

Circular 2/2016, of February 2, 2016, of the Bank of Spain, to credit institutions, on supervision and solvency, which completes the adaptation of the Spanish legal system to Directive 2013/36/EU and Regulation (EU) No. 575/2013.

## CHAPTER 4

### Internal organisation

#### *Section 1.1 Internal governance and internal organisation*

**Regulation 26.** *Nomination and remuneration committees.*

1. Pursuant to articles 31 and 36 of Law 10/2014, credit institutions must set up a nominations committee and a remuneration committee.

However, institutions may set up a joint nomination and remuneration committee if their total volume of assets at the individual level is less than €10 billion at the end of the two immediately preceding financial years. For these purposes, in the case of credit institutions for which, because they are newly established institutions, data on the total volume of assets for two financial years are not available, the data for the end of one financial year shall be considered, and in the absence of such data, the data for the end of the last quarter shall be considered. This is without prejudice to the power of the competent authority to require the separation of the two committees when it considers it necessary in the light of the internal organisation, nature, scope and complexity of the credit institution's activities.

2. The competent authority shall consider the obligation to set up the nomination and remuneration committees to be fulfilled when the credit institution meets the exemption conditions set out in article 36.5 of Royal Decree 84/2015, unless it considers it necessary to set up both committees.

3. The nomination committee and the remuneration committee, or, as the case may be, the joint nomination and remuneration committee, shall each be composed of at least three non-executive directors. At least one third of these members, and in any case the chairman, shall be independent.

**Regulation 27.** *Risk management function and risk committee.*

1. Pursuant to article 38 of Law 10/2014, credit institutions must have a unit or body that assumes the risk management function, commensurate with the nature, scale and complexity of their activities, independent of the operational functions, with sufficient authority, rank and resources, as well as appropriate access to the board of directors.

2. Institutions whose total volume of assets at the individual level is greater than or equal to 10 billion at the end of either of the two immediately preceding financial years must set up a risk committee. For these purposes, in the case of credit institutions for which, because they are newly established institutions, data on the total volume of assets for two financial years are not available, the data for the end of a financial year shall be considered, and in the absence of such data, the data for the end of the last quarter shall be considered.

3. Institutions which are not covered by the obligation referred to in paragraph 2 above and do not in fact establish a risk committee shall set up a joint audit committee which shall assume the corresponding functions of the risk committee, and whose members shall have the necessary knowledge, skills and experience to undertake these tasks.

4. The risk committee of credit institutions shall be composed of at least three non-executive directors. At least one third of these members, and in any case the chairman, must be independent.

**Regulation 28.** *Internal governance.*

1. For the purposes of the provisions of Article 29 of Law 10/2014 and Article 43 of Royal Decree 84/2015, institutions shall:

- a) Have a unit that performs the compliance function, an internal audit function and a unit or body that assumes the compliance management function risks, in accordance with the provisions of article 38.1 of Law 10/2014 and regulation 27.1 of this circular.
- b) Have sound and adequate written procedures in place.
  - i. For the exercise of the regulatory compliance function.
    - ii. To ensure that the internal audit function ensures that the policies, procedures and systems in place for risk assessment, management and reporting are complied with and are consistent and appropriate.
  - c) Assess and control all relevant risks, in accordance with the regulations laid down in this circular and in the solvency regulations.
  - d) Establish written risk-taking policies and appropriate internal measurement procedures, stress testing, operational limits, review frequency, responsible body or person and other relevant aspects. In particular, they shall have, in accordance with their level of activity, appropriate risk measurement and reporting systems for risk management, monitoring and control. They shall also adequately document the functioning of the internal control systems in place.
  - e) Have appropriate procedures in place to provide supervisory authorities with any data and information relevant to their supervision.

2. In addition, institutions included in a consolidable group of credit institutions must have:

- a) Systems that adequately identify, measure and control its transactions with the other companies in the group, including, where appropriate, the parent financial holding company or mixed financial holding company.

Where the parent undertaking of one or more institutions is a mixed-activity holding company as defined in Article 4(1)(22) of Regulation (EU) No 575/2013, those institutions shall have in place adequate risk management systems and internal control mechanisms, including sound reporting and accounting procedures, in order to identify, measure and monitor transactions with their parent mixed-activity holding company and its subsidiaries appropriately. The institution shall be able to report its large exposures and other significant transactions with such entities.

- b) Adequate mechanisms to collect data and information relevant for effective supervision on a consolidated basis.

**Regulation 29.** *Director of the risk management unit.*

Pursuant to the provisions of Article 41.2 of Royal Decree 84/2015, in credit institutions whose total volume of assets at individual level is less than €10 billion at the closing date of the two immediately preceding financial years, and in those institutions that comply with the conditions for exemption set out in Article 36.5 of Royal Decree 84/2015, the risk management function may be performed by another senior officer, other than an independent senior officer who specifically assumes this responsibility, provided that there is no conflict of interest. In this case, the person appointed must be a senior officer responsible for a control area and not a business area.

For these purposes, in the case of credit institutions for which, because they are newly established institutions, data on the total volume of assets for two financial years are not available, the data for the end of a financial year shall be considered, and in the absence of such data, the data for the end of the last quarter shall be considered.

However, the competent authority may, in the light of the nature, scale and complexity of the institution's activities, require that the risk management function be performed by a person designated exclusively for that purpose.

**Section 2.1 Suitability**

**Regulation 30.** *Application of suitability assessment requirements and procedures.*

Pursuant to the provisions of Article 24 of Law 10/2014, the suitability and proper assessment requirements and procedures shall be applied by credit institutions, financial holding companies and mixed financial holding companies, in accordance with the scope of application defined in Regulation 2 of this Circular, to:

- a) Members of the board of directors, as well as natural persons representing directors who are legal persons.
- b) Managing Directors and those assimilated to them. Those defined in article 6.6 of Law 10/2014 shall be assimilated to Managing Directors.
- c) Other key personnel for the day-to-day conduct of the institution's financial business, other than those included in (a) and (b) above.

