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Establishment of Foreign Banks in Spain[†]

This article describes how foreign banks may gain a financial presence in Spain,¹ analyzing the consequences accruing to banks that either create an office in Spain or acquire shares in a Spanish bank, as well as the procedure to make the investment in each case.

I. Introduction

Until June 1978, the Spanish government authorized only four foreign banks to operate in Spain. Those banks were Credit Lyonnais (French), Societe Generale de Banque en Espagne (French), Bank of London and South America (English) and Banca Nazionale del Lavoro (Italian). The first three banks opened branches during the nineteenth and early twentieth centuries, when the Spanish government generally placed no limitations on the establishment of foreign banks.² The fourth bank, Banca Nazionale del Lavoro, incorporated a branch in 1941, despite laws that prohibited the establishment of foreign banks, because of the close relationship and economic concessions that existed between Mussolini's Italy and Franco's Spain.

Although Spanish banking laws enacted in 1962 referred to regulations governing the establishment of foreign banks,³ no single piece of legislation

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†The legislation and procedures referred to throughout the article are updated and in force as of April 1, 1985.

1. The expression "direct establishment," as used in this article means the possibility for the foreign banks to open an office or to carry out banking activities in Spain on their own behalf and under their own name.

2. Credit Lyonnais was established in Spain in 1875, Bank of London and South America in 1916, and Societe Generale de Banque en Espagne in 1919.

3. Norm 7 d) of the Law 2/62 of April 14, 1962 provided that the Government should regulate the establishment of foreign banks in Spain, including, if necessary, the appropriate

provided norms that enabled banks to operate in Spain until 1978. An economic interpretation suggests that this delay occurred because the establishment of foreign banks posed a competitive threat to Spanish banks.⁴

Since no legislation permitted their direct establishment, foreign banks enjoyed only three minor forms of participation in the Spanish market. First, they acquired interests in the stock of Spanish banks, in accordance with, and to the extent permitted by, current banking legislation (as referred to below). Second, they entered into agreements with Spanish banks, which in turn acted as correspondent banks, so that foreign banks could contact potential Spanish clients and better serve their client's Spanish and international business interests, a goal also achieved by the foreign banks' membership in international banking associations (clubs), groups quite common among the European banks.⁵ And finally, foreign banks were allowed to create representative offices.

After the Royal Decree 1388/78, of June 23, 1978, foreign banks have conducted their activities in Spain either through a direct establishment (in accordance with the forms of establishment provided by the Royal Decree), or by acquiring stock in a Spanish bank.

II. Direct Establishment

No norm other than the Royal Decree regulates the direct establishment of foreign banks in Spain. The preamble of the Royal Decree notes why the government allowed foreign banks to enter the Spanish financial market, and it provides the criteria foreign banks must satisfy to establish a presence in Spain.

Among the reasons for liberalizing the law, the Royal Decree mentions the need to comply with the Law of 1962,⁶ and the need to conform Spanish law to the laws of countries where the principles of free enterprise govern⁷ and where, as a general rule, few restrictions limit the establishment of foreign banks. And such liberalization intended to achieve two economic benefits: first, in financing and operations in foreign currency, since foreign banks might offer new services and improve those already existing; and

limitations, and taking into account the principle of reciprocity. In accordance with Article 2, such legislation should have been enacted within two years from the date thereof.

4. For a long time the biggest Spanish banks traditionally exercised an almost absolute control over the banking system, well supported on the political levels, blocking the decisions and changes which could prejudice their dominant position (the implicit agreement which gave rise to such situation is known as "*statu quo*").

5. Such as Europartners, EBIC, ABECOR, and ORION, among others.

6. See *supra* note 3.

7. The reference to the Spanish economy as a free market economy (as opposite to the planned economy) is also set forth in article 38 of the Spanish Constitution of December 6, 1978.

second, in its effects on the domestic market, because foreign banks might increase competition among all banks in Spain, something beneficial to the Spanish financial system.

The Spanish government limited liberalization, however (within limits prescribed in the Law of 1962), in order to avoid an excessive control that foreign banks and foreign capital might come to exercise over the Spanish economy. These limitations affect, from a practical standpoint, the activities of branches and subsidiary banks, and will be referred to later in this article in connection with the establishment of foreign banks.

Most importantly, since the establishment of foreign banks in Spain depends on prior administrative authorization, the Royal Decree provides two general guidelines, which should serve as "objective" criteria to limit the discretionary power that the authorities may exercise with respect to granting or denying the authorization, and lessen the possibility that the authorities might discriminate against certain foreign banks.

The first guideline is the principle of reciprocity, and it relates to the requirements that governmental authorities in the applicant bank's home country impose on the establishment of Spanish banks there. This criterion possesses little relevance, however, given the number of offices Spanish banks have opened in other countries,⁸ so that the applicant foreign bank almost always easily meets this requirement.⁹

The second guideline refers to the benefits that the establishment of the foreign banks may represent for the Spanish economy. Unlike the first general requirement, no objective proof measures compliance with this second guideline, so that Spanish authorities theoretically enjoy more discretion, on these grounds, to accept or reject the foreign bank's petition for establishment. Spanish authorities have never rejected an application for establishment on the basis that the applicant bank failed to meet this requirement.¹⁰ This second guideline does not apply only to foreign banks, but also to Spanish banks seeking authorization for incorporation, even if they possess no foreign control or participation in their capital.

Article 1 of the Royal Decree allows foreign banks three ways to establish a financial presence in Spain: the representative office, the branch and the subsidiary bank. This section deals with the requirements and the proce-

8. When the Royal Decree was enacted, Spanish banks had opened about 65 operative offices outside Spain. However, the implementation of this requirement represents a breach of the general policy of parity of treatment in business and commercial activities between nationals and foreigners, which is stated in article 15 of the Spanish Commercial Code.

9. In this respect a foreign bank must present a certificate issued by the appropriate authorities of its home country, as referred to below.

10. As a matter of practice, the foreign bank must state in its application what activities it plans to undertake and what impact it expects to have on the Spanish economy and on the financing of Spanish companies if it becomes established in Spain.

dures foreign banks must follow to obtain authorization for establishing a presence in Spain, and it discusses the consequences that arise when a bank elects any particular form of establishment.

A. REPRESENTATIVE OFFICES

The opening of a representative office constituted the only form of direct establishment allowed foreign banks prior to the Royal Decree, but even though no specific regulation then governed their creation by foreign banks, fifty-six representative offices had been opened in Spain by 1978. Before it established a representative office, a foreign bank needed prior administrative authorization from the Spanish government, which was granted on a case by case basis since no specific authorization procedure existed.¹¹

Spanish law does not regulate representative offices *per se*,¹² but references to them in the Royal Decree constitute the first attempt to define this form of establishment. The principal feature of the representative office is that its activities are limited to providing information regarding banking, financial, commercial and economic matters, it being expressly prohibited from engaging in credit, deposit transactions or any other banking activity.¹³ The representative offices enjoy no legal status, the Royal Decree considering them merely a unit of the foreign banks they belong to.

The creation of a representative office also requires, under the Royal Decree, prior administrative authorization from the Minister of Economy and Finance upon the recommendation of the Bank of Spain and with the previous favorable report of the *Consejo Superior Bancario*.¹⁴ As a general rule, a foreign bank wins administrative approval if governmental authorities deem the foreign bank's presence in Spain within the country's best interests.¹⁵

The Royal Decree nowhere mentions the procedure foreign banks must follow to obtain authorization, but, as a matter of practice, foreign banks should address an application for authorization to the Minister of Economy and Finance and file the application with the Bank of Spain. A representa-

11. The competent authority in order to grant such authorization was the Bank of Spain with the previous advisory report of the Ministry of Commerce.

12. See J. M. MARTIN-OVIEDO, *DERECHO ADMINISTRATIVO BANCARIO* (1977).

13. As set forth in article 2 of the Royal Decree. Since they are not entitled to carry out banking activities, it has been maintained that they should not have been included in the Royal Decree governing the establishment of foreign banks in Spain, given that they cannot be considered as an establishment, in view of such limitations. See J. C. FERNANDEZ-ROZAS, *LA BANCA EXTRANJERA EN ESPAÑA* (1981).

14. The *Consejo Superior Bancario* (High Banking Council) is an administrative body created with the participation of the Spanish banks, which operates as an advisory body for the Spanish authorities in connection with banking matters.

15. The Royal Decree does not refer to the principle of reciprocity as a requirement in the case of representative offices, but only with respect to branches and subsidiary banks.

tive of the foreign bank must sign the application and provide the following information: personal data concerning the person signing the application and reference to the person's position in the foreign bank; data on the applicant foreign bank regarding applicable laws and the date of its incorporation, its corporate purpose and its domicile; a brief description of the activities the representative office plans to perform (which might be within the scope determined by the aforementioned limitations) and the goals the foreign bank hopes to achieve by creating a representative office. The application must conclude with a formal petition that the government authorize the establishment of the representative office.

The following documents should be submitted with the application:

- Reports of the applicant bank for the last years (for example, the last three years), including balance sheets, loss and profit accounts, and other information related to the bank;
- General information in connection with the applicant bank or banking group;¹⁶
- A schedule (certified by the Secretary to the Board) of members of the Board of Directors;
- A list of banks, if any, holding stock of the applicant bank;
- A list of the subsidiaries and affiliates of the applicant bank, and of its offices around the world;
- A certificate (signed by the Chairman of the Board of Directors) of the appointment of the person designated as the first bank's representative in Spain, including the capacities granted and the banking background of such representative;
- A report on the activities of the applicant bank related to Spanish companies, or otherwise in reference to the Spanish economy;
- A report on the international activities of the applicant bank.

