loss guarantee (measure E) and the two guarantees (measures G and H), the Commission recalls that the granting of those measures were the main conditions of Banco Sabadell's bid for Banco Gallego, which was made for, in essence, a substantially negative price. Those measures enable Banco Sabadell to integrate Banco Gallego into its business. In fact, were it not for those measures, Banco Gallego would not have found a buyer and would therefore have been liquidated or resolved.

(79) For those reasons, the Commission agrees with Spain that measures A through H provide an advantage to Banco Gallego.

5.1.5 Selectivity

(80) Since measures A through H are exclusively addressed to Banco Gallego, they should be considered selective in nature.

5.1.6 Distortion of competition and effect on trade between Member States

(81) The Commission considers measures A through H to distort competition since they enable the business to survive within another legal entity while it would have otherwise disappeared without public support.

(82) The Commission also considers that the measures are likely to affect trade between Member States since Banco Gallego's business activities continue – within Banco Sabadell - to compete on the Spanish retail market, the mortgage lending markets and the commercial lending markets. In all those markets, some of Banco Gallego's competitors are subsidiaries and branches of foreign banks.

5.1.7 *Conclusion*

(83) On the basis of the forgoing, the Commission considers that measures A through H fulfil the conditions laid down in Article 107(1) TFEU and that those measures therefore constitute State aid within the meaning of that provision.

5.2 Amount of aid to Banco Gallego

5.2.1 Upfront Recapitalisation (measure A)

(84) Banco Gallego will receive an upfront recapitalisation of EUR 245 million. The Commission considers the aid element in the recapitalisation to be up to 100% of the nominal amount and, hence, concludes that the recapitalisation measure entails aid of an amount of EUR 245 million.

5.2.2 Contingent grant on DTAs (measure B)

(85) Banco Gallego will receive a contingent grant on DTAs of EUR 127 million. The Commission considers that the measure entails aid of up to EUR 127 million

5.2.3 Contingent grant of other tax advantages (measure C)

(86) Banco Gallego will receive a contingent grant of other tax advantages of EUR 163 million. The Commission considers that the measure entails aid of an amount of up to EUR 163 million.

5.2.4 Contingent grant on badwill (measure D)

(87) Banco Gallego will receive a contingent grant on badwill of EUR 50 million. The Commission considers that the measure entails aid of an amount of up to EUR 50 million.

5.2.5 Second loss guarantee on adjustments linked to the asset transfer to SAREB (measure E)

(88) Banco Gallego will receive a guarantee on adjustments over EUR 1 million on the price of transfer of credits and assets (or adjustments of the perimeter to be transferred) to SAREB of up to EUR 24.3 million.

5.2.6 Impaired asset measure (measure F)

(89) As explained in section 2.6.6, Banco Gallego received an impaired asset measure which was approved in the Restructuring Decision of NCG. The aid element amounts to EUR 257.6 million.

5.2.7 Guarantee on [...] (measure G)

(90) Banco Gallego will receive a guarantee on the reimbursement of the funding granted to [...] of up to EUR 6 million.

5.2.8 Guarantee on liquidity (measure H)

(91) Banco Gallego will receive a guarantee on liquidity of up to approximately EUR 800 million during the interim period of two months from the closing of the agreement should Banco Gallego not be eligible for ECB operations during that period.

5.2.9 Conclusion

(92) On the basis of the foregoing, it should be concluded that Banco Gallego has received or will receive State aid in the form of capital injections, contingent grants, second loss guarantees and impaired asset measures amounting up to EUR 866.9 million (43.4% of RWA)[19], in addition to guarantees on liquidity and funding worth up to EUR 806 million

5.3 Legality of the aid

(93) The Commission notes that Spain notified measures A through H to the Commission for its approval prior to putting them into effect and thus complied with its obligations under Article 108(3) TFEU.

5.4 Compatibility of the aid with the internal market

(94) As regards the compatibility of the aid provided to Banco Gallego, 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 proposed measures are compatible with the internal market.

