7.1 Banco de España Circulars

By virtue of the powers attributed to it by Law 9/2012, on 30 September the Banco de España approved Circular 5/2015, implementing the accounting regime of the Asset Management Company for Assets Arising from Bank Restructuring (Sareb).

7.1.1 BANCO DE ESPAÑA CIRCULAR 5/2015 ON THE ACCOUNTING OF SAREB

The Circular establishes the criteria for Sareb to implement the methodology that it will use to estimate the potential value adjustments of its assets. In the case of property assets, the estimate will be on the basis of their collateral value, according to appraisal reports by independent experts, with the adjustments needed to reflect the market price fluctuations and the time horizons of the Sareb business plan. The valuation of the assets will be performed by appraisal companies registered in the Banco de España Official Register. As an exception, in the calculation of the value of finished homes and annexes thereto (such as garages or storage rooms), Sareb may opt to carry out comprehensive individual appraisals, statistical sampling procedures or use automatic appraisal models. At 31 December 2015 Sareb shall mandatorily have performed an appraisal under the criteria contained in the Circular of at least 50% of the assets on its balance sheet at that date that are sufficiently representative of the various types and locations, and of the total assets on the balance sheet at 31 December 2016.

7.1.2 BANCO DE ESPAÑA CIRCULAR 6/2015 ADDRESSED TO SAVINGS BANKS AND BANKING FOUNDATIONS

Law 26/2013 of 27 December 2013 on savings banks and banking foundations marked a radical change in the savings banks model and the regulation of a new legal entity, banking foundations. The latter are defined as foundations that have a minimum holding of 10% in a credit institution, or the capacity to appoint or dismiss a member of its board of directors.

The law establishes a series of obligations for banking foundations, which are more demanding the larger the holding in the credit institution. Thus, they must prepare a management protocol and an annual financial plan, when the holding exceeds 30% or there is control over the institution; and, if the holding is equal to or greater than 50% or there is control over the institution, the financial plan must be reinforced by a programme of investment diversification and risk management and a reserve fund (or, alternatively, a programme of divestment in the credit institution).

The management protocol is the document which defines the strategic criteria that will govern the management of the holding in the credit institution. Its content must include matters such as the purpose of the holding, agreements with other shareholders and relationships between the governing bodies of both institutions.

The financial plan shall analyse the potential capital needs which, in different scenarios, the investee credit institution might have and the resources it would have to meet them.

The purpose of the reserve fund is to cover potential capital needs of the investee credit institution that cannot be covered by other resources. The minimum amount to be reached, the manner in which it is recognised and the deadline for its provision are governed by Royal Decree 877/2015 of 2 October 2015.

The aforementioned documents must be approved by the Banco de España, which may also carry out the inspections and checks and require any such information it deems appropriate.

Banco de España Circular 6/2015 of 17 November 2015 completes this regulation, supporting the minimum mandatory content of the management protocol and the financial plan, the financial instruments in which the reserve fund must be held, with its corresponding valuation adjustments, the conditions for its use and the particular features applicable in the case of various banking foundations acting together in the credit institution.

7.1.3 BANCO DE ESPAÑA CIRCULAR 2/2016 ON SOLVENCY

The transposition of the European framework into Spanish legislation is completed with Banco de España Circular 2/2016 of 2 February 2016 regulating outstanding matters arising from Law 10/2014 and Royal Decree 84/2015.

The main new developments introduced by the Circular with respect to higher-ranking legislation are: the use of the national option, whereby public-sector entities may receive the same weighting as the government to which they rely on; the regulation of certain matters that had not been transposed on the supervision of financial conglomerates; the mandatory characteristics of the supervisory review and evaluation process that the competent authority will perform; and the implementation of the regulation on capital buffers, internal governance and remuneration policy.

The Circular governs numerous matters regarding the countercyclical buffer, the method for identifying global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) —in this case, based on the guidelines issued by the EBA—, and the rules for the joint application of the buffers for G-SIIs and O-SIIs and the systemic risk buffer.

With regard to internal governance, it will establish the fit and proper assessment procedure for senior officers, which must be performed by both the institutions and the supervisor, together with certain criteria for assessing their capacity to exercise good governance. It also provides for the procedure for authorising and reporting loans, bank guarantees and other collateral to the institutions' senior officers; the composition of the risk, nomination and remuneration committees; and the conditions permitting the creation of joint nomination and remuneration committees or risk and audit committees.

As for the institutions' remuneration policy, the Circular specifies, for the "identified group", the criteria applicable to it, obliging institutions to prepare a report on the annual internal assessment of their policies. Lastly, it details the information on corporate governance and remuneration policy that must feature on their websites.

