New unified regulation and supervision of credit institutions

Marisa Aparicio González
(Eligible) Professor of Corporate & Commercial Law at Universidad Autónoma de Madrid
Academic Counsel at Gómez-Acebo & Pombo

1. Meaning

The Unified Regulation, Supervision and Solvency of Credit Institutions Bill **(URSSCI)** has been published in the Journals of the Spanish Houses of Parliament (BOCG, its acronym in Spanish) of 14 February 2014**.**

This is a long-awaited proposal that attempts to tighten the prudential regulation of the financial sector. Passing of the Bill will mean not only the definite incorporation into Spanish law of international agreements adopted in response to the financial crisis of 2008, completing and absorbing Royal Decree Act (Order in Council) of 29 November 2013, which regulated the most urgent matters in this respect[1], but also the consolidation in a single text of those rules governing and disciplining credit institutions that the complex body of legislation for this market has modernised and adapted on a needs basis.

The text consists of 118 articles, 15 additional provisions, 15 transitory provisions, a single repealing provision, and 12 final provisions.

The single repealing provision specifically affects in Spain the Banking Act 1946; the Incompatibilities and Limitations of Private Banking Presidents, Directors and Officers Act 31/1968, of 27 July; the Investment Ratios, Equity and Information Duties of Financial Intermediaries Act 13/1985, of 25 May; Royal Legislative Decree (Delegated Act) 1298/1986, of 28 June, adapting loan arrangement rules to the legal system of the EU; the Disciplining and Intervention of Credit Institutions Act 26/1988, of 29 July; and, article 29(2) of the Sustainable Economy Act 2/2011, of 4 March.

For their part, the final provisions, reasonably in tune with the text being passed, includes important changes to the Spanish securities market law, which, in my opinion, after this umpteenth change, will be rendered virtually unintelligible; regarding credit co-operatives, securities payment and settlement systems, the unified regulation and supervision of private insurance, the supervision of financial conglomerates, the auditing of accounts and the compensation fund of last resort for customers of credit institutions.

Entry into force of the Act is envisaged on the day following its official publication. However, the twelfth final provision states that the date of entry into force of the specifically mentioned provisions will be 30 June 2014. Since the Bill's passage through Parliament is being expedited under the emergency (fast-track) procedure[2], the implementation of these provisions seems equally imminent.

[1] Royal Decree Act 14/2013, of 29 November, on urgent measures to adapt Spanish law to EU legislation concerning the supervision and solvency of financial institutions (BOE of 30 November). Validated by Decision of 12 December 2013 of the Presidency of the Congress (BOE of 18 December).

[2] The emergency procedure implies that the timetable of a bill is half that of the ordinary procedure in the lower House (no. 94 of the Standing Orders of the Congress), and 20 calendar days for passage in the upper House (no. 133 of the Standing Orders of the Senate).

2. Content

The Basel Committee on Banking Supervision's "Global Regulatory Framework for More Resilient Banks and Banking Systems", also known as Basel III, was the most relevant international response to the regulatory failings brought to the fore with the crisis. The core ideas of this Agreement became, in mid-2013, harmonised legislation of the European Union through a Regulation and a Directive which are now fully transposed into Spanish legislation[3], although, as we have noted, the transposition into Spanish law already began with Royal Decree Act 14/2013, of 29 November, on urgent measures to adapt Spanish law to EU legislation concerning the supervision and solvency of financial institutions.

The Bill is divided into three blocks: the first one addresses the legal regime of credit institutions, which includes the authorisation, suitability, reputation and corporate governance requirements (Title I, arts. 1 to 38); the second one deals more specifically with the solvency and prudential supervision of credit institutions and the sanctioning regime (Titles II, III and IV, arts. 39 to 118); the third one, by means of the aforementioned final provisions, amends the Spanish Securities Market Act in order to adapt it to the European body of rules, adjusts the rules for preference shares, adapts the regulation of financial conglomerates and modifies the composition of the Management Committee of the Deposit Guarantee Fund of Credit Institutions (Spanish compensation scheme).

3. Legal regime of credit institutions

The first block - Title I - covers, among other things, the financial credit establishments' loss of consideration as credit institutions, given that they may not receive deposits or other repayable funds; this was already established in Royal Decree Act 14/2013 of 29 November. There will be, however, a transitional period in which they can maintain such consideration until a singular regime for their activity is approved.

In terms of corporate governance and remuneration, the most notable developments are as follows[4]:

Limits are laid down on the number of boards (as well as general manager positions or akin) a director can serve in, according to which he may not hold at the same time more offices than one of the two combinations provided by art. 26.1, which refers to one executive position along with two non-executive positions or, alternatively, four non-executive positions; within the meaning of said article, executive positions are "those where management duties are performed regardless of the legal tie attached to said duties." The Bank of Spain may authorise the holding of an additional non-executive position if it believes that this will not prevent a proper discharge of duties in the credit institution. In any case, these persons will be subject to the prohibition of obtaining credit or guarantees, over and above the limit set by regulation (art. 26(4) and (5)), from the credit institution where they serve.

Also, the positions of board chairman and managing director may not be held simultaneously; although, exceptionally, the Bank of Spain may give permission where adequately justified (art. 29(4)).

