

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)

Law on Savings Banks and Banking Foundations (Law 26/2013, published in the official gazette (BOE) on December 28th, 2013)

This Law sets out the legal framework for the savings banks and the new regulation on banking foundations:

I. Savings banks

- Their business is limited to one Autonomous Region or up to ten contiguous provinces.
- Their main business is deposit-taking and lending.
- A focus on community welfare activities.
- Their governing bodies are defined as being the general assembly, the board of directors, and the steering committee. Membership of a savings bank's governing bodies will be incompatible with the holding of elected political office or any other government position for a period of two years.
- Savings banks are to prepare and submit an annual corporate governance report and a compensation report.

II. Banking foundations

- **Banking foundations** are foundations with a direct or indirect interest of at least **10% of a credit institution's share capital** or voting rights, or which have voting power enabling them to appoint or dismiss a member of its governing body.
- The main function of these foundations is to manage their **community welfare activities** and their shareholding in the credit institution.
- The foundation's **registered name** must include the words "fundación bancaria" (banking foundation) and they may use the names of the savings banks from which they derive.
- Banking foundations will be governed by the **legal framework** established in this law, as well as the general legislation on foundations.
- Their governing bodies will be their Board of Trustees and its delegate commissions, the Director, and other bodies provided for by the foundation's charter.
- **Conversion of savings banks into banking foundations.** If a savings bank exceeds either of the following thresholds at the consolidated group level, it will be obliged to transfer the

assets associated with its financial business to a credit institution:

- total consolidated assets of more than **10 billion euros**, or
- market share in its autonomous region, in terms of deposits, of more than **35%**.

➤ Interests in credit institutions

- If a foundation (or a number of foundations acting in concert) holds **more than 30%** of the shares in a credit institution, or exercises **control** over it as defined in the Commercial Code, it must comply with certain additional requirements:

✓ Preparation of a protocol for the management of its financial interest, which includes the basic criteria of this strategic shareholding, describes the relationships between the trustees and the institution's governing bodies, establishes the operational criteria for the relationship between them, and defines how to prevent possible conflicts of interest. This plan must be made public, and will be subject to the prior approval of the Bank of Spain, which will define its minimum content.

✓ Preparation of an annual financial plan describing how to address the credit institution's possible capital needs, and the foundation's criteria and strategy for its investments in the financial institution.

- If the shareholding of the foundation (or foundations) in the credit institution **exceeds 50% or represents a controlling interest**, as defined in the Commercial Code, the financial plan must also include:

✓ An **investment diversification and risk management plan**.

✓ The **endowment of a reserve fund**. This will **not be necessary** if the diversification plan includes a divestment programme to reduce its holding in the credit institution to below 50% over not more than five years. The Bank of Spain will be responsible for deciding the minimum content of the financial plan.

- The relevant Autonomous Region will be responsible for the **supervisory authority** for those banking foundations (the "*protectorado*") operating in just one Autonomous Region. This responsibility will lie with the Ministry of Economic Affairs and Competitiveness in the case of banking foundations extending over more than one Autonomous Region.

- Banking foundations will be required to draw up an **annual corporate governance report**.

- They will be **liable for tax** under the general corporate tax system and will not be eligible for the special tax treatment applicable to ordinary foundations.

- Within six months of the entry into force of this law, **special foundations** will be turned into banking foundations if the relevant requirements are met, or into ordinary foundations otherwise. **Ordinary foundations** that already have a shareholding of more than 10% will only be converted into banking foundations if that percentage is increased.

- **Montes de Piedad** (charitable pawnbrokers): may be assigned to the community welfare activities of savings banks, banking foundations or the credit institutions they control, and to ordinary foundations.

- Savings banks, banking foundations and credit institutions linked to them may be grouped into territorial **federations**.

- Credit institutions which have taken over a savings bank's financial business may use their **well-known commercial names or brands**,

provided they own these brands or commercial names or have the owners' prior consent to use them.

Adaptation of CRR-CRD IV through Royal Decree-Law on urgent measures to adapt Spanish legislation to European regulations on the supervision and solvency of financial institutions (Royal Decree-Law 14/2013, published in the state gazette (BOE) on November 30th) and of the draft bill on credit institution supervision and solvency

Royal Decree-Law 14/2013 adapts Spain's legislation to implement the essential changes necessary for European regulations to come into effect on January 1st, 2014. Specifically, it amends the package of legislation known as CRR-CRD IV¹ to adapt the national standards on credit institution supervision.

The main features of RD-L 14/2013 are:

- The CRR is now classified as a **banking discipline and organisation rule**.
- The Bank of Spain and the CNMV (National Securities Market Commission) are designated as the competent national authorities for discretionary application.
- The Bank of Spain's and CNMV's **supervisory measures** have been strengthened.
- **Corporate Governance**. Key points concern remunerations of credit institutions and certain investment firms.

- **Approval of fiscal rules on the monetisation of deferred tax assets (DTAs)**. The implementation of the CRR in national legislation avoids the possibility that deferred tax assets arising from temporary differences do not have to be discounted from capital provided the member state's internal tax regulations provide for their monetisation.

