The Banking Regulation Review

Tenth Edition

Editor
Jan Putnis

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THE BANKING REGULATION REVIEW

TENTH EDITION

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PREFACE

Banking regulation continues to confound the idea that views about how banks should be regulated will eventually settle down to an orthodoxy broadly accepted throughout the world.

Few global banking groups ever considered that a time would come when they would face consistent systems of regulation across the world, and still less that regulators would coordinate their activities in a way that would make life easy for those groups. Legal and compliance professionals who have worked in or with the industry since long before the financial crisis of 2007 to 2009 are generally not surprised by the examples of banking regulation diverging in many jurisdictions: in some ways it marks a return to a time when there can be no certainty that governments and regulators are all facing the same way and pulling in the same direction.

Running a global banking group continues to be a tough exercise, and the possibility of further fragmentation of approaches to regulation around the world risks adding further to the cost bases of these groups. As predicted since the UK electorate voted to leave the European Union in 2016, Europe in particular looks set to become a less cost-efficient and more complex place in which to run a cross-border banking franchise. Indeed this is already the case for the banking groups that have largely completed their Brexit reorganisations, establishing or expanding EU subsidiaries. While this has stimulated banking groups to consider cost cutting and other efficiency measures in connection with their Brexit planning, in many cases these measures scarcely compensate for the inherent inefficiency of requiring additional licensed legal entities through which to conduct business in Europe.

Aside from the largely regional challenge of Brexit, this tenth edition of *The Banking Regulation Review* is published in the midst of a number of industry developments that are challenging regulators and banks alike in all major banking centres.

The challenges are far-reaching and have no central theme, ranging from the continuing revolution in finance stimulated by emerging technologies and the related exploitation of the value of data on the one hand, to the continual revelations of the widespread use of banks for money laundering on the other.

While it is too early to say that the remarkable global consensus that emerged about prudential regulation following the financial crisis is fracturing, it is certainly eroding around the edges, with liberalising tendencies in the United States and even in the European Union.

All of these factors make work as a legal, compliance or risk professional in the sector both more interesting and more perilous than ever before: more interesting because there is so much going on, and more perilous because there seems to be more that can go wrong within banks nowadays, from misallocation of capital to business units that struggle, to whistleblowing and money laundering problems, to catastrophic IT outages.

Money laundering issues have been particularly prominent in banking in the past year, suggesting that the industry still has a long way to go to tackle this problem. Many of the issues uncovered are legacy in nature, but the industry has much to do to convince regulators and governments that those issues will not recur.

IT problems have led to an increasingly intense debate about what can be done to improve the operational resilience of banks. This is not simply a continuation of the somewhat sterile debate about the incompatibility of many legacy banking IT systems with attempts to modernise risk management and the customer experience. Regulators have realised that operational resilience is a subject that can only be tackled effectively by making two significant changes to the way that this subject has traditionally been viewed. First, operational resilience should be considered in a holistic way, looking not only at banks' own systems but also across the whole of the financial sector at the resilience of the inter-connections between banks, financial market infrastructure and other market participants. Secondly, work on operational resilience achieves little unless it is considered with customers and other end users of services in mind. The resilience of a bank's systems is not a meaningful concept unless it delivers an acceptable level of service to customers and incorporates tolerances for the levels of inconvenience that customers may suffer in the event of extreme disruption, recognising that disruption could originate outside the bank itself.

More immediately, IT challenges in banks expose the need for effective crisis management capabilities. Recovery and resolution planning has helped some banks to develop this expertise, but has been less helpful in this respect than might have been hoped. There is no substitute for more detailed planning for crises than many banks have so far included in their recovery planning. Those who disagree with this view should consider how many banks have performed poorly when crises have hit them, and how many of those banks would have argued beforehand that their systems were adequate to cope with a range of foreseeable adverse scenarios.

Conduct risk remains high up the agenda of most banks. The final report of the Royal Commission into misconduct in the banking, superannuation and financial services industry in Australia was notable outside that country for the familiarity of almost all of its findings. Whatever the ultimate legislative and regulatory response to that report, it is a reminder that banking remains vulnerable to poor conduct unless senior management make good conduct a cornerstone of their strategy and ensure that it is embedded in the incentive arrangements for all staff who have a material influence on customer outcomes.

This edition covers 37 countries and territories in addition to our usual chapters on international initiatives and the European Union. Thanks are due to all of the authors who continue to devote time to this project despite busy schedules. There must be a feeling among many of the authors that banking regulation is a subject that will never settle down; that it will never return to being the rather duller subject that it was before it became a political issue more than 10 years ago.

Thank you also to the partners and staff of Slaughter and May in London and Hong Kong for supporting this book, and in particular to Nick Bonsall, Ben Kingsley, Peter Lake, Emily Bradley, Tolek Petch, Jocelyn Poon, Tamara Raoufi and David Shone.

Finally, the team at Law Business Research deserve as much credit for their patience this year as for their usual work as the publishers of this book. Thank you in particular to Gavin Jordan and Katie Hodgetts. The uncertainties that Brexit has thrown up have left a number of authors wondering what the best time to publish would be, before the realisation dawned that Brexit is likely to be a more protracted process than many envisaged and that therefore

no one publication date would be better than any other. The other issues noted above look set to run in some form indefinitely.

Perhaps by the time the next edition of this book is published, all will be much clearer, but those of us who are endlessly fascinated by the subject of banking regulation know all too well just how unlikely that is.

Jan Putnis
Slaughter and May
London
April 2019

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SPAIN

Juan Carlos Machuca and Joaquín García-Cazorla[1]

I INTRODUCTION

Spain boasts a diversified modern financial system that is fully integrated with international and European financial markets. The Spanish banking regulator, Banco de España, joined the European System of Central Banks (ESCB) on 1 January 1999. As a result, the definition and implementation of the country's monetary and exchange rate policy, the management of official currency reserves, the efficiency of the payment systems and the issuing of banknotes are now controlled by the ESCB.

Also as a consequence of integration, the Spanish regulatory system governing credit institutions largely mirrors the legal framework in other EU Member States. As such, credit institutions from other EU Member States may provide banking services in Spain, and vice versa, without the need to establish a branch or a subsidiary.

After a number of years during which Spanish regulatory activity followed EU-wide requirements to a great extent, the outbreak of the Spanish financial crisis and, mainly, the return of the Spanish economy to technical recession at the end of 2011, triggered a revolution in the Spanish banking system that started in 2012 and lasted until 2016.

One of the main triggers of the revolution was the nationalisation in May 2012 of Bankia, the fourth-largest Spanish banking institution at the time, through the acquisition by the Fund for Ordered Bank Restructuring (FROB) of a majority stake in the entity's share capital, as it resulted in the government requesting financial assistance from the EU for the recapitalisation of certain Spanish financial institutions, which led to the signing of the memorandum of understanding (MOU) of 20 July 2012 between the Spanish and European authorities, with the participation of the International Monetary Fund (IMF). According to the MOU, the Spanish banking sector would be provided with up to €100 billion in financial assistance under a programme that would cover a period of 18 months. The MOU comprised several specific conditions designed to identify the capital needs of Spanish credit institutions, implement plans to address any capital shortfalls so identified, and reform the regulatory and supervisory framework of the financial sector.

