# The Banking Regulation Review

Twelfth Edition

**Editor**

Jan Putnis

The Law Reviews

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# THE BANKING REGULATION REVIEW

TWELFTH EDITION

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This article was first published in April 2021
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THE LAWREVIEWS

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Published in the United Kingdom
by Law Business Research Ltd, London
Meridian House, 34–35 Farringdon Street, London, EC4A 4HL, UK
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Enquiries concerning editorial content should be directed
to the Publisher – clare.bolton@lbresearch.com

ISBN 978-1-83862-762-1

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

# ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

ADNAN SUNDRA & LOW

ADVOCATUR SEEGER, FRICK & PARTNER AG

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# PREFACE

The past year in banking regulation has been dominated, in most parts of the world, by the severe economic effects of the coronavirus pandemic. Governments and regulators have taken unprecedented steps to support businesses and individuals through the crisis. In financial terms, much of this support has been channelled through banks, and banks have had to work hard to continue to lend and to serve their customers in this difficult period.

Despite the human suffering and long-term economic damage that the pandemic has caused, there has been no significant banking crisis in the past year and, in most countries, no real sign that banks are failing to weather the storm so far. While there are of course exceptions, this is in large part a consequence of the relatively strong capital and liquidity position that banks around the world were in before the pandemic struck, which was itself a position that would not have arisen in many countries without the comprehensive prudential regulatory reforms that followed the global financial crisis of 2007–2009. Indeed, some regulators have commented that the pandemic is proving to be the first real test of those reforms and that, at least so far, the rules and institutional frameworks for banking regulation that were created after the global financial crisis have proven their worth.

As in all ongoing crises, there are causes for both pessimism and optimism. A pessimistic assessment with which it is hard to argue in many parts of the world is that we are still at an early stage in the economic damage that the pandemic has caused. The gradual withdrawal of government support programmes for businesses and the consequent further increases in non-performing loans with which banks have to deal will pose a further severe test for the banking systems of many countries at a time when governments will be relying on banks to support economic recovery. In some countries the strong links between bank viability and the ability of governments to issue sovereign debt at sustainable interest rates may re-emerge as a significant problem.

The optimistic assessment is necessarily a longer-term one given the challenges that the pandemic continues to present. The pandemic has undoubtedly provided the banking sector with an opportunity to show that it can be a force for financial stability and economic renewal at a time of crisis, in marked contrast to the blow to confidence that the sector suffered following the global financial crisis. This opportunity is closely linked to moves by many banks to consider their corporate purpose, the sustainability of their activities in environmental and social terms, and the quality, and in many cases the diversity, of their governance. This somewhat disparate collection of objectives, referred to as ESG in many parts of the world, is increasingly dominating discourse between banks and their regulators and investors. Whether this would have happened in quite the way it has without the pandemic is impossible to know, but it does not seem much of an exaggeration to suggest



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that in many countries the banking sector that will emerge from the pandemic will have a series of cultural and business objectives that are quite different to those that existed before.

Regulators have become more assertive on these matters, particularly with regard to environmental objectives, and we will increasingly see a harder edge to the expectations that they are forming of banks' adherence to policies designed to address climate change. The repricing of many risks that is expected to take place as opinion settles on the pace at which transition to a low carbon economy should take place will have a profound effect on the balance sheets of many banks. Shareholder pressure will force change in some banks; and banks with significant exposures to the petroleum economy will have to consider radical changes to their business models.

On social matters, financial inclusion and fair treatment of vulnerable customers are motivating legal and regulatory reform in many countries. There is a strong link between financial inclusion and the adoption of new technologies and business models, particularly in payment services. Many of the businesses that are contributing to the adoption of these technologies are not banks but rely on banks (or payment systems that are owned or controlled by banks) in order to operate. Allied to this are the increasingly serious and well-resourced attempts by firms using distributed ledger technologies to develop new means of payment, including stablecoins.

Regulators struggle to keep pace with these developments, but they hold back at their peril on addressing the implications for banks. The concept that the same or similar services and activities should be regulated in the same way is proving to be difficult to apply in practice, not least because there is a fundamental difference in financial stability terms between institutions that take deposits and those that do not. But the challenge of how to supervise banks and non-bank payment firms and lenders on a level playing field is one that must surely be addressed, and addressed soon, by regulators in a coordinated way around the world. The time for regulators to congratulate themselves on the effectiveness of financial sector reform following the global financial crisis has come to an end. It is now time to think hard about where risks lie and how risks will develop in the emerging tech-enabled financial system, and the possible causes of the next financial crisis.

It is perhaps surprising, given all the disruption caused by covid-19, that some countries have managed to push through significant legal and regulatory reforms in banking in the past year. These measures have included significant overhauls of the whole bank regulatory regime in some countries, and in other countries further moves to implement Basel III standards. We have already seen some important changes of policy and emphasis in the United States under the new Biden administration. Legal and regulatory reform has continued in the European Union, albeit many initiatives have been delayed by the pandemic. The final departure of the United Kingdom from the European Union single market on 31 December 2020 and the resulting decoupling of London as a major banking centre from the European Union legal framework will continue to have reverberations and structural implications for banks operating in Europe. The long-term implications of Brexit for banks remain hard to predict; in particular, whether it will be a prelude to further fragmentation in banking regulation around the world.

