Recent key developments in the area of Spanish financial regulation

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Law on recovery and resolution of credit institutions and investment firms (Law 11/2015, published in the BOE on June 19th, 2015)

The purpose of Law 11/2015 is to regulate the early intervention and resolution processes for credit institutions and investment firms established in Spain, thereby transposing into Spanish legislation Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms. The Law will be applicable as of the day following its publication in the BOE (Official State Gazette), except in the case of the rules on internal recapitalisation and Deposit Guarantee Fund stress tests, which will come into force on January 1st, 2016, and July 3rd, 2017, respectively.

The Law will apply to:

- credit institutions and investment firms established in Spain,
- certain financial institutions established in Spain, other than insurance and reinsurance undertakings,
- financial holding companies, mixed financial holding companies, and mixed-activity holding companies established in Spain.
- financial holding companies and mixed financial holding companies from other European Union Member States whose supervision on a consolidated basis corresponds to one of the national supervisors, and
- branches of institutions established outside the EU.

The **main features** of the Law are described in what follows.

I. EARLY INTERVENTION

- **Planning early intervention: Recovery plan**

As a preventive measure, all institutions are to prepare and keep up-to-date a **recovery plan** envisaging the measures and actions to be adopted to restore their financial position if any of them suffer a serious deterioration.

The Law also requires the signature of agreements between institutions and their integrated subsidiaries under consolidated supervision for the provision of financial aid in the case any of them find themselves in any of the situations in which early intervention is envisaged.

The obligation to prepare a **general feasibility plan,** as referred to by Law 10/2014 and Law 24/1988 will be deemed to have been complied with when a recovery plan has been prepared.

■ **Early intervention**

When an institution **breaches or it is reasonably likely,** in the near future, **that it will breach** the solvency, organisation and discipline regulations, but is in a position to **return to compliance by its own means,** the relevant supervisor will declare the start of early intervention.

The Law establishes the **early intervention measures** that the relevant supervisor may adopt. These measures will require **monitoring**, which shall consist of the institution's sending (at least) quarterly reports on its level of compliance with the measures.

The relevant supervisor may decide to take **control of the institution or provisionally replace its administrative or management body.** These measures shall remain in place for a year. Exceptionally, this period may be renewed for further periods of equal length while the conditions justifying the provisional control or replacement persist.

During this early intervention phase, the Fund for Orderly Restructuring of the Banking Sector (FROB) may also take all the necessary steps to prepare the evaluation of the institution's assets and liabilities, and require that the institution contact possible buyers in order to prepare for its resolution.

II. PREVENTIVE PHASE OF RESOLUTION

■ **Planning resolution**

As a preventive measure, the preventive resolution authority will prepare and adopt, following a report from the FROB and the relevant supervisor, and following consultations with the resolution authorities, **a resolution plan for each institution that is not part of a group subject to supervision on a consolidated basis.** This plan will contain the resolution measures the FROB may apply if the institution complies with the envisaged conditions. When impediments to the institution's resolvability are detected, the obligation to draw up a resolution plan will be suspended until these impediments are eliminated.

Resolution plans will be **updated** at least annually and in the following cases: (i) whenever there is a change in the institution's legal or organisational structure that may significantly affect the plan's effectiveness or require changes to it; or (ii) whenever the preventive resolution authority sees fit, on its own initiative or at the request of the FROB.

■ **Resolvability assessment**

On drawing up a resolution plan, the preventive resolution authority will deem an institution to be resolvable if, should the circumstances requiring its resolution arise, it would be possible to liquidate it through insolvency proceedings or resolve it under this Law, in such a way that the continuity of the essential functions performed by the institution are guaranteed and that the process does not result in significant adverse effects on the Spanish financial system or that of the EU. The Law mentions the alternative measures that may be adopted to eliminate the impediments that may arise.