- **Other points:**

- **Preference shares will be eligible as own funds under the terms of the CRR** (additional tier 1 capital or common equity tier 1 capital).
- **The core capital requirement** established in RD-L 2/2011 has been eliminated so as to converge with the definition in the CRR. However, in order to meet the **MoU's requirement** that a minimum capital of 9% be kept until December 31st, 2014, the **Bank of Spain may prevent or restrict any distribution of tier 1 capital components** that would have been eligible to comply with the minimum core capital requirements under the aforementioned Royal-Decree Law, if, in 2014, in absolute terms, these distributions exceed the excess capital with respect to the legally required minimum on December 31st, 2013.
- **Finance companies are no longer classified as credit institutions.**

The **draft bill on supervision and solvency** aims to continue the transposition of CRR-CRD IV and consequently recasts the main rules on credit institution organisation and discipline.

¹ Regulation 575/2013 of the European Parliament and the Council, June 26th, 2013, on prudential requirements for credit institutions and investment firms, amending Regulation (EU) No 648/2012 (CRR) and Directive 2013/36/EU of the European Parliament and of the Council of June 26th, 2013, on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV).

The **main changes** the bill introduces are:

1. Corporate Governance. It includes part of the work begun by Royal Decree-Law 14/2013 on remunerations, and:

- It implements the rules on incompatible activities applicable to credit institutions' directors.
- The office of chairman of the board will be incompatible with that of chief executive, unless authorised by the Bank of Spain.
- All institutions are to have an appointments committee, a compensation committee, and a risk committee.
- Institutions are to disclose the total remuneration paid to each member of the board of directors.
- All credit institutions will be required to publish an "annual banking report."

2. Solvency of credit institutions:

- **Capital buffers.** The CRD IV treatment of the four capital buffers in addition to those required to meet the capital requirements established in the CRR has been left unchanged. Three of them are non-discretionary, namely those for capital conservation, institutions of global systemic relevance, and other systemically relevant institutions.
- **Transitional periods.** Those for capital and the various buffers are **unchanged from CRD IV**, with national options to bring them forward not having been applied. Thus, the CET 1 ratio will be 4% in 2014 and 4.5% in 2015.
- **Liquidity.** To set liquidity requirement levels appropriately, the Bank of Spain will assess the business model, corporate governance procedures and systems, supervision and evaluation findings, and all systemic risks.

- At least once a year, the Bank of Spain will subject those credit institutions under its supervision to a **stress test** to facilitate the envisaged supervisory review and assessment process.

- **If solvency regulations are not complied with**, the Bank of Spain will be empowered to intervene in the entity's activities, and if the situation is particularly serious, it may take control of the entity and replace its governing bodies.

3. Penalty system. The changes primarily concern the inclusion of new penalty rates and the modification of the amount and form of the calculation of the applicable infringements and their publication.

4. The rules for eligibility as own funds of **preference shares**, rules applicable to **institutional protection systems**, and other legal rules on the transitional application of certain precepts while they are being phased in are also defined.

Law on transparency, public access to information, and good governance (Law 19/2013, published in the official gazette (BOE) on December 10th, 2013)

This Law seeks to improve transparency in public life, recognising and guaranteeing access to information, and establishing good governance obligations public officials are to abide by.

It also **amends Law 10/2010 of April 28th, 2010, on the prevention of money laundering and terrorist financing:**

- **Application of due diligence measures**, establishing exceptions in the case of occasional transactions that do not exceed a **quantitative threshold**.
- Simplified due diligence measures, with products or transactions to which reporting entities are

entitled not to apply due diligence measures being exempt from the regulations.

- Application of simplified due diligence measures that are graduated in line with the level of risk.
- The concept of persons with public responsibilities in Spain has been broadened to include their family members and relatives.

Bank of Spain Circular amending accounting circular and the Central Credit Register (CIRBE) (Circular 5/2013, published in the BOE on November 9th, 2013)

The following rules have been amended:

- **Accounting circular** (Bank of Spain Circular 4/2004): together with a number of technical improvements, the changes aim to adapt the Spanish accounting framework to International Accounting Standards and International Financial Reporting Standards.
 - The **definition of control** has been adapted to avoid possible conflicts in the formulation of consolidated public and confidential statements where no majority of voting rights is held or agency relationships exist, by recasting the joint agreements by eliminating the method of proportional consolidation for the consolidation of joint businesses.
 - In the case of **defined-benefit pension plans** the possibility of deferring the actual results in accordance with an interval of fluctuation has been eliminated and certain clarifications have been added regarding the estimate and accounting impact of instruments measured at fair value.
 - New requirements have been added regarding information on the **transfers of financial assets and netting of balances**, including

replacement of the current statement of classification of credit by purpose by a new, broader, monthly statement.

- **Bank of Spain Central Credit Register (CIRBE)** (Bank of Spain Circular 1/2013): requiring information from entities on the financing of small businesses and micro-enterprises in order to be able to assess financing policy for this type of enterprise, while slightly lengthening the time allowed for the first data to be sent to the central credit register, due to the complexity of its implementation.