FROB Fondo de Reestructuración Ordenada Bancaria

TESTIMONY OF THE CHAIRMAN OF THE GOVERNING COMMITTEE OF THE FROB BEFORE THE PARLIAMENTARY SUBCOMMITTEE ON BANK RESTRUCTURING AND FINANCIAL CLEAN-UP

10 September 2013

Honourable Members of Parliament,

As required by the control mandate contained in Article 56 of Law 9/2012 of 14 November 2012 on credit institution restructuring and resolution, I come before this Subcommittee on Bank Restructuring and Financial Clean-up as Chairman of the Governing Committee of the Fund for the Orderly Restructuring of the Banking Sector (FROB). This third testimony is to inform you of the activities of the FROB since 24 April, the date when I last appeared before you. Before I describe the specific situation at each of the institutions, let me give a brief general introduction on the progress of the financial restructuring process as a whole.

INTRODUCTION

I would like to begin by recalling that in early July the conclusions of the third review envisaged in the Memorandum of Understanding (MoU) were made public. The reports issued in this respect by the European Commission and the International Monetary Fund coincide in that the measures envisaged in the MoU are being properly applied and are achieving the objectives set.

As regards compliance with the restructuring plans, the reports view positively the significant advances made to date and emphasise that they have strengthened the financial position of the Spanish banking system as a whole.

Specifically, the divestment programmes imposed on banks in their respective plans are being satisfactorily executed, the capacity adjustment programmes are proceeding appropriately, and the banks have readjusted their balance sheets, which has improved their efficiency, liquidity and solvency indicators.

In fact, notably the three basic measures for financial restructuring and clean-up set out in the plans of the group 1 and 2 institutions have now been executed. According to the MoU nomenclature, these groups refer respectively to the banks majority owned by the FROB and the banks with capital shortfalls unable to meet those capital shortfalls privately without having recourse to State aid.

Thus, after a total of €39,078 million of funds were injected into these banks and real estate assets for a net amount of nearly €51,000 million were transferred to the Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria (asset management company for assets arising from bank restructuring, hereafter "Sareb" by its Spanish acronym), of which measures I informed you in my previous testimony, the burden-sharing exercises have now been completed. These were implemented by means of hybrid capital and subordinated debt instrument management exercises – except at Banco Gallego, where they will foreseeably take place in some days' time – which have generated additional capital for a gross amount of approximately €13,600 million for the banks.

The burden-sharing exercises are responsive to the basic principle enshrined in Law 9/2012 and in the MoU of minimising the use of public funds in restructuring and resolution processes. This means that the holders of hybrid capital and subordinated debt instruments have to contribute to the recapitalisation of the banks affected by these processes, although they have to do so in accordance with the order of seniority of their securities and, in any event, once the shareholders have taken losses to the extent possible.

The shareholders have taken losses as a result of the reduction of their holding in the banks based on the FROB's economic valuation of it and because of the dilution caused by the capital injections by the FROB. The hybrid capital and subordinated debt instrument management exercises involved certain haircuts on the nominal value of the securities and subsequent reinvestment of the remaining value in shares and other similar capital instruments.

The FROB's actions, like those of the other authorities involved, have, however, sought to make the aforementioned principle of burden sharing compatible with mitigating to the greatest possible extent the costs borne by the most vulnerable investors. To this end, arbitration proceedings were undertaken at the nationalised banks for the investors affected by the deficient marketing of hybrid instruments and liquidity mechanisms set up so that the assets received in the exchange processes can be more easily converted into cash.

Also, the time period has expired for submitting claim applications in arbitration proceedings on the marketing of preference shares and subordinated debt instruments initiated by Bankia, NCG Banco and Catalunya Banc (CX), and the analysis of them will foreseeably be well advanced by the end of this year.

As I informed you in my testimony on 24 April, the need to alleviate the particularly unfavourable situation of the investors affected by burden-sharing exercises who receive unlisted shares in the exchange of their preference shares and subordinated debt instruments – a situation which is not expected to change in a reasonable time span – prompted the design of mechanisms to provide liquidity to these instruments.

