Recent key developments in the area of Spanish financial regulation

Prepared by the Regulation and Research Department of the Spanish Confederation of Savings Banks (CECA)

Royal Decree-law 24/2021, transposing the EU directives on covered bonds and cross-border distribution of collective investment undertakings, among others (published in the *Official State Journal* on November 3rd, 2021)

I. Transposition of Directive (EU) 2019/2162 on covered bonds

This new piece of legislation regulates the issue and supervision of covered bonds, establishing their structural features, publication requirements and investor protection mechanisms. It takes effect on July 8th, 2022.

It will apply to covered bonds issued by credit institutions operating in Spain (including the country's official credit institute, ICO) and covered bonds issued outside of Spain by Spanish credit institutions.

In broad brushstrokes, the law addresses the following aspects:

- It defines the categories of covered bonds and regulates the use of the "European Covered Bond" and "European Covered Bond (Premium)" labels. It outlines the characteristics specific to each category of covered bond, indicating the cover assets eligible for each and their requirements.

- Dual recourse: covered bonds grant their holders a claim against the issuer and the possibility that the issuer may claim payment after its maturity.

- Cover pool: all covered bond programmes must have attached a cover pool to secure the obligations assumed by the issuer vis-à-vis the holders of such instruments and hedging derivative counterparties. Covered bond liabilities must be covered at all times by the credit claims attached to the cover assets.

  With respect to the cover pool for mortgage-backed bonds, the loans secured by mortgages may not exceed 60% of the appraisal value of the mortgaged asset, or 80% if the latter is a residential property. Issuers may temporarily hold loans in the cover pool whose loan-to-value is higher than is legally stipulated with the sole aim of lending a degree of stability to the cover pool. The repayment period for covered bonds that finance the acquisition, construction or refurbishments of a regular abode may not exceed 30 years.

- Special register: issuers must keep an up-to-date register of all of the loans and credit drawdowns, if any, the substitution assets, the assets for the cover pool liquidity buffer requirement and the derivative instruments comprising each of their cover pools, as well as any collateral received in connection with positions in derivative instruments and any credit claim deriving from damage insurance.

- Overcollateralisation: the covered bonds cover pool must have a minimum threshold of overcollateralisation of total assets. The new Royal Decree-law refers to the Capital Requirements Regulation (CRR) to note that such minimum threshold for covered bonds secured by mortgages, regional bonds and trade finance is 5%. However, that level of overcollateralisation may be higher when so set down in the contractual terms and conditions of the issue or listing prospectus, if any.

- Cover pool liquidity buffer: this buffer must be made up of high-quality liquid assets

to cover the net liquidity outflow of the covered bond programme over the next 180 days. There are procedures addressing the situation in which liquidity requirements set out in other Union legal acts result in an overlap with the cover pool liquidity buffer.

- Asset valuation: the legislation establishes the rules for valuing the assets included in the cover pool and the general principles for appraising physical collateral assets.

- The quarterly disclosure requirements issuers must provide with respect to their covered bond programmes.

- The general principles of the legal regime governing appraisal firms, including how they operate and how they are supervised.

- Sale and trading of covered bonds: the securities representing covered bonds may be sold by any means permitted by law, without the need for public notarisation or notification of the cover asset debtor. Moreover, they may be admitted for trading on regulated markets and multilateral trading facilities (MTFs).

- Cover pool monitor (external or internal): the issuer must appoint a cover pool monitor, which may be an external or internal body, for each programme, to look out for investors' rights. A monitor's mission is to perform ongoing oversight of the cover pool with regard to the requirements set out. Pool monitors must be authorised by the Bank of Spain.

- The Bank of Spain is tasked with supervising compliance with the contents of this new legislation for each covered bond programme.

- Issuer insolvency or resolution: here it is worth highlighting the potential appointment of a special administrator to ensure that the rights and interests of the covered bond investors are represented; the physical segregation and transfer of cover assets in the event of insolvency; cover asset valuation; the materialisation of segregated assets and payment to the covered bond holders and other segregated asset creditors; and the effects of resolution decisions. It also ranks the claims associated with covered bonds senior to the debtor's assets, including both their movable and immovable property.

- Penalty regime: classification of the breaches and applicable penalties in relation to covered bonds and the asset appraisal business.

