3 REGULATORY CHANGES IN PRUDENTIAL SUPERVISION

This chapter describes the most significant legal changes in 2011, from a prudential supervision standpoint, in the regulation of credit institutions (CIs) and other financial intermediaries and auxiliaries subject to supervision by the Banco de España. It focuses on organisational and disciplinary rules, leaving aside other regulatory changes of a more technical nature that only affect the internal operations of institutions. It also omits rules on the mere exercise of competences by supervisory authorities. The changes set out in this chapter are grouped by subject matter, although this means that some legal provisions addressing diverse matters have to be described piecemeal under various sections.

Although this chapter has traditionally described EU and national provisions separately, that distinction has not been drawn this year since the only significant EU legislation in this connection was Directive 2011/89/EU[1] on supervision of financial entities in a financial conglomerate. This Directive, which is of an eminently technical nature, devotes itself to fine-tuning measures in the supervision of Community financial conglomerates, postponing any more substantial amendments for a later revision (currently under way).

3.1 Solvency of credit institutions

The regulatory developments concerning solvency of CIs have a dual thrust: first, the required adaptation of changes in Community regulation; and second, the pretension of the Spanish government to strengthen the solvency of Spanish CIs by setting higher core tier 1 capital requirements, in line with the aims pursued by the new international capital standards in the so-called Basel III accord.[2]

3.1.1 MORE RIGOROUS CAPITAL REQUIREMENTS

The pivotal legal provision in setting stricter capital requirements is Royal Decree-Law 2/2011.[3] To this end, the Royal Decree-Law introduced the notion of *capital principal,*[4] which comprises: share capital (or, in the case of savings banks, initial capital *(fondos fundacionales)* and non-voting equity units *(cuotas participativas),* and in that of credit cooperatives, capital contributions), excluding non-voting redeemable shares; paid-in share premiums; effective express reserves; revaluation surpluses on available-for-sale financial assets that form part of equity, net of tax effects; minority shareholdings in the form of common shares of consolidable group companies; and eligible instruments subscribed by the FROB within the framework of its regulatory regime. As usual, losses (including those attributed to minority interests) and intangible assets must be deducted from the aforementioned items.

The Royal Decree-Law also temporarily allows the inclusion, up to a ceiling of 25 % of the *capital principal* amount, of instruments mandatorily convertible into shares before 31 De-

1 Directive 2011/89/EU of the European Parliament and of the Council of 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate (OJ L 326/113).

2 The broad capital and liquidity reform package adopted by the Basel Committee on Banking Supervision in September 2010.

3 Royal Decree-Law 2/2011 of 18 February 2011 on the strengthening of the financial system (BOE of 19 February 2011). The main purpose of this Royal Decree-law was, in addition to strengthening the solvency of CIs, to speed up the final phase of bank (especially savings bank) restructuring processes, These latter measures are set out in Section 3.2.1 below, while Box 1.1 of this Report describes how this new core capital requirement has been implemented in credit institutions.

4 In line with the so-called "common equity tier 1" envisaged in Basel III, although with certain differences.

cember 2014, although those issued after the Royal Decree-Law came into force have to meet certain requirements intended to ensure a high loss-absorbing capacity.[5]

In general, the consolidated *capital principal* required of CIs is at least 8 % of their total risk-weighted exposure. This requirement increases to 10 % for those institutions that have not placed with third parties equity securities representing at least 20 % of their capital and that also have a wholesale funding ratio of over 20 %.[6] In addition, the Banco de España may require a higher level of *capital principal* to be held depending on the results of stress tests on the overall financial system.

The Royal Decree-Law also provides that in the event of non-compliance at any time by an institution of up to 20 % of the required *capital principal* ratio, the Banco de España will impose restrictions that may affect the distribution of dividends, transfers to the welfare fund, the remuneration of preference shares, the variable remuneration of directors and managers and share repurchases.