Specifically, Article 2 of Royal Decree-Law 6/2013 of 22 March 2013 on protection of the holders of certain saving and investment products and other financial measures provides for the subscription or purchase by the Deposit Guarantee Fund (DGF) of ordinary shares not listed on a regulated market which are issued by banks that have received State aid, within the framework of the aforementioned hybrid capital and subordinated debt instrument management exercises.

In compliance with this provision, the DGF, pursuant to resolutions of its Management Committee of 4 and 7 June 2013, in conformity with paragraph 4b) of the fifth additional provision of Royal Decree-Law 21/2012, made a voluntary offer to purchase the shares unlisted on a regulated market of NCG Banco and Catalunya Banc subscribed within the framework of the hybrid capital and subordinated debt instrument management exercises. This offer was addressed only to those who on 23 March 2013 were holders of preference shares and subordinated debt instruments and who were moreover retail customers, in accordance with Article 78 bis of Law 24/1988. This offer to purchase ordinary shares was made on the terms and conditions published on the websites of the issuing banks, the DGF and the Spanish National Securities Market Commission, under the “significant event” heading, and in a newspaper with a nation-wide circulation and in a newspaper of the region in which the issuer’s registered office is located. The terms and conditions of the share purchase offer and the result thereof will be announced forthwith once the analysis of each of the banks has been completed.

The hybrid instrument management exercises of each of the banks have some common features, since the security valuation rules and the criteria followed to determine the discounts applicable on the basis of the security class coincide.

Nevertheless, there are substantial differences which I will analyse in detail for each bank. They arise from commitments to European institutions, from requirements imposed by recapitalisation plans on the percentage of share capital owned by the holders of these securities, from the minimum thresholds of acceptance of the exchange and from the generation of a minimum amount of core capital as a result of its implementation.

I will now describe the specific actions taken by the FROB under the resolution and restructuring plans since last April at each of the banks in Groups 1 and 2, as well as those relating to Sareb.

I will also inform you of the current situation of the arbitration proceedings relating to the marketing of preference shares and subordinated debt instruments, the progress made in the legal actions initiated by the FROB in relation to various credit institutions and the financial position of the FROB, whose annual accounts were approved last July.

NCG BANCO, S.A.

As you will recall, the resolution plan of NCG Banco recognised initial capital needs of €5,425 million after calculation of the effect of asset transfers to Sareb and of hybrid management exercises. Those €5,425 million were injected through the ESM pursuant to a resolution of the Governing Committee of the FROB of 26 December 2012. The transfer of real estate assets to Sareb was made with effect from 31 December. Meanwhile, the implementation of the hybrid management exercises was mandated in the resolution of the Governing Committee of the FROB of 7 June 2013.

The hybrid instrument management exercises implemented were directed at the holders of these securities of NCG Banco, the outstanding amount of which was €2,047 million.

The average haircut applied for the issues as a whole was 30%. The actions taken included repurchase, following application of the related haircuts, of preference shares and of perpetual subordinated debt instruments, and the reinvestment of the repurchase amount in ordinary shares of the bank. The holders of fixed-term subordinated debt instruments were given a choice between reinvesting in shares of the bank with the specified haircut or investing, with a larger haircut, in senior securities with the same maturity date as the repurchased securities and a 2% yield payable upon maturity. The implementation of these hybrid capital and subordinated debt instrument management exercises has had a positive impact on the bank's net worth of approximately €1,959 million, before tax, which has reduced the need to resort to public funds.

Naturally the final impact on net worth may vary depending on the result of the court and arbitration proceedings which have been or may be initiated in the future.

The time period for submitting applications for arbitration, which began in July 2012, has now expired. The applications admitted amount to €497 million, providing an alternative solution to hybrid management exercises for approximately 58,000 customers, who represent 49.8% of the total.

In addition, as I noted earlier, the DGF made, on an exceptional basis, a voluntary offer to purchase ordinary shares of NCG Banco subscribed within the framework of the hybrid capital and subordinated debt instrument management exercises. The offer was addressed only to those who on 23 March 2013 were holders of preference shares and subordinated debt instruments and who were moreover retail customers, in accordance with Article 78 bis of Law 24/1988.

