

Recent key developments in the area of Spanish financial regulation

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Law on regulation, supervision and solvency of credit institutions (Law 10/2014, published in the BOE on June 27th, 2014)

The purpose of Law 10/2014 is to adapt Spanish national legislation to incorporate legislative changes at the international and EU level, in particular following the publication of Regulation (EU) no. 575/2013 (CRR) and Directive 2013/36/EU (CRD IV), thus continuing the process begun by Royal Decree-Law 14/2013. It also significantly recasts the main regulatory and disciplinary provisions to which credit institutions are subject. The Law came into force the day after its publication, with the exception of certain provisions due to be phased in later.

The **Law on regulation, supervision and solvency of credit institutions** regulates general requirements for access to the activity of credit institutions, the rules on the functioning of their governing bodies, and the supervisory and disciplinary instruments that the competent authority have available to enforce the regulations. Capital and solvency requirements, and risk management obligations, are established in CRR.

As the Law **recasts existing legislation** on banking regulation and discipline, among other things, it covers the following: general provisions of the legal framework, the rules for authorisation of credit institutions, rules on qualifying holdings and suitability standards.

The **main changes** brought about by the Law are in the areas of:

- **Governance.** The Law builds on the work on the subject of remuneration begun by Royal Decree-Law 14/2013. Specific topics it deals with include:
 - **Incompatibilities.** It transposes CRD IV's rules on incompatible activities, under which directors of credit institutions may not hold more than one of the following combinations of directorships at the same time: (i) one executive directorship and two non-executive directorships; (ii) four non-executive directorships. However, the Bank of Spain may authorise the holding of one additional non-executive directorship. Institutions will have until October 31st, 2014, to comply with these rules. Also, the **chairman of the management body** will be incompatible with that of **chief executive**, unless expressly authorised by the Bank of Spain.
 - **Governance arrangements.** Credit institutions' management bodies shall define governance arrangements that ensure effective and prudent management of the institution, with an appropriate distribution of functions in the organisation and measures to prevent conflicts of interest. The management body will oversee and be accountable for its implementation. The functions of the management body that may **not be delegated**

are also defined. Credit institutions are to disseminate information about their corporate governance and remuneration policy on their **websites**.

- **Committee structure.** Credit institutions are to establish a nomination **committee** and a **remuneration committee**, both made up of members of the management body who do not perform any executive function in the institution. At least one-third of these members and the Chair must be independent directors. The Bank of Spain will also decide which institutions, on the basis of their size and internal organisation, and the nature, the scope and complexity of their activities, need to establish a risk committee. Those institutions which, in the opinion of the Bank of Spain, do not have to establish a **risk committee**, are to set up **mixed audit committees** to assume its functions.

■ **Solvency of credit institutions.**

- **Scope.** The solvency regulations will apply to:

- ✓ Credit institutions.
- ✓ Consolidable groups and subgroups of credit institutions, including financial institutions, together with any asset management companies that they include.
- ✓ Financial holding companies and mixed holding companies.

- **Capital adequacy assessment.** Institutions are to determine whether the capital adequacy requirements laid down in CRR are sufficient, or if they need additional capital.

- **Liquidity.** To set liquidity requirement levels appropriately, the Bank of Spain will assess the business model, corporate governance procedures, systems and mechanisms, the supervision and evaluation findings, and all systemic risks. This power is a tailored

complement to each institution's liquidity requirements under CRR applicable as of 2016.

- **Capital buffers.** CRD IV's treatment of the four Common Equity Tier 1 (CET 1) capital buffers additional to those required to meet the capital requirements established in the CRR has been left unchanged. Two of the buffers are non-discretionary, namely those for capital conservation and global systemically important institutions (G-SIIs). Moreover:

- ✓ In the case of the countercyclical capital buffer, the calculation procedure, the process of setting the percentages buffer on exposures by the Bank of Spain and their periodicity, the mechanism of recognition by the competent authority of a European Union Member State or third country, and the communication process, will be defined by regulations.

- ✓ The **Bank of Spain will identify credit institutions** authorised in Spain that are G-SIIs on a consolidated basis and other systemically important institutions (O-SIIs) on an individual, subconsolidated or consolidated basis.

- ✓ The Bank of Spain may introduce a **systemic risk buffer** in order to prevent or avoid long term non-cyclical systemic or macroprudential risks not covered by CRR.

- ✓ Failure to meet with the buffer requirement will entail **restrictions** on **distributions** and the obligation to prepare a **capital conservation plan**.

The period over which the various buffers are to be phased in is the same as in CRD IV, with national options to bring them forward not having been applied (they will therefore not be applied until January 1st, 2016).