**Regulation 31.** *Internal procedures for assessing suitability.*

1. The institutions and companies referred to in Regulation 30 shall have adequate internal procedures in place to carry out, in accordance with Article 25.1 of Law 10/2014 and Article 33.1 of Royal Decree 84/2015, the selection and ongoing assessment of positions subject to the suitability regime.

These procedures shall specify the bodies involved in the preparation and approval of the suitability reports and the methods of selection of candidates, and shall identify the posts to be evaluated, detailing their functions and characteristics.

2. The suitability of the positions listed in Regulation 30 should be assessed. Without prejudice to the following regulations, the result of the assessment, the documentation supporting the assessment, an up-to-date list of the assessed positions and a description of their responsibilities and functions shall be kept available for the competent authority.

**Regulation 32.** *Suitability requirements.*

1. The institutions and companies referred to in Regulation 30 shall at all times ensure that the members of the group subject to assessment described in that Regulation are of known good commercial and professional repute and possess knowledge, skills and experience appropriate to their functions. In addition, in the case of board members, they shall ensure that they act with honesty, integrity and independence of mind, so that they are in a position to exercise good governance.

2. The assessment of the suitability requirements of the members of the board of directors shall be carried out, in accordance with article 24 of Law 10/2014 and articles 30, 31 and 32 of Royal Decree 84/2015, both individually and, in the applicable part, for the board as a whole.

Individually, the capacity of each director to exercise good governance will be assessed, taking into account, among other issues: the dedication of sufficient time, the presence of potential conflicts of interest and their capacity to evaluate and question the decision-making process and the decisions taken by senior management.

In addition, the ability of the board as a whole to adequately understand the activities on which decisions are to be taken and to take them independently and autonomously shall be assessed. For this purpose, the knowledge, skills and experience of the board as a whole shall be taken into account.

3. The institutions and companies referred to in Regulation 30 shall provide the members of the board of directors with adequate and continuous training to enable them to properly understand the risks of the decisions on which they are called upon to pronounce and to participate actively in the board's deliberations.

**Regulation 33.** *Assessment of the suitability of the members of the board of directors, Managing Directors and the like by the competent authority.*

1. The competent authority shall assess, prior to their registration in the Register of Senior Officers, the suitability requirements of the members of the board of directors and Managing

Directors or similar. Said assessment shall commence with the notification of the proposed appointment, as determined in article 33.3 of Royal Decree 84/2015, and shall be carried out within the three-month period established in article 29.2.c) of Royal Decree 84/2015.

The competent authority shall make all communications and notifications arising from suitability assessment procedures to the institution or parent financial holding company or parent mixed financial holding company concerned, which shall pass on to the proposed candidate the communications concerning it.

2. In order to assess suitability, the competent authority shall consider all information available to it and may:

- a) Consult other supervisors, Spanish or foreign.
- b) Interview the evaluatee.
- c) Request further information or documentation.
- d) Use any other means it deems appropriate to verify that the candidate meets the suitability requirements and that the information provided is truthful.

3. The competent authority shall issue a negative assessment, with due reasons, if it finds that the assessed person does not meet the necessary requirements or if during the assessment process false, misleading or deceptive information is provided or relevant information is omitted, or deficiencies identified during the process are not remedied at the request of the competent authority.

In such cases, prior to the adoption of the decision, the competent authority shall notify the entity or company and allow a period of fifteen working days for the submission of observations.

If the result of the assessment is positive, the competent authority shall also inform the entity or company so that, once the candidate has been appointed and within a maximum period of fifteen working days from the date of acceptance, the candidate may apply for inclusion in the Register of Senior Officers.

The Banco de España shall then proceed to enter the appointed person in the Register of Senior Officers, and shall notify this fact.

4. The institutions and companies referred to in Regulation 30 must notify the competent authority of any relevant circumstance which, during the exercise of the activity of a person already entered in the Register of Senior Officers, affects his or her good reputation or, in the case of members of the board of directors, his or her capacity to exercise good governance. The notification must be made within a maximum of fifteen working days from the date on which the fact was, or should have been, known to the competent authority. The competent authority shall assess whether such changes affect the outcome of the assessment previously made.

#### **Regulation 34.** *System of incompatibilities.*

1. Where the total assets of an institution individually exceed EUR 10 billion at the end of the two immediately preceding financial years, the members of the board of directors and the managing directors or equivalent of that institution and of its parent financial holding company or parent mixed financial holding company may not hold at the same time more positions than those provided for in any of the following combinations:

- a) One executive position together with two non-executive positions.
- b) Four non-executive positions.

For these purposes, in the event that, due to a new creation, data on the total volume of assets for two financial years are not available, the data for the end of a financial year shall be considered, and in the absence of such data, the data for the end of the last quarter shall be considered.

Executive positions shall be understood to be those that perform managerial functions, whatever the legal relationship that attributes these functions to them.

However, the competent authority may authorise the members of the board of directors and the managing directors or equivalent persons to hold an additional non-executive office if it considers that this does not prevent them from properly carrying out their activities. Such authorisation shall be communicated to EBA.

In any case, unless these limits apply to them because they are members of the board of directors, managing directors or similar of another entity or its parent financial holding company or parent mixed financial holding company, members of the board of directors and managing directors or similar appointed in a director replacement measure as provided for in Chapter V of Title III of Law 10/2014 shall not be subject to these limits.

2. For the purposes of the previous section:

a) All executive or non-executive positions held within the same group shall be counted as a single position.

b) All executive or non-executive positions held within institutions forming part of the same institutional protection scheme shall be counted as a single position, provided that the conditions laid down in Article 113(7) of Regulation (EU) No 575/2013 are met.

c) All executive or non-executive positions held within companies in which the institution holds a significant shareholding, as defined in Article 4(1)(36) of Regulation (EU) No 575/2013, shall be counted as a single position.

The existence of an executive position in the joint computation of several positions will determine the qualification of the resulting position of the whole as executive.

3. In accordance with the provisions of article 26.3 of Law 10/2014, for the purpose of determining the maximum number of positions provided for in section 1, those held in non-profit or non-commercial organisations or entities shall not be counted.

