Recent key developments in the area of Spanish financial regulation

Prepared by the Regulation and Research Department of the Spanish Confederation of Savings Banks (CECA)

Royal Decree/Law on the restructuring and resolution of credit institutions (RD-L 24/2012, published in the BOE on August 31st, 2012)

This Royal Decree/Law's primary objective is to provide regulations governing early action, restructuring and resolution of credit institutions. It also seeks to establish the legal and operating frameworks for the Fund for Orderly Bank Restructuring (FROB), so it can safeguard the stability of the financial system while minimising the recourse to public funds.

- **New crisis management framework**. The Royal-Decree/Law establishes various procedures for action in the case of credit institutions in difficulties, depending on their ability to fulfil requirements of solvency, liquidity, organisational structure and internal control.

  a) **Early action.** Envisaged for those cases in which a credit institution fails to comply with the requirements of solvency, liquidity, organisational structure and internal control, or there are objective signs making it reasonably foreseeable that it may do so, but where the institution is in a position to return to compliance by its own means.

  b) **Restructuring.** A credit institution will be restructured when it requires public financial aid to ensure its viability, and there are objective signs making it reasonably foreseeable that this aid will be repaid or recovered within the planned timeframe. Restructuring may also be envisaged when the entity's resolution might seriously harm the stability of the financial system.

  c) **Resolution.** This procedure is applicable to a credit institution when it has ceased to be viable, or it is foreseeable that this will happen in the near future, and for reasons of the public interest and financial stability, it is necessary to avoid bankruptcy proceedings.

- **Restructuring and resolution mechanisms.** The Royal-Decree/Law provides for the following mechanisms:

  a) **Financial aid** The FROB may provide financial support in one or more of the following ways:

  a) Giving guarantees.

  b) Granting loans or credit.

  c) Acquiring assets or liabilities, whether retaining control over them or entrusting their management to a third party.

d) Recapitalisation using recapitalisation instruments.

b) Recapitalisation instruments. The FROB may subscribe or purchase instruments of the following types, issued by institutions requiring financial aid:

a) Ordinary shares or contributions to share capital.

b) Instruments convertible into those mentioned in point a). The subscription or acquisition will take place in accordance with the principles and criteria the FROB may establish for this purpose, following a report from the Bank of Spain.

c) Specific resolution mechanisms. The resolution mechanisms available are:

a) Sale of the institution's business.

b) The transfer of ownership of assets and liabilities to a "bridge bank" for subsequent sale, or the sale of assets and liabilities, when circumstances allow, within a maximum period of five years.

c) Transfer of ownership of assets and liabilities to an asset management entity.

d) When necessary in order to facilitate implementation of the foregoing instruments, financial support may be given to the purchasers of the business, the bridge bank or the asset management company.

- **Asset management companies.** Within three months of the entry into force of the Royal-Decree/Law, the FROB will establish an asset management company, with the name "*Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A.*", to purchase assets in those institutions the FROB sees fit.

The FROB may, acting by virtue of its administrative powers, oblige the credit institution to transfer certain types of particularly impaired assets that would jeopardise the institution's viability if they remained on its balance sheet, to an asset management company. This will be reviewed regularly so as to remove impaired assets and enable the independent management of their disposal. The Bank of Spain shall specify which assets may be transferred in the case of each institution.

This transfer of ownership will be obligatory in the case of credit institutions of which the FROB is the majority shareholder when this Royal-Decree/Law comes into force, or which in the opinion of the Bank of Spain, following an independent evaluation of the capital requirements and quality of current assets, will require the initiation of a process of restructuring or resolution.

- **Legal framework of the FROB.** The RD/L defines the new framework for the FROB under which it will have the task of managing the processes of restructuring and resolution of credit institutions.

- **Management of hybrid capital instruments and subordinate debt.** Two types of measures for the management of hybrid instruments are envisaged. Firstly, measures of a voluntary nature that institutions are to include in their restructuring and resolution plans, which will be adopted voluntarily by investors. Secondly, measures that may be imposed by the FROB and which will be binding for both the institution and holders of the securities.

a) **Management by institutions of hybrid capital instruments and subordinate debt.** Restructuring and resolution plans must include management of hybrid capital instruments and subordinate debt issued by the credit institutions to which these plans correspond, in order to ensure that the costs of consolidation or restructuring the institution are distributed between the public and private sectors appropriately.

b) **Management by the FROB of hybrid capital instruments and subordinate debt.** The FROB will decide which issues or items of hybrid capital and subordinated debt instruments are within the scope of application of the management action. The management actions taken will be one or more of the following:

   a) The postponement, suspension, elimination or modification of certain rights, obligations, terms and conditions from some or all of the institution's issues of hybrid capital or subordinated debt instruments.

   b) The institution's obligation to repurchase the securities affected at the price decided by the FROB.

   c) Any other action that the affected credit institution may have conducted through a hybrid capital instrument and subordinated debt management action.