Additionally, the terms of the MOU provided for those banks receiving public funding support to segregate their problematic assets related to real estate development and their foreclosed assets into the external Asset Management Company for Assets Arising from

1 Juan Carlos Machuca is a partner and Joaquín García-Cazorla is an associate at Uría Menéndez Abogados, SLP.

the Bank Restructuring (SAREB). The design, incorporation and performing of SAREB constitutes one of the major achievements derived from the restructuring of the Spanish financial system, as it is now one of the main players of the Spanish real estate sector.

SAREB's share capital is 55 per cent privately owned (mainly by banks and insurance companies) and 45 per cent is owned by public authorities. SAREB has the mandate to divest the assets over 15 years, optimising levels of recovery and value preservation, and minimising negative effects on the real estate market and economy and the costs to taxpayers.

The EU financial assistance programme for certain Spanish financial institutions was successfully ended on 22 January 2014 (as scheduled). Such termination led to a new supervision post programme that will be in place until Spain repays at least 75 per cent of the funds provided, which is expected to occur no earlier than in 2026.

As a consequence of the reforms resulting from the aforementioned EU financial assistance programme, and the transposition of the relevant pieces of EU legislation enacted during the period from 2013 to 2015, the current legal framework of the Spanish banking sector is now mainly gathered in the following two sets of legislation, which implement in Spain the CRR/CRD IV package[2] and the EU legal framework on recovery and resolution of credit institutions,[3] respectively:

a the Credit Institutions Solvency Law;[4] Royal Decree 84/2015, of 13 February, developing the Credit Institutions Solvency Law (RD 84/2015); Circular 2/2016 of the Banco de España, of 2 February, to credit institutions on supervision and solvency and completing the adaptation of the Spanish legal system to Directive 2013/36/EU and Regulation (EU) No. 575/2013 (Circular 2/2016); and Royal Decree-Law 14/2013, of 29 November, on urgent measures for the adaptation of the Spanish law to the EU rules and regulations on supervision and solvency of financial entities (RDL 14/2013), which jointly set forth the Spanish legal regime on supervision and solvency of credit institutions and have repealed and combined the numerous and diffuse rules on the organisation and discipline of credit institutions that existed previously (Credit Institutions Solvency Law, RDL 14/2013, RD 84/2015 and Circular 2/2016, jointly, the Credit Institutions Solvency Regulations); and

b the Recovery and Resolution Law[5] and Royal Decree 1012/2015, of 6 November, developing the Recovery and Resolution Law and amending Royal Decree 2606/1996, of 20 December, on deposit guarantee funds (jointly with the Recovery and Resolution Law, the Recovery and Resolution Regulations).

2 Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (applicable since 1 January 2014) (CRR); and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 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).

3 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amendingCouncil Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EEC, 2007/36/EEC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council (Recovery and Resolution Directive).

4 Law 10/2014, of 26 June, on the organisation, supervision and solvency of credit institutions.

5 Law 11/2015, of 18 June, on the recovery and resolution of credit institutions and investment firm.

It is noteworthy that the resolution framework established by the Recovery and Resolution Regulations was tested on the occasion of the resolution in 2017 of Banco Popular Español, SA (Banco Popular), the fifth-largest bank in Spain at the time and listed in the Spanish Stock Exchange, which ended up with its sale to Banco Santander, SA (Banco Santander) as part of the resolution tool involving the sale of the entity's business for a total consideration of €1. The implementation of this resolution tool derived from the execution of the resolution of the FROB Steering Committee of 7 June 2017 (FROB Resolution), which, in turn, adopted the measures required to put in place the Decision of the Single Resolution Board (SRB) of the same date concerning the adoption of the resolution scheme in respect of Banco Popular, in compliance with Article 29 of Regulation (EU) No. 806/2014[6] (Regulation 806/2014).

As regards the background of Banco Popular's resolution, on 6 June 2017, the European Central Bank (ECB) informed the SRB that the entity was failing or likely to fail under the circumstances described in Article 18.4.c) of Regulation 806/2014. Based on the ECB's judgement, the SRB agreed to put Banco Popular under resolution, approved the resolution scheme containing the resolution mechanisms to be applied and instructed the FROB, as the executive resolution authority for Banco Popular, to take the measures required to apply the resolution scheme. The resolution scheme envisaged the writing down or conversion of shares and other capital instruments of Banco Popular that were eligible for resolution purposes and the sale of all the outstanding shares after those measures were implemented. Pursuant to the applicable EU rules and regulations on the resolution of credit institutions, prior to deciding on the resolution of Banco Popular, the SRB obtained the required valuation of the entity from an independent expert, which estimated a negative economic value of Banco Popular amounting to minus €2 billion, in the baseline scenario, and minus €8.2 billion, in the most adverse scenario.

On the basis of the foregoing, and in compliance with the SRB's instructions, the FROB Resolution was adopted. Pursuant to that:

a Banco Popular share capital outstanding prior to the date of the FROB Resolution was written down to create a non-distributable voluntary reserve;

b a capital increase was made without pre-emptive subscription rights to convert all the Additional Tier 1 capital instruments of Banco Popular into share capital;

c share capital was reduced to zero through the write-down of the shares deriving from the conversion described in point (b) to create a non-distributable voluntary reserve;

d a capital increase without pre-emptive subscription was agreed to convert all the Tier 2 capital instruments into newly issued Banco Popular shares; and

e all the newly issued Banco Popular shares deriving from the conversion described in point (d) were transferred to Banco Santander for a total price of €1.

It is worth noting that this whole process took place in a single day, and in particular that the implementation of the resolution scheme was carried out during the night of 6 to 7 June, so that when the Spanish markets opened on 7 June, the resolution of Banco Popular and its sale to Banco Santander had already been made public.

6 Regulation (EU) No. 806/2014, of the European Parliament and Council of 15 July 2015, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No. 1093/2010.

As regards the legislative developments in connection with banks, saving banks and other financial institutions in 2018, the following pieces of legislation and secondary legislation have been enacted:

a Royal Decree-Law 22/2018, of 14 December, establishing certain macroprudential tools that, inter alia, amends the Credit Institutions Solvency Law to broaden the macroprudential tools available to Banco de España. In particular, Banco de España is granted powers to increase the capital requirements applicable to specific risk exposures, limit the aggregate exposure of all of the credit institutions or of a subgroup of them to specific economic sectors, or to establish limits or specific conditions in connection with the granting of loans or the acquisition of certain financial products;

b Royal Decree-Law 19/2018, of 23 November, of payment services and other urgent measures on financial matters, which transposes into Spanish law Directive (EU) 2015/2366 of the European Parliament and of the Council of 23 November 2015 on payment services in the internal market, establishing the new regime applicable for the rendering of payment services in Spain. In addition, Royal Decree-Law 19/2018 amends the Credit Institutions Solvency Law in order to, inter alia, foresee the setting up by Banco de España of a communication channel through which credit institutions' breaches of their prudential obligations can be communicated to Banco de España, with appropriate safeguards for those submitting such communications;

