



# SPAIN

## FINANCIAL SECTOR ASSESSMENT PROGRAM

### TECHNICAL NOTE—BANK RESOLUTION AND CRISIS MANAGEMENT FRAMEWORKS

November 2017

This Technical Note on Bank Resolution and Crisis Management Frameworks for 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 in October 2017.

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October 31, 2017

# TECHNICAL NOTE

## BANK RESOLUTION AND CRISIS MANAGEMENT FRAMEWORKS

Prepared By  
**Monetary and  
Capital Markets  
Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Spain. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Please also see the Financial System Stability Assessment at <http://www.imf.org/~media/Files/Publications/CR/2017/cr17321.ashx>. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>.

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## Glossary

AMC	Asset Management Company
BdE	Bank of Spain
BRRD	Bank Recovery and Resolution Directive
CESFI	Financial Stability Committee
CMGs	Crisis Management Groups
CNMV	Comisión Nacional del Mercado de Valores
EBA	European Banking Authority
EU	European Union
FGD	Deposit Guarantee Fund
F/LF	Fail or likely to fail
FSB	Financial Stability Board
G-SIBs	Global Systemically Important Banks
G-SIFIs	Global Systemically Important Financial Institutions
IRT	Internal Resolution Teams
JST	Joint Supervisory Teams
KAs	Key Attributes of Effective Resolution Regimes for Financial Institutions
LSIs	Less significant institutions
MOE	Ministry of Economy, Industry and Competitiveness
MPE	Multiple Point of Entry
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
P&A	Purchase and assumption
RF	Resolution Fund
RRP	Resolution and Recovery Planning
RTS	Regulatory Technical Standards
Sareb	Asset management company
SI	Significant Institutions
SPE	Single Point of Entry
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SRMR	Single Resolution Mechanism Regulation
SSM	Single Supervisory Mechanism
TLAC	Total Loss Absorbing Liabilities

## EXECUTIVE SUMMARY

**The transposition of the Bank Recovery and Resolution Directive (BRRD) into Spanish law strengthened the resolution regime in Spain.**<sup>1</sup> Resolution powers in the past depended on the combination of public support, an asset separation tool (Asset Management Company, Sareb) and mergers and acquisitions. Those tools exposed the Spanish authorities to high public costs and were ineffective in the face of resolving large, complex institutions.<sup>2</sup> The BRRD established harmonized rules within the European Union (EU) for recovery and resolution of banks and investment firms; within the euro area, the Single Resolution Mechanism Regulation (SRMR) aims to establish uniform resolution rules and procedures—the BRRD and the SRMR are closely aligned with the Financial Stability Board (FSB)'s Key Attributes of Effective Resolution Regimes for Financial Institutions (KAs). The implementing national legislation contains a broad set of resolution tools and establishes a framework for improved recovery and resolution planning as well as coordination across the EU.

**The institutional framework has been strengthened and is more appropriate for managing the resolution process.** The BRRD identifies two stages for handling problem banks: the recovery stage and the resolution stage. The recovery stage is the responsibility of the supervisor and is aimed at keeping the entity in operation. The resolution stage is the responsibility of the resolution agency and is aimed at the orderly resolution of the entity. At the Banking Union level, the Single Supervisory Mechanism (SSM) is responsible for supervising all the significant entities. The Single Resolution Board (SRB) is the resolution authority for such entities, as well as for cross-border groups. In Spain, the banking resolution roles have been distributed between two authorities. The BdE is both the supervisor and shares responsibility for resolution planning with the SRB. FROB is the resolution authority that approves and implements the resolution schemes.

**Responsibility for supervision and resolution of institutions is divided between the European level and national level.** The 14 institutions identified as Significant Institutions (SIs) are supervised by the ECB with operational support from the BdE, in line with the common supervisory framework applied in Europe. Moreover, the recovery plans prepared by the institutions are reviewed and overseen by the ECB and the Bank of Spain (BdE). Oversight of the 56 remaining less significant institutions (LSIs) banks is the direct responsibility of the BdE, which is responsible for supervision and Resolution and Recovery Planning (RRP) but operates under the general oversight of the ECB and the SRB.

**While the framework for bank resolution is well designed, the system could be enhanced.** The broad framework for crisis management can be strengthened and steps can be taken to make the bank resolution framework more effective in Spain.

<sup>1</sup> This technical note was prepared by David Hoelscher (IMF consultant), part of the Spain FSAP 2017 team led by Udaibir Das. The analysis has benefitted from discussions with the staff of the Ministry of Economy and Justice, the Spanish Treasury, the Spain FSAP team, and reviewers at the IMF.

<sup>2</sup> For a description of the resolution of the Spanish banking crisis from 2009 to 2012, see the Spain FSAP 2017 Technical Note on Impaired Assets and Nonperforming Loans.

**Recovery planning for Spanish banks is progressing but further progress is warranted.**

Recovery plans are prepared by the banks and reviewed by the supervisory authorities. The recovery plans identify measures that will be taken when the institution is under distress but remains a “going concern.” The ECB and BdE have received recovery plans from most institutions. All of the 14 SIs have approved recovery plans. The recovery plans for the 56 LSIs are tailored to reflect their structure. The BdE has authorized the use of simplified recovery plans for the 13 smallest institutions. Such simplified plans can require fewer stress tests, less frequent updating (possibly every three years), and only a minimum list of financial indicators. The BdE has approved 2 of 13 simplified plans. The remaining 41 LSIs have all prepared full recovery plans, of which 39 have been approved.

**The updating of recovery plans is critical to ensure that the plans are effective.** SIs update their plans annually or when there is a material change in the institution or the operating environment. The smaller LSIs, however, have a longer period between updates, sometimes lasting up to three years. Supervisory oversight should ensure that recovery plans are updated whenever there is a change in the entities’ risk profile.

**All banks in the EU, no matter their size, are subject to resolution planning requirements.** Such resolution plans are prepared by the resolution authorities and include measures for the resolution of the firm. For SIs, the SRB is responsible for preparing the resolution plans. In the Spanish case, plans for the SIs are prepared by the SRB with participation of the BdE and FROB through the Internal Resolution Teams (IRT). For LSIs, the BdE as the national resolution authority is responsible for preparing the resolution plans and assessing resolvability. The BdE shares them with FROB, which is required to issue a non-binding report, and then with the SRB for review and consistency checks. The BdE gives final approval; and FROB executes all resolution schemes, both for SIs and LSIs.

**The preferred resolution strategy differs among institutions.** Resolution plans were developed by the SRB for 10 SIs during 2016 with an additional two transitional plans prepared in 2017. The SRB has adopted a multiple point of entry resolution model for the two global banks (BBVA and Santander), which maintain fully independent subsidiaries. Since most of the remaining SIs are not holding companies and do not have significant global operations, resolution will use the resolution tools embedded in the BRRD, including sale of business, bail-in, or a combination of tools that includes the creation of a bridge bank.