Although the new requirements came into force on 10 March 2011, the Royal Decree-Law provides for the establishment, within a period of 15 days and with the consent of the Banco de España, of a strategy of progressive compliance with a deadline of 31 December 2011, which may be extended until 31 March 2012 if the raising of funds from third parties and IPOs are envisaged.

3.1.2 ADAPTATION TO SPANISH LAW TO REFLECT CHANGES IN EU LEGISLATION

This adaptation was effected mainly through four legal provisions: Sustainable Economy Law 2/2011,[7] Law 6/2011,[8] Royal Decree 771/2011[9] and Banco de España Circular 4/2011.[10]

For the purposes of this section, Law 2/2011, in transposing Directive 2010/76/EU (CRD III),[11] requires CIs to include in their governance rules remuneration policies and practices consistent with the promotion of sound and effective risk management. Section 2.4.1 of this Report gives details of this new legislative development.

Law 6/2011 continued the transposition of the aforementioned Directive and started the transposition of Directive 2009/111/EC (CRD II)[12] in various technical respects dealing with

5 Royal Decree-Law 2/2012 of 3 February 2012 on balance-sheet clean-up of the financial sector (BOE of 4 February 2012) changes this transitional regime in that it modifies some of the requirements and puts back the conversion date to 31 December 2018.

6 This ratio is defined in Banco de España Circular 2/2011 of 4 March 2011 to credit institutions on the wholesale funding ratio (BOE of 5 March 2011) as the ratio between the net wholesale funding of available liquid assets and loans and advances to other debtors.

7 Sustainable Economy Law 2/2011 of 4 March 2011 (BOE of 5 March 2011). This wide-ranging law includes, in relation to the operating scope of financial institutions and insofar this Chapter is concerned, measures having to do with the protection of financial services users. These measures are set out in Section 3.3.1.1 of this Chapter.

8 Law 6/2011 of 11 April 2011 amending Law 13/1985 of 25 May 1985 on investment ratios, own funds and reporting requirements for financial intermediaries, Law 24/1988 of 28 July 1988 on the securities market and Legislative Royal Decree 1298/1986 of 28 June 1986 on the adaptation of current credit institution law to EU legislation (BOE of 12 April 2011).

9 Royal Decree 771/2011 of 3 June 2011 amending Royal Decree 216/2008 of 15 February 2008 on the own funds of financial institutions and Royal Decree 2606/1996 of 20 December 1996 on credit institution deposit guarantee funds (BOE of 4 June 2011). The amendments relating to the deposit guarantee fund are set out in Section 3.2.2.1 below.

10 Banco de España Circular 4/2011 of 30 November 2011 amending Circular 3/2008 of 22 May 2008 on determination and control of minimum own funds (BOE of 9 December 2011).

11 Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies (OJ L 329/3).

12 Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management (OJ L 302/97).

CI solvency, subsequently implemented by Royal Decree 771/2011, and with strengthening the competences of supervisory authorities and boosting cooperation between them through the establishment of supervisory colleges.[13]

In implementing the aforementioned laws, Royal Decree 771/2011 introduced diverse measures aimed at improving the solvency of CIs.

As regards securitisation of assets, a credit institution other than the originator, sponsor or original lender may only invest in securitised assets if the originator has, in the manner stipulated by the Banco de España, explicitly notified that it will retain, on an ongoing basis, a material net economic interest in the related exposure. Should a CI fail to comply with the notification requirement, the risk weight of the related exposures will be increased as deemed appropriate by the Banco de España. Also, the Royal Decree establishes certain obligations to monitor investments of this kind for both the investor and the originator or sponsor, stipulating that when the originating institution fails to comply with the due diligence conditions, it may not exclude the securitised exposures from the calculation of its capital requirements.

As regards large exposures, although the Royal Decree retains the limit of 25 % of the institution's own funds for exposures to a particular customer (entity or economic group), it is now permitted, when that customer is another CI or an investment firm or an economic group including one or more CIs or investment firms, that the value of all exposures to that customer may be €150 million (subject to a limit of 100 % of the institution's own funds), provided that the total exposures to entities in the client economic group other than CIs or investment firms do not exceed the general limit of 25 %. Also, the limit of 800 % of a CI's own funds for total large exposures is removed, as are some of the exceptions previously in place.