**Regulation 35.** *Procedure for the authorisation and notification of credits, guarantees and sureties to senior officers of credit institutions.*

1. Applications for authorisation to grant the credits, guarantees and sureties referred to in article 35 of Royal Decree 84/2015 must be made in accordance with the provisions of sections 2 and 3 of this regulation. For these purposes, transitory operations such as account overdrafts or credit card debit balances shall not be considered as credits, guarantees and sureties, provided that the amount drawn down is within the usual limits for this type of contract.

If thirty calendar days have elapsed since the submission of the application without the competent authority having taken a decision on the matter, the authorisation may be deemed to have been granted. Where additional information has been requested from the applicant, the time limit shall be counted from the time when it is received by the competent authority.

2. The application shall include detailed information on:

- a) Transaction holder.
- b) Position held in the entity.
- c) Amount of the transaction.
- d) Total amount of outstanding transactions carried out with the holder of the transaction or with the persons indicated in article 35.2 of Royal Decree 84/2015.
- e) Deadline for the transaction.
- f) Interest rate of the transaction.
- g) Applicable commissions.
- h) Guarantees of the transaction.
- i) Other conditions.

3. The application must be accompanied by the following documentation:

- a. Certificate of the approving body with the following content:

i. Statement that the transaction has been expressly analysed and it has been concluded that it is not exempt from authorisation, as it does not meet the exemption requirements set out in article 35.2 of Royal Decree 84/2015.

ii. The terms on which the transaction has been valued, with an indication of the documentation reviewed and the result of the valuation carried out.

iii. A statement that the transaction has been granted on terms similar to those of transactions of the same nature granted to customers or other employees.

iv. Declaration that the monitoring procedure to be applied to the approved transaction will be the one generally established for transactions of the same nature.

v. Express declaration that the transaction does not affect the sound and prudent management of the institution or proper compliance with regulatory and disciplinary rules.

Where the approving body is the administrative board and the person concerned is a member of that board, a statement that the agreement has been adopted without the participation of the person concerned.

b. Report from the compliance or internal audit department, as appropriate, including:

i. Confirmation that the transaction has been approved by the competent body following the corresponding analysis and valuation procedure for transactions of the same nature.

ii. Confirmation that the transaction does not interfere with the proper allocation of responsibilities within the organisation.

iii. Confirmation that the characteristics of the transaction for which authorisation is sought, in particular as regards amount, maturity, interest rate and collateral, are consistent with the risk policy approved by the board of directors.

4. The competent authority shall assess the application for authorisation in the light of the above documentation and any available information on the credit history of the person concerned.

5. The communication of transactions which, in accordance with the provisions of Article 35.2 of Royal Decree 84/2015, do not require the authorisation referred to in paragraph 1 of this regulation must contain the information indicated in paragraph 2 thereof.

6. Every six months, credit institutions shall report to the competent authority a list of the persons referred to in Article 35.1 and 35.2 of Royal Decree 84/2015 to whom they have granted credits, sureties and guarantees in accordance with the provisions of the aforementioned Article 35, indicating the amounts granted in the six-month period, where applicable, and the outstanding balances on the closing date of the six-month period. This list shall indicate the DNI or NIF of the borrower, the position held or the personal or corporate relationship that determines the communication. It shall also be broken down into credits, on the one hand, and guarantees and sureties, on the other.

Companies belonging to the reporting entity's own economic group shall not be included in the list.

### ***Section 3 Remuneration***

#### **Regulation 36.** *Staff subject to the rules on remuneration.*

The provisions of this section apply only to the identified group as defined in Regulation 1, except for Regulation 42.1, which applies to directors and officers of the institutions covered by this Section.

#### **Regulation 37.** *Annual internal evaluation report on remuneration policy.*

Credit institutions shall prepare and keep at the disposal of the competent authority the annual report of the internal evaluation of their remuneration policies, referred to in article 33.2 of Law 10/2014, no later than the date on which the document "Información con relevancia

prudential” (Information of Prudential Relevance), regulated in article 85 of Law 10/2014, in article 93 of Royal Decree 84/2015 and in regulation 59 of this circular, is published, or 30 June of each financial year.

This report should at least provide an assessment of the following aspects:

- a) Employees who make up the identified group.
- b) Variable remuneration schemes of the identified group, deferral clauses, share-based payment, ex-post adjustments of remuneration and retention and balancing periods with respect to fixed remuneration.
- c) Tools for measuring and assessing risk-adjusted performance for the identified group.
- d) Commitments for early termination of contracts assumed with the identified group.
- e) Pension commitments and discretionary pension benefits assumed vis-à-vis the identified group.
- f) Procedures for the proposal and approval of the remuneration scheme by the remuneration committee and the board of directors, both for the identified group and other staff.

**Regulation 38.** *Staff belonging to the identified group.*

1. Credit institutions must keep at the disposal of the competent authority a list of the names of the identified group as defined in regulation 1, with the details set out in Annex VIII. This list must be updated annually and, in any case, when significant changes have occurred.

2. Institutions shall have appropriate internal procedures to determine the composition of the identified group, which shall include both internal selection criteria, complementary to those indicated in Delegated Regulation (EU) No 604/2014, and exclusion criteria, based on the identification of activities that are deemed not to have a material impact on their risk profile, in accordance with Article 4.2 of that Delegated Regulation.

However, possible exclusions from the identified group (without omitting those of persons initially included) shall require communication to or prior authorisation by the competent authority, under the terms set out in Article 4(4) and (5) of Delegated Regulation (EU) No 604/2014.

3. In addition, the list of all excluded personnel shall also be kept available to the competent authority, with the same details as in Annex VIII.

**Regulation 39.** *Remuneration policy.*

1. Pursuant to Article 34.1.g) 3 of Law 10/2014, credit institutions may apply a notional discount rate to a maximum of 25% of the part of the total variable remuneration to be paid by means of deferred instruments, provided that the deferral period is at least five years.

2. For the purposes of the provisions of article 34.1.l) 2 of Law 10/2014, the following instruments are considered suitable for meeting variable remuneration commitments by listed or unlisted credit institutions, provided that they are issues placed on wholesale markets:

- a) Additional Tier 1 capital instruments within the meaning of Article 52 of Regulation (EU) No 575/2013.
- b) Tier 2 capital instruments within the meaning of Article 63 of Regulation (EU) No 575/2013.
- c) Other instruments that can be fully converted into Common Equity Tier 1 instruments or are loss-absorbing, and provided that they reflect the credit quality of the credit institution on a going-concern basis in accordance with Articles 1 and 4 of Delegated Regulation (EU) No 527/2014, subject to approval by the competent authority.