**The framework for bank resolution may be only partially effective for crisis management purposes.** Tools needed to resolve an idiosyncratic bank failure, even the failure of a large and complex institution, are different from those necessary in managing a systemic crisis. In this latter case, cross-institutional coordination is essential and policy tools will need to be used to address a systemic collapse of the financial sector. Consideration could be given, therefore, to establishing a cross-institutional forum or entity to monitor emerging risks and act as a forum for developing and coordinating appropriate policy responses to financial distress. One option is to rely on the proposed Systemic Risk Board to fulfill this function (see aide-memoire).

**The Deposit Guarantee Fund (FGD) plays an important role in preserving financial stability.**

Deposit protection is a central pillar of bank resolution. Accordingly, as the crisis management functions mature, the operations of the FGD could be strengthened and brought into that framework. The FGD is a simple pay box plus, responsible for paying depositors and providing some resolution financing. Accordingly, it has a fiduciary responsibility to manage industry funds. As such, its perspective in crisis management considerations can be helpful. A number of steps have already been taken to improve operations. Specifically, a schedule of stress tests will be run to examine the robustness of internal systems. Nevertheless, some steps can be taken to make the payout process more effective. Both organizational and procedural changes will be needed if the FGD meets its objective of paying out deposits in seven working days. In addition, the revenue base of the FGD could be strengthened and a source of emergency back-up funding for depositor payout should be introduced to ensure private sector confidence in the insurance system. Finally, the safeguards surrounding the use of deposit insurance funds in resolution should be strengthened. In particular, if FGD resources are to be used, it should participate in the resolution decisions. Currently, private bankers participate on the Board. There are restrictions placed on directors participating in any discussion of their own bank but the firewalls could be strengthened. Private sector participants should be restricted from any discussion of any specific bank in the financial system. As firewalls are established between the public sector and private sector Board members, the FGD, should also participate in any inter-governmental crisis group (as manager of the funds).

**Resolution is a two-staged process.** First, the pertinent authorities determine that the institution is failing or likely to fail (F/LF). In the case of SIs, both the ECB and the SRB have the power to determine if an institution is F/LF while in the case of Spain only the BdE may make such determination for LSIs. Once F/LF is determined, the resolution agencies review if the other conditions for resolution are met. They first examine whether there is a private sector alternative or supervisory action and, if a resolution action is in the public interest. If they find there is no reasonable prospect for a private-sector solution and that such public interest exists, the relevant resolution agency (the SRB or FROB) prepares the resolution scheme. For SIs, the scheme requires the European Commission's approval, which may result in amendments to the scheme. The European Commission must involve the Council of the European Union (EU Council) in certain situations. While the decision to find an entity F/LF by the authorities is subject to review by the Spanish courts, the court cannot reverse the decision.

**The BRRD introduced four principal resolution tools for the resolution of SIs.** Those tools are (i) sale of business, (ii) establishment of a bridge bank, (iii) an asset separation power, and (iv) bail-in powers. The Spanish authorities opted not to include the optional government stabilization tools authorizing nationalization and the use of government financing. FROB has the legal authority to exercise the resolution tools and needs no additional legal authority to implement the tools. There are no regulations or circulars that must be drafted to operationalize the resolution tools, including bail in powers.

**Notwithstanding this progress, steps to operationalize these tools remain to be completed.**

While the mechanics of the bridge bank and asset separation tools are well established, financing

the operations remains under review. The use of bail-in powers would be an important element of such tools. However, not all SIs in the Spanish market hold an adequate level of loss-absorbing securities to implement a recapitalization. Moreover, MREL requirements and the transition period to meet them are yet to be determined, in part due to the fact that regulations of MREL are currently under review.

**As with SIs, there are challenges in implementing the resolution tools for LSIs.** However, there are some small LSIs that play critical regional roles in financial intermediation. In some areas, a single LSI may be the only provider of financial services to the population. Such LSIs primarily hold deposit liabilities and the resolution tools for such institutions are limited. Mergers and acquisitions by other LSIs or larger institutions may or may not be a viable option. A strategy for the resolution of such LSIs should be developed. Consideration could be given, for example, to accelerating the placement of loss-absorbing securities. Alternatively, a resolution fund, financed by the industry, could provide a source of financing for the smaller institutions. If unresolvable using available resolution tools, such institutions should be subject to enhanced supervision and enhanced capital requirements.

**Given that these resolution instruments are new, crisis simulations should be run.** Two types of simulations could be considered. First, individual authorities such as FROB and the BdE could test their internal systems. Second, a coordinated systemic crisis exercise could be conducted. Such systemic crisis simulations examine and test the mechanisms for sharing diagnoses of emerging distress, test information sharing among agencies, and test the ability to develop a coordinated policy response that is consistent across all agencies.



<b>Table 1. Main Recommendations for Bank Resolution and Crisis Management</b>		
	<b>Priority</b>	<b>Authority</b>
<b>Institutional Arrangements</b>		
Establish a cross-institutional entity for risk evaluation and crisis management.	Short term	MoE
Consolidate FROB and the Resolution Department of the BdE	Medium term	MOE
Include the FGD in any cross-institution entity for crisis management.	Immediate	MOE
<b>Crisis Prevention</b>		
Ensure risk profile of LSIs monitored and updated frequently.	Immediate	BdE
<b>Crisis Management and Resolution Regime</b>		
Continue development of manuals, checklists and staff training for the new resolution tools introduced through the transposing of the BRRD.	Immediate	BdE/FROB
Develop a strategy and legal tools for resolving LSIs located in regions where there are few alternative institutions	Immediate	MOE, BdE/FROB
<b>Safety Net Arrangements</b>		
Conduct crisis simulations at the institutional level (BdE, FROB).	Short term	BdE/FROB
Conduct crisis simulations at a cross-agency level.	Medium term	Moe
Enhance the ability of FGD to payout deposits in a timely manner.	Short term	FGD
Establish an emergency/back-up liquidity system for FGD.	Short term	BdE/MoE
Ensure that FGD has a voice in any use of its funds for resolution.	Medium term	MOE
Consider making FGD a fully owned government institution and remove private bankers from the Board.	Medium term	BdE/MoE

