Recent key developments in the area of Spanish financial regulation

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Royal Decree-Law transposing the European Union Directives on empowering competition authorities, anti-money laundering, credit institutions, telecommunications, tax measures, the prevention and remedy of environmental damage, the posting of workers in the framework of the provision of transnational services and consumer protection (Royal Decree-law 7/2021, published in the *Official State Journal* on April 28th, 2021)

Royal Decree-law 7/2021 took effect the day after its publication in the *Official State Journal*, with the exception of certain provisions that will come into effect later. The standards transposed in the financial arena are as follows:

I. Transposition of the Fifth Directive on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing

Amendment of Law 10/2010 (of April 28th, 2010) on the prevention of money laundering and terrorist financing in order to transpose Directive (EU) 2018/843 so as to enhance terrorist financing prevention mechanisms and improve the transparency and availability of information about the beneficial owners of legal persons and other unincorporated entities intervening in legal arrangements.

The amendment includes the following changes:

- The universe of bound parties has been expanded to include providers engaged in exchange services between virtual currencies and fiat currencies and custodian wallet providers and a register has been created to keep record of them.
- The administrator who owns or controls a legal person is added as the beneficial owner.
- The beneficial ownership information of legal persons and trustees has been specified.
- Financial institutions are now required to apply enhanced measures equivalent to those established in the EU to mitigate the risk of money laundering or terrorist financing in certain third countries.
- A new obligation has been introduced for the reporting of cash payments or receipts not accompanied by a natural person in the amount of 10,000 euros or more within 30 days of the movement.
- Prepaid cards and commodities used as highly-liquid stores of value have been added to the universe of 'payment instruments'.
- The legal regime applicable to the temporary intervention of payment establishments has been amended to incorporate the scope for administrative claims against such supervision and the relationship with the cash movement penalty regime.
- Adjustments have been made to the Central Bank Account Register.
- The new legislation establishes the Beneficial Owner Register.

II. Transposition of CRD V

In order to transpose Directive (EU) 2019/878 on capital requirements, the Law 10/2014 (June 26th, 2014) on the structuring,

supervision and capital adequacy of credit institutions has been amended. The key takeaways are:

- The Bank of Spain has been given new powers to approve certain financial holding companies and mixed financial holding companies.

- The Bank of Spain is also now obliged to notify the EBA about branch openings and the provision of services in Spain, without a branch, by third-country credit institutions.

- The legislation introduces the requirements that third-country groups whose subsidiaries include two or more credit institutions or at least one credit institution and one investment service provider in the EU must have a single intermediate parent undertaking in the EU, so long as the group has at least 40 billion euros of assets.

- The banks no longer have to formulate and keep a general recovery plan.

- In terms of corporate governance and remuneration, the new legislation stipulates the following:

  - Remuneration policies and practices cannot discriminate on the grounds of gender.

  - The Bank of Spain must be provided with information about loans extended to members of their management body and their related parties.

  - The legislation itemises the categories of staff whose professional activities have a material impact on the institution's risk profile.

  - The deferral period for variable remuneration has been modified.

  - Exemptions have been introduced for certain institutions and staff from the requirements regarding the deferral and pay-out of variable remuneration in instruments and the conservation of discretionary pension benefits.

- As for the capital buffers, these are the relevant changes:

  - The introduction of measures to avoid the double counting of common equity tier 1 (CET1) instruments. As a result, the CET1 used to comply with one of the elements of the combined buffer requirement should be different from the CET1 to meet the other applicable elements of the combined buffer requirement, or other requirements such as their capital ratios or their additional own funds requirements other than the risk of excessive leverage.

  - An additional method for identifying global systemically important banks (G-SIBs) has been introduced.

  - The Bank of Spain has been empowered to require other systemically important institutions (O-SII) to maintain an O-SII buffer of over 3% of total risk exposure.

  - The distribution restriction regime in the event of failure to meet the combined buffer requirement has been revised and restrictions have been imposed in the case of failure to meet the leverage ratio buffer requirement.

- Lastly, the Bank of Spain will take prudential supervision measures in respect of interest rate risk arising from non-trading book activities.