7.1.4 OTHER BANCO DE ESPAÑA CIRCULARS PUBLISHED IN 2015 AND EARLY 2016

In addition to the Circulars mentioned above, in 2015 and the first few months of 2016 the following Banco de España Circulars were also published:

- Banco de España Circular 1/2015, to payment service providers, on information of the merchant service charges and interchange fees received.

- Banco de España Circular 2/2015 on rules for the submission to the Banco de España of the payment and payment system statistics envisaged in Regulation (EU) 1409/2013 of the European Central Bank of 28 November 2013 on payment statistics by payment service providers and payment system operators.

- Banco de España Circular 3/2015, amending Circular 1/2013 of 24 May 2013 on the Central Credit Register, and Circular 5/2014 of 28 November 2014,

amending Circular 4/2004 of 22 December 2004 on public and confidential financial reporting rules and formats, Circular 1/2010 of 27 January 2010 on statistics on interest rates applied to deposits and loans vis-à-vis households and non-financial corporations, and Circular 1/2013 of 24 May 2013 on the Central Credit Register.

– Banco de España Circular 4/2015, amending Circular 4/2004 of 22 December 2004, addressed to credit institutions, on public and confidential financial reporting rules and formats, Circular 1/2013 of 24 May 2013 on the Central Credit Register, and Circular 5/2012 of 27 June 2012, addressed to credit institutions and payment service providers, on transparency of banking services and responsibility in the granting of loans.

– Banco de España Circular 7/2015, on the creation and modification of personal data files.

– Banco de España Circular 8/2015, addressed to institutions and branches participating in the Deposit Guarantee Fund for Credit Institutions, on information for determining the calculation basis of the contributions to the Deposit Guarantee Fund for Credit Institutions.

– Banco de España Circular 1/2016, amending Circular 1/2015, of 24 March 2015, to payment service providers, on information of the merchant service charges and interchange fees received.

– Banco de España Circular 3/2016, addressed to institutions owning ATMs and issuers of cards and payment instruments, on information on the commissions for cash withdrawals from ATMs.

7.2 Draft Banco de España Circulars

7.2.1 DRAFT BANCO DE ESPAÑA CIRCULAR ON THE METHOD FOR CALCULATING CONTRIBUTIONS TO THE DGF ON THE BASIS OF RISK

The approval of Law 11/2015 of 18 June 2015, on the recovery and resolution of credit institutions and investment firms, resulted in the amendment of Royal Decree-Law 16/2011 of 14 October 2011 creating the DGF. With this amendment, the Royal Decree-Law incorporates the establishment of contributions to the deposit guarantee fund on the basis of the volume of covered deposits and the institutions' risk, and it mandates the Banco de España to implement the necessary methods so that the participating institutions' contributions are proportionate to their risk profile.

The objective of this draft circular is to implement, in accordance with the aforementioned mandate, the method that the DGF Management Committee must apply for calculating the contributions of the institutions participating in the deposit guarantee fund.

This draft circular is essentially based on the criteria contained in the EBA guidelines, which establish the guidelines for the design of the methods for calculating contributions to the deposit guarantee schemes.

The draft circular comprises six rules and two annexes, which include: the general calculation formula, specific risk indicators for determining institutions' risk profiles, the weightings to be applied by those indicators and other necessary items.

7.2.2 DRAFT UPDATE OF ANNEX IX OF THE BANCO DE ESPAÑA ACCOUNTING CIRCULAR

The accounting regime for Spanish credit institutions is governed by Circular 4/2004 of 22 December 2004 on public and confidential financial reporting rules and formats (hereinafter, the accounting circular). The Banco de España has recently put to public consultation a draft amendment of the accounting circular with a view to updating Annex IX on credit risk analysis and coverage, to adapt it to banking supervision and regulatory developments in recent years, in order to ensure full compatibility with the accounting framework of the International Financial Reporting Standards adopted by European Union rules (IFRSs).

The updating of Annex IX aims to reinforce the criteria relating to: i) the policies, methodologies and procedures for credit risk management on matters relating to accounting, including those relating to guarantees received; ii) the classification of transactions based on credit risk; and iii) the individual estimate of allowances and the implementation of methodologies for the collective estimate of allowances.

The main new developments to be noted are the establishment, provided for in the current Annex IX, of the minimum requirements to be met by the methodologies implemented by the institutions for the individual or collective estimate of allowances or provisions. Those requirements relate to the governance, inclusion in management, effectiveness, simplicity, documentation and traceability of the methodologies for estimating coverage.

Also, Annex IX will offer alternative solutions for the collective estimate of coverage for institutions that have not implemented their own methodologies. Those alternative solutions will also serve as a reference for the institutions that do implement such methodologies, since they are calculated on the basis of the sectoral information and the accumulated experience of the Banco de España.