The offer was formulated as a purchase of shares for a per-share cash consideration received by the seller and resulting from the application of a discount of 13.8% due to illiquidity. This discount was determined on the basis of a report by an independent expert in accordance with Article 4 of the fifth additional provision of Royal Decree-Law 21/2012.

The deadline for accepting the aforementioned offer was 12 July. The offer was taken up by the holders of shares representing 25.6% of the share capital of NCG Banco, equivalent to 89% of the shares to which the offer was addressed. The total cost for the DGF was €801.7 million.

After the aforementioned operations, the FROB is the main shareholder of the bank with 62.75% of the capital, the DGF holds 25.57% and the rest is owned by the former holders of hybrid products and subordinated debt instruments.

As you know, another of the actions required of banks under their restructuring plans, which is vital for their successful recapitalisation, is that of divestment. Thus, the actions by NCG Banco to reduce its structure in this period include the sale of 66 offices to Banco Etcheverría, and yesterday it made public the disposal, for €60 million, via a competitive bidding process, of the EVO Banco business unit to a US bank called Apollo. This business unit will, once authorised by the Banco de España, be organised as a separate financial institution through the segregation of the banking business of the 80 NCG Banco branches currently operating under the EVO Banco brand.

Simultaneously with these processes, in July the FROB decided to commission BNP Paribas to carry out a detailed analysis of the assets (portfolios and business units) in order to estimate the price the FROB could reasonably obtain for the sale, by a competitive process, of the shares of NCG Banco.

Work is practically finalised on the preliminary analysis which has to be made before the decision can be made to initiate the possible competitive process. If it goes ahead, it will foreseeably start in the closing days of this month of September.

BANCO GALLEGO

As I said in my previous testimony, originally the resolution of Banco Gallego was included in the resolution plan of NCG Banco, which required either its sale by 30 April 2013 or, failing that, its orderly winding up.

As you will recall, following the transfer of assets to Sareb and the reduction and simultaneous increase in capital which was decided and carried out in January and February, a competitive process was initiated to divest the holding of NCG Banco in Banco Gallego. To this end, NCG Banco engaged Mediobanca to act as the investment bank and, on 19 April 2013, the Governing Committee of the FROB decided to award Banco Gallego to Banco Sabadell because it considered that its offer was the most competitive in accordance with the valuation criteria set and from the standpoint of optimising the use of public funds. The details of the offer, which entails a capital injection of €245 million by the FROB, as well as additional guarantees, with obvious advantages over the alternative of winding-up estimated at a cost of more than €930 million, were given in my previous testimony, so I will now limit myself to informing you of the actions being taken to complete the process.

On 23 April 2013 a resolution plan for Banco Gallego was approved. It encompasses both the provisions included previously in the NCG Banco resolution plan and the new commitments derived from the sale agreement.

As part of the sale process, on 9 May 2013 the Governing Committee of the FROB proposed to the Banco de España the provisional replacement of the board of directors of Banco Gallego and the designation of the FROB as provisional director. On 17 May 2013 the Executive Commission of the Banco de España approved both the Banco Gallego resolution plan and the provisional replacement of its board of directors. On 22 May 2013 the Governing Committee of the FROB resolved to appoint Mr José Manuel Oliver Martínez as the individual who will administer and direct Banco Gallego for and on behalf of the FROB.

Regarding the hybrid capital and subordinated debt instrument management exercises, on 4 July 2013 the Governing Committee of the FROB, and a day later, the Executive Commission of the Banco de España approved the amendment of the Banco Gallego resolution plan for the purpose of making a change in the mandatory hybrid capital and subordinated debt instrument management exercise with respect to the initially envisaged one. As a result, the mandatory exercise requiring the subscription of senior debt of Banco Gallego is combined perfectly with the alternative posed by the purchaser, Banco de Sabadell, in order to offer the subscription of equity instruments of that bank.

This new resolution framework for Banco Gallego was approved by the European Commission at the end of July and the hybrid capital and subordinated debt instrument management exercises will be implemented in the next few day of September, giving full effect to the purchase by Banco Sabadell.

