Recent key developments in the area of Spanish financial regulation

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Law on digital transformation of the financial system (Law 7/2020, published in the *Official State Journal* on November 14th, 2020)

This law regulates the controlled testing environments better known as regulatory sandboxes that are designed to facilitate the development and implementation of innovative technology in the financial system, providing full legal and supervisory coverage and respecting the principle of non-discrimination. The law took effect the day after its publication.

The measures included in this new piece of legislation are designed to achieve two key objectives: (i) guarantee that the financial authorities have the right instruments for continuing to perform their duties in the new digital context; and, (ii) facilitate innovation through the provision of access to funding and talent in a highly-competitive, international technology environment.

In broad terms, the legislation stipulates the following:

I. Controlled testing environment, better known as regulatory sandboxes

Regarding the details about the how the sandboxes will work, the legislation provides the following:

- Access to a sandbox or the performance of tests as part of a pilot project shall not imply the granting of permission to carry on a restricted activity or provide services on an indefinite basis.

  If entities that are already authorised to engage in a given activity participate in a pilot test, they shall only obtain regulatory relief with respect to the activities that fall within the scope of the pilot project.

- Access to sandboxing shall be provided for initiatives sponsored by any natural or legal person that, individually or together with other persons, applies to sandbox a pilot project and can demonstrate a technology-based source of innovation applicable to the financial system and a sufficient level of project maturity or test readiness.

  In addition, the innovative projects must add potential utility or value added to existing use cases in at least one of the following ways: They must: (i) facilitate regulatory compliance; (ii) imply an ultimate benefit for financial service users; (iii) increase financial institution or market efficiency; and/or, (iv) provide mechanisms that improve financial regulation or supervision.

- Applications must be presented electronically before the General Secretariat of the Treasury and International Finance which will pass them along to the competent supervisory authorities. Those authorities will then evaluate the applications on the basis of a substantiated report and will send the General Secretariat the list of projects that are deemed to add value to existing use cases and meet the rest of the requirements. The General Secretariat will then publish (electronically) the list of projects that have been approved, indicating the supervisory authority or authorities that will be responsible for monitoring each.

- The parties (the sponsor and the overseeing authority/authorities) will then have three months from publication of the favourable

assessment to agree a test protocol. That protocol must set down the rules, terms and conditions that will govern the pilot project to be sandboxed.

Once that protocol has been approved, the sponsor must obtain informed consent from the participants (users) and set up the corresponding guarantee and indemnity scheme.

As for that guarantee regime, user protection and test oversight, the legislation broadly contemplates the following:

- The participants in any test must accept the terms of participation in writing and they shall be entitled to terminate their participation at any time.
- The sponsor shall be responsible for any damages incurred by the participants.
- The pilot project and any tests may be suspended or deemed terminated for due cause by the competent authority. By the same token, the sponsors can suspend or declare the pilot project terminated.

With respect to the process for exiting the sandbox, the legislation contemplates the assessment of the results obtained by the sponsor and the existence of an authorisation gateway.

II. Other measures for facilitating digital transformation in the financial arena

The new legislation stipulates the following additional measures regarding sandboxes: (i) application of the principal of proportionality; (ii) the establishment of specific direct communication channels for engaging with the supervisory authorities; and, (iii) a procedure for submitting written enquiries to the supervisory authorities with respect to the regime, the classification or application of financial sector regulations.

III. Other aspects

In order to analyse and foster the regulatory sandbox facility and the other measures contemplated, a Coordination Committee shall be set up within three months of the enactment of Law 7/2020. That committee shall be presided by the General Secretariat of the Treasury and International Finance and made up of representatives from the supervisory authorities and, at the proposal of the Secretariat, representatives from other sector institutions.

- The legislation contemplates mechanisms for international cooperation between the various public authorities so as to layer the global dimension into the mechanisms contemplated.
- Lastly, the legislation stipulates the preparation of an annual report on digital transformation in the financial sector; moreover, the supervisory authorities must include a section in their annual reports addressing the use of technology-based innovation in their supervisory duties.