c Circular of Banco de España 2/2018, of 29 December, amending Circular of Banco de España 4/2017, of 4 November, to credit institutions in connection with rules on public financial information and financial statements templates, to adapt it to Commission Regulation (EU) 2017/1986 of 31 October amending certain pieces of EU regulation as regards International Financial Reporting Standard 16 relating to lease contracts; and

d Circular of the National Securities Market Commission (CNMV) 1/2018, of 12 March, on warnings in connection with certain financial products (Circular 1/2018 of CNMV), which sets forth certain reinforced transparency duties applicable to, among others, credit institutions when marketing and distributing certain financial products and services to retail customers. Among other matters, Circular 1/2018 of CNMV sets forth the warnings that retail customers need to be provided with if they are willing to subscribe financial instruments that, pursuant to the credit institution solvency regulations, qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2, or instruments that are equivalent to those in third countries, and imposes the obligation of gathering their handwritten statements as to their acknowledgement of the relevant financial product not being advisable for retail customers. Circular 1/2018 of CNMV also imposes additional transparency obligations for the marketing of instruments that are eligible for amortisation or conversion in a credit institution resolution scenario (see Section III.iv).

A new institutional and legal framework for the Spanish banking system has been established in a multi-stage procedure that commenced in 2012, which developed intensely between 2013 and 2015 and considerably slowed since 2016. Within this process, a number of measures have been taken with the aim of improving bank transparency, regulation and supervision, and speeding up the recovery of the Spanish financial system within the context of a more propitious economic environment.

II THE REGULATORY REGIME APPLICABLE TO BANKS

The Spanish regulatory regime for credit institutions is currently set out in the Credit Institutions Solvency Regulations, Law 26/2013, of 27 December, on savings banks and banking foundations (Savings Banks and Banking Foundations Law) and its regulations, and Law 13/1989, of 26 May 1989, on credit cooperatives.[7] This regulatory framework may be supplemented by the circulars, rules and guidelines issued, from time to time, by Banco de España or by the ECB.

A credit institution is defined under Spanish law as a company duly authorised to receive from the public deposits or other forms of repayable funds, and grant credits for their own account. Spanish credit institutions may therefore primarily engage in a number of retail banking services.

Credit institutions must be recorded in a register maintained by Banco de España before they commence banking activities.

There are other types of regulated entities that play an important role in the Spanish market for financial services, among which financial credit establishments, electronic money entities and payment service entities are especially noteworthy.

i Credit institutions: banks, savings banks and credit cooperatives

Credit institutions consist of banks, savings banks, credit cooperatives and the Official Credit Institute (ICO), which is the country's financial agency. Excluding the figures relating to the ICO, banks represent 44.83 per cent of all Spanish credit institutions, credit cooperatives represent 53.45 per cent and savings banks the remaining 1.72 per cent.[8] Banks are nevertheless by far the most important category of credit institution in Spain, as the value of their assets represents 95.44 per cent of the sector, while credit cooperatives' represent 4.5 per cent and savings banks 0.07 per cent.[9]

The raising of funds from the general public, except through activities subject to the securities markets regulations, is reserved for credit institutions.

Based on the foregoing figures, banks have a central role in the financial system because of the sheer volume of their business and their involvement in every segment of the Spanish economy. Most Spanish banks provide a full range of services for corporate and private customers, including collection and payment services outside Spain through foreign branches. Banks have the legal form of public limited companies, and are therefore subject to general principles of company law as well as banking regulations.

Savings banks are a specific type of credit institution that until recently accounted for nearly half of the Spanish financial sector. Savings banks tended to be locally oriented entities of variable (but generally limited) size with strong economic and social ties to their home region. Although savings banks fully participated in the market, they were a special category within the financial services industry, as they were structured as foundations rather than

7 As regards credit cooperatives, certain matters and rules are also regulated at regional level.

8 Amounts obtained from Banco de España's registry of institutions as of 6 March 2018.

9 Approximate and estimated figures calculated on the basis of the data publicly available on the websites of the AEB (the Spanish banking association), UNACC (the Spanish national union of credit cooperatives), Caixa Pollença and Caixa Ontinyent (the only two savings banks currently in existence).

companies and governed by representatives of collective shareholders: mainly depositors, employees and local authorities. Any positive result was allocated to social welfare and cultural projects.

The corporate model of savings banks has completely changed in recent years. After a number of partial reforms during 2011 and 2012 (as a consequence of which most of the Spanish savings banks were transformed into banks through different integration processes), a comprehensive revolution of their legal regime was put in place in December 2013 when the Savings Banks and Banking Foundations Law was passed. That regulatory revolution considerably deepened in 2015 and 2016 as a result of the approval of various pieces of ancillary legislation developing the Savings Banks and Banking Foundations Law.[10]

Since 2010, 43 of the 45 savings banks (99.39 per cent of the aggregate average assets of the sector) have been part of a consolidation process, which has resulted in seven banking groups now operating. The number of branches has been reduced by 46.8 per cent and the workforce by 40.6 per cent since late 2008.[11] In the light of these radical changes to the sector, the Savings Banks and Banking Foundations Law aims to limit the role of savings banks in the credit institutions sector (capping the balance sheets, market share and geographical scope of banking activities), clarifying the role of former savings banks in their capacity as shareholders of credit institutions, and strengthening incompatibility requirements regarding the governing bodies of the former savings banks and the commercial banks controlled by them. Some of the main features of the new regime are as follows:

a savings banks will only be entitled to engage in the solicitation of repayable deposits from the public and the granting of credits within the territory of one autonomous region or a maximum of 10 neighbouring provinces;

b savings banks need to be engaged mainly in the deposit-taking and lending business;

c any person holding an executive position in a political party, trade union or professional association, elected representatives in public administrations, senior officers in such public administrations and those who have held any of the foregoing positions during the past two years, will not be allowed to be a member of a management body of a savings bank. This is a breakthrough on the prior regime that aims to avoid previous failures in the management of savings banks;

d any savings bank holding assets in excess of €10 billion or with a market share in relation to the deposits in its autonomous region of more than 35 per cent shall transfer

10 Royal Decree 877/2015 of 2 October (as amended by Royal Decree 536/2017), which, inter alia, develops the Savings Banks and Banking Foundations Law in connection with the reserve fund to be created by specific banking foundations; Ministerial Order ECC/2575/2015 of 30 November, establishing the content, structure and disclosure requirements for the annual corporate governance report of certain banking foundations; National Securities Market Commission Circular 3/2015 of 23 June on the technical and legal specifications and information requirements for websites of listed companies and savings banks that issue securities on official secondary securities markets; and Banco de España Circular 6/2015 of 17 November to savings banks and banking foundations on specific matters pertaining to remuneration and the corporate governance reports of savings banks that do not issue securities admitted to listing on official secondary securities markets and on the obligations of specific banking foundations derived from stakes in credit institutions (collectively, the Savings Banks and Banking Foundations Developing Regulations).