III. RESOLUTION

■ **Conditions for resolution**

Action will be taken to resolve an institution when all the following conditions are **met simultaneously:**

a) The institution is **failing** or is likely to fail in the near future.

b) There is no **reasonable prospect** that any private sector measures, supervisory action, or the write-down or conversion of relevant capital instruments would prevent the failure of the institution within a reasonable timeframe.

c) A resolution action is necessary or advisable in the **public interest** to achieve any of the objectives stated in the Law, insofar as the liquidation of the institution under insolvency proceedings would not reasonably enable these objectives to be achieved to the same extent.

■ **Start of the resolution process**

The relevant supervisor will decide if the institution is failing or is likely to fail in the near future and will inform the FROB and the relevant preventive resolution authority.

The FROB will ascertain whether the circumstances envisaged for the institution's resolution exist, and if so, decide to start the resolution procedure immediately.

■ **Replacement of the management body or senior management or similar as a resolution measure**

After starting the resolution process, the FROB will decide and make public the **replacement** of the management body or senior management or similar and the appointment of legal or natural persons, acting in its name and under its control, as the institution's administrators, who will exercise the powers and functions of this role. In certain extraordinary circumstances, the FROB may decide not to replace the institution's management in this way.

The replacement of the institution's management will remain in effect for a **period of up to one year.** However, exceptionally, the FROB may extend this period when it considers it appropriate in order to complete the resolution process.

The FROB will approve the special administrator's framework of action, including the periodic information to be prepared on the administrator's performance of his functions, and his appointment will be published immediately in the BOE.

■ **Resolution tools:**

The FROB may adopt the following **tools** to carry out resolution:

- ✓ Sale of the institution's business.
- ✓ Transfer of assets/liabilities to a bridge institution.
- ✓ Transfer of assets/liabilities to an asset management company.
- ✓ Internal recapitalisation, also known as a bail-in.

IV. WRITE-DOWN AND CONVERSION OF CAPITAL TOOLS AND BAIL-IN MECHANISM

One of the new tools made available by this new law is the **bail-in** mechanism, whereby the institution's shareholders and creditors **absorb the institution's losses.** This measure may be adopted to:

a) **Recapitalise the institution** such that it is able to remain in business and retain market confidence.

b) Convert into capital or reduce the principal of loans or debt instruments transferred on **applying resolution tools** comprising the creation of a bridge institution, sale of business or asset separation.

In order to internally recapitalise the institution undergoing resolution, the FROB will decide on the write-down of any of the institution's liabilities or their conversion into shares or other equity instruments. The FROB will conduct a prior **valuation of the assets and liabilities,** which will form the basis for calculating the amount needed to recapitalise the institution.

The FROB will **implement the write-down or conversion of capital instruments** in

accordance with the priority of claims in the insolvency proceedings:

a) Items of **Common Equity Tier 1** (CET1) will be written-down first, in proportion to losses, and to the extent possible.

b) If the above amount is not sufficient to recapitalise the institution, the principal amount of **Additional Tier 1 capital instruments** (AT1) will be written down or they will be converted into CET1 instruments, or both, insofar as is necessary to achieve resolution objectives, or if the amount is less, to the extent possible.

c) If the above amounts are not sufficient to recapitalise the institution, the principal amount of the **Tier 2 capital instruments** (T2) will be written down or they will be converted into CET1 instruments, or both, insofar as is necessary to achieve resolution objectives, or if the amount is less, to the extent possible.

Mechanisms are also provided to **compensate creditors and shareholders** if it is found that, after the bail-in, the level of write-down based on the preliminary valuation exceeds the requirements resulting from the definitive valuation.

All **liabilities not expressly excluded** or not excluded by the FROB's decision, will be eligible for write-off or conversion into capital in order to internally recapitalise the affected institution.

- **Minimum requirement for own funds and eligible liabilities (MREL)**

Institutions must comply with the MREL laid down by the preventive resolution authority at all times. This will be calculated as the **amount of own funds and eligible liabilities expressed as a percentage of the total liabilities and own funds of the institution.**

- **Business reorganisation plan**

The FROB will require that the institution's administrative and management body, or the person or persons appointed for this purpose, submit a **business reorganisation plan** containing the measures to restore the **long-term viability of the institution** or a part of its activities within a reasonable timeframe.