- **Strengthening credit institutions' solvency.** As of January 1st, 2013, credit institutions and consolidated groups of credit institutions taking reimbursable funds from the public must have core capital of at least 9% of their total risk-weighted exposures.

- **Measures regarding the marketing of certain financial instruments.** The following requirements must be met whenever preferences shares, convertible debt instruments, or subordinate finance that may be computed as equity pursuant to the regulations on the solvency of credit institutions are marketed to or placed with retail customers or investors:

   a) The issue must include a tranche of at least 50% of the total issue aimed solely at professional investors or customers. The total number of these investors may not be less than fifty, and customers may not renounce their treatment as retail customers.

   b) In the case of issues of preference shares or convertible debt instruments by institutions that are not listed on the stock market, the minimum nominal unit value of the securities will be 100,000 euros. In the case of other issues, the minimum nominal unit value will be 25,000 euros.

   Law 24/1988, July 28th, 1988, on the Securities Market, has also been amended to add new investor protection mechanisms in the case of the marketing of certain products.

Royal Decree approving the implementing regulations for the Law on Collective Investment Undertakings (Royal Decree 1082/21012, published in the state official gazette (BOE) on July 20th, 2012)

The new implementing regulation for Law 35/2003, November 4th, 2003, on Collective Investment Undertakings, repeals the previous regulation enacted by Royal Decree 1309/2005, November 4th, 2005, and introduces the following new features:

- **Expansion and facilitation of cross-border business.** Harmonised rules have been introduced for cross-border mergers between collective investment undertakings (CIUs). The formalities with the competent authorities have been simplified and the time taken to obtain a "passport" to market these products has been shortened.

- **European management company passport.** The rules intended to ensure that the passport for collective investment undertaking management companies (CIUMCs) operates correctly have been transposed into Spanish law.

- **Risk management, conflicts of interest and equity capital.** CIUMCs are obliged to specify the criteria they use to evaluate the adequacy and proportionality of their risk management policy in light of the nature, scale and complexity of their activities and the CIUs they manage. The rules applicable to managing conflicts of interest in CIUMCs are also set out, and CIUMCs' equity capital requirements have been reduced.

- **Investor protection.** The mandatory information investors are to be given has been expanded and new items added to the content of the brochure. A series of aspects of the "Key Investor Information" document have been set out and the previous brochure format replaced.

- **Other amendments.** A number of other points have also been introduced: the obligation to send the investment fund position statement to the CIUMC; a share/unit deposit and administration fee, authorising marketers to charge when they use omnibus accounts; and, the establishment of a register of management or sub-management entities.

Royal Decree 1082/2012 came into force the day following its publication in the BOE, although a number of transitional arrangements are envisaged and time is allowed for adaptation depending on the type of CIU.

National Securities Market Commission (CNMV) Circular amending Circular 6/2010, Circular 4/2008 and Circular 3/2006 (published in the BOE on August 4th, 2012)

- This circular amends three different regulations: Circular 6/2010, December 21st, 2010, on transactions involving derivative instruments and other operational aspects of CIUs; Circular 4/2008, September 11th, 2008, on the content of quarterly, semi-annual and annual reports by CIUs and the statement of position, and Circular 3/2006, October 26th, 2006, on CIUs' information brochures.

- In the case of Circular 6/2010, the amendments have been made with the following aims:

  - To incorporate the ESMA "*Guidelines on risk measurement and the calculation of global exposure for certain types of structured UCITS,*" defining additional criteria for the application of the compromise methodology to the cited institutions.

  - Adapt and update the regulatory framework to new market requirements and circumstances and the nature of certain CIUs.

  - Introduce modifications in counterparty solvency analysis and regarding eligibility, determination and reinvestment of security or collateral received in CIU operations (both derivatives and temporary acquisitions, simultaneous, securities lending, etc.) required at the European level with the approval of the "Guidelines on ETF and other UCITS issues."

- Define the cases where certain non-compliances affecting funds with the aim of obtaining a profit may be maintained, when resolving the non-compliance would be detrimental to profitability, and establishing actions in these cases to protect investors.