Insofar as liquidity risk is concerned, the obligation is laid down to establish robust strategies, procedures and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons (including intra-day). The Banco de España will periodically assess the CI's liquidity risk management.

The Royal Decree also changes the conditions under which preference shares are eligible as own funds. Specifically:

- in relation to maturity, although the issuer retains the right, upon authorisation from the Banco de España, to redeem early the preference shares from the fifth year after they were paid in, early redemption incentives are no longer permitted. Moreover, this authorisation is subject to the financial situation or solvency of the credit institution or its consolidable group or sub-group being unaffected. It may also be made subject to the institution replacing the redeemed preference shares with eligible capital items of the same or higher quality;

- with regard to the remuneration of own funds, the Board of Directors or equivalent body of the issuing or parent credit institution has the power to cancel, at its discretion, the payment of such remuneration for an unlimited period of time,

13 Nevertheless, some of the changes made by Directive 2009/111/EC, particularly those relating to liquidity risk and securitisation control, had already been included in Banco de España Circular 3/2008, in the form of guidelines.

on a non-cumulative basis. Payment must be cancelled if the issuing or parent institution or its consolidable group does not meet the minimum capital requirements or if so required by the Banco de España based on the financial and solvency situation of the institution, its parent or its group. In any event, payment of the remuneration may, if so permitted by the terms of issue, be replaced by the delivery of ordinary shares, non-voting equity units or capital contributions, as appropriate;

– as regards the absorption of losses, mechanisms must be set in place to ensure that preference shareholders will share in the absorption of current or future losses of the issuing or parent institution or its consolidable group, whether it be through the conversion of preference shares into equity capital or through the reduction of their nominal value. These mechanisms must be applied in certain cases, the Banco de España being empowered to specify the conversion or loss assumption criteria;

– although the rule that the nominal amount of outstanding preference shares may not exceed 30 % of the tier 1 capital of the issuer's consolidable group or sub-group remains in place, the Banco de España may change this percentage provided it does not exceed 35 %.

With regard to remuneration policies and practices, certain principles were introduced which must be observed in the remuneration of employees whose professional activities have a material impact on their institution's risk profile. These principles include most notably the following: a) the broad lines of the remuneration policy shall be reviewed at least yearly; b) the remuneration policy shall be compatible with appropriate and effective risk management; c) the staff engaged in control functions are independent from the business units they oversee and are remunerated solely in accordance with the achievement of the objectives linked to their functions; d) the remuneration of the senior officers in the risk management and compliance functions is directly overseen by a remuneration committee or by the relevant management body; e) there must be a balanced and efficient relationship between the fixed and variable components of remuneration; f) the variable remuneration component must be in line with the institution's long-term interests and may not be paid at all.

The remuneration schemes of credit institutions receiving government financial support for restructuring or balance-sheet clean-up must meet, in addition to the foregoing requirements, the following ones: a) where variable remuneration is incompatible with a sound capital base and with the waiver of government support, that remuneration shall be strictly limited to a percentage of net income, and b) the directors and managers who effectively direct the activity of the institution may not receive variable remuneration unless it is duly justified in the opinion of the Banco de España, which may, moreover, set limits on their total remuneration.

Banco de España Circular CBE 4/2011 completes the transposition of EU legislation on own funds and makes headway in the adaptation of Spanish prudential regulation to the new criteria set in Basel III. Thus it provides particularly as follows:

– The requirements of a more technical nature to be met by the issues of different regulatory capital instruments (common equity, preference shares, non-voting shares and subordinated debt) for the purpose of qualifying as own funds.

