

Spain: Financial Sector Assessment Program-Technical Note on Financial Safety Net and Crisis Management



SPAIN

FINANCIAL SECTOR ASSESSMENT PROGRAM

TECHNICAL NOTE ON FINANCIAL SAFETY NET AND CRISIS MANAGEMENT

August 2024

This paper on Spain was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on July 12, 2024.

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INTERNATIONAL MONETARY FUND

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July 12, 2024

TECHNICAL NOTE

FINANCIAL SAFETY NET AND CRISIS MANAGEMENT

Prepared By
**Monetary and Capital Markets
Department**

This Technical Note was prepared by IMF STX staff in the context of the Financial Sector Assessment Program (FSAP) in Spain. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

BdE	Banco de España (Bank of Spain)
BRD	BdE Bank Resolution Department
BRRD	Bank Recovery and Resolution Directive
CET1	Common Equity Tier 1 (capital)
CCS	Consortio de Compensación de Seguros (Spain's insurance guarantee scheme)
CMF	Crisis Management Framework
CNMV	Comisión Nacional del Mercado de Valores (Spain's National Commission for the Securities Market)
CSD	Central Securities Depositories
CSE	Crisis Simulation Exercise
EA	Euro Area
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EEA	European Economic Area
ELA	Emergency Liquidity Assistance
EU	European Union
DGS	Deposit Guarantee Scheme
FGD	Fondo de Garantía de Depósitos (Spain's Deposit Guarantee Fund)
DGSD	Deposit Guarantee Scheme Directive
DGSFP	Dirección General de Seguros y Fondos de Pensiones (Spain's Directorate General Insurance and Pension Funds)
FOLTF	Failing or likely to fail
FROB	Spain's Executive Resolution Authority
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSN	Financial Safety Net
GDP	Gross Domestic Product
G-SIBs	Global Systemically Important Banks
IADI	International Association of Deposit Insurers
IPS	Institutional Protection Scheme
IRRD	Insurance Recovery and Resolution Directive
LSIs	Less Significant Institutions
MINECO	Spain's Ministry of Economy, Trade and Enterprise
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
NRA	National Resolution Authority
PIA	Public Interest Assessment
RA	Resolution Authority

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RRP	Resolution and Recovery Planning
Sareb	Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria (Spain's asset management company)
SIs	Significant Institutions
SPE	Single Point of Entry
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism

EXECUTIVE SUMMARY

Spanish authorities have made good progress in establishing an effective crisis management and resolution regime. The authorities have supported the Single Resolution Board (SRB) in setting resolution plans for Significant Institutions (SIs) and agreed on resolution plans for Less Significant Institutions (LSIs), enhanced cross-authority coordination, developed crisis management manuals, and participated in crisis simulation exercises. There have been improvements in the resolvability of Spanish banks, for instance, with respect to their compliance with the European Minimum Requirement for Own Funds and Eligible Liabilities (“MREL”). The Spanish authorities have also improved their internal and inter-authority crisis preparedness. However, further work is required to enhance the operational capacity of the resolution regime. The Banco Popular resolution in 2017 highlighted that an adequately staffed resolution authority able to cope with fast burn cases, internally and through the capacity to engage external parties at short notice, is essential to maintaining financial stability.

The statutory powers require strengthening. Spain’s Executive Resolution Authority (FROB) should have the administrative resolution power to override shareholders’ rights and take control of a bank subject to a bail-in resolution without relying on special managers or corporate law powers. The insolvency creditor hierarchy in Spain needs to be updated to distinguish between intra-group liabilities owned by the subsidiary in the parent company (and among subsidiaries) and those owned by the parent reflecting their investment in the subsidiary (which should be subordinated). The authorities should consider providing powers to a bank liquidator to transfer deposit accounts backed by assets within the national insolvency proceedings to an acquirer and which would allow the Fondo de Garantía de Depósitos (FGD) to contribute to financing that transfer of deposits if needed.

The Spanish authorities should integrate bank resolution authority for planning and execution in one institution. Integration would ensure that the national resolution authority (NRA) responsible for implementing orderly resolution actions has control over the primary levers necessary to achieve its objectives (i.e., resolution planning and resolvability decisions). This will align incentives in the institutional framework to the advantage of bank resolvability. Two broad options exist for achieving this: 1) merge FROB responsibilities for resolution implementation into the BdE’s Bank Resolution Department (BRD); or 2) expand FROB’s statutory functions to include resolution planning and resolvability responsibilities. During the integration, the authorities should consider how to reinforce the full operational independence of the resolution function while maximizing opportunities for synergies with the BdE.

For bank resolution plans to be credible, statutory resolution tools need to be usable, at speed and with confidence to impose losses on the banks’ creditors. These resolution mechanics should: i) clearly define operational procedures in place for imposing losses on MREL holders and other bail-inable liabilities; and ii) the detailed procedures in FROB operational bail-in playbooks. The procedure for imposing losses needs to be transparent to the market. In designing bail-in mechanics, the FROB should set out how it will navigate the key strategic policy choices related to

designing a bail-in mechanic. Subsequent to the mission FROB published a policy on the bail-in mechanics (in December 2023).

The Spanish authorities need to establish a framework for addressing liquidity needs in resolution. The BdE should publish a policy framework that clarifies its role as a lender of last resort, including for liquidity to entities recapitalized through the resolution process which are viable, and ensure its emergency liquidity assistance (ELA) and liquidity in resolution lending capabilities are fully operational, including by establishing a testing arrangement for its lending capabilities with its counterparties (e.g., on an annual basis). BdE should also coordinate closely with FROB to assess the liquidity needs and available unencumbered collateral for Spanish banks in resolution.

Spanish authorities should continue to enhance cross-authority crisis coordination arrangements. This should include formalizing its existing crisis management practices and prioritizing by agreeing a cross-authority crisis simulation exercise (CSE) strategy. BdE's BRD and FROB should ensure their resources are sufficient to conduct work that has not been a major focus to date i.e., resolvability assessment and bail-in execution. FROB should also have the flexibility, where possible, under national procurement legislation to depart from procurement rules in a crisis scenario to appoint external advisory support including independent valuers at short notice.

Table 1. Spain: Main Recommendations—The Financial Safety Net and Crisis Management			
Recommendation	Priority	Timing	Agency
Framework for Bank Failure (both liquidation and resolution)			
1. Provide FROB with the administrative resolution power to override shareholders rights and take direct control of a bank subject to a bail-in resolution (¶118).	H	I	MINECO
2. Update the statutory insolvency creditor hierarchy to mitigate any legal impediments in imposing loss absorption in resolution (¶121).	H	I	MINECO
3. Enable liquidators to transfer deposit accounts backed by assets within the national insolvency proceeding to an acquirer and for the authorities (i.e., FGD, FROB) to provide the liquidator for the court to appoint or to be appointed as liquidator (¶123).	M	MT	MINECO
4. Provide backstop temporary public ownership resolution tool for the Government as a last resort option where all other resolution actions have failed (¶125).	M	NT	MINECO
5. Integrate preventative resolution authority functions (i.e., BdE's BRD) and FROB's executive resolution functions for banks (¶130).	H	I	MINECO
6. Develop a failing or likely to fail ("condition 1") assessment framework with clear prudential regulatory capital and liquidity ratio triggers for when the assessment should be conducted (¶135).	H	I	BdE
7. Develop an agreed assessment methodology for firms' recovery actions based on which the FROB should request advice on condition 2 (¶136).	H	I	FROB
Preparing for Future Bank Failure			
8. Continue to monitor LSIs' progress to becoming fully resolvable by 2025, further develop the approach to identifying and removing impediments to resolution, and develop and publish a resolvability scoring framework for reviewing Spanish LSIs' self-assessment reports (¶142).	H	NT	BdE
9. Design a policy framework that describes the range of actions to be taken by each authority when a firm no longer meets the MREL requirements (¶143).	H	I	FROB and BdE
10. Enhance the transparency of the Spanish resolution framework by publishing policy documents and encourage firms to publicly disclose non-confidential parts of their resolvability self-assessments (¶146).	H	C	BdE
11. Authorize DGSFP to set binding recovery planning requirements for insurers (¶150).	L	I	MINECO

Table 1. Spain: Main Recommendations—The Financial Safety Net and Crisis Management (concluded)			
Managing Failed Banks			
12. Engage actively with industry to develop a shared approach to overcoming challenges associated with bail-in mechanics and with the relevant foreign authorities as part of a process led by the SRB to facilitate transfer strategies for internationally active banks (¶154-55).	H	I	FROB
13. Establish an approach to addressing liquidity needs to solvent entities pre-resolution and to banks that have been recapitalized through the resolution process, publish a policy framework, ensure such lending capabilities are fully operational, establish testing arrangements and formalize an approach to assess the liquidity needs of Spanish banks in resolution (¶162-66).	H	I	BdE and FROB
14. Use the flexibility afforded within the EU legal framework to facilitate FGD's ability to finance resolution (¶169).	H	NT	MINECO and FGD
Financial Crisis Preparedness and Coordination			
15. Establish a national crisis management framework (CMF) for bank failure and ensure a coordinated approach to a firm's crisis preparedness across prudential, resolution and market operations (¶172-73)	M	NT	FROB, BdE and FGD
16. Formalize existing crisis management practices and prioritize, by agreeing a cross-authority (BdE, FROB, FGD) Crisis Simulation Exercise (CSE) strategy (¶177)	M	NT	FROB and BdE, FGD
17. Ensure resources are sufficient to conduct firm resolvability testing and bail-in implementation work that has not been a major focus to date (¶181)	H	I	FROB and BdE
18. Provide maximum flexibility where possible under national procurement legislation to allow FROB to depart from procurement rules in a crisis to appoint external advisors including independent valuers at speed in a crisis (¶183)	H	NT	MINECO
Timing: C= Continuous; I = Immediate (within one year); NT = Near Term (1-3 years); MT = Medium Term (3-5 years). Priority: H = High; M = Medium; L = Low.			

BACKGROUND¹

A. Background

1. Financial safety net (FSN) and crisis management arrangements are essential in handling financial crises. The FSN comprises: (1) early intervention, including recovery planning; (2) resolution actions, including bank resolution planning and resolvability assessments; (3) central bank emergency liquidity assistance and liquidity in resolution; and (4) deposit protection. Crisis management requires the development of tools and procedures that allow authorities to respond quickly, decisively, and in close collaboration with other authorities. This requires significant advance preparation within individual authorities and a framework that ensures the necessary level of coordinated analysis, decision making and action between several authorities, both at the domestic and cross-border levels.

2. Spain has a large and highly concentrated banking system. Total banking assets amount to over 200 percent of the country's GDP. Domestic banks hold well over 90 percent of total banking sector assets and the four largest banks (Santander, BBVA, CaixaBank, Banco de Sabadell) accounted for nearly two-thirds of total banking sector assets, as of end-2022. The capital and liquidity positions of the Spanish banks are above minimum requirements. The average Common Equity Tier 1 ratio is 12.6 percent (September 2023), below the European average of 15.6 percent (for SIs).² Given the significant cross-border activities of the largest Spanish banks, the Spanish banking system benefits from diversification of business models but is exposed to potential vulnerabilities related to asset holdings of Spanish banks abroad.

B. Scope of the Note

3. This note focuses on the financial safety net and crisis management framework for banks in Spain. It is based on a review of the relevant legal, policy, and operational documents, as well as the authorities' comprehensive responses and discussion with the team. Since the 2008 global financial crisis, the Spanish FSN has been expanded to include both recovery and resolution regimes for distressed financial institutions.

