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Subject: **Formal ex-ante consultation on the classification of the *Sociedad de activos de Restructuracion* (SAREB)**

Ref.: **Your letter of 7 December 2012**
Eurostat letter of 21 December 2012
Your letter of 20 January 2013

Thank you for your letters dated 7 December 2012 and 20 January 2013, for the background documents, and for the answers to our questions. I would like to inform you of the preliminary view of Eurostat on the above-mentioned case

The case

The issue for which an opinion is being sought is a determination of the correct ESA95 accounting treatment of the classification of the *Sociedad de activos de Restructuracion* (SAREB).

Documentation provided

- View of the Spanish Working Group on General Government Issues (composed from INE, IGAE and Bank of Spain) on the National accounts sector classification of SAREB
- Background document on the main features of SAREB
- Bylaws of SAREB
- Framework Investment Agreements between SAREB`s shareholders
- Business plan of SAREB

Description of the case

The issue for which an opinion is being sought is a determination of the correct classification of the *Sociedad de activos de Restructuracion* (SAREB).

The Spanish Government created, in 2012, according to the Memorandum of Understanding on Financial Sector Policy Conditionality, a Special Purpose Entity, called SAREB.

SAREB is a company with a majority of private investors. The objective, as stated by government, is to reach a participation of around 55% of private investors. The governance of SAREB follows a standard legal structure, with a Board of Directors that will represent the shareholders according to their participation. SAREB is supervised by Bank of Spain in accordance with Royal Decree Law 1559/2012. In addition to this supervision, a multilateral committee will be incorporated with representatives from the Bank of Spain, CNMV, the Treasury, the Ministry of Finance and International bodies.

The sole purpose of SAREB is the purchase and management of assets from financial institutions that are currently in distress in the context of the financial crisis. The transfer price of the assets is based on their real economic value, with an additional haircut.

As regards the duration of the vehicle, its lifetime is temporary (15 years) and linked to the financial crisis.

Public institutions (FROB) retain around 45% of SAREB's equity and subordinated tranche, while the remaining part is retained by private investors (comprising most domestic financial institutions and two foreign banks). The total equity will be 8% of total assets (6% subordinated debt and 2% equity). The subordinated debt pays an 8 % coupon only if net income is positive.

The Group 1 banks transferred, in December 2012, 45 billion euro of assets and the Group 2 banks transferred 15 billion euro in March 2013.

SAREB will have a subordinated tranche estimated at 4 billion euro (subordinated to the senior tranche guaranteed by government). This subordinated tranche will be defined to guarantee the absorption of potential losses over the Business plan. The subordinated tranche will be majority private-owned (around 55%).

Methodological analysis and clarification by Eurostat

Applicable accounting rules

- The Eurostat ESA95 Manual on government deficit and debt (MGDD), 2012 edition
- Decision of Eurostat on deficit and debt: The statistical recording of public interventions to support financial institutions and financial markets during the financial crisis (15 July 2009)

Availability of national accounting analysis

The Spanish Working Group view is that:

- SAREB is a separate institutional unit, having full governance capacity and autonomy of decision;
- It is a privately-controlled institutional unit, mainly owned and controlled by private investors (more than 50%);
- It is created with a temporary duration (15 years) and solely linked to the liquidation of the impaired assets generated in the context of the financial crisis;
- It will acquire the assets at a price based on real (long-term) economic value, calculated individually by an independent third party and closely monitored by the European Commission, the ECB and the IMF. These valuations were also used in the stress tests made in September 2012;
- Considering the business plan of SAREB, the company will not have significant future losses (the business plan foresees an expected rate of return of around 14%).

According to the Spanish Working Group, SAREB is a majority privately-owned and privately-controlled entity, with autonomy of decision, established for a temporary duration having the purpose to address the management and liquidation of impaired assets generated in the context of the financial crisis and not expecting significant losses in comparison with the total size of its liabilities, according to its business plan.

Following the Manual on Public Deficit and Debt, 2013 edition, page 181, footnote 29, the Spanish Working Group view is that SAREB should be classified outside the general government sector, and more precisely, in the financial institutions sector (S.12) as another financial intermediary (S.123).

Methodological analysis and clarification by Eurostat

As stated in Eurostat's decision on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis (15 July 2009), five main conditions are to be met in order that such a special purpose entity could be classified outside the general government:

- it is an institutional unit;
- it is majority privately owned;
- the main purpose of the new unit must address solely the financial crisis;
- the unit is established with a short, temporary duration;
- the expected losses that the unit will bear must be small in comparison with the total size of the liabilities.

