

Changes to the regulation of preferred securities (participaciones preferentes)

On 12 April 2011, Law 6/2011, of 11 April ("Law 6/2011") was published. Law 6/2011 modifies Law 13/1985, of 25 May, on investment ratios, regulatory capital and information obligations of financial intermediaries, Law 24/1988, of 28 July, on the securities market and Royal Legislative Decree 1298/1986, of 28 June, on the adaptation of applicable laws to EU legislation on credit entities. Law 6/2011 has been adopted with the aim of implementing Directive 111/2009 EC in Spain, including setting out the requirements for the admissibility of hybrid capital instruments as regulatory capital.

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Law 6/2011 modifies, among others, Law 13/1985, of 25 May, on investment ratios, regulatory capital and information obligations of financial intermediaries ("[Law 13/1985](#)").

In particular, Law 6/2011 introduces a series of changes to those provisions of the Second Additional Disposition of Law 13/1985 that set out the specific requirements that preferred securities (*participaciones preferentes*) must satisfy in order to qualify as regulatory capital. The modifications introduced by Law 6/2011 are intended to adapt such instruments to international standards and thereby ensure that they can be used to comply with solvency requirements.

The main changes resulting from the new regulation may be summarised as follows:

- **Payment of the remuneration:** The conditions applicable to the remuneration payable in respect of preferred securities (*participaciones preferentes*) will set out in the terms and conditions of each issuance but must contemplate the following:
 - Cancellation or suspension for an indefinite period of any remuneration payments by the Board of Directors (or equivalent body) of the issuing entity or its parent company, at the sole discretion of such body, when necessary and for an indefinite period. Any payments so cancelled or suspended will be non-cumulative;
 - Cancellation of remuneration payments in the event that the issuing entity or its parent company, or its group or consolidatable sub-group do not comply with regulatory capital requirements;
 - Payment of the remuneration must be conditional upon the existence of profits or distributable reserves at the issuing entity or its parent company;
 - The Bank of Spain may request the cancellation of payment of the remuneration based on the financial or solvency status of the issuing entity or its parent company, its group or consolidatable sub-group;

Content

Changes to the regulation of preferred securities

Entry into force and transitory regime

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- The cancellation of the payment of the remuneration agreed by the Issuer or requested by the Bank of Spain will not be considered a liability for the purposes of the determination of the insolvency of the debtor, as provided for in the Insolvency Law;
- Payment of the remuneration may be substituted by the delivery of ordinary shares, participative quotas (*cuotas participativas*) or share capital participations of credit cooperatives, of the issuing entity or its parent company, if so provided in the terms and conditions of the issue and subject to the limitations to be set out in future implementing legislation.
- **Issuer Call:** Law 6/2011 provides that the Bank of Spain may only authorise an issuer call option from the fifth anniversary of the relevant issue date if the financial status and the solvency of the issuing entity, its group [or consolidatable sub-group] are not affected. The Bank of Spain may also condition such authorisation upon the issuing entity exchanging the redeemed preferred securities (*participaciones preferentes*) for other capital instruments of equal or superior quality.
- **Loss absorption:** Law 6/2011 requires that the terms and conditions of the preferred securities (*participaciones preferentes*) provide for a mechanism obliging the holders of such securities to participate in the absorption of current or future losses (and which does not hinder the potential recapitalisation processes) by way of the conversion of the preferred securities (*participaciones preferentes*) into ordinary shares, participative quotas (*cuotas participativas*) or share capital participations of credit cooperatives or by means of a reduction of their nominal amount, in the event that the issuer (or its parent company) or its group or consolidatable sub-group show significant accounting losses or a relevant drop in the ratios that indicate compliance with regulatory capital requirements. The relevant trigger mechanisms and related specific features are to be set out in implementing legislation.
- **Limitation on the total outstanding nominal amount:** Law 6/2011 maintains the limitation to the total outstanding nominal amount of 30% of the total basic regulatory capital of the group [or consolidatable sub-group] of the parent entity of the issuer (including the amount of the relevant issue), however it also empowers the Bank of Spain to modify such percentage up to a cap of 35%.
- **Other new aspects:** Law 6/2011 specifies that, in the event of the liquidation or winding-up of the relevant entity, the preferred securities (*participaciones preferentes*) will grant the right to receive payment of the nominal amount plus accrued and unpaid remuneration, provided that such remuneration has not been cancelled in accordance with the changes described above. In the case of issues made through a subsidiary, the previous requirement in Law 13/1985 that such issuances of preferred securities (*participaciones preferentes*) be jointly and irrevocably guaranteed by the parent company has been removed.

Entry into force and transitional measures

Law 6/2011 came into force on 13 April 2011 (one day following its publication in the Official State Gazette, the BOE). Although the changes introduced by Law 6/2011, of 11 April, are aimed at ensuring that preferred securities (*participaciones preferentes*) comply with solvency requirements, there are a series of aspects that are pending development in further implementing legislation, such as the payment of remuneration by delivery of shares or the loss absorption mechanism.

Preferred securities (*participaciones preferentes*) issued before the date on which Law 6/2011 entered into force and which do not comply with the requirements of Law 6/2011, may continue to be computed as regulatory capital subject to the limitations that will be set out in such implementing legislation. Preferred securities (*participaciones preferentes*) subscribed by the Fund for the Ordered Restructuring of the Banking Sector (known by its Spanish acronym as the FROB) may also continue to be computed as regulatory capital.

In any event, the tax regime applicable to preferred securities (*participaciones preferentes*) and other debt instruments issued before the entry into force of Law 6/2011 continues unchanged.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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