5.5 Legal basis for the compatibility of the aid

(95) 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[20]. The Commission confirmed that view by adopting the 2011 Prolongation Communication[21].

(96) In respect of the Spanish economy that assessment was confirmed in the Commission's various approvals of the measures undertaken by the Spanish authorities to combat the financial crisis[22]. Therefore, the legal basis for the assessment of the measures is Article 107(3)(b) TFEU.

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19 RWA as of 31.12.2012.

20 This has been confirmed in the Banking Communication (Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ C 270, 25.10.2008, p. 8), 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 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).

21 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.

22 See e.g. Reintroduction of the Spanish Guarantee Scheme SA 34224 (2012/N), OJ C82 of 21.03.2012, p.3

5.6 Compatibility assessment

(97) Banco Gallego will benefit from several State aid measures whose compatibility has not previously been assessed by the Commission, namely measures A, B, C, D, E, G and H. Banco Gallego also benefitted from aid found compatible by the Commission in the restructuring Decision of NCG (measure F).

(98) Since all those measures have been provided in the context of the restructuring of Banco Gallego it will need to be determined below whether measures A through H are compatible as restructuring aid, in particular based on the Restructuring Plan submitted by the Spanish authorities. The Commission will therefore examine the Restructuring Plan under its Restructuring Communication which sets out the rules applicable to the granting of restructuring aid to financial institutions in the current crisis.

(99) However, prior to that examination, the Commission should examine whether the aid measures A, B, C, D, E, G and H are compatible with the Banking and Recapitalisation Communication.

5.7 Compatibility of measures A, B, C, D, E, G and H with the Banking and Recapitalisation Communications: Appropriateness, necessity, proportionality

(100) As recalled in point 15 of the Banking Communication, in order for aid 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:[23:]

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

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

c. *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.

(101) As regards the recapitalisation measure and the contingent grants to Banco Gallego (measures A, B, C, D, E, G and H), they are appropriate to remedy a serious disturbance in the Spanish economy, as they will prevent the disorderly liquidation of Banco Gallego and a threat to financial stability.

(102) They are also necessary to achieve that objective since they avoid the disorderly liquidation of Banco Gallego which would jeopardise financial stability. Those capital measures were a condition of Banco Sabadell's bid for Banco Gallego, the sale of which constitutes the least costly option for Spain to achieve its objective of financial stability, as described in section 2.5.

[23] See paragraph 41 of Commission decision in Case NN 51/2008, *Guarantee scheme for banks in Denmark*, OJ C 273, 28.10.2008, p. 2.

(103) As regards the remuneration for that measure, the Commission has accepted that a distressed bank may pay a lower remuneration than what would normally be necessary if such a discount is required to ensure financial stability and is accompanied by the presentation of a thorough and far-reaching restructuring plan, including a change in management and corporate governance where appropriate. In the case of Banco Gallego, the Commission notes that Spain has submitted a far-reaching restructuring plan, including the change of ownership and Banco Gallego's disappearance as a stand-alone entity. Therefore, the Commission considers that the absence of remuneration for the capital measures can be accepted.

(104) Given that the sale of Banco Gallego constitutes the least costly possibility to reach the objective of financial stability in the Spanish economy and, in the light of the far-reaching restructuring, the Commission concludes that measures A, B, C, D, E, G and H are appropriate, necessary and proportionate.

5.8 Compatibility of the aid measures (A, B, C, D, E, G and H) with the Restructuring Communication

(105) The Restructuring Communication sets out the State aid rules applicable to the restructuring of financial institutions in the current financial crisis. 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. Since measure F has previously been approved, the Commission will not re-examine it in the present decision, but the compatibility of the other aid measures must be analysed taking into account that aid already received by Banco Gallego.

5.8.1 Restoration of viability within Banco Sabadell

(106) 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.