- **Contribution to the National Resolution Fund**

When the shareholders and creditors of the institution under resolution have contributed to the absorption of the losses and internal recapitalisation for an amount of, **at least, 8% of the total liabilities,** and this is insufficient, recourse to the **National Resolution Fund** will be possible for an amount not exceeding **5% of the total liabilities.**

Fulfilment of the above condition (8% of total liabilities) may be replaced by that of the following conditions:

a) that the contribution to the absorption of losses and internal recapitalisation is for an amount not less than **20% of the institution's risk-weighted assets.**

b) that the National Resolution Fund has available to it at least **3% of the amount of the deposits guaranteed by the DGF** obtained in the form of ex-ante contributions, which will not include the contributions made to a deposit guarantee system, and

c) that the institution have assets below **900 billion euros** on a consolidated basis.

V. OTHER POINTS

- Changes have been made to the **composition of the FROB,** with an increase in the number of members of the governing committee. The office of president has been created, as the body's highest representative, and a member of the National Securities Market Commission (CNMV) has been added as a result of the scope of application of the law.

- As regards the Deposit Guarantee Fund, its legal status has been modified as a result of the transposition of Directive 2014/49/EU. The changes include:

  ✓ Credit institutions will contribute to the **Investment Guarantee Fund** for holdings of customers' securities.

  ✓ Resources will be assigned to one of the following separate accounting categories into which the Fund will be divided:

    - The financial resources available from the **deposit guarantee section** must come to at least **0.8%** of the amount of the guaranteed deposits.

    - Annual contributions to the **securities guarantee section** will not exceed **0.3%** of the securities guaranteed.

  ✓ Stress tests will be conducted on the Fund at least every **three years.**

- Law 9/2012 of November 14th, 2012, on Credit Institution Restructuring and Resolution is repealed, with the exception of its provisions modifying other laws and certain additional provisions.

Bank of Spain Circular on the rules for the submission to the Bank of Spain of payments and payments systems statistics covered by Regulation (EU) 1409/2013, of the European Central Bank, of November 28th, 2013, on payment statistics (Circular 2/2015, published in the BOE on May 26th, 2015)

The Circular establishes the procedures for the presentation of information on payments and payments systems that are to be followed by reporting agents, who are to send information annually to the Bank of Spain, the first reporting period being from July 1st to December 31st, 2014, such that the relevant information must be submitted no later than the last working day of May 2015.

Regulation (EU) 1409/2013 established the European Central Bank's new reporting requirements on payments and payments systems, concerning the information payment service providers and payments systems operators are to provide to national central banks. Under this Regulation, Bank of Spain Circular 2/2015 states that the **reporting obligation** applies to: payment service providers established in Spain on the official registers of the Bank of Spain and payments systems operators established in Spain.

Royal Decree amending Royal Decree 217/2008, February 15th, 2008, on the legal rules applicable to investment firms and other entities providing investment services and Collective investment institutions, and partially amending Regulation implementing Law 35/2003, November 4th, 2003, on Collective investment institutions, enacted by Royal Decree 1309/2005, November, 4th, 2005 (Royal Decree 358/2015, published in the BOE on May 9th, 2015).

The aim of the Royal Decree is, firstly, to complete the transposition of CRD IV (Directive 2013/36/EU) and, secondly, convert Royal Decree 217/2008 into the main piece of legislation at the regulatory level on the organisation, supervision and solvency of investment firms.

The amendments envisaged for Royal Decree 217/2008 may be grouped into the following blocks:

1. The **suitability requirements** that the members of the board of directors, general managers and other key officers of investment firms are to comply with are established.

2. The **functions of the three committees** investment firms are to have under the Securities Market Law (nomination committee, remuneration committee, and risk committee) are defined. The public disclosure requirements concerning corporate governance and remuneration policy are also set out.

3. The bulk of the amendments are additional provisions on the **solvency** of investment firms to complement those of CRR (Regulation (EU) 575/2013). It also covers the ordinary Common Equity Tier 1 buffers in addition to ordinary buffers established in CRR.

4. Provisions regulating the **supervisory function** of the **National Securities Market Commission** (CNMV) are also included.