The Governor of the Bank of Spain ultimately informs the foreign bank whether the representative office can open for business. If the foreign bank receives authorization, it must tell the Bank of Spain, at the appropriate time, where it plans to locate the office and when it plans to begin its activities. The notice of authorization usually includes a request that the Bank of Spain be informed of any change in the representative appointed or the domicile of the foreign bank's representative office, and that the Bank of Spain receive, prior to any release, press or other media announcements regarding the opening of the representative office so that it can grant its approval.

In addition, the foreign bank must duly and formally empower its representative in Spain by means of a power of attorney, stating the capacities and powers granted to the representative so that he can act on behalf of the foreign bank as its representative.¹⁷ The power of attorney must be granted

16. The brochure usually published by the banks is considered sufficient for this purpose.

17. Customarily, the representative is authorized by the foreign bank to carry out other operating activities on behalf of the foreign bank, in addition to its representative functions (e.g., to enter into credit agreements or other financial and banking transactions not related to Spain, such as operations made through a branch of the foreign bank in another country in

before a notary public in Spain or before a Spanish consul or local notary public in the foreign bank's home country (provided that in the last case, if the foreign country is a party to the Hague Convention abolishing the requirements of legalization for foreign public documents, the appropriate certificate or *apostille* must be added to the power of attorney;¹⁸ otherwise, the signature of the notary public must be authenticated by a Spanish consul in such country).

As mentioned above, the representative office does not have legal standing or personality, and all the necessary acts for its establishment (such as entering into a lease agreement for the location of the office, and labor contracts for hiring employees) must be made by the representative acting on behalf of the foreign bank.¹⁹ Consequently, the representative office will not be considered a permanent establishment of the foreign bank in Spain for tax purposes.²⁰ The representative office, however, must be registered at the Registry of Entities (*Registro de Entidades*) at the office of the Ministry of Economy and Finance that corresponds to its domicile, and it will be assigned a Tax Identification Number²¹ which it must use in all communications and notices to the Spanish tax authorities.

In addition, because of prohibitions on its banking activities, representative offices are not bound by the collective bargaining agreement in force for banking entities, though the representative office is subject to the labor ordinance applicable to offices in general.

Although there are no special requirements in connection with the establishment of a representative office, there are opinions to the effect that the incorporation of a representative office must be formalized in a public deed (*Escritura Publica*) granted before a notary public.²² As a matter of practice,

Europe). In such a case, it would be advisable that those powers related to banking activities were granted in a separate power of attorney, and not in the same including its capacities as representative in Spain. The power of attorney granted in order to manage the representative office, although general, should be limited to the activities allowed to such establishment.

18. The Hague Convention was signed on October 5, 1961. In the case of the U.S., the certificate of *apostille* should be issued, as a general rule, by the Secretary of the State where the main office of the bank is located (see VII MARTINDALE-HUBBELL LAW DIRECTORY, at 21 *et seq.* (1984)).

19. In this respect, the agreements shall be entered into by the "Representative Office of (name of the foreign bank)" and signed by the representative, acting by virtue of his power of attorney.

20. Given that representative offices are not mentioned among the categories considered as a permanent establishment by article 7, a) of the Corporation Tax Law (Law 61/78, of December 27, 1978); such provision is consonant with the fact that representative offices cannot engage in any banking activity. The same conclusion may be obtained by examining the definition of permanent establishment for tax purposes contained in the International Conventions to avoid double taxation entered into by Spain (see, for example, article 5 of the Convention entered into by Spain and France, dated June 27, 1973).

21. As established by the Decree 2423/75, of September 25, 1975.

22. Such opinions are based upon article 29 of the Regulations on Foreign Investments in Spain (approved by Decree 3022/74, of October 31, 1974), which provides that foreign investments in Spain must be formalized in a document granted before a Spanish notary public.

most foreign banks establish representative offices in Spain without any formal document, because under Spanish law the representative office possesses no legal standing and cannot engage in operative activities (and, moreover, because the representative himself has already been empowered by means of a formal document).²³

Consequently, a foreign bank's representative office in Spain exercises limited informational functions. In practice, it conducts negotiations between Spanish companies and its home office concerning credits in foreign currency; it prepares analysis and studies on the Spanish market, and it provides assistance and information to clients who plan to conduct operations in Spain. As a general principle, the absence of operative functions constitutes the main feature of representative offices in most countries, and results in them being considered the most limited form of establishment of a bank in a foreign country.²⁴

The Royal Decree affects no representative offices that existed in Spain before 1978,²⁵ since it merely spells out what authorities ultimately decide whether to allow representative offices in Spain. By the end of 1982, foreign banks had established 86 representative offices in Spain.²⁶

B. BRANCHES

The Royal Decree deems a branch in Spain an entity under the name and total economic liability of the branch's head office, authorized to carry out banking activities within the provisions of the Royal Decree.²⁷ As a result, the branch amounts to a permanent establishment that can engage in banking activities and bear the foreign bank's name,²⁸ though it lacks a separate legal personality and capacity.²⁹

23. As a consequence thereof, and in light of the inability for the representative office to obtain profits, it is possible to conclude that the creation of a representative office in Spain does not constitute a foreign investment.

24. See J. Rivoire, *LES BANQUES DANS LE MONDE* (1980). And this conclusion is also applicable in connection with the establishment of foreign banks in the U.S. See Robinson, *The Use of Edge Act Corporations Formed Under the Laws of the United States of America by Foreign Banks*, 17 INT'L LAW. 3, 418 (1983).

25. In accordance with its Second Transitory Provision.

26. Some of them belong to important banking entities, such as Security Pacific National Bank, The Mitsubishi Bank, Marine Midland Bank, The Fuji Bank Ltd., and The Royal Bank of Canada, among others.

27. Paragraph 2 of article 5 of the Royal Decree.

28. The name to be used by branches of foreign companies in Spain is governed by article 97 of the Regulations on the Commercial Registry (approved by Decree of December 14, 1956), which provides that branches in Spain shall have the same name as their head offices with the addition of the expression "*Sucursal en España*" (Spanish Branch). The only exception to this rule has been the branch of Societe Generale de Banque, which was allowed to add the expression "*Banco Belga*" (Belgian Bank) in order to be distinguished from Societe General de Banque en Espagne.

29. Law on Foreign Investments in Spain and its Regulations, approved by the Royal Decrees 3021/74 and 3022/74, of October 31, 1974, respectively (specifically, articles 13 and 14 of the Law, and articles 13 to 16 of the Regulations).

1. Creation

The opening of a branch requires prior administrative authorization from the Council of Ministers, which acts upon a proposal of the Ministry of Economy and Finance, which in turn acts on reports of the Bank of Spain and the *Consejo Superior Bancario*.

a. Procedure for Authorization

As for the authorization procedure, a duly empowered person acting on the foreign bank's behalf³⁰ must file a formal application with the Bank of Spain. A fully documented application must include:³¹

- a copy of the documentation evidencing the applicant bank's existence and establishment in its home country in accordance with that country's law (certificate of good standing), translated into Spanish, certified and verified by the appropriate Spanish diplomatic representative (usually a Spanish Consul) in the country of the applicant foreign bank;
- a copy of the by-laws governing the applicant bank, translated into Spanish, certified and verified by the Spanish Consul;
- the five latest annual reports and accounts in English, French or Spanish;³²
- a list that includes biographic information, of the members of the Board of Directors and the officers of the applicant bank;
- a disclosure statement regarding the identity of the applicant bank's stockholders, with a schedule of stockholders who hold more than 0.5 percent of the total stock;
- a schedule of the credit institutions and other companies in which the applicant bank has an interest;
- a schedule of all offices, subsidiaries, branches, agencies and representative offices of the applicant bank outside its home country;
- a brief description of the banking system in the applicant bank's home country, and a reference to its position in the ranking by size and volume of business;
- certified copies of the resolutions taken by competent bodies of the bank in connection with the opening of the branch in Spain;³³
- a certificate issued by the appropriate authorities in the country of origin, verified by the Spanish Consul, stating that the applicant bank is authorized to open a branch in Spain, or that this authorization is unnecessary;

30. There are no special requirements regarding the powers or the position in the bank of the person signing the application. In principle, the power to file the application should be conferred upon by the competent body (usually, the Board of Directors or Board of Trustees) of the applicant bank, and evidenced by the resolutions taken by such competent body (which have to be also submitted with the application).

31. The documentation to be submitted together with the application is not referred to by the Royal Decree, but was established by a private letter sent on September 4, 1978 by the Governor of the Bank of Spain to some representatives of foreign banks who had expressed their purpose to open an establishment in Spain.

32. However, such documents drafted in Portuguese have been admitted in the case of applications filed by Brazilian banks.

33. Such resolutions shall be certified by the Secretary to the Board or other appropriate officer of the bank authorized to issue certificates. His signature may be legalized by a local notary public, although this is not, in fact, necessary.