11 Presentation on the status of the regulatory and financial outlook of the savings banks sector issued by the Spanish Confederation of Savings Banks on 26 February 2018.

its financial activity to a credit entity and become a banking foundation or a regular foundation, depending on the stake it holds in the entity receiving its financial activity; and

e banking foundations are those foundations with a (direct or indirect) holding in a credit entity of at least 10 per cent of its share capital or voting rights, or such other percentage allowing the appointment or removal of at least one member of the board. These entities shall have the purpose of managing their stake in the relevant credit institutions and pursuing their social project or corporate responsibility programme. Depending on the stake of the banking foundation in the credit entity (the relevant thresholds being 10, 30 and 50 per cent), a number of internal rules and protocols shall be in place. Additionally, the dividend distribution of credit institutions controlled by banking foundations shall be subject to a minimum voting majority of two-thirds.

Credit cooperatives are private institutions whose corporate purpose is to attend to the financial needs of members and those of third parties by means of the development of those activities that are also carried out by credit institutions. Their current regime is contemplated in Law 13/1989, of 26 May 1989, on credit cooperatives as its developing regulation, as approved by Royal Decree 84/1993 of 22 January.

ii Other types of regulated entities that do not qualify as credit institutions under Spanish law

Financial credit establishments

Financial credit establishments (EFCs) are a special type of regulated entity that do not qualify as credit institutions (although they did until the Credit Institutions Solvency Law was approved) and that carry out, in a professional manner, one or more of the following activities:

a granting of loans and credits, including consumer loans and mortgage-backed loans;
b factoring, with or without recourse, and other ancillary activities;
c leasing;
d granting of security interests; and
e granting of reverse mortgages.

The legal framework governing EFCs is established in Law 5/2015, of 27 April, on promoting corporate financing (Law 5/2015), the main features of which include the following:

a the creation of EFCs requires authorisation from the Ministry of Economy, which, in turn, requires the issuance of a mandatory prior report by Banco de España;
b Law 5/2015 regulates the existence of hybrid institutions (i.e., EFCs that also provide payment services or issue electronic money); and
c a significant portion of the obligations applicable to credit institutions on solvency, conduct of business, control of major shareholdings and transfer of business, and corporate governance are also applicable to EFCs.

Finally, in October 2015, the Ministry of Economy made public a draft regulation aimed at developing the legal framework of EFCs. The draft regulation has not yet been approved.

Electronic money entities

Electronic money entities (EDEs) are recognised as a special type of regulated entity that issues electronic money. The legal regime for EDEs was established in 2008 and amended in 2011 by a law regulating the issuing of electronic money and the legal regime of EDEs, partially implementing Directive 2009/110/EC. Secondary legislation was approved by Royal Decree-Law 778/2012, of 4 May, developing the legal framework of EDEs, clarifying the definition of e-money and the scope of the applicable Spanish regulations, and establishing the requirements for the setting up and running of EDEs, since their supervision and sanction regime is very similar to that applicable to credit institutions. Royal Decree-Law 778/2012 fully implemented Directive 2009/110/EC.

Payment services entities

Payment service entities are entities regulated by Banco de España that are engaged, in a professional manner, in the rendering of payment services, as defined in point (3) of Article 4) of Directive (EU) 2015/2366 of the European Parliament and of the Council of 23 November 2015 on payment services in the internal market. The legal regime in connection with the rendering of payment services is set forth in Royal Decree-Law 19/2018, of 23 November, of payment services and other urgent measures on financial matters.

III PRUDENTIAL REGULATION

Given its participation in the Single Supervisory Mechanism (SSM), Banco de España qualifies as a national competent authority (NCA), which implies that credit institutions considered as significant are supervised by the ECB, while less significant institutions are directly supervised by Banco de España and, indirectly, by the ECB. Of the 117 significant institutions supervised by the ECB, 12 are Spanish (as at 2 January 2019). These 12 significant institutions represent more than 90 per cent of deposit assets in Spain.

i Relationship with the prudential regulator

Banco de España no longer sets the country's monetary and exchange rate policy, except in its role as a member of the ESCB, but it remains in control of, inter alia, the following functions:

a management of currency and precious metal reserves not transferred to the ECB;

b supervision of the solvency and behaviour of credit institutions (pursuant to the distribution of competencies set forth by the SSM);

c promotion of the stability of the financial system and of national payment systems, without prejudice to the functions of the ECB; and

d minting and circulation of coins and other types of legal tender.

Banco de España continuously monitors and analyses credit institutions, assesses the reports and regular information received from them, and conducts on-site inspections. There is close interaction between Banco de España and the entities subject to its supervision. Provisioning rules are straightforward, transparent and verified by Banco de España.

Banco de España's responsibilities include the verification of maximum rates and charges for banking services rendered by credit institutions. It also verifies the customer protection rules and keeps several registries of public banking information, including the register of institutions, registers of senior officers and shareholders, auditors' reports and a special registry of the articles of association of supervised institutions. It also receives confidential information from institutions on their financial situation and their shareholders.

Banco de España may issue general or specific recommendations to and requirements of entities (i.e., requiring adequate provisioning for less solvent obligors and improvements in the quality control over assets). It may also initiate disciplinary proceedings against institutions and their boards of directors or managers, or may even intervene and replace directors to remedy deficiencies or non-compliance.

Banco de España has powers to enforce compliance with the organisational and disciplinary regulations applicable to credit institutions operating in the Spanish financial sector. These powers are exercised not only over credit institutions and other financial institutions subject to its oversight, but also over directors and managers, who can be penalised for very serious or serious infringements when they are attributable to wilful misconduct or negligence. Sanctions can also be imposed on the owners of significant shareholdings in credit institutions and on Spanish nationals who control a credit institution in an EU Member State.

Additionally, as a consequence of the CRR/CRD IV package and the entry into force of RDL 14/2013, the supervisory powers of Banco de España and CNMV have been widened and strengthened to ensure appropriate enforcement of the new banking and supervisory discipline. Likewise, RDL 14/2013 has amended Law 13/1994, of 1 June 1994 (the rule setting out the competences and regime applicable to Banco de España) to allow it to issue technical guidelines and answer binding questions on supervisory regulation.

Finally, according to the regime set forth by the Recovery and Resolution Regulations, Banco de España is the pre-emptive resolution authority, while executive resolution powers are vested in the FROB (see Section III.iv).

ii Management of banks

The board of directors of a credit institution (with at least five members) has prominent powers to administer and manage the operations and financial matters of the entity. Members of the board and senior management must have good commercial and professional reputations, appropriate experience and the ability to carry out proper governance of the entity.

A new suitability regime was established in 2014. Although it was in line with the regime applicable up to then (which was repealed), the new regime brought some novelties. For instance, Banco de España is entitled under the Credit Institutions Solvency Law to determine the maximum number of positions that may be held simultaneously by a director, general manager or the holder of a similar position in view of the particular circumstances of an institution and the nature, size and complexity of its activities. Save in the case of directors appointed pursuant to a replacement measure, directors, general managers and holders of similar positions in institutions that are significant in size, or that are more complex or of a special nature, may not hold more than four non-executive positions simultaneously, or one executive position at the same time as two non-executive positions (for these purposes, the positions held within the relevant credit institution's corporate group are counted as one).