– Improved provisioning for exposures to various risks, particularly: (i) weighting of risk associated with covered bonds and other secured bonds; (ii) application of the new regulations on securitisation and re-securitisation, the latter defined as a securitisation where the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation position; re-securitisation positions receive the same risk weight as that assigned to the securitisation positions; (iii) requirements to be met by emergency plans for managing liquidity risk; (iv) the trading book, the positions of which must be marked to market whenever possible; (v) treatment of market risk associated with credit derivatives; and (vi) external credit assessments.

– Remuneration policies, in respect of which, first, it provides that CIs must considerably reduce the variable remuneration when an institution delivers a mediocre[14] or negative financial performance and, second, it sets out the conditions for the creation of remuneration committees.

Additionally, the Circular spells out the treatment to be applied to institutional protection schemes (IPSs) as consolidable groups. Thus the central institution of the IPS shall be considered to be the parent entity. Also, when the institutions forming part of an IPS assign to the central institution all their financial business, or pool all their profits, they shall deem certain individual solvency requirements to have been met.

Savings banks which have assigned the direct pursuit of their financial activity, and are excluded from the consolidable group to which they belong, must continue complying with solvency requirements individually. However, they shall be exempt from complying with the financial statement submission obligation set in the Circular, without prejudice to the disclosures which may be requested by the Banco de España in the framework of its supervisory actions.

3.1.3 ADOPTION OF GUIDELINES

Additionally, once the new international solvency framework had been transposed into Spanish law, the Executive Commission of the Banco de España resolved to adopt as its own nine guidelines published by the Committee of European Banking Supervisors (CEBS) before the European Banking Authority (EBA) assumed its functions. All the guidelines adopted deal with aspects of Directives 2009/111/EC and 2010/76/UE, and aim to promote effective and harmonised compliance with them.

Specifically, the guidelines adopted in Spain were as follows: Implementation guidelines regarding instruments referred to in Article 57(a) of Directive 2006/48/EC, Implementation guidelines for hybrid capital instruments, Guidelines on the implementation of the revised large exposures regime, Implementation guidelines on Article 106(2)(c) and (d) of Directive 2006/48/EC recast, Guidelines to Article 122a of the Directive 2006/48/EC, Guidelines on remuneration policies and practices, Guidelines on liquidity cost benefit allocation, Guidelines on liquidity buffers and survival periods and Guidelines on the management of operational risks in market-related activities.[15]

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14 To assess the mediocrity of results, regard must be had to whether they evidence a downward trend either compared with those of the institution itself or with those of its peers, and to parameters such as the degree of achievement of the projected targets or the performance of the institution as a whole or of the relevant business unit.

15 The texts of these Guidelines and their translation into Spanish are available on the Banco de España website in the section "Guidelines adopted by the Banco de España as its own".

3.2 Legal regime of supervised institutions

This section sets out the main changes in the legal regime and structural framework of CIs and other supervised entities.

3.2.1 RESTRUCTURING OF CREDIT INSTITUTIONS

To facilitate compliance with the new capital requirements introduced by it, Royal Decree-Law 2/2011 gave institutions, wherever necessary, a period of one month to submit a recapitalisation plan which had to be approved by the Banco de España. Within the framework of this plan, the FROB is permitted to adopt financial support measures such as contributing to the capital of institutions without such contributions automatically triggering the merger and integration process envisaged in Royal Decree-Law 9/2009.[16]

Under this plan, the cost of the shares or contributions to capital must be set by one or more independent experts designated by the FROB, following generally accepted methodologies and having regard to the economic value of the institution. The purchase of securities by the FROB entitles it to vote on the governing body of the security issuer in proportion to its percentage holding, in order to ensure due compliance with the recapitalisation plan. However, the FROB's holdings in the capital of institutions must be temporary, and have to be disinvested within five years.

If the institution requesting the financial support is a savings bank, it will have a maximum of three months from the date of approval of its recapitalisation plan to transfer its entire financial activity to a bank. It may either engage indirectly in its financial activity retaining its legal form of a savings bank, or transform itself into a special foundation thereby losing its credit institution status. If the institution requesting financial support is a bank which is jointly owned by savings banks in an IPS, those savings banks must, in the same maximum period of three months, transfer all their financial activity to the bank.