## INTRODUCTION

1. **Spain's financial system is dominated by the banking sector.** The banking system accounts for about three-fourths of financial sector assets. The rest of the financial sector includes insurance companies, pension funds, mutual funds and financial vehicle corporations.
2. **The oversight of financial institutions in Spain is undertaken by a wide range of agencies.** Banking supervision is jointly conducted by the ECB and Banco de España (BdE). Bank resolution is the joint responsibility of the Single Resolution Board (SRB), the BdE (for resolution planning) and FROB for execution of resolution. Other institutions supervise the non-bank financial system. Insurance and pension funds are under the supervision of the Ministry of Economy, Competitiveness and Industry (MEC). The Comisión Nacional del Mercado de Valores (Securities Market Commission, CNMV) is in charge of capital market oversight and has been designated as preventive resolution authority for investment firms. And finally, Fondo de Garantía de Depósitos de Entidades de Crédito (Deposit Guarantee Fund of Credit Institutions) is in charge of deposit guarantees up to the limit of 100,000 euros per depositor and credit institution.
3. **Significant changes were introduced in the legal basis for bank resolution.** In 2015 the legal framework was significantly modified, as the BRRD was transposed into the Spanish legal framework; the SRMR, which aims to establish uniform resolution rules and procedures in the euro area, is directly applicable in Spain. Those legal changes are now being operationalized as Spain moves its resolution system in line with EU standards.
4. **The treatment of nonbank institutions is covered in companion Technical Notes.** This note focuses on the institutional and policy issues on bank resolution. Issues of insurance and securities remain important for financial stability. Insurance companies are required to develop their own recovery and resolution plans and the insurance regulators establish the guidelines for such plans. Similarly, the failure of any such institution is addressed through the regulatory bodies specializing in the sector. The CNMV is entrusted with the same powers and functions (as regards prudential supervision as well as recovery and preventive phase of resolution) for investment firms as the BdE for LSI. These companion Technical Notes proved an important perspective on the authorities' policies to achieve and maintain financial stability.

## INSTITUTIONAL ARRANGEMENTS

### A. Institutional Arrangements for Crisis Prevention

#### European Level

5. **Prudential supervision in Spain falls under the scope of the SSM.** Under the SSM, the ECB, with support from the BdE, directly supervises banks identified as "significant institutions" (SIs) based on criteria including balance sheet size. While less significant institutions (LSIs) are supervised

by national supervisory authorities (see below), it is carried out under a common legal framework derived from the CRD IV/CRR, the BRRD, and EBA standards and guidelines.

**6. For Spain, the SSM has identified 14 institutions as SIs, representing more than 90 percent of total banking system assets.** The ECB conducts supervision of these banks through Joint Supervisory Teams (JSTs), which are co-led by the BdE. The JSTs are also responsible for reviewing the recovery plans prepared by the institutions. While the BdE has responsibility for supervising LSIs, the ECB oversees that supervision. The BdE reports on supervisory results and the ECB reviews with the objective of ensuring consistent application of high supervisory standards.

### National Level

**7. Institutional structure of safety net is composed of the following institutions:**

- Ministry of Economy, Industry and Competitiveness.
- Banco de España, supervisory authority and preventive resolution authority.
- FROB, executive resolution authority.
- Deposit Guarantee Fund.

**8. The LSIs are the responsibility of the Spanish authorities under the oversight of the ECB.** The BdE supervises the 56 LSIs including, savings banks and credit cooperatives plus other financial institutions including foreign branches, specialized lending institutions, electronic money institutions, payment institutions, mutual guarantee and re-guarantee companies, currency exchange establishments, and valuation companies.

## B. Institutional Arrangements for Bank Resolution

### European Level

**9. Bank resolution within the Banking Union falls under the Single Resolution Mechanism (SRM).** Within the SRM, responsibility for developing the specific resolution options and resolution decision-making is exercised by the Single Resolution Board (SRB) through SRB-led IRTs, which include staff from the BdE and FROB. The SRB's responsibility includes all SIs, all cross-border banks, and any LSI where the resolution requires the use of the Single Resolution Fund (SRF). FROB is responsible for executing all resolution schemes.

**10. Once the ECB (or the SRB) determines that the institution is failing or likely to fail, the SRB begins the resolution process.**<sup>3</sup> It requests asset valuation information and determines if there are available private sector solutions (including possible acquirers) and if it is in the public interest to

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<sup>3</sup> The SRB can also request the ECB to review a financial entity to determine if it is F/LF and the ECB must respond within three days. If the ECB, within three calendar days upon receipt of that information, does not make such an assessment, the SRB may also make it.

resolve the bank. The IRT conducts the analysis to assess the public interest in maintaining the institution and designs the appropriate resolution scheme.

## National Level

**11. In November 2015, the BRRD was transposed into Spanish legislation.** That legislation introduced the resolution tools including sales of business, bridge banks, P&A, and bail in authority. The legislation does not include the two optional government stabilization tools, equity support and temporary government ownership.

**12. The BdE in its role as resolution authority is responsible for the resolution planning for LSIs.** The BdE prepares resolution plans for each LSI and conducts resolvability assessments. Most of these plans are updated on an annual basis. For the 13 groups for whom simplified resolution plans are prepared, these plans may be updated less frequently. Once prepared, the plans are submitted to FROB, which is required to issue a non-binding report, and to the SRB, which reviews the consistency of the plan with European rules and guidelines.

**13. FROB manages the restructuring and resolution processes for both SIs and LSIs.** It was created in 2009 to channel public financial support to financial entities. In 2012 its resolution powers were enhanced and further strengthened by Law 11/2015, which sets out its current legal structure, role and powers. It is a 100 percent state-owned entity. Its Governing Committee is led by FROB's Chairman, with the Deputy Governor of the BdE as the Vice Chair, and additionally composed of three other representatives from the BdE, three representatives from the Ministry of Economy, Industry and Competitiveness, the Vice-Chair of the CNMV and two representatives from the Ministry of Finance. Governing Committee meetings are also attended by a representative from the State General Comptroller and the State Legal Service.

**14. FROB is provided sufficient information to monitor the LSIs.** It receives supervisory information from the BdE on LSIs and monitors them. The objective is to prepare for identifying and implementing any resolution scheme. Once an institution is found F/LF by the supervisory authorities, FROB determines if there are private sector solutions and determines the public interest in maintaining the institution. It then prepares a resolution scheme, which includes the specific resolution measures to be implemented. Once prepared, the scheme is submitted to the SRB, which may express any concern regarding consistency with EU rules. In addition, FROB is also responsible for collecting and managing the Spanish Resolution Fund and plays a coordinator role of the Spanish resolution authorities in international fora, which includes the Spanish representation in the SRB Plenary and Extended Executive Meetings.

**15. The Deposit Guarantee Fund (FGD) is a private institution guaranteeing bank deposits up to €100,000.** FGD has a Board with representation from both the government and the industry. All deposit-taking institutions must be a member of the FGD, The FGD fund is financed by contributions from the industry.

**16. Within the SRB, a Task Force on Crisis Management was created in which both BdE and FROB participate. This Task Force analyzes, discusses and prioritizes work on crisis management.** Among others, its main tasks include drafting a crisis management manual, operationalizing the bail-in tool, and analyzing the interaction between the bail-in tool and normal insolvency proceedings.

**17. On a national level, in 2006, the Spanish authorities established the Financial Stability Committee (“Comité de Estabilidad Financiera”—CESFI).** The CESFI is chaired by the Secretary of State for Economy and is composed of the Deputy Governor of the Bank of Spain, the Vice-President of the CNMV, the Secretary General of the Treasury and Financial Policy and the Director General of Insurance and Pension Funds. A department in the Treasury acts as the CESFI Secretariat. The objective of the CESFI was to review systemic risk. It is responsible for the risk analysis and is expected to meet at least twice a year and hold emergency meetings as needed in the face of financial. While the CESFI met several times between 2007 and 2012, its last meeting took place in April 2013.