- a certificate issued by the appropriate authorities, in the country of origin, verified by the Spanish Consul, confirming the existence and extent of the principle of reciprocity therein with respect to foreign banks;
- an explanatory memorandum providing information regarding, *inter alia*, the following specific matters:
 - a) the applicant bank's activities in the international field, and the way in which its offices and subsidiaries have contributed to the development of the economy of those countries in which they are located;
 - b) the commercial, financial or other type of relationships, which the applicant bank has had and has with Spanish companies or governmental units and, in particular, the volume of its operations within the public and private sectors in Spain;
 - c) the activities which the applicant bank plans to carry out through the branch in Spain, and the ways in which its presence could benefit the Spanish economy and Spanish companies;
 - d) an estimate of the future branch's balance sheet;
 - e) an organization chart of personnel and their functions in the future branch);
- a draft of the necessary documentation for the registration of the branch at the Commercial Registry (*Registro Mercantil*) in the event the authorization for opening the branch were granted.³⁴

Each document (except for the annual reports) must be written in Spanish. A Spanish translation prepared by an official sworn translator must accompany any document drafted in another language.

Once the Bank of Spain and the *Consejo Superior Bancario* review the application, the Bank of Spain submits it to the Minister of Economy and Finance, so that this Minister can ultimately present a proposal to the Council of Ministers, which enters a final decision on the authorization.

As this discussion suggests, the authorization process often becomes complicated, formalistic and time-consuming. Besides the two official criteria mentioned above, Spanish authorities judge applications according to certain unofficial criteria: the importance of the applicant bank internationally and in its own home country, the commercial and financial relationship among Spanish companies and companies of the applicant's home country, the attitude the applicant's home country maintains toward the establishment of Spanish banks there (i.e., a concern that the applicant bank's home country accept the principle of reciprocity) and the applicant bank's support and participation in financing Spanish companies.

34. Such documentation is a draft of the public deed which will be granted before a notary public once the administrative authorization has been obtained, and to the effect of incorporating the branch. There is no reason for this requirement, given that such document will be merely a draft, with a number of blanks and not binding on the bank with respect to the final document to be granted (given that there are some relevant aspects which most likely have not been decided yet by the foreign bank, such as the appointment of the general manager of the branch, the powers to be conferred upon such general manager, and the domicile of the branch).

b. Necessary Documentation

Once the applicant bank obtains authorization from the Council of Ministers to open a branch in Spain, it must adopt and formalize its corporate resolutions in the manner provided in Spanish law. Most often, the applicant bank's Board of Directors passes a formal resolution regarding:

- the decision to establish a branch in Spain (indicating the main characteristics of such branch; name, domicile, purpose of the branch—activities to be carried out—duration and capital assigned to the branch);
- the designation of the general manager of the branch;
- the powers to be conferred upon such general manager for the representation and management of the Spanish branch;
- the granting of a special power of attorney in favor of one or more individuals to appear on behalf and in representation of the bank before a Spanish notary public or a Spanish consul acting in his capacity as notary public in order to formalize such resolution in a public deed, and to grant the public deed of incorporation of the branch in Spain.

The Board's resolution may be formalized in a public deed before a Spanish consul in the foreign bank's country of origin, although a certificate of the Board's resolution, with the signatures of the issuers legalized by a local notary public and accompanied by the certificate or *apostille*, referred to in the Hague Convention of 1961 (if the applicant bank's home country joined the Convention, or otherwise with the signature of the local notary public legalized by the Spanish consul) also suffices. Yet applicant banks normally follow the first procedure outlined above.

c. Transfer of Capital

The branch must have an assignment of capital not less than 2,000 million pesetas, at least 50 percent of which must be received in cash prior to its incorporation. The remaining 50 percent or less must be disbursed in cash within one year following the registration of the branch at the Registry of Banks and Bankers (as explained below).³⁵ In both cases, disbursement may

35. In accordance with article 2 of the Royal Decree 677/83, of March 25, 1983. This article modified article 6 of the Royal Decree 1388/78, which provided that the minimum capital assigned to the branch be 750 million pesetas. The reasons used by the authorities to increase the capital requirements dealt with the effects of the inflation and the depreciation of the peseta with respect to most foreign currencies (which made necessary an increase in the assignment of capital to the branch in order to maintain the standards regarding its solvency). However the increase applies only to the branches created once the Royal Decree 677/83 came into force (but not to the branches of foreign banks created before such Royal Decree).

In this respect it should be noted that the Transitory Provision of the Royal Decree 677/83 provides that the foreign banks which filed the application for authorization before its enactment should change such application within one month following the date in which such Royal Decree came into effect (April 6, 1983), in order to adapt the application to the new requirements regarding minimum capital. If no change is made within such period, the application would not be considered.

When the Royal Decree 677/1983 came into force, four foreign banks (Credit Commercial de France, Banca Commerciale Italiana, The Sumitomo Bank and the First Interstate Bank of

be effected in pesetas obtained from foreign currencies sold in the Spanish market or by a transfer from an account in convertible pesetas (*pesetas convertibles*).³⁶

Transferred capital must be converted into ordinary pesetas (*pesetas ordinarias*) and deposited in a special account with the Bank of Spain before a notary public in Spain grants a public deed incorporating the branch.

Until the branch becomes incorporated and registered at the Commercial Registry in Spain (*Registro Mercantil*), the transferred capital may be used for two purposes only: to purchase notes issued by the Treasury (*Pagares del Tesoro*) and to pay the Tax on Transfers and Legal Documents (*Impuesto sobre Transmisiones Patrimoniales y Actos Juridicos Documentado*), a tax levied on the incorporation of the branch.

Foreign banks must try to expedite the formalities involved in the application procedure, since Spanish law restricts their use of transferred capital prior to incorporation of the branch. Nevertheless, the entire procedure usually takes not less than three weeks to a month to be completed, and sometimes it lasts even longer.

d. Execution of Public Deed

The execution of the public deed incorporating the branch can take place before a Spanish consul in the foreign bank's home country, although it seems more appropriate to execute the public deed before a notary public in Spain, where the branch will conduct its business.³⁷

California) had filed the application in order to obtain the authorization for opening a branch in Spain, although the authorization had not been granted yet.

However, the solution adopted with respect to such banks was different from that of the Transitory Provision (and not appropriate from a legal point of view), and it was to allow such banks to create the branch with a minimum capital of 1,500 million pesetas (as an "intermediate way" between the capital requirements existing when the application was filed and those existing when the authorization would be granted).

Also, it is important to point out that article 3 of the Royal Decree 677/83 confers upon the Minister of Economy and Finance the capacity to propose a new increase of such minimum capital in case he deems it appropriate.

36. Those are the means which may be used in connection with foreign investments in Spanish companies to be effected with foreign capital, as provided for by article 2 of the Law on Foreign Investments in Spain, article 2 of its Regulations, *Circular* 106 of the Bank of Spain (related to *Circular* 4/74 of the General Directorate of Foreign Transactions) and Ministerial Order of January 23, 1981.

Regarding the mechanical aspects of the disbursement, if the capital assignment is made by means of foreign currency, the funds must be transferred by the foreign bank from outside Spain to a Spanish bank (authorized to deal with in foreign currency) in order to convert such foreign currency into Spanish pesetas.

If the investment is effected by means of convertible pesetas (*i.e.*, pesetas held in Spain by the foreign banks as a consequence of the liquidation of a previous investment or other operations, such as the repayment of a credit by a Spanish borrower before its conversion into foreign currency) such preliminary step is, of course, not required.

37. The fact that the branch in Spain must be created by means of a public deed is due both to substantive provisions (such as those established by articles 88 and 97 of the Regulations on the

As mentioned above, persons duly empowered by the bank must execute the public deed, and the following documents must be attached to such public deed:

- a resolution of the foreign bank (adopted by the competent body) authorizing the incorporation of a branch in Spain, appointing the general manager of the branch, and granting the necessary powers to such person;
- copies of the bank's articles of incorporation and by-laws;
- a certificate of the Spanish consul in the foreign bank's home country to the effect that the bank is a duly incorporated company;³⁸
- an original of the document from the Council of Ministers communicating the authorization for opening the branch;³⁹
- a certificate from the Registry of Corporate Names (located at the Ministry of Justice) confirming the non-existence of any company (Spanish or foreign with branch in Spain) with the same name as the bank (although the notary does not always require it, it is advisable to include this certificate).

A Spanish translation prepared by an official sworn translator must accompany all of the aforementioned documents not drafted originally in Spanish. The notary also requires evidence that the applicant bank has transferred to Spain any capital assigned to the branch.⁴⁰

e. Payment of Patrimonial Transfer Tax

The establishment of a branch in Spain is a taxable act subject to the Spanish Tax on Patrimonial Transfers and Legal Documents.⁴¹ The amount subject to tax equals the amount of capital assigned to the branch, and the tax rate levied on this sum equals 1.9 percent.⁴²

Commercial Registry, given that only documents granted before a notary public may be registered as such Registry) and to exchange control provisions (as those provided for by article 29 of the Regulations on Foreign Investments in Spain and the Resolution of the General Directorate of Foreign Transactions of January 20, 1975).

38. As established by article 88 of the Regulations on the Commercial Registry.

39. The obligation of the notary public to require evidence of the authorization granted with respect to foreign investments is established by the Resolution of the General Directorate of Foreign Transactions of October 17, 1983.