(107) Points 9 and 10 of the Restructuring Communication indicate that the Member State should provide a comprehensive and detailed restructuring plan which should include a comparison with alternative options. Where a financial institution cannot be restored to viability, the restructuring plan should indicate how it can be wound up in an orderly fashion. The plan should, furthermore, also identify the causes of the difficulties faced by a financial institution and provide a business model that restores the bank's long-term viability.

(108) In the present case, the Commission observes that the Spanish authorities have chosen to sell Banco Gallego's legacy business via an open tender procedure and to discontinue Banco Gallego as an independent economic activity. The Commission, therefore, has to assess whether the integration into Banco Sabadell will enable long-term viability to be restored to the legacy business.

(109) According to point 17 of the Restructuring Communication the sale of a financial institution to a viable third party with sufficient financial means and the capacity to absorb that institution can help to restore its long-term viability.

(110) In the present case, the Commission considers that requirement to be met by Banco Sabadell, a banking group incorporated in Barcelona, with 1 853 branches, 15 596 employees, a total balance sheet of EUR 161.55 billion, and a consolidated net profit of EUR 82 million as of December 2012.

(111) First, the Commission notes that the business of Banco Gallego is absorbed by a much larger group. In terms of total assets, the ratio exceeds 1:37. As a consequence, the impact of the acquisition of Banco Gallego on Banco Sabadell's accounts and prudential position will be limited.

(112) Second, as regards viability, Banco Sabadell complies and will continue to comply with the legal solvency requirements after the integration of Banco Gallego.

(113) Third, Banco Sabadell's liquidity position is one of its strengths with approximately EUR [...] billion available liquidity and manageable future debt maturities which provides it with a capacity to absorb Banco Gallego's funding profile.

(114) Fourth, Banco Sabadell is a national leader in terms of size, since it is the fifth-largest financial institution in Spain.

(115) Fifth, the management of Banco Sabadell is considered as one of the benchmarks in retail banking in Spain. It is among the banks with the highest efficiency ratio and has a relatively low loan-to-deposit ratio as well as good quality of its credit portfolio.

(116) Sixth, Banco Sabadell has an established and favourable track record in merging with an external retail banking entity and through successful integration, extracting foreseen synergies.

(117) Seventh, the Commission notes that the quality of Banco Sabadell's credit portfolio presents a level of non-performing loans ("**NPL**") which is well below the sector's average.

(118) Eighth, the Commission acknowledges that as regards Banco Sabadell the MoU Stress Test identified a capital excess of EUR 0.9 billion (or 1.4% of estimated RWA in 2014) in the adverse case scenario, confirming it to be among the most resilient Spanish financial institutions, with 9.2% EBA Core Tier 1 after the stress period. Total loss rates of 12.2% and 63.1% were estimated for the current credit book and foreclosed assets, respectively. Those figures compare favourably to loss rates for the system (14.6% for current credit book and 63.4% for foreclosed assets), further confirming Banco Sabadell's higher credit quality.

(119) Ninth, the Commission further notes that Banco Sabadell has been actively reducing its real estate exposure, which was one of the main reasons for the failure of Banco Gallego.

(120) Tenth, the Restructuring Plan will allow Banco Sabadell to comply with the relevant regulatory requirements even in stress scenarios of a protracted global and national recession, in line with point 13 of the Restructuring Communication.

(121) The Commission thus believes that, on the basis of the information provided by the Spanish authorities, Banco Sabadell has the capacity and the required know-how to own and manage Banco Gallego's legacy business in compliance with regulatory and prudential requirements.

(122) In light of the above, the Commission considers that the integration into Banco Sabadell adequately ensures the long-term viability of Banco Gallego's legacy business.

5.8.2 Own contribution and burden-sharing

(123) 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.

(124) Point 23 of the Restructuring Communication provides that restructuring aid should be limited to the amount necessary to cover the costs which are necessary for the restoration of viability.