### C. Recommendations

**18. The institutional framework for resolution could be strengthened and complemented with arrangements for crisis preparedness and management:**

- The bank resolution framework may be less effective for crisis management purposes. Consideration could be given to establishing a cross-institutional forum or entity to monitor emerging risks and act as a forum for developing and coordinating appropriate policy responses to financial distress. Such an entity could be formed either by a re-invigorated CESFI or by expanding the role of the macroprudential unit that is under consideration (see Section IV).
- Bank resolution is conducted by two institutions: The Resolution Department of the BdE and FROB. The functions of both institutions are closely related. While coordination and information sharing is currently adequate, consolidation of the two functions could enhance effectiveness. Such consolidation could occur either by merging FROB into the BdE or by merging the BdE’s resolution unit into FROB and maintaining FROB as an independent agency. The benefits of merging them into the BdE include enhanced coordination and information sharing. The benefits of a separate resolution agency include clear independence and unambiguous mandates of the institution. No matter how the consolidation were to occur, eventually separating a holding company function for the failed institutions from the resolution agency is warranted as the skills needed for the two functions are distinct.
- The FGD plays an essential role in the safety net. As crisis management functions mature, the FGD could be brought into that framework. Because the FGD is both responsible for paying depositors and financing some aspects of resolution, its perspective in crisis management considerations can be helpful.

## CRISIS PREVENTION REGIME

### A. Recovery Planning

#### European Level

**19. All banks in the EU, no matter their size, are subject to recovery planning requirements.** Recovery plans are prepared by the banks and reviewed by the supervisory authorities. The recovery plans identify measures that will be taken when the institution is under distress but remains a “going concern.” Full recovery plans should include (i) a description of essential operations, (ii) a description of critical functions and core business lines, (iii) measures to decrease the institution’s risk profile, (iv) capital conservation measures, and (v) strategic options such as the divestiture of business lines. Plans may also include measures to restructure liabilities. Such plans should also provide the firm’s views on resolution scenarios, the triggers for recovery actions; and a description of the processes for determining the value and marketability of critical functions. It is expected that these plans are updated annually.

**20. Recovery plans must be revised on a regular basis.** For SIs, these plans must be updated at least every year or when either there are changes to the legal and organization structure of the institution or when required by the supervisor. Parents of groups with subsidiaries under SSM supervision prepare recovery plans for the group as a whole. If subsidiaries are not supervised by the SSM, separate recovery plans are prepared and then consolidated into the group’s recovery plan.

#### National Level

**21. In Spain, all financial institutions are required to prepare recovery plans.** The ECB is responsible for reviewing such plans for the SIs while it delegates responsibility for reviewing recovery plans of the LSIs to the BdE. Recovery plans are also reviewed by the resolution authorities (the SRB for SIs and FROB for LSIs). In all cases, the ECB reviews such plans for completeness and consistency.

**22. Recovery planning for Spanish banks is progressing in line with Banking Union requirements.** All of the 14 SIs have submitted full recovery plans. The recovery plans for the 54 LSIs are tailored to reflect their structure and conditions in the market. The BdE has allowed the smallest institutions to prepare simplified recovery plan, which are short and largely contain information on the structure and valuation of assets. Currently, there are 13 of the 54 institutions that have such simplified recovery plans, which require fewer stress tests, more infrequent updating (possibly every three years), and only a minimum list of financial indicators. For the remaining 41 LSIs, the BdE requires full recovery plans. While all LSIs have presented recovery plans, the BdE has not approved any to date. Final decision is expected by September 2017.

**23. The plans reviewed thus far have had several limitations.** Most frequently, the plans did not present adequate information for the BdE to evaluate the proposed recovery options. Plans have tended to include only a broad outline of the methodology and valuation assumptions. Moreover,

some plans lacked a full assessment of the impact of the recovery options, a description of communication plans, and only included limited descriptions of how the recovery plans will be implemented.

## B. Early Supervisory Intervention

**24. Early supervisory intervention measures are adopted by either the ECB (for SIs) or the BdE (for LSIs).** Triggers for early intervention include a low score on the Supervisory Review and Evaluation Process (SREP) rating (an overall SREP score of 4 or below), the deterioration of key financial indicators, or any other significant event that could have an impact of the viability of the affected institution.

**25. The ECB and the BdE have an extensive array of early intervention powers.** The ECB or BdE may, for example, direct an institution to change its business strategy, and implement elements of its recovery plan. Where these powers are insufficient to reverse the deterioration, the ECB or BdE may remove or replace one or more members of an institution's senior management or management body. Finally, the ECB or BdE may appoint a 'temporary administrator' to carry out all or part of the management functions of the institution.

## C. Recommendations

**26. The updating of recovery plans is critical to ensure that the plans are effective.** Recovery plans are prepared by the institutions and reviewed for consistency and completeness by the relevant authorities. SIs update their plans annually or when there is a material change in the institution or the operating environment. Some LSIs, however, may have to update recovery plans on a more infrequent basis, possibly only every three years. While LSIs may not be systemic, their failure may have a significant regional impact on financial intermediation. Accordingly, consideration could be given to ensuring that recovery plans are updated whenever there is a change in the entities' risk profile. If such updating proves to be too burdensome, only critical elements of the plan could be updated on a more frequent basis.

# CRISIS MANAGEMENT AND RESOLUTION REGIME

## A. Resolution Planning and Resolvability Assessments

### European Level

**27. All banks in the EU, no matter their size, are subject to resolution planning requirements.** Resolution plans are prepared by the authorities and include measures for the resolution of the firm. The plans may include scenarios for the wind-down of operations and actions to maintain critical economic services in home/host jurisdictions. Such critical services may include sustained access to payment services and insured deposits, as well as the preservation of core business lines and operations

**28. For SIs, the SRB is responsible for preparing the resolution plans.** In the Spanish case, plans of the 14 Spanish SIs are prepared by the SRB through the IRTs. Those teams are formed for

each SI or group of SIs, and are composed of staff from the SRB, BdE, FROB, and other relevant resolution authorities.<sup>4</sup> Content of the plans were determined by the final draft of the Regulatory Technical Standards (RTS) on resolution plans. The assessment of resolvability includes a description of the preferred resolution strategy for each institution.

**29. As part of the review, the SRB, with input from the IRT, assesses the institution's resolvability.** That resolvability assessment seeks to ensure that the maintenance of critical business lines and material legal entities is likely to be successful under a range of market environments. Resolution plans also identify potential impediments to orderly resolution. The SRB works with the institution to address those impediments to orderly resolution identified in the resolution planning process.