CNMV Circular on investment product and service advertising (Circular 2/2020, published in the *Official State Journal* on November 13th, 2020)

Circular 2/2020 implements the scope of application, content and formats applicable to advertising messages and sets rules for the internal procedures and controls institutions must implement as well as their advertisement record-keeping obligations. This Circular includes several key parts:

- It defines a number of concepts, including "advertisement" and "marketing message", for example. It is worth noting the definition of "advertising activity" as any activity undertaken by the entities bound by the Circular, irrespective of the means used to carry out such advertising activity.
- It limits the scope of application to the advertising activities targeted at investors or potential investors resident in Spain that offer or call attention to any financial product, service or activity subject to CNMV supervision, as well as structured deposits.

- Included in the scope of application are investment firms, credit institutions, UCITS management companies and crowd-funding platforms.

- It stipulates that certain information provided to investors in connection with the purchase of products or services prior to such purchase or to perform a transaction involving such products and the documentation/information regarding alternative investment funds provided to analysts or investors does not constitute advertising activity and is therefore excluded from the scope of application of the Circular.

- It bans targeting any advertising activity at retail investors or the general public with respect to any product or service whose sale or provision to retail customers is prohibited.

- The information contained in marketing messages must be consistent with that contained in informational content.

- Marketing campaigns and advertisements by bound entities must comply with the eligibility terms stipulated in complementary regulations.

- It requires the bound entities to formulate a marketing policy.

- Any information or message embedded in any medium shall be deemed to be advertising in nature to the extent it refers to the products and services of a given entity and the latter pays or provides remuneration of any kind for its broadcast.

- The bound entities are required to keep a duly updated internal record of their advertising activities. Smaller entities with limited advertising activities can comply with the advertising control obligations by setting up simplified marketing policies and record-keeping systems.

- The entities are allowed to join voluntary advertising self-regulation programmes.

- Lastly, the Circular contemplates the discontinuation or rectification of advertising that fails to comply with the contents of this Circular, notwithstanding application of any applicable disciplinary proceedings.

Royal Decree-law on urgent measures to support company solvency and the energy sector and addressing tax matters (Spanish Royal Decree-law 34/2020, published in Spain's *Official State Journal* on November 18th, 2020)

Below is a summary of the main measures taken in the financial arena.

With regard to the financing provided to self-employed professionals and companies that have been provided a state-backed guarantee (channelled via Spain's official credit institute, the ICO), this piece of legislation stipulates the following:

- The date of maturity for the guarantees awarded under the scope of Royal Decree-law 8/2020 is to be extended by a maximum of three years, so long as the following requirements are met:

  - The secured financing transaction is not in arrears.

  - The borrower is not on record in the Bank of Spain's risk information warehouse (known as CIRBE) as non-performing as of the date of agreeing any such extension.

  - The financier has not informed the entity that provided the guarantee of any payment breach on the part of the borrower with respect to the secured transaction as of the date of agreeing the extension.

  - The borrower is not party to bankruptcy proceedings.

  - The borrower applies to have the guarantee extended by May 15th, 2021 at the latest.

- In addition, at the request of the borrower, the credit institutions, specialised lending institutions, electronic money institutions and payment institutions must extend the principal repayment grace period with respect to the secured transactions. The principal corresponding to the grace period extended may be, subject to agreement between the parties: (i) accumulated until the last loan instalment; (ii) distributed over the remaining instalments on a *pro rata* basis; or, (iii) repaid via a combination of the two methods. If an agreement cannot be reached, the *pro rata* method shall be applied.

- The financial institutions cannot change the limits on the working capital facilities awarded to all borrowers that meet the above prerequisites before June 30th, 2021.

- The financial institutions must comply with the following requirements:

  - Apply best banking uses and practices to the benefit of their customers.

  - The costs of the loans benefitting from any such extension must remain in line with the costs charged prior to the extension, the only increase allowed being an increase that reflects the higher cost of the guarantee.

  - Their accounting and risk management systems must reflect the modification of the terms of such transactions, including any new terms and conditions, in order to facilitate their traceability. They must later add that information to the statements provided to the risk information warehouse, following the Bank of Spain's instructions.