(125) The Restructuring Communication further provides that, in order to keep the aid limited to a minimum, the banks should first use their own resources to finance the restructuring. The costs associated with the restructuring should not only be borne by the State but also by those who invested in the bank. That objective is achieved in particular by absorbing losses with available capital

(126) In that regard, the Commission observes that Banco Gallego's previous owners were fully wiped out. Moreover, the Commission notes positively that the commitments regarding the burden-sharing of hybrid instruments go beyond the prerequisites of the Restructuring Communication. As described in recitals (59) and (60), all hybrid capital instruments will also be subject to significant burden-sharing. As the Commission would normally consider an exchange of hybrid capital instruments at market price plus a premium into cash to fulfil the requirements of the Restructuring Communication. In that respect, it welcomes that commitment by Spain which results in the maximum legally possible burden-sharing by hybrid instrument holders.

(127) In addition, the Commission considers that, in the present case, the aid can be deemed limited to the minimum necessary only if (i) the sale option chosen by Spain was effectively the least costly option in terms of public resources; and (ii) the level of restructuring aid granted has been effectively kept to the minimum necessary.

5.8.3 *Comparison between a sale and an orderly liquidation - aid limited to minimum through the sale of Banco Gallego*

(128) The Commission notes that the FROB considered an alternative resolution scenario built on different assumptions as described in section 2.5. In that context, the Commission notes that the Spanish authorities estimated the long-term economic costs of the orderly winding up of Banco Gallego to be of EUR 1.04 billion, whereas the upfront capital needs for Spain would amount to approximately EUR 2.6 billion, which remains significantly higher than the restructuring aid involved in the sale (up to EUR 866.9 million)[24].

(129) In parallel, Spain continued the sales process for Banco Gallego. In that regard, the Commission notes, first, that the sale to Banco Sabadell is the result of an open tender procedure which the Commission considers as a proper way to gauge market interest. The transaction seems to be aligned with the market practice and Banco Sabadell has not received any undue advantage.

(130) Second, the Commission notes that several bidders expressed their interest in the first phase and that three of them submitted a binding offer of which Banco Sabadell's was the least costly to the State.

(131) The Commission therefore concludes that Banco Sabadell's bid adequately reflects the market price for the business.

(132) Comparing the negative sales price offered by Banco Sabadell with the cost under the alternative scenarios shows that the cost for the State to sell Banco Gallego in full are lower than the costs arising from an orderly liquidation of that bank.

(133) The Commission thus concludes that the amount of aid can be deemed limited to the minimum necessary.

5.8.4 *Limiting distortion of competition*

(134) Finally, section 4 of the Restructuring Communication requires that the restructuring plan contains measures limiting distortions of competition. Such measures should be tailor-made to address the distortions on the markets where the beneficiary bank operates post-restructuring. The nature and form of such measures depend on two criteria: first, the amount of the aid and the conditions and circumstances under which it was granted and, second, the characteristics of the markets on which the beneficiary will operate. Furthermore, the Commission must take into account the extent of the Banco Gallego’s own contribution and burden-sharing over the restructuring period.

(135) The Commission recalls that Banco Gallego will receive State aid in the form of a capital injection, contingent grants, second loss guarantee and impaired asset measures up to an amount of EUR 866.9 million, in addition to guarantees on liquidity and funding worth EUR 806 million.

[24] The sum of measures A through F.

(136) The aid amount of EUR 866.9 million in the form of capital assistance is equivalent to 43.4% of Banco Gallego's RWA[25]. As the relative amount of aid to the beneficiary is very large, and adequate remuneration is excluded, significant measures are necessary to limit potential distortions of competition.

(137) The Commission notes that the takeover of Banco Gallego by Banco Sabadell results both in the wiping out of former Banco Gallego share- and hybrid capital holders and in the disappearance of Banco Gallego as a standalone entity. The Commission considers that the exit of a failed institution which engaged in excessive risk-taking is a clear indication that moral hazard is addressed. As a result, potential distortions of competition resulting from the State aid are likely to be greatly reduced.