3. Whatever the instrument in which part of the variable remuneration is embodied, it shall be subject to a minimum retention period of one year, during which it may not be disposed of. However, in the case of instruments corresponding to the deferred part of the remuneration of

staff belonging to the identified group of staff who is neither a director nor a senior manager, the minimum holding period may be reduced to six months if the deferral of these instruments is at least five years.

4. For the purposes of article 36.2.b) of Royal Decree 84/2015, the variable remuneration of the identified group shall be reduced at the time of the evaluation of their performance, in the event of a negative performance of the entity's results or of its capital ratios, either in relation to those of previous years or to those of similar institutions, or a negative performance of other parameters such as the degree of achievement of the budgeted objectives.

In any case, the reduction of variable remuneration shall occur whenever a requirement or recommendation by the competent authority to the institution to restrict its dividend distribution policy is in force.

5. Institutions shall incorporate in their remuneration policy reduction clauses applicable up to 100% of the total variable remuneration, as well as clawback clauses of the remuneration already paid, both linked to a poor financial performance of the institution as a whole or of a specific division or area of the institution or of the exposures generated by that person. For this purpose, institutions shall compare the performance assessment made with the ex post behaviour of some of the variables that contributed to the achievement of the objectives. Factors to be taken into account shall include, at a minimum:

a) Significant risk management failures committed by the entity, or by a business unit or risk control unit.

b) The increase in an institution's or a business unit's capital requirements that was not foreseen at the time the exposures were generated.

c) Regulatory sanctions or court convictions for acts that may be attributable to the unit or the personnel responsible for them. Likewise, non-compliance with the entity's internal codes of conduct.

d) Irregular conduct, whether individual or collective. Particular consideration shall be given to the negative effects arising from the marketing of inappropriate products and the responsibilities of the persons or bodies that made those decisions.

6. The detailed recommendation of the board of directors to the general meeting of shareholders or equivalent body, which is required for the board's approval of a level of variable remuneration in excess of 100% of the fixed salary, as set out in Article 34.4.g) 2. i) of Law 10/2014, it shall take into consideration any current requirements or recommendations of the competent authority to restrict its dividend distribution policy

**Regulation 40.** *Payments for early termination of contract.*

1. In the event that the payments for early termination of the contract referred to in article 34.1.h) of Law 10/2014 exceed the amount corresponding to two annuities of the fixed remuneration, the entity must provide due transparency on this circumstance, by publishing it clearly and separately in the "Information of Prudential Relevance" document.

2. The remuneration agreements or contracts entered into must include clauses allowing for a reduction in the amount of early termination payments based on the results obtained over time, established in such a way as not to reward poor performance or misconduct, in accordance with the provisions of article 34.1.h) of Law 10/2014. For these purposes, there shall be a reduction in such payments, at least, in the event of the existence of negative results of the institution, the adjusted compliance with solvency ratios or the existence in force of requirements or recommendations of the competent authority on limitations on the distribution of dividends.

With regard to performance, account shall be taken of the performance of the entity as a whole, as well as that attributable to the person concerned and to the particular division or area for which he/she is responsible, and sufficient safeguards shall be provided in the terms of the contracts to ensure that, where appropriate, negative consequences that may arise after the



individual's departure, and which are attributable to his or her management performance may be taken into account.

**Regulation 41.** *Pension benefits.*

1. The design of the pension policy should be consistent with the institution's business strategy, objectives, values and long-term interests. To this end, pension commitments should include mechanisms that allow for adjustment of both the entity's contributions and the vesting of the corresponding rights based on performance or adverse circumstances.

In order for the pension policy of the institutions to comply with the provisions of the preceding paragraph, at least for executive directors, Managing Directors and similar personnel, as defined in article 6.6 of Law 10/2014, a significant part of the contributions agreed from the entry into force of this circular to pension commitments, which shall not be less than 15%, must be based on variable components, this part being included in the discretionary pension benefits defined in the following section 2 of this regulation.

Where discretionary pension benefit commitments are fully externalised, the documentation setting out the terms and conditions of the delegation should include clauses allowing the institution to recover the contributions made or preventing the vesting of the related pension benefits, depending on adverse performance or circumstances.

2. For the purposes of the provisions of article 34.1.ñ) of Law 10/2014 and article 36.1 of Royal Decree 84/2015, discretionary pension benefits shall be considered:

a) The proportional part of the pension benefits that exceeds that established for the entity's employees with a common employment relationship (through collective agreements or collective bargaining agreements signed with the legal representation of the workers and generally affecting the entire workforce) and whose amount is derived or has been derived from variable parameters, such as variable remuneration, achievement of objectives, achievement of milestones or similar.

b) Those resulting from extraordinary contributions, not foreseen in the initial contractual conditions or derived from legal impositions, especially those made in the six years prior to the date of retirement or termination.

c) Those related to substantial changes in pension conditions, including changes resulting from mergers or business combinations.

In this respect, contributions based on an individual quality shall not be considered as part of the general pension scheme of the institution.

3. The contributions that give rise to discretionary pension benefits, as indicated in section 2 above, shall be considered as deferred variable remuneration for all the purposes provided for in this circular and, as such, must be explicitly subject to reduction clauses, similar to those contemplated in Regulation 39 above, also forming part of the total amount of variable remuneration for the purposes of limits or other considerations that may be established.

4. Pursuant to article 34.1.ñ) of Law 10/2014, if an employee leaves the entity as a result of retirement or previously for any other cause, discretionary pension benefits will be subject to a five-year retention period.

The five-year retention period referred to in the preceding paragraph shall be counted from the date on which the person ceases to render services to the entity for any reason whatsoever.

An entity shall apply the same requirements for clawback and clawback of remuneration already paid as for variable remuneration during the retention period.