This edition of *The Banking Regulation Review* covers 37 countries and territories in addition to the usual chapters on International Initiatives and the European Union. My thanks go to the authors for continuing to prepare informative chapters in the difficult and uncertain conditions in which many of them have been working over the past year. They



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continue to make this book the useful overview and guide to banking regulation around the world that it is.

Thank you also to the partners and staff of Slaughter and May in London and Hong Kong for continuing to support and contribute to this book, and in particular to Nick Bonsall, Ben Kingsley, Peter Lake, Emily Bradley, Ben Goldstein, Selmin Hakki, David Kasal, Tolek Petch, David Shone, Adrien Yeung and Ada Zhang.

The team at Law Business Research once again deserve great thanks for their hard work and understanding of the authors on this edition. Thank you, in particular, to Hannah Higgins.

**Jan Putnis**
Slaughter and May
London
April 2021



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Chapter 33

# SPAIN

*Juan Carlos Machuca and Alfonso Bernar*[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 public Fund for Ordered Bank Restructuring (FROB) of a majority stake in the entity's share capital, and the government request of financial assistance to the EU for the recapitalisation of certain Spanish financial institutions, which led to a financial assistance programme of up to €100 billion and imposed 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 EU financial assistance programme provided for those credit institutions 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 the Bank Restructuring (SAREB); 54 per cent of its share capital is owned by private shareholders, but the main shareholder (46 per cent) is the FROB. The design, incorporation and performance of SAREB constitutes one of the major achievements derived from the restructuring of the Spanish financial system. SAREB received the mandate to divest a portfolio valued at €50,781 million over 15 years, optimising levels of

1 Juan Carlos Machuca is a partner and Alfonso Bernar is an associate at Uría Menéndez Abogados, SLP.



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recovery and value preservation, and minimising negative effects on the real estate market and economy and the costs to taxpayers. Since SAREB was founded, the company has divested €18,117 million in properties and loans, equating to 36 per cent of its original portfolio.

The EU financial assistance programme for the recapitalisation of financial institutions was successfully ended on 22 January 2014 (as scheduled), with €41.025 billion (out of €100 billion) having been used. The termination led to new post-programme surveillance 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 2026. As at 30 October 2020, the outstanding amount stood at €23.7 billion, which represents 57 per cent of the total amount disbursed to Spain under the EU financial assistance programme.

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

*a* Law 10/2014, of 26 June 2014, on the organisation, supervision and solvency of credit institutions (the Credit Institutions Solvency Law); Royal Decree 84/2015, of 13 February 2015, developing the Credit Institutions Solvency Law (Royal Decree 84/2015); Circular 2/2016 of the Banco de España, of 2 February 2016, 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 2013, on urgent measures for the adaptation of the Spanish law to the EU rules and regulations on supervision and solvency of financial entities (Royal Decree-Law 14/2013) (together, the Credit Institutions Solvency Regulations), 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; and

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) (the Capital Requirements Regulation (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 (the Capital Requirements Directive IV (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 amending Council 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) Nos. 1093/2010 and 648/2012, of the European Parliament and of the Council (the Bank Recovery and Resolution Directive (BRRD)); and Regulation (EU) No. 806/2014, of the European Parliament and Council of 15 July 2014, 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 (the Single Resolution Mechanism Regulation (SRMR)).



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*b* Law 11/2015, of 18 June 2015, on the recovery and resolution of credit institutions and investment firms (the Recovery and Resolution Law) and Royal Decree 1012/2015, of 6 November 2015, developing the Recovery and Resolution Law and amending Royal Decree 2606/1996, of 20 December 1996, on deposit guarantee funds (together, the Recovery and Resolution Regulations).

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 on the four Spanish stock exchanges (SSEs), 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, 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 the Single Resolution Mechanism Regulation (SRMR). 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 the SRMR. 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 of shares and conversion into shares of other capital instruments of Banco Popular that were eligible for resolution purposes and, after those measures were implemented, the sale of all the outstanding shares for a total consideration of €1.

This whole process took place in a single day, and the implementation of the resolution scheme was carried out during the night of 6 June 2019, so that when the SSEs opened on 7 June, the resolution of Banco Popular and its sale to Banco Santander had already been made public. In July 2019, Banco Santander communicated that the integration of Banco Popular and its branches was successfully completed. The SRB initiated the regulatory procedure aimed at evaluating whether shareholders and creditors whose instruments were amortised or converted would have received better treatment if the entity under resolution had initiated an ordinary insolvency procedure. In March 2020, the SRB concluded that there was no difference and, therefore, it was not necessary to compensate affected Banco Popular shareholders and creditors.