CATALUNYA BANC, S.A (CX)

The resolution plan of Catalunya Banc recognised initial capital needs of the bank which, after transfer of assets to Sareb and consideration of the hybrid management exercises, stood at €9,084 million, which were injected through ESM funds in accordance with a resolution of the Governing Committee of the FROB on 26 December 2012. The real estate assets were effectively transferred to Sareb on 31 December 2012 in accordance with the aforementioned plan. The hybrid capital and subordinated debt instrument management exercises were carried out further to a resolution of the Governing Committee of the FROB of 7 June 2013.

These hybrid instrument management exercises implemented were directed at the holders of securities representing an outstanding amount of €1,818 million, with an average haircut of 25% for the total issues.

The actions taken consisted of the repurchase, following application of the related haircuts, of preference shares and of perpetual subordinated debt instruments, and their reinvestment in ordinary shares of the bank. The holders of fixed-term subordinated debt instruments were given a choice between reinvesting in shares, after application of the related discounts, or investing, with a larger haircut, in senior securities with the same maturity as the repurchased securities and a 2% yield.

These hybrid instrument management exercises have had a positive impact on the bank's net worth, before tax, of approximately €1,676 million, although this amount may vary depending on the result of the court and arbitration proceedings which have been or may be initiated in the future.

The time period for submitting applications for arbitration, which began in October 2012, has now expired. Applications have been accepted by the independent expert from 28,474 customers of the bank, i.e. 36% of the total, representing an amount of €259 million. To date, positive arbitral awards have been obtained by 13,135 holders, representing a volume of €158 million. As in the case of NCG Banco, the DGF made, on an exceptional basis, a voluntary offer to purchase ordinary shares of Catalunya Banc subscribed within the framework of the hybrid capital and subordinated debt instrument management exercises. The offer was addressed only to those who on 23 March 2013 were holders of preference shares and subordinated debt instruments and who were moreover retail customers, in accordance with Article 78 bis of Law 24/1988. The offer was made on the same terms and conditions and with the same requirements as for the purchase of ordinary shares of NCG Banco, so I refer you to my earlier description of them.

The offer was taken up by the holders of shares representing 32.3% of the share capital of Catalunya Banc, equivalent to 97.1% of the shares to which the offer was addressed. The total cost for the DGF was €1,000.9 million.

Now that the recapitalisation, the hybrid management exercise and the DGF's offer have been completed, the FROB is the main shareholder with 62.75% of the capital and the DGF holds 32.3%.

Further, within the procedure for reorganising the governing body, on 10 May 2013 the terminations of Mr Adolf Todó Rovira and Mr Jaume Masana i Ribalta as Chairman and Managing Director, respectively, of the bank were declared effective and Mr José Carlos Pla was appointed as Chairman of the bank.

Finally, as a result of a competitive process, in July the Governing Committee of the FROB awarded to the firm N+1 Corporate Finance a contract for the analysis and possible sale of Catalunya Banc. Its purpose is to make a detailed study of the assets (portfolios and business units) in order to estimate the price the FROB could reasonably obtain for the sale, by a competitive process, of the shares of Catalunya Banc. Once the value of these assets has been estimated, the FROB, based on an examination of the data and valuations obtained, will decide whether or not it is appropriate to initiate a competitive sale process, given that the plan envisages the resolution of the bank within a maximum period of five years.

BFA-BANKIA

The capital needs for the bank recognised in the restructuring plan prompted an injection of ESM funds amounting to €17,959 million which was carried out pursuant to a resolution of the Governing Committee of the FROB dated 26 December 2012, although on 3 September 2012 the bank also received an initial advance of funds from the FROB amounting to €4,500 million.

Subsequently, as you will remember, on 16 April 2013 the Governing Committee of the FROB issued a resolution containing the necessary agreements for completing the recapitalisation of the BFA-Bankia Group. These agreements comprised a capital reduction by means of a reduction of the nominal value of the shares from two euro to one cent - a reverse split operation to ensure that the shares trade normally - and two capital increases. The first capital increase has a preferential subscription right, is guaranteed by the FROB through BFA and amounts to €10,700 million, and the second capital increase is for an amount of up to €5,210 million to comply with hybrid capital and subordinated debt instrument management exercises.