These improvements will not be temporary, since they are fully compatible with the accounting regime to be applied when IFRS 9 on financial instruments is adopted in the European Union. All of the foregoing is without prejudice to a future amendment of other aspects of Annex IX to adapt the coverage levels to the expected loss model that IFRS 9 will introduce.

7.2.3 DRAFT BANCO DE ESPAÑA CIRCULAR ON THE "SME-FINANCIAL INFORMATION" DOCUMENT AND THE RISK CLASSIFICATION METHODOLOGY

One of the fundamental objectives of Law 5/2015 of 27 April 2015 on the promotion of business financing is to enhance the flexibility and accessibility of bank financing to small and medium-sized enterprises (SMEs). To this end, it establishes that, when institutions decide to cancel or reduce the flow of financing to their SME or self-employed customers, they must – along with informing them three months in advance – deliver extensive information to them on their financial situation and payment record in a document entitled "SME-Financial Information". That document, which will include a classification of the customer's risk, must also be delivered at their request, following payment of the corresponding fee.

Making use of the legal mandates, the Banco de España is preparing a circular which will set out the content of the "SME-Financial Information" document, establishing the manner and the scope with which the institutions must inform customers of the matters provided for in the law. As regards risk classification, and for the purpose of its standardisation, it will also define the methodology that institutions must use for that purpose. Additionally, institutions will state the customers' relative position within their industry, and to this end a tool will be used provided by the Banco de España Central Balance Sheet Data Office.

7.3 Other significant regulations

This section details some of the regulations enacted in 2015 that are of particular interest to the Banco de España's supervisory activity.

7.3.1 ENTRY INTO FORCE OF COMMISSION DELEGATED REGULATION (EU) 2015/61 OF 10 OCTOBER 2014 ON THE LIQUIDITY COVERAGE REQUIREMENT FOR CREDIT INSTITUTIONS

The financial turbulence in the financial markets in 2008 marked a turning point in liquidity regulations. Until that moment it was assumed that the markets were capable of providing institutions with liquidity, equipping the central bank with the tools needed to be able to act as lender of last resort, but without quantitative requirements relating to liquidity risk on the part of the institutions.

The financial crisis showed that this was not sufficient and, therefore, it was necessary to establish a regulatory framework addressing liquidity risk. To this end, in 2010 the Basel Committee on Banking Supervision approved a regulatory liquidity framework as part of the "Basel III" framework, based on three pillars:

- The need for institutions to have sufficient liquidity to survive for 30 days in a stress scenario, similar to that experienced by the international markets in the recent financial crisis. This need is quantified as a short-term liquidity ratio, which relates the institution's liquid assets to the net outflows (outflows minus inflows) in a stress situation.

- The need for institutions to have sufficiently stable sources of funding. This objective is achieved through a structural funding ratio that relates the institution's assets (i.e. its funding requirements) to the stability of the sources of funding.

- The obligation of the institutions to contribute sufficient information to the supervisor so that it can analyse the liquidity risk being assumed by the institution.

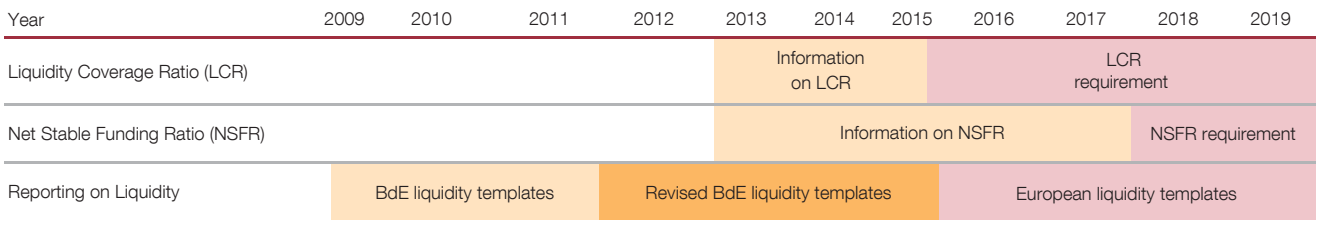
The first pillar of the liquidity regulation was incorporated into European legislation through Commission Delegated Regulation (EU) 2015/61 of 10 October 2014, which entered into force in October 2015, from which date Spanish credit institutions have been subject to a short-term liquidity ratio.

The second pillar —the stable funding ratio requirement— has not yet entered into force in Europe or internationally, although it is expected to be applicable from 2018.

As for the third pillar, harmonised reporting models on the information to be presented by the institutions (known as "liquidity reporting") were approved at the European level in March 2016, although the Banco de España has been requesting liquidity reporting from institutions in line with the Basel proposal since 2009.