In November 2016, the EU Commission proposed the adoption of new risk reduction measures to strengthen the resilience of the EU banking system and address remaining problems that had been previously identified by the Basel Committee. After more than two and a half years of intensive discussions and deliberations, these banking reforms were passed by the European Parliament and the Council in May 2019 and published in the Official Journal in June 2019; however, most of these new rules will not take effect until 28 June 2021. This new banking reform package contains amendments to the capital requirement legislation that reinforces the capital and liquidity positions of banks (with the introduction of the Capital Requirements Regulation II (CRR II) and the Capital



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Requirements Directive V (CRD V)),[4] and strengthens the framework for the recovery and resolution of banks in difficulty (with the introduction of the Bank Recovery and Resolution Directive (BRRD) II and the SRMR II).[5] Notwithstanding this, in the context of the covid-19 health crisis, the European Parliament approved certain amendments to the CRR and CRR II (the 'CRR Quick Fix')[6] to temporarily ensure favourable conditions for banks with the aim of supporting credit flows to companies and households and absorbing losses, mitigating the economic consequences of the covid-19 lockdown. More specifically, the CRR Quick Fix defers the application of the leverage ratio buffer requirement and introduces flexibility and more favourable treatment of certain types of risks (e.g., loans granted to small and medium-sized enterprises (SMEs) or infrastructure-related exposures).

As a result of the foregoing, the current institutional and legal framework for the Spanish banking system has been established in a multi-stage procedure that commenced in 2012, developed intensely between 2013 and 2015, has considerably slowed down since 2016, but which is expected to ramp up again in the context of the national transposition and implementation of the new EU banking reform package enacted in May 2019 and currently in progress.

As regards the legislative developments at a national level in connection with banks, savings banks and other financial institutions in 2020, the following pieces of legislation and secondary legislation have been enacted.

*a* Royal Decree-Law 6/2020, of 10 March 2020, by which urgent measures are taken in the economic field and for the protection of public health, established that the SAREB will not be forced to dissolve despite the fact that its net equity is reduced to an amount less than half of the share capital (one of the legal causes of dissolution for Spanish companies); therefore, it will be able to continue performing the functions that were established by legal mandate until 2027. Royal Decree-Law 6/2020 also expands the type of financial institutions that can request their transformation into banks (previously, restricted only to financial credit establishments (EFCs) and credit cooperatives). Accordingly, financial entities such as electronic money entities (EDEs), payment services entities and investment services firms may also now benefit from an ad hoc transformation into banks process, particularly when they reach a certain size and choose to grow by becoming banking entities.

4 Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending the CRR as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements (CRR II); and Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending CRD IV as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (CRD V).

5 Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending the BRRD as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC (BRRD II); and Regulation (EU) 2019/877 of the European Parliament and of the Council of 20 May 2019 amending the SRMR as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms (SRMR II).

6 Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending the CRR and CRR II as regards certain adjustments in response to the coronavirus pandemic.



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*b* Law 7/2020, of 13 November 2020, for the digital transformation of the financial system, regulating the controlled testing environment (better known as the regulatory sandbox) for technological innovation projects in the financial system came into force on 15 November 2020. The measures included in Law 7/2020 are intended to accompany the digital transformation of the financial system by focusing on two main objectives: (1) ensuring that the financial authorities have adequate instruments to continue to fulfil their functions optimally in the new digital context and with full accommodation in the current legal and supervisory framework; and (2) facilitating the innovative process in a more equitable context through better access for all production sectors to financing and through the attraction of talent in a highly competitive international technological environment.

*c* Royal Decree-Law 38/2020, of 29 December 2020, adopting measures to adapt to the UK's third-state status establishes a framework to ensure the continuity of financial services contracts provided in Spain by financial institutions established in the UK. The loss of the EU passport implies that financial institutions established in the UK will have to adapt to the third-country regime to continue providing services in Spain, including those services resulting from contracts entered into before, but expiring after, 1 January 2021. With the aim of reinforcing legal certainty, customer protection and avoiding any risk to financial stability, Royal Decree-Law 38/2020 ensures that the validity of contracts is not affected by the end of the transition period. In addition, a temporary regime is established until 30 June 2021 to ensure that the adaptation to the third-country regime does not entail a disruption in the provision of services associated with these contracts or, alternatively, to facilitate the termination of the contracts if the institution does not wish to continue its activity in Spain. The temporary regime is available for activities subject to authorisation.

*d* The Good Governance Code (GGC) for listed companies issued by the National Securities Market Commission (CNMV) was revised in June 2020, which involved 20 of the 64 recommendations comprising the GGC. The four guiding principles of the review were: (1) promoting the presence of women on boards and in executive roles in listed companies; (2) increasing the relevance of non-financial information and addressing environmental and social aspects; (3) increased attention to non-financial and, particularly, reputational risks; and (4) clarifying some aspects of directors' remuneration (particularly on variable payments and compensation).

In relation to the covid-19 crisis, following the approval of Royal Decree 463/2020, of 14 March 2020, declaring a state of emergency to address the covid-19 health crisis, the Spanish government adopted substantial and supportive budgetary measures for the worst-affected businesses and households. In particular, payment moratoriums allowed a suspension of obligations arising from mortgaged and non-mortgaged loans under certain conditions for certain borrowers. These moratoriums entailed an extension of the term of the loan equivalent to the duration of the moratorium and have been key to providing temporary space for vulnerable borrowers and their banks. Moreover, the Spanish government made available two publicly guaranteed credit line programmes to help funding continue to flow to the real economy. While the first one (€100 billion) supported the business financing necessary to guarantee liquidity and working capital, the second one (€40 billion) aimed to mainly cover businesses' financial needs derived from the realisation of new investments.