III. Transposition of BRRD II

In order to transpose Directive (EU) 2019/879, the Law 11/2015 (June 18th, 2015) on the restructuring and resolution of failing credit institutions and investment firms has been amended. The key takeaways include:

- The update of resolution plans shall take place after the application of resolution measures or the write-down or conversion of equity instruments and eligible liabilities.

- The resolution authority has been empowered to prohibit certain distributions where they consider that an institution or entity is failing to meet the combined buffer requirement when considered in addition to minimum requirement for own funds and eligible liabilities (MREL).

- A deadline has been introduced for a notified entity to provide the resolution authority with possible measures for addressing or removing the substantive impediments to their resolution.

- Greater detail has been provided for the regulations governing the write-down and conversion of capital instruments and eligible liabilities.

- The MREL calculation has been aligned with the TLAC calculation, so that its denominator must now be expressed as a percentage of the total risk exposure amount and of the total exposure measure of the relevant institution or entity.

- The legislation adds certain liabilities that cannot be used for bail-in purposes and modifies the specific bail-in rules.

- The criteria for setting each entity's MREL will be developed in implementing standards.

- The new legislation delimits the FROB's powers to suspend payment or delivery obligations, enforce security interests or temporarily suspend termination rights.

- It introduces the obligation to include a term in financial contracts under third-country law whereby the parties recognise that the contract may be subject to the exercise of powers by the FROB to suspend or restrict certain rights and obligations.

In order to introduce the provisions made in BRRD II regarding retail investor protection in the marketing and sale of 'bail-inable' debt instruments, the Spanish Securities Act has been amended as follows:

- At least 50% of the issue must be targeted exclusively at professional clients or investors.

- The seller or placement agent must assess the fit for purpose of the instruments for their clients and verify satisfaction of the additional prerequisites for enhanced suitability testing purposes when the client's financial instrument portfolio does not exceed 500,000 euros.

- Such instruments cannot be marketed or sold to retail investors without performance of the suitability test if the minimum denomination of the issue is 100,000 euros.

Law amending the consolidated text of the Corporate Enterprises Act and other financial regulations as regards the encouragement of long-term shareholder engagement at listed companies in order to transpose Directive (EU) 2017/828 into Spanish law (Law 5/2021, published in Spain's *Official State Journal* on April 13th, 2021)

Law 5/2021 introduces amendments regarding the long-term financing raised by listed companies in the capital markets, the transparency regime governing capital markets agents, remuneration of members of the management body and the performance of transactions between a company and its related parties. It took effect 20 days after its publication in the *Official State Journal*.

The key contents of this new piece of legislation are:

- An updated transparency policy for institutional investors, asset managers and proxy advisors. Contemplation of the possibility of obliging the companies that manage the above institutions and entities to draw up and publish an engagement policy.

- The definition of asset managers has been expanded to include investment firms that provide portfolio management services to investors.

- When management companies provide asset management services to insurance firms or pension funds, they must inform the entities with which they have entered into such arrangements as to how their investment strategy is consistent with the profile and duration of their liabilities, and how they contribute to the medium- to long-term performance of their assets.

- As for shareholder identification, entities are entitled to insist on the identification of beneficial owners in addition to the formal shareholders.

- The law itemises the obligations of proxy advisors.

- It also introduces new aspects to related-party transaction regulations.

And it has the effect of triggering other legislative amendments to the following pieces of legislation:

- It introduces the following changes to the Corporate Enterprises Act:

  - It reinforces directors' due diligence requirements.

  - It requires listed company directors to be natural persons and for their positions to be remunerated.

  - It introduces the 'loyalty voting share' concept: a company's bylaws may allow for the grant of additional votes to shares held by an owner on an uninterrupted basis for at least two years.

  - In relation to equity-raising processes, it shortens the minimum term for the exercise of preemptive subscription rights.

  - The regime governing rights issues has been modified to enable its application by smaller-sized companies.

  - The legislation clarifies the regime applicable to Spanish companies whose shares are traded on foreign securities markets only.