The hybrid instrument management exercises were addressed to the holders of these securities which represented an outstanding amount of €6,911 million. They had a positive impact on the bank's net worth of approximately €6,669 million, before tax, an amount which considerably reduces its capital needs, on one hand, by generating income due to the haircut on the nominal value and, on the other, through the reinvestment of capital. In this case, the outline of the exercise is identical to that in the case of the previous banks, although in accordance with the European Commission's criterion in relation to the percentage of ownership of the FROB and of the new shareholders, the amount was reinvested in ordinary shares of the bank at the same subscription price as that for the FROB. This means that the holders of the hybrid capital and subordinated debt instruments absorbed the proportional part of the bank's negative economic value.

After the above-mentioned agreements of the FROB had been completely implemented and, consequently, the group had been fully capitalised, BFA, whose sole shareholder continues to be the FROB, became the owner of 68.39% of Bankia's shares.

Lastly, the period for receiving claim applications in the arbitration procedure on the marketing of preference shares and subordinated debt instruments began on 18 April at BFA-Bankia and ended on 16 July.

On the latest data, a number of claims relating to 108,425 customers of the bank have been admitted by the independent expert, which means that to date, claims have been admitted for 37% of customers representing a total of €821 million. The positive arbitral awards made to date represent €84 million, corresponding to 18,737 customers. The bank envisages that the arbitration process, taking into account the experience in this period, will last at least until end-2013 and may even run into the first-half of 2014.

GROUP 2 BANKS

Next I will describe in detail the latest action taken in relation to the banks included in Group 2. These banks in which the FROB did not initially have a stake, had to resort to State aid to resolve their capital shortfalls and they include Banco Mare Nostrum, Banco CEISS, Banco Caja3 and Liberbank.

As you will recall, the plans of Group 2 banks were approved by the European Commission on 20 December, following their endorsement by the national authorities (the FROB and the Banco de España).

The latest measures applied to each of the Group 2 banks and their specific implementation are as follows:

- **Banco Mare Nostrum (BMN)**

BMN's recapitalisation plan recognised a final capital need of €730 million which was covered by the FROB's subscription in March 2013 of newly-issued ordinary shares of BMN.

Once its assets had been transferred to the Sareb, on 27 May the Governing Committee of the FROB issued the resolution implementing the hybrid capital and subordinated debt management exercises. These exercises were addressed to the holders of securities which represented an outstanding amount of €449 million. The average haircut on all issues stood at 26%.

The implementation of the hybrid capital and subordinated debt instrument management exercises had a positive impact on the bank's net worth of €425 million, via a capital increase and a reduction in nominal value. As a result of the operations to recapitalise the bank, the FROB owns 65% of its capital and the remainder is owned by the founding savings banks and third parties.

Lastly, as part of the divestment process that the bank had to undertake in compliance with the plan, on 31 May 2013 the network of Caixa Penedés was sold to Banco Sabadell. This sale was an essential step in the recapitalisation of the bank, since it enabled it to reduce the size of its balance sheet by approximately €10,000 million (€9,500 million of which relate to loans) and transfer 462 offices and 2,019 employees.

- **Banco CEISS**

As you will recollect, during my last testimony I informed you about a possible corporate transaction with Unicaja Banco which was being analysed by the FROB and the Banco de España together with the European authorities. This had delayed the injection of €604 million of public funds envisaged in the plan until the definitive terms of the offer became known and were included in the bank's resolution plan. This delay is justified by the benefits that the operation may bring to the banks involved and to the public purse.

Faced with the bank's urgent need to strengthen tier 1 capital, and while the plan was being amended, on 24 April it was necessary to inject the above-mentioned public funds. Nevertheless, in order to make it more compatible with the offer that might be submitted, it was implemented, instead of through the subscription of ordinary shares of Banco CEISS, as envisaged in the initial plan, through the subscription of contingent convertible bonds. These instruments set a precedent for the repayment of State aid, which contributed to reducing the risk borne by taxpayers.

On 9 and 10 May 2013, the FROB and the Executive Commission of the Banco de España approved respectively the modification of the Resolution Plan of Banco CEISS of 19 December 2012 in order to adapt it to the offer which would be submitted by the Unicaja Group for the purchase of Banco CEISS, S.A. On 13 May 2013, the European Commission validated this modification.