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## 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 2013, on savings banks and banking foundations (the Savings Banks and Banking Foundations Law) and its implementing 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 regulated 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 44.75 per cent of all Spanish credit institutions, credit cooperatives represent 53.5 per cent and savings banks represent the remaining 1.75 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 per cent of the sector, while credit cooperatives' assets represent 4.9 per cent and savings banks' assets 0.1 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.

As shown by 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. Banks have the legal form of public limited companies (*sociedad anónima*), and are, therefore, subject to general principles of company law as well as banking regulations. In some cases, banks are listed on the SSEs and, therefore, subject to the legal regime applicable to this type of entity.

Savings banks are a specific type of credit institution that historically 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 at 18 March 2021.

9 Approximate and estimated figures calculated on the basis of the most recent data publicly available on the websites of the Spanish Banking Association (AEB), the Spanish National Union of Credit Cooperatives (UNACC), Caixa Pollença and Caixa Ontinyent (the only two savings banks currently in existence).



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as 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 the past decade. 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.

In light of these radical changes to the sector, the Savings Banks and Banking Foundations Law aimed to limit the role of savings banks in the credit institutions sector (capping the balance sheets, market share and geographical scope of banking activities), clarified the role of former savings banks in their capacity as shareholders of credit institutions under the form of bank or regular foundations, and strengthened incompatibility requirements regarding the governing bodies of the former savings banks and the commercial banks controlled by them.

As a result, 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 (Kuxtabank, Liberbank, Ibercaja, Abanca, CaixaBank, Unicaja Banco and Bankia). The number of branches has been reduced by 49.9 per cent and the workforce by 42.6 per cent, since late 2008.[10]

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 1993.

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

#### *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.

10 Presentation on the status of the regulatory and financial outlook of the savings banks sector issued by the Spanish Confederation of Savings Banks on 19 February 2019.



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The legal framework governing EFCs is established in Law 5/2015, of 27 April 2015, 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* The Law regulates the existence of hybrid institutions (i.e., EFCs that also provide payment services or issue electronic money).

*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, Royal Decree 309/2020, of 11 February 2020, on EFCs, which entered into force in July 2020, completes the development of the legal framework applicable to these entities, allowing them to have their own legal regime adapted to the nature of their business model, and will provide greater legal security to the legal framework applicable to EFCs. Among the new contributions of Royal Decree 309/2020, it (1) establishes that EFCs must have a liquidity buffer to strengthen their solvency, (2) adapts the previously required corporate governance requirements and (3) empowers the Bank of Spain to modify the periodicity of the revision of the capital levels.

***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 2012, 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. Although Royal Decree-Law 778/2012 fully implemented Directive 2009/110/EC, it was subsequently amended by Royal Decree 736/2019, as defined below.

***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.[11] The legal regime in connection with the rendering of payment services is set forth in Royal Decree 736/2019, of 20 December 2019, on the legal regime for payment services and payment institutions, which continued the transposition into Spanish law of Directive (EU) 2015/2366.

One of the most important changes introduced by Royal Decree 736/2019 is the change of the competent body authorising the creation of EDEs and payment services entities. Other changes include: amendments to EDEs' and payment entities' by-laws; extensions of EDEs' and payment entities' activities; and changes to structural transactions, such as

11 Directive (EU) 2015/2366.



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mergers, spin-offs and global transfers of assets and liabilities. As of the entry into force of Royal Decree 736/2019, the competence for oversight of these entities ceased to belong to the Ministry of Economy and is attributed going forward to the Bank of Spain. In addition, the Ministry of Economy has enacted Order ECE/1263/2019, of 26 December 2019, on transparency of the conditions and information requirements applicable to payment services, which entered into force on 1 July 2020, the aim of which is to ensure that users of these services enjoy a higher level of confidence.

## 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 (based on the definition provided by the SSM Framework Regulation) are supervised by the ECB, while less significant institutions are directly supervised by Banco de España and, indirectly, by the ECB. Of the 115 significant institutions supervised by the ECB, 12 are Spanish (as at 1 January 2021).

### i Relationship with the prudential regulator

Banco de España no longer sets the country's monetary and exchange rate policy (now defined by the ECB), 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.

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 significant 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 individual recommendations to and requirements for 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.

According to the Credit Institutions Solvency Regulations, Banco de España has wide powers to ensure appropriate enforcement of and 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



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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. Likewise, Banco de España is allowed 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.

The suitability regime is supervised by Banco de España pursuant to the Credit Institutions Solvency Law and 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.

Additionally, 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. Except for 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



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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).

Significant time has been devoted to Spanish remuneration policies during the past years, as has been the case at both European and international levels. In particular, the Credit Institutions Solvency Law includes 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 except for 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 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 vested 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.