40. Such request is derived from article 29 of the Regulations on Foreign Investments in Spain and from the Resolution of the General Directorate of Foreign Transactions of April 28, 1982. The appropriate evidence to be presented is a certificate issued by the Spanish bank through which the conversion of the funds transferred in foreign currency to Spanish pesetas has been effected (or, as the case may be, by the Spanish bank where the convertible pesetas to be used for the investment are deposited) to this effect.

In addition, the public deed must include a statement made by the person appointed as general manager of the branch to the effect that he is not within the incompatibilities established for members of the Spanish Administration and other public officers. And this is also applicable to the public deed of incorporation of a subsidiary bank, as well as to the appointment of the members of its Board of Directors (as provided for by Law 25/83, of December 26, 1983, and the Ministerial Order of March 21, 1974).

41. As provided for by article 11 of the Law 32/80, of June 21, 1980, which governs such tax, and article 25 of its Regulations (approved by Royal Decree 3494/81, of December 29, 1981).

42. As established by its Third Transitory Provision (paragraph b) of number 3), and article 37.b of its Regulations.

As for tax payment procedures, a copy of its public deed of incorporation must be filed with the tax authorities in the city where the branch is to be located, together with a form evidencing the tax assessment and a form evidencing the payment of the tax.⁴³ Once they receive these documents, the tax authorities issue a provisional certificate, evidence that the branch paid the tax (tax authorities issue the final receipt after they examine the tax assessment).⁴⁴

f. Registration at the Bank of Spain

No entity can engage in banking activities before its registration at this Registry.⁴⁵ Registration can occur immediately after granting the public deed of incorporation of the branch, and possibly before payment of the tax. In order to register, a person empowered to act on behalf of the foreign bank (normally, the general manager appointed for the branch) must request that the branch be registered in a letter, accompanied by a copy of the branch's public deed of incorporation, filed with the Registry and addressed to the Governor of the Bank of Spain. In any case, such registration must occur prior to the branch's registration at the Commercial Registry.⁴⁶

g. Registration of the Branch's Manager

Neither Spanish bank officers (chairman, vice chairman, director or general manager) nor officers of a branch in Spain of a foreign bank can be registered at the Commercial Registry in such capacity without previously registering at the *Registro de Altos Cargos de la Banca*.⁴⁷

The registration procedure requires applicants to file a written form with the Bank of Spain together with appropriate documentation that evidences the applicant's position with the foreign bank and a copy of the branch's public deed of incorporation, which includes the appointment and powers conferred on the general manager of the branch.

The Registry enables Spanish authorities to regulate *incompatibilidades bancarias* (banking incompatibilities). It guards against the excessive con-

43. This procedure for the assessment of the tax (where it is made by the person subject to taxation) was introduced by article 85 of the Regulations governing such tax, and developed by the Instruction of March 15, 1982 issued by the Subsecretary of Finance.

44. This system is much more expeditious, in terms of time saving, than the former procedure, under which the assessment of the tax was made by the tax authorities, who used to spend several weeks in the procedure.

In this respect, it should be noted that under Spanish law no document which might be subject to this tax may be admitted to any Registry or court without prior evidence that the tax has been paid or that the document has been declared not subject to, or exempt from, taxation (as provided for by article 42 of the Law 32/80 and article 72 of its Regulations).

45. As set forth in article 38 of the Banking Law of December 31, 1946.

46. Article 2 of the Decree of July 9, 1948.

47. In accordance with article 1 of the Decree of April 4, 1969, and article 1 of the Ministerial Order of May 22, 1969.

centration of banking power in the hands of a few individuals.⁴⁸ Such registration therefore, should occur immediately after the branch is registered at the Registry of Banks and Bankers, because, although it is not a condition precedent to registering the branch at the Commercial Registry, it must occur prior to registration of the appointment of the branch's officers, and of the powers conferred upon them, at the Commercial Registry.

h. Registration at the Commercial Registry

This is the last formality the branch undergoes prior to its incorporation in Spain.⁴⁹ This last step requires the *primera copia autorizada* (first official copy) of the public deed authorizing the incorporation of the branch to be filed with the Commercial Registry in the place where the branch is to be located. Since the foreign bank must be registered as the branch's head office, it, too, has to file its articles of incorporation and by-laws with the Commercial Registry.

Registration generally becomes effective after a two to six week waiting period, although every effort should therefore be made to minimize any needless delay in the registration process.

Once the registration is obtained, the branch enjoys legal status under Spanish law and becomes authorized to conduct business in Spain.

2. Legal Regulation

Two types of norms regulate the activities of branches in Spain of foreign banks: general rules also applicable to Spanish banks, and rules meant specifically for the operations of branches of foreign banks.

a. General Rules

The following norms apply both to Spanish banks and to branches of foreign banks:

i. *Contract Law*. Banking activities of the branch must comply with Spanish contract law.⁵⁰ But beyond the consent of the parties contracting with the branch and their compliance with contract law, agreements between the branch and its customers must incorporate or comply with provisions established for certain types of banking transactions.⁵¹ As a matter of

48. As stated by Law 31/68 of July 27, 1968.

49. The registration of the branch at the Commercial Registry is required by articles 88 and 97 of the Regulations on the Commercial Registry, and by article 14 of the Regulations on Foreign Investments in Spain.

50. Article 8.1 of the Spanish Civil Code.

51. Neither the Spanish Commercial Code nor the Civil Code contain special provisions regarding banking contracts (unlike other countries where the system of civil law prevails, such as Italy). However, the Bank of Spain by means of *Circulares* establishes from time to time special rules in connection with some agreements when they are entered into by banking entities.

practice, branches direct their legal counsel to prepare standard forms of the most often used agreements shortly before they open for business.

ii. *Administrative Banking Regulations.* The Ministry of Economy and Finance, through the General Directorate of the Treasury and of Financial Policy, the Bank of Spain and the *Consejo Superior Bancario*, exercise administrative control over the activities of branches in Spain of foreign banks. They require them to:

- maintain certain ratios established for the control of certain financial aspects, such as to cash, investments and guarantees, which are modified from time to time;
- observe in their activities the rules enacted by the Bank of Spain and contained in the *Circulares*;
- deliver to the Bank of Spain and the *Consejo Superior Bancario* annual reports containing a balance sheet and other statistical data;
- deliver a request of authorization to the Bank of Spain prior to engaging in any bank advertising;
- deliver to the Bank of Spain a schedule reflecting the offices opened by the foreign bank in Spain;
- comply with the rules established by the Spanish authorities with regard to economic aspects of the banking activity (interest rates and level of reserves to be maintained, among others).

iii. *Exchange Control Norms.* In this respect, Spanish law treats branches of foreign banks no differently than it treats Spanish entities, since branches are considered resident entities in Spain for exchange control purposes.⁵² Therefore, branches can deal in ordinary pesetas (an activity not permitted to non-resident companies), subject to the limitations referred to below.

Laws that limit Spanish banks' transactions in foreign currencies, however, do not apply to branches of foreign banks.⁵³ This allows them to obtain the status of *banca delegada* (delegated bank), which means that they can enter into exchange currency transactions by authorization of the Bank of Spain.

b. Specific Norms Applied to Foreign Branches

The Royal Decree and norms regulating foreign investment in Spain affect branches in Spain of foreign banks. This study examines these limitations separately:

i. *Norms Contained in the Royal Decree.* An authorization for the incorporation of a branch is non-transferable. It terminates if the branch comes under new ownership.⁵⁴

52. In accordance with article 4.3 of the Exchange Control Law (Law 40/79 of December 10, 1979) and article 8.1.c of its Regulations (approved by Royal Decree 2402/80, of October 10, 1980).

53. As established by *Circular 14-DE* of the Bank of Spain.

54. Article 5.3 of the Royal Decree. However it may be argued that this norm would not be applicable in case of a merger outside Spain of the foreign bank holding the authorization for the branch and another banking institution.

Spanish law prohibits branches of foreign banks from obtaining funds and deposits in the Spanish financial market in amounts exceeding 40 percent of their investment in bonds and loans to Spanish companies in the public or private sector, plus the assets covering the cash-rate, though no legal limits apply to funds obtained by the branch in the Spanish inter-bank market.⁵⁵

The branch must obtain prior authorization from the Bank of Spain if it plans to exceed such limits on financing in pesetas. For this reason, branches usually obtain their funds from the Spanish inter-bank market and from financial markets abroad (in view of the fact that, as mentioned above, they are not subject to the limitations on external—foreign—financing established for Spanish banks).

Spanish law prohibits branches from opening more than three agencies (offices) in Spain, including the main office.⁵⁶ This limitation is intended to prevent foreign banks from controlling the Spanish banking market, and as a practical matter, it prohibits foreign banks from engaging in retail banking, restricting their activities within the area of wholesale banking.⁵⁷

Spanish law dictates that branches limit their portfolio investments to public debt certificates (*fondos publicos*) and fixed interest securities (*titulos de renta fija*),⁵⁸ though for a period no longer than 6 months branches may hold shares they receive by enforcing rights arising from loans and credit facilities they granted in good faith.

If the Ministry of Economy and Finance (and other governmental authorities, as required by the general legislation governing foreign investments in Spain, depending upon the economic sector involved) previously authorizes them to do so, branches may hold shares representing the total stock of companies that carry out activities connected with credit cards, data processing services and other collateral aspects related to the operation of the branch's business. These regulations exist to prevent foreign banks, through their Spanish branches, from investing in Spanish companies.