The Credit Institutions Solvency Law obliges credit institutions to put corporate governance arrangements in place that are sound and proportionate in view of the risks taken by the institution. In addition, the following obligations are established:

a the board of directors may not delegate functions related to corporate governance arrangements, the management and administration of the institution, the accounting and financial reporting systems, the process for the disclosure of information and the supervision of senior management;

b the chair of the board of directors must not hold the position of managing director simultaneously, unless this situation is justified by the institution and authorised by Banco de España;
c a website must be maintained on which the information required by the Credit Institutions Solvency Law is published and on which the institution explains how it complies with its corporate governance obligations;
d the obligation to draft and keep an up-to-date general viability programme that considers all the measures that will be taken to restore the viability and financial soundness of institutions in the event that they suffer any significant damage;
e the obligation to establish a nomination committee comprising non-executive directors and in which, at a minimum, one-third of its members, and in any case its chair, are independent directors. This committee must decide on a target figure for the representation of the gender currently underrepresented on the board of directors;
f the board must actively participate in the management and valuation of the assets, and regularly approve and review the risk policies and strategies of the institution; and
g Banco de España will be entitled to determine which institutions must establish a risk committee or, as the case may be, those institutions that may establish combined audit and risk committees to perform the functions of the risk committee.

Significant time has been devoted to Spanish remuneration policies during the past few years, as has been the case at both European and international levels. In particular, the Credit Institutions Solvency Law includes the provisions of the CRR/CRD IV package relating to the obligation for credit institutions to put in place remuneration policies that are consistent with their risks. In a nutshell, these provisions relate to:
a the obligation to make a clear distinction between the criteria used for setting fixed remuneration and variable remuneration;
b the obligation that the remuneration policy applicable to members of the board of directors of a credit institution is subject to the approval of the general shareholders' meeting or equivalent body under the same terms as those applicable to listed companies;
c the principles that will apply to variable elements of remuneration (inter alia, the variable component must not exceed 100 per cent of the fixed component save in cases of approval of the general shareholders' meeting granted in accordance with the procedure laid down in the Credit Institutions Solvency Law, in which case, it may reach up to the 200 per cent; at least 50 per cent of the variable remuneration is awarded in instruments; at least 40 per cent of the variable remuneration (either paid in cash or in instruments) is deferred for a period of between three and five years; the variable remuneration is paid or vests only if it is sustainable according to the financial situation and results of the institution; or 100 per cent of the variable remuneration is subject to explicit *ex post* risk adjustments – *malus* and clawback arrangements), with special attention in this regard to credit institutions that benefit from public financial assistance; and
d the obligation to establish a remuneration committee or, if Banco de España so determines, a joint nomination and remuneration committee.

Finally, as previously mentioned, credit institutions (other than credit cooperatives and savings banks) are incorporated as banks and have the legal form of limited liability companies. As such, general corporate rules will fully apply to them (i.e., they must have a suitable structural organisation, compliance and internal audit functions and risk assessments, and certain separate and delegated committees within the board, including an internal audit committee). These rules are primarily contemplated in Royal Legislative Decree 1/2010, of 2 July, approving the Spanish Companies Law.

iii Regulatory capital and liquidity

Spain's capital and liquidity requirements legislation has traditionally incorporated capital adequacy requirements in line with international standards as set out by the Basel Committee on Banking Supervision. According to these, a banking group should be adequately capitalised overall (in terms of both volume and capital quality), and there should be an adequate distribution of capital and allocation of risk, with sufficient buffers to allow ordinary growth.

Several laws, decrees and regulations on own funds, capital requirements and liquidity of individual credit institutions and consolidated groups have been approved through the years, most of them to implement the Basel I, Basel II and Basel III Accords. These regulations have been followed by specific circulars and guidelines issued by Banco de España determining the technical specifications and control of minimum funds.

Nonetheless, the entry into force of the CRR/CRD IV package and of the Credit Institutions Solvency Regulations has led not only to a deep change (at both the European and the Spanish level) in the regulation of solvency and liquidity of credit institutions but, more generally, to a fundamental step forward in the creation of the banking union. Since 1 January 2014, the nuclear regime for credit institutions solvency is condensed in the CRR (which is directly applicable in EU Member States). Where needed, the Credit Institutions Solvency Regulations supplement this regime in Spain.

One of the most interesting changes deriving from the entry into force of the Credit Institutions Solvency Law is the inclusion of capital buffers (i.e., additional capital requirements to those envisaged under the CRR), the regime of which is further developed by RD 84/2015 and Circular 2/2016. Failure to comply with capital buffers entails restrictions on distributions and payments relating to components of Common Equity Tier 1 (such as shares) or Additional Tier 1 capital (such as contingent convertible bonds) and on the payment of variable remuneration, and the obligation to submit a capital conservation plan that must be approved by the competent supervisor.

In particular, the various capital buffers provided for in the Credit Institutions Solvency Regulations are as follows:

a capital conservation buffer (2.5 per cent of the institution's risk exposure): a non-discretionary buffer, the application of which has been phased in from 1 January 2016 to 31 December 2018, and that from 1 January 2019 is set at its fully loaded level of 2.5 per cent;

b countercyclical capital buffer: a specific buffer for each institution or group, which is calculated as the weighted average of the countercyclical buffer percentages applicable in each of the territories in which an institution has exposures. The percentage applicable to risk exposures in Spain is set by Banco de España and ranges between zero and 2.5 per cent. Banco de España has decided to maintain the countercyclical buffer applicable to risk exposures in Spain for the first quarter of 2019 at zero per cent (as it was set up for the immediately preceding quarters);[12]

12 Banco de España press release dated 20 December 2018, available at https://www.bde.es/f/webbde/GAP/Secciones/SalaPrensa/NotasInformativas/18/presbe2018_69en.pdf.

c buffers for global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs): buffers specifically applicable to certain institutions by reason of their systemic importance. The identification of institutions as G-SIIs or O-SIIs is decided by Banco de España, which must annually review the classification it has carried out. Banco de España also has to set the buffer to be maintained by each type of institution, which in the case of G-SIIs will range from 1 to 3.5 per cent, and which in the case of O-SIIs may not exceed 2 per cent. These buffers are applicable from 1 January 2016, although in the case of both G-SIIs and O-SIIs, they must be fulfilled in tranches in the following four years. The only credit institution identified by Banco de España as a G-SII for 2019 is Banco Santander, which belongs to Subcategory A. The capital buffer it needs to meet in 2019 is equivalent to 1 per cent of its total risk exposure (on a consolidated basis). Besides this, Banco de España has already confirmed that Banco Santander will maintain its status as a G-SII for 2020, and that the G-SII capital buffer applicable to the entity in that year will amount to 1 per cent of its total risk exposure on a consolidated basis. The following credit institutions have been classified as O-SIIs by Banco de España for 2019: Banco Santander, BBVA, CaixaBank, Bankia and Banco Sabadell;[13] and

d systemic risk buffer: a buffer that may be set by the Banco de España to cover non-cyclical systemic or macroprudential risks where there is a risk of disruption in the financial system with the potential to have serious negative consequences for the financial system and the real economy.

Regarding liquidity, the Credit Institutions Solvency Law states that Banco de España will assess business models, corporate governance procedures and systems, supervision and evaluation findings, and all systemic risks.

iv Recovery and resolution

The Recovery and Resolution Regulations have updated the Spanish legislation on the recovery and resolution of credit institutions that was introduced in 2012 with the entry into force of Law 9/2012[14] to adapt it to the EU legislation on this matter.