- **Supervision.** The Bank of Spain has been given the necessary powers to supervise credit

institutions, the scope of its supervisory actions has been delimited and it has been granted the authority to take measures to guarantee compliance with the solvency regulations. A **system for cooperation** between supervisory authorities has also been established, in particular this covers cooperation with the European Banking Authority (EBA), and as of the entry into force of the Single Supervisory Mechanism in the European Union, with the European Central Bank.

- **Prudential supervision.** The Bank of Spain has been given powers to intervene in the entity's business in the event of breach of the regulations on solvency or on the suitability of the organisational structure or internal risk control. The measures it is authorised to take include introducing stricter capital or provisions requirements, or restricting the distribution of dividends. If the situation is exceptionally serious, the Bank of Spain may even take control of the institution and replace its governing bodies.

- **Stress tests.** The Bank of Spain will subject the credit institutions it supervises to stress tests at least annually.

- **Reporting and disclosure requirements.** By transposition of CRD IV, it will be mandatory for all credit institutions to prepare country-by-country reporting for submission to the Bank of Spain and publication.

- **Penalty system.** In order to harmonise Spanish law with CRD IV, penalties for very serious, serious, and slight infringements have been raised.

- **Other points:**

- **Rules for eligibility of preference shares as own funds.** Preference shares will be eligible as Additional Tier 1 capital for the purposes of CRR, provided the conditions laid down therein are met. The tax treatment remains unchanged.

- **Liability of the members of a savings bank's oversight committee.** The members of a savings bank's oversight committee who are responsible for infringements of the types listed in the eleventh additional provision of Law 10/2014 will be subject to administrative liability.

- **Fee for conducting the comprehensive assessment.** A fee has been created that credit institutions subject to the comprehensive assessment provided under the Regulation of the Single Supervisory Mechanism will be charged to cover the cost of the Bank of Spain's carrying out the associated tasks.

- ✓ The **basis of assessment** for this fee will comprise the consolidated total assets which belonged to taxable entities declared to the Bank of Spain as of December 31st, 2013.

- ✓ The fee will be applied to this tax base at a rate of **0.01048 per 1,000**.

- ✓ The fee will accrue on a one-off basis on **December 31st, 2014**.

- The rules applicable to **institutional protection schemes**, and the **transitional legal provisions** for the phasing in of certain rules, such as those for capital buffers, are also covered.

- **Legislative amendments.** The main changes are:

- **Securities Market Law.** Law 24/1998 has been amended in order to transpose the rules envisaged in CRD IV that are also applicable to investment firms. These amendments include an update to the regulations on central counterparties. Improvements have also been made to the penalty system applicable in the case of breach of European regulations on short selling.

- **Savings Banks and Banking Foundations Law.** The following aspects of Law 26/2013 have been amended:

✓ The regulations for the “**protectorate**” control system for banking foundations have been defined based on the banking foundation’s share of ownership of the credit institution and the territorial distribution of the deposits of those credit institutions in which it is a shareholder. Thus, the protectorate of banking foundations will be under the control of the **Ministry of Economic Affairs and Competitiveness** in the case of foundations whose main activity extends beyond a single Autonomous Region, provided the individual foundation has a direct or indirect share of at least 10% of the credit institution or institutions’ capital or voting rights, or while having a smaller percentage, the banking foundation is the main shareholder.

✓ The Law now stipulates that individuals who are **simultaneously** members both of the management body of a savings bank and of the management body of the banking institution through which the latter exercises its activity as a credit institution **may continue to hold both posts simultaneously until no later than June 30th, 2016.**

- **Derogation of existing legislation.** The following legal instruments and provisions have been derogated:

- The **Banking Law** of December 31st, 1946.
- **Law 31/1968** of July 27th, 1968, on incompatibilities and restrictions for the chairmen, directors and senior executives of private banks.
- **Law 13/1985** of May 25th, 1985, on investment ratios, own funds and reporting requirements for financial intermediaries.

- **Legislative Royal Decree 1298/1986** of June 28th, 1986, on adaptation of current legislation on credit entities to the European Community law.

- **Law 26/1988** of July 29th, 1988 on the discipline and intervention of credit institutions.

- Article 29(2) of **Law 2/2011** of March 4th, 2011, on sustainable economy.

- Subsection (g) of the Thirteenth final provision of **Law 14/2013** of September 27th, 2013, on support to and internationalisation of business.

Royal Decree-Law promulgating urgent measures for growth, competitiveness and efficiency (Royal Decree-Law 8/2014, published in the BOE on July 5th, 2014)

This Royal-Decree Law (RDL) introduces in Spanish legislation various urgent measures necessary for the execution of the Plan of measures for growth, competitiveness and efficiency, enacted by the Council of Ministers on June 6th, 2014. The Circular will come into general effect on July 5th, 2014.