The Bank of Spain inspects each branch at least once a year for a period of 5 years from the date of its incorporation of the branch bank.⁵⁹ If it discovers any irregularities, it can propose that the Ministry of Economy and Finance

55. As provided for by article 7.a of the Royal Decree. Consequently, and by virtue of this special norm, foreign branch banks in Spain are excluded from the general norm governing obtaining credits in pesetas by branches of foreign companies in Spain (Resolution of the General Directorate of Foreign Transactions of January 20, 1975).

56. Article 7.b of the Royal Decree.

57. See the Annex regarding the number of offices opened by foreign banks through their branches pursuant to the Royal Decree 1388/78. If the branch has only one office, it is normally located in Madrid; if it has two, the second one is usually located in Barcelona; in cases where there are three offices, the third one is customarily opened in Bilbao or Valencia.

58. Article 7.c of the Royal Decree.

59. This provision, set forth by article 7.d of the Royal Decree, applies to branches of foreign banks in Spain the functions granted to the Bank of Spain by article 17 of the Decree-Law 18/62 of June 7, 1962 in connection with the inspection of Spanish banking entities.

exert administrative control over the branch.⁶⁰ And if it uncovers highly significant irregularities, the Council of Ministers can revoke the branch's authorization, forcing the branch to close.

The Royal Decree originally limited distribution of profits by Spanish banks to a maximum of 6 percent on the amount of paid-in capital and surplus in each year.⁶¹ The same restrictions applied to branches in Spain of foreign banks.⁶²

This limitation no longer exists. The law now⁶³ places no restrictions on banks regarding the distribution of ordinary annual profits they obtained after 1981, provided that the banks observe a sound amortization policy and that they maintain actual reserves sufficient to guarantee their solvency, as reflected by accounts prepared according to generally accepted accounting principles.⁶⁴ This measure applies to a branch's transfer of profits to its head office,⁶⁵ in addition to other norms which may require the branch to obtain further administrative authorization before it transfers profits to its head office (as referred to below).

ii. *Norms Governing Foreign Investments in Spain.* Aside from the Royal Decree, other restrictions governing foreign investments apply to branches in Spain of foreign banks. The First Final Provisions of the Law and the Regulations on Foreign Investment in Spain spell out these restrictions. They provide that in the absence of any specific law on any specific matter, general Spanish laws on foreign investments shall govern all foreign investments, whatever the activity or the sector.⁶⁶ The following considers how these restrictions affect foreign branch bank activities in Spain.

60. Such decision may be adopted in cases where the branch fails to comply with mandatory provisions, or if there are evident risks for the funds owned by third persons (and which are deposited in the branch, for example).

The control would be exercised by persons appointed by the authorities ("Interventores") in a manner similar to the activities of the trustees, and whose agreement would be necessary for all decisions regarding the management of the branch.

However, it appears that in order to take such a step a law or a decree-law should be previously enacted (similar provisions regarding taking control of private companies are provided for by the Law of July 26, 1922 and the Decree-Law 18/69 of October 20, 1969).

61. Such a limit was established by the Decree of December 31, 1941.

62. Although in the case of branches of foreign banks the total amount allowed under such limitations included transfers of any nature from the branch to its head office (i.e., profits, payment of overhead expenses, etc.), as provided for by article 8.2 of the Royal Decree, and consequently such norm was more restrictive than the norm limiting the distribution of profits by Spanish banks (as well as by subsidiaries in Spain of foreign banks).

63. Article 13 of the Ministerial Order of January 17, 1981.

64. However, the distribution of profits obtained in the years 1981 and 1982 had to be authorized by the Bank of Spain, and regarding the distribution of profits obtained after 1982 it should be noted that article 17.b of the Decree-Law 18/62, concerning the possibility of objections by the Bank of Spain to proposed distributions, is still applicable.

65. The right to transfer abroad the profits obtained is granted to branches of foreign companies by article 16 of the Regulations on Foreign Investments in Spain.

66. As provided for by paragraph (h) thereof.

Foreign companies with branches in Spain can acquire real estate (investment in buildings) by payment in ordinary pesetas, provided they make the purchase only to carry out their business activities through the branches (i.e., for locating their offices) and provided that the total amount of the investment (the cost of the real estate) does not exceed the amount of capital assigned to the branch.⁶⁷

If the foreign company does not meet either of these two conditions, it must obtain prior administrative authorization before it makes the investment. As a practical matter, Spanish authorities display a liberal attitude on these matters, and in several cases foreign banks acquired buildings with capacities greater than necessary for the operations of their branches, even leasing excess space to other companies. Care should be taken, however, to obtain an authorization to transfer abroad income derived from utilizing the building (and any capital gains realized from an eventual sale of the building).

Each January, branches of foreign companies must send the Liaison Account or Link Account (*Cuenta de Enlace*) they maintained with their head offices, as of December 31 of the preceding year, to the General Directorate of Foreign Transactions of the Ministry of Economy and Finance.⁶⁸

This rule places almost impossible compliance burdens in case of foreign banks, since it requires them to make a very detailed report within a one month period. As a matter of practice, the Ministry of Economy and Finance treats violations leniently. It accepts reasonable delays once the report falls late. In any case, the year-end bank report serves an important function. It constitutes the basic document Spanish authorities use to determine how much of its profit a branch can transfer outside Spain.

3. *Taxation of Spanish Branches*

The Spanish Corporation Tax applies to branches in Spain of foreign banks.⁶⁹ For tax purposes, the branch is considered as its parent's permanent establishment in Spain,⁷⁰ the result being that branches must pay the Spanish Corporation Tax with respect to income derived from any economic activity carried out by the branch, even if such activity takes place outside Spain but it is clearly attributable to the Spanish branch.⁷¹ The Corporation

67. Paragraph 2 of Section 3 of the Resolution of the General Directorate of Foreign Transactions of January 20, 1975.

68. *Id.* paragraph 2 of Section 4. Such account reflects the transactions which have been made between the branch and the head office during the year.

69. In accordance with article 4.1.b) of the Law 61/78, of December 27, 1978, which governs the Corporation Tax, and article 15 of its Regulations (approved by Royal Decree 2631/82, of October 15, 1982).

70. Article 7.a of the Corporation Tax Law and article 19 of its Regulations.

71. In accordance with article 18 of the Regulations on the Corporation Tax (for example, in the case of a branch of a foreign bank in Spain granting a loan to a foreign company).

Tax also applies to any increase in value of assets assigned and used by the branch, provided that the branch obtains a capital gain from liquidating or selling such assets.

Except for some minor modifications, the income of branches in Spain of foreign banks is assessed no differently than the income of Spanish corporations. In both cases, assessed income equals the difference between gross earnings and deductible expenses.⁷² The tax rate levied on assessed income is 35 percent.⁷³ From this gross tax liability, various deductions (dividends received from Spanish companies, amounts withheld, interest derived from certain bond issues and amounts invested by the branch in certain investments) are subtracted to obtain the final tax debt.⁷⁴ Referring specifically to the amounts withheld, the branch pays an 18 percent withholding whenever it receives remuneration for investing its funds,⁷⁵ though this withholding does not apply to interest and commissions arising from credit transactions.⁷⁶

Finally, and as a practical matter, foreign banks should note that Spanish authorities have been quite strict with respect to authorizations, scheduling the establishments according to a waiting list.⁷⁷ They have enforced this measure so strictly because many branches of foreign banks have opened since 1979,⁷⁸ a development that led authorities in 1983 to increase the minimum capital necessary to open new branch offices.

C. SUBSIDIARY BANKS

The Royal Decree also allows foreign banks to establish subsidiaries in Spain. The term "banking subsidiary" as used in the Royal Decree refers to a wholly-owned banking subsidiary. If it elects this form of establishment, the foreign bank creates a new Spanish corporation, with an independent legal personality. From the point of view of liability, contracts the subsidiary enters into do not legally bind the foreign bank, since the subsidiary bank maintains a legal personality apart from the parent company's. These important differences aside, norms that govern the incorporation of foreign

72. Article 11 of the Corporation Tax Law.

73. As set forth in article 57 of the Law 50/84, of December 30, 1984 (which approved the State General Budgets for 1985).

74. The tax return to be filed, both by branches and subsidiaries, in connection with this tax, was approved by the Ministerial Order of March 26, 1984.

75. As provided for by article 60 of the Law 50/84, of December 30, 1984, in connection with article 32.2 of the Corporation Tax Law and article 253 of its Regulations.

76. This exemption from the withholding is established by article 258.b of the Regulations on the Corporation Tax.

77. Sometimes the waiting period has been too long, such as in the case of Bankers Trust Company, which received the authorization from the Council of Ministers on July 6, 1979, but establishing that the activity of the branch could not be initiated until September 1, 1980.

78. See the Annex.

bank subsidiaries resemble norms foreign banks meet when they create a branch in Spain. This discussion, therefore, refers to matters mentioned above in connection with the establishment of a branch in Spain.