4. This note looks at national aspects and operational readiness of the framework. These include the operationalization of the Spanish resolution regime, the ELA framework, depositor compensation by the FGD and the review of recovery and resolution plans for LSIs. Reference is also made, where relevant, to other types of financial institutions that are subject to the Spanish resolution regime. The note is informed by international standards—in particular, the Financial

¹ This technical note was prepared by Eamonn White (IMF External Expert). The author would like to thank the Spanish authorities for their excellent engagement, open dialogue, and warm hospitality throughout the FSAP.

² https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.supervisorybankingstatistics_third_quarter_2023_202401~918b7e766f.en.pdf

Stability Board (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions³ and the International Association of Deposit Insurers (IADI) Core Principles for Effective Deposit Insurance Systems⁴—but does not assess compliance with them.

C. Financial Oversight Architecture

5. The respective mandates and responsibilities for the FSN are established within the Banking Union framework. The European authorities that have jurisdiction in the Spanish banking system are the European Central Bank (ECB), the European Commission (EC), the Single Resolution Board (SRB), and the European Stability Mechanism (ESM). The EU’s single rulebook⁵ on crisis management and domestic legislation forms the framework under which the Spanish authorities and firms must operate. The Spanish recovery and resolution regime applies to banks, investment firms that are subject to a minimum capital requirement of €730,000, and central counterparties (since 2023). The regime covers Spanish subsidiaries of European Economic Area (EEA) and non-EEA firms and Spanish branches of non-EEA firms.⁶ The responsibilities of national authorities with roles in the financial safety net are discussed in turn below.

Banco de España

6. BdE is the Spanish central bank, has microprudential responsibilities for banks, and is the so-called “preventative” resolution authority (RA) for LSIs. The BdE also has statutory responsibility for the provision of ELA on the basis of its financial stability mandate. Any such liquidity provision by the BdE would be subject to the Eurosystem Agreement on ELA.⁷ The BdE’s Directorate General Banking Supervision, is responsible for the microprudential supervision of Spanish LSIs within the Single Supervisory Mechanism (SSM) framework and subject to ECB/SSM oversight.⁸ BdE performs its resolution tasks within the framework of the Single Resolution Mechanism (SRM), consisting of a central RA, the SRB, and a network of NRAs in Banking Union member countries. Under the SRM structure, the SRB is responsible for resolution planning for the SIs directly supervised by the ECB and all cross-border banking groups. BdE’s BRD is responsible for the resolution planning for LSIs that are not part of a cross-border group, and participates as a

³ Financial Stability Board, ‘Key Attributes of Effective Resolution Regimes for Financial Institutions’, October 2014, https://www.fsb.org/wp-content/uploads/r_141015.pdf

⁴ International Association of Deposit Insurers, ‘IADI Core Principles for Effective Deposit Insurance Systems’, November 2014, https://www.iadi.org/en/assets/File/Core_percent20Principles/cprevised2014nov.pdf

⁵ This includes 1) the Banking Recovery and Resolution Directive (BRRD); 2) the Single Resolution Mechanism Regulation (SRMR), 3) the Deposit Guarantee Schemes Directive (DGSD), and 4) the Capital Requirements Regulation and Directive (CRR and CRD).

⁶ See article 1 of Law 11/2015 which established the scope of application of recovery and resolution for credit institutions and investment firms.

⁷ <https://www.ecb.europa.eu/pub/pdf/other/ecb.agreementemergencyliquidityassistance202012~ba7c45c170.en.pdf?dca797da3212289956ac24df607eb168>. The ECB doctrine on the interpretation (e.g. of the prohibition of monetary financing and the principle of independence in the context of the provision of ELA) as reflected in ECB convergence reports and opinions, and EU State aid rules, are also relevant.

⁸ LSI licensing and sanctioning are performed by the ECB directly.

member of SRB-led internal resolution teams for SIs. On LSIs, the SRB performs an oversight function of LSI resolution planning, where it has the power to adopt guidelines and give general instructions to NRAs. The Director General responsible for BdE's resolution function reports to the sole Deputy Governor at the BdE. The Director General responsible for banking supervision also reports to the Deputy Governor. The Bank Resolution Department was established in April 2015, and has two divisions—the Bank Resolution Analysis and Policy Division and the Bank Resolution Planning Division. At the time of writing, it has 30 professional staff, (plus two business support staff), of which 24 are focused on resolution planning and 6 on resolution policy development. BdE decisions on early intervention, resolution and crisis management issues are taken by the Executive Commission.⁹ Provision of ELA is the BdE's responsibility, but it must act within a framework set by the ECB.

FROB¹⁰

7. FROB is the NRA responsible for implementing resolution or so-called “execution” RA. FROB has sole responsibility for implementing resolution measures using national statutory powers for all Spanish banks if they fail, regardless of whether they are classified as SIs or LSIs.¹¹ FROB is also a member of the SRM's internal resolution teams. FROB is responsible for the implementation of resolution decisions taken by the SRB in relation to SIs and cross-border groups. Unlike for SIs, on LSI's, FROB not only executes but also takes all the resolution decisions. At international level, FROB is the contact point and coordinator with international authorities. FROB activities are funded through levies on firms. FROB has the capacity to dedicate 23 full-time professional staff to resolution cases, up from 21 in 2017. See Annex I for the current list of Spanish SIs and LSIs with a resolution plan involving the use of resolution tools.

FGD

8. FGD is a separate legal institution, established by law, which has its own legal personality, operating under private law. FGD has a public mandate for the provision of deposit guarantees up to the limit of €100,000 per depositor and credit institution. FGD has a Board with representation from the government, the central bank, and the industry. All deposit-taking institutions must be a member of the FGD, The FGD fund is financed by contributions from the industry. Banks whose failure would not satisfy the resolution conditions are placed into a court-based insolvency procedure. In a bank insolvency, the FGD pays out eligible depositors up to the statutory limit of €100,000.

⁹ The Executive Commission is chaired by the BdE Governor and includes the BdE Deputy Governor and two elected members of the BdE Governing Council which, in turn, is composed of the BdE Governor and Deputy Governor, six elected members, the Secretary General of the Treasury and International Financing (within the Ministry of Economy, Trade and Enterprise), and Vice Chair of the Comisión Nacional del Mercado de Valores.

¹⁰ As from Law 11/2015, FROB is no longer an acronym of "Fondo de Reestructuración Ordenada Bancaria", but rather the legal name (see art. 1 of Law 11/2015).

¹¹ Unlike in the case of SIs (where the resolution decisions are taken by the SRB and EC), FROB has also general statutory responsibility to adopt the relevant resolution decisions as regards LSIs (not only to execute them).

Sareb

9. Sareb was created in 2012 to manage nonperforming assets purchased from Spanish bank portfolios following the global financial crisis (Box 1). It was created with state and private participation, with FROB and private investors originally holding 45 and 55 percent of Sareb' shares, respectively. Sareb has been deleveraging and repaying senior debt from the proceeds but is currently operating with negative equity.

Box 1. Spain: Sareb

Sareb was created in 2012 to purchase non-performing assets from troubled banks, comprising mainly developer loans and properties. Sareb's primary business objective is to maximise cashflows from its assets and complete its winddown by 2027. It was funded with equity of €4.8 billion (approximately 25 percent in share capital and 75 percent in subordinated debt). Public institutions (FROB) retained 45 percent of Sareb's equity and subordinated debt while the remaining 55 percent was subscribed by private investors (comprising most domestic financial institutions). The payment for the purchase of these assets was funded through the issuance by Sareb of fixed income securities (senior debt) with the irrevocable guarantee of the Kingdom of Spain (50.781 million). Total assets purchased had a transfer price of approximately €50 billion. Since its establishment, Sareb has managed to reduce its portfolio by 50 percent.

There have been a few important developments with respect to Sareb since the 2017 FSAP:

1. Sareb now operates with negative equity: At the end of 2020, Sareb reported own funds as negative and forecast that this could continue until the end of its business plan. As of its 2022 audited accounts, Sareb has negative equity of €14 billion equal to approximately 3 percent of GDP. Spanish legislation was changed to allow Sareb to continue operating.
2. Change from a private to a public company: Following a decision by the EC to classify Sareb debt as Spanish public debt in 2021, the government took a controlling stake in Sareb.
3. Business plan performance: The business plan has achieved €25 billion reduction in assets over the last 10 years, leaving roughly the same volume of sales to be achieved in the remaining 4 years. Sareb believes their pricing strategy leveraged upon an enhanced segmentation of its portfolio, will enable them to meet their 2027 deadline for completing the winddown.
4. New social housing objective: Sareb manages a €1 billion social housing portfolio with an objective to provide affordable rental solutions for vulnerable families.

Sareb's operation for over a decade has allowed it to enhance its understanding of the market it operates in. This has enabled it to refine its business plan over time and ensure that its assumptions are appropriately conservative. BdE's Directorate General Banking Supervision reviews on an annual basis Sareb's business plan to assess compliance with the corporate purposes of Sareb designed to ensure it delivers its business plan objectives. BdE focuses on monitoring the evolution of Sareb's financial situation, asset management controls as well as valuation and impairment evolution in its asset portfolios.

Ministry of Economy, Trade and Enterprise (MINECO)

10. MINECO is responsible for government policy on economic matters, including legislation for the financial system and use of public funds during a crisis. In resolution, FROB is required to notify MINECO if the first two conditions for resolution have been met, (i.e., a firm is 'failing or likely to fail' and it is not reasonably likely that action can, or will, be taken to change this). FROB also needs MINECO approval for implementing resolution measures that have a direct fiscal

impact or systemic implications. For decisions affecting the general state budget or the management by the FROB of its investment portfolio, the Governing Committee of FROB shall take decisions in a smaller composition, including the Chairman and the representatives of MINECO and the Ministry of Finance. MINECO has no statutory role in providing backstop solvency or liquidity support in a system-wide financial crisis where use of resolution tools has been unsuccessful in stabilizing the situation. The Government is also the sole gateway to the EC regarding all state aid cases.

CNMV

11. The CNMV is responsible for the supervision of the Spanish securities markets. CNMV's mandate is to ensure the transparency of Spanish securities markets and the correct formation of prices, as well as the protection of investors. CNMV is responsible for resolution planning for investment firms and the designated RA for CCPs.

D. Progress Since the 2017 FSAP

12. The Spanish authorities have made progress in developing their crisis management and resolution regime, including:

- On bank resolvability: a preferred resolution strategy has been set for all Spanish SIs and LSIs judged by the BdE's BRD as likely to enter resolution on failure. These banks are all subject to the Bank Recovery and Resolution Directive (BRRD) minimum requirement for MREL. BdE has communicated¹² MREL-related requirements at a national level to all credit institutions under its scope, addressing also how institutional protection schemes (IPS)¹³ should be treated. While the BdE has not published any domestic-level guidance on non-MREL resolvability expectations on Spanish banks with a resolution plan, the BdE's BRD has recommended that LSIs comply with the European Banking Authority (EBA) guidelines for institutions on improving resolvability.¹⁴
- On cross-authority coordination: the Spanish authorities, (i.e., BdE's Directorate General Banking Supervision, BdE's BRD, FROB, and CNMV), have signed several memoranda of understanding (MoUs) to enhance cooperation for both resolution planning and for banks that BdE's Directorate General Banking Supervision considers vulnerable (one with BdE and FROB and the other with CNMV and FROB). There is also a BdE internal circular which establishes the

¹² These requirements have not been published and instead are reflected in the resolution plans and communicated directly to institutions, via specific bilateral meetings as well as to the SRB, FROB and the competent supervisor.

¹³ An IPS is a contractual or statutory liability arrangement of a group of banks which seeks to protect member institutions' liquidity and solvency. An important consolidation in the LSI sector took place in 2018 when a platform to mutualize losses among several credit cooperatives was established between 30 credit cooperatives and a bank (Banco Cooperativo Español). Subsequently, some additional cooperatives have joined this or other IPSs (only 4 cooperatives remain independent).