With respect to previously issued covered bonds, note that the legal regime contemplated in this Royal Decree-law is due to apply to covered bonds issued after July 8th, 2022. Issuers will therefore be able to avail of the time elapsing between publication of the new legislation and its entry into force to make the changes and adaptations needed to facilitate compliance, particularly with respect to formation of cover pools and the corresponding asset registers. Lastly, the legislation establishes the procedure to be followed by credit institutions to allocate cover assets to the securities issued prior to July 8th, 2022, in order to ensure the neutrality and quality of the assets transferred to the cover pool.

II. Transposition of Directive (EU) 2019/1160 with regard to cross-border distribution of collective investment undertakings

This piece of legislation amends Spanish Law 35/2003 on collective investment undertakings and Law 22/2014 on private equity firms, closed-end collective investment undertakings and the companies that manage closed-end collective investment undertakings. It took effect the day after its publication.

The main measures introduced:

- It regulates pre-marketing in the EU by collective investment undertakings, other than those regulated by the UCITS Directive, managed by management companies authorised in Spain.

- It introduces modifications to the marketing in Spain of funds of collective investment undertakings authorised in another EU Member State and of funds of Spanish collective investment undertakings in the EU.

- It itemises the conditions for notifying the discontinuation of marketing by Spanish collective investment undertakings in the EU and by alternative investment funds managed by management companies authorised in Spain.

- It establishes the services on offer to retail investors under the scope of marketing in the EU of alternative investment funds managed by management companies authorised in Spain.

- It introduces reporting requirements for the CNMV with respect to information to be provided to the competent authorities of the Member State hosting the management company.

- Lastly, it regulates pre-marketing in Spain and the rest of the EU by private equity firms and closed-end collective investment undertakings managed by management companies authorised in Spain, addressing communication activities, investor contacts and the conditions for discontinuing marketing, in the same manner as it regulates those activities for collective investment undertakings.

Royal Decree-law 29/2021 enacting urgent measures in the energy field to foster electric mobility, self-consumption and the deployment of renewable energies (published in the *Official State Journal* on December 22nd, 2021)

Royal Decree-law 29/2021 amends Royal Decree-law 24/2021 in order to introduce technical improvements to guarantee the adequate entry into effect and application of the new covered bond regulation.

On the one hand, it clarifies that the submission of the covered bond issue prospectus or the base prospectus in the case of a covered bond programme is required in the event the issue is subject to such requirements under the European prospectus rules.

Elsewhere, it specifies that instruments issued before publication of Royal Decree-law 24/2021 will continue to be governed by the Mortgage Market Act and its implementing regulations until July 8th, 2022. Such issues and any carried out between publication of the above Royal Decree-law and July 8th, 2022, must be fully adapted for the new regime by that date.

Lastly, it clarifies which provisions will be repealed as of July 8th, 2022.

Royal Decree 970/2021, amending Royal Decree 1644/1997 regarding the authorisation rules and solvency requirements for counter guarantee societies, Royal Decree 2660/1998 on the exchange of foreign currency in establishments open to the public other than credit institutions and Royal Decree 84/2015, implementing Law 10/2014 on the structuring, supervision and capital adequacy of credit institutions (published in the *Official State Journal* on November 9th, 2021)

This Royal Decree partially transposes both the CRD V (Directive 2019/878) and the Investment Firms Directive (Directive 2019/2034). It took effect the day after its publication, with the exception of certain provisions, which took effect on January 1st, 2022.

It is worth highlighting the following amendments to Royal Decree 84/2015:

- It implements a new regime for the approval of financial holding companies and mixed financial holding companies.

- With respect to cross-border activities, it introduces new reporting requirements in a bid to reinforce supervision, by the Bank of Spain, of the activities of the branches of

credit institutions headquartered outside a European Union Member State.

- In relation to the prudential assessment of proposed acquisitions of significant interests, integrity and professional competence is presumed to exist when the acquirer is a public authority.

- The Bank of Spain or the European Central Bank (ECB) must assess the suitability of senior executives when there are reasonable grounds to suspect that money laundering or terrorist financing is being or has been committed or attempted. In addition, the Bank of Spain must send the information provided by the financial institutions about the gender pay gap to the European Banking Authority (EBA).

- In relation to the good governance of the institution, the legislation provides that membership of a related party need not in itself constitute an obstacle to independent decision-making.

- The regimes governing the subsidiaries of Spanish credit institutions located in offshore financial centres will have to have equivalent risk management and capital self-assessment systems, strategies, procedures and mechanisms unless the legislation in the country where the subsidiary is located so prohibits.

- The legislation introduces new obligations for the management of interest rate risk derived from activities outside of the entities' trading portfolio activity.