**Regulation 43.** *Delegation of the provision of services or the exercise of functions.*

1. The delegation of the provision of services or the exercise of the functions of credit institutions to a third party shall be governed by the provisions of article 22 of Royal Decree 84/2015. In addition, the provisions of this regulation must be taken into account, in accordance with the scope of application defined in regulation 2.

2. Institutions that have delegated the provision of services or the exercise of functions, including intra-group delegation, shall have a delegation policy approved by their board of directors, subject to explicit periodic updates at least every two years.

3. In developing this policy in relation to the provision of services or the exercise of critical functions, an entity shall assess the potential impact of any risks it incurs and specify the management of these risks according to their materiality. At a minimum, consideration should be given to:

- a) The risk of non-compliance with the regulations governing the entity's activity and with the most relevant regulations applicable to the service provider.
- b) Concentration risk arising from the accumulation of services or functions delegated to the same provider or in the same geographical area.
- c) The risk inherent in the country in which the service provider is based.
- d) Reputational risk arising from the practices followed by the service provider that could generate a negative view of the institution by customers, investors, the supervisor or the market in general.
- e) Operational risk, including legal risk, due to failures in service delivery by the provider, resulting, among other factors, from inadequate processes, internal systems or assigned staff.

The area control unit or service recipient responsible for the monitoring and control of any delegated functions or services must also be specified.

4. In relation to the delegation of the provision of services or the exercise of critical functions, the board of directors shall ensure that the requirements set out in its policy in relation to the delegation of services or functions are met through the receipt of monitoring reports, prepared by the relevant internal department. Internal audit shall review the content of these reports, which may vary in frequency and depth depending on the nature or criticality of the delegated services or functions, but which shall assess both the risks and benefits of the delegation and shall be updated at least annually.

5. In the choice of providers of services or functions, whether or not they are essential, institutions shall assess, among other factors that may be relevant in each case, the quality, experience and stability of the providers and the extent to which they comply with the most relevant laws and regulations applicable to them. In particular, the following should be assessed the manner in which anti-money laundering and customer protection regulations are complied with.

6. The delegation of the provision of services or the exercise of essential functions may not result in hindering the supervisory powers of the competent authority or in excessive dependence of the institution on the service provider. To this end, the contracts of Spanish institutions regulating the activity must:

- a) Include a clause providing for direct and unrestricted access by the competent authority to the credit institution's information held by suppliers, as well as the possibility of verifying, on the suppliers' own premises, the suitability of the systems, tools or applications used in the provision of the delegated services or functions.
- b) Allow for withdrawal and provide that the costs to the entity of such withdrawal are reasonable.
- c) Allow the entity to limit the outsourcing of services by the service provider or extend the principles of its delegation policy to such cases.
- d) Include a requirement for the service provider to have a contingency plan in place to maintain its business and limit the entity's losses in the event of a major incident.

In addition, if the supplier is based abroad, a clause should be included specifying the jurisdiction of the country to which the contract will be subject, so that the entity is aware of the potential legal risks it may incur in the event of a conflict.

7. Institutions shall ensure that their own contingency plans include and adequately address the services or functions that have been delegated, in particular those of an essential nature, and

shall establish alternatives to the contracted delegation.

8. Depending on the nature or criticality of certain functions or services, or their impact on the internal governance regime of the institution, the competent authority may set limitations to the delegation, taking into account, inter alia, the institution's established delegation policy, its organisational structure, its internal control environment and the implications of the delegation in relation to the exercise of the supervisory function of the competent authority.

9. Institutions must formally notify the competent authority at least one month in advance of their plans to delegate essential functions or services. This notification must be accompanied by the corresponding risk analysis and any mitigating measures that may be appropriate, especially when the delegation involves the use of new technologies.

## CHAPTER 6

### **Risk management**

#### **Regulation 46. *Regulations applicable to risk management.***

Credit institutions must comply with the provisions of Title II, Chapter I of Royal Decree 84/2015 regarding risk management systems, procedures and mechanisms, for which they will take into account the specificities described in this chapter in accordance with the scope of application defined in regulation 2.

#### **Regulation 47. *Concentration risk.***

1. For the purposes of article 48 of Royal Decree 84/2015, institutions shall have appropriate written policies and procedures to:

a) Measure and control the concentration risk arising from exposures to individual counterparties, including central counterparties, groups of related counterparties and counterparties in the same economic sector, in the same geographical region, in the same activity or dependent on the same commodity.

b) Evaluate the use of credit risk mitigation techniques that involve large indirect credit risks, such as those held against the same collateral provider.

c) Identify the possible existence of interrelationships between clients for the purposes of aggregation and calculation of exposures. In particular, institutions must conduct an in-depth analysis of the possible interrelationships, both legal and economic, of all their risks that represent over 2% of their equity, defined in accordance with the provisions of the second part of Regulation 575/2013, at the individual or consolidated level.

2. Institutions shall seek adequate risk diversification and monitor their risk concentrations, adopting, where appropriate, and without prejudice to the provisions of part four of (EU) Regulation no. 575/2013, the appropriate measures to correct those situations that entail the assumption of an excessive level of risk. For an adequate application of this principle, all circumstances that may affect its practical application, such as the corporate purpose of the institution and market conditions, must be taken into account.

#### **Regulation 48. *Securitisation risk***

For the purposes of article 49 of Royal Decree 84/2015, institutions acting as investor, originator or sponsor must take into account the following aspects in relation to the risks arising from securitisation transactions:

a) They shall establish in writing and apply appropriate policies and procedures to assess and control the risks derived from securitisation operations, including reputational risks such as those that occur in relation to complex structures or products. These policies and procedures should enable institutions to, among other things, determine the degree of risk transfer and ensure that the economic substance of the transaction is fully reflected in risk assessment and management decisions. Likewise, institutions shall assess whether the result of successive securitisation programs may be that only the assets of lower quality or profitability remain on the balance sheet and, if so, they shall adopt the appropriate corrective measures.

b) The originators of revolving securitisation transactions that include early amortisation clauses shall have liquidity plans to address the implications of both maturity and early

amortisation.

c) Originators of securitisations that intend to apply the treatment set forth in articles 243 and 244 of (EU) Regulation no. 575/2013 to calculate their capital requirements in relation to such securitisations must notify the Bank of Spain of the information requested in regulation 66 of this Circular.