¹⁴ https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2022/EBA-GL-2022-01%20Guidelines%20on%20resolvability/1025905/Final%20Report%20on%20Guidelines%20on%20improving%20resolvability%20for%20institutions%20and%20resolution%20authorities%20%28%29.pdf?retry=1

procedures to be followed and the exchange of information between resolution and supervision functions in BdE. Two collaboration committees have been set up—one with BdE and FROB and the other with CNMV and FROB—to support information exchange on supervisory action and resolution planning and cooperation in responding to banks and investment firms in stress.

- On financial crisis preparedness and management capabilities: the authorities have developed their respective internal crisis preparedness, as reflected in development of crisis handbooks and operational steps documents for resolution execution. FROB has participated in the SRB's host crisis simulation exercise (CSE) based on an SI failure and has also organized an LSI-focused CSE to test its internal capabilities. The BdE and FROB have participated in an SI-focused CSE and an LSI-focused CSE with European authorities.

E. Recent Crisis Experience and Policy Responses

13. Since the time of the last FSAP, one SI, Banco Popular, failed in Spain. Banco Popular was predominately a domestic bank with a business model focused on SME lending, although the main problems originated in the real estate portfolio. It was Spain's sixth largest bank with total assets of around €160 billion. It had a modest international presence, limited to the US, Portugal, and Mexico. On the evening of June 6, 2017, the ECB and the SRB determined that Banco Popular was non-viable and triggered resolution after it suffered from a severe liquidity crisis in the weeks prior. This liquidity stress had been triggered by deterioration in the bank's financial situation in the months running up to the failure. For example, the bank announced losses in 2016 after making large provisions, reducing its solvency position despite a capital increase undertaken the same year. Investor uncertainty regarding the real value of its nonperforming assets and its solvency gradually reduced the bank's stock price significantly. On June 7, 2017, following a competitive bidder process, the SRB took a resolution decision and instructed FROB to implement the 'sale of business tool', and accept an offer made by Banco Santander, preceded by the ancillary write-down and conversion into shares of AT1 and Tier 2 capital instruments.

14. The Banco Popular case highlighted clearly the challenge presented by liquidity driven failures and the importance of RAs being prepared to act quickly. Such cases reduce the authorities' control and can result in the conditions for entry into resolution being met before the "resolution weekend". It was fortunate that Santander was willing, and able, to buy the bank as a whole in a share transfer following the full write-down and conversion of capital instruments. In the future, if private sector purchasers are less willing to acquire all of a failed bank's liabilities this would significantly increase the operational challenges for the Spanish authorities in executing a resolution at speed. A temporary bridge bank may have been needed to provide the time needed to facilitate an onward partial property transfer to a private sector purchaser. The Banco Popular resolution underscored the importance of RAs having adequate expertise to cope with such fast burn cases, both internally and through the capacity to engage external parties at very short notice. Banks must also have the operational capacity to provide the information required to support resolution action at short notice. Close collaboration between the BdE's Bank Resolution Department and FROB is paramount in the resolution planning phase, to test the adequacy of banks'

reporting capabilities. Continued efforts are also required to establish effective coordination mechanisms between all involved authorities to ensure smooth and coordinated action. The authorities should consider loss sharing arrangements, and how to implement them, to facilitate share transfer resolution strategies (as further discussed in para 69).

FRAMEWORK FOR BANK FAILURE

A. Statutory Framework for Resolution

15. The Spanish statutory bank resolution toolkit aligns with the global framework for institutions that could be systemic in failure. The legal framework for the resolution regime is set out clearly in a combination of Spanish and European law. The BRRD has been implemented in Spain. The SRM sets out BdE preventative and FROB execution resolution powers and tools for the Spanish NRAs. The SRM Regulation sets out the powers of the SRB and the framework for coordination between the SRB and NRAs in resolving banks in the Banking Union.

Box 2. Spain: FROB Resolution Tools

Four resolution tools are available to the FROB, as follows:

1. **Bail-in:** Write-down or conversion of liabilities (bail-in): the nominal value of liabilities may be both written down entirely or in part, or converted into regulatory capital instruments. Bail-in can be affected, for example, through the write-down, conversion, or cancellation of shares.¹⁵
2. **Sale of business:** the institution's shares or assets and liabilities are transferred entirely or in part to another institution or third party.
3. **Bridge institution:** the institution's assets and liabilities, or its shares, are transferred (in part or as a whole) to a bridge institution that is established by the RA and under the authority's control.
4. **Asset management vehicle:** part of the institution's assets and liabilities are transferred to a separate asset management vehicle in connection with the use of one of the previously mentioned tools.

These four resolution tools can be used in combination or separately (with the exception of the asset management vehicle which must always be used in combination with another tool in the EU regime).

Overriding Shareholder Rights

16. The FROB faces significant limitations in its capacity to override shareholder rights in resolution. The FSB Key Attributes for Effective Resolution Regimes require RAs to be able to override the rights of shareholders to effect resolution. For the timely and effective implementation of resolution actions, including applying the bail-in power, the authorities temporarily need to be in full control of the failed bank. FROB can appoint a special manager or seek to take direct control only by exercising corporate law powers to override shareholder rights. The powers attributed to the special manager are those that legally or statutorily correspond to the board or general

¹⁵ The power to write down or convert relevant capital instruments and eligible liabilities may be exercised either independently or in combination with other resolution powers such as bail-in.

shareholders meeting of the entity and that are necessary in relation to the resolution tools. However, appointing a special manager can take significant time and prove destabilizing to a bank which in the interim remains open.

17. FROB estimates it would take at least two weeks to appoint a special manager in a way consistent with FROB's obligations under procurement legislation. This timeline would likely be inconsistent with a fast burn failure scenario. Even if FROB had the time to appoint a special manager, there is no guarantee it would be possible to appoint a qualified candidate, given applications are voluntary, and candidates may not be free of conflicts of interest. FROB may therefore need to rely on company law procedures to override shareholder powers. However, FROB can only take direct control of the powers corresponding to the shareholders meeting or assembly under corporate law, under certain circumstances. These are if it is not possible to meet the conditions required by law for the valid convening of, and adoption of decisions, by the general meeting or assembly; or if the new general shareholders meeting or assembly of the entity in resolution (which is likely to be made up of the former creditors of the entity converted in new equity after applying the bail-in tool), rejects or obstructs the FROB's proposed decisions necessary to implement the resolution.

Recommendations

18. MINECO should take the next legislative opportunity to give FROB administrative resolution powers to override shareholder rights directly and implement resolution. Such powers should not require FROB to appoint a special manager or demonstrate "*reasons of special urgency*" or wait for the general meeting or assembly to reject or obstruct FROB's proposals to implement its resolution action. National legislation should ensure that the FROB can assume the powers of the shareholders as a matter of primary resolution legislation, without any further requirements under corporate law. There should be no requirement for involvement of shareholder approval, annual general meetings or administrative processes and procedures.

Creditor Hierarchy

19. The Spanish insolvency creditor hierarchy subordinates intra-group liabilities, which may undermine the use of the bail-in tool. This is a specific feature of Spanish national legislation and not a matter of EU directives. Currently, the legislation does not distinguish between intragroup liabilities owned by the subsidiary in the parent company (and among subsidiaries), which would usually be senior liabilities if held by a different creditor (e.g., cash held at a parent bank) and those owned by the parent reflecting their investment in the subsidiary (which should be subordinated). This means that all intra-group liabilities currently rank, among subordinated liabilities, just above between tier 2 regulatory capital instruments and senior non preferred debt, the latter being one of the instruments typically used to support banks' compliance with MREL requirements and are designed to be written down and converted in the event of a resolution.

20. For some Spanish banks with resolution plans, intra-group liabilities can be material relative to MREL eligible liabilities. The bail-in of intra-group liabilities consistent with the current

creditor hierarchy could undermine the orderly resolution of that bank by inadvertently spreading contagion to parts of the bank or banking group in a manner that is not consistent with the authorities' preferred resolution strategy. While relying on bail-in exclusion powers to minimize these risks may be possible, such exclusion may create no creditor worse-off than liquidation compensation risks by making losses on other creditors greater than they would have suffered under the insolvency counterfactual valuation scenario. As a result, the current treatment of intra-group liabilities in Spanish law could represent a significant barrier to the orderly implementation of a bail-in resolution strategy.

Recommendations

21. MINECO should update the corporate insolvency creditor hierarchy to remove the statutory creditor hierarchy subordination of some intra-group liabilities. Instead, it should distinguish between intragroup liabilities owned by the subsidiary in the parent company (and among subsidiaries), which should rank in accordance with their ordinary insolvency ranking in line with the nature of the liability (usually senior liabilities) and those owned by the parent reflecting their investment in the subsidiary (which should still be subordinated).

Bank Liquidation

22. The capability to transfer deposits in liquidation would deliver better continuity of service for depositors. The insolvency proceeding in Spain is a judicial process governed by Royal Legislative Decree 1/2020, of May 5 (“Insolvency Proceeding”). Credit institutions that enter an insolvency proceeding are subject to the ordinary insolvency legislation applicable for natural and legal persons, with assets liquidated by a court appointed liquidator. This can also impact the resources available to the FGD if it must wait for an extended period to recoup funds used to pay out insured depositors at the beginning of the process. Vesting the bank liquidator with the power to transfer deposit accounts backed by assets of the failed bank would deliver better continuity of services to depositors than provided by an FGD payout. Such a transfer would significantly increase the speed of the liquidation process. The FGD could also use its funds to “top-up” if there were insufficient good assets to back the transfer of deposit liabilities.

Recommendations

23. MINECO should take the next legislative opportunity to establish a modified bank insolvency procedure that enables liquidators to transfer deposit accounts backed by assets to an acquirer. Such a modified insolvency procedure would ensure the rapid repayment of depositors is a priority objective of the liquidator. It should provide a bank liquidator with an effective sale-of-business tool whereby depositors backed by good assets can be transferred out of liquidation when sold to an acquirer. FGD funds should also be able to “top up” any shortfall in net assets available to back a deposit book transfer subject to an appropriate least cost test. The authorities should propose the liquidator for the court to appoint or be appointed as a liquidator themselves. For the former case the liquidator must be a bank insolvency practitioner monitored by FROB or FGD. The legislation should also require the liquidator to work with the FGD to ensure an

effective transfer of depositors and facilitate the continuity of depositor services (which may incur costs e.g., to maintain continuity of IT services). Other than these modifications the liquidator should still be tasked with their ordinary liquidation objectives to protect the interests of creditors and maximize recoveries.

Backstop Public Support Options

24. Spain did not implement the BRRD government stabilization powers into national legislation. These tools would allow the government to provide public equity support and take a systemic bank into temporary public ownership as a last resort, with the aim of reducing a serious threat to national financial stability. In using the government stabilization powers of the BRRD, authorities must ensure that losses related to a bank in the resolution must be absorbed by its shareholders and creditors equivalent to 8 percent of the liabilities of the bank under resolution.¹⁶ Spanish banks currently earmarked for resolution have sufficient resources to comply with full MREL loss-absorbency requirements. However, banks not expected to be resolved—but rather liquidated—are not required to meet MREL requirements—and under certain circumstances may need to be resolved rather than liquidated to preserve financial stability (as highlighted recently by the regional bank failures in the United States). Accordingly, the limitations on using public funding could undermine financial stability in Spain. The 2018 Euro area FSAP recommended that a financial stability exemption from the 8 percent bail-in requirements is needed for circumstances where the bail-in of all MREL liabilities would fail to stabilize the bank or would trigger a system-wide crisis.