These provisions are complemented by more detailed guidelines issued by the European Banking Authority and its predecessor, the Committee of European Banking Supervisors, on the requirements for remuneration policies applicable to all staff, the corresponding internal corporate governance arrangements and the processes that should be applied when remuneration policies are implemented, and specific requirements for the variable remuneration of staff whose professional activities have a material impact on the credit institutions' risk profile.

Finally, credit institutions (other than credit cooperatives and savings banks) are incorporated as banks and have the legal form of public limited companies and, in a large number of cases, their shares are listed on the public markets. 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) and must also have regard to the recommendations of the GGC. These rules are primarily contemplated in Royal Legislative Decree 1/2010, of 2 July 2010, approving the Spanish Companies Law.



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### 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.

The CRR/CRD IV package and the Credit Institutions Solvency Regulations not only introduced a deep change (at both the European and the Spanish level) in the regulation of solvency and liquidity of credit institutions but, more generally, a fundamental step forward in the creation of the banking union. Since the introduction of the CRR/CRD IV package on 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 aspects deriving from the supplemental application of the Credit Institutions Solvency Law is the inclusion of capital buffers for credit institutions (i.e., additional capital requirements to those envisaged under the CRR), the regime of which is further developed by Royal Decree 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 was phased in between 1 January 2016 and 31 December 2018, and that, since 1 January 2019, has been 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 countercyclical buffer percentage applicable to risk exposures in Spain is set by Banco de España and ranges between zero and 2.5 per cent (although this maximum percentage was phased in between 1 January 2016 and 31 December 2018). Banco de España has decided to maintain the countercyclical buffer percentage applicable to risk exposures in Spain for the first quarter of 2021 at zero per cent (as it was set up for the immediately preceding quarters);[12]

12 Banco de España press release dated 21 December 2020, available at www.bde.es/f/webbde/GAP/Secciones/SalaPrensa/NotasInformativas/20/presbe2020_102en.pdf.



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*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 per cent to 3.5 per cent (depending on the subcategory to which each G-SII belongs), and in the case of O-SIIs, may not exceed 2 per cent. These buffers have applied since 1 January 2016, with partial fulfilment between 1 January 2016 and 31 December 2018, and full application since 1 January 2019. The only credit institution identified by Banco de España as a G-SII for 2020 is Banco Santander, which belongs to subcategory A. The capital buffer it needs to meet in 2021 is equivalent to 1 per cent of its total risk exposure (on a consolidated basis). In addition, Banco de España has confirmed that Banco Santander will maintain its status as a G-SII for 2022, 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 2021: Banco Santander, BBVA, CaixaBank, Bankia and Banco Sabadell;[13] and

*d* systemic risk buffer: a buffer that may be set by 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.

At the time of writing, the merger of two credit institutions designated as O-SIIs (CaixaBank and Bankia) is pending completion. Should this merger be concluded in early 2021, as is envisaged, Banco de España will need to review the assessment of the resulting institution's domestic systemic importance.

Regarding liquidity, the Credit Institutions Solvency Law states that Banco de España will assess the specific business model of the credit institution, its corporate governance procedures and systems, supervision and evaluation findings, and all systemic liquidity risks that may hinder the integrity of the financial markets. Royal Decree 84/2015 provides that credit institutions should have solid strategies, policies, procedures and systems in place for the identification, management and measurement of liquidity risks, proportional to the nature, scale and complexity of their activities. In particular, Banco de España requires credit institutions to develop methods for monitoring funding positions, identify the assets free of charges available in emergency situations, have liquidity risk reduction tools such as liquidity buffers, or an adequate diversification of financing sources, that allow them to face financial stress scenarios, and prepare contingency plans taking into account the impact of different scenarios on the various liquidity profiles. If Banco de España considers that a credit institution has lower than adequate liquidity levels, it may require the adoption of measures to reinforce liquidity, taking into account the situation of the credit institution or group.

13 Banco de España press release on the setting of the capital buffers for systemic institutions for 2020, dated 27 November 2020, available at www.bde.es/f/webbde/GAP/Secciones/SalaPrensa/NotasInformativas/20/presbe2020_94en.pdf.



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Additionally, the CRR II/CRD V package will introduce important changes to the prudential framework, such as:

*a* a harmonised prescriptive minimum level of total loss absorbing capacity (TLAC) for all G-SIIs, which will be introduced into the CRR through a new requirement for (loss-absorption) own funds and eligible liabilities; the aim of which is to require G-SIIs to hold a sufficient amount of highly loss-absorbing (bail-inable) liabilities to ensure smooth and fast absorption of losses and recapitalisation in the event of a resolution;

*b* a binding (not only reporting) leverage ratio requirement for all credit institutions (leverage ratio is a ratio between a bank's capital and its exposures; therefore, this requirement would act as a backstop to the risk of excessive leverage during economic upturns), as well as an additional leverage ratio buffer for all G-SIIs with a date of application originally set at 1 January 2022; this has been deferred by the CRR Quick Fix by one year to 1 January 2023 to allow banks to increase the amount that they would be able to loan in the context of covid-19;

*c* a binding (not only reporting) net stable funding ratio, which indicates that a credit institution holds sufficient stable funding to meet its funding needs over a one-year horizon under both normal and stressed conditions (thereby preventing liquidity crises);

*d* incentives for investments in infrastructures and SMEs through discounts of capital requirements in consideration of the exposures to these investments; and

*e* a requirement for third-country institutions with significant activities in the EU to have an EU intermediate parent undertaking.