**Regulation 49. Market risk.**

For the purposes of article 50 of Royal Decree 84/2015, the policies and procedures established by the institutions must take into account, at least, the following aspects:

a) Institutions must take into account all significant sources of market risk and the effects of such risks that are significant.

b) Institutions subject to the requirements set out in title IV of part three of (EU) Regulation no 575/2013, by underwriting debt or equity instruments, shall put in place systems for monitoring and controlling their underwriting risks during the period between the initial commitment and the first business day, depending on the nature of the exposures prevailing in the markets concerned.

c) When a short position matures earlier than the long position it finances, institutions shall take the necessary measures against the risk of insufficient liquidity.

d) Institutions that hedge positions in shares that are part of a stock index with positions in futures contracts or other products based on that stock index will take into account the base risk resulting from the difference between the evolution of the value of the futures contracts or of the other products and the value of the shares that have been hedged. Likewise, the base risk resulting from holding opposite positions in futures contracts based on stock indices whose maturity or composition is not identical will be taken into account.

**Regulation 50. Balance sheet interest rate risk.**

1. For the purposes of article 51 of Royal Decree 84/2015, institutions must have specific strategies, policies and procedures to identify, measure, manage, monitor and control the risk arising from possible changes in interest rates in activities other than trading, as well as for the assessment of the internal capital necessary to hedge this risk.

2. The measurement and management of interest rate risk referred to in section 1 above must comply with the following general criteria:

a) The effects of interest rate changes on the interest rate sensitive net interest margin should be measured for at least a one-year time horizon and on the economic value of the institution. In both cases, interest rate movements of a sufficiently large amount and of a different nature that are relevant to the type of activity of the institution will be used.

b) All interest rate sensitive positions shall be considered, including interest rate derivatives, both embedded and explicit, and excluding positions forming part of the trading book as defined in article 4.1.86 of (EU) Regulation no. 575/2013. Positions for internal hedging carried out for the management of balance sheet interest rate risk that correspond to positions of opposite sign that are part of the aforementioned trading book shall also be included. Depending on the scope of application, these internal hedges may be carried out within the same individual institution or between individual institutions belonging to the same consolidable group.

c) Separate interest rate risk measurements shall be made for each of the currencies in which, in the institution's opinion, there are significant interest rate sensitive positions, as well as an aggregate calculation of the interest rate risk of all of them.

d) The different sources of interest rate risk should be captured, such as direction, curve, base and optionality risks. To this end, any of the generally accepted methodologies for the measurement and aggregation of interest rate risk may be used, depending on the complexity of the institution's activity.

e) It must be possible to justify the appropriateness of the treatment given to specific items, such as transactions without contractual maturity – in particular sight deposits -, fixed rate instruments with cancellation options and any other type of interest rate optionality, as well as the criteria for aggregating positions in different currencies. The impact of the assumptions made on the measurement of interest rate risk should be analysed.

f) When measuring the interest rate risk on the economic value, the effect of the discount curve used should be analysed, to the extent that it is material.

Specifically, the effect of using a single interest rate curve for all assets and liabilities sensitive to interest rates should be evaluated for the discount, as opposed to using an interest rate curve more appropriate to the credit and loan characteristics. liquidity of each instrument.

3. Institutions must carry out periodic measurements that will serve as the basis for the preparation of the interest rate risk statements described in regulation 63 of this circular, in which the following rules shall be applied:

a) Separate calculations will be made of the potential impact of interest rate risk on the economic value and on the net interest margin sensitive to the one-year time horizon.

b) All positions sensitive to interest rates will be considered, in accordance with the provisions of section 2.b) above.

c) The static balance assumption will be applied.

d) Parallel and instantaneous interest rate movements in each currency will be considered, defined based on the identification of the 1% and 99% percentiles of the interest rate variations of each currency, calculated with a time horizon of 240 business days and with a historical observation period of five years. In order to ensure that all institutions use the same interest rate movements with respect to the different currencies, the movements agreed to this effect by the Executive Commission of the Bank of Spain will be applied, with appropriate publicity.

e) Separate interest rate risk measurements shall be made for each of the currencies in which there are interest rate sensitive positions, as well as an aggregate measurement of the interest rate risk of all of them. For this purpose, a significant interest rate sensitive position in a currency shall be considered to be one whose assets or liabilities exceed, on average over the immediately preceding six months, 5% of the institution's total assets or liabilities.

For the purposes of aggregate measurement of interest rate risk for all currencies with significant interest rate sensitive positions, aggregation criteria with economic significance from a risk measurement point of view shall be applied, and mere linear aggregation shall not be considered acceptable if it is not based on historical correlations of interest rate movements between the currencies concerned.

f) The potential impact of interest rate risk on the economic value calculated as set out in the preceding paragraphs shall be put in relation to the economic value of the total balance sheet and total eligible own funds as defined in part two of (EU) Regulation no. 575/2013.

For these purposes, the economic value of the total balance sheet shall be understood as the sum of the fair value of the net of interest rate sensitive assets and liabilities and the net of the book value of non-interest rate sensitive assets and liabilities. The fair value of interest rate sensitive items, excluding the regulatory trading portfolio, will be obtained by discounting future principal and interest flows to an appropriate risk-free interest rate curve. For this purpose, the interest rate curve of the interbank market on the reference date may be used. The book value of interest rate sensitive positions forming part of the trading portfolio, as defined in article 4.1 (86) of (EU) Regulation n.º 575/2013, shall also be considered.

g) The potential impact of interest rate risk on the interest rate sensitive net interest margin for the one-year time horizon will be related to the interest rate sensitive net interest margin forecast at that horizon under the baseline scenario of the implied interest rate curve being met. In this case, in addition to the static balance sheet assumption, the assumption of maintenance of the balance sheet structure will be used, so that it will be assumed that the asset or liability transactions maturing in the time horizon considered will be renewed with the same repricing structure they had contracted. However, this assumption does not apply to unstable balances of sight deposits, which are deemed to be refinanced with other sources of customer financing other than sight deposits.