Recommendations

25. The Government should exercise its flexibility under the BRRD to transpose the government stabilization tools so these are available to MINECO. These powers should only be exercised when needed as a last resort option should the bail-in of a failing bank's own funds and other liabilities be insufficient to return it to solvency and viability and preserve financial stability more widely. In expanding the powers of MINECO as a last resort, the mandatory 8 percent requirement required in the BRRD related to the government stabilization tools would also limit flexibility in responding to certain banking crises. If the European legislation were revised to allow for an exemption from the 8 percent bail-in requirement, as recommended by the 2018 EA FSAP, the Spanish legislation would be further amended at that time.

B. Institutional Arrangements

26. The FSB Key Attributes state that jurisdictions should designate an administrative authority or authorities responsible for exercising the resolution powers. There is no single institutional model for a RA. Each model brings different benefits and challenges in establishing an

¹⁶ The 8 percent rule is also a condition of accessing EU level resolution financing arrangements, the Single Resolution Fund (SRF).

operationally independent RA. Different jurisdictions have taken different approaches, e.g., to reflect their existing institutional arrangements and the nature of their domestic banking system, including:

- The RA being co-located with the supervisory authority, which is separate from the central bank e.g., Australia and Austria.
- The RA being co-located with the supervisory authority within the central bank, e.g., Brazil, France, Hong Kong SAR, Ireland, Italy, Singapore, South Africa, and the United Kingdom.
- The RA is institutionally separate from both the central bank and the supervisor, often delivered by expanding the functions of an existing deposit insurance agency to include resolution functions e.g., Canada, Indonesia.
- More than one authority is designated as RA or retains resolution-related functions (“hybrid model”) e.g., Denmark, Japan, Norway, and Spain.

27. Regardless of the approach adopted, adequate governance arrangements are needed to ensure the operational independence of the RA and mitigate potential conflicts of interest.

These arrangements include adequate staffing, leadership of the same seniority, separate reporting lines, and allocation of decision-making responsibilities. The purpose of these requirements is to ensure that conflicts (perceived or otherwise) between prudential supervisory objectives (i.e., firm resilience) and the RA’s objectives (i.e., firm resolvability) are appropriately managed. Potential conflicts may include:¹⁷

- In a crisis, there may be a risk of regulatory forbearance or a difference of view between the supervisor and the RA as to whether the conditions for resolution are met (e.g., whether there is a reasonable prospect of the bank’s recovery, or not).
- In peacetime, a direction by the RA to remove impediments to resolvability (e.g., changes to legal, operational, or financial structures of a bank) may have high cost (and therefore, prudential) implications for the firm.¹⁸
- Setting the level of the minimum loss absorbency requirements may also have prudential implications e.g., by disincentivizing cheaper sources of funding, such as retail deposits.

28. Potential conflicts between banking supervision and the FROB’s additional function of managing legacy holdings of shares in entities may fall away as these holdings are unwound.

¹⁷ Similar conflicts of interest can arise between the RA and the central bank as lender e.g., the central bank as RA may need access to backstop liquidity support for banks in resolution, while the central bank as lender needs to appropriately protect the central bank balance sheet.

¹⁸ Outcomes may optimal where RAs develop their bank specific resolution planning in close cooperation with prudential supervisors; some prudential supervisors use their prudential powers to require firms to remove barriers to resolvability identified by the RA.

These holdings result from the restructuring measures undertaken in the early 2010s and in Sareb.¹⁹ MINECO plans to carry out a review of the resolution institutional arrangements by the end of 2024.

29. Preventative and execution resolution functions are directly related. While there are many practical examples of good coordination and information sharing among the Spanish authorities, consolidating the two resolution functions could enhance effectiveness, simplify decision-making arrangements, and avoid duplication.

Recommendations

30. MINECO should take the next legislative opportunity to integrate preventative RA functions at the BdE's BRD and FROB's execution resolution functions into one institution.

This integration would ensure that the authority responsible for implementing orderly resolution actions has control over the primary levers necessary to achieve its objectives (i.e., resolution planning and resolvability decisions). This will align incentives in the institutional framework to the advantage of bank resolvability. It will also ensure that the expertise developed on bank resolvability during the resolution planning process is brought to bear when it comes to implementing the resolution action on that same entity. There are two broad options for achieving the integration of preventative and execution resolution functions. A first option is to merge FROB resolution execution functions into BdE's Bank Resolution Department. The second option is to expand FROB's statutory functions to include preventative resolution functions. In either case sufficient staff and dedicated governance arrangements would be needed.

31. If the Spanish authorities decide to integrate resolution planning into the FROB, the decision-making role of other authorities in the FROB's executive governance should be reviewed. Conflicts may arise from having authorities with other statutory functions (e.g., micro-prudential supervision, fiscal authorities) involved in FROB decision-making.²⁰ For example, the BdE representative should have an advisory rather than a decision-making role in FROB resolution decision-making bodies, such as the Governing Committee. In addition, the FROB resources made available to conduct resolution planning would need to be equal to, or greater than those currently within the BdE's Bank Resolution Department. Finally, careful consideration will need to be given to how FROB will leverage BdE supervisory and other data to advance its new resolution planning objectives.

32. Whether or not FROB execution functions are transferred to the BdE's BRD, the governance arrangements within the BdE for resolution should be further enhanced. Currently, both the prudential supervision and resolution functions of BdE report to the same Deputy

¹⁹ The preamble to Law 11/2015 (which allocates the resolution functions) states that once the processes currently under way have been completed, this institutional model will be reassessed to achieve greater efficiency.

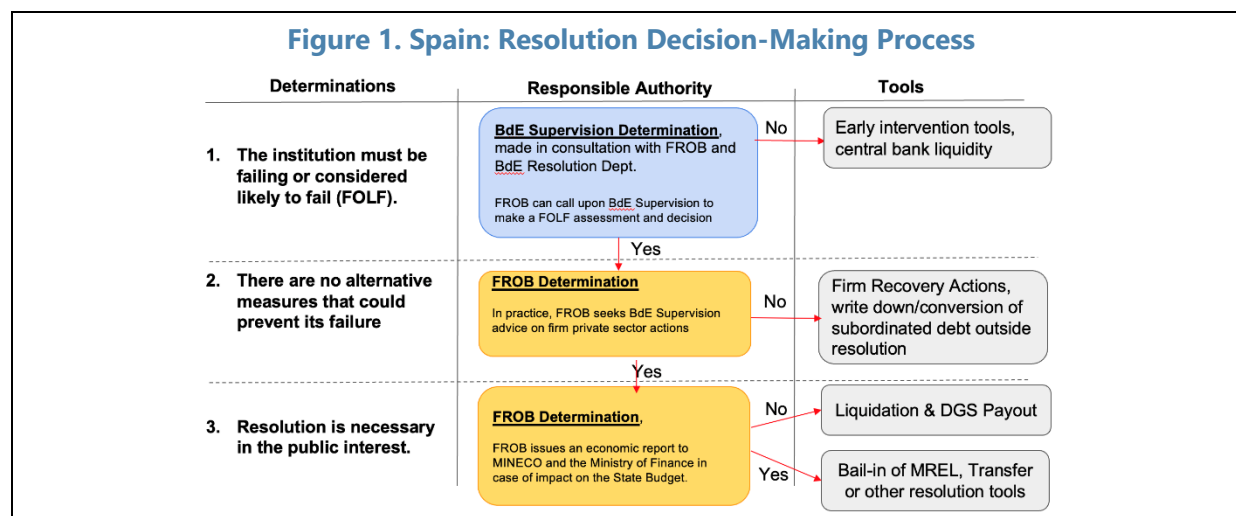
²⁰ The Deputy Governor of the BdE is the Vice Chair of the FROB Governing Committee, and it has three other representatives from the BdE, and three representatives of the MINECO, designated by the Minister; the Vice-Chair of the CNMV and two representatives of the Ministry of the Finance and Civil Service designated by the Minister. A representative each from the State General Comptroller and the State Legal Service also attend Governing Committee meetings.

Governor, and neither of the two concerned Directors General have voting powers at the BdE Executive Commission when deciding on supervisory or preventative resolution objectives. In comparable jurisdictions, it is more common for prudential supervision and resolution business areas to report to different Deputy Governors to manage the conflicts described above. An alternative option may be to provide the Director General for resolution with a vote on the BdE Executive Commission on matters related to preventative resolution. Integrating FROB into the BdE BRD may help with the appointment of external advisors from, as BdE is not subject to the same procurement rules.²¹ If the Spanish authorities decide not to integrate the preventative and execution resolution functions, the BdE should still enhance the operational independence of BRD, as discussed above, to manage potential conflicts of interest.

C. Entry Into Resolution

33. Taking a bank into resolution requires the assessment of three distinct conditions.

BdE's Directorate General Banking Supervision declares a bank to be failing or likely to fail in the case of a less significant institution, after consulting FROB and BdE's BRD (condition 1). FROB decides, with the support of BdE's Directorate General for Banking Supervision, whether the firm can take private action to recover its position and avoid failure (condition 2), and then FROB would assess whether resolution is in the public interest (condition 3). If all three conditions are met, FROB prepares and adopts a resolution scheme, which includes the specific resolution measures to be implemented. There are a range of collaboration arrangements and MoUs that describe the consultation process for triggering resolution. FROB is expected to issue an economic report (art 51(2) Ley 11/2015) to MINECO and the Ministry of Finance in case of impact on the state budget and required to seek MINECO approval if the resolution "action has an impact on the state budget."



²¹ Procurement at Banco de España is governed by Law 9/2017, of November 8 (Spanish Public Procurement Law) and its implementing rules, applicable to contracting authorities deemed not to be Public Administration, provided that they do not affect the autonomy of Banco de España.

34. BdE's Directorate General Banking Supervision does not have an established internal methodology or triggers to inform its judgement about when to conduct a condition 1 assessment for a firm experiencing stress. The procedures for coordinating FOLTF assessments between the three authorities are described in the BdE and FROB crisis management manuals. While these discuss a ranking of triggers for assessing condition 1 with reference to EBA guidance and SREP indicators, and FROB may call on BdE to make such an assessment, there is no explicit trigger framework or methodology that describes *when* BdE's Directorate General Banking Supervision will conduct such an assessment. This increases the risk of cases where condition 1 is judged as being met only after the firm's situation has deteriorated to an extent that orderly resolution is more difficult.

Recommendations

35. BdE's Directorate General Banking Supervision should define clear regulatory capital and liquidity ratio triggers to determine when a condition 1 assessment should be conducted. Currently, BdE's Directorate General Banking Supervision notifies the RAs if a bank has a SREP score of 3 or 4 and if it breaches one of a set of key indicators. However, existing supervisory frameworks do not explicitly address when to assess condition 1. Appropriate triggers could be similar to quantitative metrics in supervisory SREP scoring, triggers for reporting to the SSM (which include breaches of Pillar 1, 2, or leverage requirements), or bank recovery planning. This framework should be developed in consultation with FROB and inform FROB's exercise of the statutory powers to request an assessment of FOLTF. The triggers should form part of regular reporting between the supervisory and RA for firms on the BdE supervision watchlist, and should be at a sufficiently early stage to afford banks time to take recovery actions as well as for authorities to conduct the necessary contingency planning. A clear trigger for assessing when condition 1 assessment is conducted is met is also important to preserving structural separation between BdE's Directorate General Banking Supervision and FROB.

36. The FROB should develop an agreed assessment methodology for firms' recovery actions, based on which the FROB should request advice on condition 2. FROB cooperates with BdE's Directorate General Banking Supervision on the credibility of a bank's recovery actions when determining whether condition 2 is met. This cooperation would intensify following a BdE supervision determination that condition 1 is met. The FROB, in consultation with BdE's Directorate General Banking Supervision, should develop an agreed assessment methodology for firms' recovery actions based on which the FROB should request advice on condition 2. BdE's Directorate General Banking Supervision should ensure that it has any data required to inform the completion of the condition 2 assessment methodology or that firms have the reporting capabilities to provide it in short order.