The Governing Committee of the FROB, pursuant to the resolution of 16 May, decided on the bulk of the recapitalisation which included most of the hybrid capital and subordinated debt instrument management exercises. These exercises were completed on 15 July with the exchange of the only two remaining subordinated debt issues, once Unicaja had specified the terms of its offer and the estimation of the bank's capital needs had been updated. The exercises undertaken were unique due to the conditions of Unicaja's offer. Thus, the majority holders had to necessarily reinvest in the share subscription, whereas the minority holders had to reinvest in another capital instrument, namely the mandatory and contingent bonds convertible into shares of Banco CEISS. The exercises undertaken affected an outstanding amount of €1,433 million and had a positive impact on the bank's net worth amounting to €1,351 million.

On 15 July, Unicaja Banco made public the terms of the offer which it plans to address to 100% of the shareholders and holders of mandatory and contingent convertible bonds of Banco CEISS, excluding the FROB. Unicaja will offer to institutional investors newly-issued shares of Unicaja Banco in exchange for the shares of CEISS and to minority investors of Banco CEISS a combination of contingent bonds (Cocos) and bonds mandatorily convertible into shares

(ManCocos by their Spanish abbreviation) of Unicaja Banco. This offer will be conditional upon a minimum acceptance percentage of 75%. Also, the Unicaja offer would include the commitment to request listing on Spanish securities markets within a maximum period of three years from the implementation of the exchange offer, which would mean liquidity in the medium-term for the holders of instruments in CEISS which accept said offer.

As envisaged in the resolution plan, should this offer not actually be made or not obtain the minimum acceptance percentage established, the FROB would proceed to acquire a controlling stake in the bank by converting the contingent convertible bonds it owns into shares. In any event, the timetable established envisages that the offer might be authorised by the CNMV next month.

- **Banco Grupo Caja3**

The restructuring plan of Banco Grupo Caja3 is being pursued within the framework of the bank's integration with Ibercaja Banco.

On 23 May 2013, Ibercaja Banco and Banco Caja3 signed a definitive integration contract which meant that Ibercaja Banco acquired 100% of Banco Grupo Caja3 through a share exchange process.

For this purpose, Ibercaja Banco resolved to increase capital by €325.5 million which was subscribed by the three savings banks constituting Banco Grupo Caja3 for a consideration consisting of all the group's share capital.

The process will be completed at end-2014 with the merger by acquisition of Caja3 by Ibercaja Banco.

Since 25 July 2013 the joint holding of the shareholder savings banks of Banco Grupo Caja3 (CAI, Círculo Católico Burgos and Caja Badajoz) in Ibercaja Banco has increased to 12.2%.

As you will remember, Banco Grupo Caja 3 received public financial support amounting to €407 million, in the form of the subscription by the FROB of mandatorily convertible bonds.

Having transferred assets to the Sareb, the bank had to perform, in accordance with the recapitalisation plan, a voluntary hybrid capital and subordinated debt management exercise, conducted by the bank itself, addressed to the holders of these securities, which in this case were all majority investors. If this exercise did not obtain the acceptance percentage or generate minimum capital, a compulsory exercise would be imposed by the FROB.

Both the voluntary and compulsory hybrid instrument management exercises were adopted in June 2013. The exercise resolved by the FROB only affected one issue whose security holders did not accept the voluntary exchange proposed by the bank.

The exercises have had a positive impact on the bank's net worth of approximately €44 million, via capital and the gains obtained in the exchange of subordinated debt for senior debt.

- **Liberbank**

At the time of my last testimony, Liberbank had implemented both the voluntary hybrid instrument management exercise required by its restructuring plan, and the compulsory one required by the FROB when it failed to obtain the acceptance percentage imposed by such plan.

However, for the process of recapitalisation of Liberbank to be completed as planned, its shares had to be listed.

On 16 May Liberbank was floated by means of a listing procedure, without the need for a public offering. The opening price of the shares was €0.40, and they are currently trading at slightly above €0.44.