4. Institutions must regularly analyse the effect that interest rate risk may have on their future solvency and stability, especially when the potential impact on the economic value of interest rate movements, such as that specified in section 3.d) of this standard, is negative and entails a reduction of more than 20% of the economic value of the institution or of its own funds.

In this case, institutions must adopt the corrective measures they deem appropriate, informing the competent authority as soon as possible, which, in turn, may require the institution to adopt the measures it deems appropriate.

#### **Regulation 51. *Liquidity risk***

For the purposes of article 53 of Royal Decree 84/2015, for liquidity risk management:

a) Institutions should have sound strategies, policies, procedures and systems for identifying, measuring, managing and tracking the risks associated with liquidity needs over different time horizons, including intraday, in order to ensure that adequate liquidity levels are maintained. Such strategies, policies, procedures and systems shall be documented and shall be appropriate to the group's activities and structure (business lines, currencies, branches, institutions and existing single liquidity sub-groups) and shall include appropriate mechanisms for allocating the costs, benefits and risks associated with liquidity.

The strategies, policies, procedures and systems put in place shall be appropriate to the complexity, risk profile and type of business of the credit institution, and compatible with the level of risk tolerance set by its management body, and the importance of the credit institution in the countries where it operates. Institutions must report their risk tolerance to all business lines.

b) The methodologies developed to identify, measure, manage and monitor funding positions will encompass current and projected cash flows derived from assets, liabilities and off-balance sheet items, including contingent liabilities and the potential impact of reputational risk.

In particular, institutions shall establish adequate internal procedures to have sufficient information, on an individual and consolidated basis, to assess their short, medium and long-term funding structure, including the classification of all assets and liabilities by maturity, the effects on liquidity of commitments, derivative products and other off-balance sheet commitments and the characteristics of their funding structure in the markets.

The internal procedures must be able to provide information that allows the institution to assign different levels of stability to retail deposits, based on parameters such as the coverage of the Deposit Guarantee Fund for Credit institutions, the value or sophistication of the deposit, the contracting channel (Internet...) or its contracting in foreign currency. Likewise, institutions must be able to identify, among their wholesale customers, those with whom they have a stable operating relationship. For any financing transaction granted or received that is collateralised, it must be possible to distinguish according to the type of collateral.

c) Institutions shall classify liquid assets according to their degree of liquidity, differentiating between assets that are pledged and unencumbered assets that may be available at all times, especially in emergency situations. They shall also take into consideration the legal institution or branch in which the assets are located, the country in which the assets are legally registered, either in a registry or in an account, together with their eligibility as collateral, and monitor how the assets can be used to cover liquidity needs.

Institutions shall also take into consideration the legal, regulatory or operational limitations to possible transfers of liquidity and assets free of charges and debts between institutions, both within and outside the European Economic Area.

d) Institutions shall adopt liquidity risk mitigation tools, in particular those based on liquidity limits and levels that allow for various stress scenarios, and an adequately diversified funding structure and access to funding sources. These measures will be periodically reviewed.

Different scenarios will be studied in relation to liquidity positions and risk reducing factors and the assumptions on which decisions regarding the financing structure are based will be reviewed periodically. For this purpose, the scenarios shall cover, in particular, off-balance sheet items and other contingent liabilities, including those of Securitisation Special Purpose Institutions or other special purpose institutions, for which the credit institution acts as sponsor or provides significant liquidity support.

The internal procedures will enable the assessment of the impact of defined scenarios on liquidity needs, including, inter alia, the effect of a decrease in the credit rating of the institution or a deterioration in the valuation of collateral on the additional margin or collateral requirements to cover certain positions.

Institutions shall analyse the potential effects of different scenarios, either limited to the institution itself, or extensive to the entire market, or a combination of both. Different time horizons and scenarios with varying degrees of stress will be considered.

e) Institutions should adjust their strategies, internal policies and limits in relation to liquidity risk and develop effective contingency plans, based on the results of the different scenarios studied.

To address liquidity crises, institutions shall have liquidity recovery plans that set out appropriate strategies, together with appropriate implementation measures, to remedy potential liquidity shortfalls. These plans will be tested at least annually, updated based on the potential outcomes of the different scenarios studied, reported to senior management and submitted for

approval, adapting internal policies and procedures where appropriate.

Institutions will take the necessary operational measures in advance to ensure that liquidity recovery plans can be implemented immediately. Such measures shall include holding collateral immediately available to enable it to obtain sufficient financing from central banks in the different currencies to which it is exposed and, where indispensable for operational reasons, within the territory of a host Member State or of a third country against whose currency it is exposed. This will entail that, where necessary, institutions hold collateral that is denominated in those currencies and, where necessary for operational reasons, within the territories of the host Member States or non-EU countries against whose currencies they have exposure.

f) Institutions shall put in place appropriate procedures to prepare three-year financing plans.

**Regulation 52.** *Data aggregation and risk reporting.*

1. Institutions shall have a data architecture and technology infrastructure in place to enable them to aggregate risk data and report risk in both normal and crisis situations.

2. Institutions should consider, among others, the following principles when aggregating data:

a) They should be capable of generating accurate and reliable risk data, which should be aggregated in a mostly automated fashion to minimise the likelihood of errors.

b) They should be able to identify and aggregate all significant risk data across the entire banking group. This data should be available at least by line of business, legal institution, asset type, sector and region, in order to be able to report on risk exposures, risk concentrations and emerging risks.

c) They should be able to generate aggregated risk data to satisfy a wide range of specific and discretionary requests, such as those made in times of crisis, due to changes in internal needs and those made by supervisors.

d) They should be able to promptly generate aggregated and updated risk information.

## CHAPTER 7

### Financial conglomerates

**Regulation 53.** *Identification of financial groups as financial conglomerates.*

1. Those groups provided for in article 4.1 of Royal Decree 1332/2005, in which the largest financial sector of the group is the banking and investment services sector and in which the results relating to the insurance sector of the group in the calculations referred to in the first and second paragraphs of article 2.5 of Law 5/2005 are greater than or equal to 5% or 3,000 million euros, respectively, must comply with the reporting obligations to the Bank of Spain established in regulation 65 of this circular regarding the identification of financial conglomerates.