PREPARING FOR FUTURE BANK FAILURE

A. Plans for Restoring Banks at Risk of Failure

37. Supervisors (BdE for LSIs and the ECB for SIs) are responsible for reviewing recovery plans developed by banks, considering the plan’s potential to maintain or restore quickly and effectively the institution’s viability. BdE’s Directorate General Banking Supervision also submits the recovery plans to the RAs (BdE’s BRD and FROB), which will assess whether the recovery actions included in the plans may impede the institution’s resolvability.

B. Bank Resolution Planning and Resolvability Requirements

38. BdE and the SRB have made good progress towards drawing up the resolution plans for all Spanish SIs and LSIs judged by the BdE’s BRD as likely to meet the public interest test and enter resolution on failure. BdE has drafted and adopted resolution plans for all LSIs, including credit cooperatives. There are 51 entities subjected to simplified obligations and 6 entities with full obligations, under the remit of BdE. During the resolution planning cycle 2024, BdE will update resolution plans for 30 LSIs (25 simplified obligations and 5 full obligations). Regarding the cooperative sector, an important consolidation process took place with the creation in March 2018 of an IPS. For entities assessed as likely to enter resolution on failure, the BdE’s BRD default preferred resolution tool is the sale-of-business (i.e., share or partial property transfer resolution).

39. BdE’s BRD has developed a public interest assessment (PIA) framework for LSIs as a basis for determining which LSIs should have resolution plans and MREL requirements. This PIA builds on the relevant SRB guidance for SIs and relies on gathering additional bespoke information from Spanish LSIs to assess the availability of substitutes and counterparty dependencies on a single LSI. Where BdE’s BRD determines an LSI as having public interest or that resolution is the best way to achieve the resolution objectives in the event of failure, a resolution strategy is established which requires firm-specific MREL requirements. The BdE’s BRD has set an MREL requirement for all Spanish LSIs with a resolution plan and they all comply with their minimum MREL requirements. Most Spanish LSIs rely on CET1 resources to comply with their MREL requirements. BdE has communicated bilaterally one piece of additional MREL-related requirements at a national level to address how IPS should be treated.

40. The BdE has not published any domestic-level guidance on non-MREL resolvability expectations for LSIs with a resolution plan. BdE applies the SRB Resolution Planning Manual and to draw up the LSI resolution plans. BdE’s BRD has recommended LSIs to comply with the EBA’s guidelines for institutions on improving resolvability²² and expects them to comply with the SRB’s “Expectations for Banks” (by 2025, rather than 2023 for SIs). Consistent with European-level guidance, the BdE’s BRD has communicated an expectation to Spanish firms that they must provide

²² [Final Report on Guidelines on improving resolvability for institutions and resolution authorities \(2\).pdf \(europa.eu\)](#)

a self-assessment report on their level of compliance with these resolvability expectations. BdE has not yet formally identified any substantive impediments to LSIs' resolvability to date.

41. Recent international experiences have shown how banks deemed non-systemic a priori can end up being systemic in a crisis. This implies that the preferred resolution strategy may not always be feasible in practice, and the RA should be ready to operationalize other resolution strategies if need be. To manage this risk, BdE's BRD considers a range of information to assess the public interest when defining which LSIs are within the scope of resolution. It takes into consideration: bank-specific data; the regional implication of LSI liquidation by developing an understanding of alternative service providers in each region; the implications for regional economies of LSI liquidation by assessing the extent to which the bank's counterparties are multi-banked or are solely dependent on the LSI; and the credibility and feasibility of LSI resolution strategies taking into account the institution FOLTF in a theoretical scenario of systemic crisis (system wide events).

42. LSIs will need to undertake significant work to comply with these resolvability expectations by 2025. Given that SRB and EBA resolvability expectations were finalized relatively recently (2020 and 2022 respectively), firms may find it challenging to develop the required capabilities in advance of the compliance deadline. In addition, many of the resolvability requirements will be novel to banks. Firms may also need additional input or guidance from the BdE's BRD on how to design their respective firm-specific resolvability capabilities and ensure they comply, particularly where the European-level policy lacks sufficient detail to support consistent firm implementation. This requires the BdE's BRD to have the resources and expertise to be able to respond to firm implementation questions and be ready to provide additional clarity on good or bad practices with respect to national implementation actions by firms. Currently, BdE conducts frequent bilateral calls, meetings and workshops for LSIs on these issues. As firms submit their self-assessment reports, the BdE's BRD is likely to face the additional challenge of assessing whether a diverse range of often very detailed firm specific approaches or system capabilities are sufficient to comply with the often high-level policy expectations.

Recommendations

43. BdE's BRD should continue to monitor LSIs' progress to becoming fully resolvable by 2025, and further develop its approach to identifying and removing impediments to resolution. To support consistent evaluation of firm-specific resolvability capabilities, the BdE's BRD should develop and publish a resolvability scoring framework for reviewing Spanish LSIs' self-assessment reports. Such a scoring framework will support the BdE's BRD in providing consistent feedback to LSIs on their self-assessment report reports and help ensure LSI deliver a comparable level of resolvability ahead of the 2024 compliance deadline. Such a scoring or evaluation framework will also support the prioritization of BdE's BRD verification of firm-specific capabilities and their on-going maintenance. Other NRAs will face similar evaluation challenges. As a result, the requirement to publish a resolvability scoring framework may also be addressed by publishing a Banking Union scoring framework. The BdE's BRD should work to ensure that banks comply with its resolvability expectations by 2025. Any issues the BdE's BRD identifies with LSI

self-assessment reports should be addressed as part of the resolution planning work plan with the bank and tested in collaboration with FROB. The BdE's BRD and FROB should also keep LSI resolution strategy assumptions under regular review. Recent international experiences have highlighted the importance of preparing for an alternative resolution strategy for cases where the preferred resolution strategy (transfer in the Spanish context) could not be implemented at the point of failure. Also, that technology continues to accelerate the speed of deposit outflows these experiences and their mitigants should be reflected in the firms' playbooks.

44. BDE in close consultation with FROB, should design a policy framework that describes the range of actions that should be taken by each authority when a firm no longer meets the MREL requirements. The objective of this policy should be to ensure that LSIs should enter resolution while still having sufficient MREL resources to ensure the resolution plan is feasible and credible. Such a policy framework is particularly important where LSIs rely on CET1 resources to comply with MREL requirements. This will help ensure that CET1 MREL resources are available to support orderly resolution when banks fail rather than having already been used to avoid the bank failure. Given the importance of MREL to ensuring orderly bank resolution, if barriers to achieving the objective of this policy framework are identified in the legal framework for assessing the conditions for removal of the authorization, these should be identified, and an analysis for how to overcome them should be considered at a national and European authority level where relevant.

C. Resolution Disclosures

45. Resolution disclosures can enhance market participants' understanding of how a resolution would be conducted and build market confidence in the ability of the authorities to manage a failing firm. Ex-ante disclosures may clarify expectations and strengthen market confidence in the resolution actions of authorities. They can help investors in making informed decisions regarding the risks they may expect to bear in resolution and as a result strengthen market discipline and public accountability, thereby disclosure can provide additional incentives for firms to remove barriers to resolvability. Disclosure of firm-specific resolvability assessment should also consider the need to protect commercially sensitive information or information protected by statutory confidentiality provisions, taking care in particular that the ex-ante disclosure of resolution strategies and plans does not constrain the RA's options to respond to the specific circumstances at the time of failure.

46. Although the transparency on banks' loss-absorbing capacity is improving, further progress is needed on publicly disclosing more aspects of the resolution regime. The Capital Requirements Regulation II (CRR II) and Bank Recovery and Resolution Directive II (BRRD II) introduced disclosure requirements on total loss absorbing capacity (TLAC) and MREL, respectively, covering, among others, the composition of own funds and eligible liabilities, the ranking of eligible liabilities in the creditor hierarchy and the firm specific MREL requirements. These requirements already apply to Spanish global systemically important banks (G-SIBs) and will apply to the remainder of Spanish banks, which are already subject to resolution if they failed, from January 1, 2024, or later if a bank has a longer transition period to meet its MREL targets. Similarly, in 2022, the

Bank of England published the findings from its first assessment of the resolvability of the major eight U.K. firms as part of the Resolvability Assessment Framework (RAF). It will publish the RAF for mid-tier banks in 2024.

Recommendation

47. BdE's BRD should continue to enhance the transparency of the Spanish resolution framework by publicly disclosing its policy documents and encourage firms to publicly disclose non-public parts of their resolvability assessments. For example, FROB published in December 2023 its approach to bail-in execution (see below). Considering emerging international best practice and FSB discussion papers on the topic,²³ BdE should consider how to require firms to publish the non-confidential parts of resolvability self-assessments.

D. Insurer Recovery and Resolution Planning

48. The Dirección General de Seguros y Fondos de Pensiones (DGSFP) regulates the Spanish insurance and pension markets. DGSFP is a department within the Ministry of Economic Affairs funded by the state budget. Two of the top 10 insurers in the country are domestic and owned by Spain's banks. The top five insurers by assets comprise 44 percent of the assets of all insurers. The 2017 FSAP recommended that DGSFP develop recovery and resolution plans for the five largest insurers.

49. Spain also has a well-functioning system for winding up insurance undertakings through the "Consortio de Compensación de Seguros", CCS, the Spanish insurance guarantee scheme. The CCS has supported the winding up of 300 insurers since 1984. The main tools of the CCS are the portfolio transfer and the purchasing of credits, whereby the CCS subrogates the rights of creditors against the insurance undertaking. The entire Spanish insurance market benefits from the existence of the CCS. All insurance contracts concluded on risks located in Spain, other than life insurance and export credit insurance, contribute to the CCS's fund. In an insurer winding up, the CCS pays the liquidator's expenses and only recovers after all creditors have been repaid at the end of the liquidation.

50. EU legislation to establish a recovery and resolution regime for insurance and reinsurance undertakings (IRRD) is being developed. The Spanish authorities will wait for the outcome of the negotiations before introducing new regulations on insurance resolution. Nevertheless, the DGSFP is working on establishing a crisis management group for MAPFRE Group (the only Spanish International Active Insurance Group) to enhance preparedness for and facilitate the recovery and resolution of the IAIG. In addition, a national regulation on insurer recovery planning is currently being prepared. A provision requiring insurers to prepare and keep updated a recovery plan has been introduced into the Draft Amendment to Law 20/2015. The law was

²³ Financial Stability Board Discussion paper "Public Disclosures on Resolution Planning and Resolvability", 2019.

published on the Ministry of Economic Affairs website on March 7, 2023 for public consultation.²⁴ If approved, the legislation will empower the DGSFP to apply recovery planning requirements for insurance and reinsurance undertakings. The requirement to draw up a recovery plan will be based on risk criteria (namely, size, business model, risk profile, interconnectedness, substitutability, and cross-border activity), which shall be assessed by the supervisory authority.

Recommendation

51. MINECO should take the next legislative opportunity to pass legislation giving the powers to the DGSFP to set recovery planning requirements for insurers. DGSFP should keep under review its approach to resolution planning for Spanish insurers, considering continuing IRRD negotiations.

MANAGING FAILED BANKS

A. Resolution Execution

52. For bank resolution plans to be credible, statutory resolution tools need to be usable, at speed and with confidence to impose losses on the banks' creditors through applying either the bail-in or transfer tools. The bail-in tool relies on imposing losses on the creditors holding loss-absorbing instruments (e.g., equity, debt capital and senior unsecured debt) by cancelling or reducing the value of their claims, thereby recapitalizing the bank ensuring that it can again meet its conditions of authorization. Transfer tools can achieve a similar outcome by stranding the bank's creditors holding loss-absorbing instruments in an administration while transferring good assets and other liabilities (e.g., deposits) to a bridge bank or a private sector purchaser.