Institutional unit

According to the analysis of the Spanish statistical authorities, SAREB will be governed on a day-to-day basis by its board of directors. This board will be highly technical and professional and will work following the standard principles of corporate governance.

As a company the SAREB will be a separate legal entity entitled to own goods and assets in its own rights, have autonomy of decision in its day operations, be able to incur liabilities on its own behalf, and have complete accounting information.

The Spanish statistical authorities also confirmed that FROB[1], as public institution, has no specific and exclusive right of any kind. No *Golden Share* right has been granted or any similar benefit that may increase the control capacity of SAREB by the FROB. FROB has the same voting rights that any other equity investor and is limited to its participation on the vehicle.

The SAREB governance follows the standard legal structure, with a Board of Directors (BoD) that represent the shareholders according to their participation. 30% of the BoD are independent while the remaining 70% represent the shareholders. The BoD was defined and approved in the General Shareholders Meetings held in December 2012 with all shareholders represented and with majority of private voting rights at this meeting. Four members of the BoD are representatives of FROB, six represent the private shareholders and five members are independent. Two executive members are board representatives on behalf of FROB.

Majority privately owned

As of February 2013, the total company's equity (equity and sub-ordinated debt) amounted to 4.8 billion euro. Altogether, SAREB's private partners make a joint

[1] Fund for Orderly Bank Restructuring

contribution of 2.6 billion euro and the FROB (public partner) provided 2.2 billion euro. SAREB has 54 % private capital and 46 % public capital.

It seems that all private shareholders are privately owned companies, retain all risk and are not protected by any additional bilateral agreements with the Spanish government.

The purpose of the unit

According to the analysis of the Spanish statistical authorities, the sole purpose of SAREB is the purchase and management of assets from financial institutions that are currently in distress in the context of the financial crisis. SAREB is required to purchase assets as defined in the legislation and in the Memorandum of Understanding on Financial Sector Policy Conditionality.

The duration of the unit

As regards the duration of the unit, the legislation on SAREB clearly states that its lifetime is temporary and linked to the financial crisis. The Memorandum of Understanding sets out a projected timeline of 15 years for divestment of the unit's assets of that period.

The size of expected losses

Concerning the expected losses for government, the Decision does not set a quantitative threshold, therefore a rather detailed analysis has to be carried out, especially of the guarantee arrangements, the design of the scheme and the elements which will be in place to reduce the risks for government arising from the entity.

Regarding guarantees, the majority of the bonds issued by the SAREB itself to finance the purchase of assets are guaranteed by government. The subordinated debt issued by SAREB is not guaranteed by government, and its repayment is conditional on the unit making a profit.

The dividend payment is permitted only under very limited conditions. Dividends paid will be based on the excess cash flow defined in the Cash Protocol. 92% of the excess cash will be applied to ordinary/early amortization of the senior guaranteed notes. The remaining 8 % will be retained during the first 4 years and then will be applied either to subordinated debt early amortization and/or to dividend payment under condition that net income is positive. No minimum guaranteed dividend is assured.

Moreover, it was further clarified by the Spanish statistical authorities, that to ensure compliance with the exceptional purposes for which SAREB has been incorporated, and taking into account the concurrent public interests, in accordance, a reinforced majority in the shareholders' meetings (at east ninety five percent of the subscribed voting shares) shall be required for resolutions relating to the approval of a proposal for distribution of SAREB's profits provided that it has issued fixed-interest debt securities and provided that such issuances entail guarantees granted by public authorities.

The prices paid for the assets of banks in distress, take into account approximately a reduction of 63% on the gross carrying amount for foreclosed assets and of 45.6% on loans. The first loss (that will arise as the difference between book value and the transferred value) will be crystallized in the participating financial institution at the moment of the separation and, therefore, it will not be assumed, neither by SAREB nor by the Spanish government guarantee on the debt securities issued.

The Spanish statistical authorities provided an updated Business Plan. According to this plan, the company is estimated to have expected return on equity of around 13%.

Conclusion

Eurostat agrees with the Spanish statistical authorities' analysis that SAREB should be classified in the financial corporations sector.

Procedure

This preliminary view of Eurostat is based on the information provided by the Spanish authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009 and the note on ex-ante advice[2]. Eurostat therefore publishes all official methodological advice (ex-ante and ex-post) given to Member States on its website. In case you have objections to the publication of this specific case, we would appreciate if you would let Eurostat know before 28 March 2013.

Yours sincerely,

François Lequiller
Director

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[2]http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/EUROSTAT_ADVISE_19_JULY_2006.pdf