### iv Recovery and resolution

The BRRD introduced rules of minimum harmonisation in Member States' national laws by setting out common tools for the prevention and resolution of crises of banks and certain investment firms. This framework was completed by the SRMR, which complements the SSM and aims to manage swiftly and in orderly fashion possible crises of larger institutions in the euro area and other participating Member States. The SRMR includes a central resolution authority, the SRB, and a Single Resolution Fund financed by ex-ante contributions from the financial industry. The BRRD has been partially implemented in Spain through the Recovery and Resolution Regulations, which were initially approved as a consequence of the subscription of the memorandum of understanding and which constituted a major achievement in the Spanish regulatory landscape. These rules establish specific administrative resolution proceedings only available with respect to credit institutions and investments firms (different from insolvency court proceedings applicable to all entities) to intervene in failing or non-viable institutions when the public interest and financial stability is at stake.

The Recovery and Resolution Regulations foresee three phases (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 supervisory powers in the early intervention phase are entrusted to Banco de España or the ECB for credit institutions, and the CNMV for investment firms; 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; and the FROB holds the resolution powers in the executive resolution phase; and



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*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).

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.

***Early intervention phase***

The early intervention phase will be declared 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. The early intervention measures that can be adopted by the relevant supervisor include, without limitation, 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***

As a preventive measure and to facilitate the eventual resolution of an institution, 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 FROB, the relevant supervisors and 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 BRRD). Should any obstacles to the resolution of the institution be identified, the 'non-resolvable' institution must propose measures to reduce or 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 BRRD 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 BRRD) or it is reasonably foreseeable that it will become so in the near future, as this shall be determined by the relevant supervisor after consultation with the relevant pre-emptive resolution authority and the FROB. In any event, when the board of directors of an entity considers that it is non-viable, it must immediately notify the relevant supervisor, which in turn will promptly communicate it to the FROB and the pre-emptive resolution authority;



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*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[14] will prevent the institution from becoming non-viable within a reasonable period of time, as assessed by the FROB in close cooperation with the relevant supervisor; 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, as determined by the FROB.

When the above circumstances have been met, the execution phase of the resolution process will open and 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).

The Spanish bail-in resolution tool is specifically envisaged in the Recovery and Resolution Law, which allows resolution authorities to write-down or convert into capital 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)[15] to recapitalise the institution. This tool may be used to recapitalise the institution so that it can again meet the conditions to resume 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 other 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.

Moreover, 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).

The EU resolution framework (consisting of the BRRD and the SRMR) requires all credit institutions to comply with institution-specific minimum requirement for own funds and eligible liabilities (MREL) at all times by holding easily bail-inable instruments to ensure that sufficient financial instruments are available for write-down or conversion into equity in

14 The Recovery and Resolution Law foresees that the Fund for Ordered Bank Restructuring (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).

15 The excluded liabilities set forth in the Recovery and Resolution Law are those listed in Article 44(2) of the BRRD.



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the case of resolution (susceptible to bail-in). The MREL is the EU standard for bail-in capital and is designed based on case-by-case assessments as a percentage of total liabilities and own funds. To achieve a more credible bail-in tool, the BRRD II and SRMR II have enhanced the existing rules on subordination of MREL instruments and oblige G-SIIs and other large banks referred to as 'top-tier banks' (banks with a balance sheet size greater than €100 billion) to comply with MREL with a high percentage of subordinated liabilities (those that absorb losses before other ordinary liabilities). National resolution authorities may also select other banks (non-G-SIIs, non-top tier banks) and subject them to the top-tier bank treatment.

Additionally, the BRRD II has introduced a new moratorium tool available to supervisory and resolution authorities allowing for the suspension of certain bank contractual obligations towards third parties (including covered deposits) for a short period of time in resolution and in the early intervention phase. This tool would limit the excessive withdrawal of deposits in a bank resolution for a few days to provide authorities with additional time to manage banking crises with liquidity support.

## 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 and services 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 of and contact information for 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.



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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 have been the subject of legal debate after several 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 2015 on information obligations and the classification of financial products, and CNMV Circular 1/2018, of 12 March 2018, on warnings in connection with certain financial products, 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.