  - It introduces a limit applicable to credit institutions with respect to the delegation of the power to waive preemptive subscription rights when issuing convertible bonds.

- It introduces the following changes to the Securities Market Act:

  - It raises the threshold for offers of securities to the public for which it is mandatory to publish a prospectus to 8 million euros. In the case of credit institutions, that threshold was left at 5 million euros.

  - It eliminates the requirement that companies whose shares are listed on a regulated market publish quarterly financial information.

  - It exempts issuers of securities that are not listed joint-stock companies from having to publish an annual corporate governance report.

Law on climate change and energy transition (Law 7/2021, published in the *Official State Journal* on May 21st, 2021)

This law was published in response to the commitments assumed by Spain at the international and European levels to make climate action and the energy transition the fulcrum of its policy. It took effect the day after its publication in the *Official State Journal*. The standards related to the financial arena are the followings:

It requires securities issuers, credit institutions, insurers and all other companies obliged to include a non-financial statement in their management reports to draw up an annual report in which they assess the financial consequences of the risks associated with climate change as a result of the exposure of their specific businesses, itemising the risks of transitioning towards a sustainable economy and the measures being taken to

tackle them. The contents of these reports will be determined by Royal Decree within two years of effectiveness of the new law.

It also requires the Bank of Spain, the securities market regulator (CNMV) and the General Directorate of Insurance and Pensions Funds (DGSFP) to formulate, jointly and every two years, a report on the level of alignment with the climate targets set down in the Paris Accord and EU regulations based on future scenarios and climate risk assessments for the Spanish financial system (likewise reporting on mitigating policies).

Resolution enacting the so-called Code of Good Practices for the renegotiation of state-guaranteed debt (Resolution of May 12th, 2021, published in the *Official State Journal* on May 13th, 2021)

Endorsement by the banks of the Code of Good Practices for the renegotiation of state-guaranteed debt (the Code) is voluntary and they have been given one month to notify the authorities, which will publish a list of participating entities and a list of those who, having channelled guarantees, have decided not to endorse it. The entities must also notify their clients as to whether or not they are endorsing the Code.

The participating entities will undertake to implement the following measures upon request by viable firms/self-employed professionals whose financial situation has deteriorated as a result of the pandemic:

- Extend the term of maturity of the transactions secured by public guarantees if the corresponding requirements are met.
- Consider the conversion of financing transactions secured by the state into profit-participating loans (not convertible into equity).
- Consider reducing the amount of outstanding principal of publicly-guaranteed financing transaction with the scope for enforcing the guarantee in the percentage covered.
- Analyse all transactions granted to the applicant between March 17th, 2020, and the date of publication of Royal Decree-Law 5/2021.
- If any of the above measures are applied, the working capital facilities must be left in place until at least December 31st, 2022.

The Code additionally stipulates the following:

- The banks may not make any of the above measures conditional upon the purchase of other products.
- The banks will decide which measures to take in respect of their exposures in accordance with their internal procedures and loan grant and risk policies.
- Application of the measures contemplated is subject to compliance with applicable regulations with respect to State aid.
- A Code Oversight Committee will be set up.
- The banks must furnish the Bank of Spain with the information required by the Code Oversight Committee.
- The Resolution contemplates the creation of coordination and drag-along procedures for all creditors endorsing the Code.

The Resolution also contemplates extending the term of maturity of the guarantees for up to two to five years more.

In relation to the conversion of existing loans into non-convertible profit-participating loans, the public guarantee will be left in place to secure the latter so long as certain requirements are met with respect to all those entities adhering to the Code from which the debtor has obtained secured financing (including a reduction in revenue of 30%).

With respect to the scope for transfers, it will be necessary to renegotiate all debt granted by the entity to the applicant between March 17th, 2020, and date of approval of the Cabinet

Agreement, as well as compliance with certain other requirements. Transfers may not exceed 50% of the amount of principal guaranteed if the drop in revenue is less than 70%, or 75% if the revenue contraction exceeds 70%.

The banks must communicate the application of these measures in respect to the maturity extension and conversion measures until December 1st, 2021, and until December 1st, 2022, with respect to the debt forgiveness measures.