- The risks derived from the delegation of the performance of services or duties of credit institutions to a third party have been added explicitly to the policies and procedures in place for evaluating and managing exposure to operational risk.

- The situation in which the shortfall of own funds is smaller than the leverage ratio buffer requirement has been included as an exception to having to take measures to return to compliance with the applicable capital adequacy rules; if this situation arises the entity in question must draw up a capital conservation plan.

- The legislation modifies a number of aspects related with the capital buffers.

- On the supervisory front, the legislation explicitly obliges the Bank of Spain to apply the proportionality principle and gives it the ability to adapt the methodologies used for the supervisory review and evaluation process so as to be able to take into consideration similarities in the entities' risks. It also details when the Bank of Spain as competent authority is determined to be the consolidating supervisor of groups of credit institutions.

- It modifies certain measures regarding collaboration between supervisory authorities and introduces new prudential supervisory measures in relation to additional own funds.

- Lastly, it lays down the conditions for taking joint decisions with respect to the approval and waiving of approval of, and the supervisory measures applicable to, financial holding companies and mixed financial holding companies.

Royal Decree 1041/2021 amending Royal Decree 2606/1996 on credit institutions' deposit guarantee schemes and Royal Decree 1012/2015 implementing Law 11/2015 on the recovery and resolution of credit institutions and investment firms (published in the *Official State Journal* on November 24th, 2021)

This Royal Decree completes transposition of the BRRD II (Directive 2019/879) by amending Royal Decree 2606/1996, specifically introducing changes to the method for calculating and approving extraordinary contributions to the deposit guarantee scheme in order to introduce flexibility and specifying that deposits made by the credit

institutions do not count for scheme coverage purposes. The scheme has been vested with the power to verify the accuracy of the information regarding each depositor's eligible and coverage deposits, as well as that used to determine the basis for calculating their scheme contributions.

It additionally modifies Royal Decree 1012/2015 as follows:

- An independent expert, appointed by the so-called Fund for Orderly Bank Restructuring (FROB) must value the assets and liabilities of the troubled entity not only before ratification of any resolution measure but also when exercising its power to cancel or convert the pertinent equity instruments or eligible liabilities.

- As for resolution plans, the new legislation determines the stressed scenarios that should be used for the purpose of identifying resolution powers and tools. Resolution plans must include an estimate of minimum requirements for own funds and eligible liabilities (MREL) levels and subordination, along with a timeline that includes a deadline for compliance.

- As for the resolvability assessment, it establishes the technical criteria for calculating the maximum distributable amount for the purpose of the restrictions on distributions in the event an entity does not meet its obligations under the combined buffer requirement evaluated in conjunction with the MREL.

- It reinforces collaboration and information-sharing requirements with the resolution authorities and modifies the operating regime and dynamics of the European resolution authorities colleges.

- The legislation adds a new framework for determining the MREL, specifically introducing the technical standards related with determination of the MREL and the subordination requirement. It also regulates the procedure to be followed by the preventive resolution authority to determine the MREL and the powers the supervisor or competent resolution authorities can use in the event of non-compliance.

- The preventive resolution authority may establish a transitional period for compliance with the MREL, with full compliance required by January 1st, 2024, at the latest; any such period must include an intermediate target level to be met by the entities by January 1st, 2022.

Royal Decree 1041/2021 took effect the day after its publication in the *Official State Journal* with the exception of the annual requirement to publish supervisory reporting information and public disclosure of the MREL, which will take effect from January 1st, 2024, unless the resolution authority sets a compliance deadline later than January 1st, 2024, in which case the reporting requirements shall be met as from the date of ultimate compliance.

Bank of Spain Circular 4/2021 on confidential statement templates in the areas of market conduct, transparency and customer protection and on the registration of claims (published in the *Official State Journal* on December 1st, 2021)

The purpose of this Circular is to establish the contents and publication frequency of the confidential statement templates in the areas of market conduct, transparency and customer protection that certain financial institutions, including the banks, have to send the Bank of Spain. The first set of confidentiality statements related to conduct to be sent to the Bank of Spain are those corresponding to the second half of 2022.

The Circular also determines the minimum information contents the Bank of Spain must have access to in relation to customer claims. The entities have until December 31st, 2022, to complete their claims registers, which must include all claims received with a presentation date later than June 30th, 2022.