**30. The preferred resolution strategy differs among institutions.** Resolution plans were approved by the SRB for 10 institutions during 2016 with an additional two transitional plans prepared. The SRB has supported a multiple point of entry resolution model of two of the global banks (BBVA and Santander). They maintain a corporate structure that relies on independent subsidiaries, fully integrated into the host economies. As there is little central control, the multiple point of entry model appears more effective. Most of the remaining SIs are not holding companies and do not have significant global operations but, rather, own subsidiaries wholly located in Spain. As such, the SRM will rely on resolution tools contained in the BRRD, including sale of business, bail-in, or a combination of tools that includes the creation of a bridge bank.

## National Level

**31. All banks at the national level are subject to resolution planning, irrespective of their size or complexity.** For LSIs, the BdE as resolution authority is responsible for preparing the resolution plans and assessing resolvability. The plans also include an assessment of resolvability, which contains a description of the preferred resolution strategy for each institution. Once finalized, the plans are sent to FROB for the mandatory issuance of a non-binding report.

**32. FROB receives the resolution plans and provides input and suggests modifications before they are submitted to the SRB for their review and subsequently finalized by the BdE.**<sup>5</sup> FROB has received four resolution plans thus far with an additional 25 expected to be submitted in 2017. These resolution plans build on the strategies identified by the resolution authority for each category of banks, and set out the resolution options and means of implementation for each bank. In most cases, the resolution plan will include sale of business, bail-in, or a combination of tools that includes the creation of a bridge bank.

## B. Entry into Resolution

**33. The BRRD lays out the conditions for entry into resolution.** The resolution decision process will be initiated when the institution is failing or likely to fail. Once determined by the

<sup>4</sup> Typically, the IRTs are led by staff from the SRB, with two or three members of the BdE and several staff from the FROB.

<sup>5</sup> IRTs are only used for SIs. FROB ensures coordination and consistency for LSIs.



pertinent authorities, the resolution agency will determine whether there is no reasonable prospect for private-sector measures or supervisory action, and whether a resolution action is in the public interest. The resolution framework lays out criteria for meeting these conditions. An institution is failing or likely to fail when (i) it does not or will not soon meet prudential regulations, (ii) it is or will soon be insolvent, (iii) it is unable to pay debts or other liabilities, or (iv) it requires extraordinary public support. The public interest condition is met when resolution actions rather than insolvency proceedings can achieve the resolution objectives, including, the continuation of critical functions, avoidance of financial instability, and protection of public funds and depositors.

**34. The resolution procedures for banks in Spain will depend on whether they are classified as SIs or LSIs (Table 2).** The appropriate resolution agency is the SRB for SIs and FROB for LSIs. Once triggered, the FROB implements the resolution scheme for both SIs and LSIs.

### Significant Institutions

**35. The ECB and the SRB, after mutual consultation, may determine if an SI institution is F/LF.** Once so designated, the SRB determines if the other two conditions for resolution are met. Based on the resolution plan previously approved by the ECB, the SRB requests updated information and undertakes evaluation. It also begins a search for possible acquirers. The SRB, through the IRT, prepares a resolution scheme. That scheme is based on the resolution plans previously developed but includes an updated strategy and identifies specific resolution tools to be used and any need for public funding from the SRF. The scheme must be approved by the 'extended' Executive Session of the SRB, comprising the SRB Chair, the four full-time Board Members, and the Board Members representing the relevant NRAs. Then, the scheme must be endorsed by the European Commission, which may object with respect to the discretionary aspects of the proposal. In case of objection by the Commission, these aspects will need to be amended by the SRB. The Commission needs the EU Council's approval when it wants to object to the scheme for not meeting the public interest condition or to approve or object to a material modification of the amount that is needed from the SRF. The resolution scheme enters into force 24 hours from the transmission by the SRB of the scheme if no objection has been expressed by the Commission or the EU Council.

### Less Significant Institutions

**36. The BdE, as the national competent authority, supervises LSIs and triggers the F/LF.** Based on the SREP assessment, and its own assessment, FROB may request that the BdE review a given institution. The BdE must respond within three days, but FROB does not have the authority to trigger the F/LF.<sup>6</sup> The SRB is informed of any decision to trigger F/LF.

**37. Once an institution is determined to be F/LF, FROB begins the resolution process.** It assesses private alternatives, the public interest, reviews valuation of the firms, and assesses alternative resolution options. The final resolution proposal is prepared by FROB and the SRB, which

<sup>6</sup> In the European context, the SSM is responsible for determining if an institution is F/LF but the SRB has the authority to trigger resolution independently from the SSM. In Spain, the FROB does not have such independent authority.

may express its views concerning the extent to which the scheme meets requirements of the SRMR or with SRB general instructions. The SRB is responsible for the approval of the scheme if it involves use of the SRF. Once the SRB has approved the plan, FROB will begin implementing the resolution process.

### Role of the Courts

#### 38. The decision to trigger F/LF by the BdE is subject to review by the Spanish courts.

Spanish legislation provides that all persons affected by a decision taken by any administrative authority, including resolution and bail-in, can appeal. If the court decides against the decision, it may provide for compensation for the loss suffered by the applicant but it cannot reverse the decision. Lodging of an appeal will not result in a suspension of the decision. Further, FROB may request courts to place a stay of action on any judicial proceedings or if such a stay is necessary for effective resolution.

<b>Table 2. Direct Resolution Responsibilities</b>		
<b>Actions</b>	<b>SIs</b>	<b>LSIs</b>
<b>Pre-Resolution</b>		
Prudential oversight	ECB	BdE/Supervision
Review of recovery plans	ECB	BdE/Supervision
Assess resolvability	SRB	BdE/Resolution
Prepare resolution plan	SRB	BdE/Resolution (submitted to supervisor, FROB and SRB)
<b>Early Intervention</b>		
Identify supervisory measures	ECB	BdE/Supervision
Monitor implementation	ECB	BdE/Supervision
Obtain valuation data	SRB	FROB (w/ BdE)
Propose search for acquirers	SRB	FROB (w/BdE)
<b>Initiation of resolution</b>		
Determine F/LF	ECB or SRB	BdE/Supervision
Assess private solutions	SRB	FROB
Assess public interest	SRB	FROB
Assess need for public funds	SRB	FROB
Develop resolution schemes	SRB	FROB
<b>Resolution</b>		
Approve resolution scheme	SRB with formal approval of COM and possibly EU Council	FROB
Apply resolution tools	FROB	FROB

## C. Resolution Strategies and Tools

### European Level

**39. The BRRD introduced four principal resolution tools.** Those tools are (i) sale of business, (ii) establishment of a bridge bank, (iii) an asset separation power, and (iv) bail-in powers.

Additionally, the BRRD allows optional government financial stabilization tools. Moreover, the BRRD includes supporting powers, such as the ability to appoint a special manager or impose stays on the right to terminate contracts or execute collateral.

**40. Bail-in authority was the most innovative power introduced.** Bail-in permits the write down of creditor liabilities and their conversion into equity. Flexibility to exclude liabilities from the scope of the bail-in tool, for financial stability or operational reasons, is constrained. However, the BRRD does permit some liabilities to be excluded from the bail-in powers, by allowing for departure from strict *pari passu* treatment of creditors. Consistent with good practice, the BRRD prescribes that no creditor should be worse off as a result of resolution than if the bank had entered insolvency.