1. *Requirements for Creation*

Foreign banks generally follow the same authorization procedure whether they plan to establish a branch or a subsidiary, with the exception that the following specific requirements apply if they plan to establish a subsidiary:⁷⁹

- The subsidiary must be established as a corporation (*sociedad anonima*), simultaneously incorporated through a single act by agreement among the founders and without allowing a period for subscription of shares; Spanish banks are subject to this same requirement.⁸⁰ There must be a minimum of three founders.⁸¹
- The founders of the banking subsidiary must be foreign banks, and therefore subsidiaries of foreign banks in Spain must be formed by a joint banking venture. This norm and the preceding norm mandate that a foreign bank (as parent company) and two other wholly-owned subsidiaries (also being foreign banks) incorporate the wholly-owned subsidiary.⁸²
- The subsidiary's minimum issued capital must be 2,000 million pesetas, and a premium equivalent to 100 percent of its par value must be paid.⁸³ Upon incorporation, 50% of the minimum issued capital must be paid-in, and the full amount of the premium must be disbursed and established as a legally required reserve, which cannot be used without prior authorization from the Ministry of Economy and Finance. The total amount of capital must be fully paid-in within two years of the incorporation.⁸⁴

Moreover, capital contributions must be made by means of pesetas obtained from foreign currencies sold in the Spanish market, or by transfer from an account in convertible pesetas (*pesetas convertibles*).

The authorization procedure requires that the foreign bank submit four documents beside those documents it would submit if it intended to create a branch (all of which must be delivered), together with the application requesting the authorization. These additional documents are:

79. Article 3 of the Royal Decree.

80. Article 3.1 of the Royal Decree 2246/74 of August 9, 1974.

81. In accordance with article 10 of the Spanish Corporation Act (*Ley de Sociedades Anonimas*).

82. This requirement, regarding the incorporation of the subsidiary bank, is established by article 1.b of the Royal Decree.

83. The amount required as minimum capital for subsidiary banks was modified by the Royal Decree 677/83, of March 25, 1983. The amount initially required by the Royal Decree 1388/78 as minimum issued capital was 750 million pesetas. The disbursement of a premium equal to 100% of the par value was also required by the Royal Decree 1388/78.

84. The minimum capital required for domestic banks is 750 million pesetas, and in addition a premium equivalent to 100% of the par value. However, if they are established outside Madrid or Barcelona, the capital required is only 500 million pesetas (article 3 of the Decree 2246/74).

- a draft of the subsidiary's proposed by-laws in accordance with the provisions of Spanish law,⁸⁵ including, specifically, the limitations (as referred to below) related to the transfer of shares;⁸⁶
- a schedule disclosing the subsidiary's shareholders, of which there must be, at least, three;
- information, including biographical data, about the persons to be appointed members of the Board of Directors and as officers of the subsidiary;
- a certificate evidencing the effectiveness of the deposit to be made at the Bank of Spain. The amount of such deposit must equal 5% of the proposed capital of the subsidiary. The deposit cannot be used, and it must be made in cash with pesetas obtained from foreign currencies sold in the Spanish market or by a transfer from an account in convertible pesetas (*pesetas convertibles*). The deposit will be returned if the authorization for establishment is not granted, or if no express answer is received from the authorities in four months (if the applicant bank voluntarily cancels the deposit, the authorities consider the application withdrawn).⁸⁷

As for the Tax on Transfers and Legal Documents, foreign bank subsidiaries pay tax on the total amount of capital (par value plus minimum), at the rate of 3 percent.⁸⁸ The tax must be paid after the public deed of incorporation is granted, and prior to the subsidiary's registration at the Commercial Registry.

2. *Law Governing the Subsidiaries*

Except for limitations provided in the Royal Decree regarding their obtaining funds in pesetas, the number of establishments in Spain, the portfolio investments allowed them, and the inspections the Bank of Spain conducts of them, foreign bank subsidiaries operate under the same norms domestic banks do. However, two points—the transfer of shares and the transfer of profits—deserve special mention, since they result from the foreign ownership of the subsidiary.

a. *Transfer of Shares*

Shares representing the capital of foreign bank subsidiaries can not be subject, directly or indirectly, to transfer, assignment, pledge or any other lien, without prior and express authorization from the Bank of Spain. The share certificates and the subsidiary's by-laws must reflect this limitation.⁸⁹

85. Article 11.3 of the Spanish Corporations Act, which establishes the aspects which, at least, must be included in the by-laws of any Spanish corporation.

86. As provided for by article 4 of the Royal Decree.

87. Article 2 of the Royal Decree 63/72, of January 13, 1972.

88. As established, in connection with the incorporation of any Spanish corporation, by article 11 of the Law 32/80 and article 25 of its Regulations.

89. Article 4 of the Royal Decree. The fact that the limitations have to be reflected on the share certificates is in accordance with the provisions of articles 43 and 46 of the Spanish Corporations Act.

Even if the subsidiary obtains authorization, the special norms established in the Royal Decree for foreign bank subsidiaries still apply.⁹⁰

Likewise, shareholders in the subsidiary must subscribe for any additional shares in proportion to their participation in the subsidiary in order to maintain the same stock participation which existed when the subsidiary was incorporated. Any transfer of subscription rights requires prior and express authorization from the Ministry of Economy and Finance.

b. Transfer of Profits

The same rules dictate how foreign bank subsidiaries and domestic banks distribute annual profits.⁹¹ Both can distribute profits they obtained after 1981 with no limitations, provided they observe a sound amortization policy and provided they maintain reserves sufficient to guarantee their solvency, as reflected by accounts prepared according to generally accepted accounting principles.⁹²

Any transfer of profits abroad falls subject to norms governing foreign investments in Spain, which generally allow the free transfer of profits if the profits stemmed from activities carried out in accordance with the administrative authorization covering the investment.⁹³

3. *Taxation of Subsidiaries*

The Spanish Corporation Tax applies to the subsidiaries of foreign banks in Spain, just as it applies to domestic banks. Given that the subsidiaries constitute resident entities in Spain,⁹⁴ they pay tax on: worldwide income, whether obtained in Spain or abroad; and increases in value of their worldwide assets, whether located in Spain or abroad.⁹⁵ The most important difference between the tax treatment accorded branch banks and the tax treatment accorded foreign subsidiaries lies in the different tax deductions applicable to them.⁹⁶

Up to now, foreign banks have preferred to open branches rather than

90. Which means that shares may only be transferred or assigned to other foreign banks.

91. Article 8.1 of the Royal Decree (*supra*, note 63).

92. The content of *supra*, note 64, is entirely applicable to the case of subsidiaries.

93. As provided for by article 9 of the Law on Foreign Investments in Spain.

94. In accordance with article 9 of the Corporation Tax Law and article 16 of its Regulations, which establish that a corporation is deemed to be resident in Spain if one of the following requirements is met:

- if the corporation has been incorporated in accordance with Spanish law.
- if its corporate domicile is located in Spain; or
- if its management takes place in Spain.

95. Article 6 of the Corporation Tax Law.

96. Since subsidiaries are entitled to deductions on the same basis that domestic companies (regarding income received as dividends from other companies, income obtained outside Spain and subject to taxation abroad, and the amounts which have been withheld from the income received), not all of which are allowed for branches.

create subsidiaries in Spain, the reason being that subsidiaries operate under the same conditions and limitations imposed on branches, while Spanish laws offer branch offices greater legal and economic advantages.⁹⁷ For example:

- the opening of a subsidiary requires an investment of capital in excess (twice the amount) of that required for the opening of a branch;
- a branch, lacking a separate legal personality, affords an easier and more consistent operational link with the head office;
- the liability of the branch is attributable to the head office, which, from a commercial point of view, offers more protection to prospective customers than the sole liability of the subsidiary bank.

III. Indirect Establishment

A. LAW AND DEFINITION

The expression "indirect establishment" refers to a foreign bank's acquisition of a stock participation in an existing Spanish bank (or the incorporation of a new bank together with other Spanish banks). From a legal viewpoint, there is no establishment of a foreign bank in Spain, but merely a foreign investment in a Spanish company engaged in banking activities.

Whether Spanish law deems an investment "direct" or "indirect" depends on facts beyond the investor's purposes,⁹⁸ such as whether the stock of the Spanish company is quoted on the Stock Exchange, and if quoted, whether the acquisition is effected through the Stock Exchange. If the stock of the Spanish company is quoted in the Stock Exchange the foreign investment is considered a direct investment only if the acquisition is not effected through the Stock Exchange, and provided that the agreed price differs from the price of the stock quoted on the Stock Exchange. Therefore, whether Spanish law considers the investment "direct" or "indirect" does not depend on the degree of control the foreign investor gains over the Spanish company by virtue of the stock acquisition.⁹⁹

Neither, as a general rule, is the authorization of foreign investments in

97. Bank of America is the only foreign bank which holds a subsidiary bank in Spain, incorporated pursuant to the provisions of the Royal Decree.

98. Article 6 of the Law on Foreign Investments in Spain and of its Regulations, and Instruction 7 of the *Circular* 4/74, of December 20, 1974, issued by the General Directorate of Foreign Transactions.

99. Unlike the legislation governing Spanish investments abroad, which considers an investment as direct when the investor is entitled to exercise through its investment, a certain control over the company it invests in, or if the Spanish investor acquires at least 20% of the stock of the foreign company. In this respect, articles 3.1 and 4 of the Royal Decree 2236/79, of September 14, 1979, governing Spanish investments abroad, require that the investment be durable and that the Spanish investor participate in the administration and management of the company, in order to consider the investment as direct. See F. Fernandez-Flores, *Inversiones extranjerías y valores mobiliarios* (1980).