(138) In addition, the Commission notes that the sale of Banco Gallego's legacy business has been undertaken through an adequately open, transparent and non-discriminatory tender procedure that can be considered as a sufficient proxy for the establishment of a market price for the assets and liabilities taken over by the purchaser.

(139) As regards the sale of the legacy business to Banco Sabadell, it is necessary to assess whether the measures to limit the distortion of competition are sufficient in light of the characteristics of the market on which the beneficiary will operate.

(140) In that respect, the Commission considers that the distortions of competition due to the business' continued market presence are limited. Banco Gallego is a regional operator with a very limited market presence on the national Spanish market. In December 2012, Banco Gallego's market share in deposits at a national level represented [0-0.3] %. Even in its core region, Galicia, its market share in terms of deposits is limited to approximately [1-5] %.

(141) The Commission notes that one of the main provisions of the Restructuring Plan is the downsizing of the territorial presence of combined entity. The Commission considers that the downsizing planned by the Restructuring Plan is more than adequate since at least [10-20] % of the legacy network of Banco Gallego will be phased out. The Commission also takes note of the fact that the total number of employees of the former Banco Gallego will be reduced by at least [10-20] %.

(142) In light of the above, the Commission considers that the scale and nature of measures proposed in the Restructuring Plan are sufficient and adequate to address the distortions of competition created by the aid.

(143) Taking into account that mix of measures and commitments and in view of the assessment above that the own contribution and burden-sharing are appropriate and 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 aid Banco Gallego has received and will receive.

[25] RWA as of 31.12.2012.

5.9 Monitoring

(144) 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.

(145) In order to ensure a proper implementation of the restructuring plan and of the commitments it contains, the Spanish authorities will submit regular reports on the compliance measures taken. The first report will be submitted to the Commission no later than six months after approval from the date of notification of this decision and thereafter at six-monthly intervals until the end of the restructuring period.

5.10 Conclusions on the existence of aid and compatibility with the internal market

(146) The Commission concludes that the notified measures (measures A, B, C, D, E, G and H), namely the capital injection, the contingent grants and the guarantees, constitute State aid in favour of Banco Gallego pursuant to Article 107(1) TFEU.

(147) The Commission finds that the restructuring aid in favour of Banco Gallego, namely measures A through H referred to in section 2.6, is compatible with the internal market for reasons of financial stability on the basis of Article 107(3)(b) TFEU, subject to compliance with the commitments of the Term Sheet (Annex).

6 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
B-1049 Brussels
Fax No: (+32)-2-296.12.42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President

TERM-SHEET OF THE SPANISH AUTHORITIES' COMMITMENTS FOR THE APPROVAL OF THE RESTRUCTURING PLAN OF BANCO GALLEGO S.A. BY THE EUROPEAN COMMISSION
CASE SA.36500 (2013/N)

1. BACKGROUND

1.1. This document (the "**Term Sheet**") sets out the terms for the restructuring of Banco Gallego S.A. ("**Banco Gallego**"), which the Kingdom of Spain and Banco Gallego have committed to implement.

2. DEFINITIONS

In this document, unless the context requires otherwise, the singular shall include the plural (and vice versa) and the capitalised terms used herein have the following meanings:

AMC: Asset Management Company. Its legal name has already been established as Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria or SAREB.

The Buyer: The buyer of Banco Gallego namely Banco Sabadell, S.A..

Banco Gallego: Banco Gallego S.A., the subject of this term-sheet.

FTE: A full-time equivalent or FTE is a unit that indicates the workload of a person employed by Banco Gallego (including its fully-owned subsidiaries) who works full time.