For the particular case of credit cooperatives, provision is made for application of the regime established for merger/integration processes in Royal Decree-Law 9/2009. For this purpose, the FROB will purchase preference shares convertible into contributions to the capital of the cooperative.

Additionally the composition of the Governing Committee of the FROB is changed by the Royal Decree-Law to comprise nine members appointed by the Minister for Economic Affairs and Finance, two of whom represent the Ministry for Economic Affairs and Finance, while four are proposed by the Banco de España and three represent the Deposit Guarantee Funds.

Finally, the credit institutions which are majority-owned by another credit institution with a different legal form must join the DGF to which the latter belongs.

3.2.2 RESTRUCTURING OF DEPOSIT GUARANTEE FUNDS

Spanish deposit guarantee funds were restructured in two stages. The first involved the establishment, pursuant to the aforementioned Royal Decree 771/2011, of a system of additional contributions based to some extent on the risk assumed, whereby new contributions are required of institutions that remunerate their deposits above market rates. Specifically, deposits whose remuneration exceeds the limits specified in Royal Decree 771/2011 must be weighted at 500 % (i.e. 400 % more than the origi-

16 Royal Decree-Law 9/2009 of 26 June 2009 on bank restructuring and strengthening of the capital of credit institutions (BOE of 27 June 2009).

nal weight). This measure was implemented through Banco de España Circular 3/2011.[17]

The second stage was marked by Royal Decree-Law 16/2011.[18] This Royal Decree-Law had a dual objective: firstly, unification of the three then-existing funds (commercial bank fund, savings bank fund and credit cooperative fund) into a single fund called the credit institution deposit guarantee fund. This fund retains the functions and features of those it replaces, including particularly the twin function of guaranteeing deposits[19] and assisting institutions in difficulty. Also, the Royal Decree-Law broadens the range of situations in which the fund can take preventive action.

The new fund is administered by a management committee of twelve members, six designated by the Banco de España and six by associations representing affiliated credit institutions.[20] The annual contributions to the fund (their maximum amount is raised from 2 ‰ to 3 ‰ of the deposits guaranteed, although, as before, contributions will be suspended when the assets not committed to operations proper to the end-purpose of the fund equal or exceed 1 % of the deposits of its affiliated institutions) vary depending on the type of credit institution.

Regarding the broadening of the fund's scope of operations has been broadened so that it may now take preventive and balance-sheet clean-up measures within the framework of a restructuring or financial support plan approved by the Banco de España to strengthen the own funds of CIs. The measures adopted must be aimed at achieving the viability of the institution within a reasonable period and may consist of: 1) financial assistance in various forms, including the granting of soft loans and the acquisition of impaired or non-performing assets; 2) capital restructuring of the institution; 3) support to merger or acquisition processes or the transfer of a business to another credit institution; and/or 4) improvement of management.

3.2.3 AMENDMENT OF THE LEGAL REGIME GOVERNING ELECTRONIC MONEY INSTITUTIONS

Law 21/2011,[21] in transposing Directive 2009/110/EC, established a new regulatory framework for electronic money institutions (ELMIs) and for the issuance of electronic money.[22]

Three features define electronic money under the new legislation: 1) it is an electronically or magnetically stored monetary value representing a claim on the issuer; 2) which is issued on receipt of funds for the purpose of making payment transactions; and 3) which is accepted as a means of payment by a natural or legal person other than the electronic money issuer. The issuance and redemption of electronic money also have three basic features: a) it is compulsory to issue electronic money at par value; 2) it is prohibited to grant interest or any other time-related benefit; and 3) upon request by the

17 Banco de España Circular CBE 3/2011 of 30 June 2011, to institutions belonging to a deposit guarantee fund, on additional contributions to deposit guarantee funds (BOE of 2 July 2011).