Moreover, legislation 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 2012, on urgent measures to protect mortgage debtors without resources, as amended by Royal Decree-Law 5/2017, of 17 March 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 of Good Practice for the viable restructuring of debts guaranteed by main-residence mortgages. 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 2013, 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 residence (which was extended for three more years by Royal Decree-Law 5/2017, and for four additional years therefrom until May 2024 by Royal Decree-Law 6/2020);

*c* Law 25/2015, of 28 July 2015, 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 Royal Decree-Law 6/2012, and broadens the scope of the application of the Code so that a greater number of debtors can benefit from it; and



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*d* Law 5/2019, of 15 March 2019, regulating real estate loans, and its implementing regulation, Royal Decree 309/2019, of 26 April 2019, which entered into force on 16 June 2019 and introduced a new set of rules affecting real estate loans. These regulations, which implement the Mortgage Credit Directive[16] in Spain, have extended the protection afforded to borrowers in the context of real estate lending, which has traditionally constituted one of the major sources of business for credit institutions in Spain, by introducing certain pre-contractual information requirements in favour of the borrowers, rules of conduct for lenders and credit intermediaries, and certain minimum legal requirements that the real estate loan regime shall observe. Additionally, Banco de España Circular 1/2020, of 28 January 2020, amending Banco de España Circular 1/2013, of 24 May 2013, on the Risk Information Centre (CIR), has made the information in the CIR public database available to real estate lenders and credit intermediaries, which will allow them to improve decision-making processes when assessing the risks of their clients.

### ii Spanish banking secrecy

The duty of credit institutions to keep their clients' information confidential from third parties other than the supervisory authorities is 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 that credit institutions ultimately require to carry out their main activity, lending. These instruments include (in addition to common shares) perpetual contingent convertible debt (which will normally qualify as Additional Tier 1 for solvency purposes), senior non-preferred debt (which was introduced by Royal Decree-Law 11/2017, of 23 June 2017, on urgent actions on financial matters, and which is a type of debt eligible as TLAC or MREL) 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

16 Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No. 1093/2010.



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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).

## 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.[17]

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 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 Royal Decree 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 per cent, 30 per cent 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 per cent, 30 per cent 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.

17 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 (the SSM Framework Regulation).



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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.

Lastly, in the context of the covid-19 crisis, a new foreign investment regulation was enacted whereby investments in credit institutions by certain non-EU and non-European Free Trade Association investors will be subject to an ex-ante administrative authorisation (the Screening Mechanism), which is required prior to the completion of any transaction that would result in such foreign investor holding a percentage equal to or exceeding 10 per cent of the capital in the relevant Spanish credit institution. Gun jumping the Screening Mechanism will result in the transaction being invalid and without any legal effect until the required authorisation is obtained. In addition, fines of up to the value of the investment could be imposed.

### ii Transfers of banking business

The Spanish financial system has, during the past decade, 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 also set out in the Recovery and Resolution Regulations (see Section III.iv).

## VII THE YEAR IN REVIEW

Spain has experienced a sharp economic downturn in 2020, which is expected to be followed by a rebound in 2021. The outbreak of covid-19 in March 2020 had an unprecedented negative impact on economic activity, following the steady growth path experienced over the previous years. GDP growth stood at 1.9 per cent in 2019, consolidating the moderate growth of previous years. The disruption to economic activity caused by the pandemic, coupled with the necessary containment measures put in place in March 2020, resulted in a severe contraction in economic activity in the first half of 2020 (around 22 per cent compared to the end of 2019). With lockdown restrictions lifted gradually from May 2020, economic activity bounced back in the second half of the year. However, overall, 2020 closed with a GDP contraction of 11 per cent, which places activity at 2014–2015 levels. Spanish policy



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measures have cushioned the impact of the covid-19 crisis and were aimed at limiting job losses and supporting the budget of households, self-employed professionals and companies, particularly SMEs, which are particularly sensitive and significant in Spain. In particular, existing short-time work schemes were eased for employers at the outset of the crisis so as to mitigate job losses. These schemes, which have been extended several times and are currently to remain in place until the end of May 2021, have done much to contain job losses but could not avoid them altogether. Hence, the unemployment rate fell sharply to 16.1 per cent at the end of 2020. Additionally, liquidity was enhanced by new bank loans backed by guarantees of the state-owned development bank, the ICO, tax deferrals were allowed and moratoriums on mortgage debt payments and consumer finance were granted to the particularly vulnerable (under certain terms), among other measures.

The banking sector entered the crisis with more robust balance sheets than in the 2008 financial crisis, as well as with strong liquidity and adequate capitalisation, enabling it to remain stable in 2020. Although the reduction in non-performing loans (NPLs) has slowed down, there have not been significant inflows of new NPLs due to the aforementioned policy support measures that were introduced by the public authorities. In addition, provisioning levels have remained stable, with total impairments on NPLs representing a similar level to that of the previous year, mainly due to the European Banking Authority and the Banco de España guidelines issued in 2021, which significantly altered the way in which banks categorise risks and provision for expected credit losses. A significant proportion of new business loans granted in 2020 were covered by public guarantees, which effectively ensured that companies can continue to cover their liquidity needs while demand gradually recovered. Although these temporary measures have generally helped to cushion companies from a fall in revenues, the short-term nature of the measures could lead to significant non-payments following the expiry of the moratorium and the materialisation of corporate insolvencies that, in turn, will have a downside effect for productive capacity and employment figures. While several measures have also been implemented to address the consequences of the covid-19 crisis on insolvency (among other things, the temporary suspension until March 2021 of the obligation to file an insolvency petition and the exemption of the subordinated treatment of new financing provided by specially related persons to the debtor during the state of emergency), this will need to be complemented with more structural measures, such as effective debt resolution processes and restructuring frameworks, for corporate businesses. The new restated text of the Spanish Insolvency Law, approved by Royal Decree-Law 1/2020, of 5 May 2020, will be rapidly tested in the forthcoming insolvency context.