Spanish banks subject to general legislation concerning foreign investments. Instead, a special system of authorizations governs foreign investments in Spanish banks. The First Final Provisions of the Law and the Regulations on Foreign Investment in Spain¹⁰⁰ expressly provide (in paragraph (h) of both norms) that none of its provisions apply to foreign investments in Spanish banks already covered by other specific provisions on this matter¹⁰¹ (although the general legislation applies to any issue not contemplated by any other specific provision). Therefore, this study analyzes the various norms governing the incorporation of Spanish banks, all of which usually include express references to foreign investment in the stock of Spanish banks.

One such norm is the Ministerial Order of May 21, 1963, which develops the Decree-Law 53/62, of November 29, 1962. The Decree authorized the creation of industrial banks in Spain, and it included the first reference to the participation of foreign banks in their stock. Article 3 of the Ministerial Order allows other Spanish or foreign banks to participate in up to 50 percent of the stock of the industrial banks incorporated pursuant to the Decree-Law of 1962. Any participation requires prior authorization from the Ministry of Economy and Finance, whatever the percentage of stock acquired.¹⁰²

Article 3 leads to two significant results. First, it grants foreign banks the same treatment that the Spanish banks enjoy regarding the acquisition of stock in industrial banks governed by the Order. And second, it mandates that foreign banks cannot gain more than a 50 percent interest in the stock of a Spanish bank (and consequently this percentage is an absolute limit).¹⁰³

The second applicable norm is the Decree of 63/72, of January 13, 1972, which governs the creation of new Spanish banks, both commercial and industrial, after January 13, 1972. In accordance with paragraph (e) of its article 1, the maximum foreign participation allowed in the stock of a

100. *Supra*, note 27.

101. The law and the Regulation on Foreign Investments in Spain establish, as a general principle, that foreign investments in Spanish companies do not require any prior administrative authorization if the acquisition is not in excess of 50% of the stock of the Spanish company. The First Final Provisions of both norms exclude from this liberalization foreign investments in Spanish companies engaged in certain sectors and activities (such as banking, insurance and oil and gas, among others).

102. As established by article 1. Although the Order refers to the Ministry of Finance, such reference should be currently (since 1982) understood to be the Ministry of Economy and Finance.

103. The limit of 50% in the participation allowed to foreign banks coincided with the maximum percentage generally admitted as foreign investment in Spanish companies without prior administrative authorization, in accordance with the Decree-Law of July 21, 1959, which governed foreign investments in Spain until the enactment of the Law on Foreign Investments in Spain and its Regulations in 1974, although in the case of acquisition of stock in Spanish banks the administrative authorization was always necessary, regardless of the participation to be acquired.

Spanish bank was 15 percent, regardless of whether the foreign investor was a bank, an individual or a corporation. Consequently, a foreign investor's purchase of 15 percent or less of the stock of a Spanish bank did not require administrative authorization. Once again, 15 percent constituted a maximum limit. And in order to avoid conflicts of construction, the Decree of 1972 expressly derogated article 3 of the Ministerial Order of 1963, with respect to the participation of foreign banks in the stock of Spanish banks created after January 13, 1972.

On August 9, 1974, however, a new Decree (Decree 2246/74) modified and expanded the measures contained in the 1972 Decree. The 1974 Decree applied to both commercial and industrial banks incorporated after August 9, 1974. It maintained the 15 percent limit on the amount of stock foreign investors could hold in Spanish banks, but number 4 of its article 3 provided that the stock of the banks governed by the Decree be held by individuals, and number 5 of the same article addressed the limitation specifically to foreign investments. Therefore, the Decree allowed no foreign bank or foreign company to acquire any participation in the stock of the Spanish Banks, though the confused and misleading text of the Decree gave rise to a number of contradictory opinions and interpretations.

In order to clarify the issue, the Royal Decree 1294/81, of June 5, 1981, stated that limitations established by the 1974 Decree (to the effect that the stockholders be individuals and that foreign participation in the stock of the banks not exceed 15 percent) applied only for a period of five years from the date the bank was incorporated. Once the five year period expired, any foreign company (including a foreign bank) could acquire stock in such Spanish banks, with general norms related to foreign investment governing foreign participation in their stock. Consequently, foreign banks or other foreign investors can acquire up to 50 percent of a Spanish bank's stock, provided that the bank was incorporated after January, 1972, and foreign investors can exceed even this limit with prior approval from the Council of Ministers.¹⁰⁴

The 1974 Decree included a provision, effective only in exceptional circumstances, that allowed the Council of Ministers to establish "banks of special statute." Whether or not a bank of special statute comes into being lies within the Council's discretion, with it weighing only the estimated benefit the incorporation of the bank of special statute promises to bring to the Spanish economy. The Council of Ministers has incorporated two banks of special statute since 1974: Banco Arabe Espa ol, S.A. (Aresbank),

104. The administrative authorization is discretionary, and although this fact has been continuously criticized, the Spanish Supreme Court held on November 14, 1974 that the grant of an administrative authorization for a foreign investment in excess of 50% of the stock of a Spanish company is subject only to the governmental discretion.

created in 1975 with foreign participation in 60 percent of its stock,¹⁰⁵ and Banco Saudi Español (Saudesbank), created in 1979 with foreign participation in 50 percent of its stock.¹⁰⁶

B. FOREIGN INVESTOR PARTICIPATION

1. *Basic Considerations*

Summarizing the rules governing foreign investments in Spanish banks, and due to the confusion inherent in such complex legislation, it seems appropriate to include a discussion that reflects to what extent a foreign investor (whether a banking entity or not) can participate in a Spanish bank. Such participation is dependent on the kind of bank and its date of incorporation.

Industrial and commercial banks incorporated after January, 1972. For these banks, Spanish law allows only individuals to invest in up to 15 percent of a bank's stock during the first five years following the date of incorporation of the bank. Once this five year period ends, foreign individuals and foreign companies can hold up to 50 percent of a bank's stock without prior administrative authorization. Foreign participation can exceed 50 percent of the bank's stock only with prior administrative authorization from the Council of Ministers. As an exception to this general rule, there is no limit on stock participations foreign investors may hold in banks of special statute, although the foreign investment requires prior authorization from the Council of Ministers.

Industrial banks incorporated between May, 1963 and January, 1972. As for banks incorporated after May, 1963 and before January, 1972, foreign banks are the only non-Spanish entities that can acquire stock, and in no event can they purchase more than 50 percent of a Spanish bank's stock.¹⁰⁷

105. Such foreign participation was held by Libyan (Libyan Arab Foreign Bank) and Kuwaitien investors (Kuwait Foreign Trading and Contracting & Investment Company). The incorporation of the bank was authorized by a Ministerial Order, dated February 13, 1975, which established that the domicile of the new bank would be located in Madrid. In accordance with the by-laws of the bank, the chairman of the Board of Directors must be an Arab citizen, and the purpose of the bank is to reinforce the economic relationships between Spain and the Arab countries.

106. The incorporation of this bank was authorized by a Ministerial Order dated May 9, 1979. Its corporate purpose is very similar, and its main goal is to promote the exportation of Spanish equipment goods to African and Arab countries. The reason for the participation of Saudi Arabian capital in the bank was that Saudi Arabia was the main supplier of petroleum to Spain (and consequently one of its most important international creditors). The Saudi Arabian participation is held by The National Commercial Bank, Riyadh Bank Ltd. and The Saudi British Bank.

107. It should be noted that the Ministerial Order of 1963 is the only norm, among those regulating foreign investments in Spanish banks, which refers exclusively to investments to be made by foreign banks.

Spanish commercial banks incorporated before January, 1972. Since no specific regulations concerning foreign investment in these banks exist, the general provisions governing foreign investments in Spanish companies apply. Before October 1974, the Decree-Law of July 21, 1959 established these provisions, but the Decree 3021/74, of October 31, 1974 (the Law on Foreign Investments in Spain)¹⁰⁸ abrogated the 1959 Decree.¹⁰⁹ In accordance with the provisions of the Law on Foreign Investments in Spain, and as a general rule, foreign investments may equal up to 50 percent of the stock of the Spanish company without prior administrative authorization. Any investment that exceeds this percentage, however, requires prior authorization from the Council of Ministers.¹¹⁰

2. *Other Considerations*

Other factors demand consideration should a foreign company want to purchase participations in the stock of a Spanish bank. First, in order to acquire the ownership of the shares which are transferred,¹¹¹ the acquisition of stock must be effected by means of a purchase agreement granted before a Spanish commercial stockbroker. If the acquisition requires authorization from the Council of Ministers, a formal application to this effect should be filed with the General Director of Foreign Transactions. The documentation to be submitted is rather complicated and the procedure to obtain the authorization is time-consuming, usually lasting not less than three or four months. Even if no prior authorization is required, the foreign investor should register the investment at the Registry of Foreign Investments of the Ministry of Economy and Finance, so that it can enjoy the right to transfer abroad the funds obtained when the investment is liquidated.

Second, all the aforementioned limits on the maximum percentage of foreign participation in Spanish banks are cumulative and not individual, so

108. As expressly provided for by the Decree 1497/75, of June 19, 1975.

109. Although the abrogation of the Decree-Law did not represent any change in this respect, in light of the fact that the percentage of foreign participation in Spanish companies which does not require prior administrative approval remains the same (50%).