- In relation to Circular 4/2008, the modification of the content of the quarterly, semi-annual and annual reports and position statement of CIUs is proposed, such that the annual reports of CIUs and CIUMCs, which includes the annual accounts, management report and audit report, is submitted to the CNMV, via its electronic register, using the CIFRADOC service.

- Lastly, Circular 3/2006 has been amended to give managers the capacity to adapt quickly to market conditions in response to changes in credit ratings.

Order regarding remuneration in institutions receiving financial aid for their restructuring or consolidation (Order ECC/1762/2012, published in the BOE on August 8th, 2012).

This Order aims to set out the rules for compensation, defining the upper limits on the remuneration and compensation payable to directors and executives of credit institutions that are majority owned by the Fund for Orderly Bank Restructuring (FROB), have received aid from the Fund, or are due to apply for aid, for their restructuring or consolidation.

The compensation limits applicable as of the 2012 financial year until restructuring is complete differ according to the type of aid received, with a difference according to whether the FROB has acquired a majority shareholding in the institution or not:

- **Limits in the case of institutions majority owned by the FROB:**

  - Non-executive members of collective management bodies may not receive gross annual compensation of more than 50,000 euros, and executive chairmen, chief executives, and other executives may not receive more than 300,000 euros.

  - The above will not be entitled to variable compensation while the FROB remains a majority shareholder.

- **Limits in the case of institutions receiving financial support from the FROB:**

  - Non-executive members of collective management bodies may not receive gross annual compensation of more than 100,000 euros, and executive chairmen, chief executives, and other executives may not receive more than 600,000 euros.

  - The annual variable compensation for executives and directors may not exceed 60% of the annual gross fixed compensation, although it may reach 100%, with the Bank of Spain's approval, if the executives concerned are contracted subsequent to or at the same time as financial aid is received from the FROB.

The Order also provides that executives' and directors' contracts or agreements may not include severance compensation clauses for amounts exceeding the lesser of the following:

a) twice the maximum basic amount resulting from Article 5.3.a) rule 3 or 4, as applicable, of RD-l 2/2012 (i.e. 300,000 euros in the case of institutions majority-owned by the FROB or 500,000 euros in the case of institutions that, while not majority owned by the FROB are receiving financial aid); or

b) two years of the stipulated fixed compensation.

Specific rules are provided for the case of institutions in the process of integration and divestment:

- **Integration processes:** executives and directors who do not form part of the majority-owned or FROB-supported institution or the institution giving rise to this shareholding or support will not be affected by the limits set out in this Order.

  In the case of executives and directors from the institution requiring financial support, or giving rise to the need for support, the Minister of Economy and Competitiveness, upon receiving a proposal from the Bank of Spain, may modify the criteria and limits set in this Ministerial Order and Royal-Decree/Law 2/2012.

- **Divestment processes:** When the FROB's financial support accompanies a competitive divestment process, the Minister of Economy and Competitiveness, upon receiving a proposal from the Bank of Spain, may relax the limits on the executives and directors due to be employed by the divested institution or exempt them from these limits.

The Order came into force on August 9th, 2012, the day following its publication in the BOE.

Circular on banking-service transparency and responsible lending (Bank of Spain Circular 5/2012, June 27th, 2012, to credit institutions and payment service providers, on banking-service transparency and responsible lending, published in the BOE on July 6th, 2012).

This Circular has its origins in Law 2/2011, March 4th, 2011, on the Sustainable Economy, implemented by the Ministry of Finance Order EHA/2899/201, October 28th, 2011, on banking service transparency and customer protection.

The main new features are:

- **Scope.** The Circular applies to banking services aimed at private individuals or provided to them in Spain by Spanish credit institutions and branches in Spain of foreign credit institutions. However, it is envisaged that when customers are dealing with banks as part of their business, the parties may agree that some or all of the terms of the Circular will not apply, although there are exceptions to this.

- **General public information.** Institutions must provide the public with: interest rates usually applied to the most common banking services, the most common fees, and the current declarations of preferential rate, and the guidance rate for other lending operations.

- **Precontractual information.** The precontractual information institutions must provide free of charge to customers is to be set out in detail for each type of service and product. This information must be clear, sufficient and objective.

- **Contractual and post-contractual information.** There is an obligation to supply the contractual document to customers even if they do not ask for it. The standard forms of interest payments and fees are updated and a standard annual summary of fees and interest established.

The Circular will come into general effect on October 7th, 2012, although certain qualifications are foreseen, and some of the new obligations are due to be phased in later.