In order to offset the risk of fluctuation of the price of the securities delivered in that exercise, the founding savings banks (Grupo Cajastur, Caja Extremadura and Caja Cantabria) have offered a loyalty plan to the retail customers who previously held the securities subject to the exchange. This plan means that the savings banks assume, at their own liability, part of the risk of a loss of value on the securities acquired in the exchange by investors who have promised not to dispose of them for two years.

Sareb

Allow me to refer briefly to the asset management company for assets arising from bank restructuring (Sareb), which, as you know, is one of the essential components of the financial reform. Sareb was formally set up on 28 November 2012, and on 31 December 2012 it received the assets of the Group 1 banks which, under Law 9/2012, had to be transferred to it. This transfer was completed on 28 February this year with the assets from the Group 2 banks. In total, real estate and loans for real estate development amounting to €50,781 million were transferred.

The FROB holds 45% of the capital of the company and a similar percentage of its subordinated debt. The rest of Sareb's equity is in private hands.

Since its incorporation, the company has made a considerable effort to become fully operational as fast as possible. This has enabled Sareb's commercial activity to make rapid progress with the sale of real-estate and financial assets through the three channels planned: sales of wholesale portfolios, sales of single assets and retail sales through the transferor banks.

With respect to the company's financial information, it should be noted that Sareb's annual accounts for 2012 were approved by the shareholders in general meeting last May. They cover the period from 28 November to 31 December 2012, and they have been audited by PricewaterhouseCoopers. The auditor's opinion was not qualified. A loss was reported for the period of €5.5 million, basically stemming from external services and financial expenses.

In accordance with Royal Decree 1559/2012, within the next few weeks Sareb will publish its first half-yearly report on activity, covering the first half of 2013.

For Sareb, 2013 is a year replete with logistical and financial challenges: on top of the need to make rapid progress in setting up systems, getting to know and controlling the management of the portfolio and launching the various marketing channels, Sareb is bearing a full year's interest burden while its commercial activity really only commenced in the second quarter.

LEGAL ACTION AND PRIOR ACTION PROTOCOL

As regards the legal action taken by the FROB, you already know that the FROB takes an active role in the detection of any irregular conduct at those banks of which it has been appointed provisional administrator or to which it has provided financial support. As I have already mentioned in previous testimony, in order to identify possible criminal liability and to minimise the costs of such proceedings, the FROB has commissioned independent experts to analyse the irregular operations or operations of doubtful economic rationality carried out by the previous managers of these banks. This has enabled up to ten criminal actions to be launched, against officers or ex-officers of the banks and third parties, in which alleged offences relating to the real-estate business and their remuneration are being investigated.

As a result of the experience gained in these criminal actions, in this quarter the Governing Committee of the FROB approved the action protocol for the investigation and analysis of operations, carried out over the last five years, which have had a significant financial impact on the bank and show signs of irregularity or do not have any logical economic purpose. The protocol was notified to the banks concerned at the beginning of May, and each of them has adopted the measures necessary to implement it through investigation of the suspicious operations. Currently, the FROB is analysing reports drawn up or in the process of being drawn up by the internal audit departments of those banks that have detected suspicious operations, to assess the advisability of hiring the services of external parties specialised in forensic analysis so that, if applicable, they can continue the investigation work and enable more legal proceedings to be launched to identify possible liabilities.

During the coming months this activity will be one of the main aspects of the FROB’s work, so that the principles and objectives of the resolution can be implemented and fulfilled. Principal among these is that officers, directors or third parties who have generated costs or losses should contribute, in accordance with the applicable law, to covering the costs of restructuring or resolution. However, the principle of legal certainty, which must characterise the actions of the FROB, should be strictly observed in this area too. In particular, the deadlines for having sufficient information, signs and evidence available to establish a well-founded case regarding the alleged irregularity of the conduct must be met.

FINANCIAL POSITION OF THE FROB

The Governing Committee of the FROB, at its meeting of 18 July, approved the annual accounts of the FROB for 2012. These had been prepared in accordance with the General Chart of Accounts and the auditors had issued an unqualified opinion on them. The accounts of the FROB are – unavoidably – strongly influenced by the situation of the ongoing restructuring process, in which the banks have already been recapitalised and the foundations have been laid for their restructuring, although this will, take several years to carry out. Accordingly, the evolution of the FROB's accounts will largely depend on the results of the divestment processes and, more generally, the developments in the financial sector.