- If the guarantee extension is set down in a public deed, the financial institution in question must place the deed on public record or have the agreement notarised. Any solicitor and property registration fees, to the extent secured by a mortgage, shall by subsidised by up to 50%, subject to limits for each concept. Guarantee extensions raised to public deed shall also be exempt from stamp duty.

- The financial institutions have no more than 30 calendar days to rule on a borrower application and, should the application be approved, to notify the ICO of the request to modify the terms of the guarantee.

Royal Decree-law 34/2020 also stipulates the following exemptions for private legal persons for 2021:

- When calling their annual general meetings, the boards of directors of joint-stock companies may contemplate remote attendance voting.

- The general meetings of limited liability companies and partnerships limited by shares, the general assemblies or partner meetings of other private legal persons and trust board meetings can be held by video or multi-caller conference call.

The new legislation has the effect of amending the following pieces of legislation, among others:

- Royal Legislative Decree 4/2015 enacting the recast text of the Securities Markets Act. For the purpose of applying for admission to trading on a regulated exchange, the limit on the capitalisation of shares traded exclusively on a multilateral trading platform has been increased to one billion euros (from 500 million euros).

- Royal Decree-law 8/2020 on extraordinary urgent measures for mitigating the economic and social impacts of COVID-19. The deadline for the grant of guarantees by the Ministry of Economic Affairs and Digital Transformation has been extended until June 30th, 2021.

- Royal Decree-law 25/2020 on urgent measures for supporting economic recovery and job creation. The wording has been amended to allow the possibility of additionally extending the guarantees awarded by the Ministry of Economic Affairs

and Digital Transformation to commercial paper listed on Spain's alternative fixed-income market (MARF), also extending the deadline for the award of such guarantees until June 30th, 2021.

Bank of Spain Circular on public and confidential financial reporting requirements and financial statement templates (Circular 5/2020, published in Spain's *Official State Journal* on December 4th, 2020)

Circular 5/2020 establishes the accounting regime applicable to payment and electronic money institutions, determining the accounting documents, including the public and reserved financial statement templates, such entities and their groups must draw up. It also implements the Code of Commerce in respect of payment and electronic money institutions. It is worth highlighting the following aspects:

- Firstly, its scope of application is limited to payment institutions, electronic money institutions, account information service institutions, branches in Spain of payment and electronic money institutions whose head office is located in a Member State, branches in Spain of electronic money institutions whose head offices are not located in a Member State and groups of payment or electronic money institutions.

- It clarifies whether the public and confidential financial statements must be drawn up in keeping with the contents of the new Circular or directly under IFRS-EU.

- It determines the documents that have to be published, along with certain general requirements regarding the content of the institutions' separate and consolidated annual financial statements.

- It stipulates specific disclosure requirements for inclusion in the institutions' annual financial statement notes.

- It sets out the specifics for their confidential statements in terms of templates, breakdown, frequency and submission timing.

- It rounds out the accounting regime for hybrid specialised lending institutions contemplated in Circular 4/2019.

- It allows entities to apply the new accounting criteria on January 1st, 2021 either retrospectively or applying a regime with a number of simplifications.

- The institutions are required to measure their financial instruments, accounting hedges, property and equipment, inventories, non-current assets held for sale and their fee, commission and other income in keeping with the transitional regime provided for in Circular 4/2017.

- It amends Circular 6/2001 on owners of currency exchange establishments such that those owners must now submit the confidential financial statement template for the sale-purchase of foreign currency introduced by this new Circular for payment and electronic money institutions instead of the equivalent confidential financial statement they had been submitting to the Bank of Spain up until now.

- It amends Circular 4/2017 to keep it aligned with the European accounting framework and European Central Bank guidance for credit institutions with respect to non-performing loans. Those modifications include the express regulation of the accounting treatment of dividend distributions that take the form of assets other than cash (in-kind dividends). In addition a change has been introduced in the frequency with which the credit institutions have to switch the company tasked with updating the appraisal of the real estate assets securing non-performing loans and of those foreclosed or received in lieu of payment.