18 Royal Decree-Law 16/2011 of 14 October 2011 (BOE of 15 October 2011), amended by Royal Decree-Law 19/2011 of 2 December 2011 (BOE of 3 December 2011), created the Credit Institution Deposit Guarantee Fund.

19 The maximum guaranteed amount remains at €100,000 both for depositors and for investors who have entrusted securities or financial instruments to a credit institution. These amounts shall be applied separately for each depositor or investor.

20 Under the previous legislation, each fund was governed by a management committee consisting of eight members appointed by the Minister of Economic Affairs and Finance, of which four represented the Banco de España and four represented the affiliated credit institutions.

21 Law 21/2011 of 26 July 2011 on electronic money (BOE of 27 July 2011).

22 Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC.

electronic money holder, electronic money issuers must redeem at any moment and at par value, the monetary value of the electronic money held, generally free of charge (although the Law specifies certain cases in which the electronic money issuer may charge a fee proportionate and commensurate with the actual costs incurred in making that redemption).

The Law restricts the activity of issuing electronic money to credit institutions, certain government agencies (including the Banco de España) and ELMIs. The main change to the legal regime governing the latter is, on the one hand, their loss of credit institution status and, on the other, their conceptual assimilation to payment institutions. Thus their corporate purpose is no longer limited to the issuance of electronic money, but rather extends, in particular, to the provision of payment services not linked to the issuance of electronic money.

Although the authorisation requirements for setting up ELMIs remain similar to those under the previous legislation, the minimum initial capital is reduced to €350,000 from €1 million previously, and the own funds requirements are established on the basis of the electronic money issued and various business indicators. The safeguarding of funds received in exchange for electronic money issued and for the provision of payment services not linked to electronic money issuance is now achieved by investing the related balances in liquid assets and insurance, although an insurance policy or some other comparable guarantee may be used if authorised by the Banco de España in response to a reasoned request from the institution.[23]

3.3 Operational framework

3.3.1 IMPROVED BANK CUSTOMER PROTECTION

As indicated in Section 3.1.2 above (footnote 5), Sustainable Economy Law 2/2011 contains various measures on the protection of financial services users, particularly in relation to credit-granting policies and customer information. Thus the Law stipulates that CIs must supply to consumers, in an accessible manner and, in particular, through the appropriate pre-contractual information, adequate explanations enabling them to assess whether the banking products they are being offered, especially time deposits and mortgage or personal loans, are in line with their interests, needs and financial situation. CIs must make special reference to the essential characteristics of such products and to the effects they may have on the consumer, particularly in case of default.

In relation to loan agreements, CIs must assess the creditworthiness of the potential borrower on the basis of sufficient information, and follow practices for the responsible granting of loans. Such practices must be set out in a document to be specified in the annual report on the institution's activities.

In order to reorganise the situation and adjust it to practical reality, the Law repeals the rules on the commissioners for the protection of financial services (banking, securities and insurance) customers. Those commissioners, although envisaged in Law 44/2002 of 22 November 2002 on financial system reform measures, were never effectively implemented. In any event, the claims services of the Banco de España, of the CNMV and of the Directorate General for Insurance and Pension Funds must, in addition to attending to the complaints and claims submitted by financial services users, resolve the queries received by them on the rules applicable in relation to transparency and customer protection.

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23 The previous legislation provided for the protection of these funds through the application of a limited investment regime specified in that legislation.

These provisions of Law 2/2011 were implemented by Ministerial Order EHA/2899/2011.[24] This key Ministerial Order does not limit itself to implementing the Sustainable Economy Law, but, furthermore, replaces both the general transparency regulations in place since the 1980s and certain specific bank customer protection regulations, particularly in the area of mortgage loans. This Ministerial Order, which has to be fleshed out in certain basic respects by a Banco de España circular, is described in detail in Box 2.1 in Section 2.3.1 of this Report.