The Recovery and Resolution Regulations foresee three phases (as described below) that correspond to the various stages in the deterioration of an institution's financial situation. The rules governing each of these phases are based upon the following two main principles:

a the separation of supervisory and executive resolution functions. The resolution powers in the pre-emptive resolution phase are entrusted to Banco de España as regards credit institutions, and the CNMV as regards investment firms, while the FROB holds the resolution powers in the executive phase; and

13 Banco de España press release on the setting of the capital buffers for systemic institutions for 2019, dated 21 November 2018, available at https://www.bde.es/f/webbde/GAP/Secciones/SalaPrensa/NotasInformativas/18/presbe2018_63en.pdf.

14 Law 9/2012 of 14 November, on the framework for the restructuring and resolution of financial institutions (Law 9/2012), which was approved as a consequence of the subscription of the MOU and which was a major achievement in the Spanish regulatory landscape. The Recovery and Resolution Regulations constitute a continuation of the regime established by Law 9/2012 as they share the same principles and replicate, to a great extent, its structure and sections. This notwithstanding, the Recovery and Resolution Regulations have broadened the scope of the Spanish recovery and resolution legislation as it applies to investment firms, which were not included in the scope of Law 9/2012.

b public resources cannot be used to fund recovery and resolution proceedings, the cost of which must be borne first by the shareholders of the institution under resolution, second by certain creditors, and finally by the credit institutions and investment firms sector (if needed).

Early intervention phase

Prior to any breach of the solvency, regulatory or disciplinary rules, or the declaration by the competent authority of any of these three phases, an institution must draw up and periodically update a recovery plan elaborating on the measures and actions to be taken to restore its financial position should it deteriorate significantly. The plan must be approved by the institution's board of directors and reviewed by the relevant supervisor.[15]

Early intervention measures can be adopted by the relevant supervisor when an institution or a parent of a consolidated group of institutions breaches, or is likely to breach, solvency, regulatory or disciplinary rules, provided that it is foreseeable that the institution will be able to overcome the situation by its own means. These measures include requiring the removal of one or several members of the governing body of the institution, convening a general meeting and proposing items on its agenda, or requiring the board of directors of the institution to draw up a plan for restructuring the institution's debt or requiring changes to be made to its business strategy.

Pre-emptive resolution phase

The pre-emptive resolution authority must draw up, approve and maintain a resolution plan for each individual institution or consolidated group that falls under its remit. Among other measures, it must consult the resolution authorities from those jurisdictions in which an institution or group has established a significant branch.

When drawing up the report, the pre-emptive resolution authority must determine whether the individual institution or consolidated group is resolvable (as this term is defined in Article 15.1 of the Recovery and Resolution Directive). Should any obstacles to the resolution of the institution be identified, the 'non-resolvable' institution must propose measures to remove them. These measures have to be approved by the relevant pre-emptive resolution authority. If it does not consider the proposed measures to be sufficient, it may request the relevant institution to adopt alternative measures (in particular, any of those foreseen in Article 17.5 of the Recovery and Resolution Directive as transposed into Spanish law).

Executive resolution phase

An institution will be resolved when all of the following circumstances have been met:

a it is non-viable (as this term is defined in the Recovery and Resolution Law, mirroring the definition included in the Recovery and Resolution Directive) or it is reasonably foreseeable that it will become so in the near future;

15 The Recovery and Resolution Regulations entrust powers to the relevant supervisor (Banco de España or the ECB for credit institutions, and the CNMV for investment firms), which will play a major role in the early intervention phase; the pre-emptive resolution authority (Banco de España or the CNMV, as applicable); and the executive resolution authority (FROB).

b there is no reasonable prospect that private sector measures, supervisory measures (such as the early intervention measures), or the conversion or redemption of capital instruments[16] will prevent the institution from becoming non-viable within a reasonable period of time; and

c for reasons of public interest, it is necessary or advisable to proceed with the institution's resolution rather than liquidating it or winding it up in the applicable insolvency proceedings.

The FROB has the power to initiate the resolution process. The opening of the execution phase of the resolution will normally entail the replacement of the institution's board of directors, managing directors or similar officers (although the FROB may maintain them) with the person or persons appointed by the FROB to manage the institution under its supervision. The resolution tools available to the FROB are:

a the sale of the institution's business;

b the transfer of assets or liabilities to a bridge entity;

c the transfer of assets or liabilities to an asset management company; and

d internal recapitalisation (the Spanish bail-in tool).

In contrast to Law 9/2012, the use of a bail-in as a resolution tool is now specifically envisaged in the Recovery and Resolution Law. Moreover, the scope of this tool has been broadened in comparison to that of the measure that was foreseen in Law 9/2012 (the redemption or conversion of subordinated debt instruments). The Spanish bail-in tool, which came into force on 1 January 2016, allows all an institution's liabilities (including senior debt) not expressly excluded by the Resolution and Recovery Law (or by an express decision of the FROB)[17] to be amortised or converted into capital to recapitalise the institution. This tool may be used to recapitalise the institution so that it resumes its activities and market confidence in it is restored, or to convert into capital or reduce the principal amount of the credits or debt instruments transferred through the use of the resolution tools referred to previously. When using the Spanish bail-in tool, the FROB will require the body, or person or persons in charge of the management of the institution under resolution to submit an activities reorganisation plan containing the necessary measures to restore the long-term viability of the institution, or of a portion of its business, within a reasonable time frame.

Finally, the Recovery and Resolution Law has created a National Resolution Fund financed by the credit institutions and investment firms themselves which, under certain circumstances, will finance the resolution measures adopted by the FROB (briefly, when there are losses arising from a resolution process that have not been covered entirely by the eligible liabilities).

16 The Recovery and Resolution Law foresees that the FROB may agree to the redemption or conversion of certain capital instruments, which will be done either separately from the use of any resolution tool (including internal recapitalisation) or with any of the available resolution tools (provided that the circumstances triggering the resolution process are met).

17 The excluded liabilities set forth in the Recovery and Resolution Law are those listed in Article 44.2 of the Recovery and Resolution Directive.

IV CONDUCT OF BUSINESS

i Conduct of business rules

According to the Credit Institutions Solvency Law, credit institutions rendering services in Spain, whether domestic entities or foreign entities authorised in another Member State that open a branch or provide cross-border services in Spain, must observe the applicable rules setting out the discipline of credit institutions, as well as those enacted in the interest of the general good, whether they are dictated by the state, autonomous communities or local entities.

The general good includes, inter alia, protection of the recipients of services, protection of workers, consumer protection, preservation of the good reputation of the national financial sector, prevention of fraud and protection of intellectual property.

Some conduct of business rules relate to compliance with regulations on advertising (i.e., a prohibition of misleading or subliminal advertising, aggressive commercial practices), or to conduct that may injure or is likely to injure a competitor, and to consumer-related matters. Credit institutions are subject to Spanish regulations protecting financial services users, and they must establish consumer services departments and a customer ombudsman to handle complaints about individuals or legal persons who are deemed users of their financial services.