The coordinator of the supervision of the financial conglomerate shall use the information referred to in the preceding paragraph to carry out the exercise of identifying financial conglomerates and deciding on the additional supervision regime applicable to them, in accordance with the provisions of article 15 of Royal Decree 1332/2005.

2. The supervisory coordinator of the financial conglomerate may request from the obligor any additional information it deems necessary for the proper identification of the financial conglomerate, and in particular:

a) Information regarding the alternative calculation parameters referred to in article 4.4 of Royal Decree 1332/2005, especially in relation to management companies of collective investment undertakings and management companies authorised under laws 35/2003 and 22/2014 or equivalent regulations of other countries.

b) Information regarding the allocation to the banking and investment services sector or to the insurance sector of the management companies of collective investment undertakings and management companies authorised under laws 35/2003 and 22/2014, or equivalent regulations in other countries, if these companies do not belong exclusively or specifically to one sector.

3. The coordinator, in close cooperation with the other relevant competent authorities, shall, on the basis of the information referred to in the preceding paragraphs and at least

annually, identify the financial conglomerates and, in agreement with the other relevant competent authorities identified, classify the groups referred to in paragraph 1 above into one of the following categories:

- a) Groups not identified as financial conglomerates, to which no requirements other than the information referred to in the preceding sections of this regulation shall apply.
- b) Groups identified as fully exempt financial conglomerates, to which article 2.2.a) of Royal Decree 1332/2005 shall apply.
- c) Groups identified as partially exempt financial conglomerates, to which article 2.2.a) of Royal Decree 1332/2005 shall apply.
- d) Groups identified as affiliated financial conglomerates, to which article 2.1 of Royal Decree 1332/2005 shall apply.

4. To avoid abrupt changes in the reporting regime referred to in paragraph 1 of this regulation and in regulation 65, those groups already submitting such information and whose identification parameters fall below 5% and 3 billion euros, must continue submitting it for two years, unless the calculated parameters do not exceed 1% and 1 billion euros.

**Regulation 54.** *Application of the additional supervision and partial exemption.*

1. The groups identified as partially exempt financial conglomerates, mentioned in regulation 53.3.c), must comply with the provisions of regulation 55.

2. The groups identified as affected financial conglomerates, mentioned in regulation 53.3.d), must comply with the provisions of regulation 55 to 58.

**Regulation 60.** *Information on corporate governance and remuneration policy on the website of credit institutions.*

The website referred to in Article 29.5 of Law 10/2014 and Article 37 of Royal Decree 84/2015 shall provide at least the following information:

- a) The Articles of Association.
- b) The regulations and other organisational rules of its governing bodies and, where appropriate, of the committees of the board of directors.
- c) The organisational structure of the entity, the lines of responsibility in decision-making, the distribution of functions in the organisation and the criteria for the prevention of conflicts of interest.
- d) The procedures established for the identification, measurement, management, control and internal communication of the risks to which the entity is or may be exposed.
- e) The entity's internal control mechanisms, including administrative and accounting procedures.
- f) The composition of the board of directors and the identification of executive, non-executive and independent directors.
- g) Identification of the persons holding the offices of chairman of the board of directors and chief executive officer. In the event that the competent authority has authorised the same person to hold both offices simultaneously, this circumstance and the justification given by the entity for the existence of the duality of functions in the same person must be indicated.
- h) The composition of the nomination committee and the remuneration committee or, as the case may be, the joint nomination and remuneration committee, and the functions attributed to each of these bodies.
- i) The composition of the risk committee and the audit committee or, as the case may be, the joint risk and audit committee, including a description of the functions attributed to each and identification of the head of the risk unit.
- j) Express mention that the appointments of members of the board of directors and Managing Directors or similar have been adopted with a favourable report from the appointments committee or, as the case may be, the appointments and remuneration committee.
- k) For the identified group as defined in Regulation 1, the following information shall be published in addition to the information referred to in Article 450 of Regulation (EU) No



575/2013:

i. Description of the categories of staff whose professional activities have a significant impact on the risk profile, irrespective of the type of employment relationship of the employees performing them, common or senior management, and the number of persons identified in each of the categories.

ii. The measures foreseen to adjust remuneration in case of underperformance.

iii. A description of the criteria used in determining remuneration to take into account current and future risks, indicating the specific risks taken into account, the measures used to assess them, how those measures affect remuneration and, where appropriate, any changes to those criteria in the relevant financial year.

iv. Aggregated quantitative information on remuneration paid during the previous financial year to the members of the body in charge of supervising remuneration, if different from the board of directors.

v. Aggregated quantitative information on remuneration, broken down by the area of activity of the credit institution in which they provide services, according to whether they are 'investment banking' (which shall in any case include corporate finance, venture capital and capital markets), 'commercial banking', 'asset management' and 'other' activities.

vi. Where applicable, the terms under which the general meeting of shareholders or equivalent body has approved variable remuneration in excess of 100% of fixed remuneration, indicating the maximum percentage set, the recommendation issued by the board of directors and the staff affected by the measure.

l) The following information shall be published in relation to the members of the board of directors:

i. Information on the result of the submission to the vote of the general meeting of shareholders or equivalent body of the remuneration policy for members of the board of directors, indicating the quorum, the total number of valid votes, the number of votes in favour and against, and the number of abstentions. Total remuneration accrued by each of the members of the board of directors in each financial year, with an individualised breakdown by remuneration item; all in accordance with the terms provided in article 37 of Royal Decree 84/2015. In the case of significant institutions in accordance with Regulation 1 of this circular, the individualised quantitative information shall be provided with the breakdown referred to in article 450.1.h) of Regulation (EU) No 575/2013.

Information on the procedures in place to ensure the suitability of the persons referred to in Regulation 30, as well as on the mechanisms in place to comply with the rules on incompatibilities.

I, JAVIER GONZÁLEZ LÓPEZ, a sworn English-language translator appointed by the Spanish Ministry of Foreign Affairs and Cooperation, do hereby CERTIFY that the foregoing is a faithful and complete translation into English of Regulations: 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 43, 46, 47, 48, 49, 50, 51, 52 and 60 of the document attached in Spanish.

Madrid, 20 August 2021