Bank of Spain Circular 5/2021 amending Circular 2/2016 on supervision and solvency, completing transposition into Spanish law of Directive 2013/36/UE and Regulation (EU) No. 575/2013 (published in the *Official State Journal* on December 23rd, 2021)

The purpose of this Circular is to regulate the establishment of countercyclical capital buffers for one or several sectors, exposure limits with respect to certain sectors and the possibility of establishing limits and conditions on the granting of loans and other transactions by entities in transactions entered into with the private sector in Spain. The Circular took effect 20 days after its publication.

With respect to the countercyclical capital buffer for certain specific sectors, it is worth highlighting the following:

- The credit institutions must maintain a countercyclical capital buffer comprising common equity tier 1 (CET1) capital calculated specifically for each entity or group, which will be determined with respect to all of the entity's or group's exposures or their exposures to a specific sector.

- To determine the percentage applicable to the balance of exposures to risk in one or more sectors, the Bank of Spain will evaluate and monitor on an ongoing basis the quantitative significance of the various sectors for the credit institutions or their categories of credit risk exposure, as well as a series of indicators for each sector or category.

- The countercyclical buffer will range between 0% and 5%, calibrated in steps of 0.25 percentage points. The Bank of Spain is allowed to establish a percentage higher than 5%.

- When the Bank of Spain decides to establish a percentage countercyclical buffer for exposure to risk in one or more sectors at the same time or it decides to increase that buffer, the date on which the buffer becomes enforceable is six months after the date of the announcement. The buffer will apply until the Bank of Spain deems that the systemic risk has dissipated.

- The Circular requires the entities to report to the Bank of Spain quarterly on their exposures to the corresponding sectors in the territory in question.

As for the sector-specific limits on exposure concentration, the Bank of Spain will evaluate the entities' confidential financial information periodically to determine whether to establish a concentration limit with respect to a specific sector of the economy. Such limits will be expressed as a percentage of CET1 and will apply for a period of two years at most.

Lastly, when the Bank of Spain concludes that the policies and criteria used by the banks could have an adverse impact on the intensity of the financial system's systemic risk, it may introduce additional macroprudential tools related with the imposition of limits and conditions for the granting of loans and other transactions, whether or not secured by a mortgage.

The limits and conditions the Bank of Spain may impose with respect to the financial characteristics of transactions include the following: limiting their terms of maturity and grace periods and setting minimum principal repayment requirements.

CNMV Circular 1/2022 on the advertising of cryptoassets presented as an investment opportunity (published in the *Official State Journal* on January 17th, 2022)

The purpose of the Circular is to implement the rules, principles and criteria governing the advertisement of cryptoassets, delimit their scope of application and itemise the regulator's supervisory and control powers in this area.

The Circular will apply to providers of services over cryptoassets (to the extent they engage in their advertising), the providers of advertising services and any other natural or legal person

that advertises cryptoassets at their own initiative or on behalf of third parties.

Advertising of cryptoassets that are marketed as an investment similarly falls under the scope of the Circular. It is presumed that a cryptoasset is being offered or marketed as a potential investment when a message promotes its purchase or makes any reference to current or future returns, prices or valuation that could suggest an opportunity to invest in that asset, even if it may ultimately be used as a means of exchange.

Advertising activities targeting investors in Spain do not have to be previously notified to the CNMV except for mass media advertising campaigns and when the regulator deems fit on account of the impact they could have on their target audience. The parties bound by the legislation must keep a register containing information and documentation pertaining to the advertising campaigns underway or carried out over the past two years. The CNMV is entitled to notify the bound parties of any deviations detected in their advertising activities and require them to discontinue the campaign or correct the message.

Resolution dated November 30th, 2021 prolonging and expanding the state guarantees for loans and amending the Code of Good Practices (published in the *Official State Journal* on December 1st, 2021)

In line with the decision to expand and prolong the EU's State Aid Temporary Framework until June 30th, 2022, Spain's Council of Ministers agreed to extend the deadline for applying for state guarantees for loans until June 1st, 2022, and to adjust the benchmark limits in line with the new ceilings for limited amounts of aid contemplated in the Temporary Framework (from 1,800,000 to 2,300,000 euros).

It also extends the deadlines for applying for the various measures encompassed by the Code of Good Practices and similarly modifies the benchmark limits in line with the new ceilings established in the European Temporary Framework.

The financial institutions that have endorsed the Code of Good Practices as of the date of the Resolution will have one month to notify the General Secretary for the Treasury and International Financing of their intention not to adhere to these modifications, thus continuing to be governed by the original version published on May 13th, 2021.

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