Restructuring Plan: It is the document approved by the FROB that outlines the required restructuring of Banco Gallego in the context of the recapitalisation of the group by the FROB and is the base of this term-sheet. The Plan, in particular, defines the assets to be transferred by Banco Gallego to the AMC (or SAREB), the recapitalisation of Banco Gallego by FROB, the burden sharing exercise and the sale of Banco Gallego to the Buyer.

3. GENERAL

3.1. The Kingdom of Spain is to ensure that the Restructuring Plan ("the Restructuring Plan") for **Banco Gallego** submitted on 16 July 2013 is correctly and fully implemented.

3.2. The Kingdom of Spain is to ensure that the commitments listed below **("Commitments")** are fully observed during the implementation of the Restructuring Plan.

3.3. The restructuring period will end on 31 December [...]. The Commitments apply during the restructuring period, unless otherwise provided.

4. ADJUSTMENTS TO THE CURRENT PERIMETER OF THE BANK

The Restructuring Plan includes the execution of the following adjustments to the perimeter of Banco Gallego:

4.1. The transfer and/or contribution to the AMC of Banco Gallego real estate exposure falling within the following parameters defined by FROB:

a) all the loans to developers exceeding a net book value of €250,000

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

c) the corporate controlling holdings in real estate companies.

The gross value of these assets at Banco Gallego mounts to EUR […] million and the transfer value amounts to EUR […] million as of 31 December 2012.

5. RESTRUCTURING OF BANCO GALLEGO: SALE OF THE BANK

5.1. The Restructuring Plan consists in particular of the sale of Banco Gallego to the Buyer with a significant downsizing of the transferred activities.

(i) The activities of Banco Gallego will be reduced before the end of [...] by at least [10-20] % in terms of branches and by at least [10-20] % in terms of FTEs, as of 31 December 2012. To reach these targets, Banco Sabadell may indistinctly either reduce Banco Sabadell branches and employees or Banco Gallego's in those territorial areas where Banco Gallego is present. The net result is that after the business combination, in terms of current figures, at least [10-20] % of the Banco Gallego branches and [10-20] % of Banco Gallego FTE will be reduced.

No other undertakings will apply to the Buyer as a consequence of the transfer.

6. BURDEN SHARING MEASURES

6.1. Key principles

For holders of preference shares, perpetual and dated subordinated debt, burden sharing will be implemented through conversion of these securities into senior debt of Banco Gallego with a [1-5] % coupon or Macocos of Banco Sabadell.

(i) Should the latter be the case, when the conversion event occurs, these contingent convertible securities will be converted into shares of Banco Sabadell. Banco Sabadell may decide to give the holder of the shares an economic incentive for holding them.

6.2. Methodology for the conversion of preference shares and perpetual debt

For holders of preference shares and perpetual subordinated debt, 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.

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.

The discount factors to be applied to the dcm will be: a) [10-25] % for preference shares and other instruments of the same rank, b) [10-25] % for perpetual subordinated instruments and c) [5-10] % for dated subordinated instruments, with a premium of [15-40] % only in case of conversion into Macocos of Banco Sabadell.

The conversion rate will be maximum [70-100] % of the face value.

6.3. Specific provision for dated subordinated debt

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

(ii) Conversion into a new senior debt instrument of Banco Gallego 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 [1-5] % multiplied by the number of months to maturity with a floor of [25-40] %. The starting date for the calculation of the number of months will be 1 December 2012. The new senior debt instrument will have a [1-5] % coupon until maturity; and

(iii) Conversion into MaCoCos of Banco Sabadell according to the methodology of discounting the cash flows of the instrument ("dcm") with a premium of [15-35] %. When the conversion event occurs, these contingent convertible securities will be converted into shares of Banco Sabadell. Banco Sabadell may decide to give the holder of the shares an economic incentive for holding them.

7. MONITORING

In order to ensure a proper implementation of the restructuring plan and of the commitments it contains, the Spanish authorities will submit regular reports on the compliance measures taken. The first report will be submitted to the Commission not later than six months after approval from the date of notification of the Decision and thereafter at six-monthly intervals.