53. FROB is responsible for executing resolution measures for all Spanish banks if they fail, regardless of whether they are classified as SIs²⁵ or LSIs. To support its implementation of resolution actions, FROB has developed an internal crisis preparedness program which outlines the actions, processes, decisions and supporting templates it would use to take swift action in a resolution, identify decision points and where coordination or inputs from other authorities are required. It has also shared with the industry a process for bail-in and sale of business tools which define respective authority, and bank and financial market infrastructure roles and responsibilities.

54. The FSB has noted that public disclosure of an authority's bail-in mechanics is essential to ensure credibility and predictability of resolution actions. Such clarity on authority bail-in mechanics allows other stakeholders, e.g., financial market infrastructures like Central Securities Depositories (CSDs), to take the coordinated action required to implement the bail-in. Since then,

²⁴

https://portal.mineco.gob.es/RecursosArticulo/mineco/ministerio/participacion_publica/audiencia/ficheros/ECO_SEG_20220416_AP_APL_Resp_Civ_Autos.pdf

²⁵ In the case of SIs, FROB would follow instructions by the SRB.

good progress has been made by authorities in Germany, the Netherlands, and the United Kingdom and by some banks, to define a bail-in mechanism. In February 2023, the EBA finalized its guidelines requiring NRAs to publish their approach to implementing the bail-in tool to ensure that a minimum level of harmonized information is made public concerning the mechanics underpinning the execution of the bail-in tool. During the FSAP Mission in October 2023 FROB was developing, and has since published for consultation in December 2023, its preferred mechanism for implementing the bail-in.

Recommendations

55. FROB should engage actively with industry to develop a shared approach to overcoming challenges associated with bail-in mechanics. FROB could provide more leadership on bail-in mechanics, particularly on the treatment of MREL liabilities that are common across the Spanish industry e.g., subordinated, and senior debt governed by Spanish law. To date, Spanish banks have responded to requests to provide information to the SRB and Spanish authorities but have not yet been involved in a strategic dialogue on overcoming the key policy issues related to establishing a fully operational bail-in mechanism. In designing bail-in mechanics, FROB should publish how it will navigate the key strategic policy choices related to designing a bail-in mechanic. This should include specifying: 1) the process for the identification of the eligible securities within the scope of the bail-in; 2) the process for suspending trading of securities within the scope of bail-in; 3) the process for suspension of, or change in, shareholder rights; 4) the process for write down and/or cancellation of equity and/or debt; and 5) the process for lifting the suspension of trading and shareholder rights.²⁶ Differences in national approaches (Annex II) to bail-in mechanics in part reflect different legislative frameworks. However, ensuring a common understanding of national approach to bail-in mechanics is critical to ensuring coordinated home and host cooperation in the resolution of a cross-border bank resolution. While the experience of using write-down and conversion powers in the Banco Popular resolution is highly valuable, FROB should actively engage with industry to road test its bail-in mechanism before finalization to gather feedback on the key mechanism design choices discussed above. In December 2023, FROB issued for consultation a policy document on bail-in execution.²⁷ It focuses on the external execution and the role expected from each participant and would provide transparency on the procedure for imposing losses.

56. FROB should actively engage with the relevant foreign authorities as part of a process led by the SRB to facilitate transfer strategies for internationally active banks. Given the emphasis on the use of transfer resolution tools in Spain, FROB should agree on arrangements for securing the necessary change in control approvals on an accelerated basis from foreign prudential

²⁶ Where bail-in mechanics were to envisage the use of interim securities, they should also consider: 1) whether there will be an issuance and trading of interim instruments as part of the mechanism; 2) the process for redemption of interim instruments (if used); and 3) whether the issuance of new equity is necessary.

²⁷ <https://www.frob.es/wp-content/uploads/2023/12/Mecanica-Recapitalizacion-interna-en-Espana.pdf>

supervisory authorities that may be required for Spanish banks with a multiple point of entry resolution strategy.²⁸

B. Liquidity in Resolution

57. It is essential to ensure banks in resolution have sufficient liquidity to meet their obligations as they fall due. In the first instance, failed banks recapitalized through the resolution process to meet authorization requirements will be expected to meet any liquidity needs from their own private resources. However, where the bank's liquid resources prove insufficient (e.g., despite being recapitalized through the resolution process they are unable to access private funding markets) the recapitalized bank would need to be able to access temporary liquidity assistance to ensure orderly resolution. Such temporary liquidity support to banks in resolution (e.g., immediately after the "resolution weekend" or as part of post stabilization restructuring phase of resolution) should be securable against a wide range of eligible collateral.

58. Central banks are becoming more transparent to the market about their functions as liquidity providers of last resort to solvent banks. This includes publishing relevant details on their crisis lending facilities e.g., Canada, Hong Kong, United Kingdom, United States, and Switzerland (Annex III). As a euro area member, the BdE is part of the common Eurosystem monetary policy operations. It carries out operations which form part of the monetary policy of the Eurosystem and is responsible for the settlement operations, collateral management and payment traffic related to these operations, and it also supplies TARGET payment system services. The BdE manages the engagement with all Spanish counterparties by keeping up to date the framework of rules for counterparties and collateral associated with the implementation of normal monetary policy. The BdE is also in charge of the related analysis and risk management. As a result, the BdE can manage credit risk related to collateral eligible under the Eurosystem monetary policy collateral framework. Under domestic legislation, the BdE is also responsible for "*ensuring the stability of the Spanish financial system*" as the lender of last resort. As for all Eurosystem NCBs, the published ECB ELA agreement forms the high-level harmonized basis for any BdE provisions of ELA in Spain. Under this ELA can only be provided in exceptional circumstances to a solvent institution facing temporary liquidity problems, and it always needs to be sufficiently collateralized. However, the collateral eligibility criteria can be different from those for normal monetary policy operations. The provision of ELA depends on each national central bank's framework, subject to the limitation resulting from the ECB ELA Agreement and the competences of the ECB Governing Council under article 14.4 of the ECB Statute, as well as to compliance with other principles of EU law. These include the prohibition of monetary financing, the principle of independence provided for in the Treaty of Functioning of the European Union, and the EU State Aid framework.

59. Recent international experiences have highlighted that a bank in resolution may require more liquidity support than the Single Resolution Fund (SRF) and the ESM backstop

²⁸ Multiple point of entry resolution strategies involve resolution powers being applied by the relevant RAs to two or more resolution entities in different jurisdictions, which should be coordinated by the home authority.

(once it is in place), can provide.²⁹ The ECB ‘Agreement on emergency liquidity assistance’ does not explicitly refer to resolution. Section 4.1.b, however, provides that a bank is considered solvent for ELA purposes if *“there is a credible prospect of recapitalization [...] by which harmonized minimum regulatory capital levels would be restored within 24 weeks after the end of the reference quarter of the data that showed that the bank does not comply with harmonized regulatory minimum standards; in duly justified, exceptional cases the Governing Council may decide to prolong the grace period of 24 weeks”*. Euro Area wide policy issues on liquidity in resolution will be considered as part of the upcoming Euro Area FSAP.

60. Within the limits set by the Euro Area framework, the BdE can at its discretion provide emergency liquidity to a bank in stress if it is solvent assessed on a forward-looking basis and meets other pre-defined eligibility criteria. BdE market operations rely on written confirmation of the SSM’s or BSD’s assessment of firms’ solvency position in assessing these ELA eligibility criteria. In addition, the BdE Market Operations Department has additional capacity to value some loan collateral at scale by relying on statistical valuation models focused on assessing credit risk. These models are informed by data on banks loan assets held in the Spanish central credit register. This register is a public database management service where virtually all the loans, credits, bank endorsements and risks in general that financial institutions have with their customers are recorded. The data recorded in the register reflect the information that such institutions have on their clients in their databases. The BdE does not conduct regular testing or collateral mobilization exercises with its counterparties with respect to its role in ELA. However, BdE has found useful the ad-hoc preparatory tests and dry-runs with counterparties experiencing liquidity constraints organized in the context of the European legal requirements.

61. The FSAP understands that the BdE has an ELA manual that describes the procedures envisaged within the Eurosystem’s ELA framework for the provision of ELA. BdE considers the firm’s financial position, the quality and quantity of unencumbered assets offered as collateral, the impact of not granting ELA on financial stability, and the expected duration of any ELA facility in response to any ELA application.

62. Lending against a wider range of collateral in a crisis, including loans, requires central banks to invest in capabilities to assess such new forms of collateral and its possible mobilization. Developing frameworks for pricing and defining haircuts or for mobilizing of such collateral takes time. These frameworks should be developed well in advance of a crisis. Given the BdE’s role in Eurosystem monetary operations, the BdE has the capabilities to assess the credit risk from, and to accept, a wide range of collateral, including covered bond securities and some loans. As a result, the BdE has some existing capability to manage the valuation challenges associated with analyzing the credit risk related to loan collateral for ELA or liquidity to bank recapitalized through the application of resolution tools.

²⁹ The SRF’s projected size is around EUR 80 billion as of end of 2023. The nominal cap for ESM loans to the SRF is set at EUR 68 billion.

Recommendations

63. The Spanish authorities should establish an approach to addressing liquidity needs to solvent entities pre-resolution and to banks that have been recapitalized through the resolution process. The potential expansion of the scope of banks entering resolution, following the April 2023 EC legislative proposal on crisis management and deposit insurance, will further underscore the need for more funding options available for use for banks recapitalized through the resolution process.³⁰

64. The BdE should publish a policy framework that clarifies its role as a lender of last resort for both solvent entities pre-resolution and to banks recapitalized through resolution. The statutory objectives of the BdE create flexibility for BdE, subject to certain conditions, to ensure banks recapitalized through the resolution process can access BdE backstop liquidity if required. If there are any national legislative barriers to this, they should be identified and addressed with MINECO. Such policy clarity on the BdE's role as backstop liquidity provider to bank recapitalized through the resolution process would be consistent with the IMF's Central Bank Transparency Code.³¹ Ex-ante transparency in relation to the policy framework would improve market participants' understanding of the available backstop facilities, facilitate firms' contingency planning and it would anchor the public's understanding of a central bank's role in the context of liquidity assistance to bank recapitalized through the resolution process. Such public accountability for BdE would then leave scope for a temporary reduction in real-time transparency, where financial stability would otherwise be threatened.³² BdE note that the provision of liquidity support to banks recapitalized through the resolution process would need to be assessed by the ECB Governing Council. Only if all the conditions for the provision of ELA are fully met—including the supervisor's confirmation that the entity can be considered solvent for ELA purposes, and the Governing Council does not object—could the BdE grant liquidity support.

65. The BdE should ensure that its capabilities to provide ELA and liquidity to banks recapitalized through the resolution process are fully operational. This work should include defining collateral (eligible or non-eligible for the Eurosystem monetary policy operations) that could be accepted for ELA purposes, the haircut methodology that would be applied, and the assumed pricing of such temporary crisis liquidity support and the possible channels of mobilization of such collateral. There should be a more formal and regular review of BdE counterparty ELA liquidity capacity based on eligible and non-eligible Eurosystem collateral. This review could form part of the BdE's internal ELA governance arrangements and would support a more rapid response in a crisis.

³⁰ European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/59/EU as regards early intervention measures, conditions for resolution and financing of resolution action (2023), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52023PC0227>.

³¹ <https://www.imf.org/external/datamapper/CBT/>.