**41. For the SIs, the resolution strategy adopted is based on either a single-point-of-entry resolution (SPE) model or a multiple point of entry (MPE) model.**<sup>7</sup> In much of Europe, the SRM is operating under the assumption that bail-in powers will be exercised under an SPE for a G-SIB. The argument is that the holding company model is most common for those institutions and a bail-in/SPE approach is most cost effective.

**42. Institutions in Spain with significant cross-border presence are likely to be resolved using the MPE model.** The two largest international institutions in Spain (Santander and BBVA) are structured as a group of independent subsidiaries with little relation to the parent holding company. The parent holding company has only a limited role in managing corporate activities and the subsidiaries located outside of Spain operate as independent entities. Accordingly, the authorities have opted for an MPE strategy, arguing that the corporate structure of the two largest banks lends itself more easily to such an approach. Such an approach is feasible given the role and structure of the stand-alone subsidiaries. Most of the remaining 12 SIs operating in the Spanish market are not holding companies and do not have significant foreign subsidiaries. Accordingly, the SRB is likely to address failures at the subsidiary level, using the resolution tools embedded in the BRRD, including sale of business, bail-in, or a combination of tools that includes the creation of a bridge bank.

**43. Notwithstanding this progress, steps to operationalize these tools remain to be completed.** While the mechanics of the bridge bank and asset separation tools are well established, financing the operations remains under review. The use of bail-in powers would be an important element of such tools. In order to protect depositors, institutions will be required to hold an adequate level of bail-inable securities. However, not all SIs in the Spanish market hold an adequate

<sup>7</sup> In a single-point-of-entry resolution model, the holding company is intervened at the parent level. It recapitalized and it downstream resources to failing subsidiaries. In a multiple-point-of-entry resolution model, subsidiaries are intervened directly and resolved at the local level.

level of such securities to implement a bail-in strategy. Moreover, MREL requirements are still under development. The Commission is currently reviewing MREL regulations with the objective of bringing MREL requirements more in line with TLAC rules (see below). This revised regulation will become effective only a year after it is approved.

## National Level

**44. In November 2015, the BRRD was transposed into Spanish legislation.** Accordingly, resolution tools available to the Spanish authorities are the same as in the BRRD: sales of business, use of bridge banks, asset separation (sale of assets), and bail in power. The Spanish legislation, however, did not transpose the two optional government stabilization tools: equity support and temporary government ownership.

**45. Once an LSI is found to be F/LF and FROB assesses that the conditions for resolution are met, FROB draws up and executes the resolution scheme.** That resolution scheme will be based on the resolution plans previously submitted but updated where necessary with current information and possibly changed to meet current market conditions. For the mid-sized institutions in the financial system, resolution may entail the merger or sale of the business to a sound institution (arranged through a competitive bidding process), the transfer of assets and liabilities to a viable bank, transfer of assets to an asset management company (AMC) or financial support achieved through bail-in of creditors. For the smaller institutions, resolution tools are likely to include either the use of a bridge bank or sale of business.

**46. Progress has been made in establishing the resolution tools.** FROB has the legal authority to exercise the resolution tools and needs no additional legal authority to implement the tools. There are no regulations or circulars that must be drafted to operationalize the resolution tools, including bail in powers. Moreover, FROB is in the process of drafting specific manuals and step-by-step procedures to implement resolution.

**47. As with SIs, FROB faces challenges in implementing the resolution tools with some LSIs.** Some small LSIs have a significant regional presence. In some areas, one LSI may provide the only financial services to the region. Such small- and medium-sized LSIs primarily hold deposit liabilities. Resolution tools for such institutions are limited. Mergers and acquisitions by other cooperatives or larger institutions may pose a viable option under some conditions but the availability of appropriate merger partners in such areas is limited. Without other viable institutions in the region or interest in other institutions to expand operations, the sale or transfer of assets may be difficult. Further, such institutions may have no bail-in-able liabilities. In order to diversifying their liability structures, such firms should issue unsecured securities to hold as loss-absorbing liabilities. The market for such paper, however, is narrow and illiquid. Some institutions, especially the smaller banks, may have difficulty finding buyers for such securities. The authorities will need to develop resolution strategies that preserve banking services in such areas.

## D. Resolution Funding

### European Level

#### *(i) Minimum Requirement for Own Funds and Eligible Liabilities*

**48. In support of bail-in powers, institutions will be required to hold an adequate amount of securities that absorb losses and can be converted to equity (bailed-in).** The SRB will require that institutions hold sufficiently high quality MREL, to be issued at appropriate levels in the company. MREL levels are determined on a case-by-case basis and may vary among institutions. Levels are set based on the institution's total liabilities (including own funds), and currently set on a preliminary basis at twice the sum of Pillar 1 and the new Pillar 2 Requirement plus capital buffers, or twice the leverage ratio, whichever is higher. Eligible securities must have maturities longer than one year and be unsecured.

**49. The Commission is considering changes to the MREL requirements.** The objective of these changes is to reduce the differences between MREL requirements used in the EU and TLAC requirements promulgated by the FSB. While not completed, the major changes could include (i) a shift in the denominator from total liabilities (including own funds) to risk-based assets, (ii) establishment of a minimum level of MREL for G-SIBs, although requirements will continue to be set on a case-by-case basis, (iii) calculation of MREL at resolution entity level which is consistent with both MPE and SPE resolution, and (iv) setting eligibility of instruments as the same as outlined in the TLAC Term Sheet.

#### *(ii) The Single Resolution Fund*

**50. The SRF receives ex ante contributions from all euro-area banks.** The SRM Regulation establishes the fund, which is owned and administered by the SRB. Since all euro area banks are eligible for funding, it replaces the national resolution funds mandated by the BRRD. The SRF will be built up during the period 2016–2023 and is targeted to reach one percent of covered deposits. The SRF can be used for the resolution of SIs and LSIs in conjunction with the resolution tools authorized by the BRRD.

**51. In Spain, FROB collects contributions from both SIs and LSIs.** The SRF may be used only as last resort for financing resolution. The fund may be used to guarantee the assets or the liabilities, or to make loans to, or to purchase assets of the institution under resolution. It can also contribute to a bridge institution. Strict safeguards on its use are established in the BRRD. Specifically, before the SRF can be triggered, shareholders must have absorbed losses and creditors bailed in for a total of eight percent of total liabilities. Moreover, contribution from the SRF cannot exceed five percent of total liabilities.

### National Level

**52. The BdE as preventive resolution authority ensures that each financial institution has sufficient liabilities to meet MREL requirements.** The BdE is tasked with establishing a minimum

requirement for MREL in each LSI, based on its risk profile. The levels will be set sufficiently high to ensure the successful implementation of the preferred resolution strategy. To date, the BdE has not established MREL requirements.