## VIII OUTLOOK AND CONCLUSIONS

Spanish credit institutions were deeply affected by the 2007 financial crisis, which gave rise to an incredibly sharp increase in the level of impaired assets (both NPLs 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. 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. Nevertheless, there is still room for more consolidation, particularly among medium-sized banks, which could benefit



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from holding stronger and diversified franchises, gaining size and diluting the impact of fixed-cost bases, while facilitating IT and digitisation investments and accessing funding markets more easily. In fact, the consolidation in the banking sector has gained momentum with three ongoing merger transactions initiated in 2020: CaixaBank and Bankia, which is pending completion; Unicaja and Liberbank, which is pending approval by their respective general shareholders' meetings; and BBVA and Banco Sabadell, which kicked-off negotiations for the integration of the two entities.

The Spanish credit institution industry faces important challenges, the most notable of which are the following:

*a* a high number of impaired assets accumulated in the balance sheet of credit institutions, which entities attempt to reduce;

*b* a low interest rate environment in the eurozone, which is likely to persist in the short term, and which notably impacts the profitability of credit institutions;

*c* increasingly demanding capital and liquidity requirements applicable to credit institutions (such as the TLAC requirement) as well as the new resolution framework that demands credit institutions to issue debt securities that comply with MREL requirements, all introduced by the new banking reform package;

*d* the need to undergo a digital transformation process to incorporate new digital and payment technologies to compete against new technologies and actors that differ from traditional credit institutions (e.g., fintech entities);

*e* the restoration of customer confidence in credit institutions in light of the profuse consumer litigation against them and because of their crisis management reputation; and

*f* climate change and the transition to a more sustainable economy and the need to comply with the requirements of upcoming laws in this field.

All such challenges will have to be faced in a context in which the full impact of the covid-19 crisis on the Spanish financial sector continues to be uncertain, although stability has been maintained thanks to policy measures introduced by the public authorities and resilience built by the banking sector over recent years.

Importantly, in July 2020, the European Council approved a recovery package amounting to €750 billion (the Next Generation EU funds), the largest part of which constitutes the €672.5 billion Recovery and Resilience Facility (RRF), which will make loans (€360 billion) and grants (€312.5 billion) available to support reforms and investments undertaken by EU countries. Between 2021 and 2026, Spain is expected to receive €59.2 billion in grants, and may request up to €140 billion in grants and loans from the RRF. It is expected that initial RRF disbursements will take place by mid-2021. The Next Generation EU funds are in addition to the EU's 2021–2027 multi-annual budget amounting to €1,074.3 billion (the Multiannual Financial Framework 2021–2027 (MFF)). Unlike the MFF, which is funded through contributions by Member States and certain common taxes, the Next Generation EU funds will be financed through debt issuance on capital markets by the European Commission itself. It is envisaged that the Next Generation EU funds will increase the growth potential and resilience of the Spanish economy and accelerate green and digital transitions. In fact, at least 37 per cent of the funds must be used to meet climate objectives and 20 per cent must be focused on digital transformation. However, to access these resources, Member States will be required to design 'recovery and resilience plans', which will be evaluated by the EC and be in compliance with the specific recommendations and investment criteria for each country.



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By the end of April 2021, countries must send the final versions of their national recovery and resilience plans to the European Commission, which will assess them within a maximum of two months, checking that investments and reforms focus on the pillars set forth in the RRF.

Although Spain is still managing the health crisis, with its fluctuating rates of infection and death, the deployment of vaccines against covid-19 and the use of significant EU funding to support recovery are expected to lift economic activity over the coming months.

As regards other important regulatory developments in the first part of 2021, it is expected that the new text of the Spanish Companies Law and other financial regulations will be published soon, including the amendments to the bill of law recently approved by the Spanish Senate. Further to transposing the second Shareholder Rights Directive,[18] the reform of the Spanish Companies Law will include important amendments in respect of related-party transactions, the regime for share capital increases, the issue of convertible notes in listed companies, shareholder engagement and directors' remuneration policies.

18 Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.



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**Appendix 1**

# ABOUT THE AUTHORS

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Juan Carlos Machuca joined Uría Menéndez in Madrid in 1996, and has worked out of the firm's London office since January 2000. He is the current resident partner in London.

Mr Machuca's practice focuses on corporate law, banking, finance, regulatory matters, investment funds, private equity and capital markets. He also advises clients on M&A transactions and on insolvency and restructuring proceedings.

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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Mr Bernar's practice focuses on M&A and securities law. He also advises on wide-ranging corporate matters, such as corporate governance and national and international contracting, and regulatory aspects concerning financial activities, such as banking and investment and payment services.

Mr Bernar has been involved in numerous transactions, including all types of M&A deals and capital market transactions, including issuances, offers (public and private), listings and delistings of shares, preferential subscription rights, bonds (simple, convertible, exchangeable and high yield), commercial paper, and in the defence and launching of tender offers, spin-offs and M&A involving public and private companies.



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ISBN 978-1-83862-762-1

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