Further, a credit institution must make certain information available to customers, including:

a the existence of a customer service department and of a customer ombudsman, as the case may be, including postal and email addresses;

b its obligation to serve and resolve customers' complaints within two months;

c the existence and contact information of Banco de España's complaints service;

d its internal customer service regulations; and

e references to the legislation in force on transparency and protection of financial services customers.

In addition, there are rules on the delivery of contracts and a number of specific provisions regarding the valid incorporation of terms into consumer contracts (some of which are currently the subject of legal debate after several recent Supreme Court decisions declaring null and void certain terms traditionally used by Spanish banks).

In addition to the foregoing, a number of rules regarding the protection of consumers of investment services apply to credit institutions (categorisation of investors, delivery of appropriate and comprehensible information on the financial instruments and investment strategies offered to the customer, etc.), including rules to check that the conduct of credit institutions is sufficiently diligent, and guidelines issued by the CNMV that should be followed by credit institutions. In this regard, Ministerial Order ECC/2316/2015 of 4 November on information obligations and the classification of financial products and Circular 1/2018 of CNMV are especially noteworthy, as they establish certain information and classification obligations that must be observed by institutions that market specific financial products. Credit institutions are specifically included within the subjective scope of these pieces of secondary legislation.

New legislation approved since 2012 on consumer protection and on evictions in cases of mortgage default is aimed at reinforcing the protection of some vulnerable mortgage debtors. The main pieces of legislation in connection with this matter are:

a Royal Decree Law 6/2012, of 9 March, on urgent measures to protect mortgage debtors without resources (RDL 6/2012), as amended by RDL 5/2017, which provides for a series of mechanisms to protect mortgage debtors at risk of social exclusion, the main pillar of which is the creation of a code. This code – which, although it provides for voluntary accession, has been signed by the vast majority of credit institutions operating in Spain – envisages three consecutive stages of action with the purpose of accomplishing the restructuring of the relevant mortgage debt;

b Law 1/2013, of 14 May, on measures to reinforce the protection of mortgage debtors, the restructuring of debt and social renting, which established a four-year moratorium from 15 May 2013 on evictions on mortgagors in a situation of extreme difficulty from their principal resident (which has been extended for three more years by RDL 5/2017); and

c Law 25/2015, of 28 July, on a second chance mechanism, diminishing the financial burden and other socially related measures, which, inter alia, sets out a number of protections for debtors within their insolvency proceedings (including the possibility of release from all debts in cases where the debtor's assets do not cover his or her aggregate debts), improves the Code of Good Practices in relation to mortgage debtors without resources, as approved by RDL 6/2012, and broadens the scope of the application of the Code so that a greater number of debtors can benefit from it.

In this regard, a new law on real estate loans, Law 5/2019, of 15 March regulating real estate loans (Law 5/2019), the original draft of which was approved in 2017, underwent negotiations in Parliament throughout 2018, and was finally approved on 22 February 2019. It will enter into force during the course of 2019. Law 5/2019, which implements in Spain Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immoveable property, and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No. 1093/2010, is very likely to heavily impact real estate lending, which constitutes one of the major sources of business for credit institutions in Spain.

ii Spanish banking secrecy

The duty of credit institutions to keep their clients' information confidential from third parties other than the supervisory authorities has traditionally been a feature of the Spanish banking system and is codified in law. Credit institutions, their managers and directors, and significant shareholders and their managers and directors, must safeguard and keep strictly confidential all information relating to balances, operations and any other customer transactions unless required to disclose the same by an applicable law or the supervisory authorities. In these exceptional cases, the delivery of confidential data must comply with the instructions of the client or with those provided by the applicable law.

The sharing of confidential information between credit institutions within the same consolidated group is not subject to these restrictions.

Any breach of the aforementioned regulations will be deemed a serious offence, which may be punished according to the ordinary sanctions procedure provided under Spanish banking regulations.

V FUNDING

The main funding for Spanish credit institutions is based on deposits made by their customers. However, according to Banco de España, the global number of deposits taken from the private sector has decreased during the past few years.

Both capital and debt issuance have also been sources of funding. These instruments include (in addition to common shares) perpetual contingent convertible debt (which will normally qualify as Additional Tier 1 for solvency purposes), the newly created senior non-preferred debt (which is set forth in the Recovery and Resolution Law, as amended by Royal Decree-Law 11/2017, of 23 June, on urgent actions on financial matters, and which is a type of debt eligible for the minimum requirement for own funds and eligible liabilities, and for total loss-absorbency capacity purposes and subordinated debt. These types of debt instruments must be verified by the relevant supervisor to confirm they meet the conditions established by the bank solvency regulations, and their issuance is subject to the securities market regulations. In this regard, the Securities Market Law imposes relevant restrictions on the conditions of issuance of these instruments when they are to be marketed to retail investors. In a nutshell, a tranche of the issuance, which shall amount to at least 50 per cent of its total value, has to be addressed to qualified investors, and the face value of the issued instruments cannot be lower than a certain amount (which varies depending on the specific features of the instrument and the nature of the issuer).

In recent years, mistrust in Spanish public finances and the financial system resulted in a substantial increase in funding costs and difficulties in gaining access to wholesale markets, which had a considerable effect on sovereign debt during the summer of 2012. Additionally, as already mentioned, the Recovery and Resolution Regulations have introduced a number of instruments that are eligible for the recapitalisation of credit institutions within a resolution scenario, as well as specific FROB powers.

VI CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESS

i Control regime

The Spanish regime for the prudential assessment of Banco de España regarding acquisitions and increases of holdings in Spanish credit institutions is contemplated in the Credit Institutions Solvency Regulations. The regime set forth therein must be construed in light of the entry into force of the SSM and the distribution of competencies between the ECB and the NCAs set out in the SSM Regulations.[18]

According to the regime established on the occasion of the entry into force of the SSM, the acquisition of a significant holding is subject to a mandatory pre-acquisition non-opposition from the ECB. The corresponding application shall be notified through Banco de España. A significant holding is defined as the direct or indirect holding (taking into account conditions regarding aggregation laid down in the Spanish regulations) of shares in the issued share capital or voting rights of a Spanish credit institution in excess of 10 per

18 Council Regulation (EU) No. 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions and Regulation (EU) No. 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation).

cent, as well as any holding below that threshold that allows the holder to have a notable influence on the corresponding credit institution. In accordance with Article 23 of RD 84/2015, notable influence shall be deemed to exist when there is the capacity to appoint or dismiss a board member of the corresponding credit entity.

A similar prior control procedure shall be carried out if the owner of a significant holding intends to increase that holding up to or above 20, 30 or 50 per cent of the issued share capital or voting rights of a Spanish credit entity; or if, as a consequence of a potential acquisition, the relevant shareholder could acquire control of the Spanish credit institution.

The disposal of a significant shareholding in a Spanish credit entity, the reduction of a significant shareholding below 20, 30 or 50 per cent of the issued share capital or voting rights of a Spanish credit entity, or the loss of control of a Spanish credit entity require prior notification to the competent supervisory body.