Variable remuneration is limited to 100 % of the fixed component of the remuneration of each individual, unless the shareholders authorise raising the limit up to 200 % of the fixed component (art. 34(1)(g)).

---

[3] The European Union transferred this agreement to its legal system through 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; 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.

[4] The application of the general principles of the remuneration policy to senior management, risk-taking employees, employees who perform control duties, and any worker receiving a total remuneration that places him in the same remuneration bracket as that of senior managers and risk-taking employees, whose professional activities have a material impact on their risk profile (art. 32), will lead to a revision of the clauses relating to components of the remuneration, in most of their contracts, to adapt them to the new provisions.

A portion of the total variable remuneration to be determined by the institution must be subject to remuneration reduction clauses, or even recovery clauses regarding remuneration already paid, which shall contain the specific criteria established by the institution, particularly for situations where the employee has taken part in or is responsible for conduct that has generated significant losses for the institution, in breach of suitability and probity requirements (art. 34(1)(n).

Depending on their size, nature and scope or complexity of their activities, institutions may be faced with the obligation of having a remuneration committee (art. 36) and a, separate or joint, nomination committee (art. 31); in any event, said committees must be composed of members of the board of directors who do not perform any executive duties in the institution. A risk committee, under art. 38, shall be required by the Bank of Spain where it so decides.

Institutions shall be required to have a website publishing public information on their corporate governance and remuneration policy (art. 29(5)).

4. Prudential supervision and solvency

In the second block, and with regard to supervision, the main changes are:

For the first time, the Bank of Spain shall have the express obligation to present, at least once a year, a ***Supervision Programme*** for all credit institutions subject to its supervision, giving particulars of the content and method of supervision, and of the actions to be undertaken according to the outcome. This programme shall include resilience (stress) tests at least once a year (art. 55).

Credit institutions shall be obligated to submit to the Bank of Spain and publish every year the so-called ***Annual Bank Report***, a document containing on a consolidated basis details such as name, nature and location of the activity, turnover, number of full-time employees, gross earnings before tax, tax payable on earnings, or public grants or subsidies received (art. 87(1)).

This block contains all new solvency requirements left to national determination, most notably the capital buffers that allow supervisors to require capital levels above those set out in the relevant EU regulation, stating that credit institutions must comply at all times with the combined capital buffer requirements, understood as the total of common equity tier 1 necessary to meet the obligation of holding a capital conservation buffer (art. 43). Specifically, the following buffers are defined:

— **Capital conservation buffer** for unexpected losses. Shall apply from 1 January 2016 and will be 2.5 % in 2019 (art. 44).

— **Specific countercyclical capital buffer** that seeks to avoid the pro-cyclical effect of prudential regulation. Shall apply from 1 January 2016 and its level will be up to 2.5 % (art. 45).

— **Capital buffers for systemically important institutions**, applicable to global systemically important institutions and other systemically important institutions, on an individual, sub-consolidated or consolidated basis. Shall apply from 1 January 2016 and will be between 1 and 3.5 %, depending on the more or less systemic nature of the institution to which it is applied (art. 46).

— **Buffer against systemic risks**, applicable to all or some of the exposures located in Spain or in the Member State setting the buffer, and may be required of all credit institutions, whether or not in a group that can be consolidated. It can reach levels of 5 % and the supervisor shall have the discretion to decide when and to what extent make the requirement, in order to reduce the risks deriving from economic downturns in the financial system (art. 47).

These buffers are a complement to the direct effect Regulation, raising common equity tier 1 (composed of capital and reserves) to at least 4.5 % of the risk-weighted assets from 2015. Similarly, a narrower definition of capital is determined to ensure true ability to absorb capital losses.

There are, to finish, more demanding requirements in terms of liquidity, sufficient to meet needs in stress scenarios, and a new leverage ratio that will apply from 2018.

5. Deposit Guarantee Fund

The Bill also includes a change in the composition of the Management Committee of the Deposit Guarantee Fund, inasmuch as an institution falling within the tax consolidation perimeter. It shall comprise eleven members: one representative of the Ministry of Economy and Competitiveness, one from the Ministry of Finance and Public Administrations, four appointed by the Bank of Spain and five associations representing the adhered credit institutions: three from banks, one from savings banks and one from credit cooperatives. The term of office of the members of the Committee shall be four years, renewable upon expiry. The Deputy Governor of the Bank of Spain shall be the Chairman (eighth final provision, amending art. 7 of Royal Decree Act 16/2011, of 14 October).

6. Changes in securities market rules

As pointed out in the explanatory memorandum to the Bill, the first final provision is noteworthy in that an extensive modification of the Securities Market Act 24/1988, of 28 July, is operated by extending to investment firms the prudential supervision regime provided under Directive 2013/36/EU, of 26 June, for credit institutions[5].

[5] I have long been requesting a consolidated text of the SMA that facilitates a friendly approximation to the content, but unfortunately that task does not seem to be in the immediate plans of the executive, even though it has had the appropriate mandate for quite some time. It is an Act of great importance in the Spanish financial system and is often consulted not only by national operators, but also European and international ones. The closest we can find is a version of July 2012 of what the BOE and CNMV (the Spanish Securities and Markets Authority) websites call "consolidated text" in English; and, with updates to 28 December 2013, the Spanish version of said consolidated text.