**53. FROB can draw on two main sources of resources for restructuring.** An institution can be recapitalized through bail-in of securities. If the bail-in operation is insufficient, FROB can draw on funds held by the FGD, subject to specific safeguards designed to protect industry funds held by the FGD.<sup>8</sup> Such funds can be used for the transfer of assets to an acquiring bank or to assist the acquirer in purchasing the failed bank. The FROB can use funds indirectly as a source of loss absorption. FROB can also use resources as a source of liquidity.

**54. All institutions will be subject to MREL requirements but LSIs may face serious challenges in meeting them.** The market for securities in Spain is thin and experience suggests smaller institutions have difficulties placing securities in the market. Either their track record is uncertain or the amounts issued are below what is demanded in the market. Accordingly, the instruments for meeting loss-absorbing requirements may be difficult to accumulate. This is particularly true for institutions perceived to be weak but that play a critical role in the region where they are located. Loss-absorbing liabilities in such cases may be limited to bank equity and subordinated debt where available.

## E. Recommendations

**55. Progress has been made in operationalizing the resolution tools included in the BRRD and that progress should be continued.** The resolution tools are new and untested. Resolution agents may be unfamiliar with the mechanics of the tools. While FROB and the BdE are already developing such procedures, these efforts should be maintained. It is essential that such procedures be available and tested in an expedient manner

**56. Crisis simulations should be run.** The resolution framework is new and untested. Moreover, if it must be used at any point, unexpected needs may appear. Accordingly, two types of simulations could be considered:

- First, individual agencies such as FROB and the BdE could test their internal systems. Such tests could be formal tabletop exercises where a case is presented and the steps to be taken are reviewed, or unannounced scenario tests where the ability to respond quickly to an emerging issue can be observed.
- Second, a coordinated systemic crisis exercise could be conducted. Such systemic crisis simulations examine and test the mechanisms for sharing diagnoses of emerging distress, test information sharing among agencies, and test the ability to develop a coordinated policy response that is consistent across all agencies.

<sup>8</sup> The FGD can participate in resolution funding with the limits established in its regulation. Specifically, the liability of the FGD in a resolution process shall not be greater than the lowest amount that FGD would have paid in the case of payout, or 50 percent of the target level set for the Guarantee Deposit Compartments.

**57. Resolution of small locally essential LSIs.** While not large in size, the failure of a regional institution that is the only source of banking services to a region could pose a systemic threat to that region and expose other cooperatives to the risk of contagion. A strategy for the resolution of such LSIs should be developed. The low level of loss absorbing liabilities held by the LSIs puts depositors at risk. A comprehensive strategy, therefore, is needed. Such a strategy would take into account the existing EU regulations but, at the same time, establish a feasible approach to resolving these institutions. For example, consideration could be given to identifying ways to accelerate the placement of loss-absorbing securities. Alternatively, a resolution fund, financed by the industry, might provide a source of financing for the smaller institutions. If an institution is considered unresolvable using available resolution tools, the supervisory authorities will need to be particularly attentive to the buildup of risks in that institution and enhanced capital requirements may be required.

## SAFETY NET AND RESOLUTION FUNDING

### A. Systemic Crisis Management Arrangements

**58. On a European level, a Task Force on Crisis Management was created in the SRB in which both Bank of Spain and FROB participate.** This Task Force analyzes, discusses and prioritizes work on risk identification and crisis management. Among others, its main tasks include: drafting a crisis management manual, operationalizing the bail-in tool, and analyzing the interaction between the bail-in tool and normal insolvency proceedings. Its work will feed into SRB Plenary discussions.

**59. On the local level, in 2006, the authorities established Financial Stability Committee (CESFI).** That Committee was to oversee systemic risk and be a forum for policymaking and crisis management. However, with the outbreak of the financial crisis of 2012, policy coordination was carried out on an ad hoc basis. The CESFI has not met since April 2013.

**60. An effective crisis management framework remains elusive.** While considerable progress has been made in developing a resolution framework to manage the idiosyncratic failure of a bank—both a small and a complex bank—that framework is less effective as a crisis management arrangement. Resolving an institution is only one facet of crisis management. Moreover, as systemic pressures develop, the policy toolkit to address individual failures could be counterproductive, potentially undermining financial stability rather than reinforcing it. Arrangements are needed for developing a coordinated analysis of emerging pressures and gaining consensus on policy responses.

**61. The authorities have not conducted crisis simulation exercises, either on an individual agency basis or as a multi-agency exercise.** Such simulations are useful in identifying technical limitations to data collections, data sharing but also in highlighting how policy making can occur in a period of stress and uncertainty.

## B. Cross-Border Cooperation

**62. Spanish banks have significant cross border exposures.** Approximately half of the international exposure by loans is concentrated in the United Kingdom and the United States, with significant additional exposure in Mexico, Brazil, and Turkey. Most of this exposure reflects loans to households and non-financial corporations. Loans to SMEs at the international level experienced most growth.

**63. The ECB and the SRB are the cross-border counterparts for the BdE and FROB concerning resolution of institutions within the Banking Union.** Resolution decisions taken within the EU are automatically recognized and are subject to the rules of functioning of the resolution colleges (SRB, FROB and BdE). FROB has voting rights and the formal representation of the Spanish authorities in the SRB. The Resolution Departments of BdE and FROB participate as observers in the Crisis Management Groups (CMGs) of Banco Santander and BBVA Groups.

**64. Two of Spain's banks have significant overseas exposure.** One of them, Santander, is a designated G-SIFI. These banks have adopted a business model that treats subsidiaries as autonomous entities. The authorities argue that cross-border subsidiaries could be resolved without parent support, as they are funded in local markets and are subject to the resolution plans of the host countries. The institutions' organizational structure reflects this strategy, permitting a separation among main geographical business units. In the event of a failure, subsidiaries would be segregated from the rest of the group.

**65. For subsidiaries of SIs outside the Banking Union, the ECB establishes colleges of supervisors.** The purpose of those colleges is to facilitate the exchange of information, coordinate the supervisory activities, and ensure a consistent application of the prudential. The ECB chairs the college of supervisors as consolidating supervisor (the supervisory college tasks are performed at least on an annual basis. The decision on the college membership or observer status of authorities is based on a mapping exercise that identifies the entities (subsidiaries, branches, other financial sector entities) of a cross-border banking group and it determines and notes the significance of these entities for the local markets and the group. The BdE has signed MOUs with the major non-European jurisdictions. The MOUs allow for regular information exchange and for cooperation in developing resolution strategies.

## C. Deposit Insurance Regime

**66. The deposit insurance agency (FGD) was established in 2011.** The FGD was created by combining three separate sectorial insurance funds. The fund is a private institution with representation from both the government and the industry. The Board has 11 members, 2 representing the government, 4 appointed by BdE, and 5 representing industry. The President is the Deputy Governor of the BdE. The private sector representatives are asked to recuse themselves if their bank is discussed at the Board level. The Board does not receive information or discuss operating banks.