Likewise, immediate written notification to both the competent supervisor and the relevant credit entity is required if, as a result of the acquisition, the acquirer would hold, either on its own or in concert with other entities, directly or indirectly, 5 per cent or more of the issued share capital or voting rights of a Spanish credit entity.

The obligation to seek non-opposition for a proposed acquisition or increase of qualifying shareholding falls on the acquirer. However, the Spanish bank whose shareholding may be acquired must notify the competent supervisor as soon as it becomes aware of the proposed acquisition.

Within the framework of the assessment of the suitability of a potential acquirer and the financial strength of the proposed acquisition, a report from the Commission for the Prevention of Money Laundering and Monetary Infractions is needed, the aim of which is to ensure that the relevant credit entity is managed in a prudent manner taking into account the influence that may be exercised by the acquirer.

ii Transfers of banking business

The Spanish financial system has recently moved towards greater consolidation, mainly for efficiency and profitability, in an increasingly mature financial market and as a consequence of the restructuring of the Spanish banking system. The need to strengthen solvency is also a key driving factor. Naturally, the same factors apply to transfers of banking business, particularly considering the crucial importance of size in gaining access to wholesale capital markets.

The transfer of banking business by virtue of mergers, total and partial spin-offs, or assignments of assets and liabilities, any legal or economic arrangement analogous to any such transaction, and any structural modification deriving from the foregoing, is subject, in addition to general corporate law, to regulatory approval from the Ministry of Economy, Industry and Competitiveness as set forth in the Credit Institutions Solvency Law and the Credit Institutions Solvency Regulations.

Special regimes for the transfer of banking businesses are set out in the Recovery and Resolution Regulations (see Section III.iv).

VII THE YEAR IN REVIEW

2018 marked another volatile year for the Spanish economy, as geopolitical uncertainty (both domestically as a result of the political crisis in Catalonia, and the motion of confidence that resulted in the ousting of the Partido Popular government; and internationally, due mainly to the development of the negotiations in connection with the United Kingdom's exit from the EU) dominated the landscape and impacted on the development of the Spanish GDP, the growth of which (by 2.5 per cent) slowed down with respect to previous years. Notwithstanding the foregoing, the Spanish economy has remained solid, and avoided stagnation during 2018; in particular, job creation has continued at a rate of approximately half a million jobs per year (the unemployment rate decreased from 17 to 16 per cent in 2018).

This trend of sustained economic growth positively affected the performance of the Spanish banking sector during 2018. In this regard, the quarterly earnings obtained in the third quarter of 2018 (the latest consolidated data available at the time of writing) were at their highest level since the third quarter of 2009, although this was mainly triggered by controlling operating costs and a reduction of provisions. Weakness in revenue continued, especially the margin of interests, although this constitutes a key concern for the wider eurozone banking sector. Banking activity continued to contract: total assets fell by 2.9 per cent, therefore remaining at a volume similar to that seen in 2006. The number of staff and banking branches followed a similar trend in 2018, dropping by 31 and 42 per cent, respectively, compared with the maximum numbers of both seen in 2008. The inventory of lending to the private sector continued to decline, falling by 3.9 per cent year on year. Finally, the sector's 2018 non-performing loan (NPL) rate was especially noteworthy: it experienced a 25.3 per cent decline in comparison to the 2017 figure. The NPL rate reached its peak in December 2013, and has continuously decreased, falling by approximately 64 per cent in the period up to the end of 2018.[19]

On the regulatory side, although legislative production slowed considerably in 2018, reforms were approved that are likely to affect the activity of credit institutions (see Section I).

VIII OUTLOOK AND CONCLUSIONS

Spanish credit institutions were deeply affected by the outbreak of the 2007 financial crisis, which gave rise to an incredibly sharp increase in the level of impaired assets (both non-performing loans and foreclosed real estate assets) and an abrupt slump in entities' profitability. To address these problems, an intense process of recapitalisation and restructuring of the sector took place, which was accompanied by the setting up of a new regulatory framework enacted to enable the implementation of the sought recapitalisation and restructuring measures. As a consequence, the Spanish credit institution sector has notably concentrated and the solvency position of its actors has considerably improved, while at the same time the regulatory landscape applicable to credit institutions has changed notably. Thus, Spain's banking sector is now made up of fewer banks with adjusted risk profiles and improved corporate governance.

The outbreak of the financial crisis revealed excessive and careless risk taking in certain credit institutions, as well as a lack of compliance with the applicable rules of conduct as to the rendering of banking services, all of which resulted in profuse consumer litigation against credit institutions and a profound crisis of reputation. Although measures have been put in place to deal with these negative outcomes, they have not been as successful as those designed to restore credit institutions to a position of solvency and profitability.

19 Figures obtained from the BBVA Research Banking Outlook Report as of March 2019, available at https://www.bbvaresearch.com/wp-content/uploads/2019/03/Banking-Outlook-4Q18.pdf.

As a consequence, and despite a significant improvement in financial position, the Spanish credit institution industry faces important challenges, the most notable of which are the following:

a a low interest rate environment in the eurozone, which is likely to persist until the second half of 2020, and which notably impacts the profitability of credit institutions;
b increasingly demanding solvency requirements applicable to credit institutions;
c the fast-growing competitive environment that surrounds banking services, characterised by the emergence of new actors that differ from traditional credit institutions (e.g., fintech entities); and
d the need to restore consumer confidence in credit institutions.

All such challenges will have to be faced in a context of political uncertainty, both domestically (national, regional and local elections will take place in the second quarter of 2019) and internationally (mainly due to developments in negotiations in connection with the UK's exit from the EU).

As regards regulatory developments, some legislation was approved in the first months of 2019, with further legislation being expected to be approved throughout the year, that is likely to impact credit institutions' business: namely, Law 5/2019, of 15 March, regulating real estate lending and its implementing regulations (the draft text has already been disclosed and is expected to enter into force in 2019), and Royal Decree-Law 5/2019, of 1 March, adopting contingency measures in connection with the withdrawal of the UK and Northern Ireland from the EU without reaching agreement as foreseen in Article 50 of the Treaty on European Union. In particular, the latter's main purpose is to adopt measures aimed at adapting the Spanish legal system in the event that the UK exits the EU without an agreement materialising, which will only enter into force on the day on which EU treaties cease to apply in the UK, and insofar as no withdrawal agreement being reached between the EU and the UK prior to such date (if an agreement is reached, Royal Decree-Law 5/2019 will never enter into force).

Moreover, it is worth noting the approval on 22 February 2019 of a draft law aimed at promoting the adaptation of the financial regulatory and supervisory framework in the new digital context, which foresees, among other things, the creation of a regulatory sandbox. Although this ambitious legislative project is likely to be postponed (at least until the elections have taken place and a new government has been formed), it is, without a doubt, an interesting and challenging initiative in terms of financial regulation.

In any event, the general economic environment, and numerous and well-targeted advances in the restructuring of the credit institution system, lead us to look at the future with reasonable confidence, and to believe that credit institutions will be able to overcome these demanding challenges.

Appendix 1

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In 2007, Mr Machuca was one of the winners of the *Iberian Lawyer* 40 Under Forty awards, which recognise the achievements of the new generation of top lawyers in Spain and Portugal.

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