³² Bank for International Settlements, Committee on the Global Financial System, 'Designing frameworks for central bank liquidity assistance: addressing new challenges', April 2017, <https://www.bis.org/publ/cgfs58.pdf>.

66. The BdE should regularly test (e.g., on an annual basis) its capabilities to provide liquidity to banks in resolution. This work should be focused on ensuring both that BdE operational procedures are robust, and firms are able to provide the information necessary to inform BdE lending decisions while making clear there would be no pre-commitment from BdE, or expectations that such liquidity will be granted if it were to be requested by a counterparty. Such testing will also facilitate firms developing internal operational procedures for meeting the BdE's security requirements in relation to the pledge/mobilization of the eligible and non-eligible Eurosystem collateral. This should include "encouraging" banks to pre-position their collateral at the BdE. Pre-positioning would involve the commercial banks identifying and the BdE assessing various types of collateral ex ante so that it need not be assessed at short notice in a sudden failure (e.g., a creditor run). Assessing pools of illiquid collateral can be complex and time-consuming. The BdE may not be able to lend much, if at all, against collateral where it has not had time to conduct sufficient due diligence. Prepositioning collateral well ahead of any need to draw ELA can significantly reduce mobilization risk and increase lending capacity, should the BdE decide to grant it. A benefit of more public and transparent liquidity arrangements in resolution is that facilitates such due diligence work being undertaken. In addition, the BdE should consider how to test its own ELA and liquidity lending arrangements through conducting simulation exercises or dry runs.

67. The BdE monetary operations department should formalize an approach with the BRD and FROB to assess the liquidity needs and available unencumbered collateral for Spanish banks in resolution. It should include agreeing liquidity forecasting and collateral reporting requirements and jointly assessing the liquidity capacity of banks by monitoring unencumbered collateral.

C. Deposit Guarantee Arrangements

68. The FGD is the second largest deposit insurance scheme in the EU in terms of volume of guaranteed deposits. It guarantees deposits of €884 billion and has 144 member financial institutions. The 0.8 percent of covered deposits target in Spain meets the minimum harmonized EU target. DGF ex ante funds currently exceed this by €8.1 billion (fourth quarter, 2023).³³ In addition, FGD can raise an additional ex-post levy from industry up to a maximum of 0.5 percent of covered deposits annually. Since 2019, FGD also maintains an additional funding capacity by means of a commercial loan facility agreement, currently subscribed with 10 credit institutions for amount to an additional €5 billion of financial capacity or 0.52 percent of covered deposits. The FGD's financial capacity would allow for the individual payout of all banks with a liquidation strategy, as well as the simultaneous pay out of several of them.

69. Under Spanish law, if the resolution is triggered, the FGD can only contribute to the cost of loss absorption but not the cost of recapitalization. Spain's approach to transposing this

³³ Minimum harmonization describes a piece EU of law (usually a directive but occasionally a regulation) that sets a threshold national legislation must meet. EU Member State national legislation may exceed the terms of minimum harmonization law and in that sense the EU law does not limit member states national discretion to go further.

aspect of the EU legislation³⁴ is different to some other EU member states who do not consider themselves limited in this way e.g., Finland, Sweden. FGD capacity to contribute to resolution costs is also limited by three statutory conditions: 1) the least cost rule; and 2) eligible depositor preference; and 3) the 50 percent cap of the target level of the FGD (0.4 covered deposits). The least cost rule requires the FGD contributions to loss absorption for banks in resolution to be capped at the amount it would have lost if the bank has entered liquidation and the FGD payout eligible protected depositors. Depositor preference in the EU gives insured depositor balances rank higher than other depositors—known as super preference. This EU requirement,³⁵ combined with a restrictive interpretation of the least cost test,³⁶ reduces the likelihood of the FGD suffering losses in a liquidation. Accordingly, this limits the likelihood it could contribute to resolution costs even if the resolution would provide a better outcome from the perspective of continuity of access for depositors and incur no higher costs net of recoveries for FGD. These factors limit the FGD's role in acting as a credible source of loss absorption and recapitalization capacity for LSIs in resolution. This challenge is increased because LSIs may have insufficient MREL on entry into resolution to meet the SRF 8 percent rule without imposing losses on uninsured depositors. If an LSI resolution cannot rely on FGD funds to bridge any gap between available LSI MREL resources at the point of failure and the SRF's 8 percent rule, this could create pressure to avoid resolution e.g., via nationalization, or result in disorderly resolution. The recent EU Crisis Management and Deposit Insurance (CMDI) proposal may align the insolvency ranking of all deposits, which would rank above ordinary unsecured claims. This would increase the likelihood that FGD would suffer a loss in the counterfactual insolvency analysis, thereby increasing its ability to contribute to resolution costs.

Recommendations

70. The Spanish authorities should use the flexibility afforded within the EU legal framework to facilitate FGD's ability to finance resolution. MINECO should consider an amendment to the national implementing legislation of the BRRD and DGSD that maximizes the flexibility of the FGD to contribute to any resolution costs, including those related to the recapitalization of banks in resolution. FGD should also have the flexibility to enter into loss-sharing arrangements³⁷ with acquirers to support transfer resolution strategies. Loss-sharing arrangements

³⁴ The BRRD says "When the bail-in tool is applied, the deposit guarantee scheme shall not be required to make any contribution towards the costs of recapitalizing the institution or bridge institution pursuant to point (b) of Article 46(1)".

³⁵ Under Article 108(1), the BRRD creates a three-tier depositor preference in the hierarchy of claims in a winding up. It provides that covered deposits and claims by the Deposit Guarantee Scheme must have 'super-preference' in the creditor ranking in the insolvency laws in each EU Member State relative to non-covered preferred deposits (the part of eligible deposits from natural persons and SMEs exceeding the coverage level of EUR 100 000). The latter must rank above the claims of ordinary unsecured creditors.

³⁶ The EU authorities' strict interpretation of Article 109 of BRRD prevents deposit insurers in the EU from providing upfront support greater than its estimated cost (net of recoveries in liquidation) without considering recoveries that could accrue in certain resolutions (most notably, in a partial transfer strategy): <https://www.imf.org/-/media/Files/Publications/WP/2022/English/wpiea2022002-print-pdf.ashx>

³⁷ Loss sharing arrangements can reduce the immediate recapitalization need at the point of transfer, are operationally simple, seamless to deposit customers of failed institutions, and support the rapid transfer of assets

(continued)

can reduce the immediate recapitalization need at the point of transfer, are operationally simple, seamless to deposit customers of failed institutions, and support the rapid transfer of assets into the private sector by providing downside insurance to the acquirer on the asset values. Any such use of loss sharing arrangements need to be subject to the least cost safeguards informed by appropriate valuation analysis. Any such support should be consistent with the no creditor worse-off than liquidation compensation risk principle and subject to relevant caps e.g., least cost and 50 percent of FGD funds. To ensure consistency in the assessment of the FGD least cost, the FGD should codify that it will rely on counterfactual insolvency valuation analysis provided by the FROB or a similar valuation methodology agreed in advance. While the final valuation outcomes will not be known until well after the resolution, a preliminary valuation analysis of the treatment of creditors on a gone concern basis in an insolvency should be used to determine the quantum of FGD funds that can be contributed to cover resolution costs. FROB should set out publicly its flexibility to use FGD funds to support resolution action to reduce any market uncertainty in a crisis and to support rapid authority action by minimizing any need to interpret statutory or policy flexibility in a crisis. This is not explicitly required by current legislation and FGD currently has no pre-defined approach to the calculation of the amount it could contribute to resolution costs.

FINANCIAL CRISIS PREPAREDNESS & COORDINATION

A. Inter-Authority Crisis Coordination

71. National financial crisis management authorities (namely, BdE, FROB, FGD) must clearly define roles, responsibilities, and operating procedures. Crisis management authorities should meet periodically in normal times to actively oversee the preparation and maintenance of national and authority-specific crisis plans and coordinate their engagement with firms to discuss synergies between different authority requirements, sequence requests and capture synergies. Regular intra-and inter-authority financial crisis simulation exercises with participation by senior policymakers, which should include relevant home and host authorities, are advisable to test and enhance operational preparedness.

72. The coordination arrangements between national authorities for the preparation, planning and execution of resolution measures is set out in Law 11/2015. In addition, FROB has signed cooperation agreements with both BdE and CNMV to enhance the coordination between authorities at different stages of the process—recovery, resolution planning and implementation of resolution measures. These MoUs are also designed to ensure the speedy exchange of information so the different authorities can correctly perform their duties. These cooperation agreements were first signed in 2018 and reviewed in 2021. To ensure that the planned collaboration is carried out in a satisfactory and efficient manner, two Collaboration Committees have been set up (one with BdE and FROB and the other one with CNMV and FROB). They are composed of representatives from each authority, meet every six months and can meet more regularly as necessary. Contact between

into the private sector by providing downside insurance to the acquirer on the asset values. Any such use of loss sharing arrangements need to be subject to the least cost safeguards informed by appropriate valuation analysis.

authorities inevitably intensifies, and the exchange of information increases in the event of contingency planning for bank resolution.

Recommendations

73. The authorities should continue to enhance cross-authority crisis coordination arrangements by establishing a national crisis management framework (CMF) for bank failure.

A CMF is designed to ensure the readiness of national-level crisis management arrangements for testing Spanish banks' resolvability capabilities, executive resolution powers and backstop liquidity provision. It should ensure that the National Handbooks and Operational Steps Documents developed by the FROB are fully tested and refined for the Spanish context and subject to regular crisis simulation exercises (CSEs).

74. The Spanish authorities should develop a coordinated approach to a firm's crisis preparedness across prudential, resolution and market operations. The aim would be to achieve a clear sequencing of authority requirements on the same firm over an agreed timeline. This is not to say that there is any trade-off or de-prioritization of one objective over another, but instead to recognize that firms need a holistic understanding of authority expectations when budgeting for and designing modelling and reporting systems capabilities.

B. Authority Crisis Management Capabilities

Crisis Simulation Exercises

75. Financial sector crisis simulation exercises (CSE) are essential tools for authorities to practice decision-making in the face of a financial crisis. A CSE is not a test or exam you can pass or fail. Instead, CSE can be used to ensure that participants learn about or exercise the use of an organization's approaches to crisis response or practice crisis management plans or procedures.

76. CSEs are an important part of how the authorities develop and maintain crisis management capabilities both within their own organization as well as across authority capabilities. There are two broad purposes for conducting different types of CSE, as follows: learning and testing. Learning-focused simulations are intended to raise awareness of crisis management issues and improve knowledge of the crisis organization, plans, procedures, protocols, etc. Such learning-focused simulations are targeted at discussing and gaming aspects of the crisis management framework and reactions of those individuals responsible for implementing that aspect and related decision-makers. Testing-focused simulations are designed to probe individuals, teams, and organizational preparedness and identify areas of strength or vulnerability. Such testing-focused simulations involve more elements of surprise (e.g., akin to a fire drill), with the scenario generally unknown to the players in advance. Learning and testing-focused simulations share the same design parameters (e.g., players involved, level of realism, the openness of scenario, context and setting, player role, timing, etc.) but may make different choices as to how each parameter should be arranged in a CSE.

77. The Spanish authorities have participated in a number of CSEs since the last FSAP in 2017. The BdE and FROB have participated in an SI focused crisis simulation exercise (CSE) with European Authorities and FROB has organized an internal LSI focused CSE. These exercises have been helpful in identifying a range of enhancements relevant to assessing internal MREL, the assessment of Condition 1, and business reorganization plans.