The content of Titles I and V, which include the provisions on financial and fiscal topics, respectively, are summarised below:

Title I: Measures to stimulate economic activity

■ Chapter I: Financing economic activity

This covers various financial measures, in particular:

- **FONPYME:** Law 66/1997 of December 30th, 1997, on fiscal, administrative and social measures has been amended to adapt the Fund for foreign investment operations by small

and medium-sized enterprises (FONPYME). The aim of this measure is to extend to SMEs this type of instrument, which is already available to larger firms since the creation of the Foreign Investments Fund (FIEX) in 2013 under the Law to support entrepreneurs and their internationalisation.

- **Instituto de Crédito Oficial (ICO):** a programme of ICO guarantees has been launched to encourage support from multilateral agencies and international financial institutions for the internationalisation of Spanish firms. The programme has a budget of up to 1.2 billion euros and will be in force for one year as of the entry into force of the RDL.
- **Supplier Payment Fund:** as an exception for 2014 the possibility that local government bodies arrange new debt to cancel some or all of their outstanding debt with the Supplier Payment Fund has been created, provided certain requirements are met.

■ Chapter II: Retail trade and market unity

- **Areas with a large influx of tourists:** Law 1/2004 of December 21st, 2004, on opening hours has been amended as regards the requirements and procedure for determining areas with a large influx of tourists.
- **Retail establishments:** Law 7/1996 of January 15th, 1996, regulating retail trade has been amended in order to simplify the rules on opening, relocating or expanding retail establishments.

■ Chapter III: Limits on interchange fees charged on card transactions

● Purpose and scope:

- ✓ Upper limits have been set on the interchange fees that may be charged on debit and credit card payments at retail outlets in Spain, regardless of the distribution channel used.

- ✓ The measure does not cover transactions using company cards and cash withdrawals from cash dispensers (ATMs). These limits will also not apply to three party arrangements, except in cases where the parties grant licences to other payment services providers to issue or acquire payment cards.

● The limits established are as follows:

- ✓ **Debit card transactions:** the interchange fees per transaction may not exceed 0.2% of the transaction value, up to a maximum of 7 cents of a euro. If the transaction value is not more than 20 euros, the maximum charge may not exceed 0.1% of the value of the transaction.
- ✓ **Credit card transactions:** the interchange fees per transaction may not exceed 0.3% of the transaction value. If the transaction value is not more than 20 euros, the maximum charge may not exceed 0.2% of the value of the transaction.

- For the purpose of calculating these limits, any net commission, remuneration or compensation received by the card issuing payment services provider in respect of payment operations or ancillary activities will be considered part of the interchange fee.

- The beneficiaries of payment transactions in which the interchange fees have been limited **may not demand any additional fees or sums from the payee for the use of the credit or debit card.**

- A system has been established whereby payment services providers are to **inform the Bank of Spain** of the discount rate and interchange fees received from card transactions. The Bank of Spain has been given responsibility for establishing the form, content, and periodicity of the report. This information will be made available on the Bank of Spain's website.

- The application of this chapter will be **monitored** by the Ministry of Economic Affairs and Competitiveness through its Electronic Card Payments Observatory.
- **Penalty system:** non-compliance, except in isolated cases, with these provisions will be considered a very serious infringement.
- The date of **entry into force** of this measure is September 1st, 2014.

Title V: Tax measures

This incorporates urgent measures to stimulate economic activity, aimed at alleviating the effects of the crisis, bringing forward some of the announced tax reform measures.

Bank of Spain Circular to credit institutions and certified appraisal services companies, establishing measures to foster the independence of appraisal activities (Circular 3/2014, published in the BOE on July 31st, 2014)

This Circular aims to overcome some of the obstacles to the appropriate appraisal of real estate posted as collateral for loans and mortgages granted by credit institutions. This goal is pursued by the incorporation of new rules in Circular 7/2010 and the amendment of Circular 4/2004.

A key feature is the addition of a new rule in Circular 7/2010 on the minimum content of the mandatory internal rules of conduct for credit institutions' own internal appraisal departments and other appraisal companies, as this regulation is intended as the core of efforts to promote the independence of the appraisal business.

The opportunity has also been taken to make certain technical improvements, again within the

asset appraisal field, to the statements envisaged in Circular 3/1998, setting out the information certified appraisal companies and departments are required to provide to the Bank of Spain.

Additionally, further content is added to Circular 4/2004 in order to unify the references to the mandatory content of the annual activity report, and to complete the implementation of the recommendations of the European Systemic Risk Board on September 21st, 2011, on the granting of loans in foreign currency.

Circular 6/2010 has also been amended to refer appropriately to the rules on the calculation of APR.

Finally, Circular 2/2014 has been amended in order to harmonise the treatment of intangible asset deductions during the transitional period under CRR.