REGULATION OF CREDIT INSTITUTIONS' LIQUIDITY

SCHEMA 7.1



SOURCES: ECB and Banco de España.

7.3.2 ROYAL DECREE 84/2015, IMPLEMENTING LAW 10/2014 ON THE REGULATION, SUPERVISION AND SOLVENCY OF CREDIT INSTITUTIONS

In 2015 work continued on the reform of the Spanish regulatory framework, begun in 2013, to adapt it to European Union regulations.

Thus, Royal Decree 84/2015 of 13 February 2015 was published, implementing Law 10/2014, which recasts the main law on the regulation and discipline of credit institutions. The Royal Decree shares the essential objectives of that law: to transpose matters outstanding and recast the law at this level for the sake of greater clarity.

Title I of the Royal Decree implements the regime of access to the activity of credit institutions, although it is limited to banks, since savings banks and credit cooperatives will be governed by their own specific legislation. It also governs the qualifying holdings regime, and the latest developments introduced by the CRD IV, namely corporate governance and remuneration. With regard to corporate governance, it implements the functions to be performed by the risk, remuneration and appointments committees, and, as regards remuneration policy, it sets out the information to be published by institutions with the basic aim of allowing their shareholders to exercise greater control over the quality of senior officers.

Title II refers to the solvency of credit institutions. Although the bulk of the prudential requirements are governed by the CRR, a directly applicable regulation in Spanish law, the Royal Decree implements some of the requirements in the CRD IV, such as: the performance by institutions of an internal capital adequacy assessment process, based on the nature, scale and complexity of their activities; the obligation to have adequate procedures to cover the main risks; and —the most noteworthy new development— the establishment of "capital buffers", by virtue of which the institutions must hold additional levels of Common Equity Tier 1 capital.

Lastly, Title III refers practically in full to supervisory powers –drawing a distinction between the powers attributed to the European Central Bank and the Banco de España within the Single Supervisory Mechanism– and to the framework of cooperation with other competent authorities. Also, it details certain aspects of the supplementary supervision regime applicable to financial conglomerates.

7.3.3 REINFORCEMENT OF BANK CUSTOMER PROTECTION

On the same day it was published, 3 October 2015, Royal Decree-Law 11/2015 of 2 October 2015 entered into force in order to regulate commissions on cash withdrawals from ATMs. As a result, and in preventing the double collection of commissions on those transactions as had been occurring in the previous months due to new commercial policy decisions by some institutions, a new model of commissions for those payment services was established, with the aim of ensuring the principle of legal security and completing and clarifying the current bank customer protection regulation.

Also, on 5 November 2015, Ministry of Economy and Competitiveness Order ECC/2316/2015 of 4 November 2015 on customer reporting obligations and classification of financial products was published. Its objective is to improve the level of protection of bank customers, establishing a standardised system of reporting and classification of the level of risk of financial products. For that purpose, the reporting entities (including credit institutions and specialised lending institutions) must provide their customers with a risk indicator of certain financial products and, where appropriate, warnings on their liquidity and complexity.

The regulation establishes that each supervisor, within the framework of its powers (the Banco de España in the banking sphere), will determine the instruments it considers to

be complex, other than those already listed in the regulation. Also, the supervisors are empowered to dictate the provisions necessary for the correct application of the regulation.

7.3.4 REFORM OF THE REGIME FOR MONETISATION OF DEFERRED TAX ASSETS

Deferred tax assets (DTAs) are the accounting recognition of the difference between the tax expense recognised for accounting purposes and the amount effectively settled (calculated on the basis of tax deductible expenses), when the second amount is higher. There are two types of DTAs: those deriving from temporary differences and tax losses.

In 2013, with a view to reinforcing the net assets of Spanish firms paying income tax, mechanisms were established to guarantee for those firms the recovery of the amount of certain DTAs arising from temporary differences. In the case of credit institutions, the recoverability of those guaranteed DTAs ceased to depend on the potential generation of future profit and, therefore, in application of European Union prudential legislation, it was no longer necessary to deduct them when calculating the capital ratio (unlike what happens with other DTAs).

In 2015 the European Commission required information from the Spanish state, and from other EU countries with similar legislation, in relation to the DTAs that do not reduce institutions' own funds. Lastly, the income tax law was amended in order to ensure the compatibility of the fiscal legislation with European legislation on State aid.

The amendment involves establishing a specific regime for the potential recovery of DTAs generated before 1 January 2016 and whereby, after that date, only DTAs that meet the requirements established by the regulation and are below the limit of the income tax paid are guaranteed. In other words, guaranteed DTAs cannot be generated when the income tax payment does not occur.