110. Although there are Spanish authors holding the opinion that such banks created before 1972 should be governed, in connection with foreign investments in their stock, by the Royal Decree of February 8, 1927 which approved the Regulations on the Banking Law of 1921 (see V. Garces, *Regimen Juridico de las Inversiones Extranjeras en España* (1975)). If this Regulation is considered to be in force, the maximum percentage of foreign investment allowed would be one-third of the stock of the Spanish bank. Supporting the thesis maintained in this article, see F. Lucas Fernandez, *Inversiones Extranjeras en España* (1975), and vol. I *Temas sobre Inversiones Extranjeras y Control de Cambios* (1981).

In fact, the Royal Decree of 1927 must be considered abrogated by the Banking Law of December 31, 1946, and by the Decree of October 16, 1950.

In addition, there are precedents which permit to maintain the opinion that foreign investments in those banks are permitted in excess of one-third of the stock, such as the acquisition by Bank of America (through Bankamerica Corporation) of 50% of the stock of Banco Comercial para America.

111. As provided for by a Ministerial Order dated June 9, 1943.

that if a foreign investment has been already made, any new investment will have the limits reduced in the same percentage that the stock of the Spanish bank is already held by another foreign investor. Special provisions must be observed in computing the percentage of foreign investment if the investment is made by a Spanish company participated by foreign capital. Article 7 of the Regulations on Foreign Investments in Spain provides that if a Spanish company in which foreign investors participate in less than 25 percent of its stock acquires a participation in the stock of another Spanish company, such participation acquired will not be considered a foreign investment. But if foreigners hold 25 to 50 percent of the Spanish firm acquiring the stock, the acquisition is considered a foreign investment in an amount equal to the percentage of its stock held by foreigners. And if foreign investors own more than 50 percent of the acquiring company's stock, the acquisition is considered a foreign investment.¹¹² This rule is intended to prevent "foreign investments of second degree" made in violation of the limits established for foreign investments, by means of holding or conducting the investment through a Spanish company already participated by the foreign investor.

The Royal Decree 1388/78 does not affect legislation that governs foreign participations in the stock of Spanish banks, since the Royal Decree is applicable only to the direct establishment of foreign banks in Spain.¹¹³ It, however, allowed foreign banks that, prior to its enactment, held participations in more than 25 percent of the stock of a Spanish bank to request authorization from the Ministry of Economy and Finance to acquire the entire stock of the participated Spanish bank. The foreign bank needed to effect its request within six months from the day following the publication of the Royal Decree 1388/78, and if the Ministry of Economy and Finance (which required a prior report from the Bank of Spain) issued the authorization, and the acquisition occurred, the Spanish bank, now wholly-owned by a foreign bank, would be deemed a subsidiary bank and be governed by the provisions of the Royal Decree 1388/78.¹¹⁴

3. *Recent Foreign Acquisitions*

Foreign banks have recently acquired stock in financially troubled Spanish banks in order to conduct operations in Spain without the limitations

112. For example, if 20 percent of the stock of a Spanish company A is held by a foreign investor B, the acquisition by A of 50% of the stock of a Spanish company C shall not be considered a foreign investment. If 40% of the stock of A is owned by B, C shall be considered owned by a foreign investor in 20% of its stock. If 60% of the stock of A is owned by B, 50 percent of the stock of C shall be considered as held by a foreign investor.

113. As established by its Second Transitory Provision.

114. In accordance with its First Transitory Provision. In fact, only Bank of America requested and obtained such authorization. Bank of America, Soceidad Anonima Española (Bank of America, S.A.E.) is the only subsidiary bank created pursuant to the Royal Decree 1388/78.

imposed upon their branches and subsidiary banks. A crisis in the Spanish banking system during the last few years prompted foreign acquisitions. Mismanagement, poor credit policy and overexpansion threatened to leave several banks insolvent. Faced with this crisis, Spanish authorities intervened directly. The *Fondo de Garantía de Depósitos* (Deposit Guarantee Fund),¹¹⁵ after it adopted the appropriate safety and corrective measures, called or invited other banking institutions to make proposals or bids, stating the conditions that governed any bid for bank stock.¹¹⁶

Two foreign banks acquired a majority of stock in two Spanish banks in just this way. In April, 1981, Barclays Bank acquired 85.3 percent of the stock of Banco de Valladolid, S.A.¹¹⁷ Since English management at the Spanish bank began, the corporate name of the Spanish bank has changed to Barclays Bank, Sociedad Anónima Española (Barclays Bank, S.A.E.), bank customers have enjoyed new services, and the bank has become profitable. The French bank Banque Nationale de Paris acquired 76.7 percent of the stock of Banca Lopez-Quesada, S.A. in July 1981. The corporate name of the Spanish bank changed to BNP-España, S.A. and this entity also has since made a profit.

This method of establishing a financial presence in Spain held great advantages for both foreign banks, even though they had and now maintain a branch in Spain. On the one hand, they avoided the limitations the Royal Decree imposes on activities of branches and subsidiary banks. And on the other hand, financial problems made the Spanish bank stock less costly to purchase. These advantages aside, the foreign banks benefited from the assistance that financially troubled Spanish banks usually receive from the Spanish government.¹¹⁸ In the foreseeable future, other foreign banks will likely use this same method to establish a financial presence in Spain, since it does away with the constraints foreign banks accept if they choose to incorporate a branch or a subsidiary bank.

IV. Conclusions

Since 1979, foreign banks have operated in Spain by means of establishments (basically, branches) opened pursuant to and in accordance with the

115. The activity and philosophy of this entity are based upon those of the FDIC (see Sanchez-Calero, *El Fondo de Garantía de Depósitos*, REVISTA DE DERECHO BANCARIO Y BURSÁTIL (January-March, 1981)).

116. Usually, the authorities, through the Fondo de Garantía de Depósitos, take the first steps in order to clear the situation of the bank, changing the Board of Directors and its main officers, reducing the stock of the failing bank to setoff the losses and immediately issuing and subscribing new stock, to provide funds to the bank.

117. At that time Banco de Valladolid, S.A. had 38 offices, 2,600 million pesetas in deposits and 24,000 million pesetas in investments.

118. Such as long-term loans at a low interest rate, and exemption of mandatory ratios that the Spanish banks have to observe regarding investments, cash and guarantees, among others.

Royal Decree. Although a total of thirty-six foreign banks have operative establishments in Spain, their activities there are still small as compared to total operations within the Spanish banking system.

Despite limitations imposed on their activities, branches and subsidiaries in Spain of foreign banks have developed a new range of financial products, such as the creation of a market for the negotiation of bills of exchange in the Stock Exchange, the creation of a market for commercial paper, the introduction of floating rate credits in pesetas and operations for the purchase of receivables. All these transactions allow foreign banks in Spain to compete with Spanish banks in the wholesale banking market. Their future depends on their ability to develop new financing and marketing techniques.

As for retail banking, foreign banks most interested in a deeper involvement in the Spanish market want to discover new formulas to carry out their activities in Spain while avoiding existing limitations, such as those concerning the acquisition of participations in the stock of financially troubled Spanish banks. If Spanish authorities allow foreign banks to engage in retail banking and otherwise increase the scope of their operations in Spain,¹¹⁹ a policy of mutual cooperation between foreign banks and the government might make the Spanish banking system more competitive.

119. This policy may be promoted by the requirements as to liberalization in competition which should be developed if Spain continues the movement toward joining the EEC.

Appendix

Foreign banks authorized to open a branch in Spain
Pursuant to the Royal Decree 1388/78

NAME OF THE BANK	COUNTRY OF ORIGIN	YEAR OF ESTABLISHMENT	NUMBER OF OFFICES
Citibank N.A.	U.S.	1979	2
Chase Manhattan Bank	U.S.	1979	2
Manufacturers Hanover Trust	U.S.	1979	2
Morgan Guaranty Trust	U.S.	1979	1
Bankers Trust	U.S.	1980	1
Continental Illinois National Bank	U.S.	1980	2
Chemical Bank	U.S.	1980	2
First National Bank of Chicago	U.S.	1981	1
First Interstate Bank of California	U.S.	1983	1
Banque Nationale de Paris	France	1979	2
Banque Paribas	France	1979	2
Banque Indosuez	France	1980	2
Credit Commercial de France	France	1983	1
Barclays Bank International	England	1979	1
Midland Bank	England	1981	1
National Westminster Bank	England	1979	1
Commerzbank	West Germany	1980	2
Deutsche Bank	West Germany	1979	2
Dresdner Bank	West Germany	1979	2
Bank of Tokyo	Japan	1980	1
The Sumitomo Bank	Japan	1983	1
Banco di Roma	Italy	1981	1
Banca Commerciale Italiana	Italy	1983	1
Societe Generale de Banque	Belgium	1982	1
Banque de Bruxelles et Lambert	Belgium	1982	1
Algemene Bank Nederland	Netherlands	1980	2
Banco do Brasil	Brazil	1980	3
Banco do Estado do Sao Paulo	Brazil	1981	1
Banco Real	Brazil	1983	1
Banco de la Nacion Argentina	Argentina	1983	1
Banco Exterior de los Andes y de España	International Group	1981	1

(The Hong Kong Bank, the Mitsubishi Bank, and the Royal Bank of Canada are also authorized to establish a branch in Spain.)