The 2012 accounts reflect the financial support provided to the Group 1 banks (BFA-Bankia, Catalunya Banc, NCG Banco and Banco de Valencia). The funding of these capital injections involved a major increase in the size of the FROB's liabilities. In December 2012, the State granted the FROB a loan of €39,468 million, which covers the recapitalisation of the Group 1 banks and Sareb. However, it does not include the Group 2 banks, since the injection of funds into Sareb was made in February 2013. The loan from the Treasury to the FROB took the form of ESM bonds, since the European assistance was channelled through this instrument.

A loss of €26 billion was reported for the period. This figure is basically the result of recording, following the principle of prudence, significant impairment of investments, as a result of valuation reports commissioned, in accordance with Article 5 of Law 9/2012, from independent experts, and based on the financial hypotheses envisaged in the plans. These valuations do not prejudge the value recoverable through the divestment processes and, therefore, do not amount to the recognition of losses or profits arising from a possible disposal of the holdings in the various banks. These may only be determined when the restructuring and resolution processes are carried out, and following divestment by the FROB from each of the banks in which it currently has an equity stake.

As a consequence of the significant impairment, the FROB's net worth stood at €-21,831 million, a figure that includes the €6 billion increase in funding of the FROB carried out by the State in June 2012. In order to restore the financial position of the FROB, progress is being made on a recapitalisation through the conversion into equity of the €27 billion loan granted by the Treasury, for which the required ESM authorisation has been obtained.

In any case, the FROB has sufficient cash to meet its short and medium-term commitments. As at end-June 2013, the FROB held uncommitted cash amounting to €12,137.5 million, which was invested in government debt and short-term deposits at credit institutions and at the Banco de España.

With regard to operating costs, the reform of the FROB following the entry into force of RD-Law 24/2012 (now Law 9/2012), which grants it the status of a resolution authority, with a vast range of administrative and commercial powers, made it necessary to provide it with a structure and resources appropriate for its functions. As a result, in the first quarter of 2013, a recruitment process was conducted to provide the FROB with the minimum level of staff needed and the FROB moved from its original offices to new ones commensurate with its new size. This has led to a rise in operating costs, under items such as personnel costs and rentals. A fundamental principle observed throughout this process of design and launch of the FROB has been that of austerity, with the use whenever possible of human resources already existing in the public sector. Likewise, when the FROB's new offices were being selected, the most advantageous opportunities and prices were considered, and the building eventually selected is a publicly owned one. Finally, the growth of the workforce and its specialisation in an area as complex as the resolution of credit institutions, means that the costs incurred in the purchase of external services, which were previously needed owing to the lack of human resources, can be reduced now and in future.

With regard to purchases of services and supplies, the principles of public procurement have been observed, wherever possible. The special features of the FROB, and the fact it is subject to both public and private law, have determined its access to the services of third parties. These have been indispensable, insofar as Law 9/2012 has required it to use the services of valuers and independent experts, and to organise divestment processes, with advisers and investment banks, etc., at competitive prices based on the highest possible degree of competition.

In short, the creation of the resolution authority has been consistent with the current context and with the principle of spending rationality. However, the need for the appropriate resources to be available for such specialised and important work must always be borne in mind.

CONCLUSIONS

As I have emphasised to you today, since my last testimony before this parliamentary subcommittee, the activity of the FROB has continued to be very intense and has been focused, from an administrative point of view, on the implementation of the hybrid management exercises. As a result, the recapitalisation of the banks, provided for in the plans envisaged in the Memorandum of Understanding, has practically been concluded. In the area of management, the FROB, following an internal reflection involving the collaboration of a consultant, has initiated a process of analysis to lay the foundations for the divestment of the banks in which the public sector has a majority holding, namely NCG Banco and CX, which under their resolution plans must be sold within a finite time horizon.

I believe, therefore, that the FROB continues to make progress in implementing the programme for restructuring our financial system, in line with the established timetable and with the principles that guide its actions. These are none other than minimising the cost of the process to the public purse and maximising its contribution to the appropriate development of public policies in the financial sector.

And, with nothing further to add, I remain at your disposal.