Another legal provision promulgated to improve the protection of bank customers, particularly mortgage debtors, was Royal Decree-Law 8/2011.[25] This Royal Decree-Law contains three measures to assist mortgage debtors (whatever the collateral, even when not a dwelling): the unseizability threshold on mortgage debtors' income rises from 100 % of the minimum wage to 150 %, plus an additional 30 % for each core household member who does not receive income exceeding the minimum wage; b) the amount for which creditors can request the foreclosure of property rises from 50 % to 60 % of the appraised value of the property if there was no bidder at the property auction; and c) the deposit required of bidders to participate in an auction is reduced from 30 % to 20 % of the value assigned to the asset.

3.3.2 CONSUMER CREDIT REGULATION

Law 16/2011[26] on consumer credit agreements wrote into Spanish law Directive 2008/48/EC[27] and repealed Law 7/1995 of 23 March 1995 on consumer credit. This Law applies to those contracts whereby a creditor grants or promises to grant credit to a consumer in the form of a deferred payment, loan, credit line or other equivalent means of financing, although many contracts are excluded totally or partially from its scope on the basis of the amount or nature of the transaction. The Law limits the meaning of "consumer" to a natural person who is acting for purposes which are outside his trade, business or profession.

The main objective of the Law is to improve the information to be received by consumers in the various stages involved in arranging finance for their consumer transactions. Thus, as regards pre-contractual information, it regulates in detail the basic information to be included in advertising and that which the creditor and, if applicable, the credit intermediary must furnish to the consumer before he becomes bound by any credit agreement or offer (such information must be provided on a standard European form). Also, as a particular feature of Spanish legislation, the Law maintains the obligation to make a binding offer. It also specifies, extensively and in detail, the content of the contractual documents.

As additional protection mechanisms, the Law: a) obliges lenders and, if applicable, intermediaries to explain to the consumer in a personalised manner the characteristics of the financing products offered, so that he can evaluate whether they are suitable for him; b) introduces, in line with the provisions of Sustainable Economy Law 2/2011, the obligation of the lender to assess the borrower's creditworthiness before the credit agreement is entered into; and c) regulates the effectiveness of the related contracts and the right of the

24 Ministerial Order EHA/2899/2011 of 28 October 2012 (BOE of 29 October 2012) on transparency and protection of banking services customers.

25 Royal Decree Law 8/2011 of 1 July 2011 (BOE of 7 July 2011) enacting measures relating to support for mortgagors, to the control of public spending and settlement of debts incurred by local government to corporations and the self-employed, and to the fostering of business activity, real estate renovation and simplified administrative procedures.

26 Law 16/2011 of 24 June 2011 (BOE of 25 June 2011) on credit agreements for consumers.

27 Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers (OJ L 133/66).

parties to terminate an undefined-term credit agreement and the consumer's right to withdraw from the credit agreement.

The Law contains a mathematical formula for calculating the annual percentage rate of these transactions which has been harmonised in the EU to ensure cross-border comparability.

3.3.3 MARKET INFORMATION

Banco de España Circular CBE 5/2011,[28] by way of continuing the transparency enhancement policy adopted by the Banco de España in 2010, established for CIs the requirement to disclose in their annual accounts (and to make public at least for the situation as at 30 June of each year) the exposure to the construction sector, the financing granted for real estate development and for house purchases and the volume of assets acquired in satisfaction of debt. This information must include the policies and strategies set in place by them to deal with the troubled loans granted to finance real estate projects, and make special mention of the prospects of recovery of the liquidity of this class of financial assets, including, where applicable, those of the collateral taken as security.

The Circular also regulates the confidential information referring especially to business in Spain which institutions and their consolidated groups must submit to the Banco de España on their exposure to the real estate sector, as well as the information they must include in the special accounting books for mortgage activities.

28 Banco de España Circular CBE 5/2011 of 30 November 2011 (BOE of 9 December 2011) amending Circular 4/2004 of 22 December 2004 on public and confidential financial reporting rules and formats.