Recommendations

78. The BdE, FROB and FGD should formalize existing crisis management practices and prioritize by agreeing a cross-authority CSE strategy. Such CSEs will need to be supported by an operational manual for each authority reflective of their respective roles and responsibilities in crisis to help increase each authority's operational readiness, as well as ensure they are adequately resourced. FROB should engage with EU institutions to shape any SRB CSE priorities to ensure they reflect Spanish priorities. A CSE manual would help capture best practice established by Spanish authorities' experience to date and recognize the important role CSE play for the Spanish authorities in developing crisis management capacity. The manual should make clear the different purposes of crisis simulations: teaching versus testing. Such a crisis simulation manual would also help professionalize the role of CSE in sustaining crisis management capability while managing the risks of unintended outcomes from crisis simulation exercises undermining cross-authority or cross-border cooperation. This can best be achieved by tailoring the complexity of scenarios to the state of development of the authority's crisis operational processes, procedures, and wider arrangements.

Resources

79. The verification of firms' resolvability capabilities and the execution of resolution actions are extremely resource-intensive for RAs. RAs should have adequate staffing to cope with such cases internally and through the capacity to engage external parties. This demand on authorities' resources in a crisis continues long after the resolution action has been taken and involves executing the bail-in mechanism, overseeing the restructuring plan, ensuring the firm returns to normal liquidity markets, and responding to any litigation claims.

80. The FROB business model as an execution RA is based on rapidly upscaling resources in a crisis, relying on external advisory support. As a result, it has taken steps to improve its capability to rapidly increase its resources in a crisis by developing an external advisory procurement framework. This framework establishes a framework contract with pre-selected external professional advisory firms (e.g., valuation experts, strategic advisors, and legal advisors). In the run-up to resolution, FROB would launch a competitive process among these pre-selected candidates to award the contract. FROB's Governing Committee would decide to launch the tender and award the contract. It is estimated that the tender could be completed in approximately two weeks. If a situation demands valuation analysis before an external expert can be appointed, FROB has developed some limited in-house capacity to conduct resolution valuation and ensure it can respond to fast-burn crises.

81. Both authorities recognize that resolution cases are very demanding in terms of resources and staff. Since 2017, BdE's BRD staffing has increased from 26 to 33 divided into two divisions: policy and firms resolution planning. FROB has increased its capacity to full-time professional staff dedicated to resolution to 23, up from 21 in 2017. Both organizations describe staff turnover as low, which helps maintain scarce expertise. As evidenced by experience of the Banco Popular resolution, RAs need well prepared staff to cope with such fast burn cases, both internally, by enhancing cooperation among different authorities, and through the capacity to engage external parties at very short notice. These resources are required to update all the necessary information and to ensure preparedness to the maximum extent possible for a successful execution of the resolution. In addition, as noted above, firms will likely need additional input or guidance from the BdE's BRD and FROB on how to design their respective firm-specific resolvability capabilities and ensure they comply. This will necessitate the BdE's BRD to have the resources and expertise to be able to respond to firm implementation questions. This will place greater strain on BdE existing resources in assessing firm-specific proposals.

Recommendations

82. BdE's BRD and FROB should ensure sufficient resourcing to conduct work that has not been a major focus to date. This includes resolvability assessment and testing whether banks' resolvability capabilities are operational or not. Similarly, resolution implementation readiness will grow in focus as the FROB formalizes its resolution mechanics. Looking at jurisdictions with a financial sector of a similar proportion of GDP as Spain, the RA staffing level ranges from 30 to 100 permanent staff working on resolution policy, resolution planning and resolution implementation.³⁸

Procurement Rules

83. FROB has established an advisory framework agreement with panels of professional service providers to ensure it can appoint external advisers in an expedited manner in the run-up to resolution. The resolution will involve the appointment of advisers to perform different kinds of activity, such as an independent valuer to perform the resolution valuations and a special manager to replace the management of the firm under resolution. FROB existing framework agreements do cover financial advisers for resolution purposes. In the run-up to resolution, FROB would launch a competitive process among these pre-selected candidates to award the contract. It is estimated that the tender could be completed in approximately two weeks.

Recommendations

84. MINECO should provide FROB with the maximum flexibility where possible under national procurement legislation to allow it to depart from procurement rules in a crisis scenario to appoint quickly external advisory support including independent valuers. As

³⁸ In 2020, the Bank of England's Resolution Directorate had around 90 staff after ten years of operation. In 2019, the Hong Kong Monetary Authority Resolution Office had around 26 staff after only three years of operation. At end 2018 the Banca d'Italia's Resolution and Crisis Management Unit had 51 staff members, expected to increase to about 60. The Central Bank of Ireland resolution division had around 30 staff at end 2021.

evidenced by recent case experience, it may not always be possible to wait two weeks to appoint professional advisors required to prepare for and execute a resolution transaction. FROB's business model is based on rapid scaling up in a crisis through the leveraging of external resources. Therefore, FROB could be significantly constrained in discharging its statutory purpose to protect financial stability if it continued to be bound by all aspects of national procurement legislation. The flexibility to depart from procurement rules should be limited to in crisis, and not apply to any external advisory support FROB recruits for its preparation for future crises. This flexibility would better enable FROB to flexibility in jump to default resolution scenarios or liquidity-based drivers of bank failure where the time to conduct advance preparation can be significantly constrained, as was the case in Banco Popular resolution in 2017.

Table 1. Spain: List of Spanish Significant and Less Significant Institutions as of end-2023			
Number	Name	Type	RA
Significant institutions			
1	ABANCA Corporación Bancaria S.A.	Credit institution	SRB
2	Banco Bilbao Vizcaya Argentaria (BBVA), S.A.	Credit institution	SRB
3	Banco de Crédito Social Cooperativo, S.A.	Credit institution	SRB
4	Banco de Sabadell, S.A.	Credit institution	SRB
5	Banco Santander, S.A.	Credit institution	SRB
6	Bankinter, S.A.	Credit institution	SRB
7	CaixaBank, S.A.	Credit institution	SRB
8	Ibercaja Banco, S.A.	Credit institution	SRB
9	Kutxabank, S.A.	Credit institution	SRB
10	Unicaja Banco, S.A.	Credit institution	SRB
Less significant institutions with a BdE Resolution Plan involving use of resolution tools			
11	LSI Bank A	Credit Institution	BdE/FROB
12	LSI Bank B	Credit Institution	BdE/FROB
13	LSI Bank C	Credit Institution	BdE/FROB
14	LSI Bank D	Credit Institution	BdE/FROB
15	LSI Bank E	Credit Institution	BdE/FROB

Table 2. Spain: Banking Sector Structure (end 2022)¹					
Banks	end-2022			percent Change	
	# of firms	total assets (billion USD)	percent of banking sector	2012-2017	2017-2022
Domestic Banks	99	2.755,24	92.08	-31.47	10.77
Foreign Banks	94	205,17	6.86	-49.24	7.92
Subsidiaries	11	56,32	1.88	-55.46	0.07
Branches	83	148,85	4.97	-46.07	11.23
State-owned (if any)	1	31,76	1.06	43.39	-89.70
Total Banks	194	2.992,17	100.00	-29.23	0.21

¹ Source: BdE.

Bail-in Mechanics—Key Authority Design Choices

1. There are important variations between jurisdictions' bail-in mechanics. In designing its open bank bail-in mechanism, the FROB will need to be clear on its approach concerning these differences. The most material differences pertain to

- Valuation timelines: Some approaches assume that the final valuations of an SI and LSI can be concluded in a matter of days, while others assume a lengthier valuation process is required to arrive at valuation conclusions necessary to inform the final bail-in terms and losses to be imposed on creditors. Given the challenges associated with the rapid valuation of large and complex banks with the required level of certainty in a short period, any mechanism that assumes valuation outcomes in a matter of days will need to ensure banks' valuation systems and reporting capabilities can deliver such outputs while setting proportionate expectations on bank's reporting capabilities.
- Treatment of resolved bank shares: Some authorities assume that all shares in the resolved bank are cancelled, and new shares are issued to be distributed to the formed creditors as compensation. Alternatively, other authorities assume that existing shares are only suspended for the period until the completed resolution valuation can inform the final terms of the bail-in. In some jurisdictions, the former approach may necessitate additional regulatory approval processes, including prospectus, disclosure, and investor protection requirements. This is particularly important when a bank has issued MREL instruments to non-domestic investors. The expectation that authorities should engage at an early stage with foreign authorities on how to achieve resolution-specific exemptions from such requirements was set by the FSB *Principles on Bail-in Execution* published in 2018.¹
- Issuance of new shares: Some authorities propose to require the CSDs to create new shares on the issuance of the resolution order by the RA. It is often assumed that the stock exchange initiates the listing process for the new shares in the trading systems, preparing them for trading. Although the new shares have been created legally, a global note² is necessary for the technical creation of the shares at the CSD. Under this approach, the bank in resolution is responsible for creating the global note. The new shares/global notes will be allocated by the administrator to the former bondholders affected by the bail-in. Other authorities do not require the issuance of new shares under its certificates of entitlement mechanism. However, as noted above, some authorities envisage cancelling all shares in the resolved bank and requiring it to issue new shares to be allocated to former creditors in exchange for their right of claim. Under this approach, the statutory resolution order would be the vehicle used to facilitate the new

¹ FSB, Principles on bail-in execution, June 2018. <https://www.fsb.org/wp-content/uploads/P210618-1.pdf>

² A global note is a legal document that represents the entire amount of a certain issue or tranche of notes regardless of how many investors are involved.

shares being listed on the stock exchange and for amending the articles of association of the bank in resolution.

- Issuance of interim securities: Some authorities assume that interim securities (e.g., certificates of entitlement) are issued to the resolved bank creditors. These interim securities can be traded in the period between the resolution action and the final terms of the resolution valuation being available to inform the exchange process. For example, in the United Kingdom, issuing certificates of entitlement to former creditors of the resolved banks does not involve the acceptance of an offer by those creditors. Therefore, they do not need to comply with the listing authority or prospectus requirements to publish a prospectus, which is typically required on an offer of securities to the public or if securities are being admitted to trading on a regulated market. This is important as it means the certificates can be distributed on the Monday morning after the resolution weekend, providing clarity to the market on their economic entitlement in the resolved bank but well before the valuation on which the allocation of that economic entitlement will be based is completed.
- Compliance with change in control/other regulatory requirements: Some bail-in mechanics more explicitly address how compliance with supervisory change in control and other regulatory requirements (e.g., the CNMV role in supervising takeover bids, enforcing compliance with the Takeovers Directive and approving offer documents and prospectuses etc.) can be met, whereas others are less explicit about how their mechanism ensures that the new owners are fit and proper particularly given the challenges in identifying the holders or any interim securities or new shares in advance of any distribution or exchange process is completed. Regardless, an orderly bank resolution must demonstrate compliance with minimum authorization requirements and that its owners are fit and proper.

Resolution Liquidity Arrangements—Examples

1. Central banks and other authorities are becoming more transparent to the market about their functions as liquidity providers of last resort to solvent banks. This includes publishing relevant details on their crisis lending facilities:

- Under the Dodd-Frank Act passed in 2010, the U.S. Federal Deposit Insurance Corporation can draw on the Orderly Liquidity Authority with the agreement of the U.S. Treasury to provide temporary liquidity support to banks in a Title II resolution.
- In 2016, the Bank of Canada published a standing liquidity facility framework to support its function as lender of last resort for banks experiencing stress or in resolution.
- In 2017, the Bank of England’s sterling monetary framework and resolution liquidity framework set out the conditions for access to central banks’ liquidity against a wide range of collateral with transparent access criteria in the public domain.
- In 2019, the Hong Kong Monetary Authority (HKMA) published a comprehensive revamp of its liquidity facility framework and to reflect better the HKMA’s role as a lender of last resort in crisis management and resolution.
- In 2022, the Swiss Government announced plans to introduce legislation enabling the Swiss National Bank to bolster the liquidity of a systemically important bank in the process of resolution.