**67. The FGD is funded by the industry.** The Board determines the annual contribution of banks. Premiums are based on the amount of covered deposits and are risk-based. Risk premiums are calculated using supervisory data provided by the BdE. Premiums are accumulated in the deposit insurance fund. The impact of the financial crisis in 2012 severely depleted the fund. The FGD has been accumulating resources and expects to increase the fund from the current level of 0.25 percent of covered deposit to the targeted level of 0.8 percent by 2024. This level is in line with the European Directive on deposit insurance, FGD also is permitted to accept payment commitments rather than actual payments so long as the commitments are secured and do not exceed 30 percent of available resources

**68. Design features of the FGD are consistent with the Directive.** Membership is mandatory for all credit institutions authorized in Spain. For institutions authorized in other member states of the European Union, membership in the Spanish funds is voluntary. Coverage limits are in accordance with the EU Directive (€100,000 per depositor per institution) and effective coverage is in line with European standards, with 98 percent of all depositors being fully covered and 71 percent of the value of deposits fully covered.

**69. The FGD is responsible for deposit payout and financing resolution costs.** Accordingly, it would be classified as a pay box plus. The FGD begins the payout process once the BdE places an institution in resolution and the resolution authorities opts to liquidate the institution. The FGD does not receive early warning of failure. Nor does it have regular access to depositor data from operating banks,

**70. Once the FGD is informed by the BdE or the Judicial Court declares bankruptcy, depositor payout can begin.** The FGD must initiate the process of collecting relevant depositor information, clean the data of errors and inconsistencies, identify payout mechanisms, and ensure that the FGD has adequate resources. The FGD notifies depositors by sending letters to them, requesting that the depositors inform the FGD by return mail the account where they would like their funds deposited. Once received, the FGD makes a bank transfer to the indicated bank account. This process can take some time. The FGD has an eventual target of full payout within 7 working days after depositors loses access to their deposits and an interim target of 20 working days by end-2018. Under current arrangements, meeting such a target would be challenging.

**71. The FGD has a financing role in resolution.** FROB can draw on deposit insurance resources to finance the selected resolution option. These can be used to fund the transfer of assets and liabilities to acquiring banks, fund the creation of a bridge bank or, even support the merger of two institutions. FGD's funds may also be used to prevent the failure of an institution. Several safeguards are in place that limits the FGD's exposure to resolution costs. First, FGD resources cannot be used unless shareholders have first absorbed losses and 8 percent of liabilities have been bailed-in. In addition, (i) the use of FGD funds cannot exceed the amount of depositor payout in the event of a liquidation, (ii) the use of funds cannot exceed 50 percent of the FGD's targeted fund level (0.8 percent of covered deposits), and (iii) any institution receiving FGD funds must be under strengthened supervisory oversight.

**72. The FGD does not participate in the decisions on whether to use its funds or how its funds are used.** Notwithstanding the safeguards mentioned above, the FGD has a fiduciary responsibility to protect the funds held in the deposit insurance fund. In particular, the FGD must seek to ensure that there is not a threat of “double jeopardy,” where its resources are used to restructure an institution that subsequently fails and requires FGDS payout of depositors. Participating with voice in the discussions of resolution options is, therefore, an important role for the FGD. In that vein, the FGD should participate in any inter-governmental agencies or meetings related to financial stability or resolution. The deposit insurer adds an important perspective on systemic crisis preparation and resolution and would be a useful participant in discussions by safety net participants. Under its current Board structure, however, consideration could be given to recusing the private sector Board members were the role of FGD to be expanded.

**73. The FGD lacks any effective source of emergency liquidity financing.** In the event of a shortfall, FGD may request extraordinary contributions from the industry or issue guaranteed bonds in the market. There is no emergency line of credit with the government or the BdE. Accordingly, there could be some market uncertainty about the ability of the FGD to meet its obligations in the event of market disruptions or a series of bank liquidations.

#### D. Recommendations

**74. Establish a crisis management framework:** A cross-institutional forum should be established to monitor emerging risks and coordinate policy responses to distress. An option is to re-invigorate the CESFI, rely on the proposed Systemic Risk Board, or use the macroprudential unit to play this role. The focus of the group should be on developing a common diagnosis of the threats to financial stability and creating a common policy response. In stable times, this group could be a standing committee with responsibility for analyzing factors affecting financial stability. It would meet on a regular but infrequent basis (i.e., one a quarter or semi-annually) to review risk factors in the banking system, identify likely trends and emerging stresses. In crisis, the role of the committee will be enhanced. The group would oversee the development of a policy response to the crisis, meeting daily when necessary to manage the crisis.

**75. Conduct crisis simulation:** Systemic crisis simulation exercises should be conducted. Such exercises can range from relatively simple ones involving a single bank to comprehensive crisis simulation. The simulations would clarify the roles and responsibilities of each player and identify gaps and methodological shortcomings.

**76. Strengthen the FGD:** The FGD is a pay box plus with both payout and funding resolution responsibilities. Several changes can be introduced to make the institution more effective.

**77. The payout process is slow and paper-based.** Enhancements to the payout system may be necessary if the FGD is to meet their objective of paying out deposits in 20 working days by the end of 2018 and meet the medium-term goal of a seven-day payout. Among the recommendations would be:

- Regularly test the quality of the deposit data in banks. Frequent and pre-announced tests can ensure that public confidence will not be affected. While the BdE reviews such data, the FGD should have the authority to ensure that the data production by all banks meets established standards.
- Identify banks that can act as payment agents. The FGD transfers deposits to appointed bank. Depositors can either leave deposits in the new bank or move them to another bank of their choice.

**78. The revenue base of the FGD could be strengthened.**

- Bank premiums should be paid in cash. Payment commitments, even when guaranteed, should be discouraged or, if possible, not be accepted. To date, the FGD has not accepted such commitments. That practice should continue.
- Agree with the Government on a formal line of credit that can be accessed as an emergency line of credit.
- Reduce the cap. The limit of 50 percent of the total fund available for resolution is high and could undermine the strength of the FGD. While this limit is in the EU regulations, internal decisions on financing could voluntarily reduce the fund drawn from the deposit insurance fund.

**79. The FGD has a responsibility to protect the funds provided by industry for deposit insurance.** If FGD resources are to be used for any other purpose, it should participate in all decision-making meetings. Moreover, it should participate in any inter-governmental crisis group (as protector of the funds).

**80. Over the medium term, consider the option of converting FGD into a government agency with closer ties to safety net agencies.** A public-owned deposit insurance system has a number of benefits for financial stability. It allows the deposit insurance agency to be a full member of the public sector safety net. Concerns about confidentiality of information and protection of banking data are less of a concern. A public system is also able to have a robust emergency back-up funding arrangement, necessary to ensure private sector confidence in the strength of the deposit protection system. Once the deposit insurance system is a fully owned public sector entity, private bankers should be removed from the Board. Their support and advice, however, would be maintained through the establishment of a private sector advisory group for the FGD.